

MARKET OUTLOOK

30-June-2009

Economic Outlook

In the US, the latest data release remained consistent with the view that the pace of the economic contraction is slowing with signs that activity could bottom out in the second half of the year. Household spending has showed some sign of stabilisation but remains constrained by ongoing job losses. The continuing pressure in the housing market and tight credit conditions will also continue to add pressure on spending. In terms of monetary policy, this protracted recovery and low inflation suggest the expansionary policy settings looks set to remain for some time yet.

Signs of recovery in Europe remain unconvincing so far. The divergence of issues affecting the member countries, including the bursting of housing bubbles, the collapse in exports and the financial market turmoil, needs further targeted policy responses from their respective governments in addition to the already announced coordinated effort by the European Union. Like elsewhere, there are signs of stabilisation in business indicators but further deterioration in the labour market is likely to continue to weigh on consumer spending. The recoveries in the Eurozone will remain painfully slow.

In China, there are further signs that activity is accelerating as the aggressive policy response provides significant support to the domestic economy. Rapid credit growth should continue to support infrastructure investment for the remainder of the year. Still, with the external sector likely to remain weak, overall growth is expected to remain frail until the global economy also recovers.

Like export dependent China, Japan also needs external sectors to recover. There are some signs of stabilisation in the domestic sector but it's too early to be confident that a turnaround is underway. Corporates are likely to continue to restrain capital investment and employment, which in turn erodes personal consumption. Meanwhile deflationary pressure is likely to persist into next year, leaving another layer of risk for the fragile recovery.

For Australia, the latest National Accounts report showed that the economy has not only avoided technical recession but also proved to be one of the most resilient amongst developed economies. The current pace of decline in the leading indicators still suggests that the economy is likely to contract in the near term followed by a period of modest growth. Surprisingly there are no net job losses yet, but the market continues to expect the rise of unemployment (albeit not as severe compared to earlier this year) to be unavoidable. The minutes from the last policy meeting confirmed that the RBA retained an easing bias but with no pressing case to move rates in the near term.

Australian Sharemarket Outlook

As mentioned in last month's outlook, the prospect of shares falling back came to fruition, as the market digested a global outlook downgrade and took some profits in the lead-up to financial year end.

Signs of a meaningful recovery any time soon are still quite hazy. Leading indicators in May were strong and then stabilised in June, but lagging indicators are yet to back up any of that good news. Demand from China and India looks positive, however, unemployment is expected to increase. Volatility will remain in the short term at least.

International Sharemarket Outlook

Most discussion of late has centred around when a recovery is likely, and whether the worst of the effects of the Global Financial Crisis are behind us. Debate has raged around whether the latest rally from the early March lows was the start of the way back.

In late June, the World Bank issued a report reigniting concerns about the global economy and set a cautious tone for markets worldwide. The Bank downgraded its outlook for the global economy, predicting that the recession would cut deeper than previously thought.

Coupled with some profit taking, markets reacted on this report, but what lies ahead is still uncertain. Not everyone holds the same view that things will get worse, and therefore the next phase in the long recovery back will see continued cautiousness, waiting for the next sign of good news.

Australian Fixed Income Outlook

The performance and direction of the fixed income market will be driven by how perceptions of the so called economic "green shoots" evolve. Governments everywhere have announced fiscal stimulus responses to the downturn requiring sizeable issuance of Bonds. Given the unprecedented nature of this supply, fixed income markets will be unsettled.

We expect longer term bond yields to be choppy and subject to bouts of set back as the market copes with this ongoing supply. Nonetheless the still poor global economic backdrop, with muted inflation pressures should allow yields overall to remain at relatively low levels for quite some time.

Although the market has largely removed any expectation for further RBA rate cuts, deteriorating unemployment here could easily see this view reassessed as we move through the second half of the year. We continue to expect ongoing gradual improvement in credit markets.

International Fixed Income Outlook

Bond yields globally have suffered quite a setback in the last month. This setback in yields can be seen as an echo of the enormous rally which lowered yields around the end of last year. That rally was a massive "flight to quality" as fear swept the globe. The arrival of so called economic "green shoots" has allowed the extreme positioning of that rally to unwind returning yields towards more reasonable levels.

From here we expect some stabilisation and more range bound, as opposed to directional trading, to occur. We continue to expect ongoing gradual improvement in credit markets.

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