

# Investment Report – July 2014

Global manufacturing activity appeared to accelerate in June, buoyed by a return to growth in China and Japan and the fastest expansion in the US factory sector in more than four years. However, some dark clouds still remain over Europe where an unexpected sharp fall in French business activity dragged on the wider euro zone. Other recent global economic indicators are mostly positive.

## USA

While GDP slowed earlier in the year, the more recent economic data have been more encouraging. The US economy actually shrank by 2.9% at an annual rate in the first three months of the year, the biggest contraction in GDP since the first quarter of 2009. A notably harsh winter depressed spending and investment but exports also suffered.

In May, new home sales jumped 18.6% to a seasonally adjusted annual rate of 504,000 units, while a consumer confidence index climbed to 85.2 in June, the highest reading since January 2008, and up from 82.2 in May.

US manufacturing activity rose at a steady pace in June and automobile sales raced to their highest level in almost eight years, pointing to momentum in the economy after the turbulent start to the year. The data painted an upbeat picture for the second quarter and underscored the strength in the economy heading into the last half of the year.

## China

In recent months, China's government has unveiled a series of modest measures to support economic growth, including reserve requirement cuts for some banks that should encourage new lending. Some analysts think that China might need more stimulus yet to offset a cooling housing market and avoid a sharper than expected downturn in economic growth.

## Japan

Japan has unveiled plans to cut the country's corporate tax rate to below 30% in several stages starting next year. The move is part of Prime Minister Abe's plan to revive the economy. Japan's corporate tax rate, at nearly 36% for large companies operating in the capital Tokyo, ranks among the highest in the world.

Consumer prices in Japan rose at an annual rate of 3.4% in May, the fastest pace in 32 years, as the effect of the sales tax hike started to be felt. Japan raised its sales tax rate from 5% to 8% on 1 April. The price growth in May follows a 3.2% jump in April and is a big boost for Japan's attempt to eliminate deflation.

## Europe

In the first quarter of 2014, GDP in the euro zone grew by 0.5% over a year earlier. Germany grew by 2.3% and the UK grew by 3.1% but France, the euro zone's second largest economy, remained at a standstill. UK economic growth in the first quarter was helped by the fastest expansion in business investment in two years. Business investment grew by 5% in the first three months of this year.

The ECB's recent policy loosening should support the recovery in euro area demand and mean growth that is forecast to head towards 2% next year. The number of people unemployed in the euro zone dipped slightly in May, but not by enough to dent the unemployment rate. Some 18.5 million people were out of work in May, 28,000 fewer than in April, but the jobless rate remained at 11.6%.

## Australia

The economy is likely to grow around 3% in 2014/15 with inflation in the top end of the Reserve Bank's 2-3% target band and unemployment between 5.5-6.0%. The economy is now re-balancing: moving away from mining investment as a driver of economic growth to increased home construction and exports of resources. The trade accounts are likely to stay in surplus while the broader current account deficit should continue to contract to near balance in the next few years. Apart from the China slowdown, there appear few risks to the economy except from domestic politics and global geopolitics (such as Iraq and Ukraine).

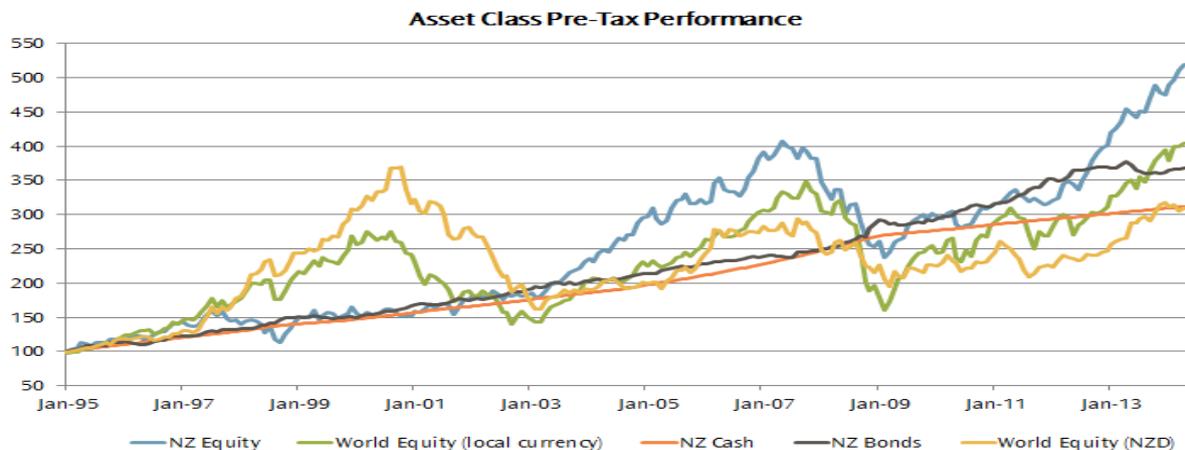
## New Zealand

While the New Zealand economy continues to retain considerable momentum, reflecting an elevated terms of trade, robust construction activity and strong net migration flows, there are increasing indications that we may now be close to a peak in the rate of growth in the current cycle. In particular, recent outturns of business and consumer confidence have shown a broad softening in sentiment, albeit from elevated levels. Moreover, the recently-weaker dairy auction prices further suggest that a high point in the terms of trade might have been reached.

## Summary

The graph shows that shares have made strong gains over the last two years mainly led by the New Zealand and developed global markets. The returns from Australian shares have been positive but reduced for local investors by the weaker Australian dollar. In this period, bonds have under-performed on a relative basis.

We still expect this general trend to continue in the rest of 2014, albeit for share appreciation at a slower pace, supported by the global upturn, robust domestic growth and still-supportive interest rate settings.



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