

MARKET REVIEW

30-June-2009

International Economic Review

United States

The latest Nationwide Manufacturing Survey showed contraction in activity slowed in May with the ISM Manufacturing Index rising to 42.8 from 40.1 in April. The ISM Non-Manufacturing Index also rose slightly higher but remained below 50 - a level associated with contraction in the service sector of the economy.

While outlook surveys have generally improved, current economic conditions remain weak. Industrial production fell 1.1% in May while capacity utilisation fell to a new record low of 68.3%. The closely watched Core (ex-defence, ex-aircraft) Capital Goods Orders rose 4.8% in May, a most encouraging sign that the severe downturn in corporate investment spending is moderating.

Retail sales rose 0.5% in May in contrast to a 0.2% decline in April, however, the gain was mainly due to higher receipts from petrol stations. Confidence data disappointed as the Conference Board's Consumer Confidence Index fell to 49.3 in June from 54.8 in May.

Housing starts raised 532,000 units in May, the highest reading since December, but remained 45% below the same time last year. New and existing home sales however continued to disappoint. The latest S&P/Case-Shiller Survey showed home prices remained around 18% lower than a year ago.

Pleasingly, the latest Non-Farm Payroll showed the economy shed jobs at the slowest rate since September 2008, by only 345,000 in May. The unemployment rate, however, rose 0.5% to 9.4%, the highest rate in 25 years.

Inflation data was softer than expected with both headline and core Consumer Price Index (CPI) rising only 0.1% in May. Consequently, the annual rate of growth for headline inflation fell deeper into negative territory at -1.3%, marking the largest annual decline in 60 years. Pleasingly however, core CPI remained positive at 1.8%.

Europe

In Europe, the German IFO Index came in better than expected, rising 1.7 points to 85.9 in June. Similarly the ZEW Index of Economic Sentiment rose to the highest level since May 2006, rising 13.7 points to 44.8 in June. In both surveys, most of the gains were due to a substantial rise in the expectation component while current conditions remained weak.

Mirroring the inflation data released in many developed economies, Euro area inflation turned negative with early estimates of the Harmonised Index of Consumer Prices showing an annualised growth of -0.1% in June, a massive turnaround from 4.0% in June last year.

Asia

In Japan, industrial production rose 5.9% in May while Core Machinery Orders fell 5.4% in April. The closely-watched proxy for growth outlook for Japan, the Shoko Chukin Small Business Confidence measure, rose 3.9 points to 38.0 in June. The latest inflation data showed deflationary pressures building as the Core National CPI fell 1.1% in annual terms.

Elsewhere in Asia, the outlook surveys for China continued to fare better. The National Bureau of Statistics measure of Chinese manufacturing (PMI) fell slightly in May but remained above expansionary levels at 53. The MarkIt-CLSA measure of PMI also stayed above 50, rising 1.1 to 51.2.

Australia

The Australian economy narrowly avoided technical recession in the March quarter with GDP up 0.4%, after contracting 0.6% in the December quarter. The better than expected figure was boosted by higher than expected net exports, while domestic demand remained weak. The annual rate of growth stands at 0.4%.

On more recent data flow, the annualised growth rate of the Westpac-MI Leading Index was -3.5%, an improvement from what does appear to have been the low point in the growth cycle of -6.1% in February. Meanwhile the annualised growth rate of the Coincident Index was -0.5%.

The Westpac-MI measure of consumer sentiment continued to improve last month, rising sharply to just above the psychological level of 100 in the latest reading. Reflecting this stronger confidence, retail sales rose a higher than expected 1.0% in May, indicating consumers clearly responded to the Government's cash handouts, the majority of which were received in late April and early May.

Employment fell 26,200 in May following a surprise 25,400 rise in April. Unemployment also disappointingly rose 0.2% to 5.7%. Private sector credit fell 0.1% in May, reversing the rise of the previous month. The annual rate of growth for credit stands at 3.9% in May.

The NAB Business Conditions Survey fell 4 points in May, but business confidence improved 12 points to -2 aided by stimulus and improving global sentiment.

International Sharemarket Review

Global sharemarkets rose higher before retreating back mid-month as investors took profits from the recent rally. Better economic indicators supported hopes that the recession had somewhat eased but concerns re-emerged over corporate earnings, particularly in the cyclical sectors. Defensive sectors performed better during the month.

Consumer confidence in the US slumped, with big players Supervalu (down 22%) and Best Buys (down 5%) suggesting that there are issues with the US consumer market.

General Motors filed the biggest bankruptcy in US history in early June, however, this did not have as big an effect as many of the others who have gone under in the last year. Theme park operator Six Flags and apparel retailer Eddie Bauer also followed GM into bankruptcy. British Airways took the desperate step of asking staff to work for free, claiming that wages would be frozen for two years.

Major bourses performed for the month as follows:

Japan Nikkei 225	4.6%
UK FTSE 100	-3.8%
US Dow Jones	-0.6%
US S&P 500	0.0%
German DAX	-2.7%

Australian Sharemarket Review

June saw the Australian market record its fourth consecutive monthly rise, gaining 4.0% (S&P/ASX 200 Accumulation Index). Strong gains early in the month saw the All Ordinaries Index reach 4,000 points for the first time since November 2008. Some territory has been given back since as both local and global markets have cooled somewhat, possibly based on the conclusion that markets had surged ahead of fundamentals, and certainly due in part to some profit taking and concerns over the strength and rate of the recovery.

Resources (up 0.2%) were flat after enjoying early success in the month and despite commodity prices continuing their climb. Banks (up 6.5%) bounced back after two months of underperformance.

Consumers have been shown to be alive and well, with the Government's stimulus spending being attributed for earnings upgrades to David Jones, JB Hi-Fi and positive commentary from Harvey Norman regarding winter sales. Capital raisings continued for some big names, including Rio Tinto and Asciano Group.

Large Caps

The best performing Australian large-cap stocks during the month were Goodman Group (48.0%), Fortescue Metals Group (44.7%) and David Jones (26.0%).

- Goodman Group benefited from increased confidence after a reported commitment by China Investment Corporation (CIC) to be a strategic partner. CIC have contributed \$200m of finance, adding to the financing facility received from Macquarie Group in May.

- Better than expected sales in May and June and improved cost controls earned David Jones a profit upgrade for 2H09.

The worst performing large-cap stocks were Nufarm (-25.1%), Aquarius Platinum (-19.1%) and ING Office Fund (-14.7%).

- Nufarm announced that due to increased price competition and a decline in demand for glyphosate, it expects to miss its previous operating profit guidance by 15%.

- Newly accepted for inclusion into the ASX 100, Aquarius Platinum's price softened on the progress of its offer for Ridge Mining.

- ING Office Fund's underperformance can be attributed to the \$415m capital raising undertaken at a discount of 16% to its previous close.

Small Caps

The best performing Australian small-cap stocks during the month were Boart Longyear (100.0%), MEO Australia (91.7%) and Pan Pacific Petroleum (46.9%).

- Debt-laden drilling services provider Boart Longyear soared from its trading lows of 14.5c early in June on speculation of a rights issue.

- MEO Australia attributed June's initial price rise on an article written in The Age on 8 June highlighting MEO's strategic location should gas be discovered in its Western Australian exploration permits. Its presentation on the Tassie Shoal Methanol and LNG Projects was also received well by the market.

The worst performing small-cap stocks were Marion Energy (-32.4%), Carbon Energy (-28.7%) and Linc Energy (-27.5%).

- Marion Energy secured an extension to its finance with its banking syndicate during the month, but only for 30 days.

- Carbon Energy completed a \$32m raising which was oversubscribed, resulting in stock being sold down as investors banked profit.

- Linc Energy began the drilling of its Galilee Basin, but went on a trading halt later in the month as the company was required to provide an update on the sale of coal assets in Queensland.

Major Indices

The major indices performed as follows during June:

S&P/ASX 200 Accumulation Index	4.0%
S&P/ASX 200 Industrials Accumulation Index	5.7%
S&P/ASX 200 Resources Accumulation Index	0.2%
S&P/ASX Small Ordinaries Accumulation Index	3.0%

Listed Property

The Australian property sector gained 4.6% in June as measured by the S&P/ASX 200 A-REIT Accumulation Index, outperforming the broader market by 0.6%. This result, while unspectacular, was a fillip for the sector as it tries to recover from 2008.

The month began well as an increase in risk appetite across the whole market continued on from May, with a rotation into stocks which had previously struggled. Re-capitalisation was again prevalent. This has been the major theme in the past year as companies have looked to pay down debt and manage the dislocation taking place in debt markets.

Australian Fixed Income Review

Although relatively better performed than the rest of the developed world, Australia and its policy-makers have moved as hard and fast as the offshore response in an effort to ward off the worst of the slowdown. The Reserve Bank of Australia (RBA) has reduced the official cash rate to an historically low 3.00% and said further cuts are possible if required. In addition, the Government has announced several fiscal stimulus packages, the latest of which was announced in the May budget. Like elsewhere the spending and revenue losses forecast will require record levels of Bond issuance over the next few years.

The Government offered the States the opportunity to borrow with a Commonwealth Government guarantee for a fee. This was seen as necessary to keep capital markets open to State Governments to ensure funding commitments can be met. Most but not all states are likely to take up this offer.

The media frenzy as to whether Australia is in so called "technical recession" (two quarters of negative growth) is moot. The domestic economy has clearly slowed appreciably and unfortunately unemployment is likely to trend higher well into next year. Most analysts and indeed the Government forecast as much.

As for market moves, offshore influences have been important. Our fixed income market largely mirrored the offshore "flight to quality" earlier this year, and the subsequent "flight out of quality" more recently. Additionally, the run of economic numbers here continues to be better than earlier feared prompting a market re-think on the possibility of additional RBA rate cuts. This severely impacted shorter term maturities and the yield curve flattened significantly as a result, evidenced by the key 3-year Bond which rose by 83 basis points to close June at 4.75%. The 10-year Bond was also impacted but much less so (curve flattening), rising by 25 basis points to 5.50%.

Non-Government corporate (or credit) markets corrected some of the price dislocation associated with the financial crisis. The benchmark UBS Composite Bond Index returned - 0.61%.

International Fixed Income Review

Fears that the world was headed for a repeat of the Great Depression earlier this year saw enormous dislocation in all asset classes. Equities and commodity prices fell heavily, currencies swung wildly, credit related securities were trashed and Bond markets enjoyed an aggressive "flight to safety" rally down to levels once thought impossible. Thankfully better economic numbers appeared throughout the second quarter allowing some of the extreme financial market pricing, which had become so dislocated earlier this year, to unwind to a large extent.

For fixed income markets this manifested itself as a "flight to quality" with Bond yields everywhere swept significantly lower as other more risky assets were effectively abandoned. However, "green shoots" throughout the second quarter allowed a strong re-pricing of risk to occur and Bond market yields retraced much of the earlier rally.

Most of the Bond market sell off occurred prior to June. For June itself, the key US 10-Year Note, the global benchmark, closed modestly (8 basis points) at 3.54%. Other major markets delivered modest gains. German Bunds began the quarter at 3.59% before closing somewhat lower at 3.39%, UK Gilts began at 3.74% closing lower at 3.69%, while Japanese Bonds opened at 1.49% before closing at 1.36%. Non-Government corporate (or credit) markets recovered some of the price dislocation associated with the current financial crisis. The JP Morgan Government Bond Index (A\$) returned a respectable 1.01%, and the broader Barclays Capital Global Aggregate Bond Index (A\$) returned 1.13%.

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