Russell Investments

Market Overview

December 2014 // Quarterly Market Overview

Equities

Australasian equities

The New Zealand equity market rose 7.4%, as measured by the Russell NZ Domestic Index. Shares with offshore earnings performed strongly, particularly Fisher & Paykel (20.4%). Other strong contributors included Auckland International Airport (9.9%) and Meridian energy (23.1%). The Australian market rose 3.0% benefiting from a strong rally across the major banks as investors focused on higher-quality assets. Falling commodity prices led to a decline across the Australian energy sector which weighed on performance.

Global equities

Global equities, as measured by the Russell Global Large Cap Index, rose 3.8% in NZ dollar hedged terms. Markets followed increasingly divergent paths over the quarter, reflecting the widening gap between a strong US economy and the weaker economies of many other developed markets. Energy was the worst performing sector following the rapid decline in the oil price, which by the end of the year had dropped by around 50% since the June 2014 peak. Powering the slump were the booming shale-oil industry in the US, higher-than-expected production from unstable countries such as Libya, a slowing economy in China, and, in late November, the decision by OPEC countries not to cut production.

The US equity market, as measured by the Russell 1000 Index, rose 4.9% as data continued to point to an entrenched economic recovery in the United States. Non-farm payroll figures for November exceeded expectations, while third-quarter 2014 GDP was revised up to 5%, from 3.9%. The eventual timing of an interest rate rise from the US Federal Reserve (Fed) was at the forefront of investor concerns this quarter with heightened speculation that the Fed may consider more aggressive policy tightening sooner than anticipated.

European markets declined 0.5%, as measured by the Russell Eurozone Index. Good news was thin on the ground in Europe with German industrial production unexpectedly slowing and Italy's sovereign debt being downgraded. Greece was the poorest performing market as it was again thrown into turmoil following the failure of the governing New Democracy party to elect a new president in December.

The UK market rose 1.7%, as measured by the Russell UK Index. M&A activity in the telecommunications sector (BT and Vodafone) and the life insurance sector, positively influenced the market during the quarter. Returns were partly offset, however, by worries about Chinese growth and a retreat in the oil price pulling down the market's heavyweight resources sectors.

The Japanese market rose 6.6%, as measured by the Russell Japan Index. While markets were shaken by third-quarter GDP figures, which came in below estimates at -1.6%, they took heart from the victory of incumbent Prime Minister Shinzo Abe in the subsequent snap election. His reappointment, along with poor economic news, were seen as signs that the central bank would opt for an even looser monetary policy. The Bank of Japan duly obliged with a massive increase in its monetary stimulus, from 60 trillion yen to 80 trillion yen, at the end of October.

Emerging markets returned 0.3%, as measured by the Russell Emerging Markets Index. In Russia the slumping oil price, along with Western sanctions, sent stocks and the currency plunging. While declining oil prices have proved very damaging to countries that depend heavily on oil revenues, they did provide a boost to oil-importing nations such as Turkey. The Chinese market, however, defied mediocre economic indicators to rise by 5.4%, helped along by a cut in interest rates and better-than-expected export figures in September.

Fixed interest

Global fixed interest

The Barclays Global Aggregate Bond Index rose by 3.2% in NZ dollar hedged terms. Government bonds generally performed well, with corporate bonds and emerging market debt underperforming as spreads widened.

US Treasuries rose over the quarter, with the 10-year yield falling 32 basis points (bps) to 2.17%. This followed a 'flash crash' in yields in mid-October on rising concerns about the global economy and the cessation of the US quantitative easing programme. The yields on shorter-dated Treasuries, however, began to rise by the end of the period on expectations that the first rate rise would arrive by mid-2015.

Government bond yields in Europe dropped as poor economic data boosted expectations of further loosening of monetary policy by the European Central Bank (ECB), including the possible introduction of full-blown quantitative easing. Meanwhile, Greek 10-year yields spiked upwards on political worries as there was a growing possibility of a change in government after the elections in early 2015.

Investment-grade credit spreads widened by 16 bps this quarter, while the spread for high yield debt increased more significantly, with a rise of 75 bps. Yields on high yield securities were ultimately driven higher by economic worries, political fears and the sell-off in lower-rated US energy bonds (amid anxiety over increased default rates on the back of declining oil prices).

NZ fixed interest

The NZ fixed interest market rose 3.0%, as measured by the ANZ NZ Government Stock Index. The Official Cash Rate (OCR) remained unchanged at 3.50%. The Reserve Bank's statement on 11 December noted that while there has been a decline in dairy prices, domestic demand remains high and is supported by ongoing growth in consumption and construction activity. Governor Graeme Wheeler stated that some further increase in the OCR is expected to be required at a later stage.