

Monthly Market Watch – July Issue 2008

MARKET COMMENTS – JUNE

Market developments during June and early July included:

- Global developed markets equities had a poor month in June, falling by 8.2%. Concerns have been renewed about the strength of the US economy, and in particular its housing and finance sectors. The prospect of inflation causing interest rate rises during a period of overall economic weakness has investors avoiding risk wherever possible.
- International emerging markets equities also suffered in June, down by 10.1%. Investors are worried about building inflationary pressures in key markets such as China and Eastern Europe, and the prospect of slowing growth in India.
- The tough economic climate also weighed heavily on Australian equities, which were down 7.6% for the month. Banks performed poorly with the NAB, Westpac and ANZ the three worst performing stocks in terms of index points. Fortescue, Woodside Petroleum and Brambles were the three top performers for the month.
- Australian Listed Property Trusts (LPT's) fell again in June on concerns about the earnings outlook and valuations. Investors anticipate downward asset revaluations.
- The RBA left rates unchanged at 7.25% at its July meeting. While it is concerned about inflation expectations causing an increase in wage demands, as well as the income effect of the rising terms of trade, signs of falling domestic demand have the RBA expecting inflation to slowly ease back towards its target range over the next few years.

Global economic and inflation forecasts project that world GDP growth will slow significantly over 2008 and 2009 to around 3% to 3.5%. This reflects the impact of US growth around 1% due to flow-on effects from sub-prime mortgage and global liquidity issues. Inflation is expected to persist at over 3.8%, given high labour cost growth and oil prices. Inflationary pressures in emerging markets are leading to a series of rate hikes and direct price controls (in some cases).

Concern remains as to whether central banks (led by the US Federal Reserve) have taken sufficient policy action to resolve the global financial system crisis, despite some

encouraging signs (eg action to improve the solvency of US mortgage lending agencies). This means that equity markets are likely to remain under pressure, particularly financial stocks. Investors are likely to remain overweight cash and bonds.

Core inflation data in the US, Australia and now in China has helped to support the opinion that the current period could be characterised as one of a transition to a moderate inflation period following 20 years of disinflation. Tight labour markets and falling productivity in key economies are expected to lead to a trend of increased labour costs. An environment of slowing growth (beyond 2008) and rising interest rates is likely to result in lower corporate profit growth rates. This outlook is reflected in ten year forecasts, where long-term equity returns are projected to be at or less than 10%. The performance of markets in 2008 appears to confirm that the equity bull market which commenced in 2003 is over.

STOCKS TO CONSIDER

Rio Tinto Limited (RIO) - BUY

Rio Tinto offers quality exposure to the resources sector as one of the industry leaders. Diversified across most commodities and continents, the company has earnings resilience and offers a low-risk entry to the sector. It has a good track record for most of its businesses, a pipeline of major projects under development and a well-respected management team.

Earnings for Rio Tinto in this cycle are expected to be strong through 2008 and 2009, underwritten by elevated commodity prices for most mineral products. The outlook for China remains good. BHP's takeover offer for Rio Tinto is expected to be the main share price driver in 2008/09.

Price as at 17 July 2008 \$118.00

Cabcharge Limited (CAB) - BUY

CAB provides a taxi charge account system to businesses and government authorities. It derives its revenues from charging a service fee for customer use of its transaction systems within taxis.

Business characteristics include the company's virtual monopoly on taxis and payment systems, high barriers to entry, its robust balance sheet, strong cash flow, virtually no net-debt and strong and fully franked dividends. There are significant opportunities for organic growth and due to its healthy balance sheet, there are also acquisition opportunities available to it.

Cabcharge's core business segment is forecast to continue to grow strongly as demand for taxis and electronic payments gain momentum. Given its market position, there is no major threat to earnings, although it is recognised that a general decrease in consumer spending will soften earnings. It is believed the company's dominant market position should insulate it from any major earnings threats.

Price as at 17 July 2008 \$7.65

Ansell Limited (ANN) - BUY

Persistently high latex prices create headwinds for Ansell, but it is expected that supply increases will come on-stream in about two years. Ansell is still among the top three globally in each of its major product categories and the difficult latex environment has forced Ansell to focus on innovating and reducing costs. The current efficiency initiatives will stand the company in very good stead when latex prices revert towards long-term averages.

Acquisitions have been made by Ansell in China, Brazil and Poland. The company has great brands in each of its three divisions and it is believed Ansell would like to add to this portfolio with a large acquisition. However there is a scarcity of attractively priced targets. High latex prices remain a challenge, but it is expected that the impact of the slowing US economy on the company's outlook will be modest.

Price as at 17 July 2008 \$9.52

Ramsay Health Limited (RHC) - BUY

Ramsay Health is Australia's largest private hospital player with market leadership in nearly every state, strong bargaining power with the health funds, high profile branding and extensive medical relationships. Ramsay Health has an excellent management team that has a track record of delivering solid earnings growth over many years. Favourable industry fundamentals underpin the bright outlook for this quality company on a long-term basis.

Ramsay Health has a dominant position in the Australian market and has now acquired a sizeable player in the UK market, which is encouraging private sector participation. Ramsay's \$550M brownfields expansion program

over the next two years should start to deliver returns from the end of 2011/12.

Price as at 17 July 2008 \$9.07

Computershare Limited (CPU) - BUY

Computershare offers two major groups of services to the global securities industry. The first is a global registry business and the second is a range of investor-relation services, which range from employee share/option-plan management to stakeholder relationship-management systems.

Computershare offers exposure to a well-managed, growth-oriented share registry provider to the global securities industry. The company's long-term growth is underpinned by the strategy of diversifying from the low-margin registry business into the higher-margin investor-relations area. It is believed the company will achieve continued earnings growth over the medium to long term.

Continued earnings growth is expected over the short to medium term based on recent acquisitions, improved operational efficiency and the development of new revenue opportunities through technological developments.

Price as at 17 July 2008 \$8.52

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