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Monthly Market Watch – September Issue 2008

MARKET COMMENTS – AUGUST

Over the month of August, the best performing sectors were Australian Listed Property Trusts (LPT) and international equities (A$ terms). Over three months, the top performing asset class was Australian fixed interest. The worst performing sector in this period was International Emerging Equities.

Market developments during August and early September included:

- The A$ fell by 8.6% in August, and is currently down 15.4% from its mid July high. Whilst falls in some commodity prices have had an effect on the dollar, the main factors have been the lowering in interest rate expectations and US$ strength. The RBA has now lowered the cash rate by 0.25% to 7%, and investors are anticipating further cuts in the coming months. Coupled with concerns over inflation in the US, this has brought a possible narrowing of the interested rate differential with the US into focus.

- The prospect of lower interest rates helped Australian equities, which were up 4% for August. BHP and Woodside Petroleum were the main drivers, while Wesfarmers and Macquarie Group had negative returns.

- Australian LPT’s bounced back strongly, returning 10% as investors returned to the sector in search of high yields. However investors are being very selective, and remain cautious of trusts with high levels of debt.

- Global developed markets equities had a moderate month in local currency terms, returning 1.1%. However, the weak Australian dollar provided a significant boost, with a return for the month 8.4% for international equities in Australian dollar terms.

- Both Australian and International fixed interest had positive months, returning 2.2% and 1.6% respectively. Yields fell as weaker economic data, particularly in Europe and Japan, signalled that central banks may be forced to ease monetary policy (as turned out to be the case for Australia in early September).

Global economic and inflation forecasts project world GDP growth to slow significantly over 2008 and 2009 to around 3% to 3.5%. This reflects the impact from US growth of around 1% due to flow-on effects from sub-prime mortgage and global liquidity issues. Inflation is expected to persist at over 3.8%, given high labour cost growth and oil prices over US$100. Inflationary pressures in emerging markets are leading to a series of rate hikes and direct price controls.

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 is likely to result in lower corporate profit growth rates. This outlook is reflected in ten year forecasts, where long-term equity returns are projected to be at or less than 10%. The performance of markets in 2008 confirms that the equity bull market which commenced in 2003 is over.

STOCKS IN THE NEWS

Incitec Pivot Limited (IPL) - HOLD

20 for 1 share split
Incitec Pivot shareholders have voted in favour of a 20 for 1 share split. The split will take effect from 24 September 2008. As a consequence, the number of shares held will increase by a factor of 20 and the share price will reduce by the same factor.

After the share split each shareholder will still hold the same proportion of the total shares in the company. The split has been done to lower the nominal value of shares, thereby improving the affordability of the shares to investors. It will also facilitate the introduction of a dividend reinvestment plan.

Price as at 16 September 2008 $132.00

STOCKS TO CONSIDER

Newcrest Mining Limited (NCM) - BUY

Newcrest Mining is Australia’s largest gold producer, with the best asset suite of the few remaining independent Australian gold producers. As a result of closing out all gold hedging and loan contracts, Newcrest Mining is now fully exposed to the gold price. Long-term growth hinges on the success of Telfer, which to date, has underperformed.

The operational issues at the Telfer mine have led to production and profit downgrades over the past year. A number of improvement initiatives focusing on improving metallurgical recoveries, lowering costs and maximising throughput of existing plant and equipment are beginning to pay off.

Price as at 16 September 2008 $21.45

Spark Infrastructure Limited (SKI) - BUY

Spark Infrastructure has investments in assets that own and operate electricity distribution networks located in Victoria and South Australia. The company predominantly earns distributions received from its asset companies, which earn their revenues by providing for the supply of energy transmitters to retailers.

In the long term, it is considered that Spark Infrastructure has the ability to maintain its high, absolute level of distributions. The company's portfolio of cash-flow-strong electricity-distribution assets offer scope for moderate volume growth. Cheung Kong Infrastructure and RREEF Infrastructure back SKI and have significant experience in both utilities and infrastructure operations.

Spark Infrastructure's immediate outlook is for steady cash flow generation derived from its three utility investments. With distribution growth from the core utility business largely determined by the regulator, there is growing support for management's plan for unregulated revenues to form a significant source of long-term sustainable distribution growth.

Price as at 16 September 2008 $1.59

Commonwealth Bank Limited (CBA) - BUY

CBA has the largest retail banking franchise of the domestic major banks and leading market position in the growth area of wealth management. The bank has achieved strong earnings growth over the past few years on the back of transformation initiatives and ongoing efficiency improvements. Growth momentum is expected to continue, and the current share price is considered to have been oversold.

CBA is facing more challenging conditions, however, it has good earnings prospects due to its strong capital position, diversified earnings profile, solid business momentum and ongoing strategic initiatives. Lending growth should remain solid and wealth management will benefit from ongoing superannuation flows.

Price as at 16 September 2008 $41.70

Oz Minerals Limited (OZL) - BUY

After the merger with Zinifex, Oz Minerals is now Australia's third-largest diversified mining company and world's second-largest producer of zinc, as well as a substantial producer of copper. The company has world-class Sepon gold and copper deposits in Laos; the Golden Grove zinc-copper-gold mine in WA; the Century zinc-lead mine in QLD; the Rosebury zinc-lead-copper-gold mine in TAS and the Prominent Hill copper-gold project in SA.

Zinifex's new Canadian mines come on stream in the middle of next decade. The value created from these new mines is expected to offset the near-term dilution to Oz Mineral's earnings from the merger with Zinifex.

Price as at 16 September 2008 $1.41

Paperlinx Limited (PPX) – SELL

Paperlinx is one of the largest paper merchants in the world, with operations in several continents. Generally, the paper industry is characterised by high levels of price competition, large fixed costs and low returns on capital. Given the highly competitive nature of its businesses, cost savings are typically passed on to the customer.

The company is facing cost pressures in the short to medium term. Unfortunately, benefits from the recent restructuring initiatives are likely to be swamped. Until there are signs of economic recovery across Paperlinx's global spread, particularly Europe, little is seen that will drive share price appreciation.

Price as at 16 September 2008 $2.24