

March 2009

Market Watch

Economic Commentary

Australia's economic growth figures (as measured by gross domestic product, GDP) made news in March. Economic growth was weaker than expected at -0.5% for the December quarter 2008 (versus +0.1% for the September quarter). This took the annual pace of growth to just 0.3%, the lowest rate since the end of 1991 (the last recession).

Of note was non-farm GDP growth (which covers just under 98% of the total economy). This fell 0.8% in the December quarter, following on from a 0.2% fall in the September quarter, meeting one of the technical definitions of a recession, being two consecutive negative quarters of economic growth. The expectation by the market is that the broad economy will meet this definition when March quarter 2009 GDP figures are released in early June.

Unemployment figures showed full-time jobs falling 53,800 in February, more than offsetting the surprising 37,700 increase in January. Part-time employment, however, was up by 55,600 jobs. The unemployment rate rose to 5.2%, its highest level since March 2005 and up from 4.8% in January and its low of 3.9% in February 2007.

The International Monetary Fund (IMF) released updated forecasts for global economic growth. The IMF now believes the global economy is set to experience a negative year of growth in 2009 for the first time in 60 years, describing the current environment as "the great recession". In releasing its latest forecast, the IMF now expects the global economy to contract between -1.0% and -0.5% in 2009 before recovering in 2010, with positive growth of between 1.5% and 2.5%.

The \$A rose in March as some hints of optimism and risk taking returned to financial markets and the Reserve Bank of Australia (RBA) left official interest rates on hold. The \$A was up 7.4% from US64.48 cents at the start of the month to US69.27 cents by month end.

The \$A bought 0.4844 UK pounds at the end of March, 0.5236 euro and 1.2189 NZ dollars.

Australian shares

The Australian sharemarket rallied off its lows in March, registering its first positive monthly return since August 2008 and its strongest monthly gain since April 1995. The All Ordinaries index rose 7.1%, but is still down 34.7% over the past 12 months.

A number of policy announcements in the US and UK, early signs of profitability returning to US banks and some signs of stabilisation in the weak economic data saw sharemarkets rise in March.

These gains came after the All Ordinaries Index tested a new low on 6 March 2009, reaching 3,111, down 54.6% from its peak on 1 November 2007. Renewed concerns over the US financial sector, with American International

Group reporting a \$US61.7 billion quarterly loss, led sharemarkets lower. The functionality of the UK banking system was also called into question, with additional capital needed for some banks. Since the low on 6 March, the All Ordinaries Index rallied 13.5% to the end of month.

The announcement of the Public Private Investment Program (PPIP) unveiled by US Treasury Secretary Tim Geithner buoyed markets. The plan will use a combination of government and private money to purchase between \$US500 billion and \$US1 trillion in legacy (i.e. bad) loans and securities. The aim is to take the 'toxic assets' off bank balance sheets and find a market price for legacy loans by creating an investment fund to purchase these troubled assets. This should reduce uncertainty within the banking system and encourage confidence.

This helped the Australian Financials ex-Property sector rise 14.0% in March. The major banks rose, with ANZ Banking Group (+18.3%), Commonwealth Bank of Australia (+16.5%), Westpac Banking Corporation (+13.0%) and National Australia Bank (+12.4%) appreciating. Some signs of risk taking returned to the market, with Macquarie Group gaining 59.3%. The ban on covered short selling was extended until at least 31 May 2009.

Among the sectors, Industrials (+15.4%) was the best performer, offsetting recent falls, on hope that financing conditions were improving and as some businesses considered restructuring. Asciano Group (+104.5%), Macquarie Infrastructure Group (+42.7%) and United Group (+24.1%) were the better performers. The Materials sector (+9.4%) also had a strong month, assisted by gains in commodity prices and renewed investor interest in the sector. Healthcare (-8.2%) and Telecoms (-4.8%) both fell, as defensive sectors moved out of favour over the month.

Some hints of optimism returned to sharemarkets in March and while this has provided the market with hope, caution is needed. Economic data in Australia is likely to get worse over coming months, reflecting the force of the global recession. While the sharemarket appears to have factored in much of the expected bad news, low confidence and risk aversion may take over and the sharemarket could retreat again. Nevertheless, recent aggressive policy actions in the US and UK are positive and should make a difference over time and help the global economy recover in 2010.

Global shares

Major overseas sharemarkets recovered in March, with major policy announcements in the US and UK and suggestions that some economic indicators were bottoming. Gains were particularly strong across parts of Asia and in the US, with European markets more muted. The MSCI World index, a broad measure of global shares, rose 7.2% in \$US but was down 0.2% in \$A. The \$A rose 7.4% against the \$US in March. Over 12 months, global shares were down 44.0% in \$US terms and have fallen 26.1% in \$A terms.

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US sharemarkets rose during the month, despite predictions by Standard & Poor's that aggregate dividends by S&P 500 companies will fall 23% this year, the biggest decline since 1938. The Dow Jones Industrial Average was up 7.7%, the S&P 500 rose 8.5% and the NASDAQ was up 10.9%. The S&P 500 had its strongest monthly gain since October 2002. Since its bottom on 9 March the index rallied 17.9% to the end of March.

Asian markets were stronger in March, despite some poor fourth-quarter economic growth figures. The Nikkei index rose 7.2%, while Hong Kong was up 6.0% and Singapore rose 6.6%. The Chinese sharemarket rallied strongly (+22.6%) with signs government stimulus measures are working.

European markets moved higher, although less so than indices in the US. European economies continue to work through very weak conditions, with the policy response muted compared to some other regions. Germany (+6.3%), France (+3.9%) and Italy (+2.6%) rose, while the FTSE 100 index in the UK ended the month 2.5% higher.

Emerging markets were stronger in March, with the MSCI Emerging Markets price index up 14.2% in \$US and 6.3% in \$A. Russia rose strongly, up 24.3%, as the oil price rose 11.0%. Other markets to perform well included the Czech Republic (+17.0%), Poland (+10.8%) and Hungary (+8.7%) after heavy falls the prior month over debt concerns.

Fixed interest

Policy makers continue to work overtime to support their financial system and encourage economic growth. In Australia, this took the form of the Commonwealth Government guaranteeing state government debt, both new and existing, for a fee and on a voluntary, time-limited basis. This effectively changed the 20-year history of the semi state government bond market.

The move came as the semi-government bond market became increasingly dysfunctional following the guarantee of bank debt in November 2008 and the large amount of infrastructure development to be funded over coming years. Just prior to the announcement on 25 March, NSW state government bonds were trading at a spread over Commonwealth bonds of 1.41%. At the end of month the spread was 1.00% and compares to 0.63% 12 months ago as the market responded favorably to the announcement. Queensland semi spreads were 1.58% prior to the announcement, 1.07% at the end of the month and 0.60% 12 months ago. Queensland is also dealing with a downgrade to its credit rating from AAA to AA+.

The US and UK introduced quantitative easing as a further tool to ease monetary policy, with official interest rates at the lowest possible level in both countries. The Federal

Reserve announced it would purchase up to \$US300 billion of long term Treasury securities over the next six months.

On the day of the announcement, US 10-year bonds rallied from 3.01% to 2.53%, before ending the month at 2.66%. The Fed also increased planned purchases of mortgage debt and agency debt, totaling \$US1.45 trillion.

In the UK, the Bank of England also introduced quantitative easing, with plans to initially purchase £75 billion of government bonds. Markets were supportive with 10-year bond yields declining from 3.39% before the announcement to 3.06% two days after, before finishing the month at 3.17%.

Globally, 10-year bond yields remain at low levels, with yields falling given the announcement of quantitative easing policies and despite expectations of an increase in bond supply as governments increase debt levels. In the US, 10-year bonds stand at 2.66%, in the UK at 3.17%, in Japan 1.35% and in Europe 2.99%.

At the end of March, 10-year Australian government bond yields stood at 4.42%, while domestic corporate bonds with credit ratings in the BBB- to BBB+ range had an average yield of 10.72%. This compares to 4.40% and 9.52% respectively at the end of February.

The UBSA Composite Bond index returned -3.46% in March for a return of 14.72% over the past 12 months.

The Reserve Bank of Australia (RBA) left interest rates on hold over the month. Markets are divided over the next move, with expectations moving towards another pause in April. The UBSA Bank Bill index returned 0.28% in the month and 6.69% over 12 months.

Listed property

The listed property sector showed signs of stabilisation, finishing the month broadly flat. The sector has fallen 57.6% over 12 months. Signs of optimism returned with renewed policy action to improve the functionality of credit markets and as several large US banks suggested they had returned to profitability in the early months of 2009.

While these signs of optimism are encouraging, the remainder of 2009 could be challenging for the sector as it deals with falling property prices, rising vacancy rates and financing issues. A number of REITs are expected to cut distributions in the coming months as a way to protect against challenging conditions ahead.

Global property markets improved in March, with major markets mixed. Asian markets rose while Europe underperformed. The UBS Global Investors index (Net TR) \$A was down 3.6% in the month (returns were held back by the stronger \$A) to be 47.1% lower over 12 months.