



Monthly Newsletter - April 2014

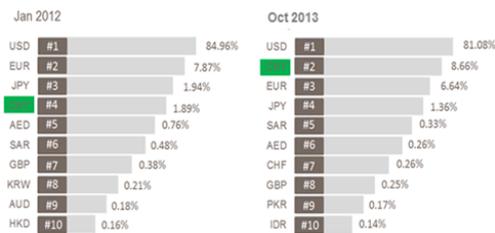
THE RISE OF THE REDBACK

China has continued its drive to internationalize the Yuan (coined the “Redback”) by signing their latest Currency Agreement with New Zealand, allowing direct trading between the two countries. Its Chinas 23rd bilateral currency agreement since signing their first with South Korea in 2008. The agreements create an important “backup plan” for China and its trading partners in the event of a liquidity crisis which eventually led to the Global Financial Crisis. It also serves as a political statement to the rest of the world that China intends to maintain its calls for the world’s financial system to be “De-Americanized”. Initially its stance merely calls for less reliance on the US dollar in all trade aspects and although not directly implied, but expected by most, the real end-game is for the Yuan to overtake the greenback as the World’s Reserve Currency. But how close are they?



There is no doubt the Yuan has increased its significance as a global currency but when you draw comparisons against the greenback it has a **long way to go before it can erode US dominance, especially in terms of trade finance**. According to the Society of Worldwide Interbank Financial Telecommunication (SWIFT), the Yuan is now the second most used currency in trade finance making up 8.66% whilst the US continues its dominance at **81.08%**. Last month the Yuan surpassed the Swiss Franc to become the 7th largest world payment currency at 1.39%, a small percentage in comparison to the EUR and US who makes up 33.51% and 38.75% respectively.

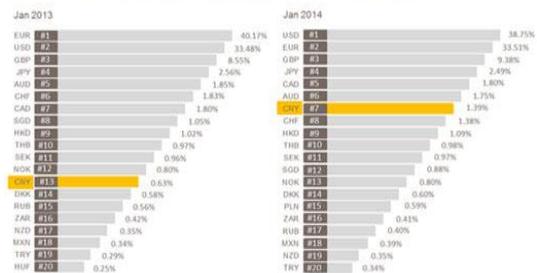
RMB as world trade finance currency in value



Source: SWIFT Watch

RMB as world payments currency in value

Customer initiated and institutional payments. Inbound + Outbound traffic. Based on value.



While the title of the world's reserve currency remains elusive for the time for the developing nation it will play a much more prominent role as the government continues its reform of the financial market. What we can expect in Australian financial markets is the continuation of volatility as reform works itself through the Chinese financial system. We are already experiencing this volatility due to concerns in areas and their perceived risk from flow on effects including;

- Shadow Banking
- Local Government Debt and
- Bond Defaults

In particular there have been two recent bond defaults which we consider "noise" purely because the Chinese Government has made it very clear such defaults will be allowed to occur, that is, **unless it's likely to cause systematic risk to the broader economy**. In effect defaults of such nature won't necessarily be perceived as bad news; instead the market will look beyond the problem and focus **on the solution** which is all 'part n parcel' of its financial reform.

The consistent weak data emerging from China are the side effects created by the deliberate strategic transition from investment and export driven growth to growth through domestic consumption. In judging forthcoming volatility the doubt placed on China to reach its 7.5% growth target is not nearly as important as the solution the market is looking for, being stimulus from the world's second largest economy. The downside risk remains in the delay of commitment to stimulus if the weak data continues and the markets concern for a slower growth rate is heightened. In this scenario market weakness is inevitable but in our view limited given the governments persistence in reassuring markets the Chinese government has capability and confidence in achieving its target. Truth be told, the majority of market participants would prefer to see action rather than trust the words of a government who they constantly battle for greater transparency in its financial data and so it is in part for this reason, until words are put into action we can expect the volatility to continue.

LOCAL CURRENCY

The Australian dollar remains persistently high adverse to the perceived preference of the RBA to assist in rebalancing the economy. There are many factors contributing to the high Australian dollar that lead us to believe it will continue to persist for a good period of time. These include;

- The Governments message to the rest of the world that "Australia is open for business"
- The RBA's indication interest rates will be on hold for a long period of time (versus market expectations of a lower rate previously)
- The RBA's optimism over the state of Australian economy.
- Hopes over China Stimulus to spur demand for exports (commodities in particular)

Naturally, companies that export and/or generate revenue overseas will feel pressure from the persistent high dollar, but companies that compete against imported goods will find it equally challenging. The high dollar has already been priced into companies, specifically a number of health care stocks that have experienced significant gains to date such as CSL Limited and Ramsay Health Care. In the immediate term we believe the high Australian Dollar will continue to hinder the upward progression of the XJO until the market is met with a significant catalyst which may very well emerge

from weaker data from China, or a breakout the from unexceptional data we are experiencing from the US and Europe.

Performance of Key Indices

Equities	Close	Change (M)	Change % (M)
All Ordinaries	5403	-12.4	-0.23%
S&P/ASX200	5394.8	-10	-0.19%
Dow Jones (US)	16457.66	+153.9	+0.94%
NASDAQ	4198.99	-132.58	-3.06%
S&P500	1872.34	+13.31	+0.72%
FTSE 100 Index	6598.37	-217.4	-3.19%
Nikkei 225 (Japan)	14827.83	-13.24	-0.09%
10-year bond rate (US)	2.72%	+0.0367%	+1.37%

Upcoming RBA Events

Reserve Bank Board Meeting – 1st April

Glenn Stevens addresses the American Chamber of Commerce Australia in Brisbane – 3rd April

Minutes of the RBA meeting – 15th April

ABS releases March

Job Vacancies -2nd April

Building Approvals – 2nd April

Retail Trade (February) – 3rd April

International Trade in Goods and Services (February) – 3rd April

Housing Finance (February) – 9th April

Labour Force (March) – 10th April

Lending Finance (February) – 11th April

Consumer Price Index (March) – 23rd April

Upcoming US Economic Releases

ISM Manufacturing Index – 1st April

International Trade – 3rd April

US Employment Situation (March) – 4th April

FOMC minutes (March) – 9th April

Retail Sales – 14th April

Consumer Price Index – 15th April

Housing Starts – 16th April

Industrial Production – 16th April

Durable Goods Orders– 24th April

GDP – 30th April

FOMC Meeting Announcement – 30th April

Jobless Claims – Weekly Basis

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