

MARKET REVIEW

28-Feb-2009

International Economic Review

United States

Economic data released in February continued to portray grim economic conditions. Revised figures showed that the US economy contracted at a much sharper rate than first estimated for the December quarter. GDP fell to an annual rate of -6.2% compared to -3.8% reported previously, marking the worst growth figures since the 1982 recession.

Non-farm payrolls fell for the thirteenth straight month in January, losing another 598,000, the largest one-month loss since 1974. Consequently, the unemployment rate rose to 7.6% from 7.2% in previous months.

The housing market appears to still be in freefall with new lows in housing starts and permits of 466,000 and 521,000 respectively. Durable goods orders, the closely watched measure of future capital expenditure spending, fell 5.2% in January, while orders ex aircraft also slumped 2.5% for the month.

Retail sales unexpectedly rose in January, climbing 1.0%. However, the December figure was revised down. The University of Michigan consumer sentiment survey fell 4.9 points to 56.3.

Headline CPI rose 0.3% in January, rising for the first time in six months, from a downwardly revised -0.8% decline in December. The core CPI was also up 0.2%. The annual headline rate of inflation was unchanged, while core inflation rose 1.7% from last year.

On a more positive note, the closely watched leading indicator for growth, the ISM manufacturing index, rebounded from a record low in January of 32.9 to 35.6. The ISM non-manufacturing index also rose to 42.9 from 40.1, indicating a slower pace of decline.

After months of negotiations through Senate and Congress, President Obama signed the \$787bn economic stimulus plan into law, and also announced a \$275bn housing plan that was intended to prevent foreclosures and attempt to stabilise the housing decline. .

Europe

Across the Atlantic, Euro area GDP contracted by 1.5% for the quarter, a record decline with the German and Italian economies contracting even more.

The German ZEW survey surprisingly rose 25.2 points to -5.8 in February, while the closely watched German IFO business survey was down slightly to 82.60, marking the ninth consecutive month below 100, a level associated with contraction in the economy.

Meanwhile, faced with one of the worst financial crises and economic recessions in the UK, the Bank of England cut interest rates by another 50bps to 1.0%, the lowest rate in its 315 year history.

Asia

For Japan, the economy contracted for the third straight quarter by 3.3% in the December quarter, bringing the annualised growth rate to -12.7%, due largely to the collapse of overseas demand compounded by the stronger yen.

Recently released data also fared badly. Industrial production fell 10% in January, bringing the annual rate to a staggering -30.8%. Real household spending fell 5.9% from a year ago. Business surveys including the closely watched Shoko Chunkin rose slightly in January but remain at a depressed level.

Elsewhere in Asia, the Chinese PMI rose to 42.2 in January from 41.2 in December, but has remained below the expansionary level of 50 for the past sixth months.

Australian Economic Review

In line with market expectations, the Reserve Bank of Australia cut interest rates by another 100 bps to 3.25% in early February, bringing the cumulative reductions to 400 bps since September.

The economic data released in February was mixed. The closely watched Westpac/MI leading indicator, which indicates the likely pace of economic activity for 3 to 9 months ahead was -1.2% in December, well below its long term trend of 3.5%.

Pleasingly, retail sales rose 3.8% in December following a small rise in November. The Federal Government's \$10.4 billion fiscal stimulus payments received in early December helped to boost Christmas sales. Still, consumer confidence fell 4.6% in February to 85.8. That followed a 2.2% fall in January, and marked thirteen straight months that confidence has fallen below 100.

Housing finance approvals surged 6.4% in December as an increase in the Government's First Home Owner Grant helped to boost activities. Elsewhere private sector credit rebounded 0.6% in January, following a -0.2% in December. The annual rate slowed to 6.1%, compared to 16.5% just a year ago.

Employment unexpectedly rose 1,200 in January, while the previous month was revised to no change from -1,200. Unemployment rose 0.3% to 4.5%, the highest level since June 2006.

Business confidence remains strained from the global credit crunch. The NAB business conditions survey reversed half its gains in December, falling 5 points to -11 in January.

GDP fell 0.5% for the December quarter, well short of consensus expectations of a 0.2% rise.

International Sharemarket Review

February turned out to be another bad month for the sharemarket, with major indices around the globe falling to new lows. The continued concern over the economy and speculation of imminent bank nationalisations drove the market down. The slump in Central and Eastern European economies fuelled concern over the stability of the banking system in Western Europe, leading most European bourses to post double digit falls for the month.

Australian Dollar Outlook

Major bourses performed for the month as follows:

Japan Nikkei 225	-5.3 %
UK FTSE 100	-7.7 %
US Dow Jones	11.7 %
US S&P 500	-11.0 %
German DAX	-11.4 %

Australian Sharemarket Review

February was another bad month for equities. The S&P/ASX200 was in decline (-5.5%) for the sixth consecutive month - the longest losing streak since the seven month record of 1974. This was driven by a relentless stream of dismal economic data and general fears over financial stability.

The index also hit a new low for this cycle, suffering lows last seen in February 2004.

Despite weak economic data the resources sector had another month of outperforming the market (-1.2%), fuelled by potential acquisition interest from China and a strong gold price.

Gold rallied sharply during February supported by safe haven investment flows. A high of US\$1,000 per ounce was hit mid-month on rising risk aversion, but it dropped back to US\$943.75 by month end.

Industrials suffered due to poor results and capital raisings. Australian companies raising capital included Wesfarmers (\$2.9bn), Suncorp-Metway (\$855m) and Newcrest Mining (\$750m).

Throughout February the domestic market was also pre-occupied by reporting season. December's half yearly earnings figures were generally as expected, partly factoring in pre-announcements, but share price reactions were largely negative.

The reporting season usually leads to higher turnover, however, this time turnover was around 10% below the average of the previous five months.

Although US and UK banks remain in crisis mode, the Australian banking sector outperformed its global counterparts and the market in general (+3.1%).

Large Caps

The best performing Australian large-cap stocks during the month were PaperlinX Limited (56.82%), Fortescue Metals Group (49.72%) and Gloucester Coal (39.5%).

- Gloucester Coal announced a record interim profit after tax of \$44 million on the back of strong revenue growth.

- Fortescue Metals shares soared 11 per cent on their reporting day in late January and have gained 55 percent since, on the strength of a \$500 million capital raising struck with Chinese steel maker Hunan.

The worst performing stocks were Goodman Group (-63.64%), AWB (-60.14%) and Asciano (-60.09%).

- Goodman Group, Australia's biggest industrial property trust, recently reported a \$465.9 million half-year loss and has since been placed on Moody's and Standard and Poor's negative credit watch.

- Asciano reported a half yearly loss of \$93.4 million (after tax and significant items). Asciano attributes the result to uncertainty around its business triggered by the global economic downturn.

Small Caps

The best performing Australian small-cap stocks were Bannerman Resources (107.1%), Marion Energy (52.8%) and Apex Minerals (36.0%).

- Bannerman Resources recovered strongly following the appointment of a new Chief Executive Officer and announcing that it had secured \$20m of funding.

- Marion Energy released preliminary results of an independent report showing a significant increase in gas resource potential at two of the company's projects.

The worst performing small-cap stocks were Timbercorp (-65.7%), HFA Holdings (-65.0%) and Galileo Japan Trust (-64.7%).

- Timbercorp announced a 32% profit drop during the month, and detailed the need to cut debt and reduce capital intensity. They also announced they may exit the managed investment scheme market altogether from next year.

Major Indices

The major indices performed as follows during February:

S&P/ASX 200 Accumulation Index	-4.6
S&P/ASX 200 Industrials Accumulation Index	-6.4
S&P/ASX 200 Resources Accumulation Index	0.1
S&P/ASX Small Ordinaries Accumulation Index	-6.7

Listed Property

After a difficult January for the Listed Property sector, February continued the trend. The Australian property sector fell 16.2%, which was significantly worse than the broader market's fall of 4.6% (S&P/ASX 200).

Reporting season contained little new information as many stocks had previously disclosed asset revaluations and earnings misses.

In February capital management remained a key focus. In contrast to January, which had been quiet, significant selling across all names was caused by a need for capital-raising funding, placing a strain on the sector.

In particular Westfield Group's \$2.9bn placement damaged the sector. Many investors felt pressured to raise their holdings in Westfield to maintain their weightings as it is the largest stock in the sector. This caused most other stocks in the index to finish the month in negative territory.

Many of the same names that dominated much of the last year continue to outperform. Abacus Property Group had two good months in a row as January's placement to the Kirsch group removed gearing concerns and raised confidence. The Commonwealth Property Office Fund returned strongly following January's raising, attracting investors willing to pay for its defensive balance sheet and solid earnings stream. Defensive performers Bunnings Warehouse Property Trust, CFS Retail Property Trust and Dexus Property Group remained strong.

Banks are reluctant to invest further in commercial real estate, leading to an absence of finance and therefore a decrease in the number of new buyers for assets. Until this is addressed, a sustained rally in the sector is unlikely..

Australian Fixed Income Review

The month began with the RBA lowering the official cash rate by a further 100 basis points to 3.25%, its lowest level since the early 1960s.

The Government also unveiled another fiscal stimulus package of \$42 billion, which combined with downside economic revisions has resulted in a large budget deficit forecast for 2008-09 and more deficits likely in the subsequent years. What this means is that for the coming few years the amount of Commonwealth Government debt outstanding will increase as the Government borrows money to fund the expected deficits.

The call on capital markets for funding in the coming years is likely to be significant. Not only is the Commonwealth now borrowing through the issuance of bonds, the State Governments have larger than normal borrowing requirements as they need funding for their various spending commitments, primarily relating to infrastructure projects. Finally Australia's major banks continue to be large borrowers under the Commonwealth Government guarantee.

A major announcement during the month was ratings agency Standard & Poor's decision to downgrade or lower the credit rating of the state of Queensland to AA+ from AAA. This action has placed upward pressure on the borrowing costs for Queensland and also on the other states albeit to a lesser degree.

In terms of economic trends, there were no changes over the month. The global economic backdrop remains poor and the outlook for the Australian economy is not much better at this stage.

In terms of market moves, the benchmark 90-day bank bill rate closed lower by 0.25% at 3.16%, the Australian 3-year benchmark Commonwealth Government bond closed higher by 0.33% at a yield of 3.24%, while in the longer end the 10-year benchmark Commonwealth Government bond also closed higher in yield by 0.38% at 4.38%. The UBS Composite Bond Index delivered a negative return of -1.23% to close at 5767.9066 points as a result of the increase in longer term interest rates.

International Fixed Income Review

The global economic backdrop remains poor and the global economy remains in a recession. During February the Bank of England met and cut their official cash rate by a further 0.5% to 1.0%. Other key central banks left rates unchanged.

The global recession combined with the large government fiscal stimulus and rescue packages has resulted in increased demand on global capital markets to raise the money to pay for these spending initiatives.

In terms of price action, in the US Treasury market the 2-year yield note closed higher by 0.02% at 0.97% and the US 10-year note, the global benchmark, closed at 3.02% higher in yield by 0.18%. Other key global bond markets were broadly stronger, resulting in lower yields. The UK 10-year gilt closed lower by 0.08% at 3.62%, the German 10-year bund lower by 0.19% at 3.11%, while the Japanese 10-year maturity closed at 1.28% lower by 0.02%. The global fixed income market return, as measured by the Barclays Capital Global Aggregate Index (hedged into AUD\$), delivered a modest positive return of +0.21%.

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