

Monthly market view

March 2011

- March was a volatile month in global financial markets, largely dictated by events in Japan and the Middle East.
- Concerns over oil price gains and sovereign debt in Europe remained major issues for financial markets to process.
- Global sharemarkets mostly fell, while emerging sharemarkets largely rose.

Economic overview

The Japanese disaster has heavily impacted the direction of the Japanese economy and the Japanese sharemarket. Given the high level of Japanese exports of critical components in manufacturing processes globally, it is likely there will be considerable supply chain impacts. The Bank of Japan provided extra funds into the Japanese financial system to limit volatility and to ensure the smooth functioning of markets. The Japanese yen rose sharply post the disaster. Given the sharp rise being negative for the large export sector, the G7 announced the first coordinated intervention into currency markets in more than a decade, to reduce the value of the yen.

Political unrest in the Middle East has led to sharp gains in the price of oil, with West Texas Crude rising 10.1% to US\$106.7 a barrel in March. The higher oil price has led to rising inflation globally; the question is whether this is temporary or if it will result in pricing pressures more broadly. Policy makers are currently debating these issues and the outcome is likely to influence the path of official interest rates over 2011.

Globally, inflation pressures are accelerating and leading some countries to lift interest rates. Inflation numbers released in the month indicated rising inflation pressures, with China (+4.9%/year), India

(+8.3%/year), the UK (+4.4%/year), EU (+2.4%/year) and US (+2.1%/year) all showing a rising trend.

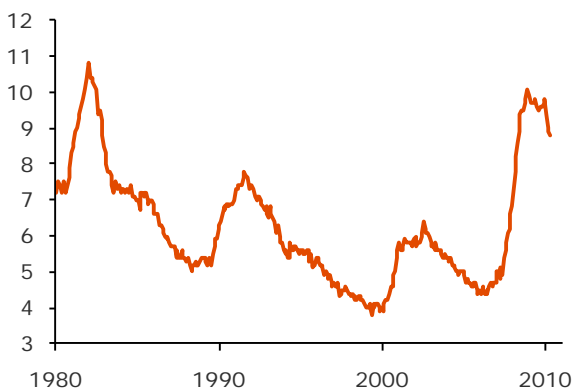
Rising inflation led to the Bank of India lifting interest rates, while expectations are accelerating that the European Central Bank (ECB) and the Bank of England (BoE) will begin to normalise official cash rates. The ECB went one step further than the BoE and hinted at an April interest rate hike, stating that strong vigilance on inflation is warranted.

Other news out of Europe focused on changes to the bailout packages that have so far provided funds to Greece and Ireland. The European Financial Stability Fund (EFSF) will be upgraded to €440bn from €250bn, although details of how this will be achieved are still being finalised. European leaders also agreed to introduce a permanent bailout fund, the ESM, to be launched mid-2013. Funding details are still being negotiated between the EU countries, with the amount of paid-up capital each country has to provide and the timeframe over which these funds are to be provided, still to be determined. The expectation is that Portugal will be the next country to seek assistance with the resignation of its Prime Minister during the month after fiscal austerity measures were rejected in parliament. As a result, Portugal suffered credit rating downgrades with 10-year Government Bond yields moving from 7.51% to 8.41% during the month.

Economic data out of the US was mixed. Housing market data continued to show very weak levels in terms of activity, with housing starts (-22.5%/month), new home sales (-16.9%/month) and existing homes sales (-9.6%/month) all recording very weak numbers. This remains a real weak point for the US economy and continues to hold down consumer confidence and household wealth.

For a housing market recovery to occur, the focus is largely on jobs. In terms of the labour market, employment data for February and March showed continued improvement with 192,000 jobs added in February and 216,000 added in March. The unemployment rate is now 8.8%. Stronger jobs growth is needed to meaningfully reduce the unemployment rate and this remains the main focus for US policy makers. See chart below for the US unemployment rate.

US Unemployment rate (%)



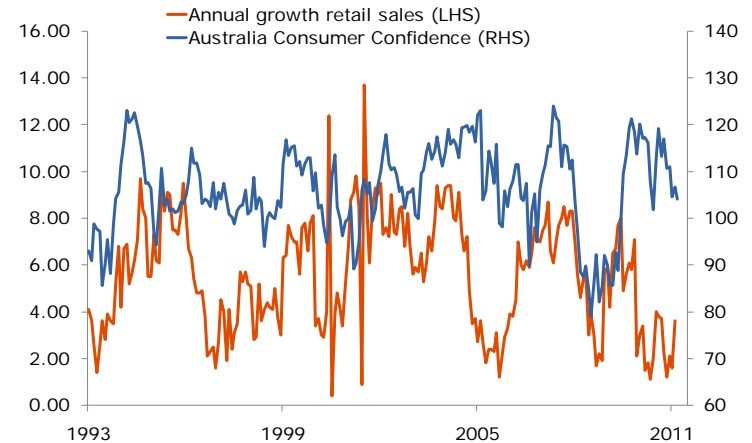
Source: Bloomberg

In Australia, there was limited economic news. Q1 GDP data was released early in the month, GDP growth was 0.7%/quarter and 2.7%/year. The Australian economy is currently in a transition period between government stimulus and the large mining capital expenditure boom. With weak consumer spending, economic growth is currently softer than expectations.

The Reserve Bank of Australian (RBA) left interest rates on hold at 4.75% and seems content to wait and assess how the economy evolves from here, before resuming the tightening cycle later in 2011. The RBA described the current stance of monetary policy as "mildly restrictive" in its early March decision. Retail sales rose +0.5%/month, the best monthly result since July 2010. Better retail sales were evident in QLD and WA and in furniture, electrics and clothing, post the natural disasters. On an annual basis, retail sales remain below a trend level, with annual growth currently at 3.6%/year, although it did accelerate from 1.6%/year at the end of January. See below for a chart of retail sales and consumer confidence. The strength of

consumer spending in 2011 will be important for the future path of RBA decisions.

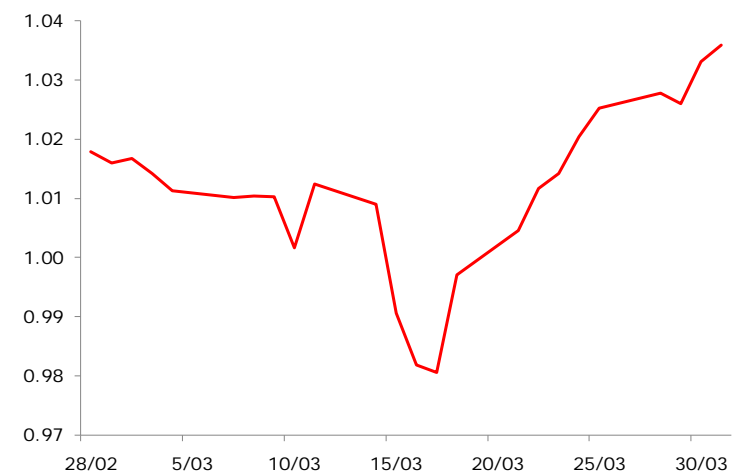
Consumer confidence versus retail sales



Source: Bloomberg

In other news, the A\$ finished the month at US\$1.0359, a gain of 1.8%, despite falling as a low as US\$0.9806 post the Japanese earthquake. Gains were also recorded against the yen and pound, but fell against the euro on interest rate hike expectations in Europe. See chart below for the A\$/US\$ performance over March.

A\$/US\$ – March 2011



Source: Bloomberg

Australian shares

March was a month of two halves for Australian shares. The market fell by nearly 6% in the first half of the month, as the earthquake in Japan – and subsequent fears regarding the crippled nuclear power station – dampened investor sentiment. However, the sharemarket

rose strongly in the second half of March, regaining all of its lost ground from earlier in the month. In March as a whole, the S&P/ASX 200 Accumulation Index added 0.7%. Trading volumes in the market were modest, suggesting that confidence in the recent rally is reasonably fragile.

Energy stocks maintained their recent momentum, supported by further increases in the oil price. Ongoing geopolitical tensions in Libya and other Middle Eastern countries continued to limit the supply of oil and pushed energy prices higher. This move, along with the increasing cost of oil refining, is affecting Australian consumers through higher petrol prices.

Stocks in the retail sector underperformed the broader market, reflecting subdued consumer expenditure. Recent comments from store owners have confirmed that the retailing environment in Australia remains challenging and that discounting is often required in order to maintain sales. Margins are also under pressure in the grocery retailing sector, as major retailers appear to be engaged in a price war in some product segments.

Towards the end of the month, investors began to focus on the possibility of further share buybacks from Australian companies. For example, BHP Billiton recently announced a \$10 billion off-market share buyback and JB Hi-Fi followed suit in March. Since the balance sheets of Australian listed companies are generally in good shape, brokers suggested other companies could pursue capital management initiatives of this type in the months ahead.

Global shares

Global equity markets recorded mixed returns in March due to a number of exogenous global events. A favourable macroeconomic environment, M&A activity and abundant liquidity due to the Federal Reserve's quantitative easing (buying government bonds) policy continue to support equity markets, despite a number of short-term headwinds. The MSCI World Net Index fell 3.0% in A\$ terms and 1.2% in US\$ terms.

The Dow rose 0.8%, one of only a few sharemarkets to record positive gains. M&A activity in the Telecommunications sector

assisted the gains. The S&P 500 was down 0.1%, while the NASDAQ recorded a small loss.

European markets recorded losses on renewed debate about bailout plans and in the lead up to stress tests on the Irish banking system. Germany (-3.2%), France (-3.0%), Spain (-2.5%) and Portugal (-2.1%) all fell and the UK FTSE fell 1.4%. The 2011 Budget was released largely in line with expectations, although there were several notable tax breaks, with reductions in corporation tax and fuel duties complemented by income tax allowances. These were offset by increases in North Sea energy taxation and other initiatives.

In Asia, Japanese equity markets fell sharply. The Nikkei finished the month down 8.2%, while the Topix fell 8.6%. The two days following the earthquake saw losses of 16%, due to concerns regarding the nuclear reactors. The market recovered somewhat before the end of the month. Asia ex-Japan recorded solid gains on expectation that these economies may benefit from the movement of economic activity out of Japan, due to damage at production facilities. Singapore (+3.2%), South Korea (+8.6%) and Thailand (+6.0%) all rose.

Global emerging markets

Emerging markets outperformed developed global equity markets in March, in a reversal of the recent trend. The MSCI Emerging Markets Index rose 3.9% in A\$ and 5.7% in US\$.

Strong gains in Saudi Arabia (+10.5%) and Russia (+6.6%) were driven by gains in the oil price. Other markets to perform well included the Philippines (+5.3%), Turkey (+5.6%) and India (+9.1%). Gains in India came despite another lift in interest rates by its Reserve Bank.

Sri Lanka (-7.3%), Argentina (-3.0%) and Israel (-0.2%) all fell. The Bank of Israel lifted interest rates in March. It is expected that interest rates will continue to be tightened in emerging markets given inflation concerns and still relatively robust growth rates.

Fixed interest

March was another tumultuous month for global fixed interest markets. Global bond markets fell in response to the Japanese

crisis, with US 10-year Treasury bonds dipping to 3.17% on 16 March, before finishing the month at 3.47%.

The Federal Open Market Committee (FOMC) maintained its stance of purchasing US Treasury bonds and retained its funds target range at 0.00-0.25%. The 15 March 2011 FOMC meeting was notable, as it appeared that the Committee's latest assessment of the US economy is more bullish when compared with its view published over the past two months.

Economic data in the eurozone pointed to further economic growth in March. Bond yields generally increased across the core eurozone markets. German 10-year Government Bonds rose by 18 basis points to 3.35%. Much of this move was in response to expectations that the ECB would begin to lift interest rates to combat inflationary pressures. The UK economy continued to be anemic in March. The UK 10-year Gilt yield finished unchanged at 3.60%.

In Japan, the 10-year Government Bond yield declined by 3 basis points to finish the month at 1.22%. As expected, news flow was dominated by the morphing of the earthquake/nuclear crisis and the response to the tragedy.

In Australia, the 10-year Australian Government Bond (ACGB) yield began the month at 5.50% before falling by 15 basis points to 5.35% on 17 March, following the Japanese earthquake, before yields moved back to 5.49% at month-end as the situation calmed down. The UBS Composite Bond Index returned 0.68% in March and 6.86% over the past 12 months.

Listed property

The S&P ASX 200 Property Accumulation Index was down 1.8% in March 2011, underperforming the S&P/ASX 200 Index. Overall, it has been an interesting reporting season with a number of REITs upgrading their FY11 guidance and no downgrades, boosting confidence that FY11 will be the trough in earnings.

In stock news, Blackstone purchased Centro's portfolio of 588 properties in the US for US\$9.4 billion, effectively lifting more debt from the A-REIT sector.

Goodman Group's (GMG) planned tie-up with ING Industrial Fund is being challenged by international hedge funds. Industry sources have indicated that hedge funds are acting to force GMG to give an assurance that holders of convertible notes would be paid out.

In terms of the global listed property sector, the UBS Global Real Estate Index was down 2.2% in March. Germany and Japan fell sharply, despite the large differences in economic performance of the two countries. The earthquake in Japan had negative implications across equity markets.