

Monthly Market Watch – May Issue 2010

MARKET COMMENTS – APRIL

Economic news throughout the month of April was dominated by the events taking place in Europe, particularly in regard to Greece and fellow European Union (EU) member countries Spain and Portugal.

The major credit rating agency Standard & Poor's downgraded the credit ratings of these three countries, which led to serious concerns over the impact these structural problems in the EU will have on the recovery of global markets. Whilst there has been some relief with a bailout package worth almost US\$1 trillion created by the EU to contain Europe's spreading debt crisis announced in early May, many analysts' commented that this would only provide a fix for the short term.

The All Ordinaries Index briefly surpassed 5,000 points in mid-April; however, the second half of the month saw the market drop sharply on Greece, Portugal and Spain's credit downgrades. Investors reacted negatively to the downgrades as it increased the risk of these issues in Europe threatening the recovery of the global economy.

Given these concerns, the Australian equities market declined by 1.4% for the month. These losses were amplified by the Australian government proposing a "super profit tax" on the resources sector, which could reduce the long-term value of Australian mining assets. Investors subsequently sold out of mining stocks and bought into defensive sectors such as Telecommunication and Utilities.

Globally, losses in equities were heavily concentrated in Europe, with the MSCI Europe ex-UK index falling by 5.3% in April in Australian dollar terms. The fall of the Euro against other major currencies was a key detractor to this performance. Markets in the US gained for the month, boosted by strength in the economic recovery and better than expected first quarter earnings reports. The Dow Jones rose 1.4% for April whilst the S&P 500 rose 1.5%.

The official cash rate was raised by 25 basis points to 4.25% in early April, with most analysts' expecting more rate increases in the near future to help curb rising inflation. These increases in interest rates, together with increased competition amongst banks and corporations for capital, is flowing through to increased interest rates for fixed interest investments.

STOCKS IN THE NEWS

Unsolicited Share Offers

Recently there have been a small number of companies making unsolicited offers to purchase an individual's shares in a particular company. The companies in question make an offer to purchase shares from a shareholder of a company, generally at a significant discount to the company's market price.

These company's typically target elderly shareholders with small to medium holdings, and it is generally the inexperienced or those under immediate financial pressure that are most at risk of accepting this offer. The offer letter boasts of charging no brokerage in the sale of the shares, and shows the dollar figure you will receive if you wish to sell your shares.

As the difference between the price the company is offering and the actual market price of the company is generally quite substantial, it is typically not in the shareholders best interests to accept these offers. Whilst such offers are not illegal, ASIC do require that the offer letter states the price for which the shares would be purchased and the market value of the shares as at the date of the offer.

Two company's which are involved in this practice include Hassle Free Share Sales Pty Ltd and Direct Share Purchasing. In the past few months there have been unsolicited offers sent to shareholders of BHP Billiton and Woolworths, however there may be offers for other companies in circulation.

These companies currently have the legal right to request a company's shareholder register, to access the names, addresses and size of each shareholder's holding. However, the Government has proposed a 'proper purpose' test which allows companies to deny access to their register to those they suspect will misuse the information, such as those making unsolicited share offers.

If you receive an unsolicited offer to purchase shares you hold, we advise that you either ignore the offer, or if you wish to sell your shares, first check the current market price of the stock or call us at Strategem to discuss.

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.

Despite this offer being rejected, Transurban's share price continued to trade between \$5.00 and \$5.60 up to the end of April, buoyed by the prospect of a higher revised bid by the Canadian Pension funds and Sydney based fund manager CP2 (14% stakeholder of Transurban).

Transurban announced a capital raising to institutional and retail investors to fund the purchase of the Lane Cove Tunnel in Sydney for \$630 million on 10 May. The capital raising is a renounceable 1 for 11 entitlement offer at a price of \$4.60 per security.

Shortly after this capital raising and asset acquisition were announced, the company received a revised takeover offer from the two Canadian pension funds and CP2 at a maximum price of \$5.57 per share in cash, which was a 13% premium to Transurban's closing price on 7 May. The offer included two proposals: a price of \$5.57 if the capital raising did not go ahead, or a price of \$5.42 if the capital raising was implemented.

Transurban were quick to reject both proposals, stating the price was inadequate for control of the company given its performance and prospects. Transurban's share price dropped on the news. On 18 May, the Ontario Teachers Pension Plan Board sold their entire holding in the company at a discounted price of \$4.44 per share, which sent Transurban's share price down over 5% to this price on the announcement.

Transurban are currently rated as "Neutral" by our major research provider Aegis Equity Research, and will continue to be monitored as further developments surrounding the company take place.

Price as at 18 May 2010 \$4.42

STOCKS TO CONSIDER

Tatts Group (TTS) - ADD

Tattersall's is one of the three licensed gaming machine operators in Victoria (including Crown Casino). TTS operates public lotteries in Victoria, Tasmania, the ACT and the Northern Territory. Following the merger with UniTab in 2006 it has wagering operations in Queensland, SA and NT.

Tatts Group was unable to renew its Victorian pokies licence, and it will lose the licence in 2012. Whilst this may affect the company's

earnings, Tatts have taken measures to offset these future losses by purchasing NSW lotteries, which represents a good growth opportunity for the company.

Tatts Group maintains a high payout ratio of around 94%, which results in high dividends being paid to investors, which are fully franked. At current prices, Tatts Group is expected to pay a dividend yield of around 8.8% for the 2010 financial year, which is well above the market average of around 3.9%.

Price as at 18 May 2010 \$2.39

Audtralian Foundation Investment Co. (AFI) - Recommended

AFI are a Listed Investment Company (LIC). A LIC is a company that is listed on the Australian Stock Exchange (ASX) and invests in a portfolio of investments that are generally listed on the ASX. The primary benefit in investing in a LIC is that it provides a highly diversified investment, giving investors exposure to a wide range of companies through a single holding.

AFI was listed on the ASX in 1936 and is currently the largest LIC in Australia, representing approximately 20% of the sector. AFI holds around 100 stocks in the portfolio, with the majority being in the top 200 stocks on the ASX.

AFI invest in companies with strong management, good free cash flow, strong sustainable margins and a capacity to pay increasing dividends. The major differentiating factor from other LIC's is that AFI focus on dividend paying companies. AFI also operate a trading portfolio which uses option strategies to generate additional income.

Price as at 18 May 2010 \$4.88

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