

## **MARKET REVIEW**

31-Aug-2009

### **International Economic Review**

#### **United States**

Housing data showed further stabilisation with new home sales rising 9.6% in July to 433,000 units while existing home sales rose to 5.24 million units or 7.2%, a higher than expected increase. Home price indices, including the S&P/Case Shiller and the official Federal Housing Finance Agency (FHFA) measures, also moved higher last month. Housing starts, however, fell 1.0% in July to 581,000 units compared to the 6.5% rise to 587,000 in June.

There was also better news in the labour market; non-farm payrolls fell less than expected, down by 247,000 in July. That compares to a fall of 443,000 recorded in June and what appeared to be a cycle low of 741,000 in January this year. Unemployment fell 0.1% to 9.4%, the first decline since April 2008.

Retail sales unexpectedly fell 0.1% in July despite a boost from the Federal Government's initiative program aimed at providing assistance of up to \$4,500 to offset the cost of new car purchases or leases. Excluding auto and gas, retail sales dipped 0.4%. Meanwhile, consumer confidence rebounded with the Conference Board's measure rising to 54.1 in August from a brief dip to 47.9 in July.

Industrial Production climbed 0.5% in July, the first positive month since October last year. Durable Goods Orders jumped 4.9% in July while the closely watched proxy for business capital expenditure, the non-defence capital goods ex-aircraft component, fell 0.3%.

Headline CPI was unchanged in July following a 0.7% rise in June, while core CPI rose 0.1%, after increasing 0.2% in June. Headline CPI has fallen by 2.1% over the year, the largest 12-month drop since January 1950 while the 1.5% annual gains in core CPI was the slowest rate since February 2004.

On the outlook, the ISM Manufacturing Index rose to 48.9 in July from 44.8 in June. There has been steady improvement in this index and most major components including new orders, production and employment registered gains. The non-manufacturing index fell slightly to 46.4 in July from 47.0 in June.

#### **Europe**

Euro-zone economic data continued to show modest improvement. Early GDP estimates showed that the economy contracted by just 0.1% in the June quarter. While this was a better than expected outcome, it still marked the sixth consecutive quarterly fall in growth for major European economies. On inflation, the Harmonised Indices of Consumer Prices (HICP) fell 0.7% in July, bringing the annual rate to -0.7%.

On the outlook, the closely watched proxy for European economic growth, the IFO Business Climate Survey, rose 3.1 points to 90.5 in August. Similarly, the ZEW Economic Sentiment Index surged 16.5 points to 56.1. The Euro-area flash Purchasing Managers Index (PMI) for August came in much better than expected, with notable rises in both services and manufacturing PMI.

Across the Channel, the preliminary GDP report showed the UK economy shrank by 0.7% in the June quarter to be 5.5% lower than a year ago. The housing data was also a little more upbeat with signs of stabilisation in housing prices. UK PMI Manufacturing Survey steadied at 50 in August.

### Asia

Data released in Japan was generally disappointing, household spending was down 1.3% in July to be 2.0% lower on an annual basis. Employment fell by 20,000 jobs in July, down 2.1% from a year ago. Unemployment rose 0.3% to 5.7%. Deflationary pressure remained as nationwide CPI fell 0.1% in July to be 2.2% lower year on year. In better news, the Shoko Chukin's Small Business Survey showed confidence rose to a 15-month high. Exports also rose 5.3% in July, remaining 36.5% lower than a year ago.

In China, the closely watched National Bureau of Statistic's PMI edged up from 53.2 to 53.3 in August while the Markit-CLSA PMI rose 1.0 point to 52.8. Industrial Production rose slightly to 10.8% annualised in July on the back of strong fixed asset investment thanks to the large government fiscal stimulus. On inflation, headline CPI stands at -1.8% from a year ago.

### Australia

The release of better than expected economic data in August provided further evidence that Australia economic downturn is relatively shallow compared to other major developed economies. The Westpac/MI Leading Indicator, which indicates the likely pace of economic activity three to nine months ahead, improved to -3.0% in June from -3.9% in May.

Employment rose 32,000 in July after falling 18,000 in June. The rise was primarily due to the creation of 48,200 part time jobs while the economy shed 18,000 full time positions in July. Unemployment held steady at 5.8% but the aggregate number of hours worked showed a 3.0% decline over the year, suggesting there is still considerable easing in the labour market to come.

Housing finance approvals rose 1.1% in June marking the ninth straight rise. Private sector credit grew 0.2% in July, dragging down the annual rate of growth to 3.0%, the lowest since September 1993. Meanwhile, consumers continued to regain confidence with the Westpac/MI Sentiment Index rising 3.7% in August, following improvements of 9.3% and 13.0% in July and June respectively. Retail sales fell 1.4% in July but that was after sizeable increases in previous months.

Regarding business confidence, the NAB Business Confidence Survey rose for the second month in a row to +10 in July, from +4 in June. Meanwhile, Real Private Capital Expenditure (capex) surprisingly rose 3.3% in the June quarter, well ahead of consensus expectations of a fall of 5.0%. The rush to get the government's tax subsidy on equipment investment (mostly on cars) looks to have helped strengthen this area in the last quarter.

## International Sharemarket Review

Global sharemarkets continued to push higher in August, extending the rally of previous months, assisted by some better than expected economic data. The financial sector was a notable performer as credit markets continued to improve. Defensives lagged cyclical stocks as companies geared toward equity market recovery benefitted. European sharemarkets generally outperformed while the concern over a bubble in China caused Asian sharemarkets to underperform.

## Australian Dollar Outlook

Major bourses performed for the month as follows:

Japan Nikkei 225	1.3%
UK FTSE 100	6.5%
US Dow Jones	3.5%
US S&P 500	3.4%
German DAX	2.5%

## Australian Sharemarket Review

The month of August saw the Australian market largely pre-occupied with the profit reporting season, which was well received overall. Earnings largely matched or surpassed analyst expectations, which coupled with positive economic data helped drive the Australian market up for the sixth consecutive month, the S&P/ASX 200 Accumulation Index gaining 6.6%. This lifted the rally over the last six months to more than 37%, reversing the previous six month (September 2008 to February 2009) return of -33.1%.

On a sector basis, Financials and Cyclical Industrials outperformed, while defensive sectors (Telecommunications, Utilities, and Consumer Staples) lagged. Despite generally higher commodity prices, Mining and Metals were standout underperformers.

Capital raisings were back in vogue in August, with Amcor (\$1.6bn), Goodman Group (\$1.1bn), Boart Longyear (\$756m) and Transpacific Industries (\$737m) the biggest of the issuers.

### Large Caps

The best performing Australian large-cap stocks during the month were Transfield Services (44.6%) and Goodman Group (33.9%).

- Transfield Services, the international provider of operations, maintenance, asset management and project management services, announced a C\$150m asset management contract within the Canadian transport market during the month.

- Investors reacted favourably to Goodman Group's refreshed balance sheet and new debt facilities. The group raised \$1.8bn in a widely anticipated capital raising during the month.

The worst performing Australian large-cap stocks during the month were Sims Metal Management (-16.6%) and BlueScope Steel (-15.1%).

- Sims Metal Management recorded a \$150m loss for the year to 30 June 2009, citing continued low scrap flows and demand, and a non-cash goodwill impairment worth \$190m.

- BlueScope Steel flagged a cautious profit outlook, expecting to post a loss in the first half of the current financial year. It also recorded a \$66m loss for the full year, reversing last year's \$596m profit.

## Small Caps

The best performing Australian small-cap stocks during the month were Moly Mines (148.1%) and ING Industrial Fund (87.0%).

- Moly Mines has been propelled by a rise in molybdenum prices by 105% since March.
- ING Industrial Fund successfully renegotiated more flexible finance terms towards the end of the month, after the stock had already rallied hard on the reduction of risk of insolvency.
- The worst performing Australian small-cap stocks during the month were the Apex Minerals (-40.0%) and Marion Energy (-25.0%).
- Apex Minerals encountered delays during the month in geotechnical works aimed at remedying adverse ground conditions at its Wiluna gold mine. Production targets have also been stretched.
- Marion Energy's plan to sell its North American oil and gas assets is taking longer than expected.

## Major Indices

The major indices performed as follows during August:

S&P/ASX 200 Accumulation Index	6.6%
S&P/ASX 200 Industrials Accumulation Index	9.3%
S&P/ASX 200 Resources Accumulation Index	0.3%
S&P/ASX Small Ordinaries Accumulation Index	6.4%

## Listed Property

The S&P/ASX 200 A-REIT Accumulation Index soared 16.0% higher in August, significantly outperforming the broader equity market by 9.4%. With reporting season providing many data points for the market, it would seem that companies within the sector have prevailed and exceeded expectations. However, most of the gains in the sector were made in the first half of the month, based on general market sentiment, and tailed off towards the second half of the month - when the majority of companies reported.

The sector, although capital-constrained, continued to outperform defensives. Industrial names excelled, with ING Industrial Fund the best performer, up 87.0%, and Goodman Group up 33.9%.

The challenge for the sector over the coming months will be to continue its rise against negative earnings outlooks. Investors seem to be looking through the weaker FY10 earnings numbers at the moment to FY11, however should near term earnings threats start to dominate perceptions again, risks for the sector become very real again.

## Australian Fixed Income Review

The global economic backdrop continued to show signs of ongoing improvement with key leading economic indicators in all the major regions continuing to rise.

On the local economic front, data released also remained positive. Both business and consumer confidence measures continued to rise and housing data released continued to improve reflecting the benefits of low interest rates and the government first home owner grants. The labour market continues to remain relatively resilient with employers choosing to reduce the number of hours worked as opposed to laying off staff.

The improving economic outlook has placed a lot of focus on the Reserve Bank of Australia (RBA) as to when they will begin to lift the official cash rate. The RBA has described the absolute level of the official cash rate at 3.0% as well below normal and also implied that at some stage the process of normalisation will need to occur.

The speculation of when and by how much the RBA will raise rates influenced the performance of shorter dated maturities as the market continued to price in and also bring forward expectations of rate hikes. The result of this was a flattening of the yield curve.

In terms of market moves the 90-day bank bill ended the month 0.29% higher at 3.49%, the benchmark 3-year bond higher by 0.10% at 5.03%, while the benchmark 10-year bond closed 0.18% lower at 5.39%. The UBS Composite Bond Index delivered a positive return of 0.72%.

## International Fixed Income Review

The global economic outlook continued to improve during August as key leading economic indicators in all the major regions continued to rise. While the bounce in these indicators is impressive, the labour market remains weak and job losses are still coming through even though the pace of these appears to be moderating.

Despite the run of generally better than expected data released during August, bond markets were able to move lower in yield. Towards month-end, sharemarkets started to wobble, led by some sharp falls in the Chinese sharemarket which also added to the bid tone in global bond markets.

In terms of price action, the US 2-year note closed lower by 0.15% at 0.97%, while the US 10-year note, the global benchmark, closed at 3.40%, lower by 0.08%. In other key global bond markets, the UK 10-year gilt closed higher by 0.24% at 3.56%, the German 10-year bund lower by 0.04% at 3.26%, while the Japanese 10-year maturity closed at 1.31%, lower by 0.11%. The global fixed income market return, as measured by the Barclays Capital Global Aggregate Index (hedged into A\$) delivered a strong positive return of +1.26%.

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