PERENNIAL INVESTMENT PARTNERS

Economic and Strategy Review

Monthly Report as at 30 September 2013

The re-emergence of US and European political risk has the potential to slow, or at worst, derail the current recovery.

Economic and Policy Trends: Just as improving Purchasing Manager Indices were signalling a cyclical lift in global production, the re-emergence of US and European political risk has the potential to slow, or at worst, derail the current recovery. Frustratingly, government instability in Italy and Greece and the inability of US lawmakers to pass a Continuing Resolution to keep the US government going have offset the reduction in geo- political risk following the deal on Syria's chemical weapons.

While markets have become conditioned to US brinkmanship, the difficulty in passing a Continuing Resolution does not bode well for the upcoming negotiations needed to raise the US debt ceiling. In hindsight, the Fed displayed good judgement in not beginning to taper its quantitative easing programme as was widely expected. The Fed indicated that the exit from its extremely accommodative settings was always going to be conditional on sustainable improvement in the labour market. The speed at which long bond yields have risen since May and the risk of heightened volatility surrounding US political negotiations were seen as risks to ongoing labour market improvement.

While political risk levels are elevated, central banks remain steadfast in their resolve to provide extremely accommodative policy settings and this should help the global economy weather any near term volatility and set up 2014 as a year of stronger growth. In our view, Fed tapering looks more like a 2014 story and conventional tightening a story for 2015.

In Australia, the RBA left the cash rate unchanged at 2.5% at its monthly board meeting. Subsequent commentary suggests that any near term moves are unlikely, but given its outlook for low inflation, the RBA has room to provide further accommodation should demand conditions falter. The latest comprehensive reading on the economy came with the release of the June quarter national accounts, which saw the economy growing at a sub-trend 0.6% rate over the quarter and 2.6% rate over the last 12 months.

Subsequent partial demand indicators remain mixed and consistent with another quarter of sub-par growth. While consumer sentiment has rebounded, retail spending remains sluggish. Business conditions remain subdued along with business sector employment intentions. Labour market conditions are slipping with employment edging lower and the unemployment rate rising to a 4 year high of 5.8%. On the more upbeat side, building approvals rose sharply in July and recent gains in house prices suggest that lower interest rate settings are beginning to help.

Equity Market Trends: Equity markets had a strong month, with evidence that the global recovery was getting more traction more than offsetting a fade towards the end of the month on rising political risk. In the US, the S&P500 gained 3%. Gains were stronger in Europe and Japan where the Euro STOXX 50 and Nikkei gained 6.3% and 8%, respectively. A strongly appreciating Australian currency was a drag on sector returns, with the MSCI World ex-Australia Accumulation Index in Australian dollars edging lower by 0.1%. In Australia, the S&P/ASX 300 Accumulation Index gained 2.2%.

Bond Market Trends: Yields rose early in the month only to end flat to lower after mixed economic data and a late month rise in offshore political uncertainty. After peaking at 2.98%, the benchmark three year government bond yield ended the month 1 basis point higher at 2.71%. At the longer end, the ten year government bond yield climbed to as high as 4.17%, before rallying to end the month 9 basis points lower at 3.81%. For the month, the UBS Composite Bond Index gained 0.50%, while the cash sector, as measured by the UBS Bank Bill Index, returned 0.21%.

Investment Strategy: Under our valuation approach, the Australian share market is showing up as being fairly valued. Consequently, multi sector funds are holding benchmark exposures to the sector. Similarly, at month end yields, the Australian fixed interest sector was also showing up as being fairly valued. Multi sector funds continue to hold benchmark weightings.

Frank Uhlenbruch, Investment Strategist

Tactical Asset Allocation Summary (as at 30 September 2013)

Asset Class	Multi Sector Trusts*
Australian Shares	Benchmark
Australian Fixed Interest	Benchmark
Cash	Benchmark
International Shares	Benchmark fixed
Australian Listed Property	Benchmark fixed
Global Listed Property	Benchmark fixed

* Multi-sector Trusts may have differing asset class weights, including no exposure to a particular asset class