Economic and Strategy Review

Monthly Report as at 30 September 2014

The US economy continues to strengthen, however in Europe and China growth momentum is slipping.

Economic and Policy Trends: On the policy front, its horses for courses. A slowing in growth momentum across Europe has the ECB loosening the monetary reins, while in the US, the Fed is preparing to tighten them. In China, momentum also appears to be slipping and local media are reporting that the central bank has asked the big four banks to ease their housing mortgage rules.

At the latest FOMC meeting, the Fed judged that there was sufficient strength in the broader economy to support ongoing improvement in the US labour market. For 2014, the Fed expects the unemployment rate to range between 5.9% to 6.0%, before falling into a 5.4% to 5.6% range for 2015 and down again in 2016 into a 5.1% to 5.4% range. From 2015 onwards, the Fed has the unemployment rate trending below 5.5%, the mid-point of their longer run range. With such a profile, it is not unsurprising that the Fed is preparing markets for an eventual normalisation in cash rates. We continue to look for the first Fed tightening mid-2015.

In Australia, data readings continue to remain mixed with labour market data particularly volatile. According to the June quarter national accounts, the economy grew by 0.5% over the quarter and by 3.1% over the year. Negative contributions to growth from net exports and the public sector were more than offset by positive contributions from consumption, business investment, housing and stocks.

After a sharp rise in the unemployment rate to 6.3% in July, an incredible 121,000 gain in employment pushed the unemployment rate back down to 6.1% for August. Looking through the volatility, the labour market appears to be flat to slightly improving. Business conditions moderated in August according to the Nab Survey while consumer sentiment for September fell. Retails sales and building approval data for July were solid.

On the policy front, the main development over the month was the RBA's increasing discomfort with the pace of investor lending and associated risks of a destabilising property cycle. Rather than use monetary policy to combat this, the RBA suggested that macro prudential tools could have a role to play. We still see the next move in the cash rate as up, but it could be some time away. In our view, a modest tightening cycle is likely to start in late 2015 but if the exchange falls quicker than we expect, this will bring forward our timing to mid 2015.

Equity Market Trends: Offshore equity markets were again whipped around by geo-political concerns with protests in Hong Kong being added to the mix towards the end of the month. Economic data was mixed; generally solid in the US, while weaker data out of Europe and China elevated concerns about the growth outlook. Against this backdrop, the S&P500 ended the month 1.5% lower. In Europe, the Euro STOXX 50 gained 1.7%, helped by a supportive central bank, while in Japan the Nikkei gained 4.9%. The MSCI World ex-Australia Accumulation Index in Australian dollars gained 4.3% over September, with a sharp fall in the Australian currency boosting sector returns. In Australia, the S&P/ASX 300 Accumulation Index had a poor month, falling 5.4% against the backdrop of weakening commodity prices.

Bond Market Trends: Yields trended higher over the first few week of the month on stronger data before rallying into the close of the month on flight to quality flows as rising geo-political uncertainty triggered a sell-off in equity markets. After rising to as high as 2.90% and 3.73%, three and ten year government bonds ended the month 8 and 19 basis points higher at 2.71% and 3.48% respectively. As a result of these moves, the sector experienced some capital loss with the Bloomberg AusBond Composite Index falling 0.33%. The cash sector, as measured by the Bloomberg AusBond Bank Bill Index, rose by 0.21%.

Investment Strategy: The recent Australian equity market sell-off has restored significant value and has taken us closer to levels where we would consider moving overweight the sector. For the time being, multi sector funds are maintaining benchmark exposures to the sector.

Multi sector funds continue to hold a benchmark weighting to Australian fixed interest sector with the rise in yields over the month restoring some value.

Frank Uhlenbruch, Investment Strategist

Tactical Asset Allocation Summary (as at 30 Sep 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

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