

## three key indicators in 2012

Lots of economic and market data is produced each week and month. Understanding how this data relates to investment issues is the challenge for investors. While inflation and economic growth rates will continue to occupy attention, there are three useful summary indicators that directly relate to key issues affecting investment markets such as how the European debt crisis is being managed, growth trends in China and the progress of US companies.

The first indicator is the difference between German 10 year government bond yields and their Italian counterpart. A tightening of this spread indicates improved confidence in Europe's debt situation. Heightened uncertainty about the ability of Italy to sustain current debt levels has seen the spread between Italian and German 10 year bond yields as wide as 5.53%. If investor's become more confident that European governments are able to engineer a viable debt stabilisation program, this spread should tend to stabilize and trend down. End of month the spread was 5.28%

Emerging economies continue to drive global growth. The Purchasing Managers Index (PMI) in China is an indicator of the activity of Chinese manufactures and exporters. A reading above 50 indicates that the manufacturing economy is generally expanding. A reading below 50 indicates that it is generally contracting. As China has been attempting to slow its growth levels to a more sustainable growth trajectory, stabilization in China's PMI around 50 is a good indicator of China's resilience to an uncertain economic environment. Some economists suggest a number below 47 would be an indicator the economy is slowing too much. In December, China's PMI climbed to 50.3 up from 49.0 in November.

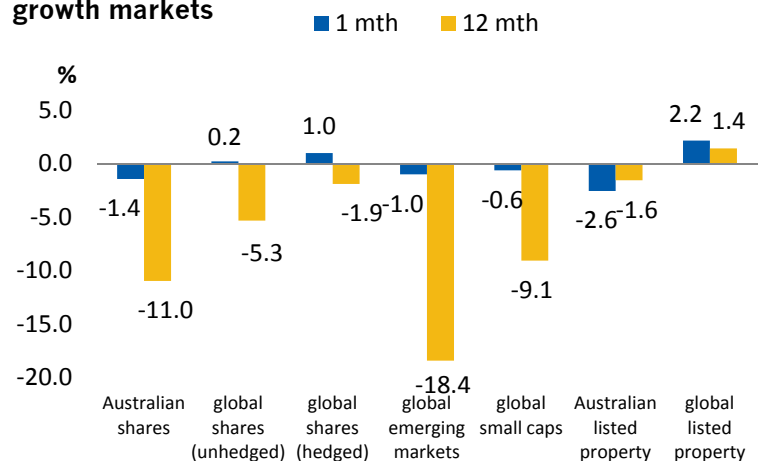
As the United States is the world's largest economy it is a key driver of investor sentiment. The Institute for Supply Management (ISM) Index measures activity in the US manufacturing sector. The dividing line between contraction and growth is 50. In December, the index climbed 1.2 points to 53.9 points, the highest reading in six months. As many US corporates are large, multinational companies, the ISM indicates that US corporate are continuing to grow and take advantage of global growth opportunities.

End of year there were small positive shifts in these indicators. The more stable environment saw growth assets rise in the fourth quarter.

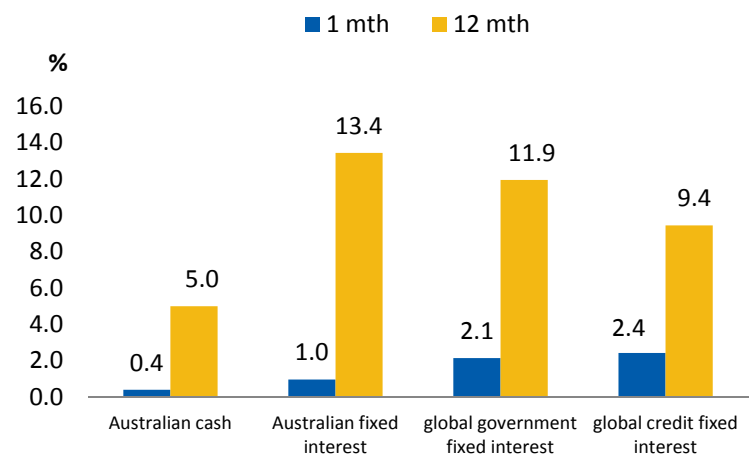
## in brief

- ~ While Australia's Gross Domestic Product is one of the strongest in the developed world (+2.5% year-on-year growth) soft domestic demand, a high \$A and uncertainty surrounding the near term outlook for the global economy hurt the ASX.
- ~ Economic data from the United States and Asia displayed strength and leadership changes in European governments showed more promise around resolving sovereign debt troubles. This helped global sharemarkets to rise.
- ~ In Australia, the Reserve Bank of Australia (RBA) reduced interest rates in December. The official cash rate is 4.25%.

## growth markets



## debt markets



## Australian shares

The S&P/ASX 300 Accumulation Index fell 1.4% in December 2011. While Australia's Gross Domestic Product is one of the strongest in the developed world (+2.5% year-on-year growth) soft domestic demand, a high \$A and uncertainty surrounding the near term outlook for the global economy hurt the sharemarket.

The Consumer Discretionary sector underperformed, down 3.9%. JB Hi Fi and Billabong announced profit downgrades in the month. Retail sales unexpectedly stalled in November, ending four months of gains said the Bureau of Statistics. Sales came from spending on recreational goods and books, (+0.3%) and at restaurants (+0.1%). Sales at retail stores as a whole slowed to 0.1%. Spending on clothing declined the most, down by 0.4%.

Australians have been saving at a rate that has not been seen since the late 1980s. The ratio of household savings to disposable income rose to nearly 10.0% in 2011. By contrast, the personal savings rate in the United States was 3.5%, according to November data.

The Manufacturing sector in Australia expanded for the first time in six months. The Australian Manufacturing Index rose to 50.2 in the month, compared to 47.8 in November. The dividing line between expansion and contraction is 50. The survey polled more than 200 companies about production, new orders, deliveries, inventories and employment.

## global shares

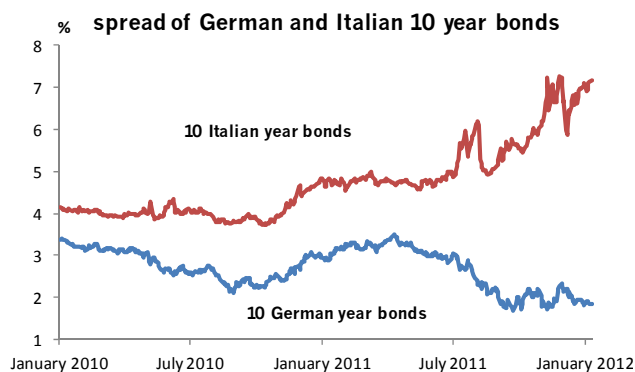
The MSCI World ex Australia Index (hedged \$A) rose 1.0% and the MSCI World ex Australia Index (unhedged) rose 0.2% in December. Economic data from the US and Asia displayed strength and changes in European governments showed more promise around resolving sovereign debt troubles. This helped global sharemarkets to rise.

The S&P 500 was up 0.9% in December and ended the December quarter up 11.2%. The US economy grew for the 31st consecutive month. Improvements in American manufacturers underpinned the positive performance of the US sharemarket, as there was a strong expansion in production growth and new orders for goods.

MSCI Asia sharemarkets rose 1.0% as positive data from Asia's 10 largest economies, excluding Japan, signalled that Asian economies are withstanding the knock-on effects of Europe's debt troubles and austerity measures. Economic activity in these economies grew an average of 5.2% in the December quarter.

## listed property

In Australia, the S&P/ASX 300 A-REIT Index fell 2.6%. Underperformance in the Retail sector was the main contributor to the fall. Worse than expected sales leading up to Christmas hurt sentiment.



source: Bloomberg as at 30 December 2011

The UBS Global Property Investors Index (hedged \$A) rose 2.2% in the month. Positive economic data from the US saw the region strongly outperform (+4.5%). The next top performing region was Hong Kong (+0.6%) which benefited from tight supply.

## debt markets

The Barclays Capital Global Government Index (hedged \$A) rose 2.1% in December and the Global Credit Fixed Interest Index rose 2.4%. Investors favoured government debt and the income earned from corporate bonds.

The above chart shows the spread between German and Italian 10 year government bond yields. The extra yield investors require to participate in Italian debt offerings has become an important obstacle for the government to reduce its deficit. The higher yield equates to a higher borrowing cost. This makes it more difficult for Italy to repay its debt. It also means there is less free cash flow available to stimulate the economy.

Yields in Italy rose above 7.11% in December before falling back down to 6.92%. The announcement of new austerity measures helped sentiment. Italy's new Prime Minister, the business minded Mario Monti, unveiled austerity measures that aimed to slash the cost of government, combat tax evasion and foster economic growth. This included spending cuts, raising the retirement age and reinstating property taxes that were abolished in 2008. The measures aim to eliminate Italy's budget deficit by 2013.

In Australia, the Reserve Bank of Australia (RBA) reduced interest rates in December. The official cash rate is now 4.25%. This helped lower lending rates, which are now around their average level for the past 15 years.

Australian government bonds rose 1.0% in December. Australia has strong debt dynamics and offers higher yields than most developed economies. For example, yields for 10 year government bonds in Australia ended December at 3.87%. Yields on 10 year US government bonds were 1.88%. This encouraged investors to invest in Australia for the higher yield.

## economic indicators

gross domestic product (annual rate %)	current	previous	1 year ago
World	6.2	6.2	0.1
Australia	2.5	1.9	2.7
China	9.1	9.5	9.6
European Union	1.4	1.7	2.1
United States	1.5	1.6	3.5

inflation (annual rate %)	current	previous	1 year ago
Australia	3.5	3.6	2.8
China	6.1	6.4	3.6
European Union	3.0	2.7	1.8
United States	3.9	3.6	1.1

official interest rates (%)	current month	3 months ago	1 year ago
Australia	4.25	4.75	4.75
China	3.41	4.89	4.52
European Union	1.00	1.50	1.00
United States	0.25	0.25	0.25

bond yields (%)	current month	3 months ago	1 year ago
Australia 3 years	3.13	3.62	5.27
Australia 10 years	3.67	4.22	5.55
United States 2 years	0.24	0.24	0.59
United States 10 years	1.88	1.92	3.29

exchange rates	current month	3 months ago	1 year ago
AUD/USD	1.0252	0.9719	1.0251
AUD/EUR	0.7897	0.7244	0.7641
AUD/GBP	0.6597	0.6239	0.6547
AUD/JPY	78.8789	74.9141	83.1367
AUD/SGD	1.3293	1.2665	1.3131

## sharemarket analysis

sharemarkets (in local currency)	5 yrs (% pa)	3 yrs (% pa)	1 yr (%)	3 mths (%)	1 mth (%)
Australia : ASX 300 Accum	-2.4	7.7	-11.0	2.1	-1.4
Germany : DAX	-2.2	7.0	-14.7	7.2	-3.1
Japan : Nikkei	-13.3	-1.5	-17.3	-2.8	0.2
United Kingdom : FTSE 100	-2.2	7.9	-5.6	8.7	1.2
United States : S&P 500	-2.4	11.7	0.0	11.2	0.9
global emerging markets : MSCI in AUD	-2.8	5.6	-18.4	-1.0	-1.0

### Indices:

Australian shares: S&P/ASX 300 Accum Index

International Shares (Unhedged): MSCI World Ex Australia Index in AUD

International Shares (Hedged): MSCI World Ex Australia Index (Hedged) in AUD

Global Emerging Markets: MSCI Emerging Markets Index in AUD

Australian Listed Property: S&P/ASX 300 A-REIT Index

Global Listed Property: UBS Global Investors Index (Hedged) in AUD

Australian Cash: UBSA Bank Bill Index

Australian Fixed Interest: UBSA Government/Treasuries

Global Government Fixed Interest: Barclays Capital Global Aggregate Govt (Hedged) in AUD

Global Credit Fixed Interest: Barclays Capital Global Aggregate Credit (Hedged) in AUD

## sector summary

Australian share sector returns	5 yrs (% pa)	3 yrs (% pa)	1 yr (%)	3 mths (%)	1 mth (%)
Consumer Discretionary	-11.8	4.2	-17.1	-0.6	-3.9
Consumer Staples	3.8	10.4	-0.4	-2.9	-1.3
Energy	3.8	2.1	-20.8	1.9	-5.1
Financials	-5.3	9.6	-4.4	5.3	0.0
Financials ex Property Trusts	-3.0	10.9	-5.0	5.5	0.6
Healthcare	2.1	0.9	-9.1	5.1	1.7
Industrials	-7.8	4.6	-7.8	6.4	-0.9
Information Technology	-3.6	4.5	-24.9	0.9	-0.9
Materials	2.2	9.4	-24.1	-2.9	-4.1
Property Trusts	-15.2	2.3	-1.6	3.8	-2.6
Telecommunications	2.6	4.4	29.2	7.0	5.1
Utilities	-2.5	7.9	9.5	8.3	3.8

MSCI World sector returns (in local currency)	5 yrs (% pa)	3 yrs (% pa)	1 yr (%)	3 mths (%)	1 mth (%)
Consumer Discretionary	-4.8	14.7	-6.8	7.1	-0.1
Consumer Staples	3.1	9.9	6.3	7.8	2.3
Energy	0.7	8.2	-1.2	15.9	-0.1
Financials	-17.4	-1.1	-20.6	3.3	0.8
Healthcare	-0.9	6.8	7.6	8.3	4.0
Industrials	-4.9	8.7	-10.4	10.5	0.9
Information Technology	-1.0	15.9	-3.8	6.7	-1.5
Materials	-2.5	10.5	-20.7	5.2	-3.8
Telecommunications	-3.8	2.1	-3.8	3.4	1.2
Utilities	-6.6	-3.7	-6.9	1.2	0.4

### Notes:

1. GDP and inflation rate is most recent data available.
2. Data for China's PMI sourced from AMPCI

While ipac portfolio management limited ABN 51 071 315 618, AFS Licence No. 234658 and ipac asset management limited ABN 22 003 257 225

AFS Licence No. 234655, trading as ipac investment services believes that the information contained in this document is correct, no warranty of accuracy, reliability or completeness is given and, except for liability under statute which cannot be excluded, no liability for errors or omissions is accepted.

The information provided in this document is general information only. In preparing this information, we did not take into account the investment objectives, financial situation or particular needs of any particular person. Before making an investment decision you need to consider whether this information is appropriate to your needs, objectives and circumstances, and we recommend you seek independent financial advice. You should obtain a copy of the relevant Product Disclosure Statement before making any investment decision.

Level 31 Grosvenor Place, 225 George Street, Sydney 2000 Australia. Sydney Office Locked Bag No. 15 Grosvenor Place NSW 1220. Telephone 02 9373 7000. Facsimile 02 9373 7111.