PICCADILLY FINANCIAL GROUP PTY LTD
UNIQUE FINANCIAL SOLUTIONS

MARKET REVIEW

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International Economic Review

United States

The initial estimate of US GDP growth for the December quarter came in at 1.4% (5.7% annualised). For calendar year 2009, however, GDP fell 2.4%, marking the biggest drop in a calendar year since 1946. The strength in December GDP was partly reflecting a slower drawdown in business inventories. The final sales of domestic product, a better indicator for the underlying pulse in the economy rose 0.6% for the quarter, compared to 0.4% in the September quarter. While not as spectacular as the headline figure, it confirms that a modest recovery is underway in the economy.

The more recent economic data released in January was relatively mixed. The Non-farm Payroll was weaker than expected in December, falling 85,000 following a small positive rise in the previous month. Pleasingly, the unemployment rate steadied at 10%.

Retail sales unexpectedly fell in December by 0.3% and brought the yearly number to -6.2%, the largest fall in 17 years. Sales excluding auto fell 0.2% for the month. The Conference Board's Confidence Index rose to 55.9 in January from 53.6 in December. Interestingly, sentiment for current labour market and economic conditions improved.

The latest data on housing continued to show a muted recovery. Housing starts slid to 557,000 units in December from 580,000 units in November. Similarly, existing home sales fell to 5.45 million units annualised from 6.54 million units, and new home sales fell to 340,000 units from 370,000 units for the same period.

Meanwhile, headline CPI rose 0.1% in December to be 2.7% higher on annual terms. Excluding food and energy, core CPI also rose 0.1% for the month, leaving the annual rate at 1.8%, marginally higher than the 1.5% low back in August.

The closely-watched ISM Manufacturing Index recorded 55.9 in December from 53.6 in November. The Non-Manufacturing Index flicked back just a touch above the crucial 50 level after falling to 48.7 in November. Recovery in the service sector remains fragile.

Europe

In Europe, Industrial Production rose 1.3% in November bringing the annual rate to -6.9%, a marked improvement from -17.9% recorded in February last year. Pleasingly, the CPI was 1.0% higher than a year ago in January, marking the third consecutive month in positive territory.

The closely-watched proxy for European economic growth, the German IFO Index, rose 1.2 points to 95.8 in January, while in contrast the ZEW Economic Sentiment Index fell another 3.2 points to 47.2 in January. The conflicting signs on the outlook suggest recovery remains fragile for the continent.

Across the channel, the UK economy rose 0.1% in the December quarter, effectively ending six quarters of decline.

Asia

In Japan, industrial production rose 2.2% in December, bringing the annual rate to 5.4%. In the labour market, the economy lost another 370,000 jobs in December, a disappointing outcome given that 360,000 job losses were recorded in the previous three months. The unemployment rate was down slightly to 5.1%. The national CPI fell 0.1% in December, reversing the previous month's rise of 0.2%. The economy continued its deflationary grip as CPI fell 1.7% from a year ago

In China, the GDP data released for the December quarter showed the economy grew a healthy 10.7% annualised, while latest inflation figures confirmed price pressure was evident, with CPI rising to 1.9% annualised in December, from 0.6% in November. In reaction to the recent higher than expected data releases, especially on inflation, the People's Bank of China raised the minimum reserve requirement for banks by 50bps to 16%, signalling a possible intention by the authority to withdraw excess liquidity.

Australia

The much anticipated inflation data release showed headline CPI rose 0.5% for the December quarter, half of the 1.0% rise recorded in the September quarter. The latest increase brought headline CPI to an annualised rate of 2.1% from 1.3% previously. Core CPI rose 0.65% for the quarter and brought the annual rate to 3.4%, above the RBA's 2-3% target band.

Other economic data releases for the month were at the higher end of expectations. Employment grew 35,200 in December, driven by a 27,900 jump in part-time employment. Unemployment fell to 5.5% from 5.7% in November. The Westpac-MI's Consumer Confidence Index rose in January despite recent interest rates hikes. Elsewhere, private sector credit rose 0.3% in December, with notable weakness in business lending. Credit increased by just 1.5% in 2009, well down from 6.8% recorded in 2008 and the brisk 16.3% rise in 2007. Housing finance approvals fell again in November consistent with the phasing out of the first home buyer grants.

Meanwhile, Australia's leading indicator continued to surge. The annualised growth rate of the Westpac-MI Leading Indicator, which indicates the likely pace of economic activity three to nine months into the future, was 7.6% in November, well above its long term rate of 3.0% and compared to -6.9% recorded in only May last year.

International Sharemarket Review

Global sharemarkets started the year on a high note before retreating sharply as the New Year celebration came to pass. Financial stocks were under pressure with a proposal announced by President Obama that will force banks to reduce risk taking activities, including owning or sponsoring hedge funds or private equity funds, and engaging in proprietary trading for their own profit. The Resources sector was the hardest hit as commodity prices reacted to a potential shift in Chinese macro policy and a firmer US dollar. Meanwhile the worsening fiscal situation in Greece, which prompted concerns over a possible default and/or possible bailout by the EU, also weighed heavily on the market.

Major bourses performed for the month as follows:

Japan Nikkei 225	-3.3%
UK FTSE 100	-4.1%
US Dow Jones	-3.5%
US S&P 500	-3.7%
German DAX	- 5.9%

Australian Sharemarket Review

The local sharemarket fell 6.2% in January (S&P/ASX 200 Accumulation Index), the largest one month decline since November 2008. Several global issues were instigators behind this result; including sovereign risk (particularly Greece), news of China's credit constraints and US banking regulation concerns.

All sectors were affected, with Resources (down 9.4%) and Consumer Staples (down 8.4%) the worst hit. Financials were mixed, with investors taking profits in the Big Four banks, with some switching to the regional banks, where Suncorp-Metway (up 4%) and Bendigo and Adelaide Bank (up 1%) took the spoils.

Not surprisingly, the start of the year was quiet for Merger and Acquisition activity, as the market took a break in between the holiday period of December into January and the lead up to February's reporting season. The only notable item for the month was Bright Foods' expression of interest in CSR's sugar unit.

Large Caps

The best performing Australian large-cap stocks during the month were Macquarie Infrastructure Group (9.7%), Macquarie Group (3.6%) and Suncorp-Metway (2.4%).

- Macquarie Infrastructure Group investors agreed to a complete demerger of domestic and international portfolios during January, where its best performing assets will be placed into a company called Intoll International and its highly leveraged assets into Macquarie Atlas Group.

- Macquarie Group had preliminary discussions during the month with Charter Hall Group, a leading property group, regarding the possibility of Charter Hall acquiring parts of Macquarie Group's real estate business.

The worst performing Australian large-cap stocks during the month were WorleyParsons (-18.9%), Alumina (-16.3%) and Transfield Services (-15.8%).

- WorleyParsons issued its third profit downgrade since October 2009, a cumulative cut of 30%. The basis of this latest revision was a fall in demand, especially in the US, adversely affecting power operations, and legislative uncertainty surrounding the treatment of carbon.

- Alumina's share price suffered as debt-laden Russian aluminium company Rusal raised $2.5bn from its IPO in Hong Kong.

Small Caps

The best performing Australian small-cap stocks during the month were Mantra Resources (20.6%), Berkeley Resources (20.3%) and Brockman Resources (16.0%).

- Mantra Resources announced encouraging results from uranium samples at the Mkuju River Project, Tanzania. The company is confident that the region is an emerging uranium province.

- Positive drill results at Berkeley Resources' Salamanca uranium project in Spain assisted the company's share price during the month. It plans to fast-track the feasibility study on the project.

The worst performing Australian small companies stocks during the month were Nomad Building Solutions (-59.1%), Neptune Marine Services (-35.4%) and Karoon Gas Australia (-32.1%).

- Modular builder Nomad Building Solutions announced a significant earnings downgrade in January, citing poor market conditions, poor management and systems, and a failure to secure anticipated future work as the reasons behind the downgrade.

- Neptune Marine announced a disappointing earnings and trading update in January, reporting that earnings for the first half of FY10 will be well below the corresponding period last year.

Major Indices

The major indices performed as follows during January:

S&P/ASX 200 Accumulation Index	-6.2%
S&P/ASX 200 Industrials Accumulation Index	-4.8%
S&P/ASX 200 Resources Accumulation Index	-9.4%
S&P/ASX Small Ordinaries Accumulation Index	-7.4%

Listed Property

The Listed Property sector fell 2.9% (S&P/ASX 200 A-REIT Accumulation Index) in January, outperforming the broader market return. The sector rallied early in the month before being dragged down with the rest of the market as global issues had a negative impact.

The first month of the year was a slow one for capital raisings, with the sector taking a breather from the almost frenzied raisings of 2009.

Westfield Group was the only company in the index to achieve a positive return for the month, buoyed by an increased appetite for USD denominated assets as the economic recovery in the US gains momentum.

Australian Fixed Income Review

Locally, both business and consumer confidence measures have consolidated at high levels and a favoured leading indicator - the Westpac/MI Leading Index - continues to surge. The local labour market remains resilient, and the unemployment rate edged down to 5.5% last month. The recent cyclical high of 5.8% recorded last October may represent the high, a marvellous result historically.

The ongoing improvement in the economic outlook has seen the Reserve Bank of Australia (RBA) start the process of returning official interest rates towards more normal levels. The Bank has hiked three times each by 0.25% lifting cash to a still low 3.75%. However, the RBA has reminded us all that both borrowing and lending rates in the economy have risen by more than the 0.75% of official rate moves. The RBA says that these moves are worth about an extra 1%, such that current interest rates in the economy are analogous to an official rate of nearer to 4.75%.

The RBA will make allowance for this when setting policy. In other words "normal" official interest rates which have previously described as being nearer to 5.50% may now be lower to account for economy-wide interest rates. As such the "new normal" may be nearer 4.50%. In any event the market is now pricing in a cash rate of around 4.75% by Christmas 2010.

Uncertainty as to the sustainability of the global recovery, Chinese policy tightening, sharemarket volatility and sovereign budget deficits and ratings concerns all conspired to push yields lower through January. This backdrop plus the local market moderating RBA rate expectations fuelled a rally to lower yields delivering respectable returns.

In terms of market moves, the benchmark 3-year bond closed lower by 0.21% at 4.85%, while the benchmark 10-year bond closed lower by 0.31 % at 5.45%. The UBS Composite Bond Index delivered a solid return of 1.32% as capital gains from falling yields boosted returns. By sector, the Semi Government component was the best performer.

International Fixed Income Review

The global economic outlook continues to improve, however, labour markets remain weak. In the USA and parts of the EU, the unemployment rate sits at 10%. Unfortunately the "maths" of economics and labour markets means that it will take years to re-gain previous levels of employment, although pleasingly the US looks set to record positive jobs growth from the next month or so and through this year.

Key central banks remain cautious, not wanting to risk nipping in the bud signs of better times ahead. After all, headwinds remain. The US Fed continues to suggest that rates are likely to be kept low for an extended period, however, some dissent has arisen. It seems the market may be being prepped for a policy adjustment around mid-year.

US Treasury yields led the move to lower yields around the world through January with UK Gilts and German Bunds following. Peripheral EU countries, the so-called PIIGS (Portugal, Ireland, Italy, Greece and Spain) suffered as unprecedented budget deficits requiring large funding tasks prompted rating agency concerns, impacting yields as a result. For instance, the Greek 10-year Bond closed appreciably higher in yield, up 1.08% at 6.85%. This now represents a significant yield spread above core EU markets.

In terms of price action, the US Treasury 2-year note closed lower by 0.32% at 0.82 % and the 10-year note, the global benchmark, closed at 3.59% lower by 0.25%. The global fixed income market return, as measured by the Barclays Capital Global Aggregate Index (hedged into A$) delivered a solid return of 1.35%.

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