Economic and Strategy Review

Monthly Report as at 31 July 2014

Growth momentum in the US and China appears to be improving.

Economic and Policy Trends: Growth momentum in the US and China appears to be improving. In the US, the advance estimate for Q2 GDP had the economy growing at a faster than expected 1% over the quarter and the size of the fall in the weather affected Q1 was revised up from -0.75% to -0.5%. The Fed also noted recent improvement, particularly in the labour market and also commented that inflation had moved up closer to its longer-run objective. The Fed remains on track to finish tapering its quantitative programme by October and by around mid-2015, labour market utilisation should have lifted enough to give the Fed the confidence to commence lifting the Fed Funds rate.

In China, the recent mini stimulus looks to be bearing fruit with the economy expanding by a stronger than expected 2% over Q2. This contrasts with a 1.5% lift in Q1. Momentum looks to be carrying over into Q3 with the July HSBC manufacturing PMI lifting to 52 and supporting the IMF's updated forecast for growth of 7.4% over 2014. For the global economy, the IMF are looking for the pace of activity to lift over the second half of the year and for world output to lift by 3.4% over 2014 and by 4% over the following year.

Australian partial demand indicators released over July were mixed and consistent with uneven and variable conditions across the economy. Weekly consumer confidence data suggest that towards the end of July confidence had recovered to pre-Budget levels. The latest retail sales data released however was for May when confidence plummeted and was much weaker than expected falling 0.5%. We had two reads on the housing sector with building approval data for May and June released. Approvals surged by 9.9% in May but fell 5% in June, despite the underlying volatility, the sector is responding to lower interest rates. So too is credit demand, with private sector credit jumping by 0.7% in June, the strongest monthly gain since September 2008.

Labour market conditions remain subdued with the unemployment rate for June lifting to 6% and employment gains limited to part time jobs. Encouragingly, business conditions and confidence lifted in the June NAB Survey. Given such mixed data, underlying inflation was expected to moderate in the June quarter. While the headline CPI rise of 0.5% for the quarter was in line with expectations, core readings were higher than expected and doused any prospects for near term monetary easing. The average of the core statistical measures was up 0.7% for the quarter and 2.8% over the last year.

Equity Market Trends: Offshore equity markets ended the month on a lower note with a combination of concerns about the implications of tightening sanctions on Russia, Argentina's debt and the direction of US monetary policy, dragging sentiment lower. In the US, the S&P500 ended the month 1.5% lower while in Europe, the Euro STOXX 50 fell 3.5%. In Japan, the Nikkei gained 3.0%. The MSCI World ex-Australia Accumulation Index in Australian dollars fell 0.25% over July, with a modest fall in the Australian currency helping boost sector returns. In Australia, the S&P/ASX 300 Accumulation Index gained a handsome 4.4%.

Bond Market Trends: Yields fell over the first half of the month on weaker domestic economic news only to reverse direction, spurred by higher than expected core inflation data and a more upbeat assessment of the US economy from the Fed. After rallying down to 2.55%, the three year government bond ended the month 1 basis point higher at 2.71%. The ten year government bond got down to 3.37% before ending the month 4 basis points lower at 3.51%. These moves meant some mild capital loss with the UBS Composite Bond Index rising by 0.29%. The cash sector, as measured by the UBS Bank Bill Index, rose by 0.23%.

Investment Strategy: The rally in the Australian equity market released some of the value that had been building up in the sector. Under our investment process we got close to an outright overweight signal, but by the end of the month the sector had moved back towards fair value levels. Accordingly, multi sector funds are maintaining benchmark exposures to the sector.

Multi sector funds continue to hold a benchmark weighting to Australian fixed interest but maintain a strong bias to move underweight following the recent rally in local yields.

Frank Uhlenbruch, Investment Strategist

Tactical Asset Allocation Summary (as at 31 July 2014)

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

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

Signatory of: PRI Principles for Responsible Investment