PERENNIAL INVESTMENT PARTNERS

# Economic and Strategy Review

**Monthly Report** as at 31 October 2013

## The world watched on in frustration as US politicians huffed and puffed their way towards an inevitable mid-month deal.

**Economic and Policy Trends:** US political risks rose as the US government was shut down and the world watched on in frustration as politicians huffed and puffed their way towards an inevitable mid-month deal to fund the government and raise the US debt ceiling. While the 11th hour deal led to a drop in political risk from acute levels, they remain elevated as all the deal did was fund the government through to 15 January and extend the debt ceiling through to 7 February. The deal also contained a proposal to establish a "Son of Supercommittee" panel to draft a deficit reduction package by 13 December. It looks like investors will need to brace themselves for another burst of volatility as we head into 2014.

Abstracting from political machinations, the tone of global data was reasonably positive with solid readings from a range of purchasing manufacturing indices. The IMF also released its latest set of comprehensive global forecasts. For 2013, the IMF has the global economy expanding by 2.9% and the pace of activity lifting to 3.6% over 2014. A key feature of the projections is an improvement in the outlook for advanced economies as the drag from fiscal austerity measures lessens. Such a profile for growth is consistent with the latest readings from the OECD leading indicators.

In Australia, the RBA left the cash rate unchanged at 2.5% at its monthly board meeting. Subsequent commentary suggests that the RBA believes the ingredients are in place for a lift in the interest rate sectors of the economy. The missing catalyst to turn potential into activity is a sustained lift in confidence. Given a lower currency would certainly help the re-balancing task and help build business confidence, it is not unsurprising that the RBA have been trying to jaw bone the currency lower.

Economic data releases out over the month were mixed but there was some improvement in the overall tone of them. Against the backdrop of improving house prices, building approvals rose sharply over September and more than reversed a modest fall over the previous month. While consumer confidence fell modestly from high levels, there was a sharp rebound in business confidence according to the September NAB Survey. This confidence has yet to translate into a lift in business conditions or hiring intentions though, both of which remain relatively subdued. Labour market conditions remain sluggish with weak jobs growth. A declining participation rate is flattering the unemployment rate. The CPI rose by 1.2% over Q3, with this higher than expected result largely driven by higher utility and fuel costs. The underlying inflation rate rose by 0.6% to be up a modest 2.2% on a year ago.

**Equity Market Trends:** Stronger economic data helped pull equity markets through a period of US political brinkmanship inspired volatility earlier in the month. In the US, the S&P500 gained 4.5% while in Europe the Euro STOXX 50 rose a very solid 6.0%. In Japan, Nikkei edged 0.9% lower. While further appreciation in the currency was a drag on sector returns, the MSCI World ex-Australia Accumulation Index in Australian dollars still managed to gain 2.6% over the month. In Australia, the S&P/ASX 300 Accumulation Index rose by 3.9%.

**Bond Market Trends:** Yields rose over the first part of the month on US political uncertainty and the improving tone of global data. Once a deal was struck to fund the US government and extend the debt ceiling, yields began to reverse direction. After peaking at 3.17%, the benchmark three year government bond yield ended the month at 3.0%. At the longer end, the ten year government bond yield climbed to as high as 4.24%, before ending the month 12 basis points higher at 4.02%. A modest rise in yields meant that the UBS Composite Bond Index fell 0.06%, while the cash sector, as measured by the UBS Bank Bill Index, rose 0.22%.

**Investment Strategy:** Under our valuation approach, the Australian share market has moved towards the expensive end of the fair value band. Multi sector funds continue to hold benchmark exposures to the sector.

Similarly, at the level of month end yields, the Australian fixed interest sector is registering as being fairly valued and so multi sector funds continue to hold benchmark weightings.

**Frank Uhlenbruch, Investment Strategist**

**Tactical Asset Allocation Summary (as at 31 October 2013)**

| 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