

Investment Comment – 4 February 2010

1 Introduction

The purpose of this note is to provide a brief commentary on the investment markets for the month of January 2010. We look at index results, comment on local and global markets and raise issues that may be concerning trustees.

2 Index results for the month of January

- Australasian shares NZSX 50 was down 2.0% while the ASX 200 was down 6.0%.
- Global Shares In unhedged terms, the MSCI World Index fell 1.8%, while in local currency terms it fell 3.6%.
- Yields Yields on NZ 5 year Government Bonds fell from 5.5% to 5.2% and US 5 year Treasury Yields fell from 2.7% to 2.3%
- NZ Bonds NZ Government Stock Index was up 1.4%.
- Global Bonds Barclays Global Aggregate Index was up 1.3%.
- Currency NZ dollar finished down 2.3% at 70.5 US cents.

3 Markets

Markets slid downwards through January – led in the USA where the S&P 500 was down 3.7%. Technology stocks and Basic Material stocks fared the worst, both down about 9% while the defensive Health Care was the only sector to post gains, up 0.7%.

Overseas, northern European markets performed the best with Denmark and Finland posting gains of 6.5% and 5.6% respectively while the Mediterranean “PIGS” (Portugal, Italy, Greece and Spain) fared the worst (-7.3%, -5.5%, -7.5% and -8.9% respectively). The UK was down 4.1%, France was down 4.4% and Germany was down 5.7%.

Asian markets were weak, led by Hong Kong down 6.4% and Singapore down 6.0%. Japan bucked the trend and only slipped 0.8%.

Emerging markets were down more than developed markets (-4.4% overall compared to -3.6% for developed markets). China was down 8.5%, India was down 6.0%, Brazil was down 4.4% but Russia was up 2.4%.

Government bond yields fell in response to the heightened volatility in sharemarkets and this led to strong performance from the bond indexes.

4 Economies

The recovery in developed economies has been sluggish. For instance in December consumer spending in the USA rose for the third straight month, but by only 0.2% - less than expected. The US housing market too remains weak now that some of the stimulus to help home-owners has worked its way out of the system. The Case Shiller index rose just 0.2% in November and new home sales for December slipped back to 342,000, the 3rd lowest month since 2002 and 75% off the peak in 2005.

The Federal Open Market Committee met on 27 January and in their [statement](#) said

[E]conomic activity has continued to strengthen and that the deterioration in the labor market is abating. Household spending is expanding at a moderate rate but remains constrained by a weak labor market, modest income growth, lower housing wealth, and tight credit.

The committee therefore retained its stimulatory stance. Interestingly however, one member (Thomas Hoenig – Kansas City) dissented believing that economic and financial conditions had changed sufficiently such that the expectation of exceptionally low levels of the federal funds rate for an extended period was no longer warranted.

In China there are signs that the government wishes to cool the economy. The People's Bank of China raised the deposit reserve requirement ratio by 0.5%. This is intended to manage inflationary expectations and to avoid a recurrence of the lending boom.

5 New Zealand & Australia

The data is suggesting a tempered recovery in New Zealand, with the CPI figure coming in at the RBNZ's predicted -0.2%. This brought the 12 month figure to 2.0%, exactly in the middle of the target range. In his [statement](#) on 28 January, Governor Bollard left the OCR at 2.5% and said

The outlook for the New Zealand economy remains consistent with the projections underlying the December Monetary Policy Statement... If the economy continues to recover in line with our December projections, we would expect to begin removing policy stimulus around the middle of 2010.

Across the ditch, the action was the same as the RBA met in early February and surprisingly left their cash rate unchanged at 3.75%. Economic conditions are stronger for our Australian neighbours and Governor Stevens said in his [statement](#)

In Australia, economic conditions have been stronger than expected, after a mild downturn a year ago. The effects of the fiscal stimulus on consumer demand have now faded, but household finances are being supported by strong labour market outcomes and a recovery in net worth. Public infrastructure spending is now boosting demand, as is an upturn in housing construction. Investment in the resources sector is strong. The rate of unemployment appears to have peaked at a much lower level than earlier expected.

Back home, the [Household Labour Force Survey](#) showed that unemployment is continuing to rise. In the December quarter it moved up to 7.3%, worse than predicted by economists. Last quarter the rate was 6.5% and 12 months ago it was 4.7%. The total number of unemployed rose from 150,000 in the September quarter to 168,000 in this release. A year ago, this was just 109,000.

The Quarterly Employment Survey showed that wage growth continued to weaken through the December quarter. Salaries and wages increased 1.8% in for the 2009 calendar year with the rise in December being the lowest quarterly increase since June 2001.

6 Outlook

While conditions are decidedly more positive than they were this time last year, we are cautious with our outlook, in particular because the jobless rate continues to rise. Economic data have yet to indicate sustained growth and consumers are likely to be reluctant to returning to their debt-fuelled spending sprees of the mid-2000s.

While inflation remains benign at the moment, there is still the potential for some inflationary shocks in the medium term. The view is that governments will err on the side of caution and are therefore more likely to be slow in removing stimulus.

7 Issues

The question of how best to structure bond exposure has been the topic of much discussion of late. We have seen a large divergence in the performance of sovereign debt compared to credit debt in recent history with the former first greatly outperforming and now lagging significantly.

One approach would be to formally declare the two separate asset classes and to set up separate asset allocation targets for them to be managed to. The other would be to manage the bond exposure in aggregate, with the fund manager making calls with regards to sovereign and credit exposure.

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