Monthly Market View

November 2011

- Financial markets continued to trade with considerable volatility in November, driven by the escalation of sovereign debt issues in the Europe Union (EU), heightened political uncertainty and confusion over possible policy responses.

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Economic overview

At this stage EU politicians seem unwilling or unable to keep pace with developments in financial markets and failed to announce a comprehensive solution to the EU sovereign debt crisis.

Despite the EU leaders summit announcement of 27 October, market volatility continued. Financial markets are now looking to the International Monetary Fund (IMF) and European Central Bank (ECB) for a comprehensive solution to the debt crisis.

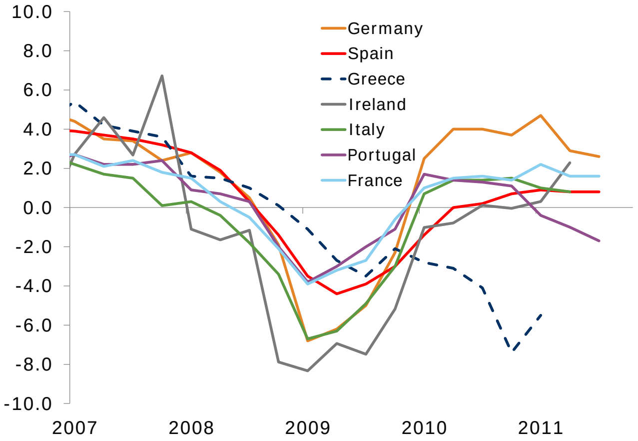
The situation in Europe looks to be heading towards one of two inevitable conclusions: a breakup of the EU and a return to individual currencies, or a full fiscal union (to go with the currency and monetary union), including Euro-bonds and a true lender of the last resort in the ECB. EU politicians continue to favour the latter option, although the ECB and German politicians appear reluctant to accept the ECB's role in the final solution.

Pressure from financial markets saw the resignations of Greek Prime Minister, George Papandreou (after a failed call for a referendum on the bailout plans) and Italian Prime Minister, Silvio Berlusconi (after a loss of confidence by financial markets and the Italian Parliament). Both were replaced with technocratic leaders, both non-elected officials and ex-economists. Mario Monti, the new Italian Prime Minister, is a former EU Commissioner and economics lecturer at the University of Turin and is expected to remain in power until early 2013. Lucas Papademos, the new Greek Prime Minister is a former Vice President at the ECB and successfully negotiated to receive Greece's sixth tranche of bailout funds in late November before a bond maturity in mid-December. Elections are due in February 2012.

There was also a change in government in Spain with Mariano Rajoy, from the People's Party's sweeping to victory. The focus of the new government will be the implementation of further austerity measures and improving growth prospects for the economy.

Economic data in Europe continued to weaken, exacerbating the sovereign debt issues. Q3 Eurozone GDP growth was 0.2%/qtr, and 1.4%/yr. Highlights included Germany (+0.5%/qtr), France (+0.4%/qtr), Spain (+0%/qtr) and Portugal (-0.7%/qtr). See chart below for details. Unemployment rose to 10.3% for the Eurozone region and the PMI Manufacturing Index fell to 46.4% from 47.1%. CPI held steady at 3.0%.

Annual GDP growth - selected EU countries (%)



Source: Bloomberg. Data to 31 March 2011 for Greece, Germany, France and Portugal. Spain to 30 September 2011. Others to 30 June 2011.

Economic news in the US was dominated by the failure of the Super Committee to find $US1.5 trillion of savings from the Federal Budget over the next 10 years. An automatic $US1.2 trillion will now be cut from the budget, 50% of which will come from defence spending. The major ratings agencies were unmoved by the failure, with Standard and Poor's and Moody's affirming the US sovereign rating at AA+ and AAA respectively. Fitch placed the US on negative outlook.

US economic data continued its run of beating expectations, but still remained well below average levels. Highlights included the unemployment rate falling to 9.0% (was 9.1% and down to 8.6% in early December) and upward revisions to employment in the prior two months. The University of Michigan Consumer Confidence index rose to 64.1 (was 60.9), retail sales gained +0.5%/mth and Thanksgiving sales late in the month were strong. Housing market data disappointed.

Data in China continued to slow, leading to considerable volatility in commodity prices and adding to global financial market volatility. The PMI Manufacturing Index fell to 49.0% from 50.4% (the first sub-50 reading since February 2009; see the chart below for details) and annual export growth slowed to 15.9%/yr from 17.1%/yr. This led to the first easing of bank capital requirements since September 2008.

China – Purchases Managers Index

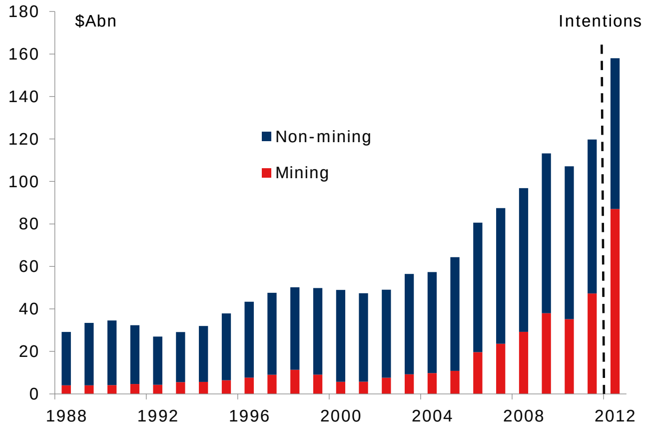
Source: Bloomberg. Data to December 2011

In Australia, retail sales data was released for October and showed sales rose by 0.2%/mth to be 3.4% higher than a year ago. This was slightly below expectations, with department store sales remaining the weak spot in retailing. The housing sector also remains weak, with residential approvals dropping 11% over the month and house prices falling 0.5% to be 4.0% lower than a year ago. The unemployment rate in Australia ticked down to 5.2% from 5.3% after employment rose by 10,000 in October. However the pace of employment growth still remains subdued.

The mining sector remains strong with capital expenditure rising by 12.3% in Q3 - well above market expectations of 8%. Total capex is now at a record pace of 31.1%/yr. Australian construction work rose 12.5% in Q3 (expected

+2%) and is now 18.5% higher than a year ago - this is the largest quarterly rise on record. Private engineering work rose 36% in Q3, with the rise predominately in WA. See the chart below for capital expenditure intentions for 2012.

Capital Expenditure – actual and intentions ($Abn)



Source: ABS. Data to December 2011

Australian shares

A wide range of listed Australian companies hosted Annual General Meetings during November, with some providing comments regarding current trading conditions. Most companies confirmed that the operating environment remains challenging, although those exposed to rising capital expenditure in the mining and energy sectors continue to perform relatively well. AGM commentaries had a limited influence on the market. Instead, investor sentiment remained almost exclusively driven by the latest headlines regarding the European sovereign debt crisis.

The failure of a global hedge fund – MF Global – did nothing to support fragile confidence in share markets worldwide. The S&P/ASX 200 Accumulation Index declined by 3.5%, offsetting some of the gains made in October. Unsurprisingly, defensive areas of the market such as Health Care, Utilities and Telecoms tended to outperform the falling market. The influential Financials and Materials sectors both underperformed. Consumer Discretionary stocks also struggled, despite some encouraging US retail sales data towards the end of the month.

The interest rate cut in early November was widely anticipated by the share market and had been fully reflected in valuations. A sustained period of monetary policy easing could, however, affect the share prices of a number of listed Australian companies. Consensus suggests that interest rates will be lowered further in the near term, which could have implications for companies' debt servicing costs and exchange rates.

Global shares

Global equity markets were faced with a number of issues in November including the escalation of European sovereign debt concerns, political uncertainty, the failure of MF Global, rising bank funding costs and downgrades to banks globally due to a new methodology by Standard and Poor's.

The MSCI World Net Index fell 2.7% in USD terms after a sharp 10% gain in October. In AUD terms, the index rose 0.6% given the fall in the AUD during the month.

The Dow rose 0.8%, the S&P 500 was down 0.5% and the NASDAQ fell 2.4%. US equity markets were amongst the best performers globally in November. US listed companies remain in a sound position with almost $2 trillion in liquid financial assets on balance sheets.

European markets were weaker across the board. The German DAX fell 0.9%, the French CAC was down 2.7%, Spain fell 5.6% and the Italian equity market was down 4.7%.

In Asia, markets also recorded losses, with Thailand the exception (+2.1%).The Nikkei fell 6.1% given the recent strength in the Yen. Economic data released over the month continues to point towards an economic recovery post natural disasters. Elsewhere in Asia, Hong Kong (-9.4%), Singapore (-5.4%), South Korea (-3.2%), Taiwan (-9.0%) and Malaysia (-1.3%) all recorded losses.

In terms of sector performance, the Financials sector was the worst performer on heightened concerns about bank solvency in Europe and contagion to US financials. The sector fell 7.3% in November. Commodity prices were mixed with gains in lead and zinc. This did not stop the Materials sector falling by 3.4%, led primarily by concerns over weakening growth in China.

The oil price rose 7.7% to more than US$100/barrel on geopolitical risks in the Middle East. The energy sector fell 0.3%. Consumer staples were the top performing sector, rising 0.3%.

Global emerging markets

Emerging markets recorded sharp losses in November on rising risk aversion, falling 6.6% in USD terms and 3.4% in AUD terms.

There were signs that inflation pressures continued to ease in emerging economies with China, Indonesia, Korea and Thailand all seeing falls in annual inflation growth. This has prompted further easing in monetary policy in Brazil, with the official cash rate now 11%, down from a peak of 12.5%. Thailand and Indonesia also eased policy in November.

There was a significant divergence of returns within the sector. Argentina (-10.8%), Czech Republic (-5.5%) and Sri Lanka (-3.7%) all recorded losses. The Chinese equity market fell 9.9% on further signs of weaker growth in both exports and domestic demand. House prices in Tier 1 cities also continued to fall.

Other major markets, including Brazil (-2.5%), Poland (-4.0%) and Turkey (-3.3%) fell. Hungary (+.2%), Russia (+.1%) and Mexico (+1.9%) recorded gains.

Fixed interest

Most major global bond markets saw a fall in yields in November. Europe's sovereign debt crisis entered a perilous new phase as the halting political progress towards a credible solution to the crisis threatened the stability of the region's economic and monetary union.

Bond market investors reacted favourably to political change in Greece and Italy with peripheral spreads narrowing momentarily mid-month due in-part ECB participation in the French and Spanish government bond auctions.

However, the fall in yields of the most indebted countries failed to inspire market confidence in risk assets and a further set-back occurred when the German government managed to sell barely half the bonds that it had offered in an auction on 23 November – a sign that the Euro area's troubles are beginning to affect its strongest economies. German 10-year Bunds sold off by 16 bps immediately after the auction.

Moreover, the ECB admitted it had failed to attract enough deposits from European banks to balance out the sovereign bonds it has recently bought.

Towards month-end, market participants became more optimistic after it emerged that a larger policy response was on the cards for Europe; several major global central banks announced a co-ordinated plan to support the global financial system.

Overall, US 10-year Treasury yields declined by 6bps to 2.05% at November month-end from 2.11% at the end of October.

At his first meeting as ECB President in early November, Mr Mario Draghi confirmed the ECB's unanimous decision to ease its monetary policy stance, cutting the official cash rate to 1.25% from 1.5% citing the deteriorating growth outlook. German 10-year bunds increased by 21bps to 2.23% at November-end.

10-year sovereign bond yields in the rest of Europe rose sharply, with France (+29bps to 3.39%), Spain (+69bps to 6.23%), Italy (+93bps to 7.02%), Portugal (+226bps to 14.05%), Greece (+876bps to 32.00%) on growing concern over the viability of the EFSF.

In the UK the Monetary Policy Committee (MPC) voted unanimously to leave the Bank of England (BoE) rate unchanged at .5% and retained its £275 billion asset purchase programme. The UK 10-year gilt yield decreased by 13bps to 2.31% at month-end. The 10-year JGB yield increased by 3bps to finish the month at 1.07%.

The Australian bond market also saw yields fall in November. 10-year CGS yields decreased by 58 bps to 3.93% at November-end, having ended the previous month at 4.51%. This was the largest monthly fall in 10-year yields since December 2008. A new intra-day low of 3.81%

was also set during the month, surpassing the previous low in January 2009.

Australian sovereign bonds were propelled below 4% as demand from overseas central banks and offshore institutional investors increased, lured by the developed world's highest government bond yields, strong liquidity and the relative safety of the Australian government bond market. Australia has a sound fiscal position when compared to Europe and the US.

In November, the Reserve Bank of Australia (RBA) decided to begin returning monetary policy to "a more neutral stance" with a 25bps rate cut to 4.5%. This decision was made as a result of a downward revision in the RBA's inflation forecast, which is now expected to be within the 2%-3% target range over 2012 and 2013.

In the Commonwealth's Mid-Year Economic and Fiscal Outlook (MYEFO), the Government made downward revisions to its economic growth and employment forecasts for both 2011/12 and 2012/13. The weakened outlook for the domestic economy follows the recent deterioration in global economic and financial conditions, mainly stemming from the European sovereign debt crises.

Real GDP growth is now forecast to grow 3.25% in both 2011/12 and 2012/13 – a downward revision of .75% and .5% respectively. Employment growth is now expected to ease to 1% in 2011/12 and 1.5% in 2012/13. The unemployment rate, while still remaining low, is expected to drift up slightly to 5.5% for both 2011/12 and 2012/13, while inflation is expected to remain well contained. Despite recent volatility in commodity prices, the terms of trade have been revised up for 2011/12.

Listed property

The UBS Global property investors' index (local currency) decreased 3.4% in November, with Australia the top performing region (+2.6%) followed by the UK (-1.7%). The worst performing regions were Hong Kong (- 7.7%) and Continental Europe (-6.0%).

The S&P/ASX 200 Property Accumulation index rose 2.6%,outperforming the S&P/ASX 200 by 6.1%.

Global macro factors continued to drive market performance. The two largest Australian REITs, Stockland Group and Westfield Group, countered this trend. Stockland outperformed following an interest rate cut and the expectation of further rate cuts, while the market responded positively to Westfield's Q3 operational update. The company provided some guidance on the timing of non-core US asset sales.