

Monthly Market Watch – June Issue 2010

MARKET COMMENTS – MAY

The month of May saw investors recoil from higher risk assets and move into more defensive investments. Triggering this flight to safety was the spreading concerns surrounding the sovereign risk of a number of European countries. Whilst the EU's rescue package has started to show signs of providing liquidity to these countries, the ongoing repayment of debt, high unemployment and cuts in government spending will most likely lead to anemic economic growth in these countries for some years to come.

Europe's debt issues have resulted in a significant decline in the value of the Euro over the past 6 months, which in turn has benefitted some EU member countries such as France and Germany, who have consequently experienced sharp rises in their level of exports.

Whilst Australia is not facing the same fundamental economic circumstances as those situated in Europe, the problems in the Eurozone have a negative influence on investor sentiment towards risk assets in a global sense, which includes Australian stocks, and the Australian dollar.

Australia's mining sector continued to be under pressure as a result of the uncertainty regarding the proposed resources super profits tax, and its impact on the long term valuations on mining assets. Declines in global commodity prices and signs of a slowing economy in China also weighed on the local mining sectors performance for the month.

The issues in Europe and proposed resources tax dominated economic headlines, and were the major contributing factors that led to Australia suffering heavy falls for the month, posting a 7.5% decline. In local currency terms international equity markets declined 7.6%, however in Australian dollar terms international shares declined only 0.4%. This was due to the Australian dollar depreciating by close to 10% against the USD for May, with the currency being considered a higher risk investment. Global investors sold down on these riskier investments and moved into defensive investments, such as gold, which rose 3.1% to break above the US\$1,200/oz mark.

With the Reserve Bank of Australia keeping rates on hold at 4.50% in light of the weakened global economic conditions, and signs of an economic

slowdown in both the US and China, Australia's ongoing recovery may be subdued, despite the relative strength of our economy.

STOCKS IN THE NEWS

Orica Ltd (ORI)

Orica manufactures and supplies industrial and specialty chemicals, commercial and mining explosives, and paints and other consumer products under brands such as Dulux, Selleys and Cabot's. Orica is the world's leading supplier of commercial explosives.

On 3 May 2010 Orica announced it was to proceed with the demerger of DuluxGroup to create a stand alone, ASX Listed company.

Subject to shareholder and court approvals, Orica expect the demerger to occur in July 2010. The directors of Orica believe that the proposed demerger will create long-term value for Orica shareholders as both Orica and DuluxGroup will be able to better focus on their respective strategies for growth, given that the characteristics of each business are fundamentally different.

Orica shareholders will receive one DuluxGroup share for each Orica share held. However, shareholders with a balance of less than 1,000 Orica shares can elect to sell all of the DuluxGroup shares that they would have otherwise been entitled to under the demerger, free of any brokerage or stamp duty, through a share sale facility. Investors who hold more than 1,000 Orica shares do not have this ability, and will receive the DuluxGroup shares on a 1 for 1 basis.

DuluxGroup are expected to commence trading on the ASX on 12 July 2010. The share price of the company will not be known until the shares begin trading. Orica's share price is likely to decline by the value of DuluxGroup's trading price, as a result of splitting DuluxGroup from the business.

Lihir Gold (LGL)

Lihir Gold rejected a \$9.2 billion takeover offer from rival gold miner Newcrest Mining back in April this year, stating that the bid didn't reflect the value of the company's assets or offer a sufficient control premium.

On May 4 Lihir entered into a Merger Implementation Agreement under which it is proposed that Newcrest will acquire all of Lihir's shares, valuing the company at approximately \$9.5 billion. Should the takeover proceed, Lihir shareholders will receive one Newcrest share for every 8.43 shares they own, plus \$0.225 cash per share, less any interim dividend declared by Lihir. This implies a total offer price of \$4.03 per Lihir share. Lihir were trading at around \$3.10 prior to the first offer being made.

Lihir's shares rose to this implied value on news of the revised bid, and have continued to rise given the increasing price of gold over the past few weeks, to close at a price of \$4.35 on 18 June 2010.

Newcrest have stated that they believe the merger has "compelling strategic logic and merit", with the combined organisation having one of the largest global gold reserves with operations in five countries. It would rank as the fourth largest gold producer in the world by market capitalisation. The merger is scheduled to take place in September 2010.

STOCKS TO CONSIDER

Wesfarmers Ltd (WES) - ADD

Wesfarmers is Australia's best known and most successful conglomerate. Activities include hardware/home improvement, supermarkets, discount department stores, coal mining, LPG manufacture and distribution, industrial and safety supplies, chemicals, fertilisers, general insurance and insurance broking.

Wesfarmers' acquisition and turnaround of Coles has created a more reliable revenue and earnings base for the company. Coles supermarkets have demonstrated tangible evidence of improved profitability, along with Target and Kmart, which delivered better than expected growth. The outlook for these businesses is positive, benefitting from an improved product mix. Recent strong rises in coal prices will also support near-term earnings growth.

Aegis Independent Equity Research believes Wesfarmers is undervalued at current prices, and have a positive long-term outlook for the company.

Price as at 18 June 2010 \$29.24

Rio Tinto (RIO) - BUY

Rio Tinto is a major international resources company. RIO has major operations in Australia, North America, South Africa, Chile and many other countries, producing a range of commodities, including gold, copper, coal, iron ore, alumina, aluminium, mineral sands and

diamonds. RIO's major earnings drivers are iron ore and aluminium.

Rio aims to operate quality long-life, low-cost mining assets, augmented by a pipeline of projects to replenish and grow earnings. Rio's management has a proven record of successfully operating and delivering low operating-cost projects.

Whilst there is still uncertainty regarding the Resources Super Profits Tax, Rio's outlook remains positive given the increased production levels and commodity prices, which should continue to improve as the global economy recovers. The recent \$15 billion capital raising, proposed iron ore joint venture with BHP Billiton and US\$7 billion in divestments have put the company back on positive footing.

Price as at 18 June 2010 \$70.85

Foster's Group Ltd (FGL) - ADD

Foster's Group is a global premium brand alcoholic beverages company. The group consists of the three main operating arms of Australia, Asia and Pacific; Europe, Middle East and Africa; and the Americas. Foster's Group recently decided to separate the company's Beer and Wine businesses.

Foster's has suffered at the hands of the precarious wine industry, compounding the volatility of its American division. With the burden of trying to juggle two very different businesses, being wine and beer, removed, Foster's corporate appeal has improved. Foster's beer assets are attractive and underpin Aegis' long-term valuation of the company.

Splitting the Wine business out of the company will help reduce borrowings at a corporate level, leaving behind a very stable and secure company which will appeal to many investors. Our major research source Aegis Independent Equity Research has a positive short-term investment opinion of Foster's Group.

Price as at 18 June 2010 \$5.81

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