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MARKET REVIEW

30-May-2009

International Economic Review

United States

US GDP for the March quarter was revised up from -6.1% to -5.7% on an annualised basis. While the magnitude of the revision was close to market expectations, the composition was not. Consumer spending was actually revised lower, but then was offset by smaller declines in exports and inventories.

On more recent data, the latest Manufacturing ISM Index figures suggest activity contracted at a slower pace in April, with the index increasing 3.8 points to 40.1 and most underlying measures, including new orders and production, showing some improvements. Pleasingly, the Non-Manufacturing Index ended higher at 43.7 compared to 40.8 in the previous month.

On the labour market, the economy continued to lose jobs at an elevated level, although the last figure was slightly better than expected. Non-Farm Payroll fell 539,000 in April after slumping 699,000 in the previous month. The unemployment rate rose 0.4% to 8.9%.

Headline retail sales slumped for the second month in a row, falling 0.4% in April. Excluding auto sales, it fell 0.5%, suggesting underlying consumer spending remains weak. Meanwhile in the housing sector, news remained grim with both starts and permits printing below expectations.

On the inflation front, headline CPI was flat in April, pushing the annual rate to -0.6%. Core CPI rose 0.3% for the same month to be 1.9% higher in annual terms.

Europe

Early estimates showed Eurozone's economy fell 2.5% in the March quarter, the biggest fall since its inception. This was the fourth consecutive quarterly fall and brought the annual rate of growth to -4.6%. Of the major nations in the zone, Germany saw the steepest decline in growth, with GDP falling 3.8% in the quarter and being 7.0% lower than a year ago.

On the outlook, the closely watched IFO Business Survey rose 0.5 points to 84.2 in May. Despite recent improvements, the index remains below 100, a level associated with economic contractions. There is also a notable improvement in the ZEW Economic Sentiment with the index raising 18.1 points to 31.3 in May.

Asia

Japan's economy contracted at record levels in the March quarter, with GDP dropping 4.0%, which translates to an annualised drop of 15.2%. Surprisingly, there is some positive news for the economy in recent data releases. Industrial production rose 5.2% in April, but is still 31.2% lower for the year. The data is consistent with recent trade statistics which showed a recovery in export volumes. The closely watched proxy for growth, the Shoko Chukin Small

Companies Survey remained weak but rose in the latest reading. Elsewhere, on a seasonally adjusted basis, household spending fell 0.9% for the month to be down 1.3% year-on-year, while unemployment rose 0.2% to 5.0%.

In China, there are more signs of recovery in manufacturing activities with the CLSA PMI measure rising above the expansionary level of 50 in April for the first time in nine months. Meanwhile the official NBS PMI also sent a signal of consistency with a rise of 1.1 points to 53.5 in April.

Australia

The closely watched Westpac-Melbourne Institute Leading Indicator, which indicates the likely pace of economic activity three to nine months ahead, fell 5.1% annualised in March, well below its long term trend of 2.8%. The annualised growth rate of the Coincident Index was 0.7%, also well below its long term trend of 3.3%.

Business Investment fell 8.9% in the March quarter to be only 6.8% higher for the year, with broad based weakness in all sectors. Intentions in business spending ahead continued to be downgraded in the face of the credit crunch and fall in demand.

Private credit growth rose a meagre 0.1% in April bringing the annual rate of growth to only 4.9%. Within its component, housing credit growth has improved since last August, albeit gradually, while business and other personal credit continued to weaken.

Employment surprisingly grew at a stronger than expected rate of 27,300 in April, partly offsetting the 37,200 fall in the previous month. Likewise, the unemployment rate unexpectedly fell 0.3% in April to 5.4%. Retail sales rose 0.3% in April after a 2.2% rise in March, a solid result in response to the Federal Government's cash handouts. Sales have risen a healthy 6.8% from a year ago.

On inflation, the TD-Melbourne Institute measure of inflation fell 0.3% in May and slowed the annual growth to a record low of 1.5%.

Meanwhile the Federal Government unveiled its financial year 2009/10 budget, with Treasury's forecast deficit of $57.6bn in the coming year or 4.9% of GDP, almost double the 2.7% in 2008-09.

International Sharemarket Review

Global sharemarkets started the month on a high note before drifting sideways for the rest of the month. News of stress tests conducted by the US Treasury that showed that some major banks require additional capital, and the expectation and subsequent Chapter 11 bankruptcy of General Motors, weighed on the market. Nevertheless, Resources and Financials were notable outperformers for the month.

Major bourses performed for the month as follows:

Japan Nikkei 225	7.9%
UK FTSE 100	4.1%
US Dow Jones	4.1%
US S&P 500	5.3%
German DAX	3.6%

Australian Sharemarket Review

The local equities market edged 1.4% higher (S&P/ASX 200 Accumulation Index) in May, similarly tracking sideways for most of the month. The result saw the market record its first positive three month period since the market highs of late 2007. Despite these numbers indicating a seemingly quiet period, May was far from it, with much going on. ASIC removed its short selling ban, profit warnings were prevalent and capital raisings ramped up, all resulting in the domestic market generally underperforming its global counterparts.

Resources (up 6.2%), both energy and mining, were the best performers supported by stronger commodity prices, while Financials were unconvincing compared to international peers. Defensives wavered, with Consumer Staples down 5.0% and Healthcare down 7.5%, led by falls in CSL and Resmed.

With the financial year end closing in, capital raising was again widespread, bringing to $66.7bn the amount raised this financial year, already the heaviest financial year of equity issuance on record, with one month still to go.

Large Caps

The best performing Australian large-cap stocks during the month were ING Office Fund (31.0%), GPT Group (28.4%) and Incitec Pivot (27.5%).

- ING Office Fund benefited from improved sentiment despite no new news flow. A syndicate facility expiring in June 2010 is still to be navigated through asset sales and undrawn facilities.

- Incitec Pivot rallied hard despite the announcement of a poor operational result.

The worst performing large-cap stocks were Elders (-42.5%), Goodman Group (-32.4%) and Billabong (-21.7%).

- Sharply reduced prices and buyer uncertainty on farm supply markets caused Elders to revise down its FY09 profit guidance from $34m to a loss of between $5-15m.

- Goodman Group's announcement of a $300m alternative finance facility to address its expiring $460m syndicated facility did not meet market expectations. Concerns remain regarding dilution, transparency and re-structuring firepower deployed.

- Billabong downgraded its profit forecast due to weakness in the US market. It also raised capital during the month ($290m at $7.50 per share).

Small Caps

The best performing Australian small-cap stocks during the month were Macquarie DDR Trust (122.2%), Centro Retail Group (90.9%) and Hastings Diversified (76.1%).

- Significant marketing transactions of up to $100m by both Macquarie DDR Trust and Centro Retail Group have raised prospects of the small end of the REIT space's ability to reduce debt and survive through the cycle.

- Hastings Diversified surged on the back of a proposal from US fund manager TCW for 100% of subsidiary Epic Energy.

The worst performing stocks were Boom Logistics (-35.0%), Oilex (-33.3%) and Babcock & Brown Infrastructure Group (-27.6%).

- The downturn in resources, non-residential construction and industrial services markets affected Boom Logistics' share price during the month, with the company reporting a NPAT loss of $0.5m for the March quarter.

- Debt-laden Babcock & Brown Infrastructure Group continues the arduous task of selling off assets, with the proposed sale of its PD Ports subsidiary hitting a road-block during the month.

Major Indices

The major indices performed as follows during May:

S&P/ASX 200 Accumulation Index	1.4%
S&P/ASX 200 Industrials Accumulation Index	-0.7%
S&P/ASX 200 Resources Accumulation Index	6.2%
S&P/ASX Small Ordinaries Accumulation Index	7.4%

Listed Property

The Australian property sector gained 3.8% in May as measured by the S&P/ASX 200 A-REIT Accumulation Index, outperforming the broader market by 2.4%. There was a continuation of last month's themes with further capital raisings, where $4.0bn was raised, and a growing appetite regarding balance sheet risk. This renewed appetite assisted stocks within the sector such as ING Industrial Fund (up 47.1%) and ING Office Fund (up 31.0%), as the capital constrained REITs outperformed the previously favoured defensives.

Australian Fixed Income Review

At its regular monthly board meeting the Reserve Bank of Australia (RBA) chose to leave official interest rates unchanged. The Bank noted the combined level of monetary and fiscal stimulus already delivered, and described policy as appropriate for now. The market continues to price in the chance of at least another rate cut towards year end.

The unemployment rate in Australia unexpectedly fell by 0.3% back to 5.4% last month. This is seen almost universally as an outlier. All employment leading indicators point to ongoing job losses and higher unemployment, and the Government forecasts unemployment to rise into the mid 8% area.

The Government released its budget and announced a sizeable deficit requiring a significant Bond issuance program to fund. On current projections, the Government will require around $1bn to $1.5bn a week for the next couple of years at least to deliver on measures announced.

As for market moves, the 90-day Bank Bill closed higher by 0.11% at 3.19%, the Australian 3-year benchmark Commonwealth Government Bond closed higher by a sizeable 0.5% to yield 3.92%, while the 10-year benchmark Commonwealth Government Bond closed much higher in yield by over 0.66% at 5.25%. The UBS Composite Bond Index returned minus 0.72%.

International Fixed Income Review

May saw the so-called "green shoots" off better economic numbers continue. Respected leading indicators edged up somewhat and both business and consumer sentiment surveys improved. This was a welcome end to the severity of the collapse everywhere and the fears that we were all heading for Great Depression 2 (GD2). Having said that, the global economy remains in recession and unemployment rates continue rising around the globe.

As for central banks, the Reserve Bank of New Zealand (RBNZ) cut rates 0.5% to 2.5%, the European Central Bank (ECB) trimmed another 0.25% to a slim 1.0%, and the Bank of England expanded its quantitative easing program. In another development of note, ratings agency S&P placed the UK on negative outlook citing a one in three chance of an actual downgrade subject to how their fiscal position unfolds in the next year or two.

In terms of price action, in the USA the 2-year Note closed modestly higher by 0.02% at 0.92% but the 10-year Note, the global benchmark, closed up some 0.34% at 3.46%. In other key global bond markets the UK 10-year Gilt closed higher by 0.25% at 3.75%, the German 10-year Bund higher by 0.41% at 3.59%, while the Japanese 10-year maturity closed at 1.49% up by 0.06%. These bond market losses were offset by strong gains in credit related securities such that the global fixed income market return, as measured by the Barclays Capital Global Aggregate Index (hedged into A$), delivered +0.38%.

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