PERENNIAL INVESTMENT PARTNERS

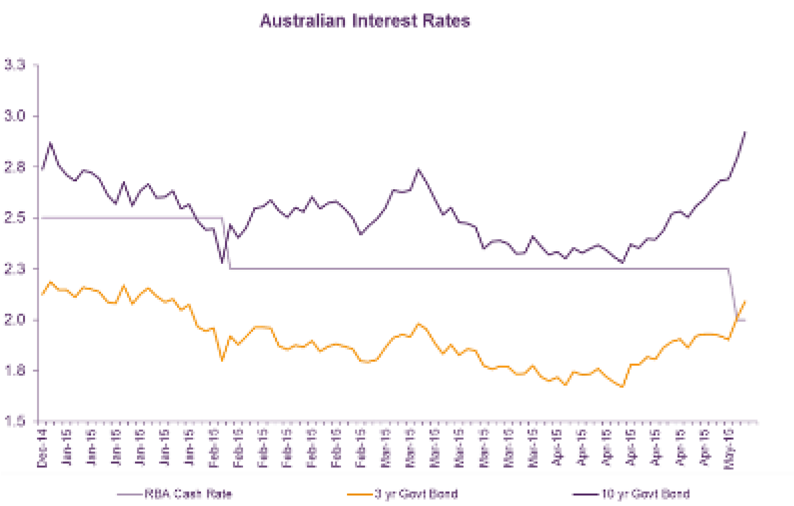
Perennial Perspective

May 2015

The curious case of the cash rate cut and bond yields rising

The Reserve Bank of Australia (RBA) cut the cash rate in early May from 2.25% to a new historical low of 2%. While this move was expected by our Fixed Interest team, they have been running defensive interest rate strategies. At first glance such defensive strategies appear counter intuitive…why wouldn't you want to have portfolios positioned for falling bond rates when cash rates are falling? Simply, it all has to do with where you are in the market cycle. Like equity markets, fixed interest markets are forward looking.

There comes a time in any easing cycle, when policy stimulus begins to get traction and markets begin to factor in the 'end-of-an-easing' cycle and the eventual removal of policy accommodation. It is no coincidence that the recent rise in bond yields has coincided with a lift in growth and inflation expectations in Europe and an improving tone to domestic data. We believe that 2% will be the low point of this easing cycle, but argue that the RBA is in no hurry to tighten given the economy still has some slack and has to navigate its way through a sharp fall in mining investment. Nevertheless, we expect the economy to improve enough to eventually allow the RBA to gradually lift the cash rate and that is the kind of environment reflected in the recent lift in longer term yields as shown in the following chart.



Source: Bloomberg

In terms of the equity market, perhaps fear of the eventual removal of policy accommodation is the kind of thinking behind the knee jerk sell-off following the rate cut.

Brian Thomas
Head of Retail Funds Management

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Economic monthly update
by: Frank Uhlenbruch

Elevated unemployment rates suggest that slack remains in the global economy and lower commodity prices are acting to depress headline inflation rates at the margin.

To read Frank's Economic monthly update, please click here.

March quarter video updates

In April, the Portfolio Managers for Perennial Value recorded their latest video updates.

Click here to watch the videos.

While the recent rise in bond yields has restored some value, yields still remain relatively low and gross yields in the equity market still remain attractive compared to a range of alternatives. History also reminds us that equity markets usually perform well during the phase from the low point in the cash rate cycle to when it moves towards neutral levels. However, it is worth noting that that point in the cycle still remains a long way off.

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