Market Update

September 2010

Financial Advice

September was a much better month for global share markets as fears about the US recovery eased and the world's banks received more time than anticipated to comply with new capital requirements. Meanwhile, oil prices surged, global bond yields moved sharply higher and the Australian dollar hit a two-year high against the US dollar.

At a glance

- Global share markets move higher
- Oil prices surge
- The Reserve Bank of Australia keeps interest rates on hold at 4.50%
- The National Bureau of Economic Research calls the end of the last US recession
- Labour retains power
- The Australian dollar hits a two-year high against the US dollar

Interest rates on hold

As was widely expected, the Reserve Bank of Australia (RBA) left the official cash rate on hold at 4.50% for a fourth consecutive month in September. However, the RBA's accompanying statement was characterised by a more hawkish tone after the words "for the time being" were added to the Bank's description of the appropriateness of current monetary policy. The last time the RBA used that phrase to describe interest rates in its post-meeting statement, was in February 2010. It also used the same phrase in its post-meeting statement in September 2009. On both occasions, the RBA raised interest rates at its very next meeting. The question now then is will the Bank pull the trigger on another rate hike when it meets in early October.

The historical importance of the words "for the time being" in the Bank's latest post-meeting statement combined with the underlying strength of the Australian economy and the pressure this is expected to put on inflation suggests that there is a strong probability that the RBA will indeed raise interest rates at next month's meeting.

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

Labor retains power

It took a while, but we finally got a result in the Australian federal election. A Labor minority government, plus one Green vote and three Independents, gave Labor the minimum 76 seats it needed for a majority in the House of Representatives (Lower House). The Greens will control the Senate (Upper House).

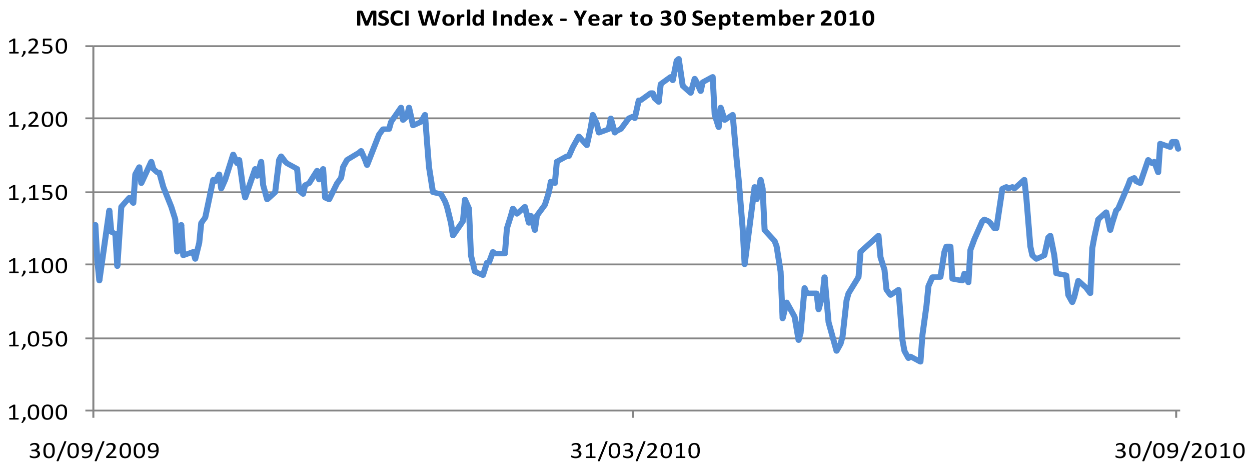
Minority governments are a rarity in Australia, with the last occurring at the federal level in 1940 under Robert Menzies. Interestingly, that government was rejected after just one term. As it stands, the key policy initiatives under the Gillard-led administration look like being the mining tax, greater spending in regional areas, the national broadband network, climate change and a return to (budget) surplus by 2012-13. The election result had no immediate or significant impact on the local share market.

Global share markets rise

Global share markets jumped ahead in September, despite the month being a historically difficult one for the world's major bourses. The gains came amid further merger and acquisition activity in both Europe and the US, including IBM's US$1.7 billion bid for data analytics company, Netezza, and increasing expectations that the US economy will avoid a 'double dip' recession. Also adding to the gains were some stronger Chinese economic data and the decision by the Basel Committee on Bank Supervision to grant banks as much as eight years to meet new (and tougher) capital requirements.

The Basel Committee on Bank Supervision essentially acts as the regulator of global financial markets. The new capital requirements are designed to make the global banking industry safer and to prevent the sort of financial meltdown that occurred in the wake of Lehman Brothers' collapse in 2008. However, the success (or failure) of the new requirements will depend on the capacity of national regulators to enforce the new standards. So far, national regulators' records are not encouraging. However, after the near calamity of the past couple of years, it's more than likely that their thinking will have changed and therefore real enforcement may actually occur.

In the US, the benchmark S&P 500 Index closed the month 8.8% higher and this had a positive knock-on effect elsewhere, with share markets in the UK (+6.2%[1]), Japan (+6.2%[2]) and Europe (+4.8%[3]) also closing higher. Collectively, global share markets ended September 9.1%[4] stronger (see following chart).



Source: Bloomberg

NBER calls the end of the recent recession

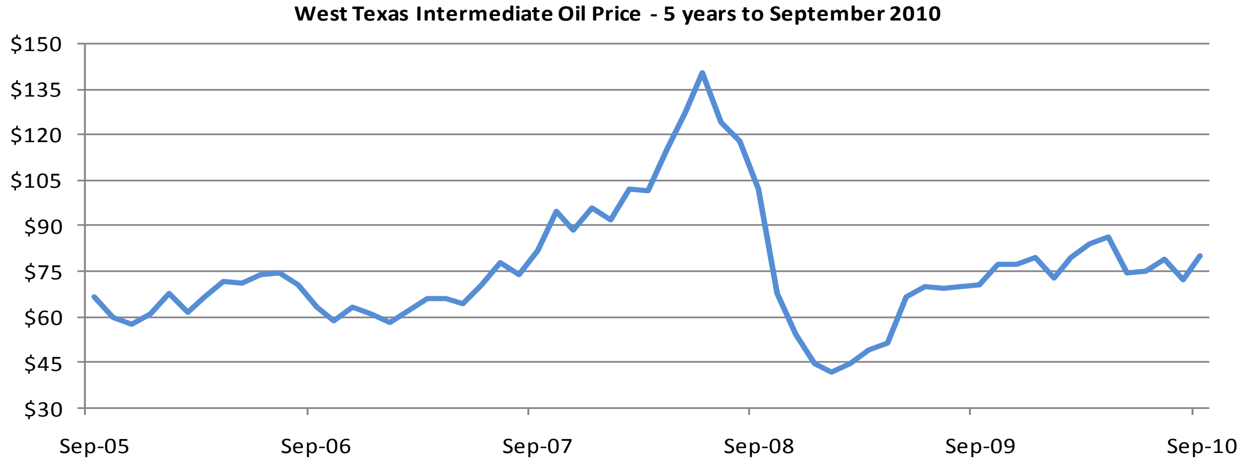
The National Bureau of Economic Research (NBER), the US-based group entrusted by the government with determining when US recessions begin and end, announced that the recession which began in December 2007 officially ended in June last year. That makes the 18-month slump the longest in the US since the Great Depression. Previously, the longest recessions in the modern era lasted 16 months – one in 1973-75 and the other in 1981-82. Ironically, the announcement comes amid lingering concerns about the current state of the US economy.

[1] UK shares measured by the FTSE 100 Index
[2] Japanese shares measured by the Nikkei 225 Index
[3] European shares measured by the Dow Jones Eurostoxx50 Index
[4] Global shares measured by the MSCI World Index

Oil prices gain

September saw oil prices surge after global share markets jumped ahead, US stockpile levels dropped off and a report showed that Chinese demand increased almost 8% for the year to 31 August 2010. However, the gains were tempered by comments from the Secretary General of OPEC[5], Mr. Abdalla El-Badri, who said that OPEC remains concerned about demand growth over the next 12 months.

Oil closed the month 11.2% higher at US$79.97 a barrel. After gaining 78% in 2009, oil prices are now just 0.8% higher so far this year. Meanwhile, gold prices continued to hit record highs above US$1,300 per ounce after the Fed's commitment to ease US monetary policy further should it be required weighed heavily on the US dollar.

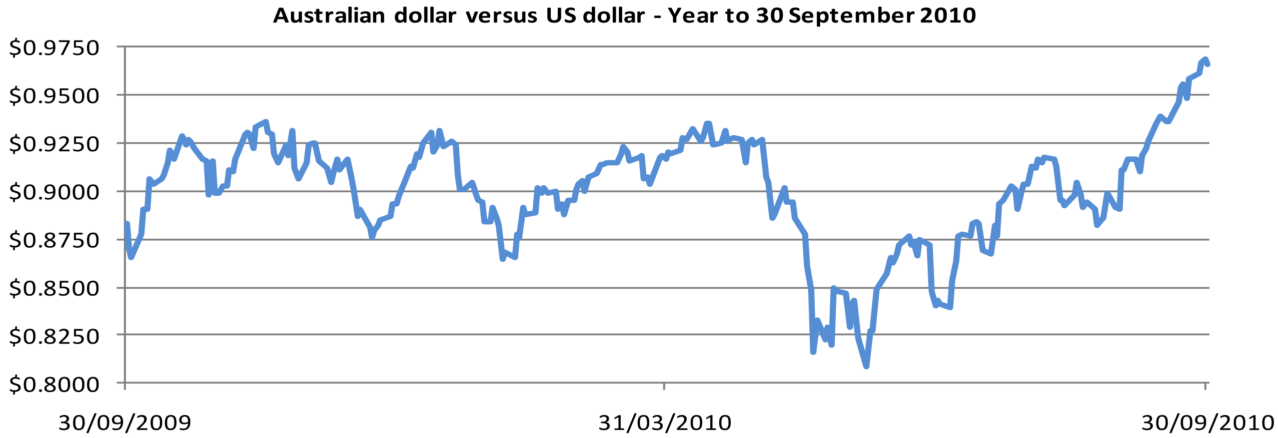


Source: Energy Information Administration

Australian dollar at US$0.97 cents

The Australian dollar (A$) surged against its US counterpart in September, gaining 8.5% on the back of higher commodity prices and increasing expectations that the RBA will soon move to raise interest rates in a bid to slow the economy and cool inflation. The A$ hit US$0.9733 cents on 30 September – its highest level since July 2008 – before eventually closing at US$0.9662 cents.

Perhaps not surprisingly, the strong gains in the A$ over the past month has led to renewed speculation about the likelihood of the A$ reaching parity with the US dollar. Given the combination of further easing of monetary policy in the US, rising commodity prices and expectations of higher interest rates in Australia, there's now a very good chance that the local currency will in fact match its US counterpart dollar for dollar in the coming months.



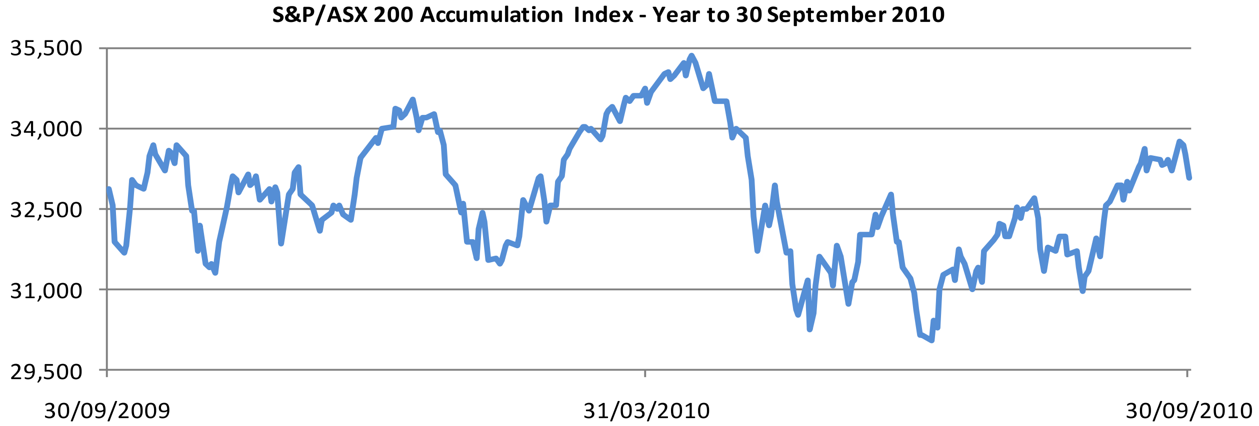
Source: Premium Data

[5] OPEC refers to the Organisation of the Petroleum Exporting Countries

Australian market higher

Australian shares moved higher in September, with the S&P/ASX 200 Accumulation Index closing the month up 4.6% after figures showed that the local economy grew at its fastest pace in three years in the June quarter. Gross domestic product (GDP) growth was 1.2% for the three months to 30 June 2010, which came after a 0.7% rise in the March quarter. The consensus had been for GDP growth of 0.9%. Essentially, Chinese demand for our raw materials continues to be the main driver of economic growth here in Australia and the good news is that this looks set to continue for a while yet. Also contributing to the local market's gains in September were stronger commodity prices, which helped to boost our big miners, and a positive lead from overseas bourses.

Despite September's gains, the local market remains in negative territory so far in 2010, having fallen 2.7% since the beginning of the year. This compares with +2.5% in the UK, +2.3% in the US, -7.4% in Europe and -11.2% in Japan. 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.



Source: Premium Data

Bond yields rise

Global bond yields moved higher[6] throughout September as investors offloaded government debt in favour of shares and listed property amid expectations that the global recovery will be sustained, albeit at a slower pace. In the US, the yield on 10-year bonds rose four basis points to close the month at 2.51% and it was a similar story in Australia, with the yield on our 10-year bonds rising 20 basis points to close at 4.96%.

[6] Bond yields have an inverse relationship with bond prices, meaning that when yields rise, prices fall (and vice versa)

Looking ahead

Concerns about a ‘double dip’ recession in the US have eased in recent weeks, though there remains little doubt that the US recovery has stalled, particularly given the run of mixed economic data in the last month or so. The US Federal Reserve’s concession that further easing of monetary policy may be needed to help spur the economy is also causing some uncertainty (as such comments hardly inspire confidence). Whilst fears about Europe’s sovereign debt crisis have abated somewhat, the impact of government austerity measures are yet to take full effect and this will likely weigh on investors’ minds in the coming months.

The Australian economy remains relatively well-placed compared to the likes of the US and Europe and looks set to continue benefiting from strong Asian demand for our raw materials. The resolution of the Federal election had a relatively muted impact on the local market and investor sentiment remains high, particularly as recent economic data points to further positive economic growth ahead.

In terms of interest rates, the RBA has turned somewhat hawkish in its assessment of domestic monetary policy. This is essentially the result of the impact that the commodities boom is expected to have on official inflation measures. Inflation currently sits at the top end of the RBA’s 2-3% target range and in order to limit the commodity boom’s impact on prices, the central bank will more than likely raise interest rates at least once by the end of the year.

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