ADVANCE
ASSET MANAGEMENT

BANKS, BONDS & BREXIT

March 2016

It's all about Banks, Bonds and Brexit and with the RBA holding steady on interest rates, Australia is positioned as a very attractive proposition to global investors seeking a decent return in a world now affected by both negative short term and moreover negative long-term interest rates. Whilst on the other side of the globe in Europe opinion polls have the likelihood of a Brexit as a very, very close call.

AUSTRALIA

The Q4 GDP report revealed the national economy expanded by 0.6%, convincingly beating the estimated 0.4% increase, however, a relatively small increase compared to a year earlier, when growth reached an impressive 3%. Performance was driven principally by robust consumer activity and public investment. Conversely, with the mining investment boom unwinding private non-dwelling construction was a detraction.

US

The second of the mandated three assessments of the Q4 GDP report saw annualised growth revised upwards from the initially reported 0.7% to 1%, which was driven almost entirely by a much stronger than anticipated inventory adjustment. Inventory accumulation is now deemed to have reached $82 billion over the quarter rather than the initially reported $69 billion. However, although this inventory revision improved the economy's performance over the year's final quarter it may well detract from the current quarter's performance. The well regarded Atlanta Fed's GDPNow assessment of current Q1 growth dropped to 2.1% from 2.5% leading into this publication.

JAPAN

January's trade report saw both exports and imports declining at their most concerning pace since the all-time low of the GFC in late 2009. Exports slumped by -12.9% while imports plummeted by -18%. Consequently, although the Bank of Japan is widely anticipated to ease monetary policy further while there are tenuous but growing rumours of a delay in next year's proposed GST hike nonetheless there is a mounting concern amongst experts that Abenomics may have had its day.

EUROZONE

The preliminary release of the currency headline CPI report revealed that prices had fallen by 0.2% from a year earlier – confusing consensus' call for a half-hearted 0.1% increase after January's revised and relatively impressive 0.3% gain. Ratcheting up the pressure upon the European Central Bank (ECB) considerably – the less volatile core (ex food & energy) CPI metric declined to just 0.7% last month from a year earlier a most unwelcome development after January's 1.0% gain. Concerningly, it seems this core metric is now being impacted by the headline's efforts – a most unwanted development for the ECB. Consequently, at its scheduled March interest rate setting meeting the ECB is universally anticipated to ease monetary policy even further with not only a deeper cut into negative territory for the ECB's deposit rate expected but also an increase of the current asset purchase or QE programme.

TIM
ROCKS

Tim is Head of Market Research and Strategy, BT Investment Solutions.

UK

Most if not all members of the Bank of England's rate setting Monetary Policy Committee believe in a relationship which ties declining unemployment to increasing wages and thus rising inflation – the Phillips Curve. However, since the GFC this relationship appears to have either broken down or at the very least perhaps temporarily taken a leave of absence as Britain's unemployment rate is either at or very close to an historic low while wage growth is perplexingly declining. Thankfully for British workers annual inflation gains are practically non-existent which at least provides some form of cushion to the cost of living.

CHINA

February's trade report saw exports collapsing by a quarter from a year earlier while imports were off by a relatively lukewarm but still alarming -13.8%. However, although such declines are alarming – particularly for the world's second largest national economy – nonetheless last month's trade narrative was affected considerably by the timing of the lunar New Year. Indeed, exports were exceptionally strong in February of last year as the lunar New Year started later than usual with activity consequently brought forwards to February. As such – it is perhaps likely that a significant trade reversal will be recorded in March's trade report. But even if March's trade report bounces back appreciably nonetheless for the first two months of this year exports have declined by an outlandish -17.8% with imports down by an equally concerning -16.7%. Looking forwards - not only is monetary policy anticipated to be lowered accordingly but it is becoming more likely that Beijing will open the fiscal stimulus tap further - with Premier Li recently proposing the widening of the current budget deficit to some 3% of GDP from the current 2.3%

Why has the Australian dollar recently been trading close to $0.75 US dollars, when many commentators have been adamant that the Australian dollar will decline towards $0.65?

With its AAA rating, independent and well respected central bank, 2% official short-term interest rate, and government debt to GDP ratio of just over 30% - Australia is a very attractive proposition to global investors seeking a decent return in a world now affected by both negative short term and moreover negative long-term interest rates. Indeed, the Japanese government bond market has negative yields out to eleven years while the ten-year German Bund may well find itself yielding less than zero after the European Central Bank's scheduled March meeting. As such, an Australian 10-year government bond yielding close to 2.5% is proving irresistible to global investors faced with a dearth of attractive investment opportunities and consequently such demand is causing the Australian dollar to appreciate on the exchanges.

How globally pervasive are negative government bond yields?

The surprising late January decision by the Bank of Japan to push a benchmark short term interest rate below zero in order to combat a mounting deflationary threat subsequently spurred global investors to purchase government bonds - taking the universe of negative yielding bonds in both Japan and Europe to a fresh peak of some US 5.5 trillion. Revealingly, in Europe – the first region to adopt negative interest rates – approximately half of all government bonds carry sub-zero yields. Meanwhile, although negative yielding bonds were until now considered an improbable theory, nonetheless they now account for slightly over one quarter of J P Morgan's index for government bonds. Is it any wonder the Australian dollar has been rallying recently as global investors find the allure of relatively high yielding Australian government bonds so beguiling?

What is the likelihood of Brexit – the UK voting to leave the European Union on 23rd June?

Traditional opinion polls have the likelihood of a Brexit as a very, very close call. However, such surveys do not have a particularly solid track record – indeed the current Conservative government of David Cameron was anticipated to lose last year's General Election by a fairly wide margin – obviously this was not to be the case. Consequently, a likely truer reading of the probability of Brexit is to be found at the turf accountants – or book makers – who currently have the odds of a Brexit at just south of 40%.

For more information on the Advance Multi-Blend Funds, please speak to your adviser or call Client Services on 1800 819 935.

Advance Asset Management, GPO Box B87, Perth WA 6838

Client Services 1800 819 935 Adviser Services 1300 361 864

advance.com.au

ADVANCE ASSET MANAGEMENT