

April 2009

# Market Watch

## Economic commentary

Australia's latest inflation rate was released over April. The headline Consumer Price Index (CPI) increased by just 0.1% in the March quarter 2009. This took the annual rate of inflation to 2.5% for the 12 months to March, down from 3.7% in the year to December 2008. This means that Australia's headline inflation rate is right back into the middle of the Reserve Bank of Australia (RBA) 2%-3% target range, the first time it has been inside the range since late 2007.

While the headline inflation rate fell, thanks to falls in petrol prices, travel costs and interest rates, it should be noted that underlying inflation remained stubbornly high, rising 1.1% over the March quarter. This saw the annual rate of underlying inflation ease only marginally, to 4.2% from 4.4%. As the economy remains weak, both headline and underlying inflation is expected to ease further over coming quarters.

Unemployment figures deteriorated further over the month, with the unemployment rate rising to 5.7% in March, up from 5.2% in February. A total of 34,700 jobs were lost over March, with the number of full-time jobs falling 38,900 and part-time rising 4,200. The unemployment rate is the highest since February 2004 and well up from the low of 3.9% in February 2008.

The International Monetary Fund (IMF) released updated forecasts for global economic growth. The IMF now believes the global economy is set to contract -1.3% in 2009 before recovering to 1.9% in 2010. This was down from estimates in March of between -1.0% and -0.5%. The advanced economies are expected to 'grow' at -3.8% in 2009 before achieving flat growth in 2010. Emerging economies are still expected to grow, with a forecast of 1.6% growth in 2009 and 4.0% in 2010. The forecast for Australia was -1.4% in 2009.

The \$A rose in April as some optimism remained in markets. The \$A was up 5.2% from US 69.27 cents at the start of the month to US 72.87 cents by month end.

The \$A bought 0.4932 UK pounds at the end of April, 55.17 euro and 1.2866 NZ dollars.

## Australian shares

The Australian sharemarket continued its rally over April, the first back to back monthly gain since April and May 2008. The S&P/ASX 200 Accumulation index rose 5.6% in April but is still down 28.8% over 12 months. The index finished the month at a 2009 high and is up 20.5% from its low on 6 March 2009.

While economic conditions remain tough globally, a number of 'green shoots' buoyed sharemarkets over April. Some better than expected new and existing house sale data out of the US, an improvement in confidence data globally and a pickup in new orders in the US and China assisted the gains.

Some key and concrete policy measures from the G20 meeting in April helped set the tone for the month. An increase in financial commitment totalling \$US 1.1 trillion was announced to help restore credit, growth and jobs in the world economy, including an increase in funding for the International Monetary Fund (IMF). Other commitments were around ensuring sustained fiscal efforts to promote jobs and to maintain expansionary monetary policies for as long as needed, including unconventional policies, consistent with price stability. A commitment to ensuring the flow of credit and the soundness of key institutions was also well received.

In April millions of Australians began receiving cash handouts from the Federal Government. The aim is to boost consumption to help in the economic recovery. The RBA also cut rates by 25 basis points to 3.00%. In response the consumer staples sector (+11.9%) and consumer discretionary sector (+11.7%) were the top performers over the month. Among the better performers were Pacific Brands (+185.7%), Lion Nathan (+45.2% on a takeover offer) and Billabong International (+23.5%).

There was a lift in takeover activity over April, especially from offshore. This could be a signal of attractive valuations and optimism. Lion Nathan received a takeover offer from Japanese food and beverage maker, Kirin. There has also been a takeover activity in the resources sector, helping the sector rise 4.7% over April. Gains in commodity prices also helped as better economic news out of China was digested.

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Late in the month both National Australia Bank and Australia and New Zealand Banking Group reported profit results. Both results indicated the deteriorating economic environment, with bad debts rising and expected to continue to rise over the next 12 months. Compared to the US, the Australian banking system remains in good shape with profits being made, rather than losses recorded. All the major banks rose over the month, with the financials ex REIT sector up 3.6%, but the sector was the bottom performer over the month.

Among the sectors, Industrials (+7.7%) was among the top performers, after good gains in March on improved sentiment. Within the top 20 companies, Macquarie Group (+23.8%) was the best performer on some better news flow out of US banks, while Newcrest Mining (-8.5%) fell on improved risk appetite and lower demand for the defensive gold sector.

The tone has shifted in sharemarkets. While there is an understanding of the bad economic news still to come, sharemarkets are looking through the immediate period of weakness to a time of recovery. Some relatively more positive economic indicators helped the situation, but caution is needed. Further volatility may arise as unemployment rates worsen, profit remains constrained and confidence is lost. Nevertheless there has been an unprecedented level of policy response with Australia at the forefront of stimulus given the better economic position we entered the recession in. This should put us in a better position when the global economy recovers.

## Global shares

The major global equity markets continued to rise in April, following some concrete policy announcements to help improve finance and economic conditions and signs the unprecedented policy response was starting to work. Gains were particularly strong in Europe and Asia.

The MSCI World index, a broad measure of global shares, rose 10.9% in \$US and was up 5.4% when measured in \$A. The \$A rose 5.2% against the \$US in April. Over 12 months, global shares were down 40.8% in \$US terms and have fallen 23.4% in \$A terms.

US economic growth figures were released with the US economy contracting at an annualised rate of -6.1% over the March quarter. While this was barely changed from -6.3% in the December quarter, markets were buoyed by the slower fall in inventory levels (which will need to be reversed at some stage) and some signs that the economy may be turning the corner. The US is also dealing with the stress testing of its banking system to ensure enough capital is held. If banks fail the stress test they will have six months to raise additional capital. If they can't do this, the government will provide the capital but will likely attach a number of conditions to the funding.

The Dow Jones Industrial Average was up 7.4%, the S&P 500 rose 9.4% and the NASDAQ was up 12.4%. Since its bottom on 9<sup>th</sup> March, the Dow has rallied 19.0% to the end of April.

Asian markets were stronger in April with some signs of better economic data out of China and to some degree in Japan. The Nikkei index rose 8.9%, while Hong Kong was up 14.3% and Singapore rose 13.0%. The Chinese sharemarket rose 0.9% after strong gains the previous month. March quarter economic growth figures were released with the Chinese economy growing 6.1% in the 12 months to March 2009, down from 6.8% for the 12 months to December 2008 and its peak of 12.6% in June 2007.

European markets were strong. The ECB cut interest rates by 0.25 percentage points to 1.25%, although stopped short of announcing quantitative easing measures. Germany (+16.8%), France (+12.6%) and Italy (+18.6%) rose, while the FTSE 100 Index in the UK ended the month 8.1% higher.

Emerging markets were stronger in April, with the MSCI Emerging Markets price index up 16.3% in \$US and 10.5% in \$A. Eastern European countries rose strongly, despite ongoing debt concerns with Russia (+21.0%), Poland (+20.7%) and Hungary (+16.3%) all up with the G20 announcements helping.

## Fixed interest

With the global economy to face the worst recession since World War II in 2009, this has implications for the debt position of governments around the world.

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In Australia, this will mean the first budget deficit in Australia in 2008/09 since 2001/02, when the Budget is released on May 12. This will mean a large increase in the government's borrowing program with the number of Commonwealth Securities on issue rising significantly. As result bond yields in Australia are expected to rise over coming months.

The Reserve Bank of Australia (RBA) cut official interest rates by 25 basis points over April to 3.00%. In making the cut, the RBA noted that there was scope for further moderation in interest rates. However there has been a significant boost to domestic demand as result of the stance of monetary policy and the substantial fiscal initiatives.

Internationally, central banks continue to lower interest rates to help economic growth recover and to improve the functioning of financial markets. The European Central Bank cut interest rates 25 basis points to 1.25%. The Bank of Canada cut by 25 basis points to 0.25% and Reserve Bank of New Zealand lowered rates by 50 basis points to 2.50%. The US Federal Reserve left interest rates on hold (at near zero) but noted that while the economy continues to contract, the pace of contraction has slowed and the outlook has improved.

Globally, 10-year bond yields rose over the month as the supply of government bonds to come onto the market forced yields higher. In the US, 10-year bonds rose from 2.66% at the end of March to 3.12% at the end of April, despite the implementation of quantitative easing. Elsewhere, 10 year bond yields stand at 3.50% in the UK, in Japan 1.43% and in Europe 3.18%.

At the end of April, 10-year Australian government bond yields stood at 4.57%, up from 4.42% at the end of March. Ninety day bank bills were 3.08% at the end of April, down from 3.14% at the end of March.

The UBS Australian Composite Bond index returned a flat return in April for a return of 12.76% over the past 12 months.

## Listed property

The listed property sector continued to show signs of stabilisation, finishing the month up 6.1%. Out of the 16 stocks in the index, only one fell in April. The sector has fallen 56.9% over 12 months.

The pace of capital raisings slowed in April although there it is likely there will be additional raisings over coming months. Some REITs downgraded profit forecasts and altered distribution payments. REITs are busy reducing debt levels and increasing capital levels to provide a buffer as property values fall. Signs of optimism returned with improved functionality of credit markets.

Global property markets rose sharply in April although major markets were mixed. Markets in Europe and the US performed well with the general lift in optimism. Asian markets were weaker after a positive March. The UBS Global Investors Index (Net TR) \$A rose 19.3% in the month to be 51.6% lower over 12 months.