

Market commentary

Provided by Advance Investment Solutions

Growth assets have recouped much of the losses incurred over the past 12 months with the return of investors' risk appetite and stability in global financial markets. The global economy has also gained much-needed traction.

Economic overview — September 2009 quarter

Global recovery prospects received a boost with news that key major economies had emerged from recession. China's economic growth rebounded to 7.9% annualised. Germany and France grew by 0.3%, while Japan grew by 2.3% annualised. In the US, while June quarter official GDP figures still showed the economy contracting, business confidence continues to improve and the housing sector appears to have stabilised.

The Australian economy grew by 0.6%, placing Australia as one of the strongest performing advanced economies with both private capital investment and household consumption responding well to policy stimulus. Underlying inflation has fallen to 3.9% but the risk of inflation rising again over the medium term is significant.

Outlook by asset class

Australian shares

We are cautious in the very short term because the market appears to be highly vulnerable to seasonal risk-aversion. We expect a decline of around 7.0% from present levels. However, we look for the market to move higher and are positive on consumer discretionary, financials, industrials, materials and telecommunications. We would look to gradually accumulate cyclical stocks and reduce defensive stocks during bouts of market weakness.

International shares

We continue to hold a positive bias towards global equities with a strong cyclical sector bias, particularly for Asian equity markets, over the short and medium term, as investment-driven cyclicals gain from infrastructure spend. However, the market may show seasonal weakness, giving investors an opportunity to accumulate cyclical global equities in the very short term.

Diversified Property

We continue to believe that many Real Estate Investment Trusts are advantageously positioned for investment opportunities. We feel global property securities should offer better value relative to domestic listed property through efficient diversification and country allocation.

International bonds

Using US 10-year bellwether as a guide, we expect yields to fall to around the 3.0% level before reversing trend and heading higher towards 3.8%. As a defensive asset class, global fixed income now offers more opportunities to the nimble investment manager through efficient sub-sector investing.

Australian bonds

We expect yields to fall to around 4.8% and then move higher towards 5.6% around the same time next year. The likelihood that official interest rates will have to move higher will make Australian bonds lag behind global bonds in terms of total return prospects.

Alternative Assets

We favour macro and managed futures funds and are cautious on hedge funds subject to industry controls and/or regulation.

Funds that employ relative-value strategies (such as credit long/short, equity long/short, fixed income arbitrage, convertible arbitrage or multi strategies with sound risk controls) stand a better chance of generating alpha relative to most directional strategies as most asset classes will be subject to continued volatility in the foreseeable future.

Commodities

We remain positive on commodities in the medium and long term. As a stand-alone investment, commodities are an extremely volatile asset class.

However, as part of a balanced or diversified portfolio, the negative correlation to other asset classes can help generate a superior portfolio risk/return outcome. Commodities can be a good hedge against unanticipated inflation and an excellent hedge against geopolitical turmoil and macroeconomic risks.

Currencies

We expect the Australian dollar to trade lower towards the 0.82 to 0.78 levels before resuming its uptrend, perhaps testing the mid 90s by mid-2010. The Australian dollar is likely to remain strong against most major currencies but weak against key emerging market currencies.