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Perennial Perspective

February 2015

The Big Squeeze

It's interesting to come back from a New Year break and look at the continued dramatic changes that are effecting global investment markets, punctuated by the ambitious Quantitative Easing plan in Europe, the new Greek Government and our Reserve Bank's interest rate cut to an all-time low of 2.25%. Looking forward, the futures market is now pricing in rates to fall below 2%. Amidst this, our share market (S&P/ASX200 Accumulation Index) was up 12 days in a row, the longest continuously daily positive market since that Index's inception 15 years ago with the Index up around 7.5% for the year (as at 9 February).

To illustrate, below are some of the big changes over the last five months (ie. from 1 September 2014):

	Sept 14	Feb 15	% change	Comments
AUD/USD	$93.33	$77.97	-16.6%	Lowest level since July 2009
Aust. 10 Year Bond Yield	3.32% p.a	2.4% p.a	-27.4%	Hit all time low of around 2.26% in intraday trading on 3 Feb 2015
Aust. Official Cash rate	2.50%	2.25%	-10.0%	Rate cut on 3 February. All time low
Oil (Brent Crude USD)	$102.69	$56.56	-46.6%	Lowest level since May 2009
Iron Ore (Spot price end Aug 14 and Jan 15)	82.38	68.00	-17.5%	Lowest level since May 2009
S&P/ASX 300 Accumulation Index (includes dividends)	47,713	49,819	2.7%	All time high for market when you include dividends
S&P500 Index (USD)	2003.4	2062.5	1.9%	Only 1.4% off record high set on 29 Dec 2014

The Reserve Bank also released an economic report card (The Statement of Monetary Policy) on 6 February that points to a softening in their forecast growth, with GDP now expected at 2.25-3.25% for calendar year, down around 0.25% compared to their November forecast. Their longer term projections have also softened by about the same amount. Overall this has lead us to conclude that the easing we have just experienced together with our forecast of another in the next 6 months (down to 2%) is the RBA reacting to the near term slack in the economy rather than this being a sign of more fundamental, bigger problems ahead.

This is great news for those with a mortgage. However, the "Big Squeeze of 2015" is all about income investors feeling squeezed with rates expected to stay low for some time. 12 month term deposits from the major banks are now under 4%. Fundamentally, expectation of lower cash rates tends to drive asset prices up (essentially shares and property) and we have already seen this happen so far this year with our sharemarket bouncing and pushing share valuations up.

Brian Thomas
Head of Retail Funds Management

Economic monthly update
by: Frank Uhlenbruch
Central bankers continue to treat their economies with kid gloves. To read Frank's Economic monthly update, please click here.

December quarter video updates
In January, the Portfolio Managers for Perennial Growth and Perennial Fixed Interest recorded their latest video updates. Click here to watch the videos.

So what does 2015 hold for investors?

- Low interest rates will underpin property prices and the share market, particularly in the first half of 2015
- We expect a further interest rate cut of 25 basis points in the next few months, although the market has priced in the possibility of more interest rate cuts with rates below 2%
- The oil price will stabilise as more production is sidelined, particularly in US Shale
- The weak Australian economy may force the Government to think harder about increasing the spend on infrastructure
- A weaker Australian dollar to weaken further to around 74c at year end
- Overseas issues and higher share valuations to bring about some volatility/re-rating of shares in the second half of 2015

Overall, 2015 is set to be a tough year for investors trying to strike a balance between a) being too conservative and squeezed by low income or b) being too aggressive and squeezed by potential capital losses. Investors should set reasonable expectations and think about their investment diversification strategies whether it be with non-correlating assets or other protection strategies.

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