

Monthly Market Watch – October Issue 2009

MARKET COMMENTS – SEPTEMBER

The Australian equities market recorded its seventh consecutive monthly gain in September, up 6.3% for the month and over 50% from the nadir of early March.

In this buoyant environment, defensive stocks continued to lag the broader market with Telecommunications up just 0.3% and Utilities appreciating by a comparatively modest 2.7%.

Although base metal prices fell during September and the Australian dollar strengthened considerably, the Materials sector managed to rally 2.7%. Once again, however, Financials (including Listed Property) drove the market higher with a gain of 9.8%. Consumer Discretionaries and IT also posted significant increases, up 9.4% and 8.4% respectively.

The rebound in global equities performance continued during September, with optimistic market sentiment driven by still more positive economic news emanating from the US and parts of Europe. Although currency appreciation ensured that the MSCI World ex-Australia Index returned -0.7% for the month in Australian dollar terms, underlying performance of the index in local currency terms was 2.9%. In local currency terms, the best performing region was the Asia Pacific ex Japan (6.6%), followed by Europe and North America (both at 3.9%), with Japan (-5.1%) again underperforming the broad market by a significant margin.

In Australian dollar terms, emerging market equities substantially outperformed developed markets with a 4.4% return last month, where currency depreciation had far less impact on index returns (6.3% in local currency terms).

In the second half of 2009, economic momentum appears to have gathered speed and the former consensus about a 'W' shaped recovery has wavered to be replaced by those arguing the normal 'V' shaped recovery is underway.

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 benefitted from its Asian trade exposure. Economic forecasts have been revised up with

the economy now likely to escape recession in 2009. These factors should boost equities further in the short-term.

The Australian cash rate just has been raised to 3.25% by the RBA in the context of previous policy easings taking effect (e.g. in positive retail sales data and increased consumer confidence). The forward interest rate markets have factored in rate hikes to 4.5% by mid-2010 which seem more realistic in view of recent strong economic data and temporary stabilization of unemployment levels. Although unemployment is still expected to rise and underemployment is a growing problem, the RBA has foreshadowed that further tightening of monetary policy is likely to curtail the potential development of asset bubbles and incipient inflationary pressures.

STOCKS IN THE NEWS

Bendigo Community Telco (BCT)

The 2008/09 Annual Report of the Bendigo Community Telco has been released. Those of our clients who use our mailing address will not have received a copy as we do not generally forward them. For those interested, the Annual Report can be downloaded at the company's website www.bendigotelco.com.au. The website also provides notice about the upcoming Annual General Meeting to be held on Tuesday 27 October.

Myer Holdings (MVF) Float

Investors can apply if they are registered Myer One cardholders. Gold and Silver class cardholders are guaranteed a minimum allocation of \$25,000 and \$5,000 respectively. Standard cardholders have no guaranteed allocation.

Myer is the country's largest department store retailer with 65 stores across the nation, it wants to increase this to 80 stores in the next four or five years.

The company has indicated a full-year dividend of 20.5 cents to 21.2 cents, fully franked. It says it will have pro-forma 2010 earnings per share of 27.3 cents to 28.3 cents.

Myer shares will be priced at \$3.90 to \$4.90 each. The final price will be determined by an institutional bookbuild process. Depending on the final price the offer implies a fully franked dividend in the range of 4.3% to 5.3%.

The minimum application for eligible Myer one cardholders in the priority offer is \$2,000.

The offer closes on 23 October and the stock will list on 11 November.

STOCKS TO CONSIDER

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.

CBA continues to benefit from strong volume and revenue growth in both lending and deposits. Credit conditions have started to stabilise and improvements are expected over 2009/10 further supporting near-term earnings.

Earnings are leveraged to CBA's diversified revenue base, strong momentum and the BankWest acquisition.

Price as at 15 October 2009 \$55.52

Australian Worldwide Exploration Limited (AWE) – ADD (higher risk)

AWE operates in the oil and gas exploration and production industry. AWE has interests in some very good projects, including BassGas and the Casino gas developments offshore Victoria, which have locked in long-term, secure gas sales agreements. The Cliff Head oil project offshore Perth, WA, and the New Zealand oil discoveries add more variable, but potentially more profitable, oil earnings.

The Tui oil field is currently producing within expectation, but this field and AWE's other existing fields are in decline. AWE must gain additional reserves to extend its production profile through either exploration success or acquisition. With strong cash reserves, AWE is undertaking a substantial wildcat exploration program in New Zealand, Indonesia and Yemen.

AWE has embarked on a period of significant exploration activity during the next 2 years, including potential oil plays in the prospective Taranaki Basin, necessary to build upon the declining reserve base. Success may provide catalysts for share price re-rating; however, it

does increase AWE's risk profile. As such, investment in AWE is only appropriate for investors with a higher risk appetite.

Price as at 15 October 2009 \$2.72

Healthscope Limited (HSP) - ADD

Healthscope is the second and third largest private hospital and pathology player in Australia 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. Pathology has good fundamentals and Healthscope should progressively improve performance of this division. Asia presents growth prospects for the company, which offers good long term upside.

Healthscope's 2008/09 result showed encouraging revenue growth and margin expansion in both hospitals and pathology, although lacking the pathology scale enjoyed by Sonic and Primary. Healthscope is expected to continue to pursue bolt-on acquisitions in pathology in Australia, but are also expected to make a substantive acquisition of a hospital portfolio in SE Asia. Healthscope is trading on a modest Price Earnings ratio for its forecast earnings growth.

Price as at 15 October 2009 \$4.68

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