UniSuper

January 2014

Investment market update

The Australian share market ended December close to where it started, but took a round trip to get there - at one point falling 5.5% during the month, before clawing back all of its losses. Overall, 2013 was a good year for the Australian market, climbing 15.1% (or 20.2% including dividends). As a new year begins, attention now turns to what is in store for markets this year. This month, as well as assessing the fundamentals, we draw on fields as diverse as the Eastern Zodiac, astronomy and numerology in a light-hearted look at what 2014 may hold.

PERFORMANCE OF KEY MARKETS

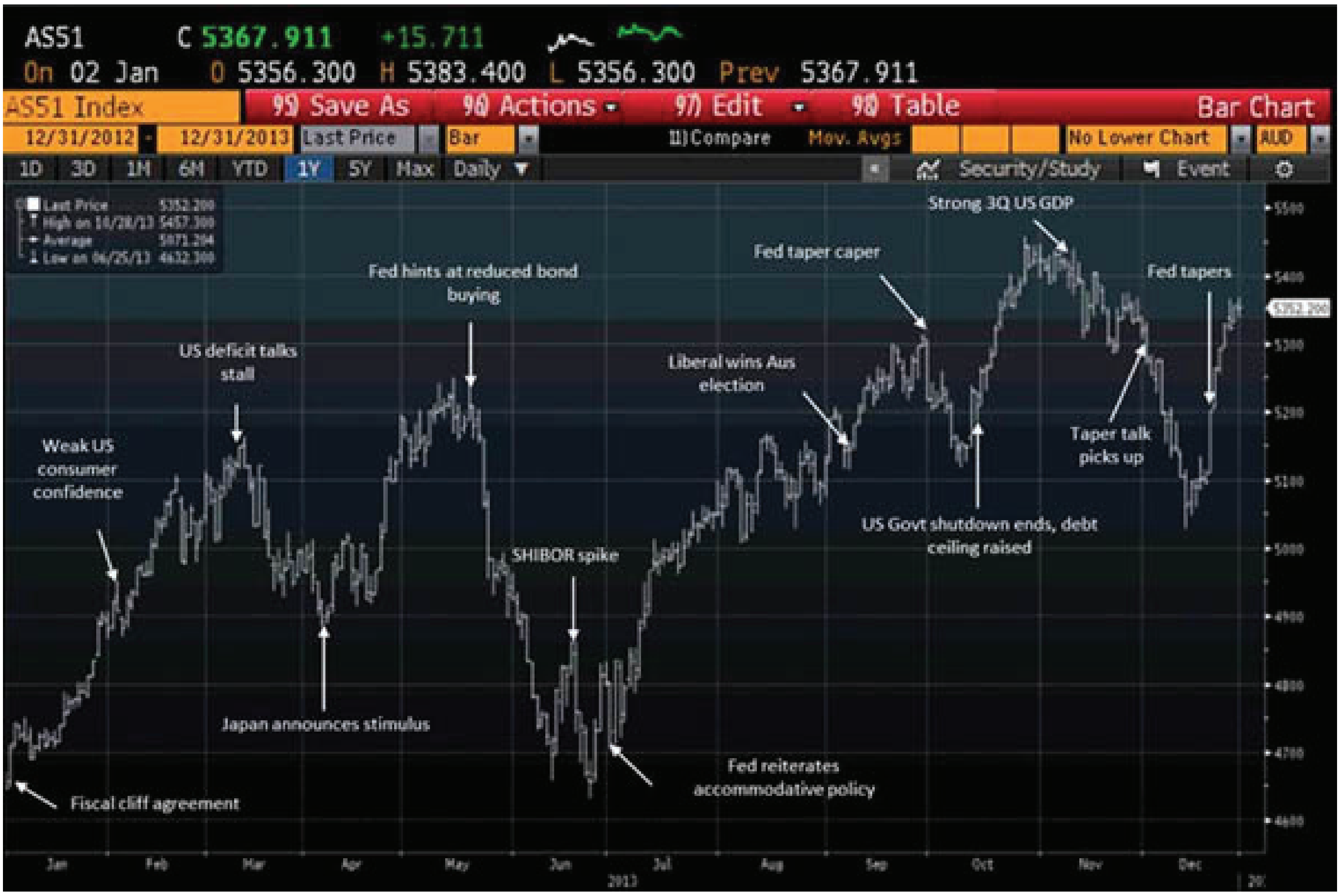
	% CHANGE				
	MONTH	FYTD	1 YEAR	3 YEARS P.A.	5 YEARS P.A.
Australian Shares (ASX 300)	0.8	14.0	19.7	8.5	12.3
US Shares (S&P 500)	2.5	16.3	32.4	16.2	17.9
Asian Shares (MSCI Asia)	-0.9	7.9	3.5	0.1	13.0
Australian Dollar (AUD/USD)	-2.1	-2.3	-13.8	-4.4	5.1
Australian Fixed Interest (UBSA Composite)	0.5	1.4	2.0	7.0	5.7
Cash (UBSA Bank Bill)	0.2	1.3	2.9	3.9	4.0
Balanced Option*	1.5	9.7	17.6	9.5	9.3

Returns are for periods to 31 December 2013. Past performance is not an indication of future performance.
* Returns relate to our Accumulation (not Pension) investment options and are published after fund taxes and investment expenses, other than account-based fees.
See performance information on all options

Looking back

Though the 0.6% gain in Australian share markets in December may look uninspiring, the round trip to get there was anything but dull. The first two weeks saw November's weakness with the market continue – at one point down 5.5% during the month – before an equally impressive rally in the second half of the month saw the market regain all its losses.

The key turning point in December was the final meeting of the year for the US Federal Reserve (the Fed). Leading up to the meeting, there was increasing anticipation that the Fed would wind down the rate of quantitative easing (tapering) rather than wait until early 2014. Though US markets were relatively resilient during this period, a number of emerging markets considered vulnerable to Fed tapering were softer. As well as further weakness in the Australian dollar (associated with offshore selling) and a number of profit downgrades, the Australian market was pushed sharply lower.



Source: Bloomberg

Once the Fed announced that they would begin winding down the purchase program, reduced uncertainty and ongoing commitment to keep rates low for an extended period helped initiate a rally. This coincided with the seasonal end of year strength that often takes place in Australia.

In other markets, the Australian dollar (AUD) continued to weaken during the month and is now near three year lows. RBA Governor Glenn Stevens continues to reinforce his desire to see the AUD lower.

Overall, 2013 was a good year for the Australian market, climbing 15.1% (20.2% including dividends). Defensive sectors were the strongest performers as low yields pushed investors into high yielding securities. Meanwhile, the resource sector performed poorly as the commodity price outlook softened.

You can see how major events shaped the Australian share market last year in the following chart. Offshore developments (particularly around political negotiations and the extent of monetary accommodation in the US) were the significant driver of market movements throughout the year.

An alternative look at what's in store for 2014

2013 proved a fruitful year for investors, with key global share market indices producing positive results. The Australian share market in particular, delivered a 20% return to investors over the year. As a new year begins, attentions now turn to what is in store for markets in 2014, with a range of market pundits assessing the economic fundamentals and generating return forecasts.

Before checking on the fundamentals, let's take a light-hearted look at the predictive power of 'alternative variables' that may appeal to some of our more superstitious members. We draw from a wide range of interesting thoughts from the Eastern Zodiac, astronomy, numerology and even the sporting calendar as well as contributions to society through the Australian of the Year award.

The market bulls should be encouraged by the following stats:

- A defining astronomical event in 2014 will be the return of Comet Holmes. Initially discovered in 1892, but seemingly "lost" for more than 50 years after 1906, Comet Holmes has been seen every seven years since 1964. Seeing Comet Holmes has historically meant a strong year for Australian share markets. Going back to 1900 shows that Australian equity markets averaging a total return of 25.9% in the years that Comet Holmes has been seen compared to just 10.9% in other years.

- Others may think Australian society places too much recognition of sporting stars and too little attention to artists, academics and humanitarians, but it looks like financial markets favour sports people as well. Going back to 1961, Australian equity markets have returned 20.3% in years that the Australian of the Year has been a sportsperson. At least financial markets have a good sense of gender equality however. Australian markets return 15.1% when at least one of the winners has been a female.
- The 2013 Melbourne Cup was won by the favourite, Fiorente. Again going back to 1900, when the favourite won the Melbourne Cup, the following year the Australian share market has returned 17.2% on average. This is more than 6% higher than when the "race that stops a nation" has been won by a non-favourite.

On the other hand, the market bears could point to the following:

- Starting on 31 January is the Year of the Horse in the Chinese Zodiac. Should we expect to see markets exhibit optimism? Will good fortune soon be on the way? Unfortunately history tells us this is unlikely. Annual data going back to 1900 shows that Australian equity markets have averaged a total return of only 3.3% in "Horse" years. This is the weakest of all of the Zodiac years and compares to an average of 12.7% in "non-Horse" years. On this basis, investors may need to wait until 2015 before the market accelerates again. 2015 will be the Year of the Goat. "Goat" years have averaged 21.4% over the last 112 years, the second highest returning year across the zodiac.
- For those with an interest in numerology, 2014 does not look like a good year for returns. The individual numbers of 2014 (2+0+1+4) equal 7. Though Number 7 years are often considered to be exciting, historical analysis of stock market returns is less so. From 1900, Number 7 years have returned 9.8% per year, which is less than the 12.2% return of other years.
- Again turning to Chinese culture, the number four is considered bad luck as are longer numbers that end in four. Since 1900, years ending in four have returned just 7.1% per year, which is more than 5% less than the 12.5% return of other years.

BE WARY OF MARKET PREDICTIONS

At UniSuper we are very sceptical of any attempt to predict where the share market will end up in 2014 because the future is inherently unpredictable. The best we can do is look at whether conditions are favourable or unfavourable for further gains in the market. And when considering conditions, you'll be pleased to note that we prefer to steer away from astrology, numerology, or other mystical pointers and focus on economic fundamentals and financial conditions. There seems to be little doubt that the global economy continues to steadily creep back to something approaching (but not quite reaching) trend growth. While the Australian economy is lacklustre at best, a recession remains a low probability. However, as is invariably the case, it will be financial conditions, rather than economic fundamentals, that will drive markets in the short term. The three key financial conditions we focus on are as follows:

Valuation: Given the strong rally we have seen over the past year, share markets are no longer cheap relative to historical valuations. The Australian market is trading on a P/E of 15.0, which is slightly above its long term average of 14.1. However, relative to bonds and cash, shares still look attractively priced. On balance, valuation looks to be "neutral to positive" for shares.

Liquidity: Interest rates remain at historical lows and the global economy is still being flooded with liquidity. This factor remains a clear positive for shares.

Sentiment: Sir John Templeton (a great investor) once said 'bull markets are born on pessimism, climb on scepticism, mature on optimism, and die of euphoria.' Gauging sentiment is a very subjective exercise, although there is little doubt that sentiment is far more positive today than it was 18 months ago. While some would argue that we are now starting to be over-optimistic, we are clearly a long way from the euphoric days before the GFC. We would therefore rate current sentiment as a "neutral" influence on the markets over the short term.

THE VERDICT

Conditions are in place to see further rises in equity markets during 2014, largely due to the abundance of liquidity and relative valuation of equity markets compared to cash and bonds. However, given more expensive valuations, the chances of a repeat performance of the past couple of years are considered low. This is not a prediction, or advice, but rather a simple summary of our outlook based on the balance of probabilities. Then again, in the words of T.S Eliot, 'there will be time for decisions, and revisions, which a minute will reverse.'

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