

## **MARKET OUTLOOK**

**30-Sep-2009**

### **Economic Outlook**

#### **United States**

The US economy remains delicately poised. Consumer and business confidence indicators have improved, and real economy data is supportive of the view that the US economy is finding a floor. However, they are yet to show signs of decisive improvement. In a recent speech, US Federal Reserve chairman Alan Greenspan indicated that the monetary easing put in place rapidly over the last five months will eventually stimulate domestic demand. He warned, however, that the US economy's period of sluggish growth is not over yet and that further interest rate cuts may be needed. In light of the ongoing weakness in the US manufacturing sector, and the risk that this weakness may continue to seep into the broader economy, it is reasonable to assume that the Fed will announce another rate cut when it next meets in late June. Confidence has responded to previous rate cuts, but it needs to recover further in order for a recession to be avoided.

The US economy will flirt with recession through the June and September quarters, however, a modest economic recovery is still forecast through late 2001 and the first half 2002. Scope for a sharp rebound through this time is less likely, because the inventory unwind still has some way to run and there remains considerable over-investment in the IT sector. In addition, the need for the US consumer to rebuild some level of savings is likely to keep a lid on consumption spending through the coming months.

#### **The Eurozone**

Leading European economic indicators maintain the deceleration bias while forecasts for Euroland growth continue to be revised lower. The European Central Bank, with strict inflation and money supply targets, is reluctant to trim interest rates, however, it will feel increasing pressure to do so if the outlook continues to deteriorate. Japan's outlook is likely to remain gloomy until Prime Minister Koizumi releases more details of his reform package or the Bank of Japan steps up the pace of monetary easing. Sluggish US and Japanese economies do not bode well for the Asian economies.

#### **Australia**

In Australia, central authorities are mindful of the decelerating external growth environment. However, they are also aware of the stimulatory conditions (low interest rates, fiscal easing and a very weak \$A) that are now clearly in place to kick start the domestic economy. Leading indicators are starting to respond to these stimuli (particularly the housing sector) and stronger domestic demand growth is forecast through the second half of this year. In the absence of a protracted US recession, it may not be necessary for the Reserve Bank of Australia to cut rates much further. That said, with the external growth environment still cloudy, and the domestic recovery still in its gestation phase, it would be unwise to call an end to the domestic easing cycle at this time.

### Australian Fixed Interest Outlook

The sell-off in the bond market continued into May, as investors increasingly came to believe that enough policy stimulus had been delivered to ensure an improved growth profile next year. Given bond yields are around 1.20% above the yield lows posted in mid-March, current 10-year bond levels of 6.00% are more fairly priced given current economic conditions.

Although monetary policy, fiscal policy and the current level of the Australian dollar are widely recognised as being accommodative for economic growth going forward, the near-term outlook remains mixed. As a result, the market is expected to consolidate at current yield levels, and remain range-bound in the nearer-term between 6.20% and 5.80% as measured by the key 10-year bond.

However, as the year progresses and the effects of the monetary policy easing begin to flow through to economic activity, it is likely that yields will trend higher towards year-end.

### Australian Fixed Income Outlook

Although the US Federal Reserve has, by its own admission, 'front loaded' its monetary policy response to the sharp economic slowdown (and expect an economic recovery around the end of the year), recent rhetoric by the US Federal Reserve Chairman Alan Greenspan and other Federal Reserve Governors continue to point to further easings albeit in 0.25% moves.

As a result the nearer term outlook for US treasuries favours range-bound trading conditions while the timing and pace of economic recovery remains uncertain.

In the European region, bond yields are expected to remain supported given their economy continues to slow and the monetary response has been slower.

### Australian Share Market Outlook

The short-term sharemarket outlook points to fairly flat conditions. The previous interest rate cuts that boosted confidence are now being tempered by the reality of a synchronised slow down in global activity. Profit downgrades have remained a feature of both the US market and Australian market.

The two recent high profile corporate collapses of HIH Insurance and One-Tel have focused investor attention on risk. Other stocks of a speculative nature are unlikely to rally quickly in this environment after such a severe setback to investor sentiment. While investors will again favour safety, they are unlikely to abandon cyclical stocks completely, rather the focus will remain on the higher quality cyclical stocks, as the falls in interest rates will eventually feed into growth. Caution surrounds the valuations of many cyclical stocks that have rallied strongly and appear to have already fully anticipated an economic recovery.

After the rebound in long-term interest rates, the sharemarket is fairly valued on a bond yield/earnings yield basis. The S&P/ASX Industrials excluding News Corp is trading on a P/E for 2001 of 17.4. Earnings growth is expected to be 5.5% for 2001 and 12% for 2002.

The outlook for liquidity remains favourable. Capital raisings in May supported market liquidity. There is an expectation of further 'unexpected' capital raisings in the months ahead which will continue to provide support to the market's liquidity. Several large market capitalisation companies have stated growth objectives that include growth through acquisition. If these acquisitions are to take place, it is likely that those making the acquisitions will look to the market to raise the capital required.

The medium-term outlook for shares remains positive. However, the short term may see the market experience some weakness as economic conditions dampen some of the enthusiasm that currently exists in estimates for sharp and sustained earnings rebounds. In particular, the market will aggressively sell down companies that produce profit warnings or disappointing results.

### **International Sharemarket Outlook**

The US interest rate cuts have provided the US sharemarket with a powerful liquidity boost through the last two months. The US sharemarket has 'bought' the recovery story strongly, and appears willing to look through the likelihood of further near-term economic and earnings weakness. This willingness of US investors to look forward to better times poses a risk to share prices if the current period of earnings and economic weakness is deeper or persists for longer than currently anticipated. Although the Fed meets again in late June, a rate cut has already been factored into current prices. US sharemarket participants may therefore focus on the upcoming earnings warning season in the very near-term. With sharemarket valuations no longer as compelling following the recent strong rally, and if recent earnings warnings from some US companies are any guide, the US sharemarket will remain vulnerable through the coming weeks.

The threat of fresh jitters on Wall Street casts a cloud over global sharemarkets in general, and Asian sharemarkets in particular. The Japanese sharemarket can be expected to remain sluggish until clearer signs of action are exhibited by either the Government (regarding structural reforms) or the Bank of Japan. Fears of a faltering Japanese economy is also likely to keep a lid on positive sentiment. European sharemarket players may also need to

re-assess the recent rally if economic conditions continue to decelerate and the European Central Bank is slow to deliver further interest rate cuts.

### **Listed Property Outlook**

The Office sector continues to offer the greatest prospects of outperformance over the next three to six months. Listed office trust performance will be driven by healthy levels of net absorption, low vacancies and limited supply, particularly in the Sydney market.

The Retail sector may continue to improve from its strong May performance (+2.4%) as evidence of retail sales recovery continues. A de-coupling appears to be occurring between retail sales and the current depressed levels of sentiment.

### **Australian Dollar Outlook**

The \$A is struggling to hold onto gains above US\$0.52. Although the \$A remains fundamentally undervalued at its current levels against the \$US, the currency is unlikely to bounce higher until the market becomes convinced of a more favourable global economic backdrop and an improved outlook for commodity prices.

## DISCLAIMER

The information in this document reflects NULIS Nominees (Australia) Limited's ("NULIS") ABN 80 008 515 633 AFSL 236465 RSE L0000741 understanding of existing legislation, proposed legislation, and rulings as at the publication date.

The information given in this article is of a general nature. It has been prepared without taking into account your particular objectives, financial situation or needs. Before making an investment decision, you need to consider, with or without the assistance of a financial adviser whether the information is appropriate for your particular needs, objectives and financial circumstances.

Investors should consider the Product Disclosure Statement ("PDS") before deciding to acquire or dispose of the product. Applications to invest in a financial product issued by NULIS must be made by completing the applicable PDS which can be obtained from NULIS.

© Copyright Aviva, 2009