

September Quarter 2009 Consolidated Review & Outlook

Australia

Economic fundamentals look quite strong, relative to most OECD countries, with increasing links to Asia (China in particular) providing good support. Resilient house prices, relatively low unemployment and improving business and consumer confidence should see Australia continue to outperform most OECD economies.

One of the main risks to the economy is now inflation, with the RBA moving to raise rates in recent weeks. Our view is that the cash rate will gradually increase to 4.0% by June 2010. Given that Australian has the highest cash rate in the G20, this should be supportive of the AUD. There is a possibility that the AUD may reach parity and perhaps exceed the USD if the US Government continues to supply liquidity to the US economy and financial system. Commodity prices are likely to remain buoyant as OECD demand recovers and USD continues to remain weak.

Global

The IMF has upgraded its outlook for global growth, with activity expected to decline by 1.4% over 2009 and expand by 2.5% over 2010.

Credit conditions are expected to remain tight, with the potential for a rise in bond yields over 2010.

In terms of inflation/deflation, deflation is more likely in the short term due to the build-up of excess capacity but Government liquidity could lead to inflation emerging later.

The G7 is expected to experience a mild recovery over 2010. We believe that China will maintain an 8% growth rate; while Japan is expected to experience a mild recovery.

Australian Shares

The Australian share market (as measured by the S&P/ASX 300 Accumulation Index) recorded a solid return of 21.6% for the September quarter.

We are generally positive on the fundamentals of the Australian economy and its increasing links to Asia. The US economy is now less relevant to Australia than in the past but sentiment is still driven by the US lead. It seems that if Australia's future is increasingly tied to the developing economies of Asia then the US lead will become increasingly less relevant.

Given the strong run in the market since March, a correction over the December quarter is a possibility as profit taking sets in.

Global Shares

Over the quarter, global shares returned 7.2% (as measured by the MSCI World ex Australia Index in \$A).

Financial markets have rebounded since March 2009. Apart from a rising unemployment rate, most of the US data has improved over the US summer and results from the 2Q and 3Q US reporting season have surprised on the upside. Consumer and business sentiment is also improving across the US, Europe and Asia.

Overall, we expect the AUD to outperform USD denominated assets.

Global & Australian Listed Property

Domestic REITs returned 30.5% for the quarter. While valuations are attractive on certain A-REITs, the sector continues to face a number of issues primarily concerning gearing, refinancing and bank covenants.

Weighing up the attractive valuation of most stocks and the obvious risks still prevalent,

Global REITs returned 30.9% for the quarter. We believe the sector is now trading at around 'fair' value; however, a certain level of risk remains.

Over the long term, we expect the global property securities sector to deliver an average return of 8-10% p.a.

Global Fixed Interest

Global fixed interest returned 3.9% for the quarter. We find the investment case for global bonds to be unattractive as yields range from 3.0% to 3.5% on most major global 10-year bond issues.

We believe that at some point in the future, Central Banks and Governments will be successful in jump-starting inflation either by conventional or non-conventional means i.e. money printing.

Australian Fixed Interest

Australian fixed interest returned 1.8% for the quarter. Australian Government and Corporate bonds have recently rallied as inflation concerns abate and credit spreads narrow. However, we still remain concerned that inflation will return over the medium to long term and hence bond yields will rise i.e. bond prices will fall.

Cash

Cash returned 0.8% for the quarter. The RBA has begun the process of lifting the cash rate from its historic low of 3.0% which had been put in place to insulate the economy against a global recession. Recent economic data confirms the Australian economy has avoided recession and indeed has outperformed most OECD countries.

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