

Monthly Market Watch – May Issue 2009

MARKET COMMENTS – APRIL

Australian equities posted strong gains in April, further extending a rally that began since early March. Last month saw investors brush aside weak economic data releases of local and overseas markets as well as company profit warnings and seemingly become more confident that the economic downturn is near bottoming.

Investor's interest in the domestic equity market was also lifted by improvement in economic activity from China and firmer commodity prices. All industry sectors posted positive return last month on reduced risk aversion from investors. Sectors such as Consumer Discretionary (+12.0%) and Industrials (+8.2%) enjoyed the strongest gains as they are generally viewed as more leveraged to the improvement in economic activity. In comparison, defensive sectors such as Health Care (+4.6%) and Telecommunication (+4.5%) lagged the broader market as assets continue to rotate into more cyclical companies.

The Small Ordinaries Accumulation Index rose 13.5% last month, significantly outperformed the large cap market index. Small cap resources and AREIT (listed property) companies were the standout performers, benefited strongly from the improvements in investors' risk appetite. Similarly, global small cap also posted strong relative performance gains against large and mid cap developed market companies.

Global equities rallied 10.5% (in local currency terms) in April and has now retraced a large proportion of the investment losses recorded in January and February.

The performance gains were broad-based with Europe (+13.3%), followed by the US (+9.7%) and Asia Pacific (+9.0%). Emerging signs of stabilization across global markets have raised hope that "green shoots" of economic recovery are slowly appearing.

Early indications from the stress test results for US banks suggest that the results may indicate that US banks are better capitalised than in earlier prognosis and this in turn may reduce the need for large capital raisings. The likelihood of less draconian pressure on capital raisings for US financial companies saw the share price of financial companies surge globally.

For Australian investors, the return from global

equities investment was negatively impacted by the strong appreciation of Australian dollar against US dollar (5.0%) and Euro (6.5%).

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 strength of any recovery (despite recent positive lead indicators) 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.

Emerging market equities have rallied strongly as there have been positive indicators in key countries (notably in China). However there is a risk markets have overshot given the high trade dependence of emerging economies on developed economies in the current economic cycle.

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 held at 3.00% by the RBA as there are signs that previous policy easings 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. 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).

Caution remains that the current bear market rally will be extended given there is a risk of a multi-year contraction in GDP (or very slow below trend growth at best – as forecast by the IMF).

STOCKS TO CONSIDER

Australian Infrastructure Fund Limited (AIX) – BUY (For yield)

Australian Infrastructure Fund is a diversified infrastructure fund, with investments in airports, ports, toll roads and light rail. Its strategy is to maximise both income and capital returns. The company's portfolio of airports ranges from the stable, mature Melbourne Airport to high-growth locations such as Perth and Gold Coast.

The company retains a strong portfolio of reliable cash-generating assets, with significant growth potential through increased passenger throughput, and retail and property development. It is considered that there is significant upside within its airport assets. Despite the fact soft traffic growth is forecast this year, the security presents a solid short-term buying opportunity based on the price discount to its fundamental valuation.

Price as at 15 May 2009 \$1.605

Commonwealth Bank of Australia Limited (CBA) - ADD

CBA's large retail banking franchise, strong business banking operations and its market leading position in wealth management underpin its longer term earnings outlook. Earnings are expected to recover in the medium term as CBA leverages its strong market positions and underlying business growth. Ongoing efficiency gains, recent acquisitions and organic growth are expected to support CBA's earnings outlook.

CBA continues to benefit from strong volume and revenue growth in both lending and deposits; however, deteriorating credit conditions will negatively impact near-term earnings. Earnings are leveraged to a diversified revenue base, strong business momentum and the Bankwest acquisition. CBA's underlying business is expected to continue to grow despite the slowdown in economic activity.

Price as at 15 May 2009 \$35.82

Iress Market Technology Limited (IRE) - BUY

Iress is the dominate software supplier for the equities and financial planning sectors in Australian and NZ. It provides information on equity, equity options and futures markets through its information service.

It has successfully diversified into the wealth management practice software segment. The company continues to generate quality, high margin, recurring revenue; leveraging its strong focus on customer service; new product

development; tight cost control; and an increasingly diversified revenue base.

Its businesses continue to benefit from strong market position and high margins. Recent acquisitions are expected to boost future earnings growth in the wealth management sector. The company's core businesses in Australia and New Zealand plus the expansions into Canada and South Africa are expected to underpin its earnings performance.

Price as at 15 May 2009 \$6.58

QBE Insurance Limited (QBE) - BUY

QBE is a well-managed 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 2006/07 and 2007/08 plus organic growth will be key factors in supporting earnings in future years. QBE is very adept at managing risk and re-balancing its portfolio of businesses towards those that offer greater profitability. Despite the earnings set-back in 2007/08, QBE remains the preferred general insurer exposure.

Price as at 15 May 2009 \$20.60

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