

Stable Government and Economic Recovery

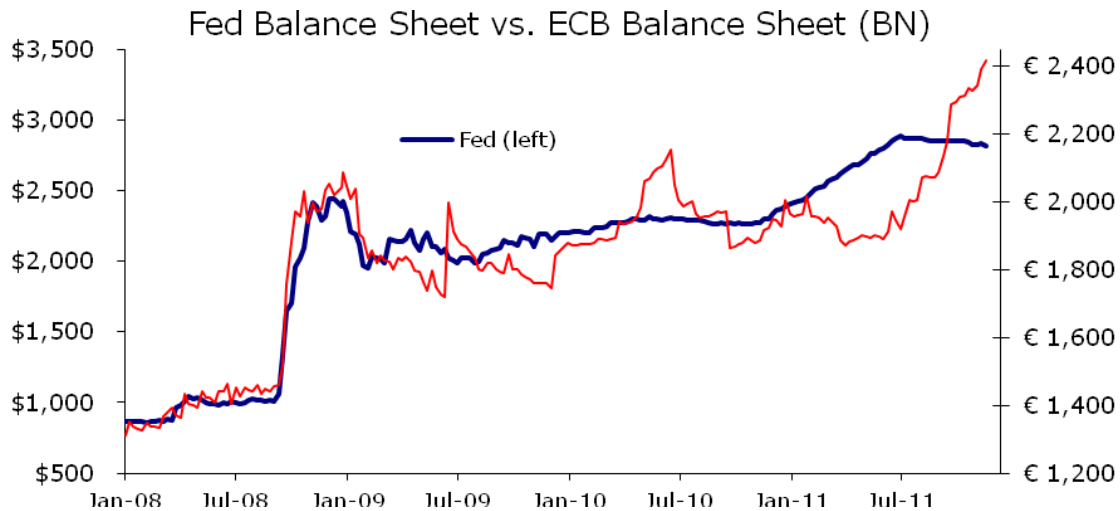
Australasian Equities Monthly Commentary

14 December 2011 | andrew@harbourasset.co.nz +64 4 460 8302

- The New Zealand equity market ended down 1.9% in November, but was one of the stronger performers globally. The NZ market out-performed Australian equities which fell 4.1% in Australian dollars. Global equities ended down 2.7% in US dollars, after rallying 3.7% on the final day of November.
- Investors remained focussed on Europe, attempting to read various reports and untangle the political mix. Visibility remained low; however, it is strongly evident that investors were bearish as to potential outcomes and any small positive steps forward were welcomed by markets. The co-ordinated Central Bank easing on the 30th of November provided another pointer toward easing liquidity concerns. Perhaps more importantly, subsequent US data (especially housing, business confidence and employment) was stronger than expected.
- The main New Zealand focus was on the General Election and the likely potential now of three further years of stable government. In addition, there were several positive economic data outcomes as well, with clear signs of an improvement in the housing sector and strong agricultural growing conditions. Telecom was split in the month, with significant trading in debutant Chorus.
- In Australia, economic outcomes were mixed and the Reserve Bank of Australia commenced an easing cycle, while the market reacted negatively to both European developments and a sense that Chinese demand was softening.
- Commodity prices gave back some of their October gains, although iron ore prices continued to rise. Against that headwind, bell-weather stocks BHP and Rio Tinto fell in the month. The banking sector also came under pressure as concerns regarding banks becoming locked out of offshore funding markets took hold.
- As we head into the New Year, equity markets seem in the near term overly bearish as to outcomes for US growth, and for a continuing muddle through in Europe. We expect domestic growth expectations may stabilise (and even improve) providing scope for better performance of equities.

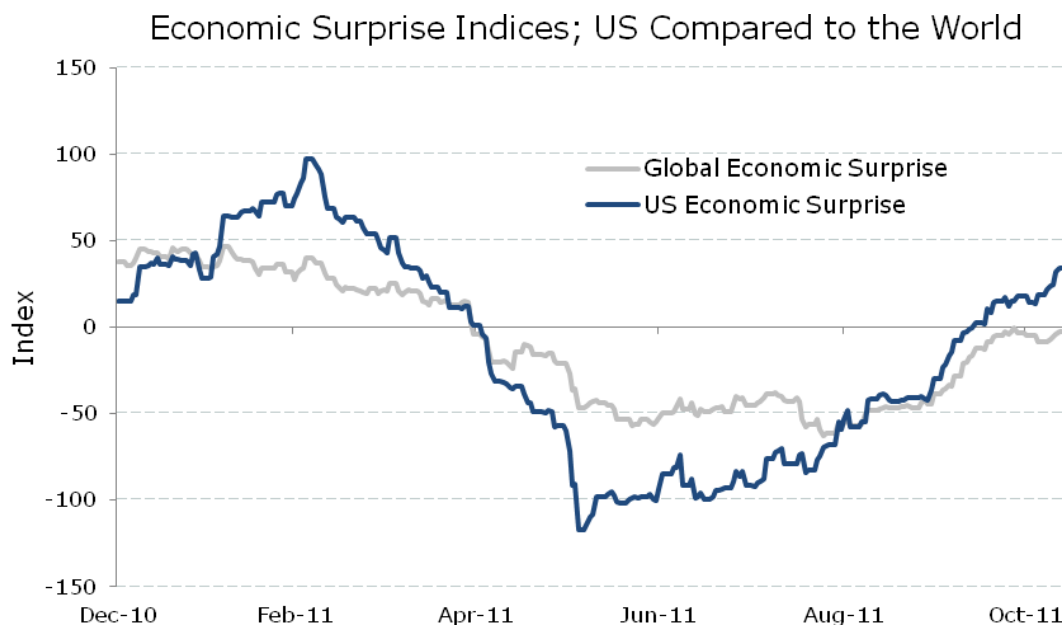
Still uncertainty – but concerted action a start

Concerted Central Bank action on the 30th of November was not a game changer. However, Europe is still slowly moving toward a 'grand plan'. Italy have announced a credible austerity plan, with yields on Italian debt falling from over 7.5% to beneath 6%. The extension of US dollar swap lines reduces the probability of a liquidity crunch as experienced in 2008. Meanwhile global markets await further announcements for a European stability "package". Despite all this waiting it is evident that despite the rhetoric suggesting little action, that the European Central Bank is expanding its balance sheet.



Source: Strategas

US business confidence, retail, employment and housing growth appears to have picked up – despite further political wrangling over the debt ceiling and in a month where European fall-out could have dented confidence. Whereas a poor European growth outcome is expected by markets, an improving US outlook seems to have provided some forward impetus to equity markets in early December.



Source: Bloomberg

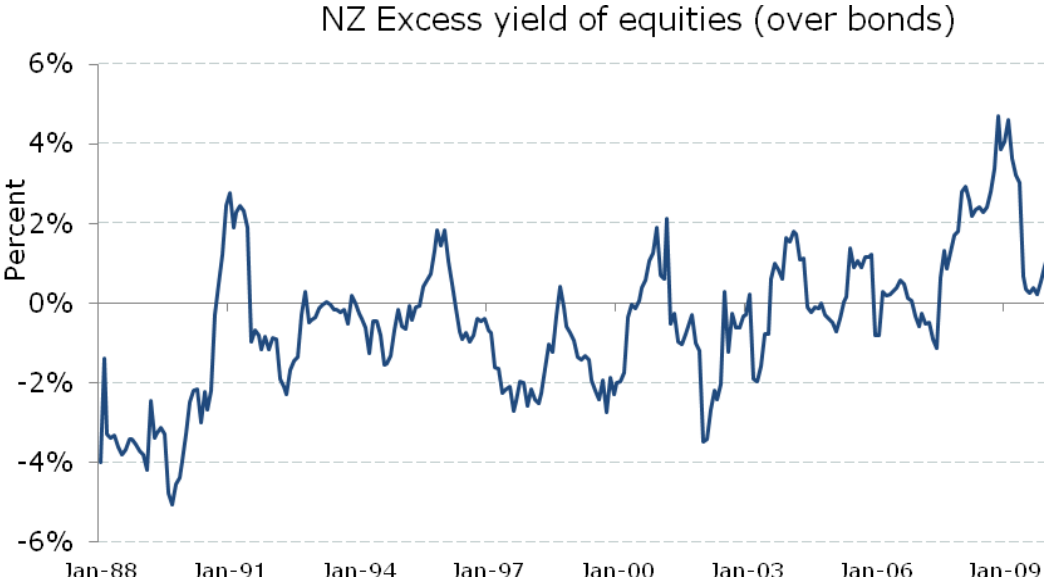
In New Zealand economic data has also remained robust. Real retail sales were up 2.2% in the 3rd quarter and residential building permits rose 11% in October. The REINZ house price index rose 3.4% in October, and the number of house sales increased significantly (up 28% on last year). Weekly mortgage approvals data is also trending up.

We think that the NZ housing market has now bottomed. Anecdotal evidence from the broader Canterbury region shows a marked lift in section sales with recent media reports of developments in Wigram, Kaiapoi, Amberley, and Pegasus Town all moving ahead. We remain over-weight Fletcher Building in the portfolio.

At the same time, there is some evidence of slippage in consumer and business confidence although both indicators are consistent with economic growth continuing through 2012. The November consensus forecasts of economic growth for the New Zealand economy edged back to 2.9% for 2012 (down 0.3% on the previous month).

Looking at the general election, it is by now clear that National will lead the Government down the pathway outlined before the election. The partial sell-down of SOEs (with market expectations highlighting Mighty River Power), further fiscal consolidation and public sector reform, are all likely to be implemented in the next six months.

Looking ahead, we feel that NZ equities remain slightly stretched relative to NZ bonds.



Source: Harbour, Bloomberg

Looking across the Tasman, we have taken profits on some higher risk Australian positions in our portfolio – including Westpac, CBA, and Rio Tinto. The portfolio now has greater diversification with positions established in TransPacific Industries (the old Waste Management) and we have added to AMP, IPL and Seek.

Meanwhile in New Zealand we have added to positions in the aged healthcare sector through a placement in Metlifecare, and we also took advantage of indiscriminate foreign index selling in Chorus shares, increasing our position to a significant overweight.

In aggregate, the portfolio has reduced 'market exposure' or beta in the month, but we remain constructive on New Zealand growth prospects, especially relative to market expectations.

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