December 2014

As the year came to a close, the headline story (for at least the second half of the year) was the dramatic fall in oil prices. Both Brent and West Texas Intermediate oil prices have declined by around 50% since the start of the financial year.

The implication of lower oil prices has been that inflation and inflation expectations have softened globally. This has provided greater flexibility for central banks around the world with their ultra-accommodative policies. In particularly, the US Federal Reserve could keep rates "lower for longer" and may have their first interest rate increase even with inflation below their 2% target as their economic recovery progresses. In their statement, the US Federal Reserve signalled to the market that it was getting closer to rates "lift off" by dropping the use of "considerable time" and replacing it with "can be patient" on raising rates.

In the latest US nonfarm payrolls report, 252,000 new jobs were added in December leading to another fall in the unemployment rate to 5.6% indicating the ongoing improvement of the US labour market. However, the US Markit manufacturing Purchasing Manager Index (PMI) for December was reported at 53.9 (versus 54.8 in November) and has been declining (albeit still positive) since September. The PMI data comes in stark contrast with other positive US data releases. The question is whether it is foretelling something the other indicators are not picking up.

Over in the Eurozone, which is likely to be a key focus for 2015, its provisional headline inflation rate for December came in at -0.2%. The weakness in the headline inflation rate was mostly driven by the falling oil price as evidenced by the core inflation rate being at 0.8% (which removes oil and other volatile items).

Despite this, deflation risk will be a key focus for the European Central Bank (ECB) in 2015 as it considers whether to embark on quantitative easing (the purchasing of government bonds) to stimulate the European economy.

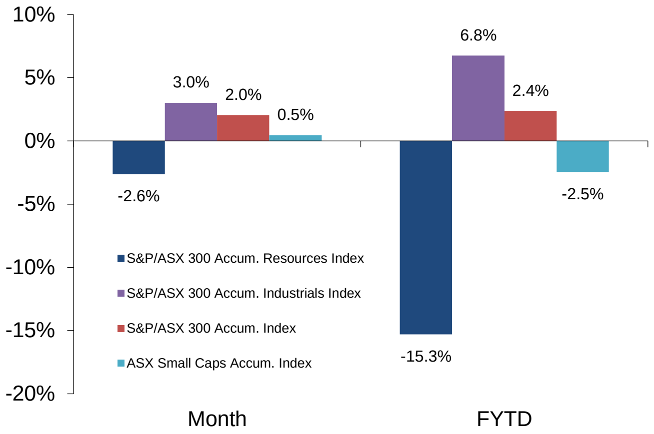
To add to the European deflation fears, the failure by Greek politicians to elect a president in December has meant that there will be an election held in January 2015. Concerns about the outcome of the election, with the potential of the Syriza party being elected, led to a selloff in Greek sovereign bonds. The Syriza party want parts of Greece's debt to be written off and also to reduce government austerity measures. This would raise the possibility of Greece being forced to leave the Eurozone as other member countries may not accept such terms.

In Japan, Prime Minister Shinzo Abe's coalition was re-elected and retained its "super majority" to pass laws without the approval of the upper house of parliament. This has provided Abe with a fresh mandate to continue to drive forward his "Abenomics" policies that include making structural changes to Japan's economy.

Elsewhere in Asia, China's official manufacturing PMI continued its decline, edging down to 50.1 from 50.3 in November. Readings from the HSBC/Markit Chinese manufacturing PMI were even worse as it slid below 50 to 49.6 (50 is the threshold between expanding and contracting manufacturing activities).

The news was brighter locally with the Australian unemployment rate falling to 6.1% in December. In its last meeting of the year, the RBA maintained the cash rate at 2.5%. Additionally, Governor Glenn Stevens made a statement during the month, saying he would prefer the Australian dollar to be at 75 US cents.

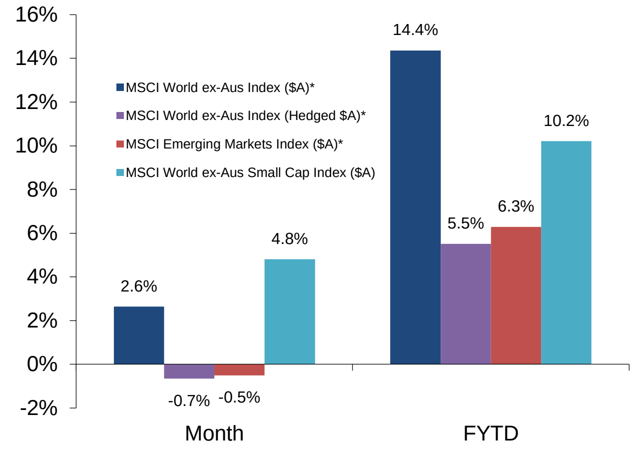
Australian equities



The last month of the calendar year was positive for Australian equities despite the Resources sector continuing to fall due to plummeting commodity prices. Although the Energy (-1.7%) and Materials (-0.3%) sectors recorded a negative return in the month, it was the Consumer Discretionary (-2.2%) sector that fell the most in December. The strongest performing sector over the month was Industrials (5.8%).

Australian equities (5.3%) was the worst performer over the calendar year relative to developed market (15.0%) and emerging market equities (6.9%) in Australian dollar terms.

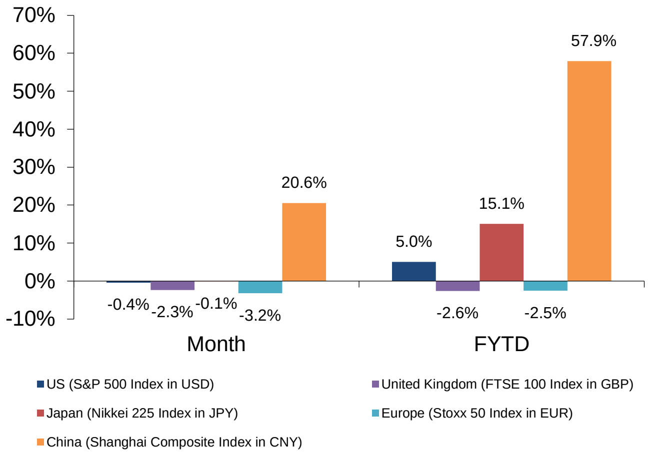
International equities ($A)



Developed market equities posted a positive return over the month driven by the US mostly. Conversely, emerging markets had a negative month with a wide variation in performances across countries. Russia was the main culprit as crude oil prices continued to fall. China on the other hand was the main positive performance contributor (and had a stellar year with returns in excess of 50% over the calendar year).

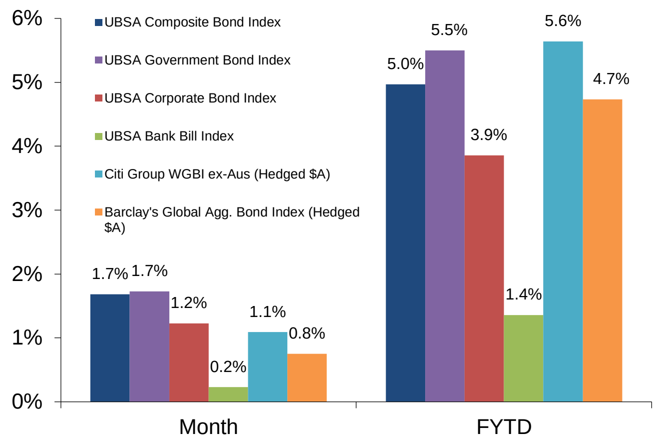
The fall in the Australian dollar saw unhedged international equities outperform their hedged equivalents, from an Australian investor's perspective.

International equities (local currencies)



Most key local equity markets had a negative month in December with the exception of China. The Chinese equity market has had a boost in performance with expectations that the government will loosen monetary policy to support a weakening economy.

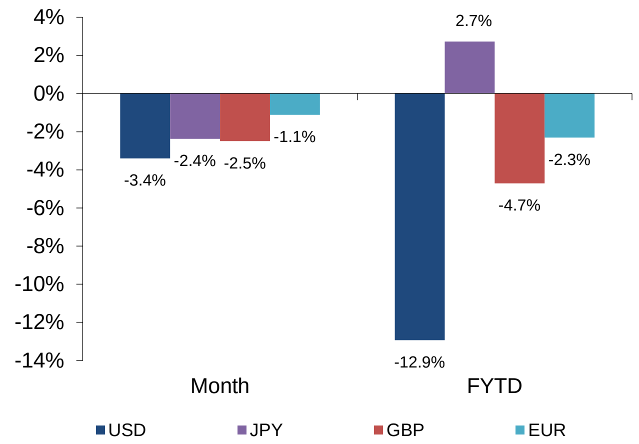
Fixed income



International and Australian fixed interest posted a positive month as sovereign yields fell across most countries. One notable exception was Greece. Market jitters over the Greek election have led to a selloff in Greek bonds, its yield rising by 1.5% over the month.

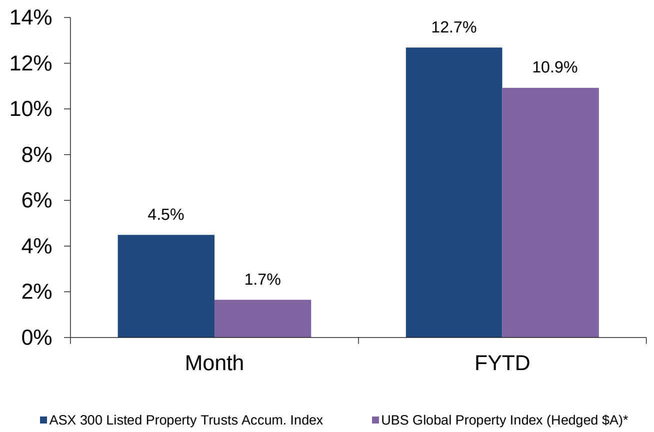
It has been an exceptional year for bonds against market expectations with sovereign yield curves across major markets flattening as yields for longer term bonds fell (outperformed) shorter term bonds.

Australian dollar against major currencies



December saw the Australian dollar depreciate against all the major currencies. However, over the calendar year, the Australian dollar has appreciated against the Japanese Yen and Euro. The likely causes are due to the increase in monetary easing by the Bank of Japanese (BOJ) and speculation of quantitative easing by the ECB.

Property



Although both produced a positive return, Australian listed property trusts outperformed their international counterpart in December. However, over the calendar year, international listed property (hedged back into Australian dollar) outperformed Australian listed property trusts.

31-Dec-14	Index value	Month	3 months	FYTD	1 year
Australian equities					
S&P/ASX 300 Accum. Index	46,426	2.0%	2.9%	2.4%	5.3%
S&P/ASX 300 Accum. Industrials Index	94,298	3.0%	6.8%	6.8%	11.0%
S&P/ASX 300 Accum. Resources Index	18,153	-2.6%	-13.1%	-15.3%	-16.6%
ASX Small Caps Accum. Index	5,198	0.5%	-3.9%	-2.5%	-3.8%
International equities					
MSCI World ex-Aus Index ($A)*	6,238	2.6%	8.2%	14.4%	15.0%
MSCI World ex-Aus Index (Hedged $A)*	1,192	-0.7%	4.0%	5.5%	12.6%
MSCI Emerging Markets Index ($A)*	491	-0.5%	2.1%	6.3%	6.9%
MSCI World ex-Aus Small Cap Index ($A)	393	4.8%	9.8%	10.2%	10.2%
US (S&P 500 Index in USD)	2,059	-0.4%	4.4%	5.0%	11.4%
United Kingdom (FTSE 100 Index in GBP)	6,566	-2.3%	-0.9%	-2.6%	-2.7%
Japan (Nikkei 225 Index in JPY)	17,451	-0.1%	7.9%	15.1%	7.1%
Europe (Stoxx 50 Index in EUR)	3,146	-3.2%	-2.5%	-2.5%	1.2%
China (Shanghai Composite Index in CNY)	3,235	20.6%	36.8%	57.9%	52.9%
AUD versus …					
USD	0.82	-3.4%	-6.3%	-12.9%	-8.3%
JPY	98.04	-2.4%	2.4%	2.7%	4.4%
GBP	0.53	-2.5%	-2.1%	-4.7%	-2.9%
EUR	0.67	-1.1%	-2.2%	-2.3%	4.0%
Property					
ASX 300 Listed Property Trusts Accum. Index	34,091	4.5%	11.3%	12.7%	26.8%
UBS Global Property Index (Hedged $A)*	2,078	1.7%	12.6%	10.9%	28.2%
Australian Fixed Interest					
UBSA Composite Bond Index	8,345	1.7%	4.0%	5.0%	9.8%
UBSA Government Bond Index	8,715	1.7%	4.5%	5.5%	10.3%
UBSA Corporate Bond Index	8,436	1.2%	2.7%	3.9%	8.1%
UBSA Bank Bill Index	8,174	0.2%	0.7%	1.4%	2.7%
Global Fixed Interest					
Citi Group WGBI ex-Aus (Hedged $A)	-	1.1%	3.4%	5.6%	11.2%
Barclay's Global Agg. Bond Index (Hedged $A)	-	0.8%	2.9%	4.7%	10.4%
Oil and commodities					
Crude Oil ($/bbl)	53	-19.5%	-41.6%	-49.4%	-45.9%
Copper Spot ($/tonne)	6,368	-0.7%	-5.2%	-9.6%	-13.7%
Gold Spot ($/ounce)	1,184	0.7%	-2.3%	-10.5%	-1.9%

Fixed income (yields) as at …	31-Dec-14	30-Nov-14	30-Sep-14	30-Jun-14	31-Dec-13
Australia Bank Bill	2.77	2.76	2.69	2.68	2.61
Australia 10 Year Government Bond	2.74	3.03	3.48	3.54	4.24
US 10 Year Government Bond	2.17	2.16	2.49	2.53	3.03
UK 10 Year Government Bond	1.76	1.93	2.43	2.67	3.02
Germany 10 Year Government Bond	0.54	0.70	0.95	1.25	1.93
Japan 10 Year Government Bond	0.33	0.42	0.53	0.57	0.74

* Net dividends reinvested