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Monthly Market Watch – May Issue 2008

MARKET COMMENTS – APRIL

Over the month of April, the best performing sectors were International Emerging Equities and International Equities (in local dollar terms), and Australian Equities. Over three months, the top performing asset class was International Emerging Equities. The worst performing sector in this period was Australian Listed Property Trusts (LPTs).

Market developments during April and early May included:

Australian equities returned 4.5% over April due largely to increases in commodity prices, which heavily influence the direction of resource share prices. BHP's 17.3% rise was largely responsible for the overall market's gains for the month. Australian LPTs performed in line with the broader share market, as bargain hunters continued to move in on a sector heavily sold down earlier in the year.

Strong results in global developed equity markets, which rose by 6.2% in local currency terms. This was led by Japan which gained 12.6%, but was also supported by the USA and Europe. Equity markets have been supported by growing investor optimism that the worst of the credit crunch may be over.

Emerging Markets also performed strongly in April, led by Chinese shares which rose 15.8% in local currency terms after a large fall in recent months. Markets in India, Brazil and Turkey also returned double digit gains for the month. However the rising A$ halved the A$ return from emerging markets in the month.

Globally, economic and inflation forecasts project that world GDP growth will slow significantly over the next two years to around 3% to 3.5%. This reflects the impact of US growth at under 1% (with two flat to negative quarters likely) due to flow-on effects from sub-prime mortgage and global liquidity issues. Inflation is expected to persist at around 3.8%, given high labour cost growth and oil prices over US$100/bbl. Steady productivity growth and low labour costs in Asia remain moderating factors, although Chinese inflation appears to be increasing.

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. This means that equity markets are likely to remain under pressure, particularly financial stocks. Investors are likely to remain overweight cash and bonds (despite valuations being stretched).

Despite the likelihood of Australian inflation running well above the Reserve Bank's 2% to 3% target range for a considerable period, the Australian cash rate appears to be peaking at 7.25%. Forward indicators of growth (business and consumer sentiment) have weakened sharply and the RBA seems to have moved to a more neutral policy stance but is leaving its options open, according to public statements. Also, the Federal Budget met market expectations. Overall, there is still a risk of a further rate hike to 7.50% but an easing phase beginning in early 2009 appears realistic unless the economy weakens more rapidly than projected by the RBA (that is, to 2.25% at end December 2008).

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 (as bond market inflationary expectations rise) is likely to result in lower corporate profit growth rates. This outlook is reflected in the ten year forecasts, where long-term equity returns are projected to be at or less than 10%. The very weak start to 2008 suggests that the equity bull market which commenced in 2003 may be over.

STOCKS IN THE NEWS

Telstra Instalment - Payment Due (TLS)

With the due date of 29 May imminent, it is timely to remind holders of Telstra 3 Instalment Receipts (TLSCA) that there is a legal obligation to pay the final instalment by the due date.

Failure to pay the final instalment by this date will incur an administration fee of at least A$82.50 (including GST) for each notice. It will also result in the loss of Bonus Loyalty Shares (1 for each 25 shares held) and could result in the sale of some or all of the underlying Telstra shares.

In the event the shares are sold, costs and expenses incurred in the sale of the relevant shares, plus an additional administration fee of A$82.50 (including GST) will also be charged.

Interest is payable at a rate of 12% per annum calculated on daily balances while the amount in question remains unpaid.

Price as at 20 May 2008 $4.79

Proposed Merger – St George Bank (SGB) & Westpac (WBC)

The agreed merger terms are 1.31 Westpac shares for each St George share. The merger ratio values St George at $33.10 per share equating to a 28.5% premium on the closing share prices on 9 May 2008 (excluding 1st half interim dividends). Westpac has two weeks to undertake exclusive due diligence on St George. The merger is subject to regulatory and shareholder approval.

The St George board has recommended the merger proposal to its shareholders subject to no superior alternative proposal and an independent expert report. The proposed merger would create a strong financial services company, well capitalised and benefiting from a broad funding base.

Price as at 20 May 2008 $33.53 (SGB)
Price as at 20 May 2008 $24.15 (WBC)

STOCKS TO CONSIDER

United Group Limited (UGL) - BUY

United Group is a well-run contractor focusing on property services, locomotive/rolling stock design, facilities management, labour outsourcing and engineering construction work. The work is spread across six sectors: property, rail, water, power, resource and defence. Growth potential is aided by a pursuit of increased recurring revenue streams, plus still healthy infrastructure and resource sectors. To date, the company's acquisition strategy has delivered and continues to be active.

The 2008/09 outlook is promising, underpinned by confidence that the infrastructure sector will remain buoyant, which opens the door to an even larger contract book over the next year or so. Even if signs emerge that the resource and infrastructure sectors are levelling out, United Group's push into services, helped by its PREMAS, Equis and UNICCO purchases, should help allay cyclicality concerns.

Price as at 20 May 2008 $13.44

Crown Limited (CWN) - BUY

The company's key assets are the Crown casino in Melbourne and the Burswood Casino in Perth. Crown also holds stakes in several gaming related developments across various countries including high profile gambling destinations such as Macau and Las Vegas.

It is expected that Crown will expand locally and overseas via a combination of its internal development and acquisition. The company's Australian assets are liked; however, caution remains on the proposed acquisition of Cannery Casino Resorts and several of Crown's overseas businesses.

Price as at 20 May 2008 $10.79

Oxiana Limited (OXR) - BUY

Oxiana is an emerging mid-tier mining company with world-class Sepon gold and copper deposits in Laos; the Golden Grove zinc-copper-gold mine in WA; the Prominent Hill copper-gold project in SA; and the Martabe gold project in Indonesia.

Oxiana's bid for Zinifex is well timed. Zinifex's new Canadian mines come on stream mid next decade, and it is expected that the value created from these new mines will offset the near term dilution to Oxiana's earnings from the merger with Zinifex. The merged group of Oxiana and Zinifex will be more diversified and therefore less volatile. The shareholders will vote on the merger on 16 June.

Price as at 20 May 2008 $3.44