Colonial First State

Monthly Market View

November 2012

Latest monthly commentary from the Investment Markets Research team at Colonial First State

- Most equities markets posted positive gains in November, although the US Presidential election and US Fiscal Cliff negotiations resulted in considerable volatility during the month.

Economic overview

The US Presidential election returned the status quo: Barack Obama remains as President, the Democrats retain their majority in the Senate and the Republicans still control the House. President Obama won 332 Electoral College votes, easily surpassing the 270 minimum required to claim the Presidency.

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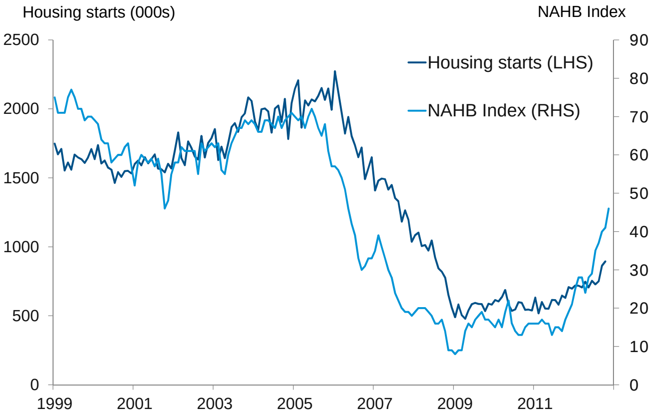
US economic data released in November was mixed, with some data negatively impacted by Superstorm Sandy. Early in the month, employment data was released which showed that 171,000 jobs were added in October. The unemployment rate rose to 7.9% from 7.8%. Conditions appeared to worsen in November, with initial jobless claims rising from 361,000 to 439,000 in the middle two weeks of the month.

US industrial production also fell 0.4% per month, with the Federal Reserve estimating that Superstorm Sandy cut total industrial production by almost 1 percentage point in the month. The largest impact was felt in production cutbacks in utilities, chemicals and electronics.

Housing market data continued to show improvement. The NAHB Housing Market Index – an indicator of homebuilders' confidence – rose from 41 to 46, a six-year high. Existing home sales rose 2.1% per month, while housing starts rose 3.6% per month to be up 42% per year. See chart below of NAHB Index and housing starts. Consumer confidence softened slightly, with the Fiscal Cliff now the main area of concern for both US consumers and businesses. This was also evident in the release of ISM Manufacturing data in early December. The index fell from 51.7 to 49.5.

HOUSING STARTS AND HOMEBUILDERS CONFIDENCE



Source: Bloomberg. Data to November for NAHB and housing starts to 31 October 2012

Following the US Presidential election, negotiations for the Fiscal Cliff started with a conciliatory tone by leaders of the Republican and Democrat parties. However as negotiations continued into December, hope of a deal being reached faded. Proposals have been put forward by both sides that are unlikely to be approved by the other party.

In Europe a third Greek government debt deal was agreed to after Greece announced further austerity measures and passed its Budget through parliament. Greece approved a new round of austerity measures – worth €13.5 billion – including cuts to public sector wages, increasing the retirement age from 65 to 67 and cuts to pension entitlements.

As a result Greece received a new deal that included a 100bp lower interest rate charged on loans provided in the context of the Greek Loan Facility, a 0.10% discount on guarantee fees paid on EFSF loans, an extension of the maturities of the bilateral and European Financial Stability Facility (EFSF) loans by 15 years and a deferral of interest payments on EFSF loans by 10 years, as well as some other minor advantages. This new package is designed to reduce Greek debt to GDP from 190% in 2013 to 124% in 2020 and below 110% in 2022.

Other economic data released in Europe in November continued to show an economy in a weak position. PMI Manufacturing data remains below 50 across Europe, including; Germany (46.8), France (44.5), Italy (45.1) and Greece (41.8).

In China the focus was on the 18th party Congress meetings and the leadership transition. Vice President Xi Jinping has been appointed both the Communist Party General Secretary and the Chair of the Military Commission.

There are unlikely to be any immediate policy changes or initiatives in the coming months. Rather the focus is likely to continue to be on medium-term reform of financial markets, particularly the relationship between the market and the government. The focus on improving income distribution between rural and urban residents is also expected to continue.

Economic data released in China continued to show stabilisation and some improvement in growth momentum. The PMI Manufacturing data rose to 50.6 in early December, for example, up from 50.2. See chart below for details.

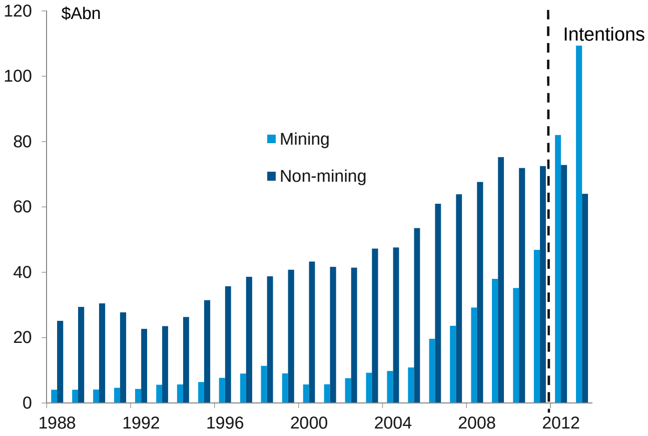
PMI MANUFACTURING INDEX - CHINA

Source: Bloomberg. Data to November 2012

In Australia, the Reserve Bank of Australia (RBA) left interest rates on hold at 3.25% in November in a surprise move. However on 4 December 2012 the Bank eased monetary policy by cutting the official interest rate to 3.0%, back down to its post-GFC low.

The RBA appears to remain concerned about future sources of economic growth, given the peak in mining investment is perceived to be approaching. This was reflected in revised expectations for mining investment. Mining investment plans for 2012/13 were revised lower by 8.1% to $A109 billion. See chart below for capital expenditure pipeline.

CAPITAL EXPENDITURE PIPELINE ($ABN)



Source: ABS. Data as at November 2012

Employment data released over the month showed job gains of 10,700, with the unemployment rate remaining steady at 5.4%. With somewhat weaker employment conditions, wage inflation remains contained, rising 0.7%/qtr for Q3 and 3.7%/yr.

Australian shares

Thanks to a rally in the second half of the month, the Australian share market registered a sixth consecutive month of gains in November.

The S&P/ASX 200 Accumulation Index rose by 0.5% in the month as a whole, extending gains in the 2012/13 year to date to 12.6%.

A wide range of listed Australian companies hosted Annual General Meetings during the month. Several companies updated investors with current operating conditions and, in some cases, announced revised earnings forecasts for the full year.

Most companies are continuing to focus on cost control. Diversified mining group Rio Tinto, for example, announced it plans to reduce costs by $5 billion by 2014 (9% of its existing cost base).

Investors continued to focus on the uncertain outlook for global economic activity. This dampened sentiment towards cyclical stocks whose earnings are leveraged to an improvement in the pace of economic growth. The Materials and Industrials sectors, for example, underperformed.

Stocks with defensive earnings streams – including those in the Health Care and Telecoms sectors – typically fared relatively well. Consumer Discretionary stocks also performed reasonably well following an improvement in consumer confidence and retail sales data.

Listed property

Australian listed property securities fell by 1.3% in November, underperforming the broader share market by 1.8%.

The Reserve Bank of Australia's surprise decision to leave interest rates unchanged at 3.25% on 6 November impacted the sector, which had been anticipating a rate cut.

At a stock specific level, Goodman Group (+4.3%) and Dexus Property Group (+2.0%) performed most strongly. Goodman Group was the best-performing A-REIT for the second consecutive month as it announced a number of expansionary moves, including its entry into the Brazilian property market via a new joint venture, and the consolidation of its Japanese property business.

Dexus Property Group announced the acquisition of a B-grade office building in Melbourne at a yield of 8.9%, and is believed to be close to arranging the long-anticipated sale of its large US-based portfolio of industrial property.

Most A-REITs are in strong financial positions with healthy balance sheets and we expect the low interest rate environment to be supportive of the sector in the medium term. The sector currently yields 5.8% on the basis of financial year 2013 earnings.

Overall, offshore listed property markets generated positive returns in November. The UBS Global Property Investors Index (local currency) returned 0.6%. Regionally, Singapore (+2.5%) and Continental Europe (+2.2%) performed most strongly. Australia (-1.3%) and the US & Canada (-0.4%) underperformed.

Global shares

Global equity markets were mixed in November, although most major markets produced positive returns. There remains considerable uncertainty regarding the outcome of Fiscal Cliff negotiations in the US, however, and this is resulting in market volatility. The MSCI World Index rose 1.1% in US$ terms and 0.6% in A$ terms.

US equity markets were mixed with the S&P 500 (+0.3%) and NASDAQ (+1.1%) higher while the Dow Jones (-0.5%) weaker. Some companies in the US have accelerated share buybacks ahead of the Fiscal Cliff. Considerable uncertainty remains about tax policy in 2013 leading to a hiatus on capital expenditure plans.

European equity markets were stronger; Italy (+1.7%), France (+3.7%), Spain (+1.2%) and Germany (+2.0%) all rose. The UK FTSE 100 Index rose 1.5%. The Greek debt restructuring deal helped clarify the future of the EU, at least until German elections in late 2013.

Markets were mixed in Asia. The Nikkei rose 5.8% on expectations that the Bank of Japan would soon ramp up its Asset Purchase program if there is a change in government in December.

Elsewhere Taiwan (+5.8%), Thailand (+1.9%), Korea (+1.1%), Singapore (+1.0%) and Hong Kong (+1.8%) all rose. Malaysia (-3.7%) and China as measured by the Shanghai Composite Index fell 4.3%.

Global emerging markets

Emerging market equities rose 1.3% in US$ terms, and 0.8% in A$ terms, although this masked large divergence between different countries.

Russia fell 1.4% after stronger falls in October, despite a recovery in the oil price. Saudi Arabia was also weaker – down 3.8% – while Hungary (-5.0%) and Sri Lanka (-3.0%) also fell.

Poland (+4.1%), Argentina (+4.0%), Czech Republic (+2.7%) and Israel (+1.5%) all rose.

Global Fixed interest

Longer maturity high grade global bond yields in the major markets (US, Germany and UK) decreased in November.

Escalating tensions in the Middle East, political uncertainty in Japan, protracted negotiations over a new debt plan for Greece and concerns over a possible US fiscal contraction drove demand in these bond markets.

Moreover, the ‘status quo’ outcome of the US Presidential election triggered a risk-off move in major developed bond markets as concerns about the US fiscal cliff negotiations escalated. The yield of the 10-year US Treasury bond decreased by 0.11% to 1.58% in November.

Developments in the Eurozone – particularly in Greece – led to a falls in peripheral sovereign bond spreads compared to German Bund yields in November. The yield of the Spanish 10-year government bond reached an eight-month low of 5.18% on 29 November 2012.

Italian bond yields also fell sharply. Italy sold €3 billion of its benchmark 10-year government bonds at an auction on 29 November 2012 at a yield of 4.45%, the lowest since November 2010, and down from 4.92% at the previous auction on 30 October 2012.

Despite the improvement in peripheral bond markets, German Bunds continued to be well sort after, as economic data released in November confirmed that the Eurozone was in a technical recession during the September quarter. The yield of the 10-year German Bund fell by 7 basis points to 1.39%.

The Australian 10-year government bond yield increased by 3 basis points to 3.09% in November. This was the second consecutive month that yields have rose, having fallen in six of the seven previous months. This was driven by a mixture of positive domestic and offshore news flow, which boosted market sentiment.

Australian yields also reacted positively to the smooth leadership transition in China and announcement of the details of the latest Greek debt plan.

However, yields fell into month-end due to escalating concerns about the Fiscal Cliff negotiations in the US.