

Market commentary 18 January 2012

Market volatility set to continue

The second half of 2011 ended with share markets considerably lower than where they started, the Australian dollar trending lower, commodity prices weaker and the global economic outlook still suffering at the hands of the European debt crisis.

Early in the second half, share markets suffered their worst period since the height of global financial crisis in response to continuing concerns about the debt levels in Europe, worries of a 'double dip' US recession, and fears of a faster than anticipated slowdown in China. It was a very volatile period for share markets as investors sold off more risky assets such as equities and commodities, and generally moved to safer assets such as government bonds and US dollars.

During October, markets were encouraged by the European Central Bank (ECB) pledging €1 trillion to the European Financial Stability Fund to help stabilise European financial institutions. A strong start to the US corporate reporting season also raised the mood. Unfortunately, these events weren't enough to recover the losses sustained during the prior months.

The negative sentiment soon returned as attempts to reach a consensus on measures to reduce the US Budget deficit failed. The rating agency, Fitch, also lowered its outlook on France's AAA credit rating from "stable" to "negative" and placed six other Eurozone countries, including Spain and Italy, on "ratings watch". Late in 2011, China reported the sharpest fall in manufacturing data since March 2009 due to weaker overseas demand for goods manufactured in China. The US economy was one of the better stories of late 2011 with the US reporting a three-year low for jobless benefit claims, the strongest sales data of existing US homes in 18 months, and improvement in consumer confidence and retail spending.

The Reserve Bank of Australia dropped the official cash rate by 0.25% in both November and December 2011, following seven consecutive 0.25% cash rate increases from October 2009. The 10-year government bond prices for Australia, Eurozone, UK and US remain expensive, reflecting strong demand as investors continue to move to the comparative safety of developed market government bonds.

Market Performance – December 2011	Performance (income and capital gain/loss) %	
	Month	3 months
Australian Shares (S&P/ASX 300 Accumulation)	-9.8	-11.0
International Shares (MSCI World ex-Australia) unhedged	-5.9	-4.8
International Shares (MSCI World ex-Australia) hedged	-6.8	-1.5
Unlisted Property (Mercer Unlisted Property Funds Index (Pre Tax))	3.6	8.3
Listed Property Trusts (S&P/ASX 300 Property Trusts Accumulation)	-4.6	-1.6
Australian Bonds (UBS Composite Index)	6.7	11.4
Global Bonds (Barclays Global Aggregate (Hedged))	6.4	10.5
Cash (UBS Bank Bills)	2.5	5.0
Appreciation of \$A against \$US	-4.2	0.0

Looking ahead

Investors should expect volatility to continue for the time being as market sentiment responds to political and policy announcements. Global factors, especially the European debt position, will tend to dominate market activity in early 2012.

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