

## Monthly Market Watch – July Issue 2009

### MARKET COMMENTS – JUNE

After beginning strongly in the month, the equity market rally faded as investors showed more concern over the prospect of a sustained economic recovery in the second half of 2009.

More evidence emerged during the month that the economic descent which began last year has stabilised and important leading indicators, such as consumer confidence, were showing steady improvement. As expected, market sectors which are most sensitive to a reflating economy were the key benefactors. Mining and energy companies recorded substantial gains earlier in the month, as did some heavily discounted cyclical companies.

The market rally came to an abrupt halt, as investors switched their attention to the fading economic impact of policy stimulus and the fragile state of the global economy. Renewed doubt over the timing and magnitude of the eventual recovery was accentuated by the weak growth outlook produced by the World Bank, mirroring the forecasts made by the IMF. Prices of cyclical companies fell as investors took profits from earlier gains and waited for more definitive evidence of the anticipated corporate earnings recovery. The Australian equities market slid lower, but still managed to post a solid monthly return of 4.0%.

Global equities were flat over June in local currency terms, but registered a moderate loss (-1.7%) in Australian dollar terms. There was substantial divergence in return between regions, with European markets moving sharply lower, while Asian markets (inclusive of Japan) and the US posted gains. Market indicators showed investors' risk aversion continued to fall amid signs that the economic decline is moderating. While Western economies continue to reel from the near collapse of their financial systems, massive government stimulus gave impetus to the resurgence of manufacturing activities in China.

Questions, however, remain over the sustainability of these stimuli provided by governments and the effect of excess production capacity on employment and consumer spending.

Global economic forecasts project a contraction in world GDP (by over 1%). This would represent the first contraction in world GDP since World War II. The consensus has factored

in this forecast and there is now a more widespread belief that the shape of the recovery will be a "W" rather than the normal "V" given the structural problems remaining in the global economy. This outlook is likely to trigger a reversal in equity markets.

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

In the short-term, global inflation has fallen substantially, allowing key central banks to cut rates to near zero. It is uncertain if a deflationary environment will persist (as it has in Japan since the early 1990s) or if the massive easings by central banks will eventually translate into an inflation problem.

Australia is holding up well compared to other countries as its large budget surpluses have been spent, a 'temporary' budget deficit has been engineered, monetary policy has been eased aggressively and the economy has benefitted from its Asian trade exposure. These factors should boost equities further in the short-term but concern remains about the rising unemployment trend (projected to peak around 8% to 9%) and further deleveraging in the over-extended consumer sector.

The Australian cash rate has been held at 3.00% by the RBA as there are signs that previous easings are taking effect (eg in retail sales data and consumer confidence) but there is still scope for the cash rate to fall to around 2.5% as inflation falls towards the bottom of the RBA's 2% to 3% target range (given a strong A\$). An important offsetting factor is the highly stimulatory stance of monetary policy – the 2009-10 budget deficit is forecast by Treasury to be 4.9% of GDP (\$57.6B – a record level).

### STOCKS TO CONSIDER

#### **Toll Holding Limited (TOL) - ADD**

Toll Holdings is Australia's largest fully integrated logistics provider, specialising in express freight transport by road, rail, air and sea. The company provides storage, warehousing and distribution of freight nationally and is growing its presence internationally.

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. Toll has excellent financial strength and the long-term view is positive.

Not only is Toll considered to be an excellent growth stock, as the 1<sup>st</sup> half 2009 result proved, in difficult times it is also relatively resilient. Toll will ride out the current economic crises without taking a backward earnings step and emerge on the other side stronger, in good financial strength. The company will also be in good position to offer its end-to-end supply chain solutions to a more consolidated market and to acquire weaker competitors.

*Price as at 14 July 2009 \$6.00*

### **Seven Network Limited (SEV) - BUY**

Seven Network is an investment company. In 2006, the company sold its major asset, a metropolitan free-to-air TV network,

The long-term outlook for Seven Network is unclear, as the market is still waiting to see what it does with its cash on hand. However, it is considered that, as the chairman, Kerry Stokes, has a proven track record of unlocking value that at current asset prices, Seven Network is well positioned. Investment risks do exist, but given the level the stock is trading at, this is more than priced in.

Seven Network holds what everyone craves for right now, cash. This positions the company well in an environment where available assets outweigh demand, and sellers are desperate. At current levels, Seven Network is considered to be at a significant discount to its intrinsic value.

*Price as at 14 July 2009 \$5.53*

### **AXA Asia Pacific Limited (AXA) - ADD**

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 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, and the new capital issue, AXA remains a quality business.

*Price as at 14 July 2009 \$3.74*

### **Crown Limited (CWN) - BUY**

Crown is a listed entity born out of the demerged PBL. The company houses the gaming interests of PBL and has set about building a position as a global provider of gaming services. Melbourne's Crown Casino and Perth's Burswood Casino are the key assets.

Long term, it is expected that Crown will position itself as a global gaming business, with operations established in several continents. The company is expected to add more monopoly-type investments to its portfolio over time to assist in maintaining the reliability of cashflow while further development opportunities are sought.

Local and overseas expansion is likely to occur via a combination of its internal development and acquisition. The company's Australian assets are well liked but caution remains on the company's overseas ventures. The termination of the Cannery acquisition is favourable for the company and restores balance sheet flexibility.

*Price as at 14 July 2009 \$6.94*

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