

Market Watch

Economic Commentary

In mid-August, the Reserve Bank of Australia (RBA) noted that, "given the slower trend in demand, scope to move towards a less restrictive setting of monetary policy was judged to be increasing." While the RBA left official rates unchanged in August, the statement lifted awareness of the slowdown in the economy. It has also led to speculation of an imminent cut in interest rates.

As the economy slows, it would be expected that inflation should also slow over time – thus giving the RBA room to reduce rates. If inflation does not abate, official interest rates would have to remain higher for longer.

For the record, the unemployment rate remained at 4.3% in July and a further 10,900 jobs were created. Year on year retail spending slowed to 3.2% in June, while building approvals were 7.8% lower than a year earlier. At the same time, the price of oil has fallen from a high of \$US 145 per barrel to \$US 115 at the end of August.

The AUD slumped in August. It fell 9.0% from US 94.15 cents at the start of the month to US 85.69 cents by month end. Talk of a cut in interest rates encouraged the decline as did forecasts of slower global economic growth and lower oil prices.

The AUD bought 0.4714 UK pounds at the end of August and 1.227 NZ dollars.

Australian shares

August saw a rebound in the sharemarket. The S&P/ASX 200 Accumulation index rose 4.1% but remains down 14.2% over 12 months. Rebounds come and go. Sustained recovery is more likely to occur when the market can see good prospects for solid earnings growth, a steadily expanding economy and when bad news out of the United States subsides.

A major focus for the market during August was company profit reporting for the second half of 2007-08. With most companies having now reported, earnings are up 12.4% on the same period last year. Resource companies led the way with their earnings up 38.5% (or 19.8% excluding BHP Billiton and Rio Tinto). Non-resource companies lifted earnings almost 6.0%.

Solid increases in profits came from companies across a range of industry sectors and included good results from BHP Billiton, Santos, Oil Search, OneSteel, JB-HiFi, David Jones, Telstra, Brambles, Coca Cola Amatil, Sonic HealthCare and Stockland.

Some companies, however, saw their profits fall. Among them were Iluka Resources, Lend Lease, Harvey Norman, Boral, Virgin Blue, Paperlinx and Insurance Australia Group.

Profit outlook statements have been mixed. BHP Billiton and OneSteel both pointed to the ongoing growth in China and suggested further earnings growth in 2008-09. Comments made by Flight Centre and Brambles were equally upbeat. At the same time, however, Qantas warned of lower earnings while Commonwealth Bank spoke of weaker earnings growth than in recent years.

Events locally and offshore led to considerable market volatility during August. On over half the trading days, the market rose or fell by 1%. Individual company share prices were also volatile with the market continually shifting between banking and resource stocks.

By the end of the month the strongest performers in August included David Jones (+27.9%), Cochlear (+26.4%) and CSR (+26.1%). Other companies to rise by more than 10% for the month included Commonwealth Bank, Fosters, Harvey Norman, Woolworths and Woodside Petroleum.

At the other end of the scale were companies such as Babcock & Brown (-62.2%), ABC Learning (-25.5%) and Bluescope Steel (-20.6%) which all fell on earnings related issues. Other companies to fall more than 10% in the month included Suncorp-Metway, Fortescue Metals Group, Lihir Gold and Macquarie Group.

In other company news, the Australian Competition and Consumer Commission (ACCC) stated that it would not oppose the proposed acquisition of St George Bank by Westpac while Asciano, a transport infrastructure company, rejected a purchase offer from a private equity group.

The investment landscape continues to change. The RBA is talking about lower interest rates, oil prices have fallen more than 15% and the Australian dollar has fallen almost 10% against the US dollar. With these factors in mind, the sharemarket can grow from here but it could be a bumpy ride for the rest of 2008.

Global shares

Global sharemarkets had a mixed month. A slowing global economy hurt some markets while lower oil prices added a hint of optimism to others. The MSCI World index, a broad measure of global shares, fell 1.6% in USD but was up 8.1% when measured in AUD. Over 12 months, global shares were down 13.9% in USD terms and have fallen 18.0% in AUD terms.

The US market received mixed news during August. Its financial sector continues to be rocked by sub-prime losses and capital raisings yet a weaker USD has seen exports surge. There were surprisingly good economic growth figures to come out of the US despite job losses over the last seven months but US earnings for the 4th quarter of 2007-08 were down 23.4% on the same period last year thanks mostly to losses incurred by US investment banks.

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During August, the Dow rose 1.5%, the S&P 500 was up 1.2% and the NASDAQ rose 1.8%. The S&P 500 index is down 13.0% over 12 months.

Japan saw its market go backwards with the Nikkei index down 3.6% in August and 22.2% over 12 months. The Japanese economy contracted in June quarter bringing with it fears of a recession.

Elsewhere in Asia, China's Shanghai B market fell 27.8%, despite its international exposure via the Olympic Games. China's economy continues to grow at a rapid pace but rising costs and slower exports will hurt some Chinese firms. The markets in Hong Kong and Singapore were both down 6.5% while South Korea posted a 9.0% decline.

European markets were mixed. The United Kingdom (+4.2%), France (+2.1%) and Italy (+1.5%) posted gains but Germany (0.9%) and Spain (-1.5%) both fell. The European economy is slowing and some of its banks have experienced large losses as a result of sub-prime related investments. Over 12 months the 'strongest' European market was the UK which fell 10.6%. The weakest of the major markets was Italy which was down 26.7%.

The weakest global sector for the month was materials (-7.0%) as concerns over a global slowdown gathered pace and commodity prices slipped lower. Xstrata, a large London based diversified mining group, was down 15.9% for the month while Nippon Steel was down 15.6%.

Despite growing concerns over a slowdown in global economic activity, the strongest sector during August was the consumer discretionary sector (+2.3%). Harley Davidson rose 5.1% while fashion label Guess was up 17.7%. Retail therapy?

The MSCI Emerging Markets price index fell 8.2% in USD but was up 0.8% in AUD during August. The Russian market fell a further 13.3% while Brazil was down 6.4%. Gains were made in the Philippines (+3.1%) and Saudi Arabia (+0.2%).

Financial conditions and high oil prices continue to slow the global economy. Slower economic activity makes the task of lifting earnings more challenging and, when combined with the on-going US sub-prime saga, continues to unsettle investors. The task will be made easier when sub-prime losses are resolved, new capital is raised by banks and if oil prices continue to ease back.

Fixed interest

The Reserve Bank of Australia (RBA) left its official cash rate unchanged at 7.25% in August but did say that the scope for reducing official interest rates had increased. Higher cash rates, combined with higher 'sub-prime induced' business borrowing rates, have slowed the economy and should act to constrain inflationary pressures.

The UBSA Bank Bill index returned 0.67% in August and 7.64% over 12 months. In light of the RBA's comments and the subsequent expectations of a rate cut, ninety day bank bills fell from 7.76% at the end of July to 7.27% at the end of August.

Trust is coming back to credit markets and yields on corporate bonds are edging lower. Companies with credit ratings in the range BBB- to BBB+ saw average yields on their corporate bonds fall from 9.6% at the end of July to 9.2% at the end of August. This is still well up on the 7.24% seen in June 2007 but an improvement nonetheless.

In line with the slowing economy and the expectation of lower cash rates, Australian government 10 year bond yields fell from 6.22% at the end of July to 5.76% at the end of August. The UBSA Composite Bond index returned 2.16% in August for a return of 6.95% over the past 12 months.

Listed property

After months of misery, the listed property sector rose 10.3% in August. Despite the rebound, the sector is still down 35.3% over 12 months. The prospect of lower official interest rates, lower bond yields and reasonable levels of economic activity attracted buyers to the sector.

Companies in the sector experienced considerable price volatility in the month. Macquarie DDR Trust rose 40.0% while Goodman Group was up 24.7%. At the same time Centro Properties fell 35.2% and Tishman Speyer was down 17.3%. Westfield Group which makes up almost 43% of the sector rose 10.2%.

At the end of August, the estimated distribution yield on the listed property sector was 8.6%, compared with the 5.76% yield on a 10 year Commonwealth government bond.

Global property markets moved higher in August but much of the improvement came from the weaker AUD. The S&P/Citi Group BMI World Property index rose 7.2% in AUD terms but it is down 26.7% over 12 months.