

Monthly Market Watch – April Issue 2008

MARKET COMMENTS – MARCH

Market developments during March and early April included:

Australian equities fell 3.4% for the month. Australian equities have now fallen 14.6% for the three months to March. Continued weakness in the financials sector and profit-taking in resource leaders were negatives for the market.

Australian Listed Property Trusts stabilised as there was some evidence of 'bargain hunting' as investors reacted to the 19% fall in the sector year to date and bond yields eased lower.

Signs of weaker Australian leading indicators and equivocal comments from Reserve Bank officials have increased market confidence that the Australian cash rate has peaked. Thus Australian Fixed Interest was the best performing sector in March. However, with underlying inflation at 3.8%, an easing in monetary policy seems some time off.

Emerging Markets were particularly weak, with Chinese 'A' class shares falling 20% in March. This highlighted investor concerns that the impact of the US recession would be greater than initially thought. Global developed equity markets did relatively better despite more negative news from banks (in particular UBS reported further profit writedowns).

World GDP growth is forecast to slow significantly over the next two years to around 3% to 3.5%. This reflects the impact of US growth at under 1% (with two flat to negative quarters likely) due to flow-on effects from sub-prime mortgage and global liquidity issues.

There are concerns as to whether central banks (led by the US Federal Reserve) have taken sufficient policy action to resolve the global financial system crisis. This means that equity markets are likely to remain under pressure, particularly financial stocks. Investors are likely to remain overweight cash and bonds (despite valuations being stretched). There is a risk of a global bond market 'bubble' developing.

Equity valuations are now moderately positive based on yields but earnings growth can be expected to weaken markedly. Given that there is clearly a structural increase in volatility underway, this supports a bias to quality stocks and neutral style bias.

Despite the likelihood of Australian inflation running well above the Reserve Bank's 2% to 3% target range for a considerable period, the Australian cash rate appears to be peaking at 7.25%. Forward indicators of growth (business and consumer sentiment) have weakened sharply and the RBA seems to have moved to a more neutral policy stance but is leaving its options open, according to public statements by officials. Overall, there is still a risk of a further rate hike to 7.50% but an easing phase late this year and early 2009 seems more realistic than previously expected.

STOCKS IN THE NEWS

Margin Lending Accounts

We have had several inquiries regarding the implications of the Opes Prime collapse for margin lending arrangements. Under a normal margin loan contract, the shares are held in trust to protect the borrowers assets. If the borrower defaults on the agreement those shares are sold and gets whatever is left from the sale of the shares. If the lender goes broke, the borrower will be required to pay the outstanding amount or allow the shares to be sold. The borrower will get the balance after the loan is repaid.

However, the loans taken out by Opes clients were based on a different arrangement - an AMSLA agreement. Under this agreement, title to the shares passes to the lender and all of the various clients' assets are pooled. In the case of Opes, title to the shares was then passed again to the firms' lenders - in this case ANZ Bank and Merrill Lynch. They are now selling those shares to recover their debts.

Those clients are effectively unsecured creditors of Opes. If their agreements with Opes had been normal margin loan contracts they would have effectively been secured; but because AMSLA contracts were used they are unsecured. In reality it was Opes who bought the shares and the clients simply helped to pay for them.

STOCKS TO CONSIDER

Telstra Corporation Limited (TLS) - BUY

Telstra is the incumbent carrier in Australia and, like others, suffers the ignominy of core margins under pressure, heightened competition and unsympathetic regulators. However,

management have undertaken a transformation strategy to lower their cost base and enhance its product offering. Telstra is delivering on its milestones and is continuing to deliver growth in other areas, while slowing the decline in their traditional landline business.

The company's transformation strategy should position Telstra to respond to changing market dynamics. Yet this initiative is only 60% complete and has many challenges ahead, notably the rationalisation of their IT. Nevertheless, Telstra's legacy telecom business is delivering encouraging results, and is expected to focus on organic growth and improving cost efficiencies.

Price as at 15 April 2008 \$4.51

Seek Limited (SEK) - BUY

Seek is the clear market leader in the Australian online employment advertising sector. It has built a dominant position over the past decade through strong branding and as a result of the structural shift from print to online advertising. Seek has diversified its earnings by increasing its presence in learning, while also investing in high growth foreign markets to sustain longer term growth.

Seek generates strong cash flows, has an ungeared balance sheet and offers a fully franked dividend and 70% payout ratio. Seek is expected to aggressively grow revenues and net profits over 2008/09, both in Australia and overseas. Domestically, it will benefit from the strong economy and low unemployment rates. At its current price the stock is considered to be undervalued.

Price as at 15 April 2008 \$5.45

Westpac Banking Corporation Limited (WBC) - BUY

Westpac offers exposure to a well-managed bank with a consistent track record of delivering double-digit earnings growth. Earnings have been driven by solid organic revenue growth, an ongoing focus on costs and a conservative approach to risk management. Shareholder returns have been supplemented by an active capital management program.

Westpac is expected to deliver solid earnings growth in the short to medium term. The sector outlook remains reasonable, with solid lending growth and benign personal credit quality. However there has been some deterioration in business credit quality. It is considered that Westpac is well positioned to take advantage of these conditions. Double-digit earnings growth is forecast for 2008/09.

Price as at 15 April 2008 \$22.60

AXA Asia Pacific Limited (AXA) - BUY

AXA is a leading Australian provider of life insurance, specialist risk insurance, superannuation and funds management in Australia, NZ and Asia. AXA concentrates on selling products to the retail market and also provides financial planning and advice through its own adviser networks.

The medium- to long-term outlook for AXA is positive, with the company operating in the high-growth wealth management industry in Australia. AXA is well placed in New Zealand and the key growth markets in Asia. The company has repositioned itself as a leading player in the Australian and New Zealand wealth management industry and has successfully expanded rapidly into the Asian region, particularly in Hong Kong.

Price as at 15 April 2008 \$5.56

Commonwealth Bank of Australia Limited (CBA) - BUY

CBA has the largest retail banking franchise of the domestic major banks and leading market position in the growth area of wealth management. The bank has achieved strong earnings growth over the past few years on the back of transformation initiatives and ongoing efficiency improvements. The growth momentum is expected to continue.

CBA is facing a tough banking environment; however, it has good earnings prospects due to its strong capital position, diversified earnings profile, solid business momentum and ongoing strategic initiatives. Lending growth should remain strong and wealth management will benefit from ongoing superannuation flows. There are expectations of single-digit earnings growth and a strong dividend yield.

Price as at 15 April 2008 \$41.67

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