

November 2009

Market Watch

Economic overview by the Investment Markets Research team

The global economy continued its gradual recovery in November. However, the Dubai World debt stand still late in the month rattled investor nerves and indicated some fragility of belief in financial system stability. Concerns over systemic and sovereign risks also emerged in the month and negatively impacted markets.

The US economy recorded positive Q3 annualised GDP growth of 2.7% (revised down from the advanced estimate of 3.5%), the first positive figure since Q2 2008. The main drivers of growth were personal consumption, particularly auto sales, residential investment and government expenditure.

The US housing market data was mixed. US existing home sales (+10.1%) and new home sales (+6.2%) rose over October while inventory levels continued to fall from the peak in mid-2008. House prices rose, with the S&P Case Shiller index gaining 0.3% over September, the fifth consecutive monthly gain. The missing ingredient from the recovery is housing starts (which fell 6.0% over the month), reflecting caution and a lack of credit amongst home-builders. Broadly, rising sales and improving house prices will boost consumer confidence as wealth recovers while falling inventory should signal an eventual supply response.

The main downsides for the US economy remain elevated unemployment and tight credit conditions. Job numbers disappointed with 175,000 jobs lost in October seeing the unemployment rate rise to 10.2% from 9.8%, the highest level since 1982. However, improvement in initial jobless claims and strong productivity growth suggest jobs growth in the first quarter of 2010 is possible.

A survey of banks by the Federal Reserve showed credit conditions remain very tight. The Federal Reserve Chairman was highlighting concerns over the labour market and credit conditions when he said "significant economic challenges remain". Financial markets interpreted these comments as a signal that interest rates will stay at low levels in the US well into 2010. The Federal Reserve did highlight the negative side of extended low interest rates, particularly, inflation expectations and speculation in asset prices.

Europe recorded a positive Q3 GDP growth of 0.4%, the first positive recording since Q1 2008. However

growth is still marginal and some hard hit nations, such as Spain and the UK, are still in recession. Germany, France and Italy led the improvements, but were weaker than expected. Consumption remains weak, held back by a weak labour market and tight credit conditions. In Asia, the emerging economies continued on their positive growth path, while in Japan inflation data remained weak and promoted deflationary fears. The Yen rose to its highest level against the US dollar in 14 years and could prove a further headwind for a Japanese export led recovery.

In Australia, data continued to point towards strong economic recovery relative to other developed economies. The labour market continued to add jobs in October (21,500), though the unemployment rate rose to 5.8% from 5.7%, while business and consumer confidence remains at very high levels.

As a result of this strength the Reserve Bank of Australia (RBA) lifted the official cash rate to by 0.25% in November and then again on 1 December, taking the official cash rate to 3.75%. In November the RBA made a number of positive speeches and commentary highlighting mining investment, strong links to Asia, sound banking system and population growth as major economic growth drivers. In its quarterly Statement of Monetary Policy the RBA lifted its economic growth and inflation forecasts. By the end of 2010, forecasts are for economic growth of 3.25% (was 2.25%) and inflation of 2.25% (was 2.0%). This suggests further interest rate rises in 2010 as the RBA returns the level of interest rates to a more average level to match Australia's medium term growth profile.

Australian shares

The Australian sharemarket added value in November, although some volatility in share prices persisted as investors absorbed economic data and corporate news flow. Late in the month the market declined 2.9% in the day following the release of the Dubai World news – the largest one-day fall since June 2009 – but these losses were offset by a 2.8% rally in the following trading session. The S&P/ASX 200 Accumulation Index added 1.8% in the month as a whole, extending gains in the financial year to date to more than 20%.

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The performance of individual industry sectors was mixed. Investors appeared to switch out of Financials (-2.2%) and in to Materials (+8.9%) stocks, which enabled the latter to perform well. The weak US\$ saw commodity prices remain firm, improving sentiment towards stocks in the Materials sector. Other sectors to outperform the broader share market included Telecoms (+2.0%), Consumer Staples (+1.1%) and Consumer Discretionary (+0.7%).

A fair amount of corporate activity took place in November with the targets share prices rising accordingly. AMP combined with AXA SA to launch a surprise A\$10 billion bid for AXA Asia Pacific (which rose 36.8% over the month), an approach which was rejected. Transurban Group (+19.7%) received an unsolicited, conditional and non-binding joint proposal from two Canadian pension funds. Kathmandu successfully completed its initial public offering during the month, although Investa Property Group was unable to proceed with a new listing due to a lack of investor support, suggesting that domestic and international investors are scrutinising potential investments closely. Underperformers in the top 50 included BlueScope Steel (-10.3%) and Macquarie Infrastructure Group (-10.0%).

The local sharemarket has been well supported by overseas investors in recent months but, with Australian shares trading at a premium to their international peers, this support could dissipate in the months ahead. The overall outlook for the Australian equity market remains on the positive side despite some mild concerns over valuation. This is supported by the growing outlook for the Australian economy over the coming period. Some tests will be how the sharemarket deals with higher official interest rates in 2010 and as company profits recover.

Global shares

Global sharemarkets were mixed in November with different regions reacting to the varied pace of global economic recovery. The MSCI World Index rose 3.9% in US\$ terms and 2.4% in A\$ terms. Over 12 months returns are 7.5% lower in A\$.

Globally, investors moved into Materials (+10.2%) given the strength in China other emerging Asian economic and rising commodity prices as the US\$ depreciated further. Financials (+1.6%)

underperformed with concerns centred on further need to raise capital and regulatory changes. The US sharemarket outperformed Europe and most parts of Asia in November, assisted by some better signs out of the US economy. The Dow Jones index rose 6.5% with the S&P 500 gaining 5.7%.

In Europe equity markets were stronger; Germany (+3.9%), France (+2.0%) and Spain (+2.0%) all rising. Japanese equity markets were weak negatively impacted by the poor economic data. The Nikkei fell 3.9% while Hong Kong (+0.3%) and Singapore (+3.1%) rose.

Global emerging markets

Emerging markets were stronger although performed relatively in line with the broader global equity index. The MSCI Emerging Markets index rose 4.2% in US\$ although suffered falls late in the month with the Dubai World announcement.

Leading emerging markets higher was China, up 19.3% on economic optimism and large amounts of liquidity within the economy. Other top performers included Brazil (+8.9%) and Mexico (+8.1%).

Sri Lanka (-2.1%) and Czech Republic (-2.2%) fell, Sri Lanka agreed to purchase \$US 10bn in gold from the International Monetary Fund.

The Dubai World debt issue saw equity markets in that region decline sharply late in the month with both the Dubai and Abu Dhabi general index down 11.7%.

Global fixed interest

Global government bond yields fell during the month. Comments by some central banks, including the US Federal Reserve, that policy rates will be kept low for a long period of time was the main driver. Heightened uncertainty stemming from some concerns over sovereign (country) risk saw some investors move back into US government bonds causing yields to fall. These sovereign risk concerns were heightened at the end of the month when Dubai World requested its debt restructuring.

In the US, short term bond yields fell given the heightened uncertainty, with the 10 year bond yields finishing November at 3.19%, from 3.38% at end of October.

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In Europe, concerns over the budget positions of the UK and Greece impacted on markets.

In the UK, the Bank of England kept rates at 0.5% and voted to extend its Quantitative Easing (QE) program by GBP25bn to GBP200bn. Bond yields in the UK fell as a result, with 10 year government bond yields falling from 3.62% at the end of October to 3.052% at the end of November.

In Australia domestic factors added to the generally positive global backdrop for Australian bonds in November, and this led to a fall in bond yields. There has been rising demand for government bonds by Australian banks as part of new regulatory measures imposed on banks. These factors, together with the improving economic outlook and revisions to Budget Deficits also drove 10 year government bond yields lower from 5.54% at the end of October to 5.24% at end of November. The UBS All Maturities Composite Bond index returned 1.51% over November and 3.40% over 12 months.

The lift in cash rates by the Reserve Bank of Australia saw 90 day bank bills rise from 3.94% at end of October to 4.03% at end of November. The market is still expecting further interest rate rises in 2010. The UBS Bank Bill Index returned 0.31% in November and 3.58% over 12 months.

Listed property

Stocks in the Australian listed property trust sector remained reasonably volatile in November. The S&P/ASX 200 Australian Real Estate Investment Trust (A-REIT) Accumulation Index climbed 1.0% in the month as a whole but traded in a fairly wide range, affirming that investor sentiment towards the sector remains fragile.

Returns from individual stocks were diverse with Charter Hall Group (+13.8%) the top performer, versus ING Industrial Fund (-17.5%) the bottom performer.

The Diversified sub-sector (+5.0%) generated the strongest returns, buoyed by solid returns in index heavyweights Stockland Group and Mirvac Group. Stocks in the Industrials sub-sector (-6.7%) were

among the worst performers as investors appeared to take profits from the recent rally in the sector. In spite of this, the Industrials sub-sector as a whole has returned more than 75% in the financial year to date.

A pick up in property transactions is encouraging for the sector and suggests confidence is steadily improving. The number of asset sales has certainly recovered from earlier in the year, when almost no transactions were proceeding. Several sales have been completed at the smaller end of the market and deals are also now proceeding on larger assets – the sale of a prestige office tower in the CBD of Sydney was agreed towards the end of the month. On a less positive note, the planned initial public offering of Investa Property Group was unable to proceed due to a lack of investor support, confirming that investor confidence in the listed property sector has not yet been fully restored.

The global property market outperformed the domestic market with the UBS Global Investors index rising 2.8% in Hedged A\$. Regional performance was mixed, driven by varying fundamentals and investor appetite for property as credit conditions and transactions remain tight in the sector. Hong Kong and China were top performers, likely liquidity driven while Japan significantly underperformed.