Markets Monthly

Magazine | July 2014

In this issue

Spotlight: Dancing on the ceiling?
Equities: Eurozone recovery broadening out
Fixed Income: Fed to drive bond yields
Currencies: NZD may be vulnerable
Commodities: Seasonal demand may boost bulks and energy

Risk Warning Statement :
Investment involves risks. Past performance is not indicative of future performance.
Investors should not make an investment decision based solely on this document

Spotlight

Dancing on the ceiling?

With US growth strengthening and inflation creeping up towards 2%, the end of the bond rally appears nigh. This leaves equities with the potential for further gains in the second half of 2014, but has the equity market become too expensive after the bull run of the past few years?

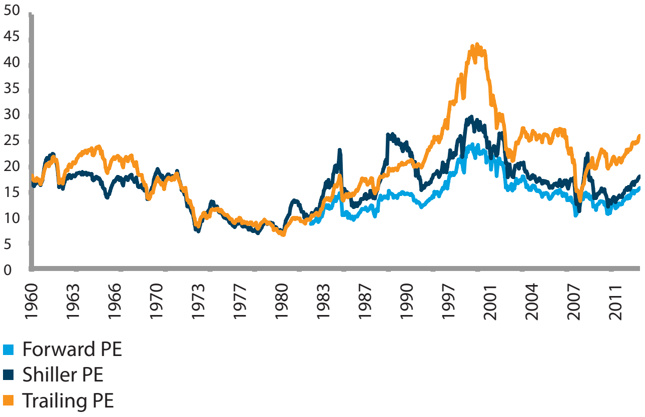
So far in 2014, bond returns have surprised on the upside versus market expectations. Government bond yields have fallen and credit spreads narrowed further, driving a 4.9% return in global investment grade bonds, not far short of the 6.6% return for global equities (In USD terms). As we have argued in recent months, we expect this rally in the bond market to come to an end as US growth improves, inflation begins to move back towards 2% and the US Federal Reserve's quantitative easing program draws to a close.

When looking at the prospects for financial markets in the second half of the year, along with the debate about the direction of bonds, attention is increasingly focused on equity markets and invariably, valuations. Not surprisingly, the US equity market gets most of the attention given the high correlation of most developed market equity markets to the S&P 500 and the strength of its rally in the past five years.

However, different measures offer up varying degrees of over-valuation for the US equity market:

- The trailing PE (price earnings) for the S&P 500 currently stands at 18.2x versus a five decade median of 17x
- The S&P 500 one year forward earnings PE is 15.9x versus a 30 year median of 14.3x
- The Cyclically Adjusted PE ratio, also known as the Shiller PE, which uses a 10-year average of earnings to value the market, gives a more worrisome picture, standing at 26.2x versus a five decade median of 19.8x or 16x over the past century

Valuation measures suggest the US share market is over-valued



Source: Datastream, Robert Shiller. ANZ Global Wealth. July 2014.

The report is published by ANZ Wealth Asia. All charts and tables are individually sourced. "ANZ analysts" refer to investment professionals within the ANZ CIO Office, ANZ Economics & Markets Research and ANZ Wealth Asia. For more information, please contact your ANZ Relationship Manager.

We believe that inflation is one of the factors which can help explain some, but not all of the highs and lows of the PE series. Generally speaking, high PEs tend to correspond with low inflation while low PEs are prevalent at the time of high inflation. This is because periods of higher inflation correspond with greater degrees of uncertainty, which in turn warrants a larger equity risk premium. Meanwhile, on an inflation-adjusted basis, the current valuation of the US share market appears quite neutral.

On the other hand, the significant over-valuation as suggested by the Shiller measure can be attributed to the earnings used to derive the PE ratio. Notably, the Shiller measure uses average earnings over the last 10 years while the other metrics use either the earnings for the trailing 12-month period or expected earnings for the coming 12 months. As the current earnings and profit margins are well above their long-run moving average, the Shiller PE implicitly assumes that actual earnings will revert back to the 10-year mean.

On the contrary, we believe that the rise in profit margins is part of a multi-decade secular trend. In the past few decades, the significant increase in labour population globally, largely due to India and China, coupled with globalisation and technological advances, helped raise profit margins. While the profit margin in the US may fall as Chinese labour loses its low cost status and demographics help drive a tightening in the US labour market, these will only play out over an extended period of time. Therefore, with the current high level of earnings relative to history not about to mean revert any time soon, the Shiller PE could be overstating the risk of a correction, and the shorter-term focused metrics are a better guide for the moment.

In summary, although the US market is now fully valued and no longer cheap, valuation metrics currently do not provide a strong signal either way for the market's future direction. The economic cycle is strengthening at present, with robust earnings in prospect. But market risks are rising as the economic recovery continues into its later stage and the US labour markets tightens. Sentiment indicators are also now on balance becoming bearish and need to be watched closely. Therefore, although we continue to maintain our moderate overweight to equities, we are keenly aware of the risks of shorter-term setbacks.

Investment Summary

Our base case view remains for a stronger pace of growth in the global economy in 2014 against a backdrop of continued low, but rising, inflation. While this backdrop warrants a moderately overweight position towards equities, with equity markets now fairly priced, the pace of growth in share prices is likely to be subdued compared to that seen over the past 12-18 months. In addition, as central banks eventually start returning policy to more normal settings, thereby removing one key support for financial markets, volatility may increase, resulting in a greater balance between risk and return.

We continue to favour developed market equities over their emerging market counterparts. There is risk that the latter could be vulnerable to renewed outflows when the market begins to focus on the potential for interest rate rises in the US. In addition, the continued uncertainty surrounding China's transition towards slower but more balanced growth could cause investors to maintain a relatively cautious stance towards this key economy in the medium term.

As for fixed income, with inflation in the US showing some signs of gradually rising as unemployment falls, risks have become skewed towards a rise in bond yields (i.e. a fall in prices) from current levels.

Over in the currency markets, the AUD and NZD have moved beyond levels that are justified by their economic fundamentals, in our view.

Finally, while the coming months could usher in stronger commodity prices, particularly for the oversold bulks markets, there is still a healthy level of caution over the sustainability of the improvement in China's macro data.

Asset Allocation	3-12 month view
Global Equities	Moderately Overweight
US	Moderately Overweight
Europe	Moderately Overweight
UK	Moderately Overweight
Japan	Neutral
Emerging Markets	Moderately Underweight
Asia ex Japan	Neutral
Global Bonds	Neutral
Cash	Moderately Underweight

Source: ANZ Global Wealth. July 2014.

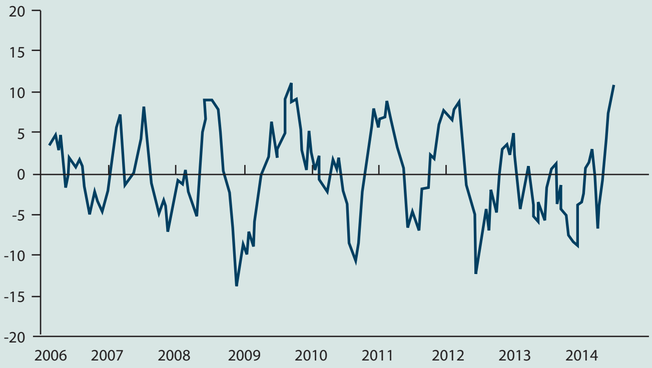
The report is published by ANZ Wealth Asia. All charts and tables are individually sourced. "ANZ analysts" refer to investment professionals within the ANZ CIO Office, ANZ Economics & Markets Research and ANZ Wealth Asia. For more information, please contact your ANZ Relationship Manager.

Equities

A broadening out of the eurozone recovery would help underpin earnings. On the other hand, we remain somewhat sceptical that Abenomics would be able to lift Japan's longer term growth prospects.

US - The S&P500 reached new highs in June and valuations are slightly above fair value with the trailing and forward PER around 18x and 16x respectively. We note that the US data surprise series is currently at its highest in a decade, and a short period of data disappointment cannot be ruled out. This could pose a near term risk for the market.

US Data Surprise Index - 3 month rolling index



Source: Bloomberg. ANZ Global Wealth. June 2014.

However, over the medium term, the trend in economic dataflow remains robust and is likely to lead to a gradual improvement in sales volumes. Accordingly, the trend in earnings revisions has turned positive and analyst earnings growth expectations seem reasonable. Therefore, the US continues to be one of our favourite equity markets over the medium term.

Europe - While the headline PMI readings in the Eurozone have softened somewhat in the past couple of months, the new orders index has risen to a 3-year high, consistent with growth of close to 2%. While this growth remains dominated by Germany, the improvements in the business surveys across the peripheral countries suggest that the recovery is broadening out. Encouragingly, recent data and lending surveys suggest that the credit shrinkage is moderating and that the appetite for debt may soon pick up. This would be a positive for domestic demand or at the very least, remove a major headwind for the euro area, which would in turn help to underpin earnings.

Japan - We remain somewhat sceptical that Abenomics will be successful in raising investment levels and labour productivity. Almost one year on, Japan's exports do not appear to have benefited from a weaker JPY. In fact, the converse may be true. The trade balance has deteriorated, as the weak yen caused energy imports to rise more sharply than exports. In addition, Japan's real export volumes have been flat over the past year despite a weaker currency as Japanese producers continued with their long-term strategy of shifting production offshore.

With our expectation that US bond yields would track higher as inflation normalises and the search for yield wanes, the tailwinds which the Emerging Markets have been experiencing could potentially dissipate.

We continue to favour developed market equities over emerging market equities. While the return of the search for yield has taken the pressure off EM economies and markets, they are not out of the woods yet. Notably trade growth is still subdued and high levels of debt in selected countries limit any significant domestic policy response to support growth. As such, we see less certainty over the earnings outlook in the emerging markets.

Within Asia

Taiwan – The Taiwanese market remains one of our favoured markets with its attractive valuations and positive earnings trend. Its manufacturing sector is currently the region's strongest, with increases seen in output, new orders, including new export orders in June. In addition, with inflation far below the central bank's target, rates are likely to be on hold for some time, further supporting growth.

Korea – Our positive stance on the Korean equity market has not been rewarded, with the market relatively flat year to date. The downward earnings revisions since the start of the year have clearly been a drag on the market as Korean exporters faced significant competition, a situation not helped by the strong KRW. Notably, in June, the manufacturing sector recorded its sharpest contraction since August 2013 with output and new orders recording sharp declines.

While we believe that Korean exporters would eventually benefit from the uplift in the global economy in 2H14, FY14 earnings growth forecasts for the market currently appear somewhat aggressive at 22%. Given that valuations are currently slightly expensive, we have turned neutral on the market. We would review our stance when the currency weakens and /or when the earnings outlook improves.

China – The market is cheap and the latest PMI readings suggest that the government's recent targeted easing measures are helping to stabilise growth, in the face of a slowing property sector. Home prices fell marginally in May, the first month on month decline since June 2012, as more developers have started to offer price discounts. Meanwhile, industrial profits grew 8.9%yoy in May, slowing from the previous month. More stimulatory measures are possible, in order to achieve the government's 7.5% growth target.

Hong Kong – Valuations are slightly expensive and after a short-lived reprieve, analysts continue to revise their earnings forecasts lower. We believe that Hong Kong could benefit from improved investor sentiment should the Chinese growth outlook improves further but we prefer to see greater clarity on this front. Loans growth rebounded in May after a sluggish start to the year. However, given lagging deposit growth, HKD funding costs are inching up and may pressure bank margins. On this front, the larger banks could fare better. On balance, we remain neutral on the market.

India – Valuations are expensive but not excessively so. We continue to give the Modi-led government the benefit of the doubt. The recently announced hikes in gasoline and diesel prices, as well as the increased railway passenger and freight fares suggest that the new government is serious about curbing subsidies and the fiscal deficit. Meanwhile, on the macro front, the Markit PMI inched higher in June and our economists expect the Indian economy to enter a sweet spot in the second half of the year.

That said, the risk to our positive stance stems from a poor monsoon which would revive inflationary pressures. In addition, should the Modi-led government fail to meet market expectations in the months ahead, investors may want to move to protect their gains as the election-related euphoria fades.

ASEAN – The ASEAN markets continue to look expensive, with the exception of Malaysia which is fairly priced and Singapore, which remains cheap. Monetary conditions are likely to become tighter in Malaysia and Philippines. The former could see rate hikes in the second half of the year as adjustments in electricity tariffs and gas prices exert upward pressure on inflation. Meanwhile, Philippines, which is experiencing rising inflationary pressures and a slowing growth momentum, moved to raise rates on its Special Deposit Accounts last month.

Over in Thailand, since the National Council for Peace and Order has been established post the coup, Thailand's fiscal programme has been revitalised and consumer as well as business confidence has lifted. As such, a modest growth revival is likely. That said, while things appear to be looking up, we are cognizant that the military government is only a temporary solution before the eventual restoration of democratic governance. Meanwhile, despite the moderately better economic outlook, earnings continue to be revised lower.

As for Indonesia, domestic momentum is strong, pushing the manufacturing PMI to 52.7 in June, the highest since April 2011. Earnings revisions have also been relatively stable. However, Indonesia's current account deficit widened to 3.5% of GDP in 2Q14, and the trade balance could remain volatile as imports and activity pick up post elections. This could in turn increase the vulnerability of the currency should US bond yields and market volatility head higher. Finally, given the uncertain election outcome, investors may want to maintain a relatively cautious stance for now.

The Singapore market is not expensive but the outlook remains relatively unexciting, with tight labour costs acting as a constraint on the economy. Notably, industrial production fell in June on the back of a decline in semiconductor production. That said, we saw better output from the marine & offshore, as well as the aerospace segments. As such, we continue to favour selected industrial companies within Singapore, whose earnings are likely to be boosted by the global growth recovery.

Within Asia	3-12 month view
China	Neutral
Hong Kong	Neutral
India	Positive
Korea	Neutral
Taiwan	Positive
ASEAN	Neutral

Source: ANZ. July 2014.

The report is published by ANZ Wealth Asia. All charts and tables are individually sourced. "ANZ analysts" refer to investment professionals within the ANZ CIO Office, ANZ Economics & Markets Research and ANZ Wealth Asia. For more information, please contact your ANZ Relationship Manager.

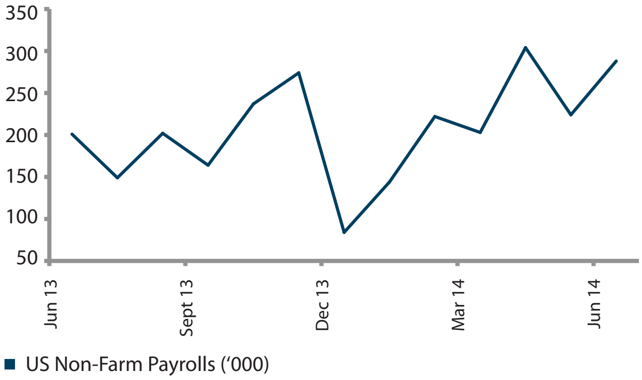
Fixed Income

While geopolitical strife and ECB monetary easing could keep yields low, the Fed is likely to be the main driver of global bond yields over the next 12 months.

Speaking at the IMF in early July, Fed Chair Janet Yellen reiterated that the Fed's mandate is to achieve stable prices and maximum employment, and there is no need to raise interest rates for the sake of tackling financial stability concerns. Instead, the central bank would prefer to use tougher banking regulations and stress tests to address any potential excesses in the financial system.

That said, with the momentum in the US labour market clearly picking up in recent months, we can expect the debate at the FOMC on the appropriate settings for monetary policy to intensify going forward. Notably, not only did the June payrolls beat market expectations (See chart), payrolls for the previous two months were also revised upwards. The unemployment rate fell another 0.2% to 6.1%. At the same time, US inflation is showing signs of bottoming, and the Fed's preferred measure of inflation – the core personal consumption expenditure (PCE) deflator – rose 0.2% m/m for the third month in a row in May.

US labour market gaining momentum



Source: Bloomberg. ANZ Wealth Asia. July 2014.

Against this backdrop, we believe that US bond yields are likely to track higher in the months ahead even if the first rate hike by the Fed remains some time away. Our analysis sees the US 10-year Treasury bond yield rising to slightly above 3% over the next 12 months, which would translate to more reasonable bond valuations then.

However, before we get there and as US Treasury bond yields start to rise, we could see some capital outflows in bond sectors which had earlier benefitted from the extended search for yield. This would potentially include high yield bonds, in particular Asian high yields.

It should be noted that the investment in the Asian high yield space is largely made up of private client money, which has historically been less sticky. At the same time, the relatively lower levels of liquidity in this bond segment could give rise to bouts of higher volatility. Finally, given the ensuing property market slowdown in China and the risk of defaults, a widening of credit spreads cannot be ruled out. As such, we maintain a relatively cautious stance in the Asian high yield bond space.

We continue to favour high quality European corporates. We expect the euro area recovery to continue to be supported by accommodative monetary policy and highly stimulatory financial conditions. In particular, the ECB's targeted Long Term Refinancing Operations (TLTROs), which will take place in September and December this year, should help to support a recovery in credit growth. That said, while we remain optimistic over the Eurozone economy, the pace of recovery is likely to be modest and cause only a gradual decline in the unemployment rate. This suggests that inflation would probably remain low for some time, leaving the door open to quantitative easing measures from the ECB. Overall, the backdrop appears constructive for European fixed income.

Finally, while we expect Australian sovereigns to underperform cash, we see room for further credit spread tightening among the Australian corporates as the net issuance is unlikely to meet investors' strong demand for high quality corporate bonds.

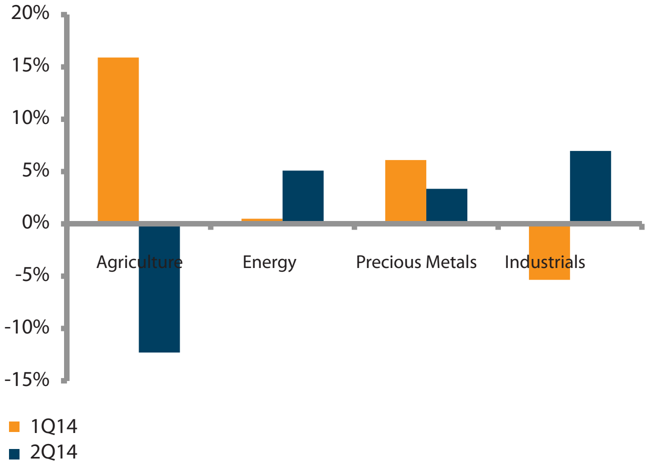
Commodities

The bulks and energy markets may have the greatest upside potential over the next two to three months, as seasonal demand rises.

Commodity markets have been choppy in recent months with investors showing signs of returning after heavy selling in the first quarter. Notably, recent price gains have been skewed towards the precious metals and energy markets. However, this is a result of safe haven flows, or concerns of an oil supply disruption on the back of Iraqi tensions, rather than a reflection of greater confidence over commodity demand.

While Chinese data has started to improve, there is still a healthy level of caution on its sustainability. Therefore while the coming months could usher in stronger prices, particularly for the oversold bulks markets, much still hinges on the confidence of Chinese consumers.

2014 Commodity market returns



Source: Bloomberg. July 2014.

As long as physical demand remains lacklustre, gold's recent rally in June is unlikely to be sustainable.

The escalation of unrest in Iraq spurred renewed buying of gold, lifting prices above its June low of US$1240/oz. However, we believe that the longer term trajectory for gold prices is downwards. Notably, China's demand for gold remains subdued and the domestic gold price is currently trading at a low premium to the London spot price. It would likely require greater CNY appreciation or lower gold prices before Chinese demand for gold improves. In addition, it would take time to run down the large stock holdings of gold which was built up in the mainland over 1Q14, thereby keeping fresh demand subdued for the next few quarters.

At the same time, although the ongoing civil unrest in Iraq has initially boosted gold prices, we continue to see renewed redemptions of physically-backed gold Exchange Traded Funds. In fact, global ETF holdings of physical gold declined by 11mt in the first 20 days of June, adding to a decline of 8mt in May.

We had pointed out in May, that a gold/silver ratio of 67 was stretched relative to historical standards, and the risk for silver prices was to the upside. Since the beginning of June, silver prices have rallied by 12%, outperforming gold prices. Accordingly, the ratio has retraced to a 3-month low of 62. If gold were to continue to rise in the near term, we would expect silver to continue outperforming and for the ratio to move lower.

In South Africa, striking platinum miners have returned to work after a wage agreement ended a 5-month strike. As a three month lag time is usually needed for full production to resume, the news so far has had limited impact on platinum and palladium prices in the near term. However, net positioning in palladium and platinum have recently reached record longs, potentially presenting substantial downside risks in prices when inventory levels normalise.

Any positive Chinese data in the months ahead could trigger a relief rally in iron ore prices.

Iron ore prices have fallen 30% since the start of the year, Market confidence in iron ore has suffered from an extended period of tight credit conditions in the Chinese steel industry, rising seaborne supply and structural reform. Notably, Australian iron ore exports to China reached a record high of 47mt in April, up 45% year-on-year, helping to push Chinese port stocks to a record high of 106mt. Indeed, supplies from newly installed capacity in Australia has seen Chinese steel mills shy away from restocking, preferring to rundown stockyard inventories in a falling market. While this backdrop has triggered heavy shorting activity amongst speculators in the iron ore and steel markets, there is risk that these bearish positions could be covered quickly if Chinese data continues to improve.

While copper looks oversold, any price rebound may be mild given concerns over inventory financing in China.

Copper prices have dipped below US$6,800/t after the port of Qingdao stopped exports of industrial metals to investigate irregularities in reported inventories. The probe focuses on allegations that the same stock of copper, aluminium and alumina at the port may have been pledged multiple times as collateral for financing purposes. The investigation has eroded confidence in the inventory financing trade in China and likely to impact demand in the short-term. Overall, with concerns over inventory financing, weaker imports, and a closing of the import arbitrage, copper prices should remain subdued over the next month or two. We think prices are unlikely to breach US$7000/t by year-end.

Currencies

With US capacity utilisation approaching pre-crisis levels, the market may start to actively consider Fed rate hikes soon. This could lead to higher market volatility, causing periphery currencies to underperform.

USD – In our view, the current low volatility environment is unlikely to last indefinitely, and there is a risk that the return of volatility could be abrupt and sharp. After all, raised capital requirements, curbs on proprietary trading and moves towards the central clearing of some derivatives have acted to reduce secondary market liquidity across a range of markets. At the same time, the current high levels of foreign ownership in emerging market debt potentially increases the vulnerability of the asset class should investors start to bring forward their timing for rate hikes in the US.

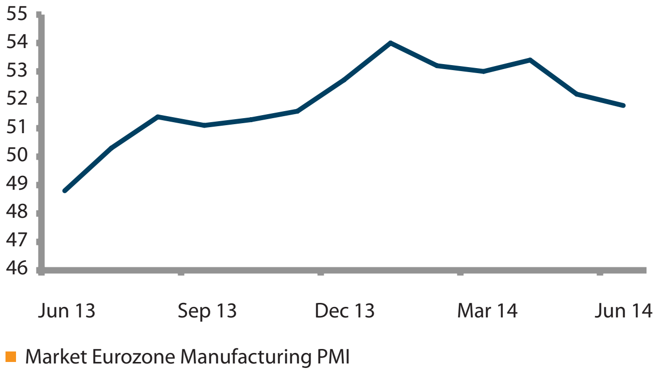
Therefore, the transition to tighter US monetary policy could be less smooth than many seem to expect. On this basis, we expect the commodity and Asian currencies to underperform the USD over the medium term.

EUR – The euro has stabilised in the aftermath of its decline in May in expectation of the ECB's move to a negative deposit rate. Notably, the ECB's statement that interest rates have reached their lower bound and that policy was on hold until further assessment helped to soothe investor sentiment towards the common currency.

We have a constructive view of the euro over the medium term. Euro strength has been strongly correlated with the improvement in the balance of payments, meaningful progress towards greater fiscal sustainability, recapitalisation of the banking system and implementation of economic reforms.

We expect these drivers to continue to support the currency. Meanwhile, although the euro area's composite PMI reading shows that the recovery may have lost some momentum in late 2Q, the modest uptrend remains intact, in our view. See chart.

The uptrend in the Eurozone economy remains intact



Source: Bloomberg. ANZ Wealth Asia. July 2014.

JPY – Japan's core inflation (ex consumption tax effect) has been hovering around 1.3%yoy for some time. In our view, inflation has peaked and may begin to soften in the third quarter. Indeed, the impact on inflation from a weaker JPY seems to be easing. At the same time, although wage growth has improved, it is likely to be too modest to sustain inflation at 2%yoy, which is the BoJ's inflation target. As such, we expect the central bank to come under pressure to ease policy again around October. This, coupled with our expectation for higher US bond yields, suggests that further weakness could be in store for the JPY.

GBP – The recovery in the UK economy remains impressive and growth is likely to be above trend for some time. Notably, the improvement in the labour market has been encouraging and the unemployment rate is currently 6.6%, significantly below the BoE's earlier unemployment target of 7%.

That said, the recovery in the labour market has yet to be accompanied by a rise in real wages. Nevertheless, if unemployment continues to fall by 0.1% per month, then the spare capacity in the labour market could potentially be absorbed within 9-12 months. Since monetary policy tends to work with a lag, this suggests that interest rates could rise in the UK sometime later this year. As such, the backdrop remains supportive for the sterling.

AUD – The current environment of suppressed volatility is encouraging yield seeking behaviour and driving the AUD further from fundamentals.

Domestically, challenges posed by the decline in mining investment are likely to keep the RBA on hold but the risks are tilted to the reintroduction of an easing bias, especially if the AUD continues to rally independently of commodity prices. Although a relief rally in iron ore prices cannot be ruled out in the short term, the longer term outlook for the metal is lacklustre, as non-profitable Chinese steel mills continue to be shuttered and clean air policies remain a priority.

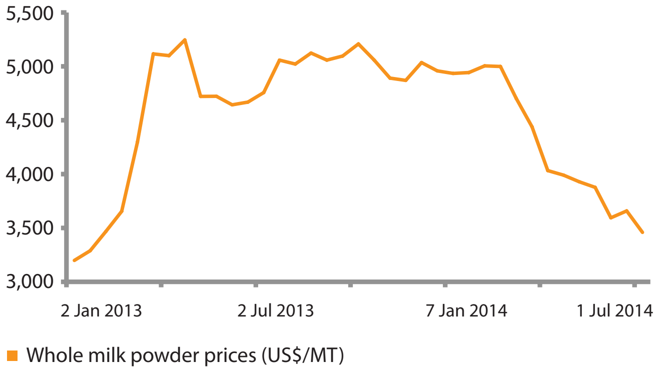
Meanwhile, rising trends in both US activity and inflation mean that the current low-volatility environment is not sustainable. The AUD would be vulnerable should US rate expectations shift, in turn strengthening the USD and pushing market volatility higher.

NZD – The RBNZ is expected to hike rates again in July, but thereafter the outcome of subsequent meetings is likely to be data dependent.

In our view, most of the good news for the NZD is priced in, thereby limiting further upside for the currency. In addition, the decline in dairy prices is worrying. See chart. Indeed, dairy prices are now about 30% below their levels in February and ANZ analysts have lowered their milk price forecasts for 2014-2015. The drop in milk prices, coupled with higher interest rates and a high proportion of short term debt is expected to hurt discretionary spending.

This backdrop is likely to weigh on the NZD. In particular, the currency looks vulnerable against the GBP as the BoE looks set to start tightening monetary conditions.

Average auction milk prices



Source: GlobalDairyPrices. ANZ Wealth Asia. July 2014.

A firmer USD and elevated oil prices would keep most Asian currencies relatively subdued.

CNY – Relative to its regional peers, we are not as wary of the RMB in the event of an oil spike, given China's lower reliance on imported oil. At the same time, there have been further signs of a rebound in the Chinese economy. China's official manufacturing PMI edged up from 50.8 in May to a 7-month high of 51.0 in June. Encouragingly, a pick-up was seen in the output, new orders as well as the new export orders components. As such, we expect the RMB to resume its appreciation over the next 6-12 months.

IDR – Indonesia's current account deficit widened to 3.5% of GDP in 2Q14 and the trade balance could remain volatile as imports and activity pick up post the presidential elections. This could increase the vulnerability of the currency should US bond yields and market volatility head higher. At the point of writing, there is still uncertainty surrounding the outcome of the presidential elections, which could weigh on the IDR in the near term.

INR – We see the INR staying close to current levels on a 6-12 month horizon. A slow and genuine recovery seems to be falling in place in India. April's industrial production growth jumped to +3.4%yoy from -0.5% in the previous month. Manufacturing and services PMIs have also improved in recent months. While CPI inflation moderated from 8.6% to 8.28%yoy, we would still need a favourable monsoon rainfall to help keep inflation contained. Therefore while rate cuts cannot be entirely ruled out, it may be a little premature to view them as a given.

That said, if oil prices were to move higher on the back of geopolitical tensions, we could see some volatilities in the INR in the near term. After all, the Indian economy is highly dependent on imported oil and runs the third largest oil deficit (as a % of GDP) in Asia.

SGD – We maintain our view that the SGD will weaken towards 1.29 against the USD by year end. This is partly premised on our belief that the USD will strengthen over the second half of the year, on the back of an improving US economy and higher US yields. In addition, with our leading indicators suggesting that Singapore's growth could moderate going forward, lower foreign investor demand for Singapore assets should also result in a weaker SGD. Accordingly, industrial production contracted 2.5%yoy in May, and we expect output to be flat for the rest of the year, as Singapore's semiconductor production declines.

TWD – The CBC held policy rate at 1.875% as expected in June as low inflation continues to permit the central bank to be accommodative. In our view, Taiwan's political risk has heightened as the municipal elections will be held in November. Any worsening of cross-strait relationship could increase economic uncertainty and affect business sentiment. With this in mind, the CBC is likely to keep the policy rate on hold throughout 2014.

Nevertheless, the global recovery is expected to continue to support Taiwan's exports, helping the economy to grow by 3.1% in 2014, higher than last year's 2.1%. Therefore, we believe that the policy rate direction is biased towards a hike, which we have pencilled in for 1Q15.

The report is published by ANZ Wealth Asia. All charts and tables are individually sourced. "ANZ analysts" refer to investment professionals within the ANZ CIO Office, ANZ Economics & Markets Research and ANZ Wealth Asia. For more information, please contact your ANZ Relationship Manager.

Returns

Country Equity Markets	YTD	1-Yr	3-Yr
ASX 200	0.8%	12.4%	17.1%
FTSE 100	-0.1%	8.5%	13.4%
Hang Seng	-0.5%	11.5%	3.5%
India Sensex	20.0%	31.0%	34.9%
Jakarta Comp	14.1%	1.2%	25.5%
Korea KOSPI	-0.5%	7.5%	-4.7%
Malaysia KLCI	0.8%	6.2%	19.2%
Nikkei 225	-9.5%	7.8%	50.2%
S&P 500	6.1%	22.0%	48.4%
Shanghai-A	-3.2%	3.5%	-25.8%
Singapore ST	2.8%	3.3%	4.3%
Taiwan Weighted	9.1%	16.5%	8.6%

Regional Equity Markets	YTD	1-Yr	3-Yr
MSCI World	4.9%	20.5%	25.4%
MSCI Europe	3.4%	25.9%	17.1%
MSCI BRIC	2.9%	12.6%	-18.0%
MSCI Emerging Market	4.8%	11.7%	-8.3%
MSC AP ex Japan	5.5%	14.3%	2.6%

Fixed Income	Yield	1-mth chg	YTD chg
Aust Govt (10Y)	3.54	-12	-69
Bunds (10Y)	1.25	-11	-68
Gilts (10Y)	2.67	10	-35
JGB (10Y)	0.57	-1	-18
NZ Govt (10Y)	4.41	17	-31
SG Govt (10Y)	2.32	8	-24
US Trsy (2Y)	0.46	8	8
US Trsy (10Y)	2.53	5	-50

Currencies	Level	1-mth chg	YTD chg
USD-JPY	101.33	0.4%	3.8%
EUR-USD	1.37	0.4%	-0.4%
AUD-USD	0.94	1.3%	5.8%
USD-SGD	1.25	0.6%	1.3%
NZD-USD	0.88	3.0%	6.6%
GBP-USD	1.71	2.1%	3.3%
USD-CAD	1.07	1.6%	-0.5%
USD-TWD	29.89	0.4%	-0.3%
USD-IDR	11875.00	-1.7%	2.4%
USD-INR	60.19	-1.8%	2.6%
USD-KRW	1011.84	0.8%	3.6%

Source: Bloomberg. As of 30 June 2014.

Commodities	Level	1-mth chg	YTD chg
Aluminium	1891	2.9%	5.0%
Copper	7015	2.5%	-4.7%
Gold	1322	6.1%	10.0%
Lead	2173	3.7%	-2.1%
Nickel	19040	-1.1%	37.0%
WTI Oil	105	2.6%	7.1%
Zinc	2217	7.9%	7.9%

Forecasts

Precious Metals (US$/oz)	Sep-14	Dec-14	Mar-15
Gold	1220	1180	1220
Platinum	1480	1520	1500
Palladium	850	870	849
Silver	18.4	18	18.5

Energy (US$/bbl)	Sep-14	Dec-14	Mar-15
WTI Nymex	103	100	102

Currencies	Sep-14	Dec-14	Mar-15
USD-JPY	107	110	110
EUR-USD	1.40	14.2	1.42
GBP-USD	1.72	1.73	1.75
AUD-USD	0.9	0.87	0.86
NZD-USD	0.85	0.83	0.8
USD-SGD	1.28	1.29	1.30
USD-TWD	30.5	30.6	30.7
USD-IDR	11800	12000	12200
USD-INR	57.5	59.5	60.0

Cross Rates	Sep-14	Dec-14	Mar-15
AUDNZD	1.06	1.05	1.08
AUDSGD	1.15	1.12	1.12
NZDSGD	1.09	1.07	1.04
EURSGD	1.79	18.32	1.85
SGDJPY	83.59	85.27	84.62
GBPSGD	2.20	2.23	2.28
AUDIDR	10620	10440	10492
NZDIDR	10030	9960	9760
EURIDR	16520	170400	17324
JPYIDR	110	109	111
GBPIDR	20296	20760	21350

Source: ANZ Economics & Markets Research. As of 7 July 2014. Forecasts are quarterly averages.

The report is published by ANZ Wealth Asia. All charts and tables are individually sourced. "ANZ analysts" refer to investment professionals within the ANZ CIO Office, ANZ Economics & Markets Research and ANZ Wealth Asia. For more information, please contact your ANZ Relationship Manager.

Terms and Conditions

This ANZ Markets Monthly (this "document") has been prepared by Australia and New Zealand Banking Group Limited ABN 11 005 357 522 or its affiliates ("ANZ"). In certain jurisdictions ANZ is represented by its branch office, representative office or affiliate companies, in which case this document is distributed in the relevant jurisdiction by such representative.

This document contains factual information and may also contain professional opinions which are given in good faith and based on information and assumptions believed to be reliable as at the date of this document. The views expressed in this document accurately reflect the authors' personal views, however the authors make no representation as to its accuracy or completeness and the information should not be relied upon as such. Any opinions, estimates and forecasts herein reflect the authors' judgments on the date of this document and are subject to change without notice. Any prices or values herein are as of the date indicated, and no representation whatsoever is made that any transaction can be effected at such prices or values or that any prices or values may be provided at a later date. The value and income of any of the securities or financial instruments mentioned in this document may fall as well as rise and an investor may get back less than invested. Foreign-currency denominated securities and financial instruments are subject to fluctuation in exchange rates that could have a positive or adverse effect on the value, price or income of such securities and financial instruments.

In preparing this document ANZ may have also relied on information supplied by third parties and whilst ANZ has no reason to doubt the accuracy of information used to prepare this document, ANZ makes no representation and gives no warranty as to the accuracy, timeliness or completeness of any information contained in this document or its relevance to the recipient. Copyright in materials created by third parties and the rights under copyright of such parties are hereby acknowledged. This document is issued on the basis that it is only for the information of the particular person to whom it is provided. This document contains confidential information and it is not to be reproduced, distributed or published by any recipient for any purpose without the prior written consent of ANZ.

Nothing in this document constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances or otherwise constitutes a personal recommendation and it does not take into account the specific investment objectives, requirements, personal needs or financial circumstances or tax position of any recipient. This document does not contain and should not be relied upon as containing investment recommendations or advice and does not constitute an offer or an invitation to deal in, or a recommendation to acquire or sell any product or subscribe to any service. None of the services and products referred to in this document is available to persons resident in any country, state and jurisdiction where it would be contradictory to local law or regulation to offer such services and/or product. The recipient should seek its own independent financial, legal credit, tax and other relevant professional advice and should independently verify the accuracy and appropriateness of the information contained in this document.

The capabilities described herein are not necessarily available in all jurisdictions and the provision thereof is subject to licensing, regulatory and other limitations. This document is for distribution only under circumstances as may be permitted by applicable law, rule or regulation. ANZ may have material interests in, or provide investment banking, financial services and other business relationships with the company or companies that is or are part of this document. ANZ, and its respective directors, officers and employees may have positions in the securities or effect transactions in the securities mentioned herein. Changes may be made to products and services at any time without prior notice to you. Any product or service referred to herein may not be offered or sold within the United States or to or for the benefit of US Persons. Neither this document, nor any copy thereof may be sent to or taken into the United States or distributed in the United States or to a US person.

While the information set out above is based on sources believed to be reliable, ANZ Group (together with its directors and employees) makes no representations or warranties expressed or implied as to the accuracy, completeness or timeliness of any of such information, ANZ Group shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the recipient relying on, in any way, the contents of and/or any statements, representations omissions made in this document (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof except where a Liability is made non-excludable by relevant legislation.

© Copyright Australia and New Zealand Banking Group Limited ABN 11 005 357 522 All rights reserved

China: Neither ANZ nor any of its affiliated companies (each, an "ANZ entity") represents that this document may be lawfully distributed, or that any services of ANZ generally mentioned in the document may be lawfully offered, in compliance with any applicable registration or other requirements in the People's Republic of China (the "PRC"), or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by any ANZ entity which would permit a public offering of any products or services of such an ANZ entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such an ANZ entity are not being offered or sold within the PRC by means of this document or any other document. This document may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations.

Hong Kong: Investment involves risks. Past performance is not indicative of future performance. Investors should not make an investment decision based solely on this document. This document is distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered by the Hong Kong Securities and Futures Commission to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. Please note that the contents of this document have not been reviewed by any regulatory authority in Hong Kong. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Indonesia: This document has been prepared by Australia and New Zealand Banking Group Limited ABN 11 005 357 522 ("ANZ Group") and distributed within the Group including to PT. ANZ Bank Indonesia ("ANZ"), its subsidiaries. The full disclaimers at our website anz.com/indonesia are deemed to be incorporated herein.

Japan: The information contained in this document is just for informational purposes. No information in this document constitutes a solicitation, an offer, or a recommendation or advice to buy or sell or not to buy or sell any product, instruments or investment, to effect any transactions, or to conclude any legal act of any kind whatsoever. When making any decision about your investments, you should seek the advice of a professional legal, tax and/or financial advisor.

Singapore: The full disclaimers at our website anz.com/singapore are deemed to be incorporated herein.

Vietnam: The information contained in this document is for general information purpose only. Nothing in this document constitutes a solicitation, an offer, or a recommendation or advice to buy or sell or not to buy or sell any product, instruments or investment, to effect any transactions, or to conclude any legal act of any kind whatsoever. When making any decision about your investments, you should seek the advice of relevant professional advisor. ANZ and its officers, employees and agents accept no liability (including for negligence) for any loss or damage arising in connection with the use of information contained in this document. ANZ reserves the right to change any information in this document where it deems fit or as required by applicable laws.

The report is published by ANZ Wealth Asia. All charts and tables are individually sourced. "ANZ analysts" refer to investment professionals within the ANZ CIO Office, ANZ Economics & Markets Research and ANZ Wealth Asia. For more information, please contact your ANZ Relationship Manager.

© Australia and New Zealand Banking Group Limited (ANZ) ABN 11 005 357 522 (2014)

anz.com/connectivity