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May 2011 – Market Update

Domestic Market

Australia

- The All Ordinaries Accumulation Index lost 1.9% during May, as risk aversion was back in fashion.
- Questions were again being asked about global growth as weak economic data, both domestically and abroad, hit the $A (-3c vs. $US) and WTI Oil (-$11 to US$103).
- Defensive stocks outperformed those with more cyclical earnings - Telstra continued its rebound (+4%), while Consumer Staples (+0.5%) beat Consumer Discretionary (-3%).
- In Consumer Discretionary, Retail was hit hard, with MYR, DJS & JBH all down more than 9%. Media was also hit as FXJ (-18%) had a profit warning due to the softening ad market.
- Mid month Treasury Wine Estates (TWE) was spun out of Fosters, with the latter adding 6% on the back of further rumours of a foreign takeover.
- The RBA remained on hold in May although inflation data seems to be leading a push for another rate rise sooner rather than later.

Derivatives

- The Australian Vix Index which measures volatility in our markets has moved in a narrow band of 18 – 19% which is indicating that uncertainty over market direction is rising, be it slowly.
- The continuing strength of the $AUD, weaker GDP growth in the March quarter, is leading to downward pressure on equity markets. The political morass is also not helping our market, as foreign investors reduce or hold their capital flow.
- Uncertainty leading into the reporting season is also starting to feed into our markets, primarily driven by uncertainty regarding China growth metrics. Volatility is therefore anticipated to rise in the upcoming months.

Resources

Aluminium

- Demand expected to grow by 12% in 2011.
- China is largest consumer (52% of global output).
- China's production mainly goes essentially to internal consumption.
- Light-weighting of transport vehicles and rail wagons are key energy efficiency initiatives (over 120 million vehicles to be built in China in next five years).
- Urbanisation in developing countries is main driver to construction usage.
- Electrical infrastructure development in China and developing countries is underpinning demand.

Iron Ore

- April global steel output increased 1% month-on-month and 5.4% year-on-year.
- Improvements were posted during the month from France, Turkey, China, India, South Korea and Australia.
- Iron ore prices for quarter to 31 September 2011 in line or possibly higher than immediately preceding quarter (to 30 June 2011).

•Price support expected during September quarter due to Indian supply disruptions caused by monsoon season commencement, which is usually in May.

Zircon

•Price up 60% since beginning of year.
•Main use is ceramics (wall and floor tiles and sanitary ware) with 60% of demand and increasing with Chinese urbanisation.
•Foundry sands and refractory applications account for 22% and consumption increasing slightly.
•Overall market remains tight with world's largest supplier Iluka Resources rationing customers.
•Price rise to date likely to consolidate and be retained for balance of 2011 at least.

Global Market

US

•US High oil & food prices constraining growth in short term, durable goods orders down & IP stalled.
•Economy slowing to 1.8% y/y but jobs growth should continue
•housing still near record lows Current = 0.25, CPI @ 2yr highs but Fed claims current inflation is temporary so rates to stay low until year end at least
•US likely to pause after hitting new YTD highs, trend is still upwards & monetary policy remains a positive driver in the short to medium term

ASIA

China

•China Growth slowing & inflation may be near a peak
•electricity shortages & monetary policy raises risk of hard landing
•state of property market a major talking point
•How China comes out of this period is critical for global outlook,
•a peak in inflation & monetary policy will be positive (our current view) but an overshoot & hard landing will be a MAJOR negative, needs to be watched carefully

Japan

•Japan Officially back in recession
•Industrial Production down 15% m/m & probably still worse to come before reconstruction demand kicks in Q3/Q4
•Some suggesting Japan is cheap but the upside is a long way off & there are better opportunities

Singapore

•Singapore GDP up 8% y/y in Q1, but likely to slow,
•property taking off again so further measures to slow it are likely
•Monetary Authority of Sinpagore will continue tightening bias via SGD but less aggressively
•Singapore fundamentals are still strong but a peak in tightening cycle is required for market to resume upward trend

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UK & EUROPE

UK

•GDP forecasts cut to under 2% & inflation pushing 5%+,
•consumer spending falls most since Q2 '09, but exports rising at fastest pace in 30yrs,
•inflation likely to be above target of 2% this yr & next,growth taking priority
•The UK has not been able to clear Mar'11 high & -ve YTD, significant gains look difficult given fundamentals

Europe

•German growth surprises again (+5.2% y/y) but Euro debt problems back in the headlines, Greek default a matter of time,
•ECB likely to raise rates again which is negative for stocks,
•GDP forecast <2% in 2012
•ECB on tightening bias & look set to increase rates by another 25bp
•German growth looks ok but rest of zone poor, debt problems, increasing rates a negative, unlikely to be best performing equity market

Bonds

AUS

•After the release of data which showed the Australian economy shrank during the March quarter, a small change to the longer term bonds was weaker. Three to10 year bond futures fell slightly.
•Short term rates are steady, but the pressure is building for the RBA to raise official rates sooner than later, as inflationary items come to the surface.
•The benefit for investors will be in short term interest baring investments compared to long term.

US

•US Bonds Yields have fallen again despite CPI rising, slowing GDP growth & risk aversion in May the key factor
•Longer term yields will be much higher but in the short term market remains distorted by Fed & end of Fed buying may be catalyst for yields to rise, avoid Govt bond allocations

UK

•UK Gilts Yields fallen to lows for the year @ 3.27% despite CPI rising & above target, economy has stalled the main driver
•Yields look set to remain low & below 4% for some time but longer term will be much higher, no value in owning bonds

Corp Bonds

•Corp Bonds High grade & high yield spreads have stabilised, investor exposure in still near record highs
•spreads are low & have probably fallen too far, investors are already very long so a reversal of

positioning would be negative