

August 2009

Market Watch

Economic commentary

Australia's economic recovery took further hold over August, and was most evident in the labour market. In July, the number of jobs rose 32,000, leaving the unemployment rate unchanged at 5.8%. Consumer sentiment rose to levels not seen since late 2007 and continues to show that households are generally optimistic.

Other data also pointed to further improvement in economic conditions over the remainder of 2009. Building approvals and housing finance also improved further in the month, as did business confidence. On a negative note, retail sales fell 1.4% in June, but are 7.5% higher than a year ago.

Internationally, the end of the worst period of decline in US economic activity seems to have been reached in recent months. US GDP growth of -1.0% in the quarter was well above market expectations. Other signs of stability in activity came in the form of an improved housing market with monthly gains in both existing home sales and new home sales, as well as new home starts. In addition, the S&P Case Shiller Index showed US house prices rose for the second consecutive month in June, rising 1.4% over the month. This follows a 0.5% gain in May, although prices were 15.1% lower over the 12 months to June.

The improvement in housing activity was matched by rising industrial output and, as a result, a likely stabilisation in job losses. Elsewhere, signs of improvement in economic activity were evident in Europe and Asia. However, the market became concerned that Chinese authorities would implement premature policy tightening as concerns about asset price bubbles mounted, leading to falls in the Chinese sharemarket.

The \$A rose in August, closing the month at US 84.27 cents, a gain of 1.3% over the month. The \$A continued to rally as market sentiment improved and commodity prices rose.

At the end of August, the \$A bought 0.5174 UK pounds, 0.5875 euro and 1.2307 NZ dollars.

Australian shares

The S&P/ASX 200 Accumulation Index rose 6.6% in August, following a 7.3% rise in July. Over the 12 months to 31 August 2009 the index was down 8.1%. However, since reaching its low on 6 March 2009, the S&P/ASX 200 Accumulation Index has risen 45.3%.

The Australian sharemarket rose for the sixth consecutive month in August. This is the longest consecutive gain since the market rose for 10 straight months up to May 2007.

The strong performance of the Australian sharemarket in August reflected the emerging recovery in the global economy, a better than expected profit reporting season and the continued ability of firms to raise capital in the sharemarket.

Profit reporting season made the biggest headlines in the domestic sharemarket in August. On the whole, profits were better than market estimations with few disappointments, although profits were still down around 17% from a year earlier. On the whole, companies have done well to reduce costs to support profits in the face of weak revenue growth. This is good news and, with the prospects of an economic recovery growing, improves the outlook for profits when revenue growth recovers and businesses are now more cost efficient.

Companies continued to find it easier to raise capital from the sharemarket. Over \$A5 billion was raised in August with the largest raisings from Telstra, Seek, ConnectEast Group, Boart Longyear, Mirvac Group, Transpacific Industries and Ten Network.

The continued improvement in market sentiment meant those sectors that had been most unloved during the downturn outperformed in August. Strongest were the Australian A-REIT Index (+16.0%) and Financials (+13.3%) as re-capitalisation and an improved profit outlook boosted prices. Commonwealth Bank of Australia and ANZ Banking Group also provided the market with positive updates. Other strong performers included Industrials (+11.7%), as Australian economic activity continued to improve, and Healthcare (+7.3%), after a poor July.

August 2009

Market Watch

The weaker sectors in the Australian market included defensive sectors with Telecoms (-3.6%), and Utilities (-3.3%) posting declines. The Materials sector was also lower (-0.5%) reflecting concerns over China's move to tighten policy to slow the economy and despite the signs of recovery in the global economy.

Among the top 50 companies, industrial companies Amcor (+28.3%), Brambles (+24.0%) and Leighton Holdings (+22.4%) were the better performers, reflecting the improved signs in Australia's economy. Bluescope Steel (-15.1%) and ASX Ltd (-9.9%) fell as the Federal Government took steps to remove supervision of the Australian sharemarket from the ASX and transfer it to the Australian Securities and Investment Commission (ASIC).

For the sharemarket rally to continue, the global economy and the Australian economy will need to show strong signs of a sustainable economic recovery. While this is possible, question marks are still held over the repair of balance sheets within the financial sector and whether this could hold back economic growth.

Global shares

The major global sharemarkets rose in August with signs of recovery in the global economy. The MSCI World Index rose 3.9% in US\$ and 3.2% in \$A terms. Over 12 months, global shares were down 19.3% in \$US and have fallen 17.9% in \$A.

The global economy continues to show signs of strength with improving business and consumer confidence measures and improving manufacturing surveys. This suggests that the period of inventory destocking is ending and there should soon be a recovery in manufacturing production. This is particularly evident in the US, where manufacturing surveys have moved into expansionary territory for the first time since August 2006.

Following on from an improved profit reporting season in the US, the Financials sector was the strongest performer over August, rising 9.5%. Balance sheets are slowly improving and this should also help the global economic recovery over time.

In the US, the Dow Jones Industrial Average was up 3.5%, the S&P 500 Index was up 3.4%, while the NASDAQ was up 1.5%. Since its bottom on 9 March

2009, the Dow rallied 45.0% to the end of August. Over 12 months the Dow is down 17.7%.

Asian markets were mixed over the month with concerns centring on possible policy tightening in China. The Chinese sharemarket fell 15.4% but is up 22.9% from a year earlier and 115% from its low in late October 2008. In Japan, the Nikkei Index rose 1.2% (with the election of a new government), while Hong Kong and Singapore were down 4.9% and 2.3% respectively. The Indian sharemarket was flat in the month after its impressive gains of earlier in the year.

European markets also posted solid gains in August as economic data showed some improvement, particularly in the larger economies of Germany and France. In the June quarter, both of these economies recorded positive GDP figures for the first time since March quarter of 2008. France (+6.6%) and Germany (+2.5%) both rose and the UK FTSE was up 6.5%. The UK FTSE has risen 39.8% from its early March low.

Emerging markets were weaker in August, led lower by the falls in the Chinese sharemarket. The MSCI Emerging Markets Index was down 0.5% in \$US terms, and 1.2% in \$A. Eastern European markets continued to enjoy some of the strongest gains as concerns over the region's banking system eased further. The Hungarian (+12.2%) and Czech (+9.0%) sharemarkets were the best performers. The performance of some emerging markets highlights the increased appetite for risk amongst many global investors and the stronger economic activity in many of these economies, particularly China and Brazil.

Fixed interest

In both Australia and globally, fixed interest markets continued to trade in a less volatile manner over the month. The increase in issuance of government bonds continued to occur but, as in previous months, issuance continued to be met with strong demand by the market. Credit spreads narrowed but bond yields generally fell.

August 2009

Market Watch

The Reserve Bank of Australia (RBA) left official interest rates on hold in August at 3.0%. 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. However, in other dialogue over the month, the RBA indicated it was moving towards a tightening bias, suggesting inflation was unlikely to be persistently below the target.

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 17 basis points above the Fed Funds rate at the end of August. LIBOR has now returned to levels observed in the period before the global financial crisis began.

In the US, 10 year bond yields continued to trade in a wide range, starting at 3.52% and reaching as high as 3.85% on 7 August before finishing at 3.40%. The rise in bond prices coincided with rising share prices and removal of tightening expectations in US official cash rates.

Elsewhere, 10 year bond yields fell over the month in the Euro area, Japan and the UK, with relatively weak economic data emerging over the month. They stand at 3.56% in the UK, 1.31% in Japan and 3.26% in Europe. At the end of August, Japanese voters elected the Democratic Party of Japan to power, the first time since 1955 that the Liberal Democratic Party has not held a majority in the lower house.

At the end of August, 10 year Australian government bond yields stood at 5.42%, down from 5.62% at the end of July and a low of 3.85% in mid-January 2009. 90 day bank bills were yielding 3.49% at the end of August, preempting a rate hike in coming months by the RBA.

The UBS Australian Composite Bond Index returned 0.69% over August. Over 12 months the index has returned 7.67%. The UBS Australian Bank Bill index returned 0.25% in August and 4.62% over 12 months.

Listed property

The listed property sector rose for the fourth consecutive month in August, recording a sharp 16.0% gain. The sector has undertaken a large work-out program 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 with an improving domestic economy.

The index was impacted by large gains in ING Industrial Fund (+87.0%), Goodman Group (+33.9%) and Macquarie CountryWide Trust (+20.0). This led the industrial sector higher (+41.7%) over the month, although it remains down 70.8% over 12 months. All other sub-sectors were also higher over the month.

Global property markets also moved higher in August. With the exception of Hong Kong and China, all major markets recorded positive returns. The strongest performances were in the UK and France. The UBS Global Investors Index (Net TR) \$A rose 13.4% in the month to be 34.2% lower over 12 months.