View from the hill

NOVEMBER 2014

HILLROSS

Market update

The table below provides details of the movement in average investment returns from various asset classes for the period up to **31 October 2014.**

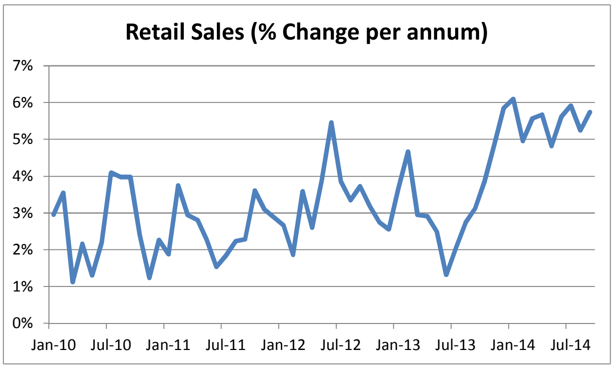
Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	4.4	-0.6	6.4	13.8
Smaller companies	-0.5	-3.8	-3.3	-1.0
International shares (hedged)	1.3	2.9	12.5	17.1
International shares (unhedged)	0.0	6.0	17.4	22.1
Emerging markets (unhedged)	1.4	-1.0	5.6	7.5
Property – Australian listed	6.8	2.7	10.3	13.4
Property – global listed	8.0	5.5	18.8	17.5
Australian fixed interest	1.0	1.6	7.1	6.3
International fixed interest	1.0	2.5	7.9	6.9
Australian cash	0.2	0.7	2.7	3.3

Overview & Outlook

Share markets recovered from the losses of the previous month, although there was considerable volatility on equity markets over October. This volatility may have been reflective of very mixed economic data, particularly in the United States. U.S. retail sales showed an unexpected decline in September, however employment data was strong. The U.S. unemployment rate at 5.9% is now at its lowest point since mid-2008.

The month of October was also notable as the month in which the U.S. Federal Reserve concluded its asset purchase (Quantitative Easing) program. With the end of this program being widely anticipated, there was little in the way of market reaction to the news. In addition, an increase in the size of the Japanese Quantitative Easing program last month, and expectations of a more expansionary policy in Europe, may more than neutralise the impact of the conclusion of the U.S. program.

Policy decisions in Europe are taking on an increasing focus from investors, as concerns build over the lack of improvement in European economic growth. With economic growth for the region hovering around the 1% level, pressure is mounting on the European Central Bank to further step-up the size of its monetary stimulus. There was, however, some comfort provided by last month's stress testing of European banks, which indicated that only a relatively small number of banks required additional capital.



Source: Australian Bureau of Statistics.

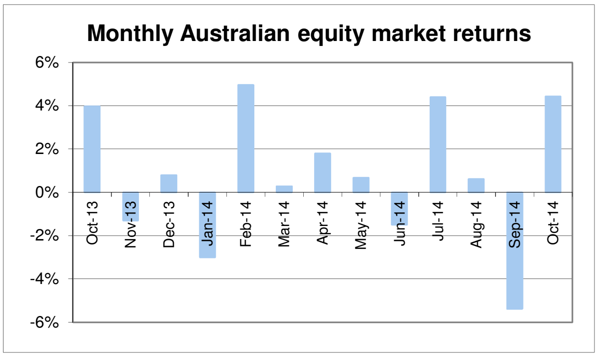
The state of the local economy has become more difficult to assess over recent months due to revisions being made to employment data. Although the unemployment rate at 6.2% is at a cyclical high, job vacancy data and surveys of business employment intentions suggest that some improvement in the labour market may be imminent.

Consumer spending has continued to grow at a faster rate than has been typical in the post GFC era, despite measures of consumer sentiment indicating confidence is still below the longer term average. Australian retail sales in the month of September increased by 1.2%, bringing the annual growth rate to 5.7%.The healthy rate of consumer spending belies the ongoing subdued rate of growth in wages, which averaged 2.6% in the year to September.

Share markets

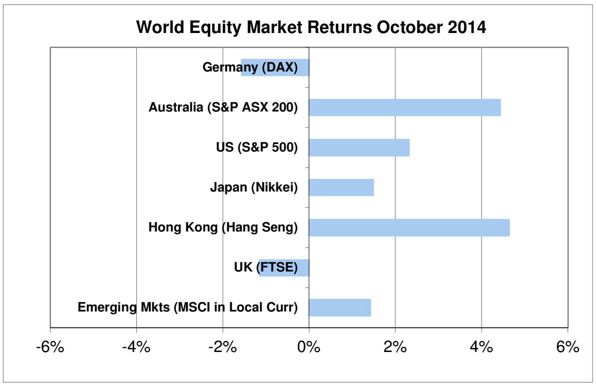
A combination of some week economic data, concerns over conflicts in the Middle East and the Ebola virus saw share markets sell-off in the first half of the October. However, confidence returned in the second half of the month, with strong U.S. company earnings results providing a source of support.

The Australian share market out-performed most major developed markets during October, with the S&P ASX 200 Index rising4.4%. Outside of the mining and energy sectors there was solid growth recorded. The finance and healthcare sectors led the market higher, with increases of more than 6%. However, ongoing weakness in commodity prices and further declines in oil prices resulted in negative movements in both mining and energy stocks. A fall in the oil price of 12% over the month weighed heavily energy stocks, but was a potential benefit to various industrial sectors.



Source: S&P ASX 200 Index

In contrast to the growth recorded on share markets in Australia, the United States and across Asia, European markets were weaker in October. Although valuations may appear cheap relative to other markets, the subdued state of economic growth and ongoing high levels of government debt continues to be a concern for investors. Last month the German DAX Index fell by 1.6% and the French CAC Index was 4.1% lower.



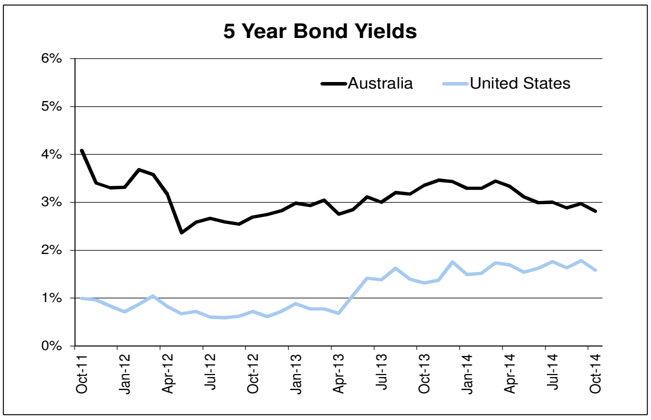
Source: Index as shown on chart. Returns in local currency of index

On average, Australian investors with hedged overseas share investments received a positive return of 1.3%.

Interest rates

After rising in September, longer term interest rates drifted lower in October, despite the U.S. Federal Reserve signaling the end of its quantitative easing program. Possibly reflecting a lower inflation outlook due to falling oil prices, the U.S. 5-year Government bond yield fell from 1.8% to 1.6%. The subsequent rise in bond prices created a positive return for investors. Movements on the local bond market were similar, with the 5-year bond yield here falling from 3.0% to 2.8%.

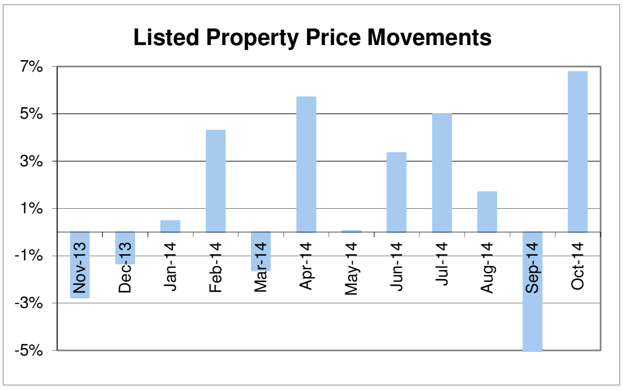
There was no change in the local overnight cash interest rate, which remains at 2.5%.



Source: Reserve Bank of Australia. US Federal Reserve.

Property

The sharp falls on listed property markets over September were more than reversed in October. The Australian listed property sector recorded a sharp 6.8% increase over the month, thereby outperforming the movement in equities more generally. Increases on global listed property markets were even more impressive, with the sector posting an 8.0% rise, to bring the annual gain to 18.8%.



Source: S&P ASX 200 A-REIT Acc Index.

There are some signs the residential property market may be “cooling” with the rate of growth in prices beginning to ease. During the September quarter, the Australian Bureau of Statistics House Price Series for capital cities increased by 1.5%, resulting in the annual rate of growth falling from 10.1% to 9.1%.