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## April 2011 – Market Update

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### Domestic Market

- The ASX100 accumulation index was range-bound during April, closing virtually flat (-0.07%).
- \$A strength, or rather \$US weakness, was the story of the month – with the local currency moving from \$1.03 to \$1.097.
- The impact on the market was to build in expectations of downgrades for those companies with significant offshore earnings (ALL, IPL, BBG).
- Despite improving commodity prices, the resource sector underperformed the broader market. This was in part due to poor quarterly production data.
- The defensive nature of Telstra (+3.2%) and the Financials (NAB +4.8%) attracted buyers during April, a trend we think is likely to continue.
- Rumors and fact with regard to M&A also helped the market, with Computershare taking advantage of the \$A to buy BNY Mellon's shareholder services business.
- The RBA held rates in April (and have done so again in early May) at 4.75%. The market is factoring in one 0.25% move by July.

### Resources

#### **Nickel**

- Inventories are starting to decline again following a short period of net inflows during the latter part of 2010.
- Sumitomo Metal Mining says Japanese government to support SMM developing major Isabel lateritic nickel in Solomon Islands through provision of 30% of investment.
- Production increasing from lower cost nickel pig iron.
- Some higher marginal output from established sulphide operations later in year.
- Price rises to dampen in latter part of calendar 2011.

#### **Tin**

- Demand (and price) benefiting from main use of soldering in burgeoning electronics and television industry.
- Higher demand for tin in solder as lead phased out.
- Record-breaking price performance has not yet triggered significant industry supply response.
- Japan's huge participation in electronics sector could be impacted medium term by March earthquake damage.
- Ongoing supply disruptions from Indonesia, world's second largest producer and biggest exporter of tin, as government limits exports of unprocessed ore or concentrate in favour of added-value products.

#### **Zinc**

- Japanese earthquakes closed 65% of country's production of galvanised automotive steel sheet and building construction applications.
  - Some output now coming back on stream.
  - More cars sold in China in 2010 than any other country at any time in history.
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- But 30% sales growth to more than 18 million vehicles probably unsustainable as car restrictions under consideration to reduce Beijing traffic congestion.
  - Inventories remain high and supply/demand balance is not conducive to significant price gains this year.

## **Global Market**

### **Asia**

- Asian heavy weights China & India are the most significant drags.
- YTD performance lags behind the leading developed markets, rising inflation leading to tighter monetary policy is the main factor behind the under performance.
- China increased interest rates for the 5<sup>th</sup> time & the Yuan has been allowed to rise more quickly, the economy still grew 9.7% in the 1<sup>st</sup> qtr.
- But evidence continues to build that this extended period of tightening is having an impact, manufacturing slowed in April, fixed asset investment is falling & inflation is expected to ease in the 2<sup>nd</sup> half.
- We see China “H” shares as a developing opportunity. When/if inflation peaks & monetary policy moves to “on hold” we expect China stocks to move much higher.
- The 1<sup>st</sup> set of data from Japan is as bad as expected, Industrial production fell 15.3% in March, the sharpest fall since 1953, in addition, household spending fell a record 8.5%.
- The Nikkei has been relatively stable over the month, it seems anybody needing to sell has done so, but it will take some time before the economy can support rising prices.
- Asian currencies have been rising against a weak USD, there is some talk of intervention to halt the speed of that rise but that is unlikely, inflation concerns still dominate central bank thinking.
- Higher currencies will have a negative impact on exports & growth and reduce the need for tighter monetary policy which is very unpopular domestically, as a result, Asian CBs will tolerate further appreciation.

### **US**

- US equities have rallied to new highs for the year & their highest level since mid '08, US Small Caps are now at record highs
  - The possible downgrade of US debt rating & the US deficit had a big impact on the USD but equity investors do not seem to be worried.
  - The Fed has played a clear role in the rally to new highs and has indicated that interest rates will remain at near zero lows for a good while yet.
  - The economy has slowed to 1.8% pa from 3.1% in Q4 but there are still concerns about the sustainability of the recovery once QEII comes to an end.
  - Confidence has improved from a 16 mth low as a result of an improvement in the jobs market - retail sales are up 7.0% y/y, but higher food & energy costs are starting to squeeze households.
  - Oil prices are therefore a concern, some research suggests oil in the \$135-\$150 will reduce global GDP growth by 2-3%. Clearly the US & the developed world cannot afford this & a double dip recession would result.
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- But while the Fed tells us there is no inflation (& we believe it!) they will continue to keep rates low.
  - How the US is going to fix its debt, deficit & real inflation issues is a BIG problem & it is unlikely to end well. But for now that is a tomorrow's problem.

### **UK & Europe**

- The German DAX rebounded very quickly from last month's sell off and is now trading at its highest level since early '08.
- The ECB was the first to move with an increase in interest rates, the Euro has now reversed nearly all of the 2010 fall.
- This currency fall was important in the export surge in Germany during '09/10, a higher Euro will be negative. GDP is forecast for 3.1% y/y this year, but some leading indicators are turning down & growth may only be 2% y/y in 2012.
- With the ECB likely to increase rates further, a strong Euro & a slow down in growth it is difficult to see German stocks keeping pace. Needless to say the rest of Europe is in much worse shape
- The FTSE 100 is testing its highs for the year, but performance still lags behind the US & even Germany.
- UK Retail sales fell by record amount in March. Household spending power is being eroded at the fastest pace in 60 yrs as inflation rises & wages stall. The stalled UK economy also is causing concerns over job security for households.
- Growth estimates have been trimmed to under 2% for 2011 with 2012 only marginally better. While this will probably delay rate rises, which is positive, there are other opportunities available.

### **Bonds**

- Bond yields have fallen again after peaking in early Feb'11
  - Equity markets are pricing in ongoing recovery in contrast with bonds as falling bond yields do not normally equate with this view.
  - The bond market is distorted by Government intervention so we need to be careful drawing conclusions.
  - The Fed are still indicating interest rates are likely to remain low for some time but bond investors seem comfortable accepting the view that there is no inflation at present.
  - Spreads to corporate bonds fell to their lowest level since mid '07.
  - Investors are chasing corporate bonds for yield but with spreads at these levels there is no value. Stocks with decent dividend yields are much more attractive at these levels.
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