

Market commentary

For the month ending 31 October 2010

Commentary provided by ipac asset management

In brief:

The Reserve Bank of Australia raised the cash rate by 0.25% to 4.75% in its November meeting, the first increase in the cash rate in 6 months.

The S&P/ASX 300 Accumulation index rose 1.8% and the US was the top performing share market (+3.7%), in local currency terms.

In Australia Listed Property, October was an active month for mergers and acquisitions, highlighting the strong cash flows of Australian trusts.

Investment market performance to 31 October 2010

asset class	index	7 yrs (% pa)	5 yrs (% pa)	3 yrs (% pa)	2 yrs (% pa)	1 yr (%)	6 ms (%)	3 ms (%)	1 m (%)
Australian Cash	UBSA Bank Bill Index	5.7	5.7	5.4	4.1	4.5	2.4	1.2	0.4
Australian Fixed Interest	UBSA Composite Bond Index	6.2	6.2	7.6	6.1	7.4	4.3	1.0	0.0
Global Fixed Interest	Barclays Capital Global Aggregate Index (Hedged) in AUD	8.0	8.0	9.7	12.1	10.8	6.3	2.6	0.3
Australian Listed Property	S&P/ASX 300 A-REIT Index	-0.8	-8.1	-24.6	-0.9	4.5	-2.0	2.3	-0.4
Global Listed Property	UBS Global Investors Index (Hedged) in AUD	n/a	n/a	-10.2	17.2	29.8	7.7	9.4	4.0
Australian Shares	S&P/ASX 300 Accum Index	9.8	5.4	-7.6	13.0	4.7	-0.7	5.6	1.8
International Shares (Unhedged)	MSCI World Ex Australia Index in AUD	0.5	-3.1	-9.9	-5.7	3.9	-2.2	0.7	2.5
International Shares (Hedged)	MSCI World Ex Australia Index (Hedged) in AUD	5.8	1.9	-7.8	13.5	14.7	0.5	7.1	3.2
Global Smaller Companies	MSCI World Small Cap Index in AUD	n/a	-1.3	-6.2	3.9	13.2	-2.5	2.1	2.7
Global Emerging Markets	MSCI Emerging Markets Index in AUD	12.7	8.9	-5.8	16.8	13.9	4.4	3.5	1.6

Australian cash: The Reserve Bank of Australia (RBA) left the cash rate unchanged at 4.5% in October.

At its November meeting, the RBA increased the cash rate to 4.75% saying the Australian economy grew faster than trend over the year. The RBA said it expects growth to remain subdued in the United States and Europe and that global growth will ease back to trend pace in 2011 as strong recoveries in the emerging markets give way to more sustained growth.

The RBA's outlook is that inflation is likely to rise over the next few years leading to market speculation of further tightening in monetary policy. The rise in the Australian Dollar exchange rate, which reflects the high



level of commodity prices and difference in interest rates between Australia and other developed countries, will assist in containing the rise in inflation, assuming the high exchange rate is sustained.

Australian fixed interest: In Australian fixed interest, the UBSA Composite Bond index was flat. Yields on 10 year government bonds increased from 4.96% to 5.20% for the month. Australian three year government bond yields rose from 4.75% to 4.87%. Corporate credit increased 0.6%.

October data from the RBA showed consumer price inflation rose 2.1% in September and 0.7% during the September quarter. When the inflation rate rises, the price of bonds tend to drop, because issued bonds may not pay enough interest to stay ahead of inflation.

Global fixed interest: In global fixed interest, the Barclays Capital Global Aggregate index rose 0.3%. Bond yields rose slightly during the latter half of the month as the announced size of US government stimulus, a program called quantitative easing, was not as large as originally expected.

The yield on US 10 year government bonds rose from 2.51% to 2.59%. Two year government bond yields decreased from 0.42% to 0.34%.

Corporate bonds outperformed government bonds. Demand for corporate bonds is increasing. Companies continue to demonstrate strong cash levels in an environment where concerns about sovereign risk are increasing.

Australian listed property: The S&P/ASX 300 Property Accumulation index was down -0.4% for the month, underperforming the S&P/ASX 300 Accumulation index by 2.2%.

The Commercial sector (+2.4%) was the best performing sector in October, followed by Retail (+0.7%). The Diversified and Leaders sector lagged. Charter Hall Office and ING Industrial Fund were the strongest performing trusts.

October was an active month for mergers and acquisitions, highlighting the strong cash flows of Australian listed property. Stockland Trust Group acquired Aevum, and Goodman Group announced a conditional cash offer to acquire ING Industrial Fund.

In other news, at the end of the month Westfield, the world's largest owner of shopping centres, announced plans to turn a significant proportion of its Australian assets into a new Westfield Retail Trust. The new trust will be one of the three largest real estate investment trusts (REIT) in the domestic market.

Global listed property: The UBS Global Investors (hedged) Index increased 4.0% in October. The United Kingdom (+6.0%) was the top performing region followed by the US and Canada. The worst performing regions were Singapore and Australia. Global property continues to build from low levels post the global financial crisis.

Australian shares: The S&P/ASX 300 Accumulation index rose 1.8% and the US was the top performing sharemarket, in local currency terms. The Materials sector was the key driver of return, while the cumulative return of the other sectors, excluding Materials, was flat.

The best performing Australian stocks during the month included Perpetual (+24.5%), Fortescue Metals Group (+20.0%) and Boart Longyear (+14.6%). The worst performers were Primary Health Care (-11.4%), retailer Harvey Norman (-9.8). In October, Harvey Norman reported a 30% fall in profit before tax. The reduction is partly due to start-up losses from the introduction of new stores and partially due to lower profits from electrical goods due to the strong Australian Dollar.

Australian companies raised approximately A\$14 billion in international bonds this year, demonstrating the global demand for high yielding bonds. Companies that would typically borrow domestically are now borrowing from foreign lenders, capitalizing on historically low bond rates and the global demand for higher returns.



Asciano, Fortescue Metals Group, Rio Tinto, Telstra and Woolworths have all participated in corporate issuance. The investment of foreign lenders in Australian corporate credit reaffirms the confident outlook global investors have on Australian companies.

New York based global asset manager Kohlberg Kravis Roberts' (KKR) bid for the wealth management firm, Perpetual, and a merger proposal by the Singapore Exchange (SGX) to acquire the Australian Securities Exchange (ASX) are further endorsements that global investors are optimistic about the health of Australian companies.

International shares: The MSCI World ex Australia (unhedged) index increased 2.5% and the MSCI World ex Australia hedged (AUD) index rose 3.2%.

The Information Technology (+5.3%), Materials (+4.8%) and Energy (+4.0%) sectors were the leaders in October. All sectors posted gains for the month, but Financials (+1.2%) and Healthcare (+1.4%) lagged.

The US market was the best performing major market in local currency terms. The S&P 500 index increased 3.7%. US economic data reported in October was healthier, following stronger than expected consumer spending in September. Economic uncertainty, however, remains. The US Federal Reserve announced in early November it will stimulate the slow recovering economy through a second round of quantitative easing (QE2).

US companies like Google, Apple, IBM, and 3M, a diversified technology company, are benefiting from exposure to the fast growing economies in Asia and emerging markets. Profits outside of the US by US companies are roughly 35-40% of total US company profits. Foreign capital inflows have helped to underpin Asia's growth rates and are contributing to their lead in the global recovery.

Global emerging markets: The MSCI Emerging Markets index was up 1.6% in October. The Chinese local sharemarket was the big story of the month. Having been the regional laggard for the year, the share market rose 15.1% in local currency terms after the release of the nation's latest five-year growth plan. The report announced Beijing's intentions to restructure the country's economy and make it less reliant on exports. Chinese officials said they are committed to the policy of boosting domestic demand and maintaining stable and strong economic development, while controlling inflation.

The People's Bank of China, the central bank, implemented two unexpected policy moves during October to manage inflation. China increased its official interest rates by 0.25%, lifting rates to 5.56%, and increased the required cash reserve ratio for banks in an attempt to slow the purchasing of assets. More confidence that China would be able to engineer stable growth was a boost to equity markets.

China's efforts to steer its economy towards more sustainable growth levels has a great impact on the emerging markets, but also developed nations that rely on China's demand for resources. The outlook for China and emerging markets has been a key driver of the Australian share market performance.

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