View from the hill

JANUARY 2015

Market update

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

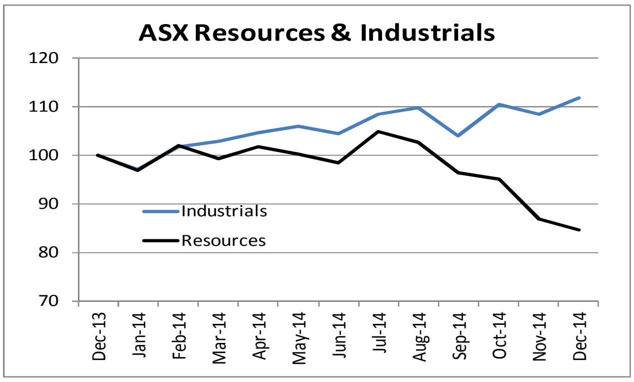
Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	2.1	3.1	5.6	15.1
Smaller companies	0.5	-3.9	-3.8	0.6
International shares (unhedged)	2.6	8.2	15.0	24.8
International shares (hedged)	-0.6	4.0	12.3	20.7
Emerging markets (unhedged)	-0.8	1.8	6.6	11.8
Property – Australian listed	4.5	12.7	27.0	21.9
Property – global listed	1.5	12.7	28.4	19.7
Australian fixed interest	1.7	4.0	9.8	6.5
International fixed interest	0.8	2.9	10.4	7.4
Australian cash	0.2	0.7	2.7	3.2

2014 in review

All major asset classes recorded positive returns over 2014, with the strengthening economic recovery in the United States providing a positive backdrop for share markets. With the U.S. economic recovery being accompanied by ongoing low inflation across the globe, central banks were able to maintain historically low interest settings. This low interest rate environment provided significant support for property prices and also created price growth in longer term bond investments.

Of the major share markets, the U.S. was the strongest performer over 2014 and consistently hit new record highs throughout the year. The S&P 500 Index finished 11.4% higher. Results in Europe were more subdued with growth in the economy and company earnings relatively sluggish. Japan continued to benefit from its aggressive monetary policy position, with the Nikkei Index climbing 7.1%.

Locally, the Australian share market underperformed global averages. The S&P ASX 200 Share Price Index rose by just over 1%. With dividends included, the overall return from Australian shares averaged 5.6%. Falling commodity prices had a significant impact on the Australian market, with resource stocks falling 16.6% over the year. In contrast, non-resource sectors performed more in line with the international average, posting a gain of 11.0% for the year.



Source: ASX 200 Index. Index value of 100 at Dec 2013.

The fall in commodity prices gathered significant momentum in the second half of the year with a 46% decline in the price of oil being the catalyst for a wider sell-off on commodity markets. Australian producers were partially compensated for the fall in commodity prices by the decline in the $A; which fell from U.S. 89.5 cents to U.S. 82.0 over the course of the year. This fall in the exchange rate also benefited Australian investors with unhedged international equity holdings, which appreciated in value by 15.0% (due to a combination of the falling $A and rising share prices).

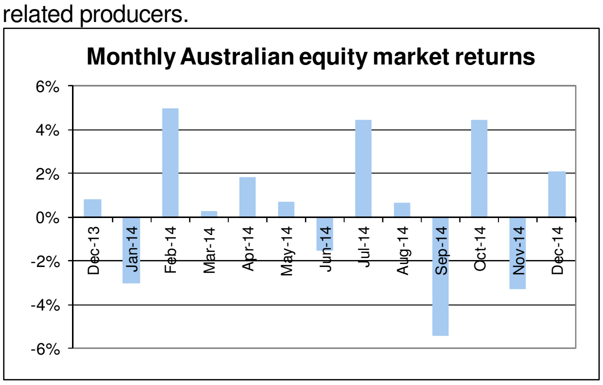
The significant oil price fall also further entrenched the outlook for low inflation and low interest rates. Yields from property and infrastructure became relatively more attractive as a result - with property being the best performing of the major asset classes over 2014.

December in review

Share markets

The Australian share market recovered some lost ground during December, outperforming the majority of overseas markets. The Australian S&P ASX 200 Index finished the month 2.1% higher, with the industrial and healthcare sectors leading the gains. These sectors are well positioned to benefit from the sharp fall in the $A over recent months.

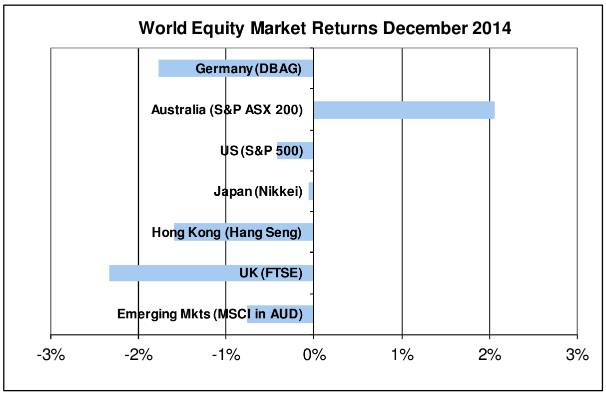
Despite a recovery in the second half of the month, resource stocks were once again lower, with a decline in value of 2.6%. Falling commodity prices continued to weigh heavily on the sector. In particular, a 19% fall in the oil price over the month triggered a sell-off in energy related producers.



Source: S&P ASX 200 Index

Most major overseas markets experienced negative movements over December. However, for Australian investors with unhedged currency exposures, the positive impact of the decline in the currency (the $A fell 3.4% against the $US) more than offset the negative share price movements.

Losses were heaviest in Europe where pre-election concerns over the management of Greek Government debt generated selling pressure. The lack of any tangible plans for a renewed monetary expansion by the European Central Bank also dented sentiment. The U.S. market only pulled back marginally from record highs, with the S&P 500 Index dropping by 0.4% over the month.



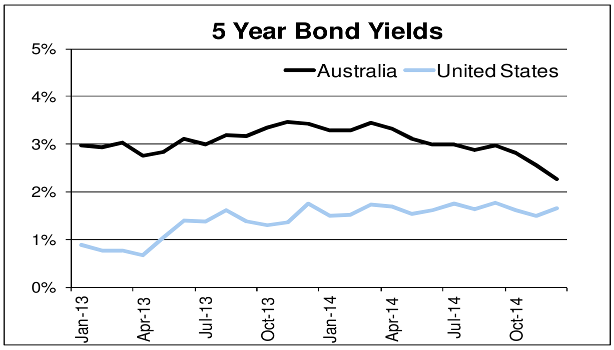
Source: Indexes as shown.

Those emerging markets sensitive to commodity prices also recorded price falls last month. Brazil and Russia both experienced losses of around 10%. In contrast, China, being a beneficiary of lower commodity prices, experienced a strong rally over December.

Interest rates

There was no change in the Australian overnight cash interest rate last month, which remains at 2.5%. However, expectations of a reduction in 2015 are firming as inflationary pressure and growth momentum in the economy wanes. The outlook for lower interest rates has pushed longer term bond yields downwards with the Australian 5-year Government bond yield falling 0.3% over December to 2.27%.

The fall in Australian bond yields was in contrast to the U.S., where the Government 5-year yield rose from 1.49% to 1.65% last month. The narrowing in the differential between Australian and U.S. bond yields (see chart below) could be contributing to the weakness in the $A.



Source: Reserve Bank of Australia. US Federal Reserve.

Property

Despite subdued employment growth and weak retail sales, Australian listed property continued to be in strong demand and once again benefited from falling interest rate expectations. The A-REIT sector recorded a gain of 4.5%. Returns on overseas listed property markets were also positive with the UBS Global Investors Listed Property Index rising 1.5% in hedged currency terms.

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