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Monthly Market Watch – June Issue 2009

MARKET COMMENTS – MAY

Australian equities recorded their third consecutive month of positive performance in May with a 1.5% gain. After advancing strongly in the first week of the month, the domestic equities market began to trend downward following the release of softer than expected retail reports in the US and the easing of price gains in commodities. However investor sentiment was increasingly positive as confidence grew over the prospect of an economic recovery later this year. To capitalise on the buoyant market conditions, Australian companies announced over $13B of capital raisings last month. The largest of these included Santos ($3B), ANZ ($2.5B) and Stockland ($1.98B).

The second half of the month was characterised mostly by sideways market movements and more subdued performance gains. Resource companies were the key performance leaders last month. Energy companies, in particular, benefited from the strong rally in crude oil prices. And, in addition to firmer commodities prices, the mining sector was also buoyed by the better than expected outcome in the iron ore price negotiations between BHP and its Asian clients (excluding China).

Global equities performed strongly in May, as measured by the MSCI World ex-Australia Index (local currency). The US equities market extended its rally that began in early March to end the month 5.31% higher. Key positives last month were the better than expected economic data from the US and the release of stress test results on US banks, which suggested that the elevation in systemic risk of the US banking sector is slowly receding. In Asia, both Japan and China recorded sharp rebounds in manufacturing activity, raising hopes that these two economies are emerging from the economic collapse late last year.

For Australian investors, the return from global equities investment was again negatively impacted by the strong appreciation of the Australian dollar against the US dollar (9%) and Euro (2%).

Global economic forecasts project a contraction in world GDP (by 1%). This would represent the first contraction in world GDP since World War II. The consensus has factored in this forecast but there is a great deal of uncertainty about the sustainability and magnitude of any recovery (despite recent positive lead indicators) and the type of economic environment that will eventuate over the next five years or so.

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 policy easing 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 benefited 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 it's effect on consumer spending.

The Australian cash rate has been held at 3.00% by the RBA as there are signs that previous policy easing are taking effect (eg in retail sales data) 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.

STOCKS TO CONSIDER

Westpac Banking Corporation Limited (WBC) – BUY

The St George Bank merger and the additional capital raised during 2009 place the bank in a good position to continue driving revenue growth, despite slowing economic conditions. Westpac is expected to leverage its brand and distribution strengths; its cost-to-income advantage; and improving margin performance to underpin further earnings growth.

Earnings forecasts have been impacted by increased bad-debt expenses and elevated funding costs. The slowdown in economic activity is also a concern. However, recent capital raisings will support business growth and provide some short-term buffer. Westpac is well positioned to take advantage of market conditions and strong earnings recovery is expected in 2009/10, following softness in 2009/09.

Price as at 15 June 2009 $19.94

Woolworths Limited (WOW) - BUY

Woolworth's retail format is considered to be superior and it is believed the new 2010 store formats, which are currently being implemented, will help to deliver above-average EPS growth. The company is very well managed and has a very strong balance sheet.

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 should insulate the company's earnings to a slowing economy and its share price will follow. An attractive acquisition could also spark the share price, although this is unlikely in the immediate term.

Price as at 15 June 2009 $26.20

Incitec Pivot Limited (IPL) - BUY

Phosphate fertiliser prices are thought to be approaching a bottom, while urea is forecast to remain flat, longer-term. Many potential growth options are seen for the company, including internal production increases and efficiency gains across the Dyno businesses. There are also several logical acquisitive growth options on the horizon. Industry fundamentals should favour manufacturers over the longer term.

Although the current share price is seen as representing value, investors need to be cautious as the share price is likely to remain volatile in the immediate future. A weaker A$ will have the effect of shielding some of the company's earnings from weakening global fertiliser.

Price as at 15 May 2009 $2.83

Healthscope Limited (HSP) - BUY

Healthscope is the second and third largest private hospital and pathology player respectively. Healthscope has a long track record of successfully growing its hospitals business through acquisition or brownfields development, expanding margins in underperforming properties along the way. Private hospitals are viewed as a good business. Pathology has good fundamentals and Healthscope should progressively improve performance of this division.

Healthscope is a very capable hospital operator which is starting to see benefits from its foray into pathology, although it lacks the scale enjoyed by Sonic and Primary. Both private hospitals and pathology are seen as recession resistant businesses. The Budget proposed private health insurance rebate changes are not expected to cause Healthscope any material concerns.

Price as at 15 May 2009 $20.60

James Hardie Industries NV (JHX) - SELL

James Hardie is well positioned in the long run: its differentiated product (fibre cement) allows it to capture a greater share of the value chain and to grow faster than the housing market by winning share from competing products. However, the company will struggle against fierce short- and medium-term headwinds and is burdened by legacy issues. As there is little visibility as to when these will be overcome, a negative investment view is held.

Although James Hardie has the ability to handle construction sector slowdowns better than many competitors, caution remains in the short term, especially as the bulk of James Hardies's earnings come from US operations. No reason is seen to be in this stock until the cycle definitively turns upward.

Price as at 15 May 2009 $4.22
