

February 2009

Market Watch

Economic commentary

Making news over February was a number of government spending packages. The Australian government announced a large plan worth A\$42 billion over four years. Around A\$12 billion will be spent on cash handouts to provide an immediate boost to economic growth and around A\$28 billion will be spent on infrastructure projects over the coming years.

In order to fund the additional spending, the Federal Government will move the budget into deficit in 2008/09 and each year out until 2011/12. This also means the government will need to raise an additional A\$24 billion of debt this year and a total of A\$118 billion over the next four years.

Monthly retail sales figures saw a jump in December, thanks to the first round of government cash handouts distributed in early December. Retail sales rose 3.8% over December to be 5.6% over 12 months, up from 2.0% for the 12 months to November 2008.

In the US, further measures were announced to support the financial market and economic growth. President Obama outlined a US\$2 trillion Financial Stability Plan to improve conditions in financial markets. US\$1 trillion will be spent buying illiquid assets off bank balance sheets, with the remainder spent on further capital injections and initiatives to encourage lending to consumers and businesses.

President Obama also outlined a plan to stem mortgage foreclosures. The aim is to reduce the number of houses put up for sale and to cushion further falls in house prices, which are down over 19%. President Obama also released his budget, indicating a possible deficit of US\$1.75 trillion over the 2009 financial year and net borrowing of US\$2.6 trillion.

The A\$ rose over February. It was up 1.1% from US 63.81 cents at the start of the month to US 64.48 cents by month end.

The A\$ bought 0.4494 UK pounds at the end of February, 0.5060 euro and 1.2811 NZ dollars.

Australian shares

The Australian sharemarket continued its new year trend in February, ending the month lower. Profit reporting season, the global economic slowdown and further concerns in the international banking system saw the sharemarket retreat. The All Ordinaries index fell 5.2% to be down 41.9% over 12 months.

On 25 February, the All Ordinaries index reached its second new low of 2009 at 3281. The previous low was recorded on 23 January at 3,300. Fears over bank nationalisations in the US, possible bank collapses in Europe, the Australian economic outlook and domestic profit results saw the new low reached. On the first day of March the All Ordinaries index reached another new low of 3,203.

Growing concerns over the government takeover of some large US banks saw markets rattled in February. After sharp falls in share prices, concerns were raised over the need for more capital injections in Citigroup and possible nationalisation by the US government. Following the large falls, US Federal Chairman Ben Bernanke suggested nationalisation was a last resort plan. Instead a stress test of US banks will be conducted to ensure they can cope with a worst case scenario for economic growth.

This statement calmed markets slightly and saw a late month rally in financial stocks. In Australia the financials sector ex property fell 3.1% in February. Commonwealth Bank of Australia reported better than expected profits, albeit first-half profit fell 16% on high bad debt provisions. Commonwealth Bank, Westpac and ANZ finished the month higher. ANZ gained despite announcing a cut to its dividends. The sector was weighed down by Macquarie Bank (-34.7%) following a profit downgrade and AXA Asia Pacific (-34.9%) based on a disappointing profit result.

Making news in Australia over the month was profit reporting season. Some companies announced gains in profits, including CSL, JB Hi-Fi, WorleyParsons, Coca-Cola Amatil, Cochlear and Sonic Health Care. A weaker Australian dollar benefited CSL, Cochlear and Sonic Health Care, as did ongoing demand for healthcare. JB Hi-Fi, Coca-Cola Amatil and WorleyParsons were assisted by strong demand for their products and services.

Some companies reported falls in profits. Perpetual and AMP suffered from investment losses and lower investor demand for their products in the face of volatile markets. Qantas suffered from high oil prices and reduced demand for travel given slower economic conditions. Boral and James Hardie suffered from the weak US housing sector. All these stocks ended the month lower.

Among the sectors, consumer staples (-0.1%) and energy (+2.7%) were the better performers in a tough market. The Industrial sector (-21.2%) was the worst performer, weighed down by some poor profit results and concerns about the outlook for profits in a tough economic environment. Asciano Group (-60.1%), Qantas (-36.1%) and Brambles (-32.1%) weighed the sector down.

The sharemarket is re-adjusting to a difficult economic outlook in the first-half of 2009. Economic conditions are tough and further bad news is expected over coming months especially in relation to employment. Investors are also digesting the ongoing fallout in the international financial system and this could create further volatility.

Some companies have shown some resilience with positive profit results while others are raising capital and reducing dividends to prepare for the tough times ahead. Companies that can demonstrate sustainable earnings, stable cash flows and quality management have the potential to outperform in 2009.

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The S&P/ASX 200 Accumulation index (which includes re-invested dividends) fell 4.6% in February to be down 36.9% over 12 months.

Global shares

The major global equity markets fell over February, with reignited concerns over major US banks and continued weak economic data. Falls were particular hard in the US and Europe, with Asia fairing slightly better.

The MSCI World index, a broad measure of global shares, fell 10.5% in US\$ and was down 11.8% in A\$ terms. The A\$ fell 9.4% against the US\$ over January. Over 12 months, global shares were down 48.4% in US\$ terms and have fallen 25.1% in A\$ terms.

Data released late in February showed the US economy contracted sharply over the December quarter, at an annualised rate of 6.2%. These were the worst quarterly figures since March 1982. This is impacting on profit expectations of US companies, with some companies cutting forecasts and dividends. The Dow Jones Industrial Index was down 11.7%, the S&P 500 fell 11.0% and the NASDAQ was down 6.7%. The S&P 500 reached its lowest level since 1996 over the month.

Asian markets were predominantly lower in February, weighed down by a weak global economy. The Nikkei index fell 5.3%, while Hong Kong was down 3.5% and Singapore fell 8.7%. The Chinese sharemarket went against the trend and rose 5.3% on tentative signs of stabilisation in the economy.

European markets moved lower as poor economic data releases continued, particularly out of Germany and credit markets remained tight. The UK cut interest rates to 1.00%, with its sharemarket down 7.7%. Germany (-11.4%), Spain (-9.8%) and France (-9.1%) all ended the month lower.

Emerging markets were predominantly weaker with the MSCI Emerging Markets price index falling 5.7% in US dollars and 7.1% in A\$. Concerns heightened over the large debt levels and possible defaults of a number of emerging European economies. The respective sharemarkets the hardest hit with the Czech Republic (-17.2%), Poland (-12.1%) and Hungary (-11.5%) falling sharply.

Fixed interest

Policy makers continue to work overtime to support their financial system and encourage economic growth. Policy action is moving from cutting official interest rates to other policy options, with the Federal Reserve at the forefront of this action.

Over the month Chairman Ben Bernanke took steps to introduce a formal target for inflation with a long run target for inflation of 2%. The aim is to stabilise inflation expectations in what is a difficult time for the US economy and to promote sustainable employment and economic growth.

Both the US and UK have adopted plans to purchase long term securities in the market to encourage lending in the sector and bring down inter-bank lending rates. The Federal Reserve is expected to start the process of buying mortgage backed securities and agency debt, lifting its balance sheet to higher levels as part of its Financial Stability Plan.

Globally, 10 year bond yields remain at low levels with yields falling (apart from the US) over the month with further loss of confidence in financial markets. In the US, 10 year bonds stand at 3.01%, in the UK at 3.62%, in Japan 1.28% and in Europe 3.62%. Government bond yields rose in the US over the month as the market digested news of President Obama's plan to significantly lift debt levels.

At the beginning of the month, 10 year Australian government bond yields stood at 4.10% while domestic corporate bonds with credit ratings in the range BBB- to BBB+ had an average yield of 8.40%. By the end of February, the yields were 9.52% and 4.40% respectively as risk aversion rose over the month.

The UBSA Composite Bond index returned (-1.23%) in February for a return of 14.43% over the past 12 months. The Reserve Bank of Australia (RBA) cut interest rates by an expected 1% to 3.25% in February. The UBSA Bank Bill index returned 0.28% in the month and 7.11% over 12 months.

Listed property

The listed property sector continued to suffer losses in February, down 16.2% in February. The sector has fallen 57.4% over 12 months. Deep concerns are held over the ongoing viability of several REITs given falling property prices, weak economic conditions and capital requirements.

A number of profit results stunned the market over the month with heavy downgrades to property valuations and profit outlooks. Over the month Westfield Group, GPT Group, Centro Properties Group, Lend Lease and Goodman Group provided sobering profit results and outlooks. The remainder of 2009 will be challenging for the sector as it deals with falling property prices, rising vacancy rates and financing issues.

Global property markets fell in February with all major markets ending the month lower. The UBS Global Investors Index (Net TR) A\$ Hedged was down 15.7% in the month to be 58.0% lower over 12 months.