May 2008

AMP capital INVESTORS

Markets and Economies Report

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Global economy

Review: Despite ongoing concerns, the global economy showed some resilience during May. In the US, data was mixed and remained consistent with subdued growth. Industrial production, retail sales and unemployment data all deteriorated and consumer sentiment fell to its lowest level in 28 years. However, durable goods orders were stronger than expected and an Institute of Supply Management survey showed a marginal improvement in conditions. Supported by the trade sector, March quarter US gross domestic product (GDP) growth was revised up from +0.6% annualised to +0.9% annualised, suggesting that the US economy has avoided recession so far. However, weakness in the US housing sector persisted – housing activity data and existing home sales fell further and house prices declined 14% over the year to March. The minutes from the US Federal Reserve's (Fed) last meeting indicated that the central bank is likely to leave rates on hold at its next meeting in June. Notably, the Fed upgraded its inflation forecasts but downgraded its growth expectations. April consumer inflation data was softer than expected with inflation ex food and energy contained at 2.3% year-on-year (yoy). Japan's economic data were largely soft. A leading indicator fell sharply, pointing to weaker growth ahead. In addition, data for household spending, industrial production and unemployment were all subdued. However, Japan's March quarter GDP growth was stronger than expected. In China, industrial production and exports slowed in April, retail sales growth accelerated and fixed asset investment remained very strong. Inflation also remained high, which saw the People's Bank of China again increase banks' required reserve ratios. However, with non-food inflation remaining low at 1.8%, the global economy slowing and destruction in the wake of the Sichuan earthquake, aggressive moves to further slow the economy are not likely. European data releases were quite weak in May with falls in Euro-zone retail sales and manufacturing conditions. As expected, the European Central Bank left interest rates on hold and remains primarily concerned about inflation. Euro-zone GDP growth was stronger than expected in the March quarter, but leading indicators for the region point to softer growth ahead.

Outlook: Global growth is likely to slow further, but the combination of US monetary action, tax rebates and solid growth in emerging countries should mean a long and deep downturn is unlikely.

Australian economy

Review: Australian economic data was generally soft. Declines in housing finance, business confidence and services sector conditions suggested a slowing economy and this was confirmd by a slowdown in GDP growth in the March quarter. Furthermore, growth in private sector credit rose at its slowest pace since July 2001, housing affordability fell to a new record low and a leading index pointed to much slower growth ahead. The Australian Federal Budget for 2008-09 saw the delivery of promised tax cuts and increased spending in areas such as health, education and infrastructure. The budget surplus is projected to be a record $21.7 billion. The Reserve Bank of Australia (RBA) left interest rates on hold at 7.25%, although minutes from the May rate setting meeting revealed that the central bank seriously considered raising interest rates again, indicating that the risks for rates are on the upside.

Outlook: Domestic economic conditions are likely to slow this year, with growth around 2.5%. However, a collapse is unlikely due to strong investment and more increases in iron ore and coal prices.

International shares

Review: The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned 1.6% in local currencies (or 0.3% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned 1.3% for the month. In the Euro-zone, the Eurostoxx Accumulation Index returned 1.0%, while the UK FTSE 100 Accumulation Index returned -0.2%. Shares in Asia were mixed in May – Japan's Topix Accumulation Index returned 3.7%, while Chinese shares lost considerable ground, with the S&P/CITIC 300 Total Return Index returning -9.7%.

Short-term outlook [six to 12 months]: Turmoil may continue in the short term on US recession worries, profit downgrades and high oil prices. However, global shares are likely to provide reasonable returns on a 12-month view, given the reasonable fundamental valuations and better growth prospects for 2009.

Medium-term outlook [five to ten years]: Modest dividend yields and a slowdown in profit growth to around nominal GDP growth will constrain the returns from mainstream global shares to circa 7% to 8% per annum on average.

Australian shares

Review: Despite some volatility, the Australian share market continued to rally in May, although there was some retraction in the later part of the month as softening local economic indicators and a fall back in resources shares weighed on investors. Gains were largely focused on energy stocks due to the record oil price (which exceeded US$135 a barrel during the month). Shares were also buoyed by Westpac's takeover bid for St George and speculation that Chinese aluminium giant Chinalco may buy into BHP. The S&P/ASX 200 Accumulation Index returned 1.5% for May.

Short-term outlook: The Australian share market is likely to remain volatile over the next few months. However, shares should improve into year-end. Valuations remain attractive and profit growth is likely to remain positive.

Medium-term outlook: Reflecting a solid dividend yield and reasonable growth prospects, medium-term returns of around 10% per annum are expected.

Listed property securities

Review: The S&P/ASX Property 200 Accumulation Index returned -9.0% in May. Commercial was the best performing sub-sector with a return of -6.3%. Tishman Speyer Office Fund (-3.1%) was the top performing commercial trust, with Commonwealth Property Office Fund (-7.8%) the laggard. Centro Properties Group was the worst performer in the retail sub-sector, due to investor concerns around the group's ongoing debt refinancing and litigation issues.

Short-term outlook: The next few months are likely to remain volatile due to worries about gearing levels. However, conditions should improve on a sustainable basis into year-end.

Medium-term outlook: Now solid yields and moderate growth prospects mean medium-term returns of around 10% per annum are expected.

International bonds

Review: International bond yields rose in May on inflation worries and gains in equity markets encouraged investors to move away from safe haven assets. The US ten-year bond yield gained 33 bps to 4.06% and the UK ten-year bond yield increased 32 bps to 4.99%. Japan's ten-year bond yield rose 17 bps to 1.76%, while Germany's ten-year bond yield added 29 bps to 4.41%.

Short-term outlook: Bond yields may fall back in the short term on the back of soft economic conditions.

Medium-term outlook: AMP Capital expects low returns from global bonds, reflecting low bond yields.

Australian bonds and cash

Review: Australian bond markets were affected by global inflation concerns in May. This was reinforced by the revelation that the RBA was much closer to tightening rates in May than the market factored in at the time. Expectations of an eventual US recovery firmed toward the end of the month, which pushed US bond yields higher. This led Australian yields to break out of the range in which they traded over the previous six weeks, with three-year yields ending the month up 36 basis point (bps) at 6.73% and ten-year yields up 24 bps to close the month at 6.53%.

May saw short-date bank bill yields close at similar levels to those at which they opened, although they traded in a relatively wide range. The three-month bank bill rate opened at 7.81% and closed at 7.79%, although traded as low as 7.66%. The six-month bank bill rate traded in a narrower range, opening at 7.95% and closing at the high of 8.03%, though trading as low as 7.83%.

Short-term outlook: AMP Capital's view is that Australian bonds will deliver modest returns over the next year.

Medium-term outlook: Returns from local bonds over the medium-term are also expected to be modest, reflecting low yields.

Australian dollar

Review: The Australian dollar (A$) gained significantly in May, closing up against the US dollar (US$), the Japanese yen (JPY) and the currencies of Australia's major trading partners (as per the Trade Weighted Index [TWI]). The A$ closed May at 95.43 US cents (up 1.3% from 94.24 US cents) and JPY100.54 (up 2.5% from JPY98.07). The TWI closed the month at 72.8 (up 3.0% from 70.7).

Short-term outlook: The next six months are likely to be volatile with the A$ buffeted between worries about global growth and high local interest rates.

Medium-term outlook: The A$ should remain solid over the medium term, helped by high commodity prices.

Key financial markets

	31 May 2008	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	36,605	+1.5%	-6.6%
MSCI World (ex-Aust Accumulative/ unhedged in A$)	3,695	+0.3%	-16.7%
US S&P 500 Accumulation Index	2,219	+1.3%	-6.7%
Dow Jones Eurostoxx Accumulation	541	+1.0%	-14.5%
UK FTSE 100 Accumulation Index	3,588	-0.2%	-5.1%
Japan Topix Accumulation Index	1,683	+3.7%	-18.5%
S&P/CITIC 300 Total Return Index	2,965	-9.7%	-7.8%
S&P/ASX 200 Property Accum. Index	30,490	-9.0%	-32.1%
UBS Warburg Global Real Estate Investor Index	268	-1.5%	-19.8%
Aust 90-day bank bill yield	7.79%	-1 bp	+143 bps
Aust 10-year bond yield	6.53%	+24 bps	+52 bps
US 10-year bond yield	4.06%	+33 bps	-83 bps
A$ in US cents	95.43	+1.3%	+15.2%
A$ Trade-weighted index	72.8	+3.0%	+8.7%

Contact us

If you would like to know more about how AMP Capital can help you, please visit ampcapital.com.au, or contact one of the following:

Financial Planners	AMP Capital's Investment Representative on 1300 139 267
Personal Investors	Your Adviser or Financial Planner
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