

Monthly Market Watch – July Issue 2010

MARKET COMMENTS – JUNE

Continued uncertainty regarding the momentum of the global economic recovery led to market declines both domestically and internationally, with the Australian sharemarket decreasing by almost 3% and international equities falling by 4.2% in local currency terms for the month of June.

Fears of a “double-dip” recession developed throughout markets, due to poor economic data coming out of the US, signs of a potential slow down in China and the withdrawal of government stimulus, which if too early and too aggressive, could hinder global economic growth. It was made clear at the recent G-20 meeting that the world’s largest economies are aware of the possibility of a double-dip and the risks associated with removing public stimulus too early. As a group these countries have agreed to keep cash rates low to help stimulate growth and ease fiscal stimulus to reduce government deficits and debt levels.

Economic news released out of the US for June was not very encouraging overall: new house sales declined by 33% due to the expiration of the housing tax credit; employment data was weak with new jobs created well short of expectations; and there was a reduction in consumer confidence as a result of the oil spill in Mexico and continued debt concerns of European countries. This data indicated that an upward movement in US interest rates is not expected until 2011.

In Australia the economic data released was slightly more positive, with GDP growth coming in at 0.5% for the June quarter, and employment data indicating that almost 30,000 jobs were added to our economy. The month of June also saw a change in Australia’s Prime Minister, which resulted in a resolution to the proposed mining tax. Further information regarding the changes to the tax is outlined under “Stocks in the News”.

China announced that it would allow its currency to appreciate, rather than be pegged against the US dollar. This move reflected a level of confidence in the Chinese economy and a more positive view of global economic conditions, as the change would refocus the Chinese economy on domestic sources of economic growth rather than exports, and rebalance the economy to more sustainable levels. However the change had no lasting effects on the global economy, as the appreciation of the currency was minimal.

Despite the recent decline in the Australian sharemarket, the 2009-10 financial year saw Australian equities return 13.05% (including dividends), with all major asset classes providing positive performance for the 12 month period, largely due to the market rally experienced between mid-July 2009 and October 2009.

STOCKS IN THE NEWS

Mining Sector

The June quarter saw the proposal of the Resources Super Profits Tax (RSPT) announced, which initially sought to impose a 40% tax on any profits of mining companies which were considered to be “super”. This caused a large disruption in the mining sector and led to investors selling down the major companies affected, such as BHP Billiton and Rio Tinto. The Government’s lack of consultation and communication with Australia’s miners did not sit well with the industry and its major players, and was one of the contributing factors which led to the change of Prime Minister on 24 June 2010.

Under Julia Gillard’s reign as Prime Minister, the Government and Australia’s largest three miners (BHP, Rio and Xstrata) quickly came to an agreement on the RSPT (now referred to as the Mineral Resources Rent Tax) on 2 July 2010. The outcome was considered to be a positive resolution for the large miners, with a reduction in the headline tax rate to 30% from 40%, the tax only applying to iron ore and coal companies with resource profits greater than \$50 million pa, and a significant increase in the base rate, which determines the point at which the new tax kicks in.

Whilst there is still some uncertainty regarding the specifics of the proposed tax, which would be implemented from 1 July 2012, we continue to believe that exposure to the mining sector through large, well rated companies is integral to any well diversified, long-term portfolio.

Telstra Corporation (TLS)

On 20 June 2010 Telstra finally reached an agreement with the government regarding the National Broadband Network (NBN). Telstra will receive \$9 billion for migrating traffic to the NBN and allowing use of its existing infrastructure. Telstra will receive a further \$2 billion in value, for avoiding Universal Service Obligation costs.

The signing of this deal removed some of the uncertainty surrounding Telstra, and as such sparked an increase in the share price. We caution that the deal is yet to be approved by the Australian Competition and Consumer Commission (ACCC) and Telstra Shareholders themselves, although we see the latter to be less of a risk. The signing of this deal helped to lift the entire telecommunications sector, rising by more than 9% for the month of June.

Telstra has a "Buy" recommendation with Aegis Equities Research and at current prices offers an attractive dividend yield of around 9.0% fully franked.

STOCKS TO CONSIDER

WorleyParsons Ltd (WOR) - ACCUMULATE

WorleyParsons provides engineering design, project services plus maintenance and reliability support services across a range of industrial segments. WorleyParsons has equity investment in some of its major infrastructure projects. It is also involved in the development and commercialisation of technological innovation in areas such as communications, energy, commerce and system integration.

WorleyParsons operates in the following industrial sectors: hydrocarbons (oil, gas, refining and petrochemical); minerals and metals; infrastructure; and power (coal, nuclear and gas-fired).

WorleyParsons' exposure to large-scale projects through its diversified blue-chip client base helps it to weather commodity price weaknesses. The company is also well placed to benefit from the long-term prospects for renewable energy. This stock would be more suited to longer-term growth investors willing to accept above average risk.

Price as at 20 July 2010 \$19.98

Coca-Cola Amatil (CCL) - ACCUMULATE

Coca-Cola Amatil is a participant in the beverage industry and is the principal Coca-Cola licensee in Australia, Oceania and Indonesia. The company is responsible for the manufacturing, marketing and distribution of Coca-Cola and related brands throughout these regions. CCL's key brands are Coca-Cola, Diet Coke, Coke Zero, Fanta, Sprite, Lift, Lift Plus, Powerade, Glaceau, pump mineral water brands Deep Spring and Mount Franklin and fruit juice Fruitopia.

The competitive beverages landscape has put pressure on Coca Cola Amatil to expand its product range. The company is starting to gain the full benefits from expanding into packaged fruit and snack food after acquiring SPC

Ardmona. Its shift to higher-value products is delivering results and there is optimism about its diversification into alcoholic beverages. Its position in the non-alcoholic beverage market is strong and its distribution platform is first-class, with competitive advantages including the Coke brand power, innovative new products and solid financial management.

Research provider, Aegis Equity Research sees long-term growth opportunities in less mature regions for Coca Cola Amatil, particularly in Indonesia, and at current prices considers the stock to be attractive.

Price as at 20 July 2010 \$11.94

CSL Ltd (CSL) - BUY

CSL operates in the global plasma products industry and is one of the world's two largest plasma therapeutics companies, with only pharmaceutical giant Baxter operating a larger plasma business. As a result of its plasma operations, CSL enjoys global franchises in both coagulation and immunology. It is also a minor player in pharmaceuticals and has a modest, relatively early-stage Research and Development portfolio.

CSL's global footprint in the recession-resistant plasma business is a positive for the company. The industry enjoys strong organic growth from population increases, spreading health insurance and greater government spending on healthcare. Industry dynamics in the US are broadly favourable as Baxter and CSL dominate a "rational oligopoly" structure, although there is some threat from new entrants.

Price as at 20 July 2010 \$32.63

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