Economic and Strategy Review

Monthly Report as at 28 February 2014

The slowdown in global economic activity in early 2014 is being viewed as temporary, for the moment.

Economic and Policy Trends: The pick-up in the pace of global economic activity evident late last year appears to have lost some momentum in early 2014. The slowdown seems more a function of a severe winter in North America than any policy induced slowdown. In the US, housing, labour market and output indicators undershot estimates and for the time being, the Fed and financial markets are viewing this as a temporary setback that will snap back once seasonal conditions improve. Lunar New Year timing is also making it a little more difficult to get a read on the underlying pace of activity in China. While their Purchasing Managers Index has been drifting lower, growth in China's new bank lending and total social financing housing was particularly strong over January.

Central banks continue to provide high levels of policy support, but to broaden and deepen the current recovery, other arms of policy need to be engaged as well. There was a welcome shift in thinking at the latest G-20 finance ministers and central bank governors meeting in Sydney, where the focus shifted from austerity measures, to policies that will structurally enhance growth prospects. A target was set to lift collective GDP by more than 2% above the base case over the coming five years via policy initiatives aimed to increase investment, employment and participation and enhance trade.

In Australia, the Reserve Bank of Australia (RBA) at its early February board meeting effectively moved from an easing bias to a neutral bias. They also signalled that the currency had moved from an "uncomfortably high" level, to a lower level, that if sustained, would assist in achieving balanced growth in the economy. Subsequent data releases have been mixed. A rebound in business conditions in the NAB survey and solid retail sales vindicated the shift. However, sluggish labour market conditions and a sharp fall in capital expenditure plans for 2014/15 suggest that any monetary tightening is unlikely this year. We continue to hold our view that a modest tightening cycle will commence in the first half of 2015.

Equity Market Trends: Offshore equity markets were generally stronger over February. In the US, the S&P500 rose by 4.3% as markets looked through weather effected data. In Europe, improving economic data helped push the Euro STOXX 50 up by 4.5%. In Japan, the Nikkei declined by 0.5%. The MSCI World ex-Australia Accumulation Index in Australian dollars gained 2.3% over the month, with a strengthening Australian currency a modest drag on returns. In Australia, the S&P/ASX 300 Accumulation Index powered ahead by 4.9% over the month supported by a relatively solid reporting season.

Bond Market Trends: Yields rose over the first half of the month after the RBA's shift to a neutral policy bias and stronger domestic data. However, a combination of rising geopolitical tensions and weak capital expenditure data underpinned a late month rally. After rising to 3.04% and 4.22%, three and ten year government bond yields ended the month at 2.83% and 4.02%, respectively. For the month, the UBS Composite Bond Index rose by 0.34%, while the cash sector, as measured by the UBS Bank Bill Index, rose by 0.20%.

Investment Strategy: An early month pull back in the Australian equity market restored significant value to the sector and took us to the threshold of moving overweight on our valuation metrics. However, the value we saw building up was released as the equity market rallied. We currently view the sector as being fully valued, so multi sector funds continue to hold benchmark exposures to the sector. Given where we are in the cycle, we hold a bias to move overweight and would regard periods of weakness as an opportunity.

Multi sector funds continue to hold a benchmark weighting to Australian fixed interest. Nevertheless, the rally in yields in late February has taken the sector to the expensive end of our fair value band and we have a bias to move underweight should yields rally significantly further.

Frank Uhlenbruch, Investment Strategist

Tactical Asset Allocation Summary (as at 28 February 2014)

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