

## Market Update for June 2010

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# Market Update – June 2010

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The month of June saw further weakness in global share markets as investors continued to fret about the effect that Europe's debt crisis will have on global growth. Oil prices were able to recoup some of last month's losses, bond yields continued to fall and the Australian share market closed lower for a third consecutive month.

## At a glance

- Global share markets continue their slide
- Oil prices edge higher
- The Reserve Bank keeps interest rates on hold
- Gillard replaces Rudd as Prime Minister
- The Australian share market falls in line with global markets

## Global share markets weaker

Global share markets weakened further in June amid some softer-than-expected economic data in the US and lingering concerns that Europe's sovereign debt crisis will impact on global growth. In addition, some tax-related selling ahead of 30 June will have undoubtedly contributed to the losses, with many investors selling stocks that have lost value over the course of the financial year in order to offset capital gains and lower their tax liability.

In the US, the benchmark S&P 500 Index closed the month 5.4% lower while share markets in the UK (-5.2%<sup>1</sup>), Japan (-4.0%<sup>2</sup>) and Europe (-1.4%<sup>3</sup>) were also weaker. Globally, share markets closed June 3.6%<sup>4</sup> lower (see following chart).

MSCI World Index - Year to 30 June 2010



Source: Bloomberg

<sup>1</sup> UK shares measured by the FTSE 100 Index

<sup>2</sup> Japanese shares measured by the Nikkei 225 Index

<sup>3</sup> European shares measured by the Dow Jones Eurostoxx50 Index

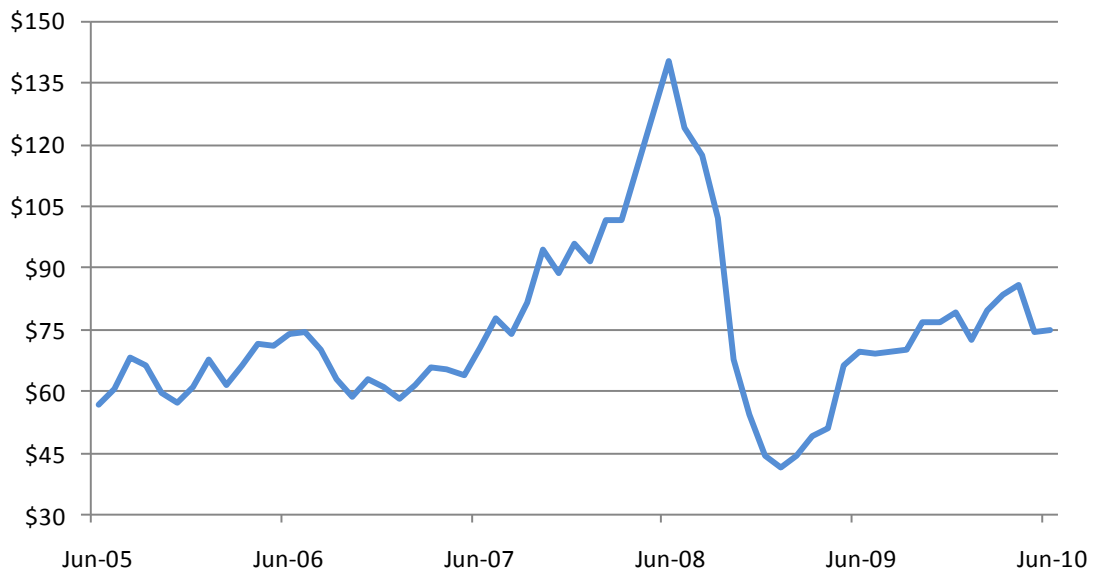
<sup>4</sup> Global shares measured by the MSCI World Index

### Oil prices edge higher

Oil prices edged slightly higher in June, gaining 1.1% to close the month at US\$75.28 a barrel. The gains came largely on the back of an announcement by the Energy Information Administration that it had raised its 2010 global demand growth forecast by 70,000 barrels per day. Another contributing factor was inclement weather across the Atlantic Ocean, which impacted on oil production in the region.

After gaining 78% in 2009, oil prices have so far fallen 5.1% in 2010.

West Texas Intermediate Oil Price - 5 years to June 2010



Source: Energy Information Administration

### Bond yields continue to fall

Global bond yields were again lower in June as euro-zone debt contagion risks continued to escalate amid ratings cuts for Greece and Spain, as well as for several European banks, including France's largest bank, BNP Paribas. The ongoing debt concerns in the region prompted a 'flight to safety', with investors offloading riskier assets such as shares and listed property in favour of the relative safety of government debt; namely government debt outside of Southern Europe.

In the US, the yield on 10-year bonds fell 35 basis points to close the month at 2.93% and it was a similar story here in Australia, with the yield on our 10-year bonds falling 29 basis points to close at 5.09%.

### **Interest rates on hold**

As was widely expected, the Reserve Bank of Australia (RBA) left the official cash rate on hold at 4.50% following its early June Board meeting, saying that it considers the current monetary policy setting “appropriate for the near-term”. The decision comes after six previous rate hikes dating back to October last year, though the pause is unlikely to signal the end of the Bank’s tightening cycle. Above-trend growth, a strengthening labour market and inflation running above target means that interest rates still have further to go. However, the RBA’s decision to take a breather will at least give it the time it needs to gauge the impact of recent rate hikes and the extent of the fallout from the European debt crisis. The Bank (and the market) will now focus on the upcoming June quarter inflation report.

Elsewhere, the Reserve Bank of New Zealand (RBNZ) joined Australia as one of the few countries to raise interest rates in the wake of the global financial crisis. The central bank lifted its official cash rate by 0.25% (to 2.75%), suggesting that faster inflation is seen as a much bigger threat to growth than further gains in the nation’s currency. The last time the RBNZ raised interest rates was back in July 2007.

Meanwhile, the US Federal Reserve (0-0.25%), the Bank of England (0.50%), the European Central Bank (1.00%) and the Bank of Japan (0.10%) all left their respective benchmark rates on hold in June.

### **Rudd stands down**

On 24 June, Prime Minister Kevin Rudd stood down from the top job following a leadership challenge from his deputy, Julia Gillard. Essentially, Mr. Rudd jumped before he was pushed given that the proposed vote on the Labor Party leadership was expected to result in an overwhelming majority for Ms. Gillard.

Whilst Mr. Rudd’s decision to stand aside will have some obvious political implications, it’s unlikely that Ms. Gillard’s appointment will have a significant impact on Australian fiscal policy. However, what will be interesting is how Ms. Gillard approaches the controversial 40% Resource Super Profits Tax (RSPT). She has already intimated a desire to resolve the dispute between the government and Australia’s mining industry that prompted her predecessor’s downfall. Expectations are that Ms. Gillard will adopt a much more conciliatory tone regarding the RSPT, though talk of her abandoning it altogether seems premature.

### **China to allow greater currency flexibility**

The Chinese government announced that it would allow its currency, the yuan, to float more freely against the US dollar (US\$), which comes after two years of being pegged to its US counterpart. China will implement a so-called crawling peg, in which the yuan’s value will be tied to a basket of other currencies. The US had for some time been pressuring China to take the step, arguing that the dollar peg gave China an unfair advantage in global trade and contributed to trade imbalances. The decision should result in a gradual, albeit modest, appreciation of China’s currency.

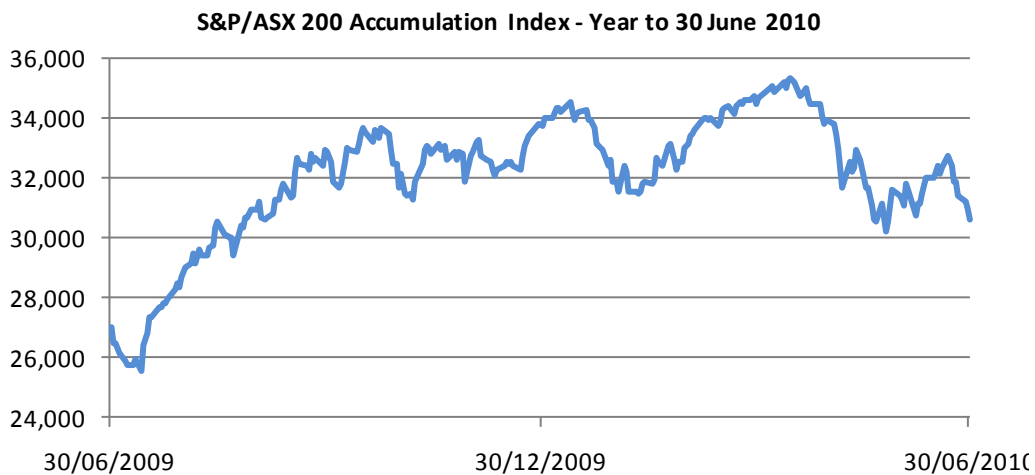
Maybe not so coincidentally, the announcement came just days ahead of the G20 meeting in Toronto, where Chinese officials were expected to face some hard questions on the issue from several other countries.

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### Australian market lower

The Australian share market fell for the third consecutive month in June, with the S&P/ASX 200 Accumulation Index closing 2.6% lower on the back of ongoing concerns about the impact of the Government's Resources Super Profits Tax and another poor lead from global share markets.

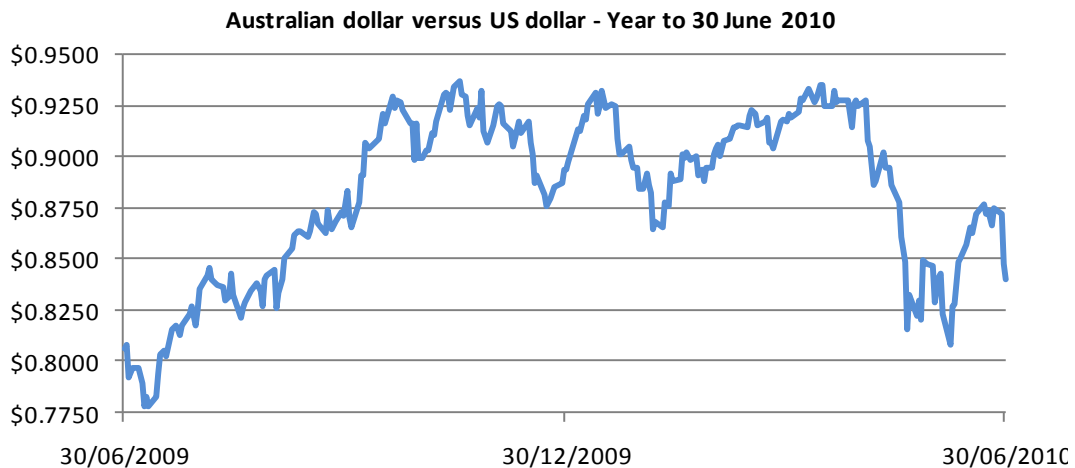
June's fall extends the Australian share market's loss for 2010 to -9.9%. This compares to -13.2% in Europe, -11.0% in Japan, -9.2% in the UK and -7.6% in the US. However, it is worth noting that global share markets, including our own, continue to trade well above the bear market lows they set back in March 2009.



### Australian dollar falls

The Australian dollar (A\$) lost further ground against the US\$ in June, closing 0.8% lower as the European debt crisis continued to cloud the outlook for the global economy. This was enough to offset stronger commodity prices and increasing speculation that the US Federal Reserve will keep interest rates near zero for an extended period. The A\$ moved as high as US\$0.8859 cents mid-month before eventually closing at US\$0.8401 cents.

Despite the recent weakness in the A\$, the outlook for the local currency remains fairly positive given that Australia maintains a favourable interest rate differential against the major economies, and because Chinese demand for our commodities is expected to remain strong.



**Looking ahead**

Concerns about the European debt crisis are persisting and this is beginning to have a negative impact on investor confidence not only in the euro-zone but in all the other major markets as well. Importantly, though, the majority of economic data in the US, Europe and Japan has been broadly consistent with an ongoing recovery, which is helping to offset this negative sentiment.

In Australia, underlying economic data remains relatively robust and consistent with further economic growth. Business conditions and the labour market continue to strengthen and commodity prices are likely to move higher over the near-term, particularly if concerns over global growth begin to ease.

Whilst the knock-on effects from the European debt crisis is having an impact locally, the Australian economy nonetheless remains relatively well-placed compared to many of its global counterparts. In addition, China now looks like it may hold off on raising interest rates in the near-term, which should bode well for our resources sector.

In terms of interest rates, the uncertainty in Europe and the impact of previous rate hikes on consumer confidence should be enough to see the RBA sit tight in the near-term. That said, the upcoming June quarter inflation report – due out on 28 July – will obviously have a significant influence on the RBA's thinking.

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