

Investment Comment (written 7 February 2012)

Index results for the month of January 2012

Australasian Shares	The NZSX 50 was up 0.7% while the ASX 200 was up 5.1% in local currency terms. In NZ dollar terms it rose 2.8%.
Global Shares	The MSCI World rose 4.5% (hedged to the NZ dollar). In unhedged terms, it fell -0.9%. The MSCI Emerging Market Index was up 7.4% in local currency terms.
NZ Bonds	The NZX NZ Government Stock Index fell 0.1%, the NZX Corporate A Index rose 0.2%.
Global Bonds	The CitiGroup WGBI rose 0.9%, the Barclays Global Aggregate Index rose 1.2%.
Currency	The NZ dollar finished up 5.9% at 82.6 US cents and up 2.2% at 77.8 Australian cents.

Markets

Share markets began the year in roaring fashion. The MSCI World was up over 4% in local currency terms led by Greece, Singapore and Germany. Australia also performed well, rising 5.1% and beating the United States – the S&P 500 was up 4.4%. The earnings season kicked off positively in the US with Apple announcing a net profit of US\$13 billion for the December 2011 quarter. By contrast, Google's share price suffered after it announced a decrease in advertising revenue.

Emerging markets trumped the developed world with the headline index rising 7.4% in local currency terms. All four of the BRICs rose strongly, while countries perhaps less prominent in investors' minds lagged (Mexico and Malaysia for example).

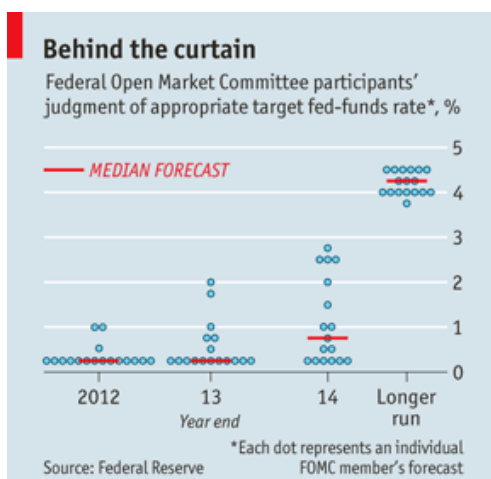
Global bonds also performed well over the month as credit spreads tightened. The global aggregate index outperformed the sovereign bond index as yields in the latter sector were more or less unchanged in the major markets. New Zealand bonds had a muted month.

As might be expected in such a "risk on" month, the New Zealand dollar rallied strongly. At month end it was worth 82.6 US cents (up 5.9%) and up over 4% against the Euro, British Pound and Japanese Yen. It gained 2.2% against the Australian dollar.

Economies

The strong returns from markets came amidst a much more accommodative stance by central bankers. Out of the 31 interest rate decisions across the globe, nine banks cut rates while just one (Colombia) raised rates this month. Contrast this to January 2011 where 11 central banks (including Brazil, India and Russia) tightened monetary policy and just three eased. See our chart this month.

On 25 January, the US Federal Reserve released for the first time a detailed projection for interest rates. This added several months onto the market's consensus of the time horizon for low rates (it was previously assumed to be "mid 2014"). The chart below (from [the Economist](#)) displays the data.



This announcement drove up stock prices and gold rose over 11% in the month. This policy, of course, is not unusual in this part of the world. (The Reserve Bank of New Zealand regularly publishes its rate outlook.)

The Fed also announced an explicit inflation target of 2% pa.

Amidst this the Fed lowered its projections for economic growth to 2.2%-2.7% in 2012 and 2.8-3.2% in 2013.

US unemployment was revealed in early February to have fallen to 8.3% - the lowest since February 2009. The US economy grew by a 0.7% in the final quarter of 2011 taking the growth for the year to 1.6% - not stellar, but better than many had feared.

Across the Atlantic, Britain announced a weak GDP figure for the December quarter (the economy contracted 0.2%) meaning that in the calendar year 2011 it only grew 0.8%. The government debt-to-GDP ratio rose to 64%.

After placing the Eurozone countries on credit watch in December, Standard and Poor's made good on its warning and downgraded 9 of the 17 nations. France and Austria lost their AAA ratings, slipping one notch to AA+. As a consequence the European Financial Stability Facility (EFSF) was also downgraded to AA+.

The pain of the Euro crisis is acute in Greece where unemployment is approaching 20%, yet the current account deficit is still 10%. An IMF report published at the end of 2011 said that a 50% write-down on private-sector bonds, together with €130 billion of extra official financing at low interest rates would give Greece a decent chance of getting its public debts down to 120% of GDP by 2020. However, this now looks overly optimistic, even if the private debt holders were not threatening revolt at the terms of the "voluntary" write-down. Greece's GDP is expected to have contracted 6% in 2011.

In the emerging market, China's GDP grew 2.0% in the fourth quarter bringing annual growth to 8.9%. A strong result by global standards but the slowest for the Asian giant since the second quarter of 2009.

New Zealand

On the balance, New Zealand data were slightly better than expected. In particular, the BNZ-BusinessNZ seasonally adjusted PMI for December stood at 51.9, which was 5.9 points up from November and the highest level of activity since August 2011. A reading above 50 indicates an expansion.

It was confirmed that Reserve Bank Governor Alan Bollard would not seek a further term when his current one expires on 25 September 2012. While many in the market think the official cash rate will stay at its low levels until there is tangible improvement in Europe, the uncertainty of Dr Bollard's replacement is something of a wild card. In his statement of 26 January, Governor Bollard [said](#):

"Since the time of the December Statement, financial market sentiment has improved slightly, with increased liquidity in European financial markets. However, the global economy remains fragile and risks to the outlook remain."

"World prices for New Zealand's export commodities have remained elevated but the recent appreciation of the New Zealand dollar is reducing exporters' returns. The European debt crisis has also increased the cost of international funding, which will likely pressure funding costs for New Zealand banks over the coming year."

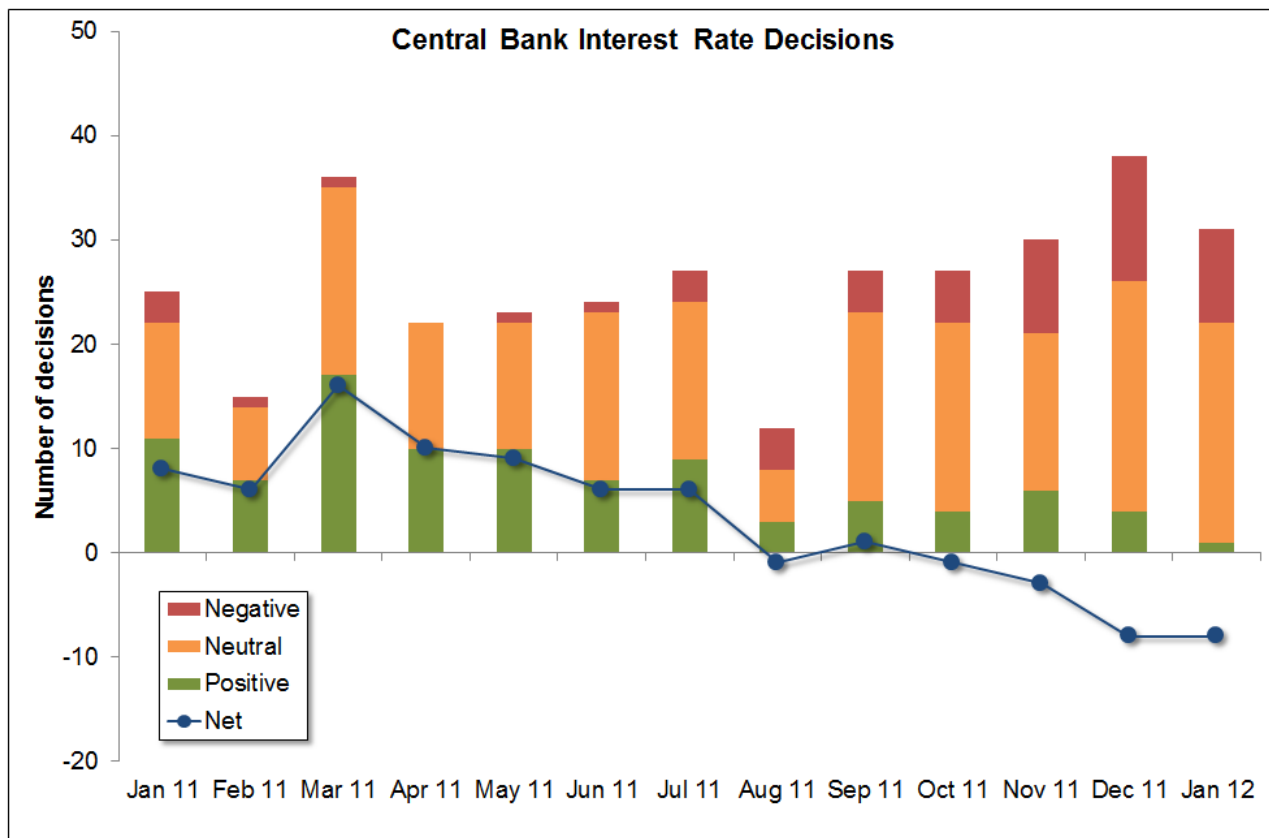
"In the domestic economy we continue to see modest growth. Over recent months there have been signs of a limited recovery in household spending and the housing market. Further ahead, repairs and reconstruction in Canterbury will also provide a significant boost for an extended period, though there may be further delays resulting from the aftershocks."

The CPI was confirmed to have fallen in the December quarter. It was down 0.3% for the quarter and this, combined with the effects of the GST rise in 2010 dropping out of the 12 month figure, saw annual inflation fall below 2% - the midpoint of the range that the Reserve Bank targets.

Outlook

There's no denying that Europe is in a mess. However, the US continues to look like it is (finally) recovering from a very rough period. The easy monetary policy that has been confirmed by the Fed (and that is demanded in Europe by the weak sovereigns) looks set to increase inflation expectations. While we are yet to see long term bond yields rise, one gets the feeling that we cannot be a long way off if conditions continue to improve.

Chart Corner



The chart shows the number of interest rate decisions made by central banks. Positive decisions are those where interest rates have been raised (monetary policy has been tightened), neutral decisions are those where interest rates have been left on hold and negative decisions are when interest rates have been cut (monetary policy has been eased). The net line subtracts the number of negative decisions from the number of positive decisions.

We can see that in 2011 the number of positive decisions easily outnumbered the negative ones. However as the global economy weakened over the year more central bankers began to ease policy (or at least not raise rates).