

MARKET REVIEW

30-Sep-2009

International Economic Review

United States

In September, there was a considerable improvement in manufacturing activity in the US. The closely watched ISM Manufacturing Survey rose to 52.9 in August from 48.9 in July, breaking above the crucial level of 50 for the first time in 18 months - a level associated with expansion in manufacturing output. The Non-Manufacturing Survey also rose to 48.4 from 46.4 in July, suggesting the service sector is also on the mend.

On the consumer side, the Conference Board measure of consumer confidence slipped 1.4 points to 53.1 in September. Consumer sentiment has been on a seesaw pattern, ranging from mid 40 to mid 50 in recent months. Retail sales rose 2.7% in August, marking the largest monthly advance since January 2006. The gain was bolstered by the Federal Government's 'Cash for Clunkers' program - an incentive to trade in old cars with new ones. Retail sales excluding auto was also respectable with a 1.1% rise for the month.

Pleasingly, Industrial Production for July was revised higher than the previous estimate of 0.5% to 1.0% in July thanks to the ramp up in auto production to meet the "clunker" demands. Industrial Production rose another 0.8% in August.

On the labour market, the Non Farm Payroll fell only 216,000 in August, a marked improvement from a loss of over 700,000 early this year. However, the unemployment rate rose 0.3% to a 26-year high of 9.7%. Housing starts rose 0.1% in August to 598,000 annualised. New Home sales rose 0.7% to 429,000 in August, a modest gain compared to the 6.8% rise in the previous three months

On the inflation front, headline CPI rose 0.4% in August after a flat reading in July. Core CPI rose 0.1% following a similar rise in the previous month. Headline CPI stood at -1.5% in annualised terms as the economy recessed, while core CPI was 1.4% higher from a year ago.

Europe

Euroland Industrial Production fell 0.3% in July - a mild downturn following the collapse earlier this year. Production is still 16.1% lower than a year ago. Euroland's flash estimate of the annual Harmonised CPI fell 0.3% from a year ago, a slight deterioration from 0.2% in the previous month, but an improvement from -0.7% recorded in July.

On the outlook, the closely watched proxy for European economic growth, the IFO Business Climate Survey, rose 0.8 points to 91.3 in September. Similarly, the ZEW Economic Sentiment Index rose 1.6 points to 57.7, following a 16.6 point surge in the previous month. Euro-area PMI Manufacturing was slightly up, while the Service PMI was marginally down.

Asia

Chinese data continued to point to a solid recovery with Industrial Production up 14% in August to be 12.3% higher from a year ago. Retail sales rose 1.8% in August, bringing the annual rate to a healthy 15.4%. Fixed Asset Investment rose 33.5% higher in annual terms assisted by a RMB 410bn surge in bank lending. China's trade balance printed a larger surplus of US\$15.7bn. On inflation, headline CPI remained 1.2% lower than a year ago despite a 0.5% rise in August.

In Japan, data releases were relatively mixed with Household Spending falling 0.4% in August. That brought the annual rate of growth to just 0.1%. Deflationary pressure continued with another 0.1% fall for the nationwide CPI in August, bringing the annual rate to -2.3%. Employment surprisingly jumped 260,000 in August and the unemployment rate retraced to 5.5% from 5.7% in the previous month. Industrial Production rose 1.8% in August but remained 18.7% down from a year ago. The closely watched proxy for growth outlook in Japan, the Shoko Chukin's Small Business Survey, showed confidence rose 1.2 points to 44.7 in August, a strong recovery from a cyclical low of 25 recorded in February.

Australia

Australia's economy grew 0.6% in the June quarter, the fastest pace since the March quarter in 2008 and following a 0.4% rise in the March quarter this year. The annualised growth rate of the Westpac/Melbourne Institute Leading Index, which indicates the likely pace of economic activity three to nine months ahead, continued to improve, rising 1.5% in July from -3.3% in June. It remained well below its long term trend of 2.5%, but the result was a marked improvement from -7.0% recorded in May this year.

Reflecting confidence on the economy, the Westpac-Melbourne Institute Consumer Sentiment Index rose 5.2% in September to 119.3, the highest level since July 2007. Retail sales unexpectedly bounced 0.9% in August, reversing the fall in July.

Building approvals fell 0.1% in August driven by the 'other dwelling' component (mainly multi-dwelling apartment buildings), while private sector house approvals remain strong. Meanwhile, private sector credit rose slower than expected by 0.1% in August, owing to a large contraction in business lending. This brought the annual rate of growth to a meagre 2.8%, the lowest since June 1993.

The NAB Business Confidence Survey spiked 8 points to 18 in August, marking the third consecutive positive month in a row.

International Sharemarket Review

International sharemarkets posted another positive month with a strong rally in the first half of the month, helped by further evidence of a turning point in the global economy. Most major markets have recovered strongly from the low in February this year. Asian ex-Japan and emerging markets outperformed most major indices for the month. Resources stocks were a notable performer, while Financials slightly lagged behind but still remained positive for the month.

Australian Dollar Outlook

Major bourses performed for the month as follows:

Japan Nikkei 225	-3.4%
UK FTSE 100	4.6%
US Dow Jones	2.3%
US S&P 500	3.6%
German DAX	3.9%

Australian Sharemarket Review

September saw the Australian market rise 6.2% (S&P/ASX 200 Accumulation Index), marking the seventh consecutive monthly rise, after bottoming in early March. The relief rally is now very much in full swing, with investors likely needing to see a recovery in earnings to justify current levels.

Banks were a standout performer in September as improving economic data created much optimism in the sector. The Reserve Bank of Australia (RBA) basically re-affirmed the banks' optimism during the month, by raising rates by 0.25% at its October meeting, and delivering a positive half-yearly Financial Stability Review. Government announcements on reforms to the domestic telecommunications industry weighed heavily on Telstra and the sector in general, gaining a meagre 0.3% for the month.

Capital raising was steady for the month, but a revival in the IPO market was where the real interest was. Carsales.com.au began proceedings with an \$800m IPO, with upcoming floats of Myer and Kathmandu to keep investors interested in the near term.

Large Caps

- The best performing Australian large-cap stocks during the month were Cochlear (18.6%), David Jones (17.0%) and Fairfax Media (16.7%).
- David Jones posted a 6.3% rise in annual profit, attributing the performance to improved revenue. It has reported that early sales figures for FY2010 are also better than expected.
- Discontent amongst the Fairfax Media Board failed to affect the company's share price, as media experts suggest that online ads are likely to bounce from their recent slumber.
- The worst performing Australian large-cap stocks during the month were Fortescue Metals Group (-13.4%), Centennial Coal (-8.3%) and CSR (-7.8%).
- Fortescue Metals Group missed a self-imposed deadline to re-finance up to A\$6.8bn from Chinese steel mills, causing investors to question future expansion plans and a related deal with the mills to discount its ore.
- CSR is proceeding with plans to divest its sugar and renewable energy divisions by no later than March next year and also advised during September of some future management changes.

Small Caps

- The best performing Australian small-cap stocks during the month were Centro Properties (88.2%), Horizon Oil (60.0%) and Ceramic Fuel Cells (56.8%).
- Centro Properties were supported strongly late in September, and in response to an ASX price query, the company stated it did not know of any information not made public that would account for the rapid price movement.
- Horizon Oil announced positive results from drilling tests, and reported a reduction in losses to \$8.1m in the year to 30 June 2009 from a previous \$16.2 million loss, on revenue up from \$80,000 to \$8.2 million.

- The worst performing Australian small companies stocks during the month were Apex Minerals (-43.0%), Elders (-38.5%) and Babcock & Brown Infrastructure (-30.3%).
- Apex Minerals sold its Aphrodite gold exploration project during the month, whilst also undertaking a \$108m rights issue to fund further development at its Wiluna mine and to extinguish debt.
- Elders struggled after announcing its recapitalisation plan, where a debt refinancing deal was completed and the launch of a deeply discounted capital raising. An annual loss of \$A415.4m for FY09 was also announced during the month.

Major Indices

The major indices performed as follows during September:

S&P/ASX 200 Accumulation Index	6.2%
S&P/ASX 200 Industrials Accumulation Index	7.8%
S&P/ASX 200 Resources Accumulation Index	2.4%
S&P/ASX Small Ordinaries Accumulation Index	5.0%

Listed Property

The Australian property sector soared 9.8% higher (S&P/ASX 200 A-REIT Accumulation Index) in September, again outperforming the broader equity market (6.2%). On a rolling 12-monthly basis though, the sector is still down 30.0%, indicating how far the sector had plunged in the grips of the Global Financial Crisis.

September saw all of the Australian REITs post a positive return, with the capital-constrained and growth oriented companies again outperforming defensives. But it was really a case of splitting the good performers from the great performers, as a rotation from retail names to office names occurred during the month.

Moving into the final quarter of the calendar year, valuation concerns are being bandied around with fears that the sector has run too hard. However, on a relative basis, the A-REIT sector has lagged its global counterparts, so the sector may well still be attractive to global investors.

Australian Fixed Income Review

The global economic backdrop continued to improve and key leading economic indicators in all the major regions continued to rise. Central bankers everywhere are becoming more confident of better times ahead but understandably remain cautious. Policy remains stimulative understandably.

Locally, data released also remained positive but somewhat mixed. Both business and consumer confidence measures continued to rise, housing data continued to reflect the benefits of low interest rates and the Government first home owner's grant. On the flip side, retail sales have taken a step back as the benefits of earlier Government stimulus packages have now passed. The labour market continues to remain relatively resilient with employers choosing to reduce the number of hours worked as opposed to reducing staff. The unemployment rate is currently 5.8%, up from the cyclical low of 3.9%.

The ongoing improvement in the economic outlook has prompted much discussion as to the appropriateness of current stimulatory policy. The RBA has clearly flagged that current interest rate levels are at emergency levels and a return towards more normal levels is coming. Markets will always debate timing but the first movement expected by year's end came to fruition after the October Board Meeting, where the official cash rate was raised to 3.25%.

Market speculation as to RBA timing influences the performance of shorter dated maturities and therefore the shape of the term structure of interest rates or yield curve. An aggressive move towards a flatter curve (shorter term maturities selling off as RBA rate hike expectations are brought forward) has been a feature of recent weeks and continued into quarter end.

In terms of market moves, the 90-day bank bill ended the month lower by 0.07% at 3.39%, the benchmark 3-year bond moved higher by 0.01% at 5.04%, whilst the benchmark 10-year bond closed 0.04% higher at 5.43%. The UBS Composite Bond Index delivered a positive return of 0.72%.

International Fixed Income Review

The global economic outlook continued to improve during September as key leading economic indicators in all the major regions rose further. Whilst the bounce in these indicators is welcome, labour remains weak and job losses are still coming through even though the pace appears to have moderated. Unfortunately the "maths" of economics and labour markets means that it will literally take years to re-gain previous employment levels.

Interestingly, despite the run of generally better than expected data released during September and respectable sharemarkets, bond markets were able to hold their ground. The debate regarding the timing of policymakers exiting from extreme policy accommodation has begun, which could have been expected to adversely impact yields. Inflation appears to be a non-issue for the next year or two which may be an offsetting factor.

In terms of price action, the US Treasury's 2-year note closed lower by 0.02% at 0.95%, whilst the US 10-year note, the global benchmark, closed at 3.31%, lower by 0.09%. In other key global bond markets, the UK 10-year Gilt closed higher by 0.03% at 3.59%, the German 10-year Bund lower by 0.04% at 3.22%, and the Japanese 10-year maturity closed at 1.30%, lower by 0.01%. The global fixed income market return, as measured by the Barclays Capital Global Aggregate Index (hedged into A\$), delivered a return of 1.05%.

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