FEBRUARY 2015 MARKET UPDATE

Market and economic overview

Australia

- The Reserve Bank of Australia (RBA) eased monetary policy on 3 February 2015, cutting the official cash rate to a record low of 2.25%, from 2.5%. The first move in interest rates since August 2013. The RBA followed up on 3 March 2015 with no change to the official cash rate.
- The statement accompanying the rate cut was little changed from the views expressed last year when rates were held unchanged.
- The RBA highlighted that “the economy is likely to be operating with a degree of spare capacity for some time yet”. In addition, the Australian dollar (AUD) remains “above most estimates of its fundamental value” and “a lower exchange rate is likely to be needed to achieve balanced growth in the economy”.
- The RBA released its quarterly Statement on Monetary Policy (SOMP) on 6 February 2015 and downgraded its GDP and inflation forecasts.
- GDP growth was revised down from 2% - 3% to an average between 1.75% and 2.75% for 2015.
- Inflation forecasts were also revised. Headline inflation is now forecast at between 1.25% as at June 2015, down from between 1.5% and 2.5% with underlying inflation at 2.25% compared to between 2% and 3% as at November 2014.
- The RBA noted in the SOMP that “over recent months there have been fewer indications of a near-term strengthening in growth than previous forecasts would have implied. Hence, growth overall is now forecast to remain at a below trend pace somewhat longer than had earlier been expected”.
- The Westpac Consumer Confidence Index bounced 8% post the RBA rate cut, rising to 100.7; its highest level since January 2015. Lower petrol prices and improved political stability also contributed to the gains.
- The NAB Business Confidence Index rose 1 point to 3, while the NAB Business Conditions Index remained unchanged at 2.
- The unemployment rate rose to 6.4% in January, up from 6.1% in December. There were 12,200 jobs lost in the month.

United States

- The Federal Open Market Committee (FOMC) of the US Federal Reserve Board did not meet in February. The next meeting is scheduled for 17-18 March 2015.
- FOMC Chair Yellen did provide the semi-annual monetary policy report to the congress and continued to guide the markets towards the view that the Fed will soon remove the ‘patient’ descriptor for when monetary policy normalisation will begin and noted the pace of interest rate hakes will be data dependent.
- Chair Yellen did remain upbeat about the health of the US labour market, stating that since her last appearance before the Committee in July 2014, “the employment situation in the United States has been improving along many dimensions”. However

given the lack of growth in wages there does remain some cyclical weakness to the labour market.

- Chair Yellen continued to express the view that “the Committee expects inflation to decline further in the near term before rising gradually toward 2% over the medium term as the labour market improves further and the transitory effects of lower energy prices and other factors dissipate, but we will continue to monitor inflation developments closely”.
- The second estimate of Q4 2014 GDP was released indicating growth was 2.2% on a seasonally-adjusted-annualised-rate, compared to the first estimate of 2.6%. The downgrade was due to a smaller gain in inventories than previously expected and came despite upgrades to final sales and business investment.
- For all of 2014, growth in the US was 2.4%, compared to 2.2% in 2013.
- The fall in the oil price and the strong US dollar saw inflation fall 0.7% per month, the most since December 2008, taking the headline inflation rate to -0.1% per year in January. Core inflation rose 0.2% per month with the annual core inflation rate remaining steady at 1.6%.
- The US labour market continued to improve, 257,000 jobs were added in January. The unemployment rate did tick up to 5.7% with more people searching for work.
- Wages growth recovered, rising 0.5% per month after falling 0.2% in December. This took the annual rate to 2.2%.
- House prices continue to rise, helped by limited supply on the market. The FHFA House Price Index rose 0.8% per month in December, taking gains over the past year to 5.5%.

Europe

- The European Central Bank (ECB) did not meet in February, its next meeting is scheduled for 5 March 2015.
- Instead the focus in February in Europe was on Greece and its negotiations around its extension to its current loan program post the election win by Syrzia in late January.
- Negotiations were underway for much of the month, with the new Greek government and the Eurogroup initially far apart on a prospective deal, creating market volatility. However, as Greece formally requested an extension to its current bailout program, a “common ground” was found between the new Greek government and the Eurogroup.
- This extension of its bailout program will last for four months when a new arrangement will have to be negotiated.
- Greece has committed to “a successful completion of the review on the basis of conditions in the current program”, requiring Greece to not rollback any measures or make unilateral changes to policies. In return Greece will be provided some flexibility.
- Greece also had to submit a list of draft commitments that it will undertake. It will now be a tough sell for Alex Tsipras and the Syrzia party to ‘sell’ this program to the parliament and general public with expectations of some backlash likely over coming months.
- In terms of economic data, Q4 2014 GDP data was released, rising for the euro area at 0.3%, taking annual growth to 0.9%, up from 0.8%. Germany grew by 0.7% per quarter and continues to suggest that the cyclical downturn in Europe’s largest economy has past. Elsewhere Spain, Portugal and France all recorded growth. While Greece recorded negative growth.
- The first estimate of February CPI for the euro area was recorded at -0.3% per year, an improvement on the +0.6% per year in January. A stabilisation in the price of oil helped the recovery. Core inflation was 0.6% per year.

United Kingdom

- The Bank of England (BoE) left policy unchanged at its 5 February meeting. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn.
- The BoE released its quarterly Inflation Report over the month and contained a mix of lower inflation forecasts. For end 2015, inflation is forecast at 0.6% before rising to 1.8% at end 2016 and 2.1% at end 2017. As at January 2015 inflation was 0.3% per year.
- GDP growth forecasts have also been revised down for 2014 to 2.5% from 2.9%, however were upgraded for 2015 to 2.9% with growth of 2.7% expected at end-2016 and 2.5% at end-2017.

Japan

- The Bank of Japan's (BoJ) policy board convened on 18 February 2015 and left its qualitative and quantitative easing (QQE) program at an annual increase of Y80trillion to its monetary base.
- Q4 2014 GDP data was released, with the Japanese economy growing by 0.6% per quarter, annualising at 2.2% per year and lifted the economy out of recession. This was a big improvement on Q3 2014, with growth -0.5% per quarter and annualising at -2.3% but still below expectations.

China

- The People's Bank of China lowered benchmark interest rates for the second time in this easing cycle on 28 February 2015. The 1-year lending rate was cut by 25bps to 5.35% and the deposit rate was cut by 25bps to 2.50%.
- Inflation continues to cool, falling to 0.8% per year for January, down from 1.5% per year in December. This is the lowest rate since November 2009, driven by lower food and oil prices.

Australian dollar

The Australian dollar rose in February, up 0.6% against the US dollar to US$0.8100 and the first gain since October 2014. The Australian dollar traded with some volatility over the month, falling post the RBA rate cut before moving higher during the second-half of the month.

The Australian dollar (AUD) rose against the euro and yen while fell against sterling. The AUD also fell 3.3% against the NZ dollar.

Commodities

Commodity prices were mixed in January, though the oil price did rise after seven months of falls.

Metal prices were generally weaker, with some growth concerns in China. The exception was copper which rose 7.3%, while nickel, lead and tin all falling.

The gold price fell 5.5% to US$1213 an ounce after sharp gains in January.

The iron ore price[1] rose 0.6% in February, it finished the month at US$62.6 a metric tonne.

Australian shares

Australian shares generated strong returns in February, with the S&P/ASX 200 Accumulation Index adding 6.8%. This was the highest monthly return in more than three years and lifted the return from the Index to more than 10% in 2015 to date.

The market was led higher by an 11.7% rise in the Materials sector, which was supported by a solid semi-annual result announcement from BHP Billiton. Energy stocks also rose, buoyed by the oil price which recovered.

Listed property

The Australian listed property sector continued to deliver positive performance in early 2015, with the S&P/ASX200 Property Accumulation Index up by 3.7% in February 2015.

Global listed property markets underperformed their Australian counterparts in February with the UBS Global Property Investors' Index (local currency) decreasing by 1.3% over the month.

Global Shares

Global developed equity markets were universally strong in February, with strong investor sentiment, promoted by search for yield and higher returns than can be found in global developed bond markets. This has driven price to earnings ratios higher and while profits have risen, price to earnings ratios are now close to levels since in 1999.

While the global growth outlook remains constructive, the threat of excess liquidity in global markets driven by quantitative easing in Europe and Japan, as well as interest rate cuts in January and February have also driven equity markets higher.

The MSCI World Index rose 5.7% in USD terms and 5.1% in AUD terms.

The S&P 500 Index made new highs in February, rising 5.5% in the month and taking returns over the past 12 months to 15.5%.

The Euro Stoxx top 50 was up 7.4%. The UK FTSE 100 rose 2.9%.

The Japanese Nikkei 225 rose 6.4% over the month, with the yen continuing to depreciate over February. It has now fallen 17.5% over 12 months.

Global emerging markets

Emerging market (EM) equities rose in February but underperformed developed markets. The MSCI EM Index returned +3.1% in USD terms and +2.5% in AUD terms.

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[1] Iron Ore delivered to Qingdao China - 62% Ferrous Content - USD/dry metric ton
Source: Colonial First State. This information is current at 11th March 2015 but is subject to change.