

# Market Summary

Global stock markets recovered some of their losses for the year in the fourth quarter of 2011. Slowing global economic growth and sovereign debt worries that have hung over markets for the last six months were by no means fully resolved. However, some measures put in place by policy makers were considered to be steps in the right direction. In local currency terms, the MSCI World Index gained 7.9% for the quarter. The strength of the NZ dollar was a drag for NZ-based investors, limiting gains for unhedged investors to 5.6%.

Investors in global bonds (or those invested in conservative funds) had a solid quarter, with the JP Morgan Global Government Bond Index rising 1.5%. NZ bonds once again outperformed their global counterparts, delivering a 3.8% return.

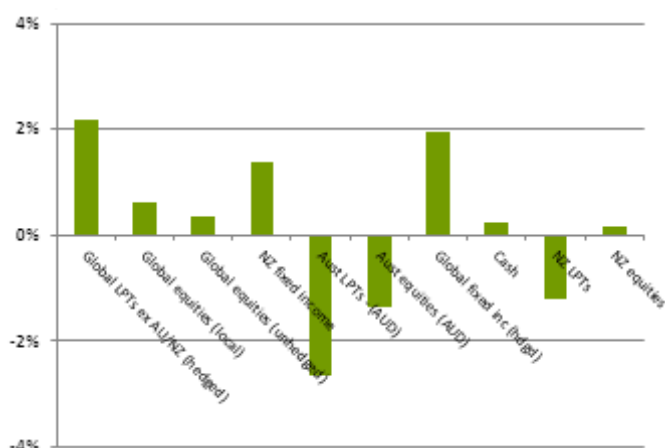
## Bonds outperform equities again....

For the fourth time in the last five years, bonds have outperformed equities on an annual basis. New Zealand Government Bonds were the star performer with the NZ Government Bond Index up 13.3%, outperforming their global counterparts. The JP Morgan Government Bond Index was up 9.0%.

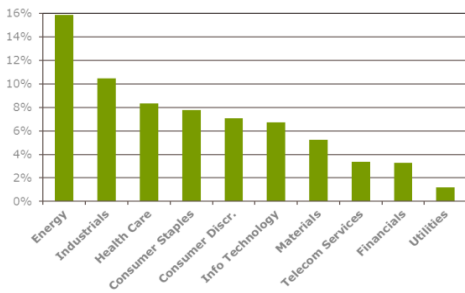
Equity markets endured a volatile twelve months, with the majority of markets around the globe finishing the year down. The US market (as represented by the S&P 500) ended up almost exactly where it started, while most European bourses were down. The MSCI World Index was down -5% in local currency terms, almost identical to the return for an unhedged NZ based investor (-4.9%). New Zealand Equities were one of the few to finish in positive territory, grinding out a 1% return for the 12 months (including imputation credits). Across the Tasman the ASX 200 fared considerably worse falling -10.5%. NZ listed property was one of the strongest performing sectors for 2011, highlighting the benefits of a stable revenue stream and high dividend payout ratios in a period of low interest rates. The New Zealand Property Index was up 11.8% for the year.

## 'Risk on' switch flicked early in the fourth quarter

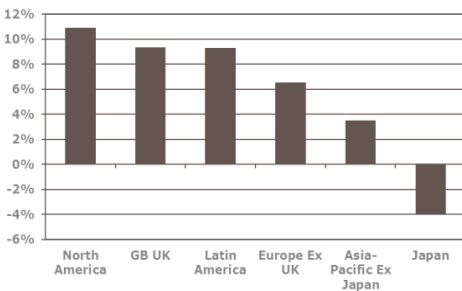
The start of the fourth quarter saw equity markets sold down due to escalating concerns around sovereign debt in Europe and signs the US economic recovery was losing steam. The negative sentiment that had pervaded the market at this time set the stage for a rally on even the slightest hint of 'good' news. That good news came early in October in the form of the promise of a large, comprehensive solution to the European sovereign debt crisis by the Group of Twenty (G20) when it met in November. Economic data in the US and China came in ahead of expectations for October. The remainder of the quarter saw equity markets



### MSCI sector returns (Q4 2011)



### MSCI regional returns (Q4 2011)



### Global yield curves (Dec 2011)

### NZ dollar performance (Q4 2011)

### Corporate earnings remain solid

Third quarter earnings reports were solid, suggesting corporates continue to do a good job in managing costs in line with their revenue. Earnings in the US and Europe were once again ahead of consensus expectations. With high cash levels and low cost of debt, corporate balance sheets remain one of the bright spots in the current capital markets landscape. Future earnings guidance, however, was of a more sombre tone, with forecast earnings gradually being lowered and guidance proving difficult in the current uncertain macro environment.

### Central banks continue to prime the liquidity pump

To date, central banks have responded to the slowing economic growth resulting from the debt overhang by ensuring ample liquidity is available for the global financial system to continue functioning. The fourth quarter saw more of the same from the UK and US central banks. The Bank of England (BOE) announced a further, larger-than-expected quantitative easing programme, and US Federal Reserve Chairman, Ben Bernanke suggested he had more monetary tools at his disposal to battle further deterioration in the US economy.

To date, the ECB has resisted calls for it to embark on unsterilised quantitative easing, fearing they will lose their inflation fighting credentials if they do so. However, in December they took a partial step in this direction when they unveiled a 3-year, long-term repo operation, which will allow European banks to borrow money for 3 years at very low rates, the hope being that some of this cheap money would be used to buy European sovereign debt.

### Political casualties from the Euro sovereign debt crisis

The leaders of Greece, Italy and Spain were replaced in the fourth quarter as the implementation of harsh austerity packages took their toll. The change in Spain was via the ballot box, but both Italy's Berlusconi and Greece's Papandreou agreed to step down to allow a unity government to form headed by an impartial technocrat.

US politics briefly took centre stage when the US congressional "super committee" failed to reach an agreement on a deficit reduction package, triggering a number of automatic spending cuts and accentuating the political gridlock that currently prevails in Washington. With 2012 being an election year, it is unlikely that the dysfunctional political environment will improve in the near future.

# House View and Asset Allocation

Asset class	Relative position	Rationale
International Equities	↓	The debt crisis in Europe has had a marked impact on consumer and business sentiment in developed markets. While EU leaders have indicated plans to implement constructive steps towards a cohesive solution it will take time to implement and increasing fiscal austerity and tighter credit conditions will lead to a recession in Europe. Meanwhile, leading economic indicators in the US have improved and are consistent with a modest expansion next year. Modest growth and strong corporate balance sheets will help companies maintain profit margins; however, we believe the risks are to the downside with analyst earnings expectations still at cyclically high levels despite an overall weaker outlook for global growth.
Domestic Equities	–	We are less optimistic on the domestic economic environment than we have been previously; with activity around the World Cup behind us and the Christchurch rebuild still some way off. This could weigh on the outlook for earnings, and although the market looks reasonable value, a valuation re-rating seems unlikely given prevailing risks.
Domestic Listed Property	–	Listed property securities will continue to benefit from a stabilisation in sector fundamentals and asset values. The outlook for rental growth has now stabilised with a slight bias to the upside. The high yields on offer also make the sector attractive; however, it is still difficult to get a clear picture on asset prices, with limited transactional activity in the market.
Global Property	–	Global REITs have strengthened their balance sheets through equity and debt capital raisings and are now better positioned to create value via a combination of managing existing portfolios while deploying and sourcing capital in a way that enhances shareholder return. Dividend yields are attractive relative to interest rates, and fundamentals are improving, albeit off a low base. However, the sector will continue to be impacted by big moves in the broader equity market.
Global Government Bonds Global Corporate Bonds	↓ ↑	On a risk-adjusted basis, government bonds are unattractive relative to cash, given the state of government finances and the yields on offer. The recent rally in global government bonds makes this sector particularly expensive; however, in an environment where economic risks are still high and cash rates remaining low, bonds are a safe haven for risk-averse investors. Ongoing turmoil in sovereign debt markets has caused credit spreads to widen, making high-grade corporate bonds more attractive relative to sovereign debt.
Domestic Government Bonds Domestic Corporate Bonds Cash	↓ ↑ –	In the current uncertain global economic environment and with near-term domestic inflation risks subsiding, we believe it is unlikely that the RBNZ will raise rates before the second half of next year. On this basis, the yield curve is relatively steep, making longer-dated fixed interest assets more attractive than cash. Domestic credit continues to offer better value than government bonds.
NZ Dollar	↑	The NZD continues to face a set of conflicting influences. Extremely easy monetary policy in the US and a policy of benign neglect towards the USD will remain as supportive factors for the NZD, as will our terms of trade. While the NZ dollar is overvalued against other major currencies and global financial distress will have a negative impact on the kiwi, policy settings in the major developed regions of the world will have a negative impact on their currencies for some time.

Key: – Neutral    ↑ Overweight    ↓ Underweight

# At a Glance as at 31<sup>st</sup> December 2011

## Indices

	Level	1-month % change	3-month % change	YTD % change	1-year % change	3-year ann. % change	52-week high	52-week low
Index close as at:	31-Dec-11	30-Nov-11	30-Sep-11	31-Dec-10	31-Dec-10	31-Dec-08		
MSCI World Index (G)	2860	0.6%	7.9%	-5.0%	-5.0%	10.0%	2741	1696
<b>ASIA PACIFIC</b>								
MSCI AC Asia ex Japan (G)	983	0.9%	3.5%	-14.6%	-14.6%	18.1%	996	541
NZSX50 (G) *	3275	0.1%	-2.1%	-1.0%	-1.0%	6.4%	3584	3055
ASX200 Accum.	30879	-1.4%	2.1%	-10.5%	-10.5%	7.6%	36618	29146
Nikkei 225	8455	0.2%	-2.8%	-17.3%	-17.3%	-1.5%	10892	8136
<b>AMERICAS</b>								
Dow Jones	12218	1.4%	12.0%	5.5%	5.5%	11.7%	12876	10404
S&P500	1258	0.9%	11.2%	0.0%	0.0%	11.7%	1371	1075
Nasdaq	2605	-0.6%	7.9%	-1.8%	-1.8%	18.2%	2888	2299
<b>EUROPE</b>								
MSCI Europe (G)	4676	1.0%	7.5%	-8.8%	-8.8%	8.0%	4802	2920
FTSE100	5572	1.2%	8.7%	-5.6%	-5.6%	7.9%	6106	4791
France CAC	3160	0.2%	6.0%	-17.0%	-17.0%	-0.6%	4170	2693
Germany DAX	5898	-3.1%	7.2%	-14.7%	-14.7%	7.0%	7600	4966
<b>PROPERTY</b>								
NZX Property (G)	2408	-1.2%	-0.4%	11.2%	11.2%	8.7%	2456	2123
Aust LPTs (G)	19068	-2.7%	3.7%	-1.5%	-1.5%	1.9%	20647	17037
Int'l LPTs (USD) (G)	510	1.0%	6.6%	-5.6%	-5.6%	16.5%	444	211

Note: returns are in local currency, except where designated capital

\* Excludes imputation credits (G) = Gross, all other indices are

## Currency

	Rate	1-month chge	YTD chge	1-year chge
AUD+	1.0255	0.0%	0.2%	0.2%
EUR+	1.2960	-3.6%	-3.0%	-3.0%
GBP+	1.5509	-1.3%	-0.5%	-0.5%
JPY+	77.0	0.7%	5.2%	5.2%
NZD+	0.7802	0.3%	0.1%	0.1%
NZD/AUD	0.7606	0.2%	-0.1%	-0.1%
NZD/GBP	0.5029	1.6%	0.6%	0.6%
NZ TWI	69.31	2.2%	0.1%	0.1%

+ vs USD (positive % represents a rise against the USD)

## Economic Data

	GDP qtr on qtr	GDP yr on yr	CPI yr on yr	Unemployment rate
US	0.5/1.8 ann.	1.50	2.15	8.50
Japan	0.40	1.50	-0.20	4.50
Germany	0.50	2.60	1.20	6.80
Euro	0.20	1.40	1.60	10.30
UK	0.50	0.50	5.31	5.00
Australia	1.00	2.50	2.20	5.30
NZ	0.80	1.90	3.20	6.60

## 10-year Bonds

	Yield	1-month chge	1-year chge
Australia	3.67%	-0.26%	-1.88%
Germany	1.83%	-0.45%	-1.13%
NZ	3.81%	-0.21%	-2.06%
UK	1.98%	-0.34%	-1.42%
US	1.88%	-0.19%	-1.42%
Japan	0.99%	-0.08%	-0.14%

## Central Bank Target Rates

	Rate
NZ	2.50%
US	0.25%
Japan	0.10%
Europe	1.00%
UK	0.50%
Australia	4.25%

Source: Bloomberg