

June 2009

Market Watch

Economic commentary

Gross domestic product (GDP) figures for Australia were released for the March quarter 2009 in June. Australia's GDP rose 0.4% over the quarter, following a 0.6% contraction in the previous quarter. A strong contribution from net exports and government stimulus-induced consumer spending led to the positive quarterly number. Dwelling investment and business investment were the main detractors from growth.

The annual rate of GDP growth slowed to 0.4% at the end of March 2009, down from 0.8% at the end of December 2008 and 3.4% at the end of March 2008. With the rise in the March quarter figure, Australia has avoided one technical definition of recession, being two consecutive quarters of negative GDP growth. While this is a positive, it is important to focus on the composition of growth and on the view expressed by the RBA Governor that the 'two consecutive quarters of negative growth' definition is not very useful. Attention needs to be paid to unemployment and the income side of the economy, both of which have showed weakness in recent periods.

The International Monetary Fund (IMF), World Bank and Organisation for Economic Cooperation and Development (OECD) all made changes to economic growth forecasts over the month. The IMF upgraded its outlook for the Australian economy in 2009. Economic growth was revised from -1.4% to -0.5%. Strong commodity exports, a flexible exchange rate, a strong banking sector and aggressive, early policy response led to the improved outlook.

Revisions were also made to global economic growth forecasts. The table below shows the various forecasts for global growth in 2009 and 2010. The general consensus is that emerging economies and the US will come out of the downturn first, while Japan and Europe remain problematic and will lag the recovery.

	2009	2010
IMF	-1.3%	+1.9%
World Bank	-1.7%	+2.8%
OECD	-2.2%	+2.3%

Source: IMF, World Bank and OECD.

The \$A rose slightly over the month to end at US 80.75 cents, a gain of 1.0% over the month.

The \$A continued to rally as market sentiment improved and commodity prices rose.

At the end of June, the \$A bought 0.4905 UK pounds, 0.5748 euro and 1.2501 NZ dollars.

Australian shares

The S&P/ASX 200 Accumulation Index rose 4.0% in June but finished the 2008/09 financial year down 20.1%, the worst performance for the Australian sharemarket since 1981-82. The bright spot is that since the low on 6 March 2009, the S&P/ASX 200 Accumulation Index has risen 27.0%.

The Australian sharemarket rose for the fourth consecutive month in June. This is the first fourth-month consecutive gain since the period between February and May 2007.

Over the past few months there have been signs of 'green shoots' in the global economy, leading a rally in sharemarkets. This month saw markets take stock of the global economic outlook and reassess what this means for profit growth and the ability of sharemarkets to move higher. Some weaker global economic data provided a wake-up call for markets, with a growing understanding that the recovery is likely to be slow and grinding, rather than sharp.

Sharemarkets were volatile mid-month following the release of World Bank global growth forecasts. Headlines showed a large contraction in global growth was forecast (at -2.9%), much larger than IMF figures at -1.3%. This rattled sharemarkets and hosed expectations of a global recovery in the second-half of 2009. On closer inspection of the detail, the difference in the forecast can be attributed to two different measurement techniques. The forecasts on an equivalent basis are shown in the table above.

Driving the Australian sharemarket over the month were changes to profit forecasts and more capital raisings. Over the past 12 months, over \$A50bn has been raised in the Australian sharemarket. This month saw Asciano raise over \$A1bn, while Macquarie Leisure Trust, MacArthur Coal, ING Office Fund, Mirvac Group and a number of small miners also raised capital. Large companies continue to tap the equity market rather than the debt market to raise capital. Financing conditions and bank lending remain tight for businesses in Australia, especially

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small businesses, and could be an impediment to growth in the remainder of 2009.

A number of companies also announced profit downgrades. Origin Energy, PMP and Nufarm downgraded their profit guidance while Rio Tinto and Pacific Brands made changes to their dividend payout. Caltex raised profit expectations.

Despite market sentiment holding firm, the relatively defensive sectors performed well in June. Telecoms (+8.6%), Health Care (+8.1%) and Financials ex Property (+7.1%) rose over the month. Utilities (-2.4%) was the poorest performer. It is a similar story over the financial year, the best performing sectors were Information Technology (+4.0%) and Health Care (-0.8%) while Materials (-33.3%) and Industrial (-29.5%) underperformed.

Among the top 50 companies, Fortescue Metals (+44.7%), Macquarie Group (+23.5%) and Macquarie Airports (+16.2%) were the best performers. Fortescue rose despite Rio Tinto and BHP Billiton announcing they are forming an iron ore joint venture in Western Australia. Toll Holdings (-11.2%) and Incitec Pivot (-10.9%) fell.

June was a test for the strength of the sharemarket rally, with questions being raised about the pace of economic recovery. While it is positive that the market has rallied off its low, there are still several impediments to a sustainable economic recovery. Financial market conditions need to continue to stabilise, the US housing sector must recover and there are concerns that rising bond yields and rising oil prices may limit the ability of the global economy to recover. On the upside, despite the recent rally, valuations still look reasonable, but an improvement in business conditions and profits will be required for further sustainable gains in the sharemarket.

Global shares

The major global equity markets were mixed in June. The MSCI World Index fell 0.6% in \$US and 1.6% in \$A terms. Over 12 months, global shares were down 31.2% in \$US and have fallen 18.5% in \$A.

In the US, ten banks repaid money lent from the government as part of the Troubled Asset Relief Program (TARP). This involved buying back preferred shares sold to the government at the height of the global financial crisis. Banks to pay

back the TARP money included JP Morgan, Morgan Stanley and Goldman Sachs. At the same time President Obama announced plans for regulatory changes as a result of the global financial crisis. The Federal Reserve will receive enhanced powers and will oversee big financial. The Fed and the Federal Deposit Insurance Corporation will have power to seize and wind down important institutions if there is a systemic threat.

The Dow Jones Industrial Average was down 0.6%, the S&P 500 Index was flat, while the NASDAQ was up 3.4%. Since its bottom on 9 March 2009, the Dow rallied 29.0% to the end of June. Over 12 months the Dow is down 25.6%.

Signs of weakness in the US economy remain, with the unemployment rate standing at 9.4% at the end of May. Since the global financial crisis began, about seven million people have become unemployed, making a total of about 14 million people unemployed. Unemployment rates stand at 7.2% in the UK, 9.2% in Europe (including 17.4% in Spain), 5.2% in Japan and 5.7% in Australia.

Asian markets were stronger in June, with the Chinese economy continuing to show signs of a sustainable recovery. The Nikkei Index rose 4.6%, while Hong Kong was up 1.1% and Singapore rose 0.2%. The Chinese sharemarket rose 8.8% and is up 119% from its low in late September 2008. Over the financial year, the Indian sharemarket was one of the few that recorded positive gains, up 7.7%, especially after the decisive election win by the incumbent government.

European markets posted mixed results in June. The economic data in Europe continue to point towards weakness, with Europe likely to be the last zone to come out of recession. France (-4.2%) and Germany (-2.7%) both fell, with the UK FTSE down 3.8%. The UK FTSE has risen 21% off its early March low.

Emerging markets were weaker in May, with the MSCI Emerging Markets Index down 1.5% in \$US terms, and 2.5% in \$A. This follows a strong gain the previous month. Russia (-12.3%) and Saudi Arabia (-5.0%) both fell despite gains in the oil price. Weakness came as investors reassessed their appetite for risk following recent price gains, after several months of renewed risk taking activity.

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Fixed interest

In both Australia and globally, fixed interest markets appeared more settled over the month. The increase in issuance of government bonds picked up pace, but to date these have been met generally with strong demand by the market. Credit spreads narrowed and bond yields rose, although they traded with some degree of volatility.

The Reserve Bank of Australia (RBA) left official interest rates on hold in June at 3.00%. In leaving interest rates on hold, the RBA noted improving confidence levels, evidence that the global economy was stabilising and better conditions in financial markets.

In financial markets, LIBOR (London Interbank Offer Rate), the interest rate at which banks borrow and lend from each other, continued to fall. From a peak of 330 basis points over the Fed Funds rate back in October 2008, LIBOR traded at 35bp above the Fed Funds rate at the end of June. While this is an important improvement, levels still remain above the average of 20bp before the global financial crisis.

In the US, 10 year bond yields rose over the month and traded in a wide range, as high as 3.95% and as low as 3.48%. Bonds rallied late in the month as markets became more realistic over the pace of economic recovery in the US. Some unrealistic expectations about potential hikes in the US Federal Funds rate saw bonds initially sell off, but with the release of some more subdued data, these expectations were partially removed and bond yields fell.

Elsewhere, 10 year bond yields fell over the month with economic conditions in the UK, Europe and Japan remaining weak. They stand at 3.39% in the UK, 1.38% in Japan and 3.69% in Europe. Over the month, first-quarter GDP was revised down in the UK to -2.4%. This was the biggest quarterly fall since 1958.

At the end of May, 10 year Australian government bond yields stood at 5.52%, up from 5.28% at the end of May and a low of 3.85% in mid-January 2009. Ninety day bank bills were yielding 3.19% at the end of June, unchanged from the end of May.

Over the month, the NSW and Queensland State governments released their Budgets. Both governments have a large borrowing program for 2009/10 with the NSW government to borrow over \$A10bn and Queensland over \$A22bn. As a result, both State governments have said they will use the Commonwealth Guarantee. Semi-government spreads continued to fall over the month in anticipation of the use of the Commonwealth guarantee.

Victoria has stated they will not use the Commonwealth guarantee, while Tasmania will only use the guarantee for new debt.

The UBS Australian Composite Bond Index returned -0.59% over June as bonds sold off. Over 12 months the index has returned 10.82%.

Listed property

The listed property sector rose for the second consecutive month in June, rising 4.6%. The sector has undertaken a large work-out programme over the past 12 months, raising capital and setting more realistic earnings expectations. The sector is also trading on a firm yield which has started to prove attractive to investors.

The index was impacted by a large (+48.0%) rise in Goodman Group and strong gains in Macquarie CountryWide Trust (+35.3%) and Charter Hall Group (+23.3%). This led the industrial sector higher (+34.8%) over the month, although it remains down 85.7% over 12 months.

The pace of capital raisings continued to slow in June although FKP Property, ING Office Fund and Mirvac raised additional capital.

Global property markets were slightly weaker in June, with markets in the US, China, Germany and France all falling. Hong Kong and Japan were up strongly. The UBS Global Investors Index (Net TR) A\$ fell 0.5% in the month to be 43.4% lower over 12 months.