

Monthly Market Watch – February Issue 2009

MARKET COMMENTS – JANUARY

Over January Australian Equities fell for the fifth consecutive month to finish -4.8% lower as measured by the S&P/ASX 300 Accumulation Index. The worst performing sectors were Industrials (-12%), followed by Financials (-9%) and Consumer Discretionary (-9%). Defensives once again outperformed with Health Care and Telecommunications the only sectors reporting positive returns in January.

Equities continued to be dominated by poor economic data, profit downgrades (Boral, David Jones, Leighton, Sims Metal and Westfield) and capital raisings (Dexus Property, ING Office and Macquarie Office). A number of earnings downgrades hit the market in January ahead of the start of the official reporting season. While difficult conditions are expected, investors have reacted poorly to profit downgrades beyond market expectations with relevant stock prices pushed substantially lower upon profit warning announcements. Conditions continue to be difficult for the Financials sector with broad-based losses across major banks, insurance companies and listed property trusts.

Global equities continued their downward trend in January with the broader market index falling -7.3% in local currency terms. While the announcement of a proposed US\$800B stimulus package by the new US administration, and the slight easing of credit conditions offer some hope to investors, the enormity of the global recession continues to weigh down prospects for corporate earnings. For Australian investors, the decline in the Australian dollar has helped offset lower returns from global equities.

Despite being down for the month, emerging markets strongly outperformed developed markets last month, after risk aversion eased among investors and the decline of commodity prices slowed toward the end of the month.

Global economic forecasts project world GDP growth slumping in 2009 to just 0.3%. This pessimistic outlook (the IMF has also recently cut their estimate from 2.2% to 0.5%) reflects the view that advanced economies will contract by around 2% on a full year basis in 2009 (the first time post World War II) as the impact of the global financial crisis hits consumer spending and business confidence.

The developing economies' data has also weakened quickly (especially in China)

debunking the view that they would be 'decoupled' from the advanced economies this economic cycle. Weak commodity prices further undermine the outlook for some emerging economies though some offset is provided by their better fiscal starting point and higher per capita incomes compared to previous crises.

In the short-term, global inflation has fallen substantially allowing central banks to cut rates significantly (the US official cash rate is at 0% to 0.25%, UK at 1.0%). The longer term outlook could be deflationary if a full-blown recession develops but the more likely risk is a surge in inflation as the system is flooded with liquidity. This should benefit real assets.

The Australian cash rate has been cut further by 1.00% to 3.25% in February, as the RBA tries to avert a recession. In fact, the RBA has projected non-farm GDP to fall to zero in the June quarter 2009. Underlying inflation is projected by the RBA to fall into the target range by June 2010. Thus there appears scope for the cash rate to fall to around 2.50% notwithstanding the second Federal government fiscal package (estimated to total \$42B over four years).

Progress has been made in adding liquidity to the global financial system but problems remain in capitalizing banks, dealing with 'toxic assets' and giving consumers spending power through fiscal packages as they are reluctant to spend given impending large scale job losses.

STOCKS TO CONSIDER

ASX Limited (ASX) - BUY

ASX provides direct exposure to the expanding equity and derivative markets, with leverage to trading volume activity. Consistent with a positive long-term view on equity markets, further increases are expected in trading volumes across ASX's product range, supported by growth in superannuation flows and program trading.

The exceptionally high growth rate achieved in equity and derivative markets in 2007/08 is forecast to fall in 2008/09 and income from listings to decline due to weakness in equity markets. However, fee increases, the increased proliferation of programmed trading and growth

in secondary capital raisings are expected to provide some resilience.

Price as at 12 February 2009 \$27.00

Toll Holdings Limited (TOL) - BUY

Toll's recent acquisitions have enabled the company to gain a foothold in Asia and as these businesses integrate, strong long-term growth is forecast. The continued growth of multi-national companies will make total supply chain solutions essential in order to be competitive, especially end-to-end logistics with the rise of China and India and their importance to world trade. The company's long-term outlook is positive.

While smaller acquisitions may become available, major acquisition are not expected in the short term. The separation of the Virgin Blue is positive for Toll, as it removes considerable uncertainty and enables a more transparent valuation of the company's assets. Toll is a quality company and the current share price does not reflect its underlying value.

Price as at 12 February 2009 \$5.50

Woolworths Limited (WOW) - BUY

The company's retail format is considered to be superior and it is believed that the new 2010 store formats, which are currently being implemented, will help to deliver above-average earnings growth. The company is very well managed and has a very strong balance sheet. Although the company trades at a high forward-earnings multiple, it has very little debt. The company's long-term outlook is positive.

Woolworth's position as market leader in the supermarkets business should ensure the company has an effective platform to leverage its expertise into businesses outside its core competencies. The defensive nature of its assets and its market position suggests that the company's earnings will be well insulated to a slowing economy and its share price will follow. An attractive acquisition could also spark the share price, although unlikely in the immediate term.

Price as at 12 February 2009 \$27.64

Origin Energy Limited (ORG) – BUY

Origin is positioned in the competitive rather than regulated energy segment. Integration of exploration, production, generation and retail of gas and electricity lifts the range of development opportunities and reduces risk. Strategy is to explore and develop gas where easy to market.

The country's largest coal seam gas reserve holder is leveraged to potential export parity

pricing. Financial objectives are steady and predictable cash flows and earnings growth of 10-15% pa. In the five years to 2007/08, average annual earnings growth was 14.4%. A number of new projects will produce over the next few years. In future a 60% payout can be expected thanks to joint venture partner ConocoPhillip's US\$5B up-front cash injection for 50% of CSG. Suitable for investors seeking a medium risk energy exposure with growth potential.

Price as at 12 February 2009 \$13.70

AXA Asia Pacific Limited (AXA) – BUY

The long-term outlook for AXA is positive, with the company operating in the high-growth wealth management industry in Australia. AXA continues to invest in the key growth markets in Asia with many now making a positive contribution to the group.

Earnings from AXA's wealth business are expected to fall in 2008/09 due to significant declines in funds under management, administration and advice. Despite the difficult operating conditions, AXA's underlying wealth business is coping well, and is well placed to leverage the expected market recovery. Despite the difficult market conditions, AXA is a quality business.

Price as at 12 February 2009 \$4.14

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