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Monthly Market Watch – February Issue 2010

MARKET COMMENTS – JANUARY

Equity markets opened the New Year in positive territory with the All Ordinaries Index almost reaching the 5,000 point mark. Hopes of the market breaking through this level were quickly dashed as markets declined on rising concerns over various global events.

Chinese authorities announced that they were to restrict lending to curb asset and price inflation, and prevent an 'overheating' of their economic growth. This led to fears of a prolonged global recovery, as China is one of the main driver's of the global economy. US stocks declined on the news, and also fell as President Obama proposed changes to the US banking regulations, effectively limiting the banks' risk-taking in regard to investing.

Fears of sovereign risk also took hold of investors in January as Greece revealed concerns over their debt repayments. This led to widespread concerns about large government deficits, which partially resulted from the massive government expenditure on economic stimulus throughout 2008 and 2009. Portugal, Ireland, Spain and several other countries were targeted as being higher risk, given their government's high debt levels.

For the month, the MSCI World ex Australia Index fell -2.9% in Australian dollar terms. Australian equities fell -6.2% while emerging markets declined -4.5%. Falls in prices for metals and energy commodities led to declines in the resources sector. The market has effectively priced in a higher risk to commodities demand given China's restrictions on bank lending to ease the threat of excessive asset inflation. Discretionary retail spending also recorded sharp losses in January.

Term deposit rates increased on analysts' predictions of the Reserve Bank of Australia lifting the official cash rate to around 4.5% by mid-2010. However, as investors turned to less risky assets, demand for government and corporate bonds lifted prices, which lowered yields.

The market outlook for 2010 is positive with the majority of analysts' predicting the Australian market to rise almost 13% to around 5,500 points by the end of 2010.

STOCKS IN THE NEWS

Telstra Corporation (TLS)

Telstra reported its first half results on 11 February 2010, which were below market expectations. Telstra announced that the interim dividend would remain flat at 14 cents per share (fully franked). The results were seen as disappointing for the telecommunications company, sending the share price down 5% for the day.

Net profit to 31 December 2009 was down 3.3% from the previous corresponding period, whilst sales were down 2.5%. Telstra attributed the fall in revenue to the decline in the value of the Australian dollar and the sale of one of its businesses, KAZ.

Additional contenders in the broadband and mobile phone sectors led to Telstra admitting to lost market share, as prices and products were extremely competitive. Also, no news was announced in regard to Telstra's negotiations with the government's National Broadband Network (NBN), stating that "the path ahead remains intensely complex".

Whilst Telstra did not increase their upcoming interim dividend payment in March, the yield remains very strong at 9.2% fully franked, at current prices. Telstra continue to be rated as "Add" by our major research provider Aegis Equity Research.

Price as at 16 February 2010 $3.10

Commonwealth Bank (CBA)

CBA's half year results released on 10 February showed cash net profit up 54% on the previous corresponding period, which was above analysts' expectations.

CBA benefitted from strong momentum across its operations, with good banking income growth, tighter cost controls, fewer bad debts and solid earnings from its wealth management division. CBA's wealth management division's earnings surged 59%, as markets began to rise in the last half of 2009. An interim dividend was declared at $1.20 per share (fully franked), an increase of 6% on the previous interim payment. Investors may have hoped for a higher dividend payment increase given the considerable rise in profits, as shares in CBA dropped 1.7% for the day.

CBA's results were an indication that the worst of the bank's bad debt provisions was over, and Australia is on the road to a sustainable economic recovery. Commonwealth Bank is Australia's largest bank by market capitalisation, which places the company in a good position to benefit from further improvements in the economy, as lending regains pace and markets continue to rise.

Price as at 16 February 2010 $51.51

Harvey Norman (HVN) – BUY

Harvey Norman operates franchise and company-owned stores throughout Australia and New Zealand, with an overseas expansion strategy resulting in stores opening in Ireland, Singapore and Slovenia. Harvey Norman sells electrical goods, computers, furniture and other homeware-related goods, whilst also providing customer finance and generating revenue from its property portfolio.

With strong demand for audio-visual and IT products, Harvey Norman has experienced solid earnings growth in recent times, and this division is expected to be a major contributor to future earnings growth. As the economy continues its recovery, consumer discretionary spending will increase, thus benefitting Harvey Norman's sales growth.

Our major research provider Aegis Equity Research currently rate Harvey Norman as a "Buy" as they see the stock to be undervalued with good earnings per share growth forecasts.

Price as at 16 February 2010 $3.75

JB Hi-Fi (JBH) - ADD

JB Hi-Fi is a specialty discount retailer of leading brands of home entertainment products through an ever-increasing network of stores. The company is continuing to successfully roll out stores across Australia in major cities and some regional areas.

JB Hi-Fi has developed a strong retail brand and is well positioned to achieve long-term earnings growth through the store rollouts and expansion of product lines. The company can continue to improve efficiencies and decrease running costs due to their increasing size. Management's track record of excellent earnings growth was proved once again as first half sales grew by 23% on the previous corresponding period, as announced on 8 February 2010.

Whilst JB Hi-Fi's share price trades at a premium to the sector and market, this is justified by the company's ongoing increases in earnings and declining costs. Aegis Equity Research rate the stock as "Add" and view the company as one of Australia's better-managed retailers.

Price as at 16 February 2010 $20.00

David Jones (DJS) - ADD

Davis Jones is an operator of up-market department stores, offering a wide-range of international and domestic brands. The stores are located in Australia's capital cities, with some stores in major regional centres in New South Wales and Queensland. David Jones targets affluent, mature customers by providing a variety of different brands and maintaining a focus on high customer service levels.

Given that David Jones operates at the top end of the market, the company has effectively established a niche market, with a substantial market share of the department store industry, with Myer having moved out of the top-end retail space.

The management of David Jones is committed to implementing strict financial discipline, which has enabled the company to consistently meet or exceed earnings guidance. The re-development of the Bourke St store and the new store opening in Doncaster should provide David Jones with a long-term strategic advantage in the Victorian market.

David Jones benefit from good inventory and cost control management, and remain committed to generating net profit and dividend growth through the cycle. David Jones dividend is 6.1% full franked at current prices, which is much higher than that of the industry's average.

Price as at 16 February 2010 $4.91
