

## Monthly Market Watch – March Issue 2009

### MARKET COMMENTS – FEBRUARY

Australian equities fell -4.6% in February, extending the losses for the year to -9.2%. The local market continues to be heavily influenced by developments overseas, particularly over the on-going instability to the global financial system. By sector, industrials was the worst performer for the month, falling -21%. In comparison, the resources sector was buoyed by the price increase in selective commodities such as crude oil (4.8%) and copper (9.2%). The energy sector finished the month 2.1% higher while materials outperformed the broader market to be down -3.3% for the month.

Profit results from Australian companies in the February reporting season were mixed but they were mostly in line with lowered market expectations. As companies look to strengthen their balance sheets in anticipation of more difficult market conditions, an increasing number of companies have announced dividend cuts or equity raisings. So far this year, corporate Australia has raised a total of \$38.9 billion in new equity.

Global equities fell heavily in February with broad based declines across all regions. The MSCI World ex-Australia Index declined -11.2% in Australian dollar terms with the monthly loss accentuated by the strengthening of the Australian dollar. The market was left disappointed by the lack of details on the US bank rescue plan and this continues to feed to investor's concern on the health of the US financial system. The continual flow of negative economic data from the US, Europe and even Japan revealed the depth of the market slowdown, the first global recession in decades. Reacting to this negative backdrop, market indices in the US fell to 12 year lows while European markets also moved substantially lower.

Global economic forecasts now project a contraction in world GDP (by 1%). This would represent the first contraction in world GDP since World War II. The consensus is increasingly factoring in such an outlook for 2009 and markets have adjusted accordingly but there is a great deal of uncertainty about the strength of any recovery and the type of economic environment that will eventuate over the next five years or so.

A major concern is that escalating global unemployment may lead to a second round of

consumer spending reductions in advanced economies. In emerging markets there is a risk of increased social unrest as material expectations are not met.

Developing economies' data has also weakened quickly (especially trading orientated Asian economies) 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 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 easings by central banks will eventually translate into an inflation problem.

The Australian cash rate has been cut even further by 1.0% to 3.25% in February 2009, as the RBA desperately tries to avert a recession. In fact, in the February Statement on Monetary Policy, the RBA projected non-farm GDP to fall to zero in the June quarter 2009, compared to the previous year. 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 – equivalent to 4.5% of GDP 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. Consumers are reducing debt so this could limit potential economic growth in the medium-term.

### STOCKS TO CONSIDER

#### **Woodside Petroleum Limited (WPL) - BUY**

Woodside is Australia's leading oil and gas company. Its core asset is the NW Shelf gas and

Liquefied Natural Gas (LNG) facility, Australia's largest-ever resource project.

A significant proportion of Woodside's value can be attributed to the cashflows from its future LNG projects. Woodside is a blue chip energy stock that could be considered a core long-term holding in a diversified portfolio. There is good potential for future growth and at current levels.

Concerns over a slowing global economy and declining energy demand are creating negative sentiment towards energy stocks, and Woodside no exception. However, the company has high-quality oil and gas assets and as a leader in Australian LNG, Woodside is seen as capable of weathering the current environment. For more growth-orientated investors.

*Price as at 13 March 2009 \$37.85*

### **AMP Limited (AMP) - BUY**

AMP is a well-managed wealth manager with solid market positions and significant distribution capabilities. Despite the current turmoil in investment markets, a positive view is held for the longer term outlook for both AMP and the wealth management industry.

Although the recent declines in market indices will erode margins and hence short-term earnings AMP is expected to benefit from the continued expansion of its product range and distribution capabilities and has also demonstrated prudent cost control.

*Price as at 13 March 2009 \$4.08*

### **QBE Limited (QBE) - BUY**

QBE is an Australian general insurer with a significant global presence and a conservative approach to risk management. It has a long-established history of delivering above-average returns. The company continues to grow via an active acquisition program and is well placed to continue delivering superior long-term returns.

The benefits of acquisitions made in 2007/08 and 2008/09 plus organic growth will be key factors supporting future earnings. QBE is very adept at managing risk and re-balancing its portfolio of businesses towards those that offer greater profitability.

*Price as at 13 March 2009 \$16.72*

### **Incitec Pivot Limited (IPL) - BUY**

Incitec Pivot operates an integrated fertiliser business throughout eastern Australia, with a market share in this region of 65%. The company has moved into the explosives sector via the acquisition of Dyno Nobel.

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

Fertiliser prices have come off sharply over recent months, sparking an earnings downgrade. The stock is considered to represent value at current levels, but investors are cautioned that the share price is likely to remain volatile in the immediate future. The falling A\$ will have the effect of shielding some of the company's earnings from weakening global fertiliser prices and provides a benefit from US earnings.

*Price as at 13 March 2009 \$2.34*

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