

> Economic risk and implications for financial markets



// Investment Strategy and Economics
Multi Asset Group

March 2012

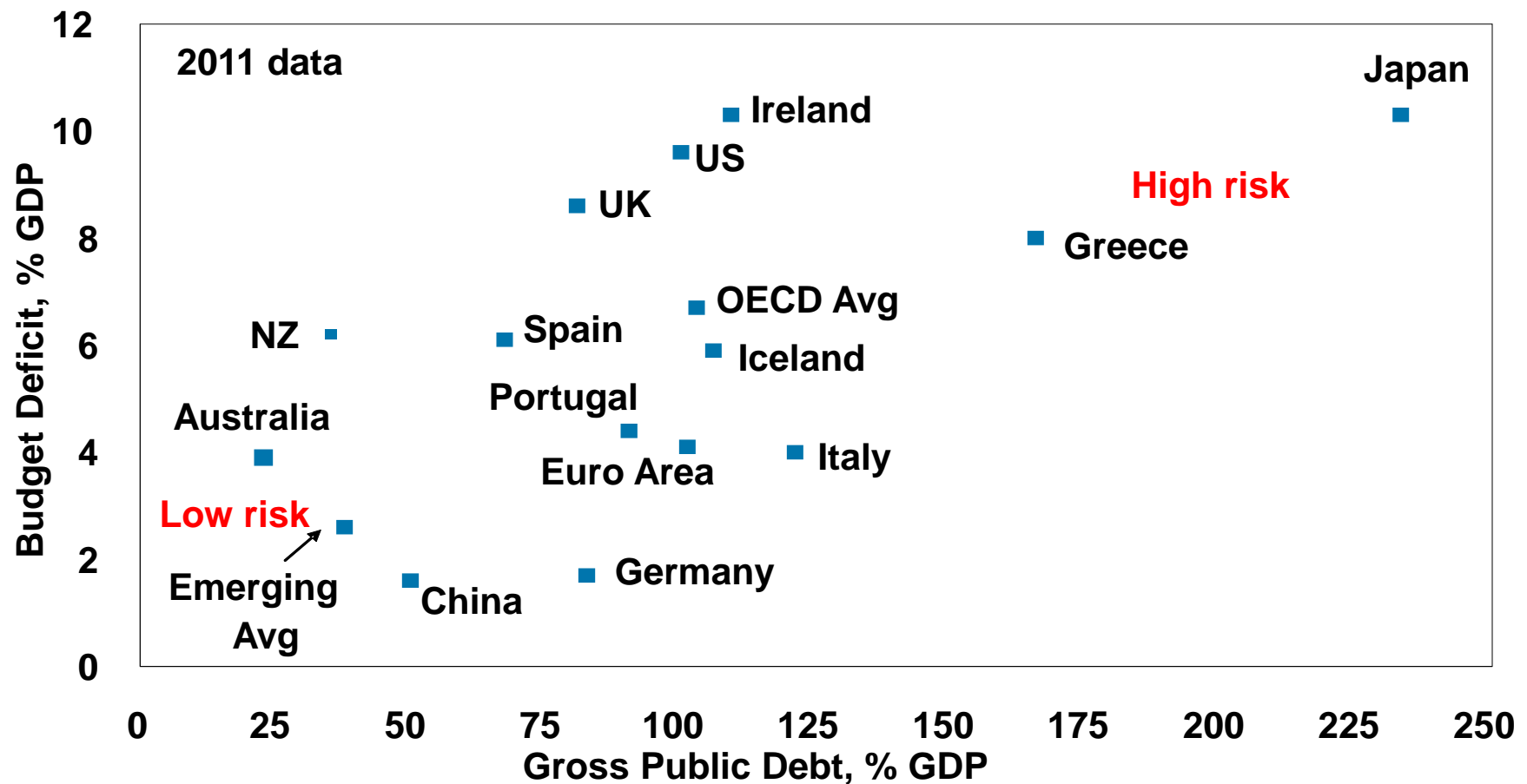
Outlook for the year ahead

- > Budget cutbacks in Europe and US, but global monetary easing, including in Aust
- > Global growth of 3% - ranging from mild recession in Europe to 8% growth in China
- > Expect 3% growth in Australia, but a slight rise in unemployment
- > Europe, oil, etc will result in a volatile ride, but expect stronger share markets helped by attractive valuations, continuing global recovery and monetary easing
- > Bonds are poor value
- > The \$A is likely to remain volatile but strong

The macro worry list of risks remains long but has faded a bit

	Risk assessment
• European debt	medium/high
• US debt	medium
• US fiscal drag	medium/high
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• Oil prices	medium
• Extreme monetary settings in US, Europe and Japan	low
• Near record low bond yields	high
• Australian two speed economy	low
• Australian house prices	medium/high

Public debt problems remain



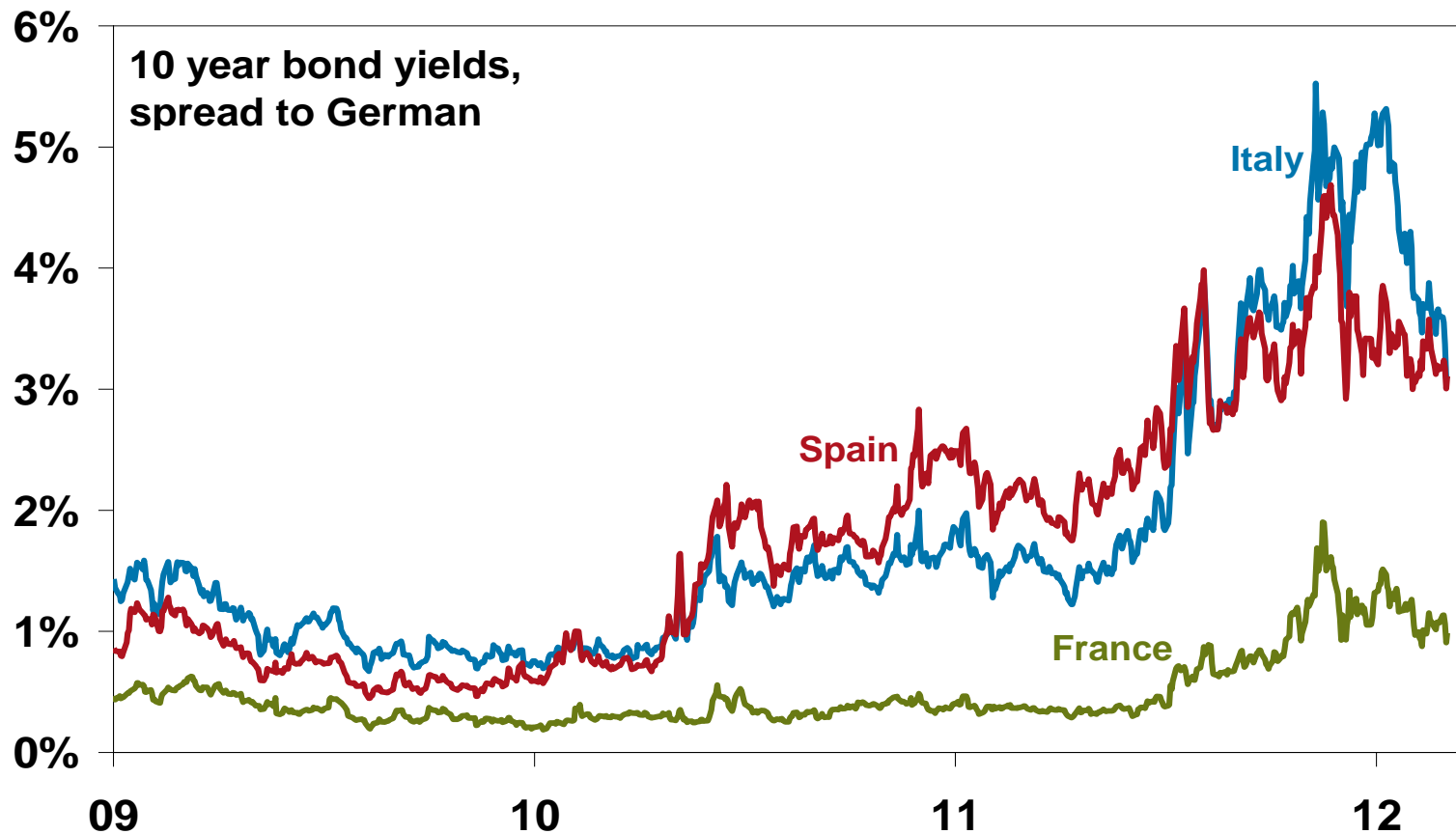
Source: OECD, IMF, Eurostat, AMP Capital Investors

Europe is probably already in recession, but recent economic indicators suggest it is mild...



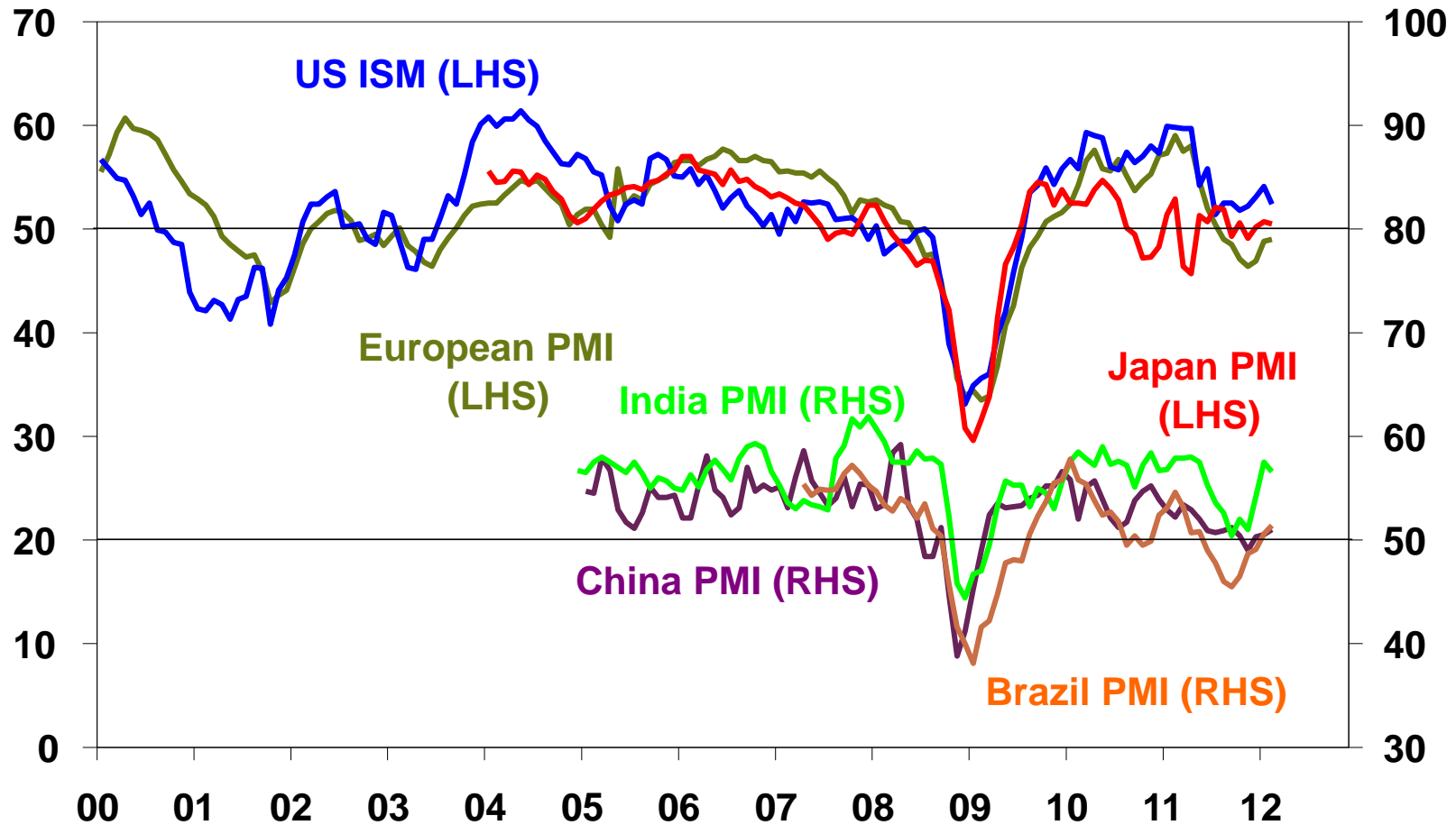
Source: Bloomberg, AMP Capital Investors

...and ECB support for banks and bond buying suggest the risk of a meltdown has receded



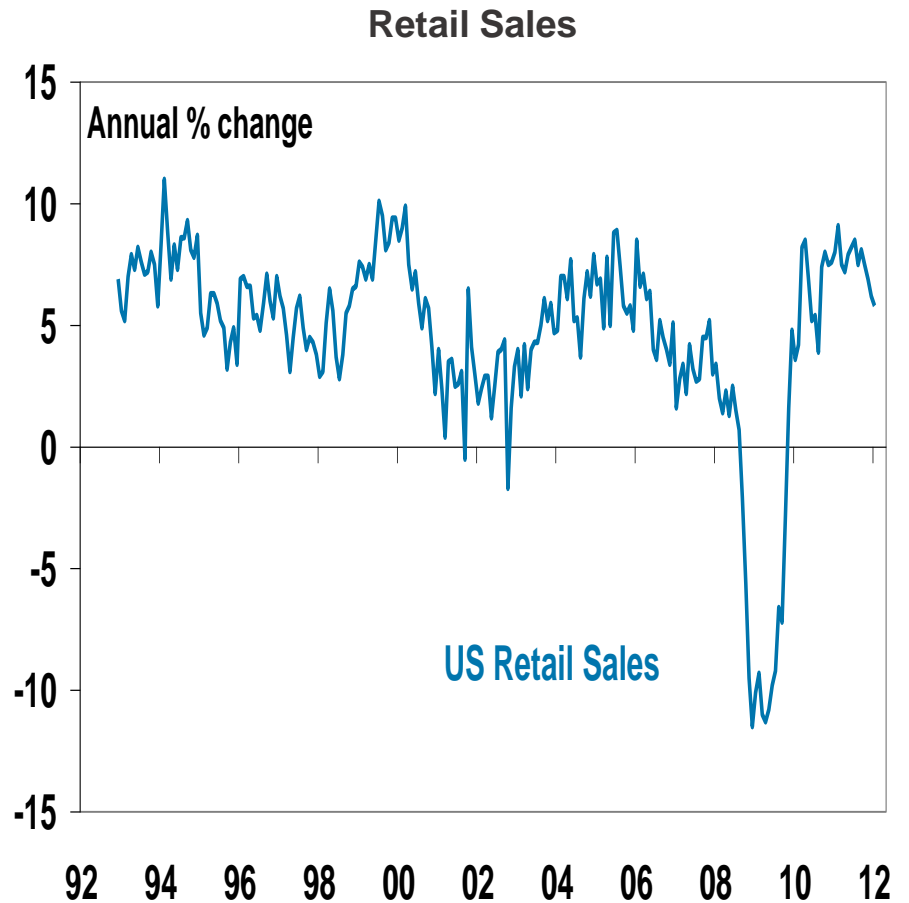
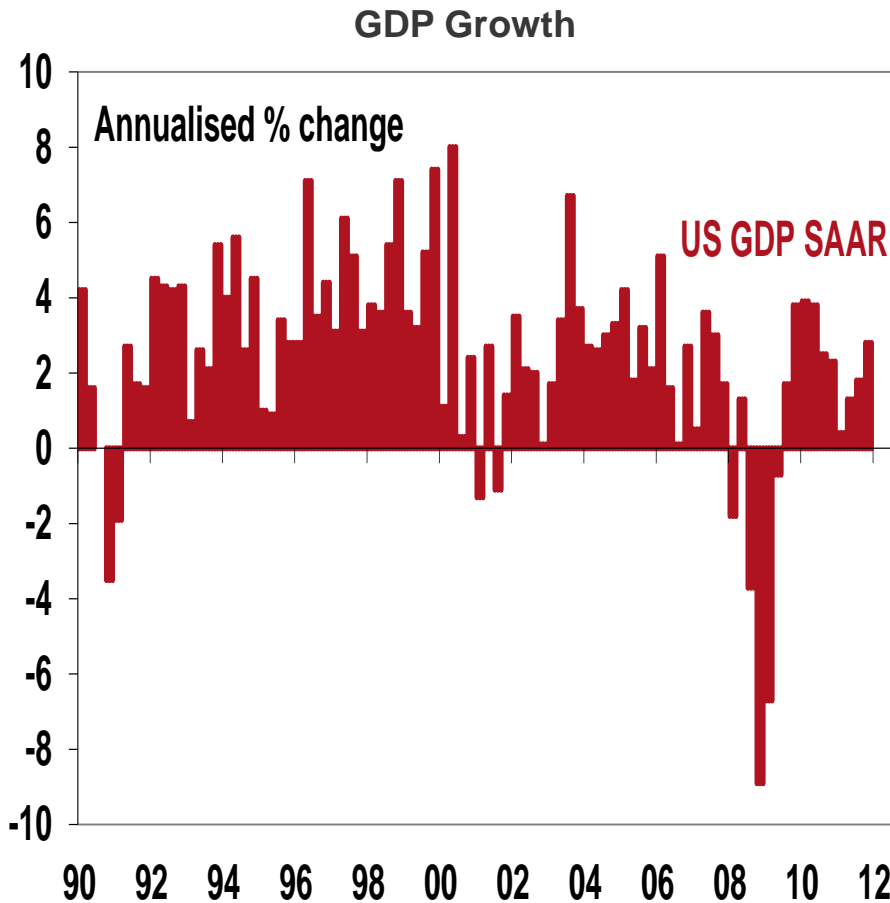
Source: Bloomberg, AMP Capital Investors

Global business conditions indicators generally have stabilised or improved – suggesting less risk of global recession



Source: Bloomberg, AMP Capital Investors

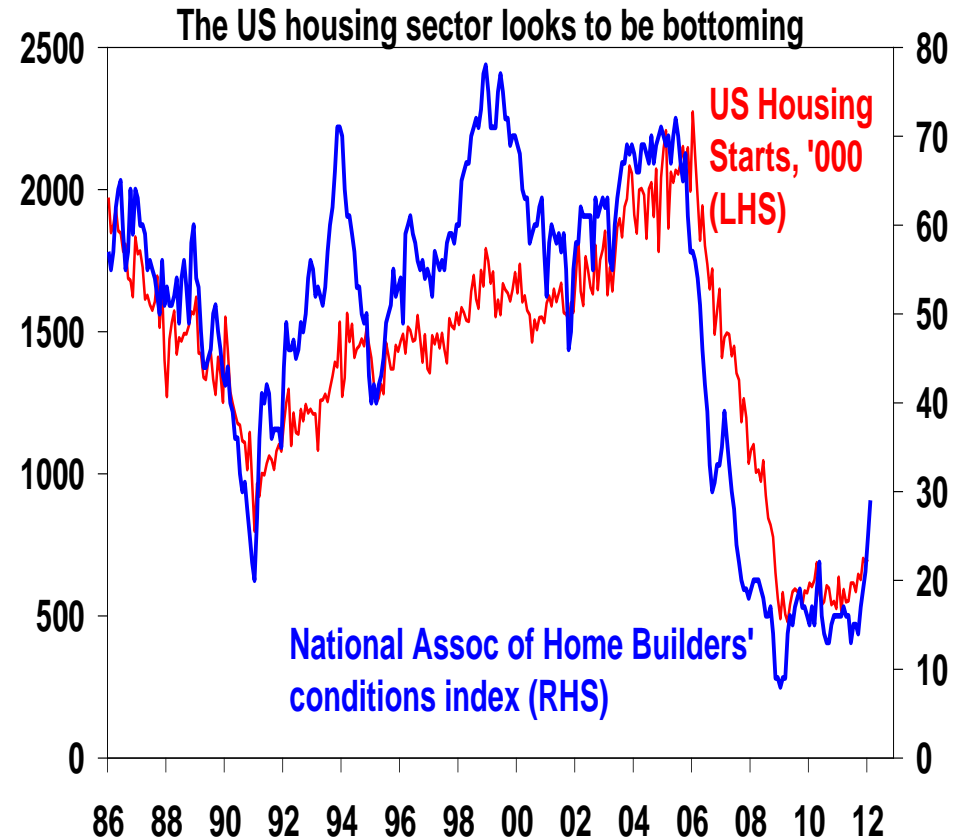
The US has avoided the much feared “double dip recession”



Source: Datastream, AMP Capital Investors

Positive signs for the US from a longer term perspective

- > Housing bottoming
- > Manufacturing renaissance – Maserati, Honda, Whirlpool, Caterpillar, Intel, Caterpillar all setting up plants in the US
- > US (shale) oil production rising strongly



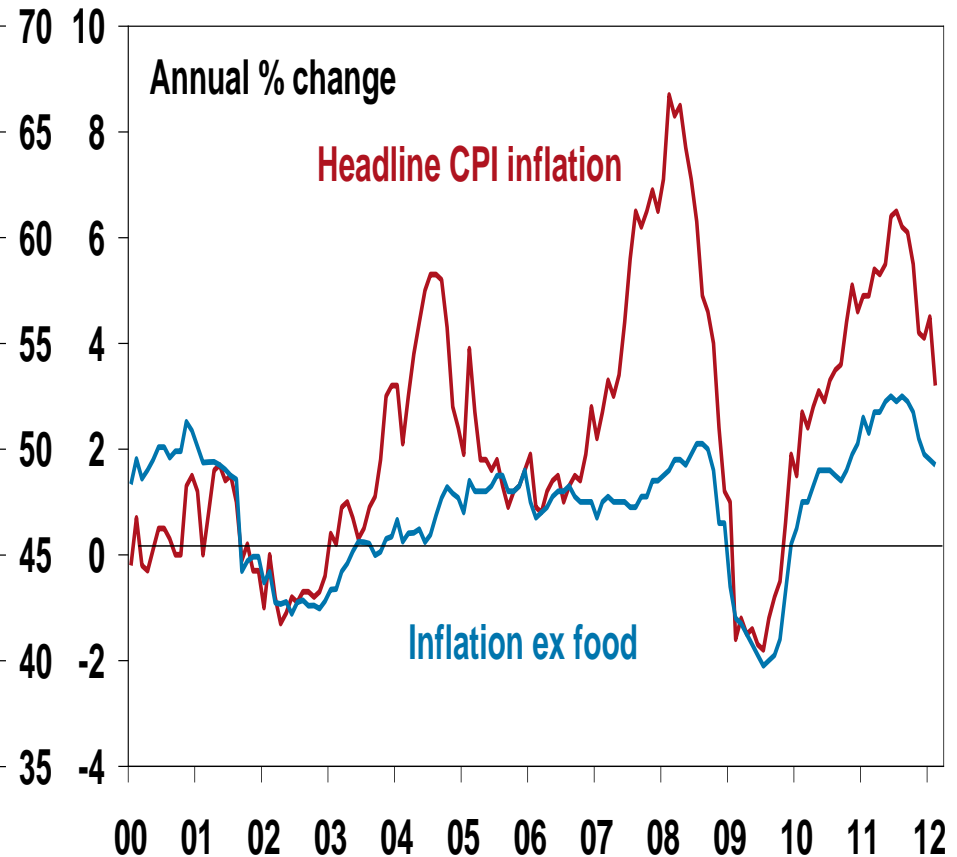
Source: Bloomberg, AMP Capital Investors

There is no sign of a hard landing in China and authorities are starting to ease up on the policy brake

Growth slowing – not collapsing

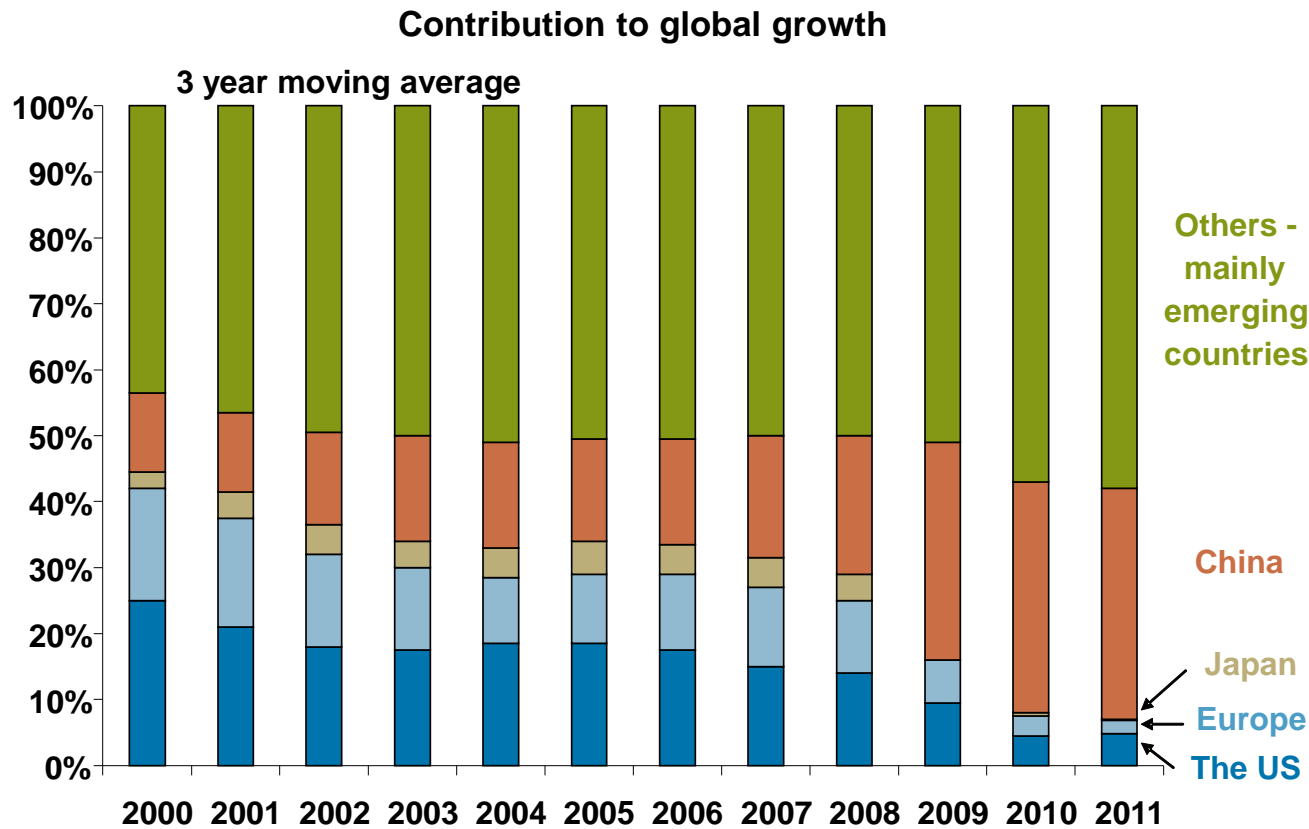


Cooling Inflation = room to ease



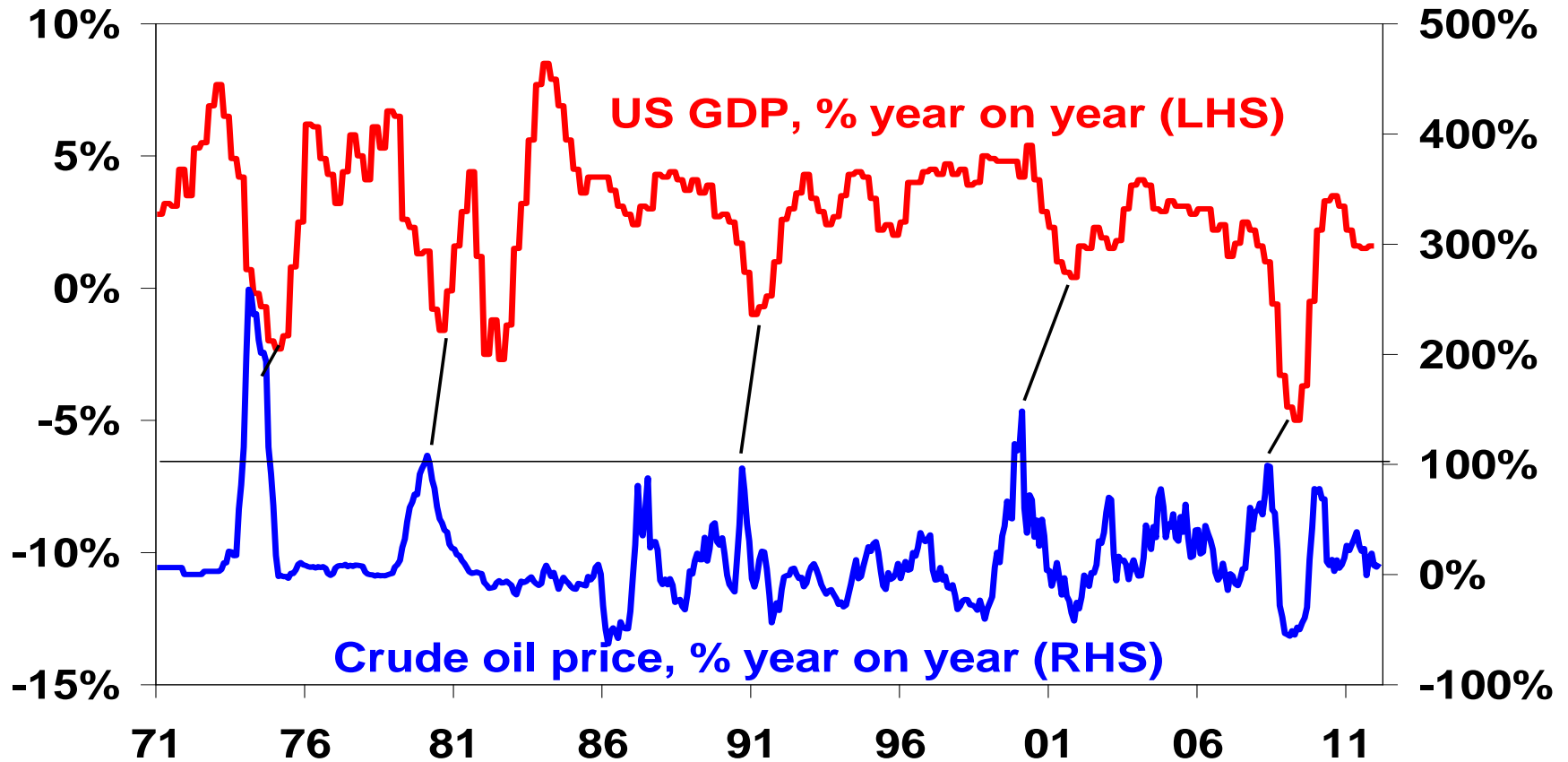
Source: Thomson Reuters, AMP Capital Investors

Emerging countries are the dominant driver of global growth – will support growth & volatility

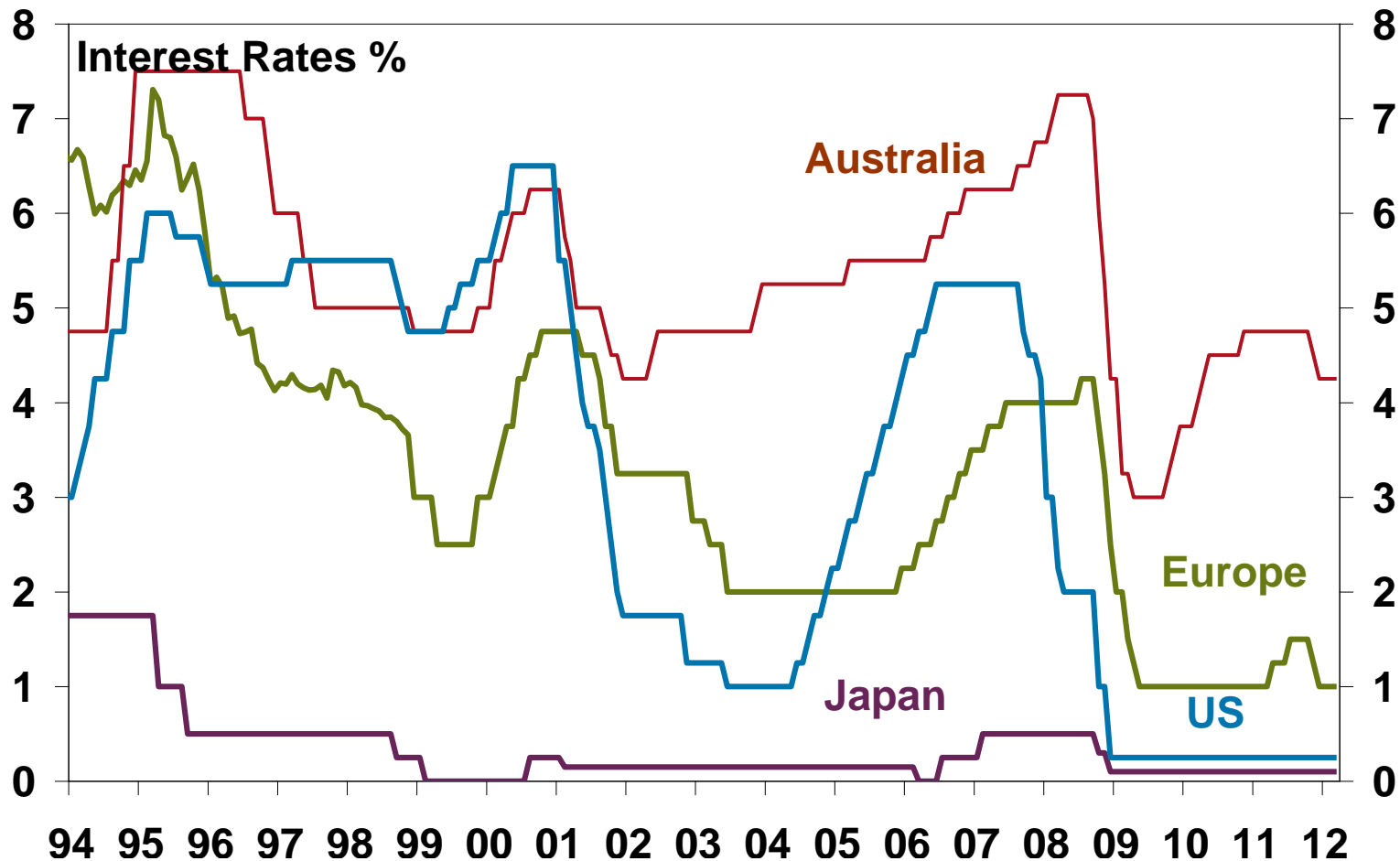


Source: IMF, AMP Capital Investors

Oil prices are not at a choke point - yet



Interest rates are likely to remain low globally. Australian and European interest rates to fall further



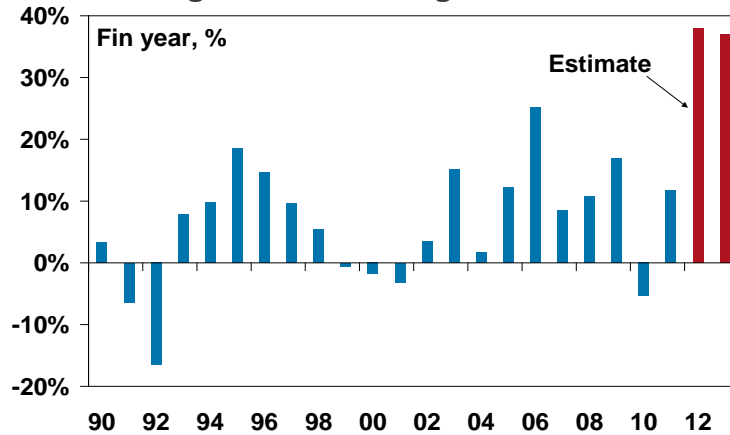
Source: Datastream, AMP Capital Investors

Global growth watch list for 2012

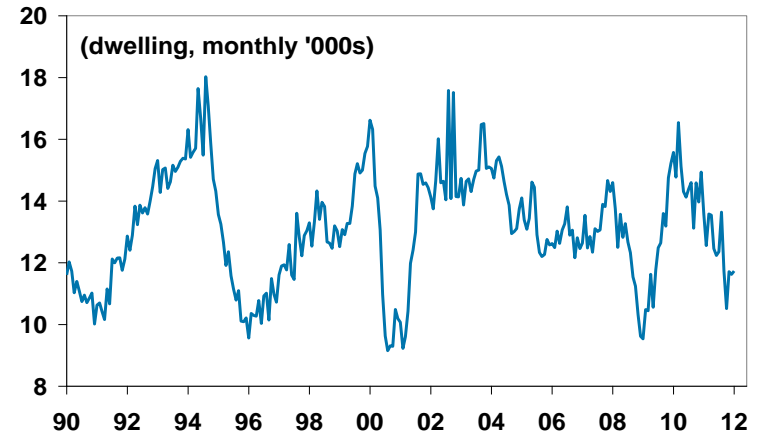
- > Italian bond yields
- > US ISM manufacturing conditions index
- > Chinese money supply growth
- > \$A
- > Oil price
- > ...December 21, when Mayan calendar ends!

The Aust economy is recording soft growth – but is multi speed

The mining boom is driving an investment boom



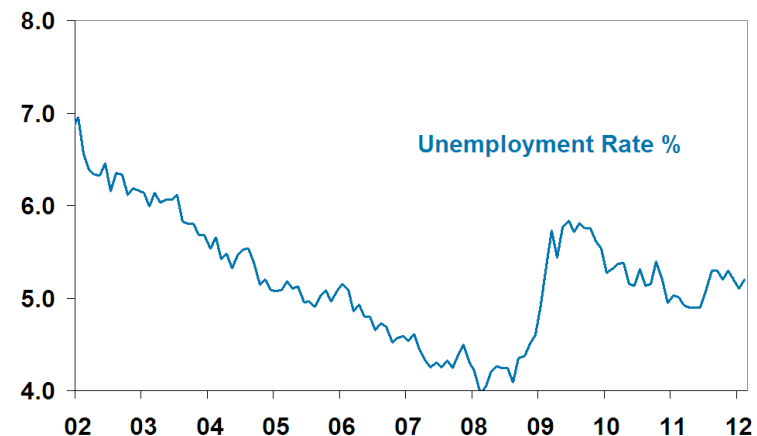
But building approvals are soft



retail sales are weak

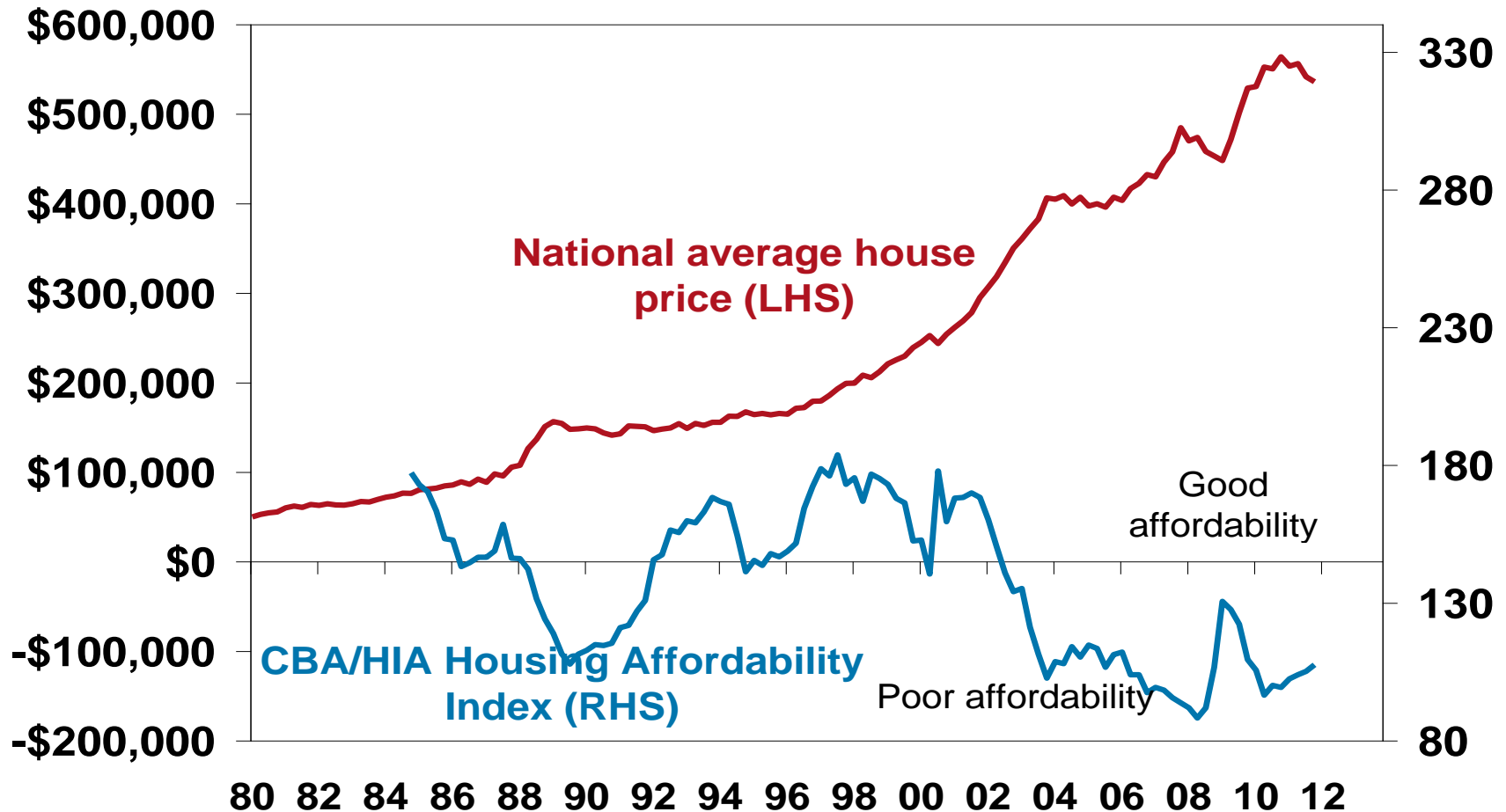


and the labour market is soft



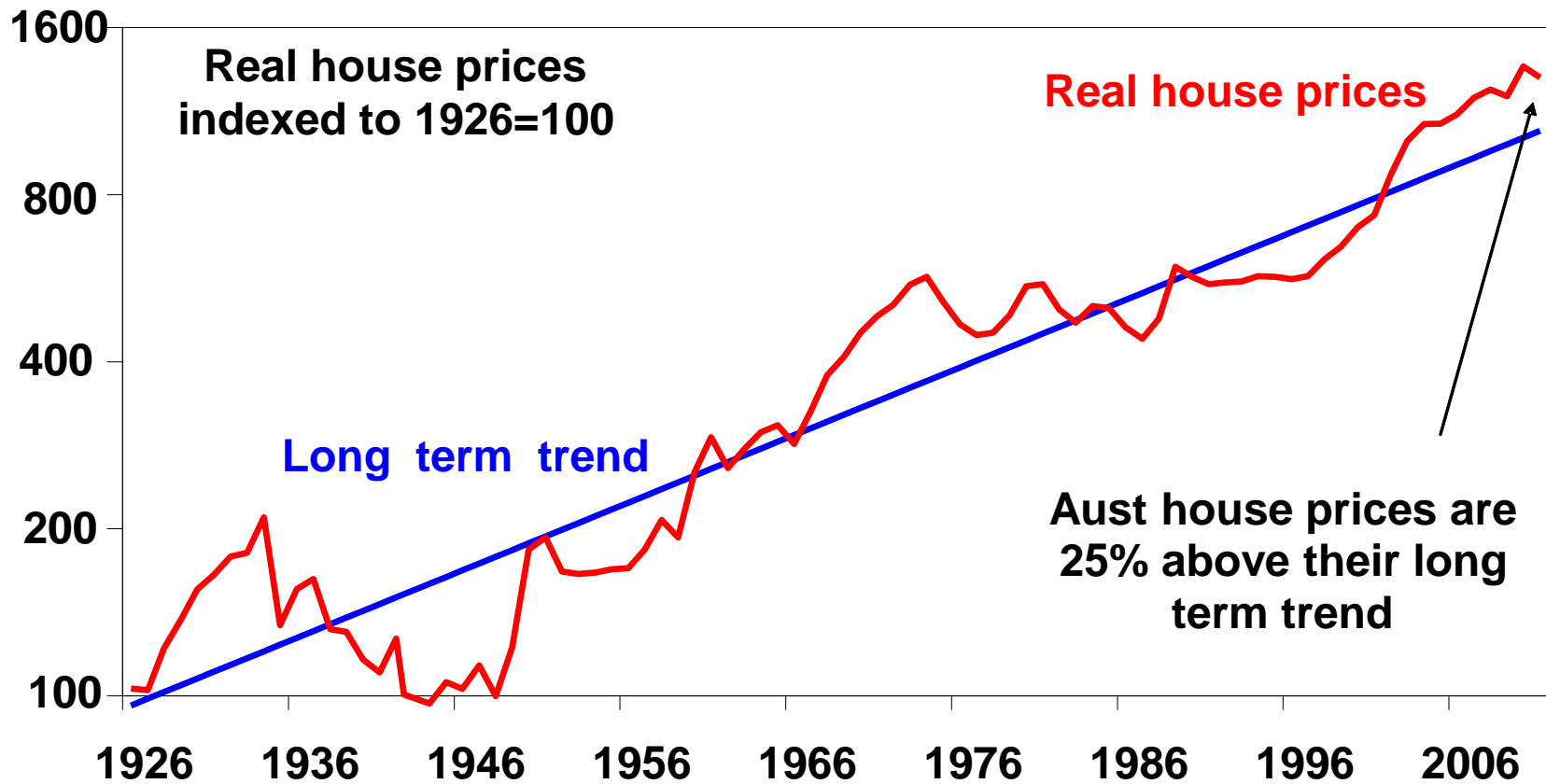
Source: Thomson Financial, AMP Capital Investors

House prices caught between constrained supply and falling affordability



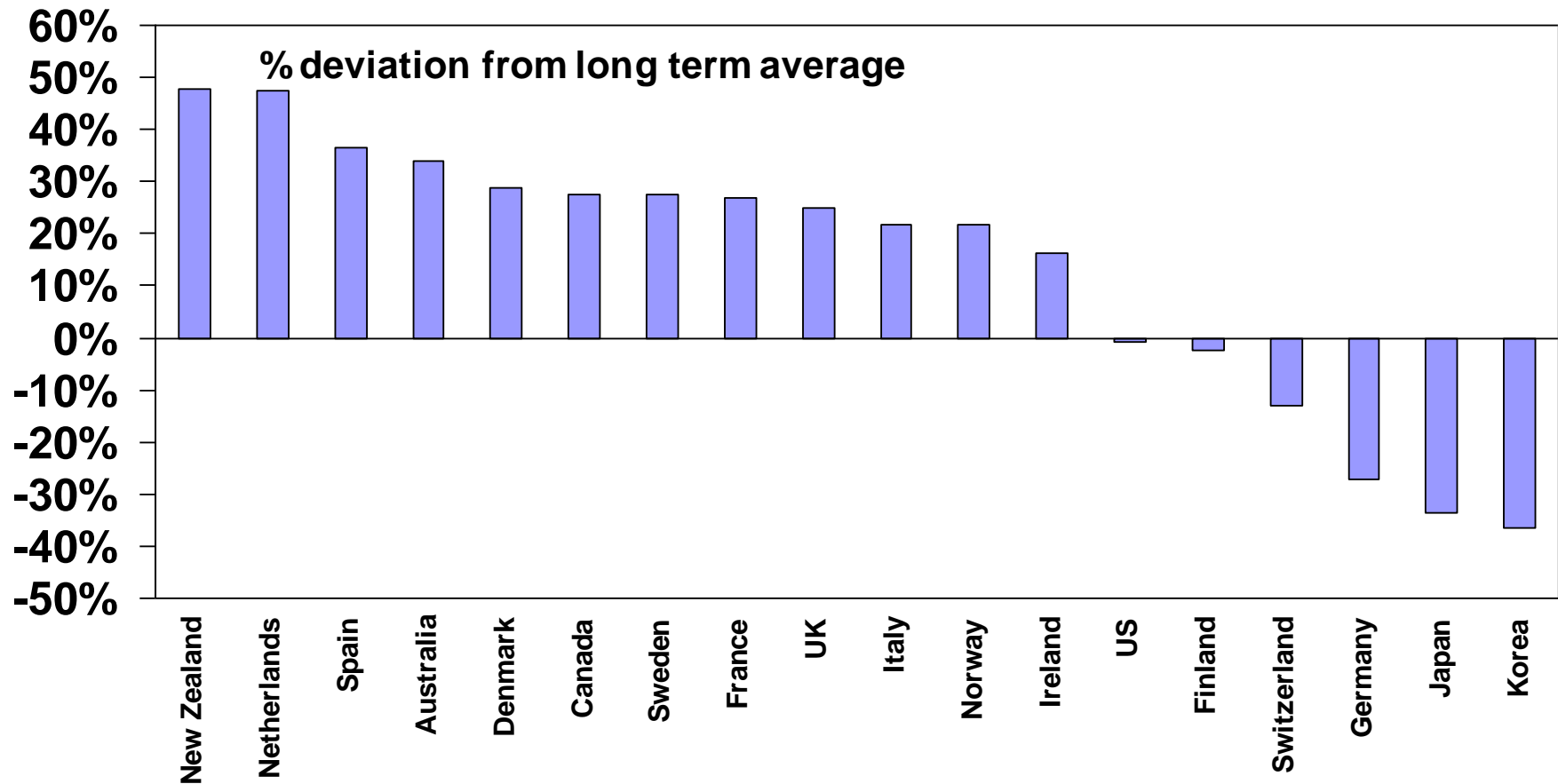
Source: Commonwealth Bank/HIA, REIA, AMP Capital Investors

High house prices, which have gone hand in hand with high household debt levels, are Australia's Achilles heel



Australian house prices are high relative to incomes

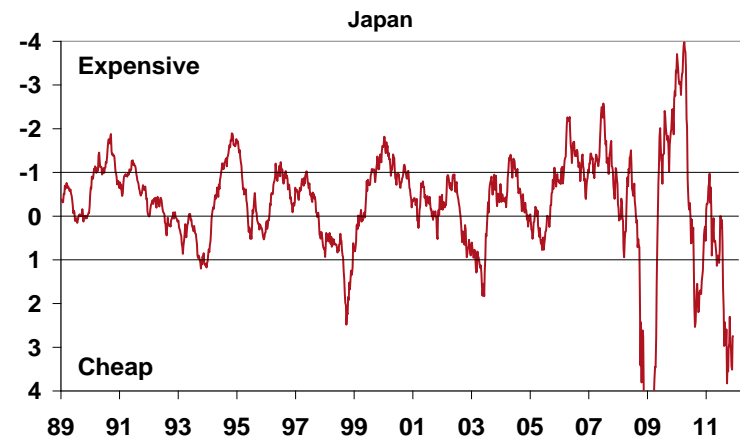
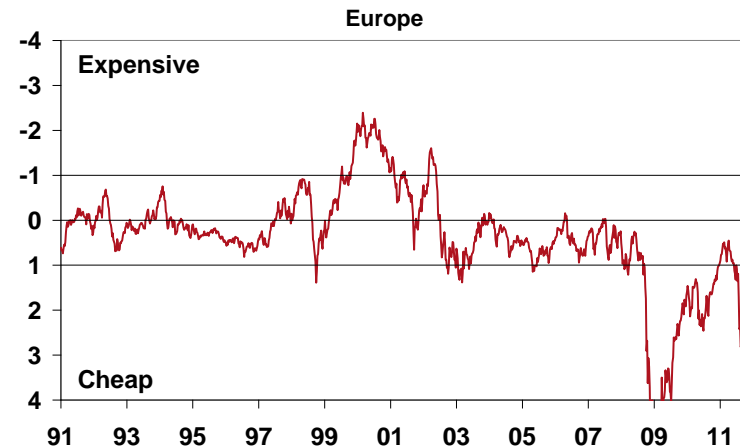
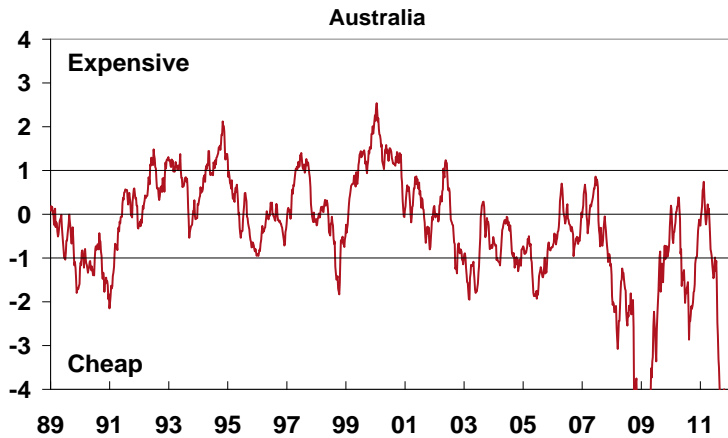
House price to income ratio



Source: OECD, AMP Capital Investors

Share market valuations are cheap

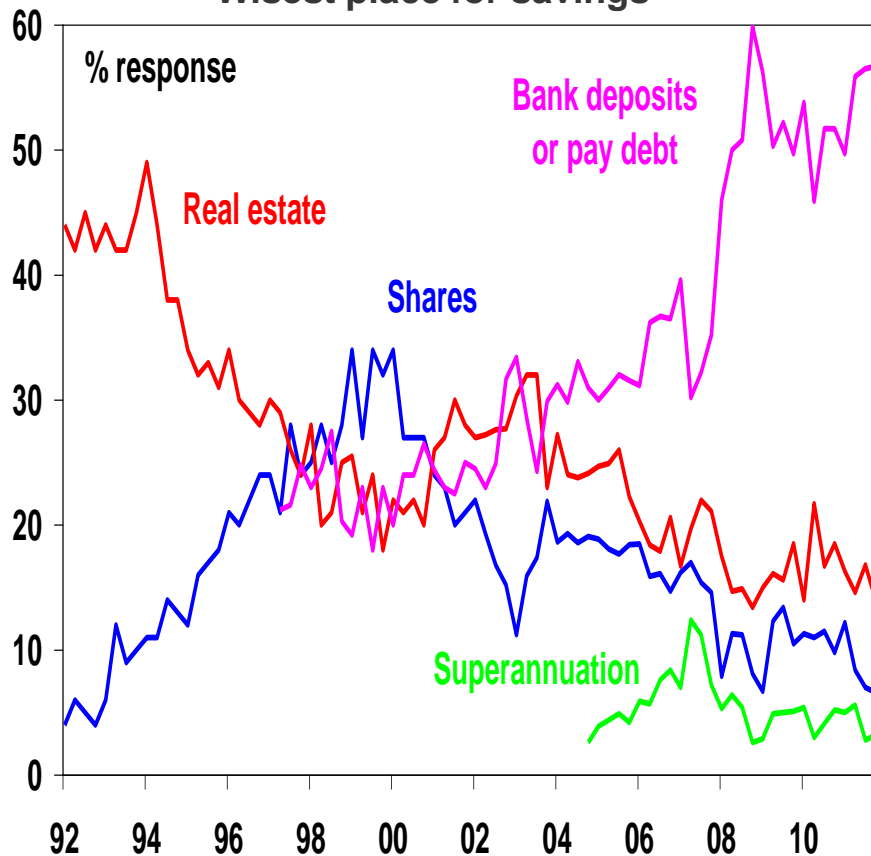
Share market valuation indicators



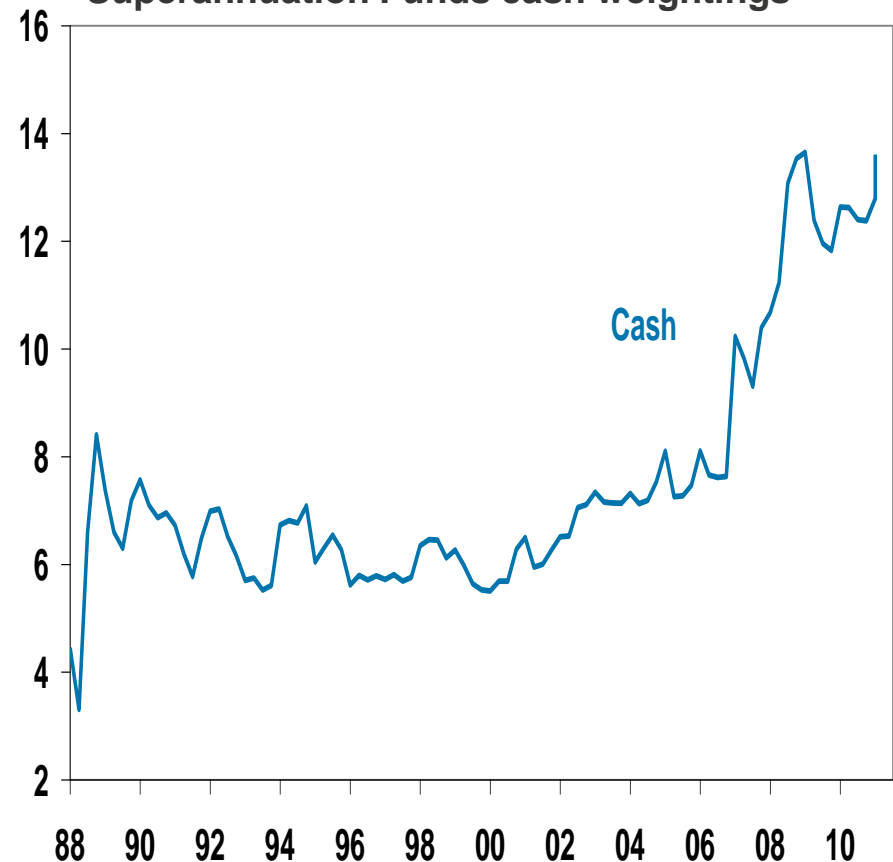
Source: Thomson Reuters, AMP Capital Investors

There is plenty of scepticism regarding shares and plenty of cash still on the sidelines

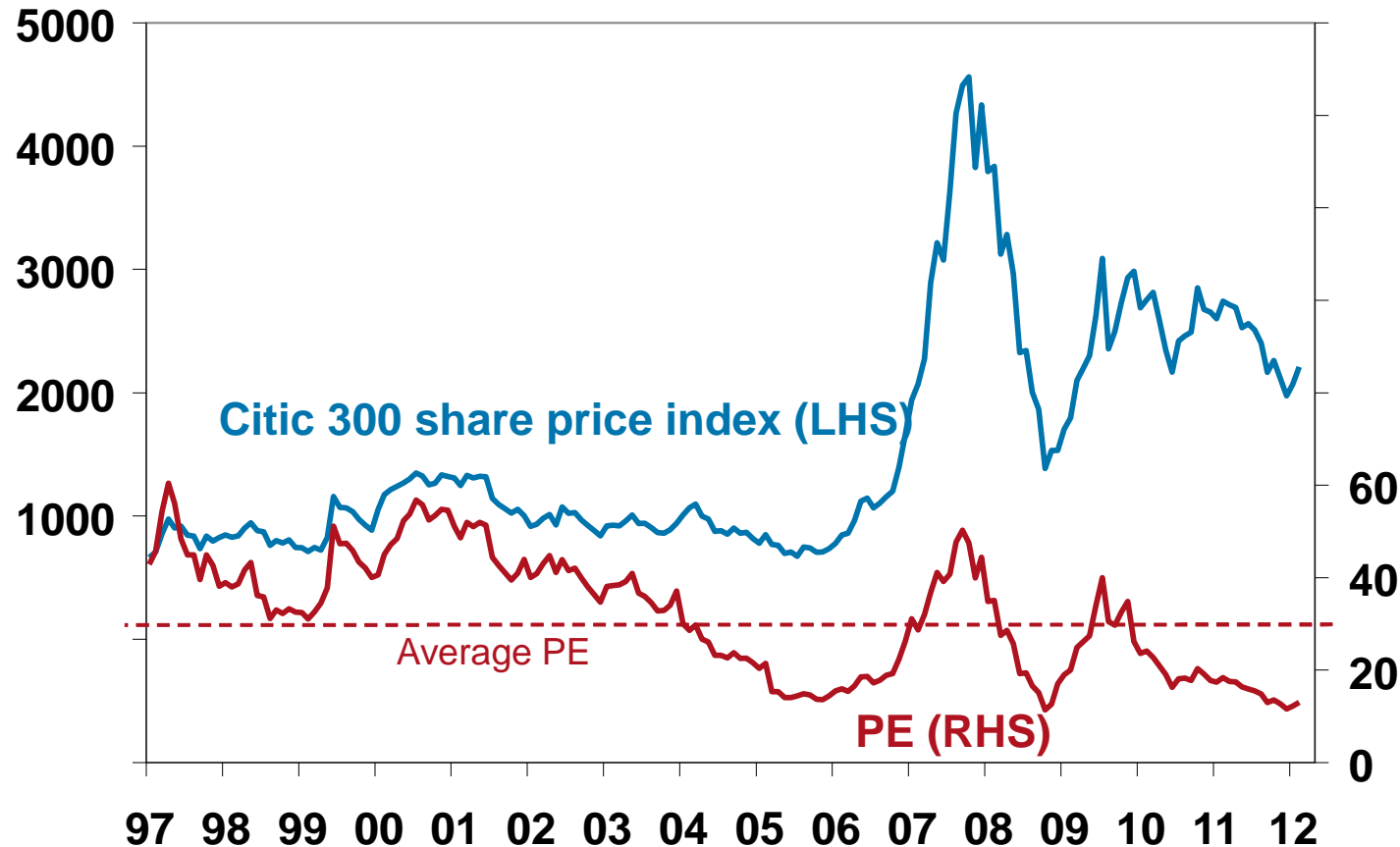
Wisest place for savings



Superannuation Funds cash weightings



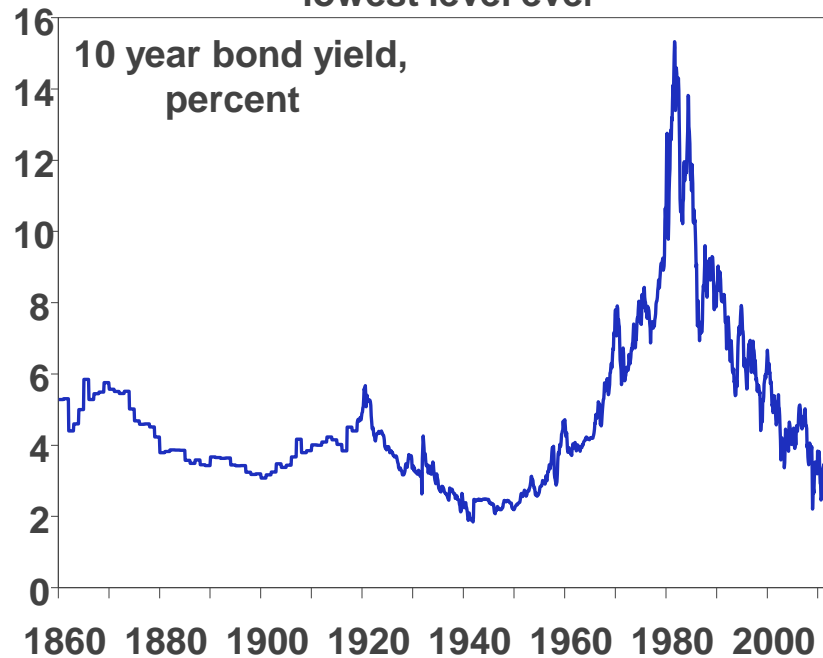
Chinese shares are historically cheap – expect a recovery this year as policy eases



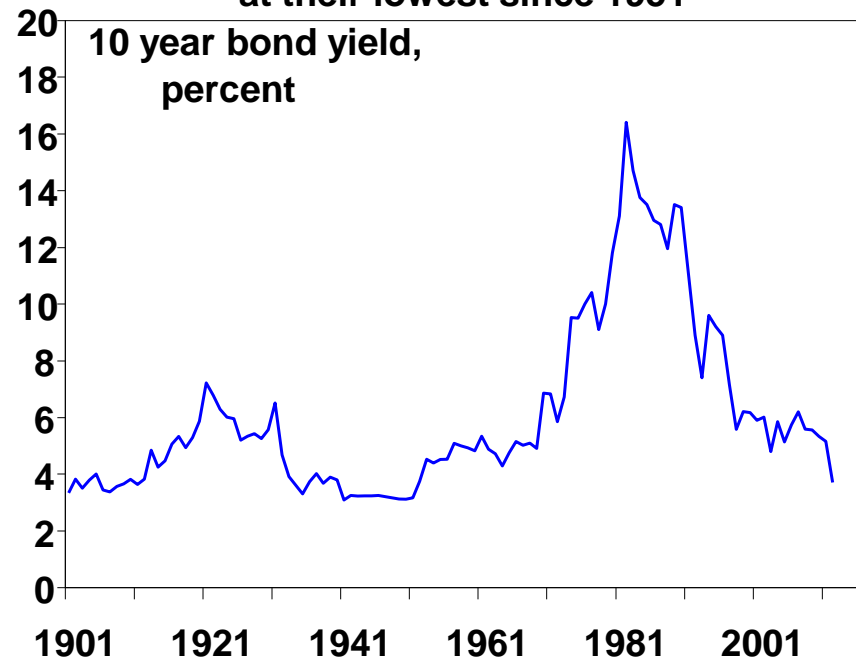
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Very low bond yields will mean low returns from bonds over the next 5-10 years

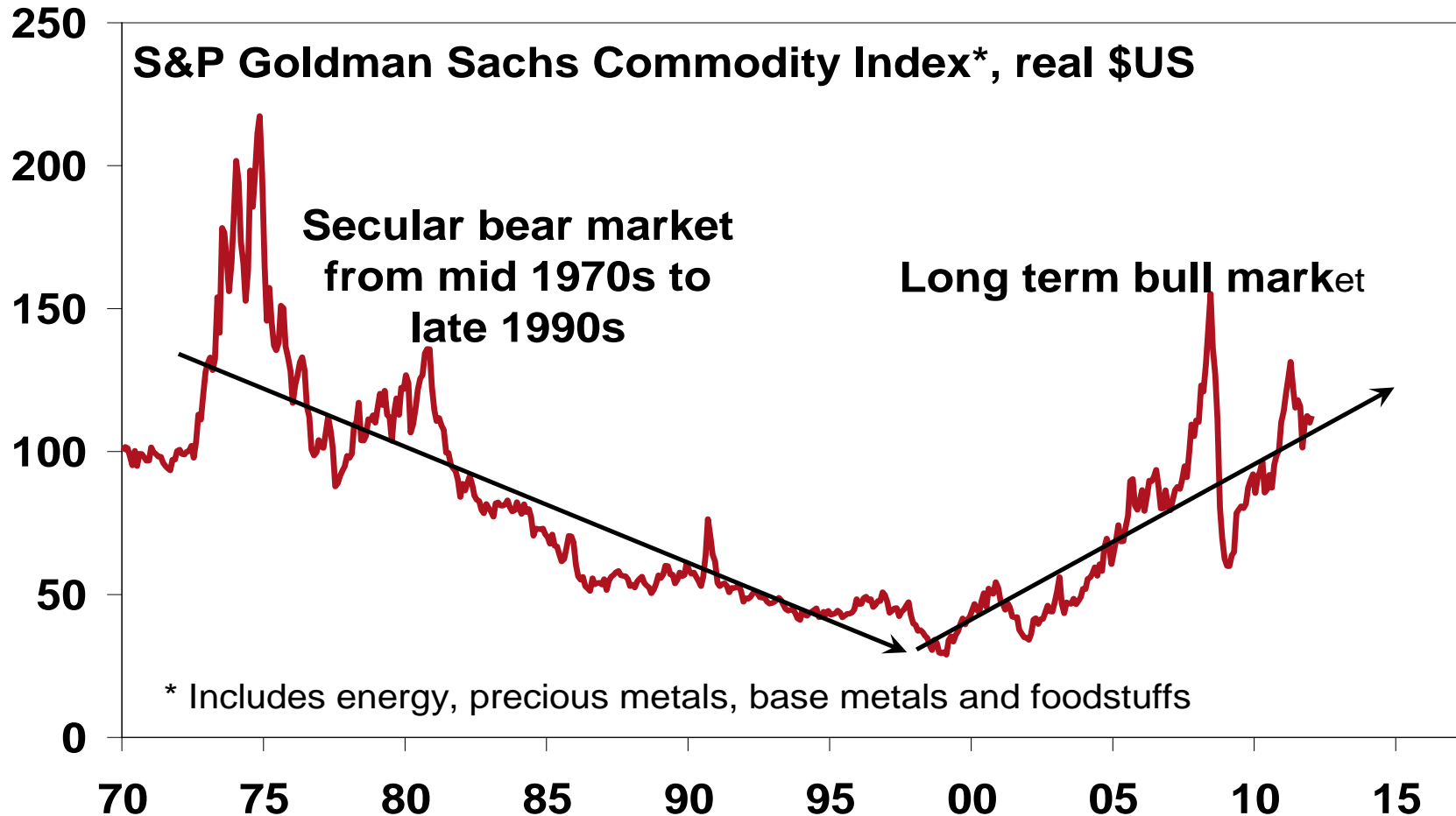
US 10 year bond yields at their lowest level ever



Australian 10 year bond yields at their lowest since 1951



Commodity prices still in a long term uptrend, which is good while it lasts but also a risk for Australia



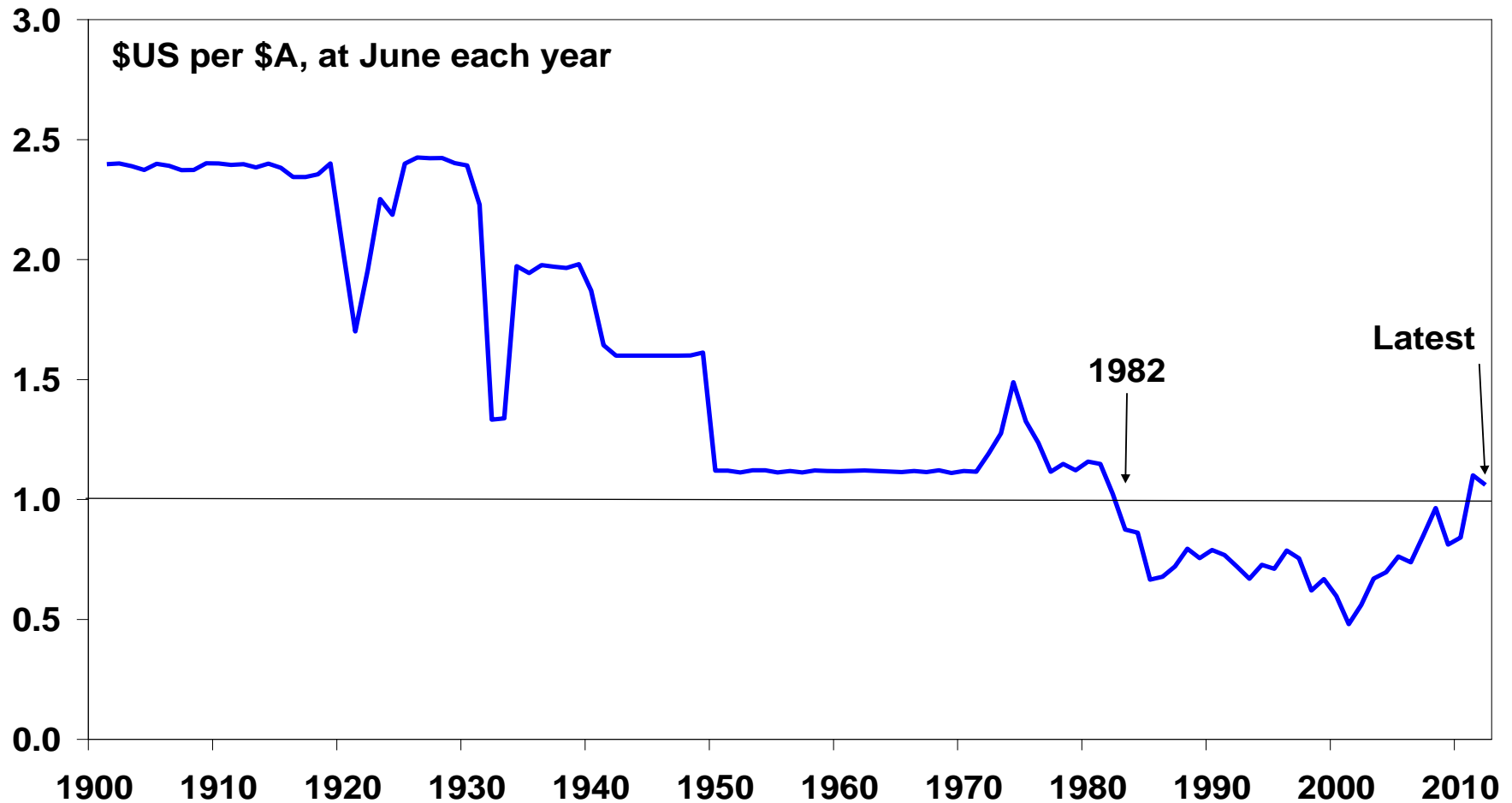
Source: Thomson Financial, AMP Capital Investors

Huge catch-up potential in China, along with other emerging countries, will drive commodity demand

Chinese level per person as %
of US level per person

Road network	14
Rail network	6
Telephone lines	43
Living space	35
Passenger cars	5

Expect the \$A to remain relatively strong



Source: RBA, Thomson Financial, AMP Capital Investors

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