

**May 2014**

It's taken more than six years, but US payrolls have now exceeded their pre-GFC peak. May's report showed an additional 217,000 jobs were created – further evidence of a solid recovery in the labour market. Following on from April's significant decline, the unemployment rate held firm at 6.3%, as did the participation rate at 62.8%.

In a strange turn of events, the Institute for Supply Management had to issue two corrections to its key manufacturing activity index for May. The original release of 53.2 had suggested a weakening in the pace of manufacturing activity, but it was later discovered to have been the result of a software glitch. The final correction came in at 55.4 – much more in line with the Markit PMI reading of 56.4, which showed an acceleration in output.

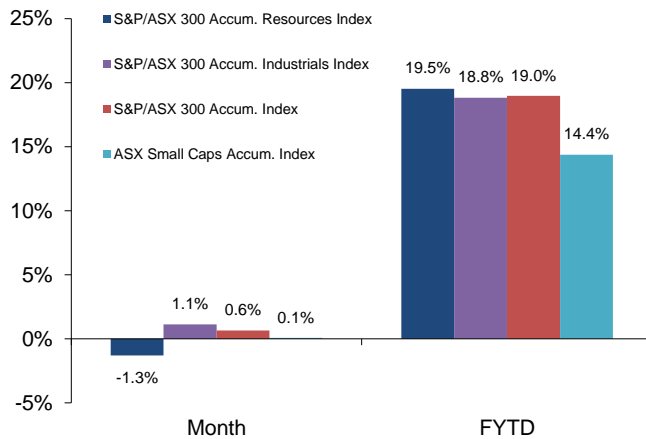
After months of speculation and growing expectations, the European Central Bank (ECB) cut its benchmark interest rates. In an unprecedented move, the ECB decreased the rate it pays commercial banks for depositing cash to -0.10% – the first major central bank to cut an indicator rate below zero. The ECB also lowered its central refinancing rate (the overnight lending rate) to 0.15% from 0.25% and its marginal lending rate (the emergency lending rate) by 0.35% to 0.40%. Accompanying the rate cuts are targeted liquidity injections and a EUR400 billion package to incentivise banks to increase business lending. Although the market reaction was muted on the day, European equity market returns and peripheral European bond yields had been gradually pricing in the move in the preceding months. These extraordinary measures are designed to fight the prospect of deflation in Europe. Euro area inflation slowed to 0.5% y/y in May.

Over in China, the economy looks to be showing further signs of stabilisation. The official manufacturing PMI increased to 50.8, the highest level in 2014, driven by increases in the more forward looking new orders sub-index. Policymakers are also doing their part. In an effort to support the farming/rural sector and small-/medium- sized firms, the People's Bank of China, China's central bank, announced a 50bps cut in the reserve requirement ratio, the amount of cash banks need to set aside as reserves, for banks that hold significant loans to those sectors. This nuanced approach is aimed at supporting a more targeted segment of the economy, without exacerbating existing imbalances.

In Japan, 1Q14 real GDP growth beat expectations, accelerating to 5.9% q/q annualised. As a result, Japanese real GDP has now exceeded its previous peak, recorded in 1Q08. As predicted, private consumption was a strong contributor to growth ahead of the consumption tax hike in April. More surprising was the sharp increase in business capital expenditure (capex). Looking ahead, the picture is mixed. Further increases in capex are expected as a result of higher corporate profits, but some of this should be offset by a slowdown in consumption following the rise in the consumption tax.

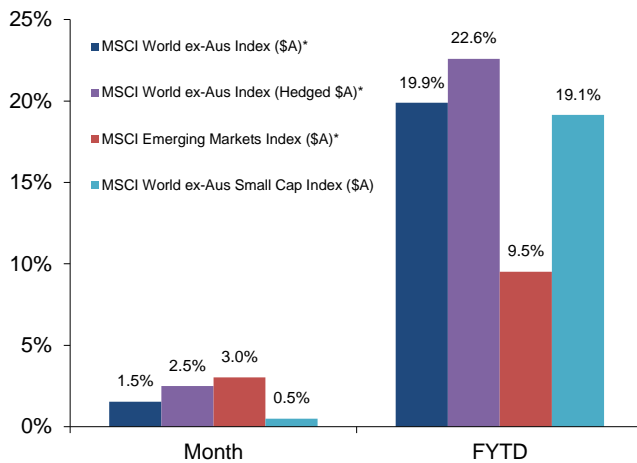
In Australia, the Reserve Bank left interest rates unchanged at 2.5% in their June Board meeting as was expected. Following the decision, the labour force survey showed Australia's unemployment rate held steady at 5.8% in May with 22,000 full-time jobs created and 27,000 part-time positions lost. Earlier in May, national accounts data showed the Australian economy grew at a rate of 3.5% y/y in the first quarter of 2014, beating expectations. Strong export volumes more than compensated for weaker export prices as evident from the 3.8% y/y decline in the terms of trade.

## Australian equities



Australian equities generated a modest positive return for the month (+0.6%), although the overall market was dragged down by the resources sector which lost 1.3% largely due to a significant fall in iron ore prices. As a result, small caps unsurprisingly underperformed broad caps, although they were still able to finish in the black (+0.1%).

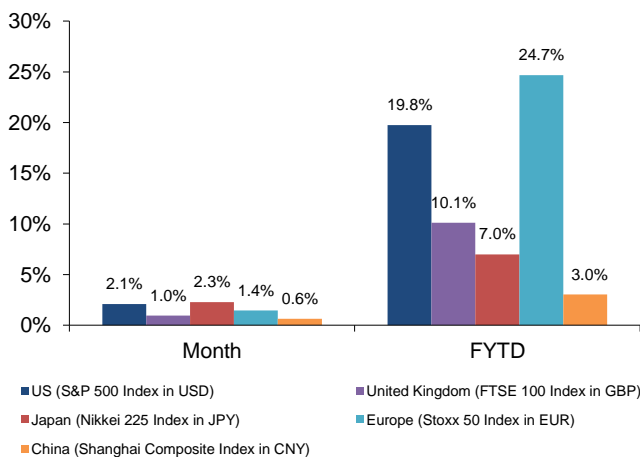
## International equities (\$A)



From an Australian investors' perspective, international equities outperformed Australian equities in May. Emerging markets were the standout, with previously underperforming markets such as China, India and Russia rebounding strongly.

Developed equity market returns were almost entirely driven by a strongly performing US market. With the Australian dollar increasing in value over the month, particularly against the euro and UK pound, hedged equities outperformed their unhedged equivalents.

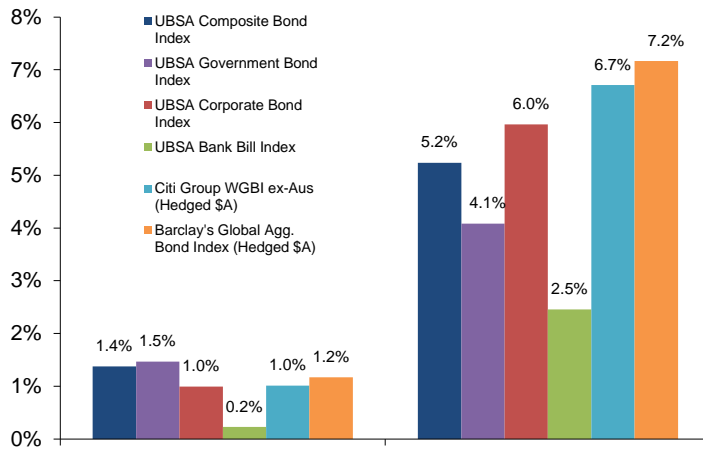
## International equities (local currencies)



International equity markets experienced a positive month in May, with most major markets recording a positive return. The S&P 500 closed the month at an all-time high, while the Nikkei rebounded from the significant decline in April.

European equity markets have been the standout performer in 2014.

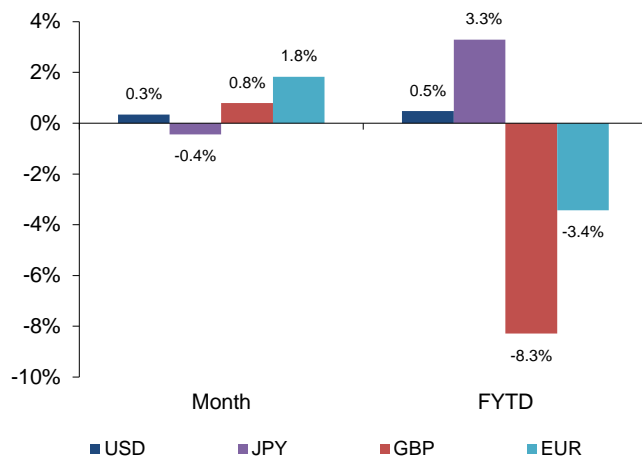
## Fixed income



Australian and international fixed interest investments recorded solid gains as Australian and international government bond yields fell. The decline in yields was more significant at the long end of the yield curve and in core markets such as the US, UK, Germany and France.

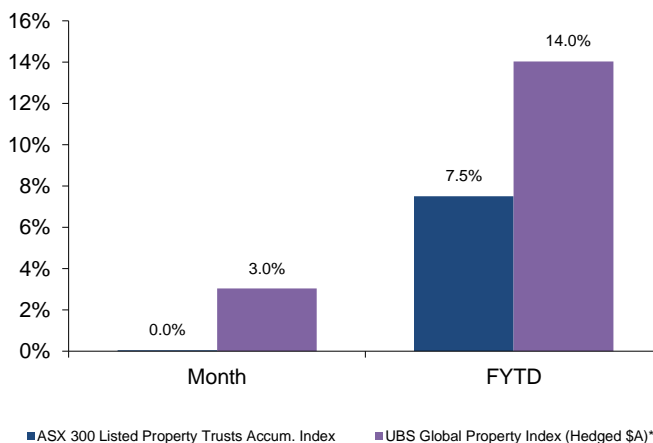
Yields of peripheral European government bonds were mixed, but have rallied strongly in 2014. Spanish and Italian 10 year government bonds finished the month yielding less than 3%.

## Australian dollar against major currencies



The Australian dollar appreciated against most major currencies over the month despite the sharp fall in iron ore prices. The largest move came against the euro as speculation of an interest rate cut by the European Central Bank and the possibility of a European quantitative easing program weighed on the value of their currency.

## Property



Australian listed property securities ended May effectively where they began in contrast to their international counterparts. The combination of an appreciation in the value of the Australian dollar and likely increased yield seeking behaviour saw global listed property securities return 3.0% in hedged AUD terms for the month.

# Monthly Markets

31 May 2014	Index value	Month	3 months	FYTD	1 year
<b>Australian equities</b>					
S&P/ASX 300 Accum. Index	46,017	0.6%	2.6%	19.0%	16.1%
S&P/ASX 300 Accum. Industrials Index	89,574	1.1%	3.7%	18.8%	18.5%
S&P/ASX 300 Accum. Resources Index	21,796	-1.3%	-1.9%	19.5%	7.4%
ASX Small Caps Accum. Index	5,388	0.1%	-2.3%	14.4%	6.2%
<b>International equities</b>					
MSCI World ex-Aus Index (\$A)*	5,431	1.5%	-0.9%	19.9%	22.7%
MSCI World ex-Aus Index (Hedged \$A)*	1,111	2.5%	3.8%	22.6%	19.6%
MSCI Emerging Markets Index (\$A)*	456	3.0%	2.9%	9.5%	7.4%
MSCI World ex-Aus Small Cap Index (\$A)	348	0.5%	-5.4%	19.1%	22.2%
US (S&P 500 Index in USD)	1,924	2.1%	3.4%	19.8%	18.0%
United Kingdom (FTSE 100 Index in GBP)	6,845	1.0%	0.5%	10.1%	4.0%
Japan (Nikkei 225 Index in JPY)	14,632	2.3%	-1.4%	7.0%	6.2%
Europe (Stoxx 50 Index in EUR)	3,245	1.4%	3.0%	24.7%	17.1%
China (Shanghai Composite Index in CNY)	2,039	0.6%	-0.8%	3.0%	-11.4%
<b>AUD versus ...</b>					
USD	0.93	0.3%	4.2%	0.5%	-3.4%
JPY	94.66	-0.4%	4.1%	3.3%	-2.8%
GBP	0.56	0.8%	3.8%	-8.3%	-12.2%
EUR	0.69	1.8%	4.9%	-3.4%	-7.4%
<b>Property</b>					
ASX 300 Listed Property Trusts Accum. Index	29,278	0.0%	4.0%	7.5%	6.5%
UBS Global Property Index (Hedged \$A)*	1,854	3.0%	6.8%	14.0%	11.0%
<b>Australian Fixed Interest</b>					
UBSA Composite Bond Index	7,887	1.4%	2.3%	5.2%	4.1%
UBSA Government Bond Index	8,188	1.5%	2.2%	4.1%	2.8%
UBSA Corporate Bond Index	8,068	1.0%	2.0%	6.0%	5.3%
UBSA Bank Bill Index	8,047	0.2%	0.7%	2.5%	2.7%
<b>Global Fixed Interest</b>					
Citi Group WGBI ex-Aus (Hedged \$A)	-	1.0%	2.2%	6.7%	5.8%
Barclay's Global Agg. Bond Index (Hedged \$A)	-	1.2%	2.4%	7.2%	5.8%
<b>Oil and commodities</b>					
Crude Oil (\$/bbl)	103	3.0%	0.1%	6.4%	11.7%
Copper Spot (\$/tonne)	6,919	3.9%	-2.3%	2.8%	-5.0%
Gold Spot (\$/ounce)	1,246	-3.9%	-5.8%	1.4%	-11.0%
<b>Fixed income (yields) as at ...</b>					
	<b>31-May-14</b>	<b>30-Apr-14</b>	<b>28-Feb-14</b>	<b>30-Jun-13</b>	<b>31-May-13</b>
Australia Bank Bill	2.69	2.67	2.62	2.79	2.78
Australia 10 Year Government Bond	3.66	3.95	4.02	3.76	3.36
US 10 Year Government Bond	2.48	2.65	2.65	2.49	2.13
UK 10 Year Government Bond	2.57	2.66	2.72	2.44	2.00
Germany 10 Year Government Bond	1.36	1.47	1.62	1.73	1.51
Japan 10 Year Government Bond	0.58	0.63	0.59	0.85	0.86

\* Net dividends reinvested