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Monthly Market Watch – November Issue 2009

MARKET COMMENTS – OCTOBER

The seven-month rally of Australian equities stalled in October with the broader market index posting a -2.1% monthly loss.

The positive sentiment in the market dissipated in late October when mixed economic data from overseas hampered investor confidence in a sustainable rally. And after strong gains in recent months, the local equities market began to look comparatively expensive on valuation.

The renewed aversion to riskier assets resulted in a sell down across most cyclical securities. Energy and Consumer Discretionary sectors were -5.4% and -3.2% lower respectively, while Financials were down -3.6%. Defensive stocks generally performed well in October, with Consumer Staples up 1.4%, Utilities up 0.6% and Telecommunications up 0.1%.

While higher yielding stocks supported by stable earnings performed well last month, lower quality companies fell amid the broader market sell-off of risk assets.

Global Equities fell -4.1% in October with currency effects contributing close to half of the monthly loss. During the month, investor optimism was replaced by renewed concern over the sustainability of the economic recovery in the US, Europe and potentially emerging markets such as China, once government stimulus is exhausted. Mixed economic data from the US confounded investors, with jobless claims continuing to climb and home and durable goods sales below analysts' expectations. Weakness in European economies, particularly the ongoing contraction in the UK, was also viewed as a key negative.

The movements of global equities markets last month were heavily influenced by the earnings reporting season in the US. In all, the market was positively influenced by these earnings reports, with a number of bellwether companies such as American Express, Microsoft and McDonalds, all exceeding analysts' expectations. However, current valuations suggest that the market could be vulnerable to any economic or earnings disappointments.

Emerging markets fell by -0.4% in local currency terms during October. Asia fell -1.1%, while Latin America dropped -0.4%. Divergence in performance within Asia was substantial, with China posting a 6.5% gain compared to heavy losses in India (-6.3%) and Korea (-6.0%). Losses across Latin America were broadly based with only Brazil producing a positive monthly gain (0.6%).

Australian small caps (companies with a small capital value) outperformed domestic large caps in October, whilst global small caps underperformed in relation to the Australian small caps. The relative performance between domestic and global small cap equities was reflected in part through valuations of the different regional markets and the relative strength of the Australian economy.

STOCKS IN THE NEWS

Myer Holdings (MYR)

Myer Holdings listed on the ASX on 2 November 2009 at a price of $4.10, which was at the low end of the indicative range of $3.90 to $4.90. Our primary research provider Aegis Equity Research has rated Myer as "Add", whilst our secondary research provider Huntley's has rated the stock as "Accumulate". However, Myer does not form part of Strategem's Model Portfolio given independent analysis which indicates that the company's financial position is not as strong as some of its peers.

Aegis believes that Myer has delivered an impressive turnaround under the private equity ownership, rectifying many fundamental retailing errors previously made.

Price as at 13 November 2009 $3.92

Transurban (TCL)

On 5 November 2009, Transurban rejected a $6.7 billion bid from its second and third largest shareholders – the Ontario Teachers' Pension Plan Board and the Canadian Pension Plan Investment Board. The offer price was $5.25, a premium of close to 20% on TCL's closing price on 4 November.

Transurban rejected the bid "on its current terms" but remains open to offers "which provide appropriate value and certainty to security holders in a change-of-control transaction". The bid was stated as being incomplete and highly conditional.

It has been argued that due to the vast number of fund managers in Australia, our individual fund managers do not have the same financial capacity as the Canadian pension funds, which is why there has been no domestic interest for a takeover of Transurban, or any talk of a counter-bid.

The Canada Pension Plan Investment Board also bought Macquarie Communications Infrastructure Fund in June this year, but only after major shareholders pressed for a substantially higher offer.

Price as at 13 November 2009 $5.54

ANZ Convertible Preference Shares (ANZPA)

ANZ recently announced that they will issue a second convertible preference share (ANZ CPS2), which will be listed on the ASX. Convertible preference shares operate as a hybrid security, paying interest up until their conversion date, where the securities then convert to shares in the issuing company, or are re-purchased by the company.

The issue price will be $100 per security and will pay an indicative margin of between 3.1% - 3.3% over the 3 month Bank Bill Swap Rate (4.08% as at 13 November 2009), including franking credits.

ANZ CPS2 are expected to be rated 'A+' by Standard & Poor's. The conversion date will take place on 15 December 2016, where security holders will receive ANZ ordinary shares, provided that Mandatory Conversion Conditions are met and ANZ does not elect for a third party to purchase the CPS2.

The CPS2 securities will commence trading on the ASX on 18 December 2009. If you are interested in purchasing the ANZ CPS2, or would like any additional information, please contact our office.

STOCKS TO CONSIDER

QBE Insurance Group (QBE) - BUY

QBE is a very well-managed insurance business with a significant global presence and a conservative risk management approach. The company operates primarily in general insurance markets, with the majority of premium derived from outside of Australia, particularly in the US and Europe. The company's history of delivering long term above-average returns is a real plus for investors. QBE's acquisitive growth strategy is also expected to deliver superior shareholder returns.

QBE is very adept at managing risk and re-balancing its portfolio of businesses towards those that offer greater profitability. QBE remains Aegis' preferred general insurer exposure, with a positive short-term view of the stock.

Price as at 13 November 2009 $22.49

Singtel (SGT) - Add

Singapore Telecommunications is the leading provider of telephony, data, mobile and postal services in Singapore, and has been the parent company of Australian telecommunications company Optus since 2001.

SGT is investing in new media-based revenue streams to drive local growth. The mobile associates will be the key share price driver for SGT, while the mature businesses with strong cashflows such as Optus will cover yield, or fund further acquisitions.

We anticipate low double-digit growth being provided by the associates in the near term, as these markets offer considerable room for growth. SingTel and Optus businesses are expected to provide flat to marginally higher results over the same period, while the company pursues growth in mobile and broadband to offset other declines.

Price as at 13 November 2009 $2.29

WorleyParsons Limited (WOR) - ADD

WorleyParsons provides engineering design, project services plus maintenance and reliability support services across a range of industrial segments. WOR's exposure to large-scale projects through its diversified blue-chip client base helps it to weather short-term commodity price weaknesses. WOR is also well placed to benefit from the long-term growth outlook in renewable energy.

WOR is leveraged to the lucrative hydrocarbons sector and has the diversification benefits of the commodity and infrastructure industries. WOR is also continuing to expand into the alternative and renewable energy sectors, which provide ample growth prospects. WOR has recently won a number of 'mega' contracts, which are expected to support earnings over the medium term, offsetting any potential pressure on margins.

Price as at 13 November 2009 $27.16
