

## Monthly Market Watch – December Issue 2007



### MARKET COMMENTS – NOVEMBER

The Australian sharemarket took a step backwards in November as investor confidence was dented by the ever widening ripple effects of the US sub-prime problem. Over the month, the S&P/ASX 300 Accumulation index fell 2.9% to be up 23.8% over 12 months.

At the beginning of November, the S&P/ASX All Ordinaries index hit an all-time high of 6,853 points. It finished a volatile month at 6,593 points having coped relatively well with a rate hike, a federal election and an ongoing problem in global credit markets. Activity in the resources sector cushioned the decline. A takeover proposal by BHP Billiton for Rio Tinto and the discovery of very significant iron ore reserves by Fortescue Metals encouraged investors in that sector. Another positive during the month was the relative performance of the consumer staples sector (+2.4%).

Among the weaker companies during the month were those in the financials sector. Apart from weakness in the property trusts, Babcock & Brown, Allco Finance and National Australia Bank all suffered. Babcock & Brown and Allco Finance were caught in the downdraft of negative sentiment associated with US sub-prime issues while investors appeared to be nervous about National Australia Bank's foray back into US banking.

Without doubt, uncertainty and fear in global credit markets are acting as a drag on the sharemarket. In the first instance it is affecting sentiment towards financial institutions but a second round effect is the increasing cost of borrowing for Australian companies. The higher cost of borrowing is eating into company profits.

While most Australian financial institutions have minimal exposure or involvement in the US sub-prime market, the problems and losses seen by US institutions has affected sentiment towards their Australian counterparts. A cut in official US interest may help swing the tide in coming months.

At the same time as the US economy is slowing, the Australian economy continues to gain momentum. This is both good and bad. It is good in the sense that Australian companies have the potential to lift their earnings. It is bad in the sense that the Reserve Bank of Australia (RBA) may feel compelled to lift our cash rate still higher.

The objective of the RBA is to keep inflation under control. This is important for our medium and longer term prosperity but it does hurt in the short term. To date, outlook reports from company annual general meetings has been generally positive with a few comments on increased costs and the impact of the strong \$A.

Major global sharemarkets all fell during November. The MSCI World index, a broad measure of global shares, fell 4.2% in \$US but rose 0.4% when measured in \$A. This month a weaker AUD boosted returns for Australian investors.

In the United States, the Dow fell 4.0%, the S&P500 was down 4.4%, and the NASDAQ fell 6.9%. With the US profit reporting season now over, companies in the S&P500 saw earnings fall 2.5% over the same period last year.

The US market is hoping for a cut in official US interest rates. Credit markets are pushing US interest rates up so a cut in the US Fed Funds rate would balance out the pressures. It is clear that the US economy is slowing, but the big question is whether the slowdown morphs into a recession. The US Federal Reserve has room to cut interest rates but investors are nervous.

The listed property sector fell 6.3% in November as investors became concerned over the rising cost of its debt. The sector has seen a marked increase in its borrowing levels in the past few years and the sub-prime inspired rise in the cost of borrowing has added to earnings risk among listed property trusts. The decline in the S&P/ASX 200 Listed Property Trust Accumulation index in November has seen its growth over the past 12 months whittled down to 5.3%.

### STOCKS IN THE NEWS

#### **Publishing and Broadcasting Limited (PBL) - Scheme of Arrangement**

PBL has split into two separately listed companies for gaming (Crown) and media (Consolidated Media Holdings, or CMH). PBL management's long-term focus is on expanding its gaming operations around the globe. It is expected that the market will positively re-rate PBL's gaming assets as a "pure play" entity under Crown, although the share price may be subject to volatility in the short term as the market works out efficient pricing and Crown

expands internationally. In contrast, it is expected that a re-rating of PBL's media assets under CMH is possible, but not necessarily probable. CMH is essentially a passive investment vehicle for media assets and CMH will not have management control over its media investments.

#### Crown Limited (CWN) –

Long term, it is expected that that Crown will position itself as a global gaming business, with operations established on several continents.

Crown is expected to expand locally and overseas via a combination of its internal development pipeline and acquisition. The company's Australian assets are attractive however a cautious stance is maintained on the company's overseas expansion plans.

#### Consolidated Media Holdings Limited (CMJ) –

Each business segment is primed for growth, in particular Foxtel. Foxtel has virtually a monopoly in pay-for-view television in the metropolitan areas of Australia, while PBL Media's assets have a strong presence across printed media. The company also has an excellent platform to move into other related media segments, online, print, television and digital media.

Owing to the market position of the individual business, the company's outlook is viewed favourably. A strong contribution is sought from all business divisions, particular Foxtel. Now that the company is once again purely a media stock, its risk profile has changed considerably. However, the share price is expected to be volatile while the re-rating of the former PBL assets (CMJ and CWN) occurs.

#### **BT Investment Management Limited (BTT) - New Float**

Due to the strong flow of applications for the initial public offer of shares in BT Investment Management, the Westpac shareholder offer was closed on 28 November ahead of the previously announced closing date of 3 December 2007.

There has been a scaleback of shares allocated. Successful applicants have been allocated the first \$5,000 worth of shares applied for and 30% of the application above that amount at the final price of A\$4.80.

#### **STOCKS TO CONSIDER**

#### **Alumina Limited (AWC) - BUY**

Alumina is a 40% partner in Alcoa World Alumina & Chemicals (AWAC), a globally dominant, low-cost bauxite mining and alumina refining company. Earnings tend to be cyclical, with the alumina price linked through long-term contracts to the aluminium price. Alcoa may

decide at some stage to bid for Alumina and move to 100% of AWAC.

The aluminium market is in the midst of flux, with rapid growth in production from China, which now accounts for 33% of the global output. This is closely matched with China's growth in consumption, estimated by Alumina to be above 20% per annum. It is anticipated that Alumina's strong business fundamentals will continue into 2008. Increased productive capacity coming on-stream and a relatively strong aluminium market will result in solid earnings.

*Price as at 12 December 2007 \$6.32*

#### **Transfield Services Infrastructure Limited (TSI) - BUY**

TSI's portfolio consists of equity stakes in five power stations and two water filtration plants that were either developed or acquired by Transfield Services. It is managed by its major shareholder, Transfield Services Limited.

TSI offers good exposure to the relatively high-yielding energy infrastructure sector. It is forecast that the company under its present debt structure and earnings levels will pay distributions out of operating cash flow after capital expenditure. It is believed that if the company secures further assets at attractive prices, there is further upside to our valuation.

The company's long-term pricing of energy contracts should ensure that earnings are stable. TSI presents a well-balanced infrastructure portfolio, diversified by asset type, geography, operational mix and fuel source. At current levels, it is felt that the share price presents an attractive short-term buying opportunity. The 2007/08 dividend looks attractive at around 8% and there is good potential upside to our conservative forecasts.

*Price as at 8 November 2007 \$2.01*

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