

## June Quarter 2009 Consolidated Review & Outlook

### Review

#### Australia

The Australian economy is proving resilient thus far, with the economy yet to officially enter recession (two negative quarters of economic growth).

The Government is likely to continue providing fiscal stimulus to help buffer the fall in private demand that is expected. It is expected that the Budget will stay in \$50-60bn deficit (representing 5-6% of GDP) for some time, as tax revenues decline as a result of slower growth and spending increases.

The slowdown in economic growth is likely to have an impact on the unemployment rate. The unemployment rate is expected to climb to 7.0% during the year and 8.5% in 2010.

All in all, the Australian economy is likely to perform better than most developed economies, primarily because its financial system is stable and Public debt levels are low. Expansionary fiscal and monetary policy is likely to be effective in cushioning the economy. However, the severity of the global recession and global credit crisis will still have a major impact, so a mild to moderate recession has to be expected. Expectations are for the Australian economy to contract by 1% over FY10.

#### Global

While the global economy and financial markets appear to be on the mend, many commentators and research houses are wary of the high debt levels that now burden both the private and public sectors of Europe and the US. While China is a net surplus country and is expected to continue growing during 2009, it is unreasonable to expect China alone to rescue the global economy. It is expected that the global recession will deepen over FY 2010, stabilising in 2011.

Credit conditions are likely to remain tight, with bond yields expected to rise over 2009/2010.

Deflation is more likely to occur in the short to medium term due to a build up of excess capacity. The risk of inflation may increase later, largely due to 'money printing', notably by the US.

Commodity prices are likely to remain subdued until production is cut back to meet lower levels of demand. However, prices could rise in nominal terms, if the US further increases money printing.

### Outlook

#### Australia

Research Houses and Analysts remain cautious about the outlook for local equities, believing investors still face the prospect of a slow and long road to recovery which is reflected in a "Slightly Underweight" position to domestic equities. Whilst the local market has more than likely seen its lows in March and that economic conditions stabilised in the second quarter of 2009, there are a number of key issues that need to be considered before increasing the allocation to Australian equities.

Central to this cautious view is the large amount of equity capital raised and its dilutive impact on EPS and DPS in the short term. In addition, the domestic market may have further downside if earnings decline by more than expected in 2009 and 2010. The upcoming FY09 reporting season in August will therefore be a key to providing further clarity around these issues.

The extent of the market's correction from its peak implies that Australian equities are trading on a forward market Price to Earnings Ratio (PER) of around 12-13x, versus an historical average of 14x. Whilst the market would appear cheap based on valuation alone, factors such as those mentioned above and the potential for rising bond yields (which would be a negative for equities) as a result of rising fiscal deficits across the OECD, continue to outweigh the benefits of a broad based move back into equities at this time.

The financing environment for many companies remains challenging in the near term. However, quality companies with strong balance sheets should be well positioned to survive this difficult period.

### **Global**

Despite the recent improvement in global equity performance, lingering doubts remain regarding the pace of global economic recovery, which will likely continue to weigh on investor sentiment. While it seems that the darkest days of the recession may be behind most economies, aided by government and central bank stimulus programs, there continue to be a number of challenges for economies to contend with. These challenges include labour market weakness, subdued corporate earnings and anaemic profitability. While emerging market equities have enjoyed a recent minor recovery, mainstream global equity portfolios are dominated by the large deficit economies such as the US and Europe and it is here that economic problems are the most ingrained. Given this, it is difficult to confidently make a case for an increased allocation to global shares.

The global financial crisis is likely to restrain company earnings and constrict global economic growth. While the P/E for the global market has come down, the forward looking earnings part of the equation remains uncertain.

For a full review and outlook of market sectors go to [www.prl.com.au](http://www.prl.com.au) and follow the links.

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