

Investment Report – April 2014

Worldwide bond and sharemarkets have generally made small gains in the first three months of the year, albeit with renewed volatility deriving largely from the recent troubles in the Ukraine as well as concerns about the financial strength of some of the emerging market countries.

USA

The US economy grew a bit faster than previously estimated in the fourth quarter of 2013. GDP expanded at a 2.6% annual rate in the final three months of last year, up from the previous estimate of 2.4%. Consumer spending, which makes up for more than two thirds of US economic activity, was raised sharply higher in the new estimate.

The economy officially added 175,000 new jobs in February and the unemployment rate rose slightly to 6.7%, in spite of the recent harsh weather conditions in the US.

US retail sales rose in February for the first time in two months. Over the past twelve months, retail sales have risen by only 1.5%. Economists expect sales to pick up as the weather and household finances both show signs of improvement in the spring.

Manufacturing slowed in March after nearing a 4-year high in February, but the rate of growth and the pace of hiring remained strong.

China

China has set its economic growth target for 2014 at 7.5%, as it looks to continue its efforts to stabilise and rebalance the economy. Most economists now interpret recent statistics to suggest that it will be lower than this. It also set its inflation target at 3.5% pa. In 2013, the economy grew at 7.7%, about the same rate as 2012.

In February, exports sank 18.1% from a year earlier, much lower than the 5% growth expected and far lower than the 10.6% expansion in January. Although the sharp fall raised concerns over Asia's largest economy, distortions due to the long Lunar New Year holidays could have contributed to the surprise fall.

China's industrial production in January and February combined rose 8.5%, while retail sales also rose 11.8% from the year before. Nevertheless, these figures were less than expected, further adding to fears of a slowdown. The manufacturing sector also showed a further contraction in March.

Japan

The pace of economic growth will remain strong during 2014 aided by buoyant household consumption ahead of an imminent sales tax increase, continued expansion of public investment, a cyclical expansion in business spending and several demand stimulus measures from the so-called "third arrow" of Abenomics, named after the Prime Minister. The Bank of Japan is expected to maintain an accommodative monetary policy, which will probably give further yen weakness.

Europe

The Euro area should continue to recover as it emerges from the recessions and crises of recent years. While restructuring is still not complete, much progress has been made. The pent up demand and spare capacity created from an extended recession opens the door for a number of years of improving economic growth. Recent data in Europe has surprised on the upside, but sharply lower inflation still indicates some deflationary risks.

The ECB kept its benchmark interest rate steady at 0.25% in March. The bank also raised its forecast for growth in 2014 to 1.2%. However, deflation remains a concern in the euro zone.

Australia

The growth rate is likely to be near 2.5% this year. Despite the unemployment rate still rising and resource sector capital investment still slowing from the strong rates of recent years, 2015 should register some improvement. The Governor of the Reserve Bank, Glenn Stevens, noted in late March that there were encouraging early signs of a hand over of mining-led growth to domestic consumption and the economy may well improve later in 2014.

Following soft domestic macro data in Australia, the RBA left the cash rate unchanged at 2.5% and shifted its view to a more neutral stance, suggesting a period of stable interest rates in the near term. However, the RBA still left its options open to reinstate its easing bias in the second half of the year.

New Zealand

The economy is strong: business and consumer confidence remain robust, the terms of trade are at a 40-year high, household spending is increasing helped by high net immigration and housing market activity continues to be supported in Auckland construction and the Christchurch rebuild.

Thus, as expected, the RBNZ began its tightening cycle in mid March, when it lifted the official interest rate from 2.5% to 2.75%. We expect further similar increases in coming months with a pause over the second half of the year before resuming tightening in 2015.

While headline inflation has been moderate, inflationary pressures are increasing and are expected to continue doing so over the next two years.

By increasing the OCR as needed now to keep future average inflation near the 2% target mid-point, the Reserve Bank is seeking to ensure that the economic expansion can be sustained.

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