



The KFM Investment Committee met this week, and the following summarises our view of the markets over the next six months.

Market Outlook (for next 6 months)

	Current Measure	KFM view Last month	KFM view Current
PNG Macro Environment			
Real GDP Growth Source: National Budget for 2013	6.1%		
Inflation (trailing 12 mth) As at March 2013	3.20%		
PGK/AUD	0.4514		
PGK/USD	0.3962		
PNG Cash & Fixed Income			
28 Days CBills	1.83%		
180 Days TBills	2.53%		
5Year GIS	8.01%		
10 Year GIS	9.17%		
PNG Equities			
KSI index	3,870		
KSHI index	8,216		
Global Macro Environment			
Implied World Growth (Reuters Breaking Views)	3.6%		
International Cash & Fixed Income			
US 10Y Bond	2.82%		
International Equities			
MSCI ACWI	US \$180		
Commodities			
Oil (WTI)	US \$94		
Gold	US \$1,252		

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Senior Risk Officer

PNG Macro Environment

KFM maintains the view that medium term economic growth will be slow, as government infrastructure spending fails to compensate for falling private sector demand and investment. Sluggish local demand, completion of the construction phase of the PNG LNG project and inefficiencies in implementing government spending programs will all contribute to reduce economic activity. We believe inflation will increase over 2014 towards 5% - 6%, in particular following the 2013 depreciation of the PNG Kina. We believe the PNG Kina will depreciate in H1 2014, but only marginally against USD.

PNG Cash & Fixed Income

Deposit rates offered by banks continue to be stubbornly low, as excess liquidity continues. However, interest rates for State securities have increased at both the short and long end of the yield curve. We expect short term rates to increase marginally over H1 2014, but to not reach the BPNG KFR of 6.25%. In 2014, if economic activity and credit demand remain sluggish, BPNG may relax the statutory deposit requirements currently in place. *We still believe that the most likely scenario for longer dated securities is that interest rates will stabilise around current levels, following an increase in rates in late 2013 due to increased issuance to finance the budget deficit. We believe these rates are attractive rates for long term investors, especially compared to our long term inflation forecast.*

PNG Equities

We repeat last month's comment that "KFM believe that local share prices should be flat for the next half year, notwithstanding the lack of liquidity and hence potential for drawdown if sellers emerge." Lack of liquidity remains an issue, but dividend yields in excess of bank deposit rates continue to support share prices.

Global Macro Environment

We are increasingly confident that US economic activity is improving, and will have a positive impact on confidence, and on the (official) unemployment rate. That should allow The Fed to reduce QE stimulus further, and be largely complete by mid 2014. Evidence is emerging of some pick-up in activity in Europe and China, and by 2014 should be confirmed. We believe this will also help activity in emerging markets.

International Cash & Fixed Income

We still believe the Fed Funds rate should be effectively zero for a prolonged period. We expect the US Federal Reserve to reduce Quantitative Easing (QE) by year-end, with little impact on markets which have factored in an end to QE stimulus.

International Equities

KFM believes US equities appear fully priced, and subject to volatility as share prices have rallied so strongly through the past year. KFM have believed for several months that US equities in particular appear fully valued, but recent confirmation of improving economic conditions will most likely continue to support prices. Whilst emerging market equities have underperformed in 2014, we expect this to change in 2014 as global growth should support emerging markets also.

Commodities

KFM still expect oil prices to stay around current levels, and for gold prices to continue to decline through H1 2014.

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