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How have investment markets performed?

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Investment commentary

Australian shares

The Australian sharemarket performed strongly in the year to 31 December 2006. The S&P/ASX 300 Accumulation Index closed at a record high, having posted a gain of 24.5% for the year. The market sustained its lengthy record-breaking run from 2005 until May 2006, when fears of rising inflation and interest rates and slower US economic growth caused a sell-off on equity markets around the world. This lasted until mid-June, when prices started to recover, and the market rallied strongly from September to the end of the year. There was a dramatic increase in merger and acquisition activity towards the end of the year, led by international and local private equity funds. These funds, which have had large capital raisings from enthusiastic investors, appear in many cases to be desperately chasing target companies for investment. This has led to privatisations and partial buyouts of listed companies all over the world. Many companies at this point in the economic and investment cycle are finding it difficult to lift earnings per share from normal business activities and some are looking to mergers and acquisitions as the solution. There has been a flurry of activity as media players jockey for control of assets after the recent deregulation of the industry. Time will tell if the prices paid, at what may be peak of the earnings cycle, for some of these assets are too high. Market sentiment is high, however, and the amount of liquidity in Australia and around the world means expensive merger and acquisition activity may well continue.

International shares

International sharemarkets performed well for the 12 months to 31 December 2006, despite a dip around the middle of the year. The global benchmark, the Morgan Stanley Capital (excluding Australia) Accumulation Index (MSCI), returned 19.8% in US dollar terms, but as the Australian dollar appreciated by 7.4% against the US dollar over the year, the return from the global equity benchmark fell to 11.5% in Australian dollars. As with the Australian market, global markets were strongly influenced by the large increase in merger and acquisition activity, particularly over the past few months. Emerging markets performed strongly until May, when they suffered a substantial correction, but recovered to post a return of 7.9% in Australian dollars for the year.

Listed property trusts

In the 12 months to 31 December 2006 the S&P/ASX 300 Property Trust Accumulation Index returned 34.1%, which was above the broader sharemarket return of 24.5%. Australian property trusts have benefited from a move by investors towards defensive sectors and from the globalisation of listed property securities, which has encouraged buying by offshore managers. This trend is likely to continue this year.

Direct property

Australia's major office markets experienced buoyant conditions in 2006 as businesses expanded, taking up space and pushing up rents. In the retail sector, sales growth improved late in the year, supporting moderate rental growth in shopping centres. Demand has been patchy in the industrial sector, particularly in NSW, but there has been plenty of development activity as logistics firms move to take advantage of new motorways. Growth in capital values has been strong, reflecting high investor demand and firming yields.

Fixed interest securities

Australian 3- and 10-year bonds rose 94 and 68 basis points respectively in 2006 to end the year at 6.11% and 5.88%. The weaker performance at the front end of the curve reflects the fact that the Reserve Bank of Australia lifted cash rates by 75 basis points over the year. The Australian economy went through a soft patch in the March quarter, but it was short-lived. Economic data strengthened in the June and September quarters as inflation and employment data picked up. As measured by the UBS Warburg Composite Bond Index, the Australian market returned 3.14%. The return on cash investments was 6.02%, as measured by the UBS Warburg Bank Bill Index. The US economy showed clear signs of slowing in the second half of 2006. Oil prices fell from a record high of US$77 to US$60 by early October, and markets began to factor in an easing of inflation. The upshot was that the Federal Reserve held interest rates steady after 21 consecutive rises. Over the year the US 10-year bond rose 29 basis points to finish at 4.68%.

Investment market returns

How investment markets have performed annually over the past 5 years (to 31 December)

	Shares			Fixed interest		
Year	Australian %	International (Unhedged) %	Listed property trusts %	Australian %	International (Hedged) %	Cash %
2002	–8.64	–27.44	11.85	8.81	11.57	4.77
2003	14.96	–0.76	8.81	3.05	6.59	4.90
2004	27.92	9.94	32.18	6.96	8.92	5.62
2005	22.45	16.83	12.14	5.88	6.62	5.74
2006	24.51	11.54	34.05	3.14	4.41	6.02

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