PERENNIAL INVESTMENT PARTNERS

Economic and Market Review

Monthly Report as at 30 April 2015

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.

Frank Uhlenbruch,
Investment Strategist

Economic and Policy Trends: 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. Against this general backdrop, policy makers have room to run or add to extremely accommodative policy stances to meet longer term growth and inflation targets.

The net effect of lower oil prices and a shift up in the US dollar and lower Euro and Yen are seen as positives for the growth outlook according to the latest set of comprehensive forecasts in the International Monetary Fund's (IMF) April World Economic Outlook. They have the global economy expanding by 3.5% in 2015 and 3.8% in 2016. Behind those numbers, growth remains uneven globally.

Advanced economies growth rate is expected to lift from 1.8% in 2014 to 2.4% in both 2015 and 2016. The lift in 2015 reflects an improving outlook for the Euro area where growth is expected to rise from 0.9% in 2014, to 1.5% in 2015 and 1.6% in 2016. These projections are slightly softer in the out years than last month's European Central Bank's (ECB) staff estimates but have inflation lifting from 0.1% in 2015 to 1.5% in 2016. The IMF see a reduction in deflation risks and a projected rise in headline inflation. With European sovereign bond yields very low at the longer end of the curve and negative at the shorter end, a strengthening in Euro area growth and inflation over the years ahead suggest that the ECB's Quantitative Easing programme can end in September 2016 and investors should be prepared for a lift in yields.

The IMF revised down their forecasts for the US economy, but still had growth lifting from 2.4% in 2014 to 3.1% in both 2015 and 2016. Similar to the US Federal Reserve (Fed), the IMF have inflation lifting once the effect of lower oil prices drops out of the numbers. The US economy has got off to a slow start with March quarter GDP edging ahead by a bare 0.06%. Poor weather and port strikes appear to have played a role and some catch up is expected over the coming quarters. Nevertheless, the Fed is likely to react to the sluggish start by pushing back the timing of 'lift off' towards the end of the year. By then its two pre-conditions for monetary tightening, namely evidence of further improvement in the labour market and reasonable confidence that inflation will return to 2% in the medium term, will be met.

After setting a growth target of around 7% for 2015, Chinese authorities resolve was tested following the releases of weaker than expected data and heightened concerns about the ramifications of a slowdown in the property sector. The Chinese economy expanded by a less than expected 1.3% in the March quarter and authorities responded by dipping into the 'toolbox' and announced a lowering in the reserve requirement ratio by 1% to 18.5%, potentially allowing Chinese banks to lift lending by 1.2 trillion Yuan. Targeted policy support is likely in the months ahead following the dovish commentary from the latest Politburo meeting. Such actions would support the IMF's forecast profile of Chinese growth of 6.8% in 2015, moderating to 6.3% in 2016.

Australian economic releases suggest that early February's rate cut helped lift sentiment and activity. Retail sales rose 0.7%, stronger than expected. According to the NAB survey, both business confidence and conditions lifted in March. Likewise, employment growth surprised on the upside in March, gaining 37, 700.

Revisions to history as seasonal adjustment factors were re-estimated led to an upward revision to February's employment gain from 15,600 to 42,000. The unemployment rate fell to 6.1% in March.

Not all data releases were on the stronger side. Consumer confidence fell in April, while building approvals also declined 3.2% in February, albeit off high levels. Inflation data was mixed. The headline rate increased by 0.2% over the quarter with lower fuel prices a major factor. The yearly headline rate dropped from 1.7% to 1.3%. Underlying measures were a little stickier, with the average of the Reserve Bank of Australia's (RBA) statistical measures gaining 0.6% over the quarter and 2.4% over the year.

The RBA left the cash rate unchanged at its April meeting and maintained an easing bias. Subsequent commentary from the Governor noted that further easing remained on the table. We continue to hold the view that the RBA will cut the cash rate once more to 2%, with May the most likely time. Thereafter we expect the RBA to maintain an easing bias but not act on it. The main risk to this view is that the further the Fed pushes back 'lift off', the greater the risk that the currency doesn't plays its role in helping the economy rebalance.

Equity Market Trends: A late month sell-off triggered by mixed economic and corporate earnings data unwound earlier gains across a range of offshore bourses. Nevertheless, both the US and Japanese equity markets ended the month in positive territory with the S&P500 and Nikkei gaining 0.9% and 1.6%, respectively. In Europe, heightened concerns about Greece's ability to meet its sovereign debt obligations added to headwinds with the Euro STOXX 50 ending the month 2.2% lower. The MSCI World ex-Australia Accumulation Index in Australian dollars fell 0.8% over April. In Australia, the S&P/ASX 300 Accumulation Index ended the month down 1.6%.

Bond Market Trends: Domestic yields lifted across the curve and reflected the combination of improving local economic data and a lift in longer dated offshore yields as investors began to demand more of a term premium as inflation expectations shifted. Three year government bonds ended the month 23 basis points higher at 1.93%, as stronger economic readings meant that markets began to revise up their expectations of how much easing the RBA had to do before the low point in the current cycle was reached. At the longer end of the curve, ten year government bond yields rose 33 basis points to end the month at 2.65%. These moves meant that the Bloomberg AusBond Composite Index fell 1.11% over April. The cash sector, as measured by the Bloomberg AusBond Bank Bill Index, rose by 0.18%.

Signatory of:

Issued by: The Investment Manager, Perennial Investment Partners Limited ABN 59 087 901 620, AFSL: 238763 ('Perennial'). Responsible Entity: IOOF Investment Management Limited ABN 53 006 695 021, AFSL: 230524. This promotional statement is provided for information purposes only. Accordingly, reliance should not be placed on this promotional statement as the basis for making an investment, financial or other decision. This promotional statement does not take into account your investment objectives, particular needs or financial situation. Whilst every effort to ensure the information in this promotional statement is accurate; its accuracy, reliability or completeness is not guaranteed.