Investment Report – March 2015

2015 looks set to be dominated by low inflation for most countries as well as the battle by some countries to avoid deflation. The slump in oil prices adds a further dimension to this inflation/deflation story, while at the same time providing a welcome boost to growth for the many countries that import oil. Global growth is expected to be modestly stronger overall in 2015.

Interest rates will remain low: in recent weeks, there has been easier monetary policies announced by the Swiss National Bank, European Central Bank, Denmark National Bank and Bank of Canada. In Emerging Markets, there have been rate cuts in India, Russia and Turkey. The most recent addition to this growing list is Australia and China.

USA

Most US economic indicators remain positive.

The United States added 257,000 jobs in January and the number of jobs created in November and December was revised sharply higher**.** January was the 11th consecutive month in which more than 200,000 jobs were created - the best run since 1994. An average of 336,000 jobs have been created a month for the past three months - the best three-month pace in 17 years and underlining the strength of the economic recovery in America. A year ago, the three-month average stood at just 197,000.

January car sales by the three Detroit-based automakers topped analysts' expectations, as low gasoline prices and easy credit terms helped fuel sales of utility vehicles and big pickups.

However, consumer confidence declined in February for the first time in seven months, as gasoline prices started to rise from a six-year low and tempered Americans' optimism about the economy.

Producer prices recorded their biggest drop in more than five years in January as the cost of energy and a range of other goods tumbled**,** hinting at a disinflationary trend that could argue against the Federal Reserve raising interest rates.

China

China is now in a monetary easing mode. In late January, the People's Bank of China (PBOC) announced that it had injected 90 billion yuan ($14 billion) into the banking system via reverse repurchase agreements, following its recent moves to add liquidity via open market operations.

In early February, PBOC decided to cut banks' reserve requirement ratio by 50 basis points to 19.5%. This move is the first such cut since May 2012. It will lower the amount of deposits that each lender is required to hold as reserves. In late February, the Reserve Bank cut the official cash rate for the second time in three months.

China's trade performance slumped in January, with exports falling 3.3% from year-ago levels while imports tumbled 19.9%, far worse than analysts had expected and highlighting deepening weakness in the Chinese economy. Largely as a result of the sharply lower imports - particularly of coal, oil and commodities - China posted a record monthly trade surplus of $60 billion.

China's factory sector unexpectedly shrank for the first time in nearly 2-1/2 years in January and firms see more gloom ahead, raising expectations that policymakers will take more action to forestall a sharper slowdown. The official Purchasing Managers' Index (PMI) fell to 49.8 in January, a low last seen in September 2012 and a whisker below the 50-point level that separates growth from contraction on a monthly basis. The December level was 50.1.

Europe

The euro zone's economy grew by a stronger-than-expected 0.3% in the last three months of 2014**,** helped by rapid growth in Germany. Germany's economy - the largest in the euro zone - grew by 0.7% in the quarter. However, France's economy grew by just 0.1% in the same period. The euro zone's economy grew by 0.9% across 2014 as a whole.

Inflation in the Eurozone has now fallen below zero, registering a -0.2% year-on-year rate to December 2014. Only 7 of the 18 euro zone constituents recorded inflation above zero in the 12 month period and, even then, the peak rate was a modest +0.8% in Austria. Greece experienced deflation of 2.5%.

Retail sales in the euro zone rose for the third straight month in December, and at the fastest annual pace in almost eight years, an indication that falling oil prices are boosting consumer spending and helping to support economic growth. Separate surveys of purchasing managers also released showed the euro zone economy grew more rapidly than first estimated in January, driven by pickups in Germany, Spain and Italy, while France still floundered.

In late February, a bailout plan for Greece was given a four-month extension and approved by Germany.

Japan

Japan's economy rebounded from recession in the final quarter of last year but growth was weaker than expected as household and corporate spending disappointed, underlining the challenge premier Shinzo Abe faces in shaking off decades of stagnation. Japan’s industrial output edged higher in December, suggesting that the world’s third largest economy may be turning the corner on its recession exacerbated by a hefty sales tax increase last year.

Australia

Australia cut its benchmark interest rate to a record low of 2.25% in early February, joining a procession of central banks that have eased policy settings this year in response to the deflationary impact of tumbling oil prices. The 0.25% cut represents a dramatic shift for the Reserve Bank of Australia, which ended 2014 with a message to financial markets that interest-rate stability was likely to feature again in 2015, to help underpin certainty for businesses and support the economy as the mining-investment boom fades. Governor Glenn Stevens said the decision to lower rates was driven by concern that Australia’s resource-rich economy was facing another year of below-average growth.

In Australia, recent data suggests that growth is continuing at a below-trend pace, with domestic demand growth overall quite weak. As a result, the unemployment rate has gradually moved higher over the past twelve months. The fall in energy prices can be expected to offer significant support to consumer spending, but at the same time the decline in the terms of trade is reducing income growth. Overall, the Reserve Bank's assessment is that output growth will probably remain a little below trend for somewhat longer in 2015 and that the rate of unemployment will peak a little higher. The economy is likely to be operating with a degree of spare capacity for some time yet.

New Zealand

Macroeconomic data released over February has continued to portray a domestic economy maintaining growth momentum around the 3% level. In particular, retail spending strengthened over the December quarter, with annual growth in excess of 5%, supported by a historical high in net migration, strengthening house prices and a further increase in annual building consents. Moreover, while the unemployment rate increased from 5.4% to 5.7% over the fourth quarter, this reflected the sharp rise in the participation rate to a new record high level. Despite signs that momentum in the NZ economy continues to remain above trend, the further softening in inflation expectations to a historically low level suggests little in the way of domestic inflationary pressures.

Summary

Overall, 2015 is set to be a tough year for investors trying to strike a balance between a) being too conservative and squeezed by low income or b) being too aggressive and squeezed by potential capital losses. Investors should set reasonable expectations and think about their benchmark positions and investment diversification strategies.