Market Update

October 2010

- **Concern over sovereign debt in Europe re-emerged in September**
- **Employment rose in Australia by 49,500 jobs in September but was offset by a higher participation rate**
- **China continues to grow strongly despite some recent weakening**

What's inside?

The pulse

→ **Australian unemployment** unchanged at 5.1%

→ **Australian cash rate** steady at 4.5%

↑ **AUD/USD** 8 US cents to 97 US cents

September market performance

Equity Markets – Price Indices	Index	At Close 30/9/10	% Change 1 Month	% Change 12 Months
Australia	All Ordinaries	4636.86	4.46%	-2.16%
Japan	Nikkei	9369.35	6.18%	-7.54%
Hong Kong	Hang Seng	22358.17	8.87%	6.69%
UK	FTSE 100	5548.62	6.19%	8.08%
Germany	DAX	6229.02	5.13%	9.76%
US	Dow Jones	10788.05	7.72%	11.08%
EMU [1]	Euro 100	2218.23	2.73%	4.64%
World [2]	MSCI - Ex Aus (Gross)	831.48	6.86%	4.37%
Property – Price Index	**Index**	**At Close 30/9/10**	**% Change 1 Month**	**% Change 12 Months**
Listed Trusts	S&P/ASX 300 A-REIT	846.20	-1.08%	-9.84%
Interest Rates		**At Close 30/9/10**	**At Close 31/8/10**	**At Close 30/9/09**
Aust 90 day Bank Bills		5.01%	4.75%	3.38%
Australian 10 year Bonds		4.96%	4.77%	5.44%
US 90 day T Bill		0.16%	0.14%	0.12%
US 10 year Bonds		2.51%	2.47%	3.31%
Currency		**At Close 30/9/10**	**% Change 1 Month**	**% Change 12 Months**
US dollar	A$/US$	0.97	8.56%	9.59%
British pound	A$/STG	0.62	5.98%	11.41%
Euro	A$/euro	0.71	0.97%	17.68%
Japanese yen	A$/yen	80.77	7.66%	2.00%
Trade–weighted Index		72.90	5.65%	6.89%

1 Top 100 European stocks trading on the FTSE
2 Price Index – Source: www.msci.com
Source: Iress Market Technology
Past performance is not a reliable indicator of future performance.

Global economies

In the US, recent weak economic data, including a fall in consumer confidence and lower manufacturing indices, led to increased speculation the Federal Reserve (Fed) will up its quantitative easing policy.

Quantitative easing is when the Fed injects liquidity into the financial system by buying outright a range of financial assets with newly printed money.

At the September Federal Open Markets Committee (FOMC) Meeting, the Fed left its zero interest rate policy unchanged but took a clear step towards quantitative easing.

The lack of inflation was a key focus point with the FOMC stating inflation levels were "somewhat below those the Committee judges most consistent … with its mandate to promote maximum employment and price stability."

Deflation remains a concern. With an excess of spare capacity in the US economy, this could lead to a fall in demand with lower wages and pricing of goods.

The Committee also re-affirmed it was "prepared to provide additional accommodation … to support the economic recovery and to return inflation … to levels consistent with its mandate."

In Europe, sovereign debt concerns resurfaced with Moody's releasing a fresh round of ratings downgrades to banks in Ireland, Portugal and Spain.

Standard & Poor's also warned it might further downgrade Irish bonds as the total bailout cost for the Irish Government continues to rise.

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Adding to European growth concerns was disappointing manufacturing survey results. These suggested Gross Domestic Product (GDP) growth for the EU in September was moderating.

In contrast to Europe and the US, the latest Chinese economic indicators show the economy is still expanding quickly. This is despite a modest easing in the pace of growth in August.

The Chinese manufacturing sector strengthened over the month, with industrial production rising by around 2% for August and 13.9% year on year. This increase more than offset the decline in July.

On the home front, key economic indicators particularly in the labour market, support the likelihood of an interest rate increase.

Employment rose by 49,500 jobs in September, with the three month moving average running at 35,400. The unemployment rate is at 5.1%, unchanged from August but still down from 5.4% six months ago. NAB Economists believe that with Australian GDP growth expected to rise above 4% year on year in 2011, the unemployment rate should fall to 4.5% in 2012.

Another positive number was retail sales, with the latest (August) report revealing increasing sales momentum. Sales rose 0.3% in August after a rise of 0.7% in July. This points to an overall strengthening of consumer spending throughout the September quarter.

While domestic economic indicators are good overall, there are pockets of weakness in the data. Credit growth was just 0.1% in August, while building approvals fell 4.7%.

However, the outlook is for stronger growth ahead, with the further tightness in the labour market leading to a pick-up in wage and price pressures.

While the Reserve Bank of Australia (RBA) kept the interest rate at 4.5% in October, NAB Economists still expect the RBA to raise interest rates by December.

Big movers this month

↑ Materials & Industrial +7.6% each

↓ Telcos -4.5%

Equity markets

Equity markets strengthened in September while the US dollar (USD) weakened following hints from the Fed that they were willing to embrace further quantitative easing.

The rising possibility of more Fed intervention saw an increase in investors' appetite for risk which in turn bolstered sharemarkets.

Australian equities

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 Acc.	0.65%	-7.31%	4.16%	10.00%
	S&P/ASX 50 Acc.	0.27%	-6.38%	4.64%	10.13%
	S&P/ASX Small Ordinaries Acc.	6.63%	-9.47%	3.44%	9.24%

September was a reasonable month for the Australian sharemarket with key benchmark indices reaching six month highs. The resources sector was the better performer this year, while the consumer discretionary sector softened.

NAB Economists aren't sure whether the recent S&P/ASX200 underperformance, relative to global markets, can be attributed to global uncertainty or weaker earnings.

This is because the S&P/ASX200 underperformed the S&P 500 this year and earnings have generally surprised on the upside.

In contrast, they believe the softer performance may be due to a combination of:

- the good Australian growth story being well priced into shares
- some uncertainty for the resource sector around the mining tax
- RBA interest rate increases and higher interest rates taking the edge off sharemarkets and the banks particularly, and
- the higher AUD reducing some corporate earnings.

In Australia, the ASX 300 Accumulation Index was up 4.79% over September.

Investment Index/Benchmark returns

Sector	1 Mth	3 Mths	1 Yr
Energy	2.9%	8.2%	-7.7%
Materials	7.6%	10.6%	13.9%
Industrials	7.6%	17.8%	-0.7%
Consumer Discretionary	4.7%	7.5%	-2.9%
Consumer Staples	3.5%	11.9%	13.0%
Health Care	2.2%	3.6%	-3.1%
Financials	5.1%	8.0%	-6.0%
Info Tech	3.2%	-3.7%	-10.1%
Telcos	-4.5%	-13.6%	-13.0%
Utilities	7.0%	11.9%	12.6%
Property	-0.9%	3.8%	-4.5%

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Global equities

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Global	MSCI World Ex Aus Acc. ($A)	-2.79%	-11.15%	-3.63%	0.28%
	MSCI World Index Hedged ($A)	6.42%	-10.12%	-1.10%	4.17%
	MSCI World Small Cap ($A)	3.44%	-7.01%	-2.05%	3.44%
Emerging	MSCI Emerging Mkts Free	9.58%	-4.39%	7.52%	13.01%
	MSCI AC Far East Free (ex Japan)	8.01%	-5.83%	6.98%	9.33%

Reversing the dismal returns in August, global markets had strong gains over September and into October. This improvement was bolstered by better durables goods orders in America.

Durable goods orders are a core measure of orders for Capital Goods (ex Transport and Machinery) and a good leading indicator of US business investment. Earlier falls in this measure was one of the main reasons a US double-dip recession was feared.

The US Dow Jones Industrials Index was up 7.7% in September, while the S&P 500 rose 8.8%.

The MSCI Far-East Free (ex Japan) Acc. Index was up 1.76% while the MSCI Emerging Markets Acc. Index was up 2.14% in September.

The broader global sharemarket as represented by the MSCI World (ex Australia) Acc Index was marginally higher over September, rising 0.33% with the hedged equivalent, boosted by a strong Australian dollar, rising by 6.76%.

Property

	Index/Benchmark	1Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 A-REIT Acc	-4.52%	-24.65%	-8.39%	-0.39%
Global	UBS Global Investors ($A)	8.69%	-13.05%	-4.40%	N/A

The S&P/ASX 300 A-REIT Accumulation Index fell by 0.85% in September, underperforming the broader sharemarket which gained 4.79%.

The Australian property market still remains highly concentrated. Despite extensive recapitalisations and strengthening balance sheets, sentiment toward the sector remains weak.

However, property valuations have stabilised and recent mergers and acquisitions (M&A) activity may mark a turnaround for the sector moving forward.

The UBS Global Investors $A Index also fell over September, down 1.44%.

Fixed interest

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	UBS Composite 0 + Years	7.34%	7.61%	6.19%	5.99%
	Australian 90 Day Bank Bill	4.42%	5.20%	5.57%	5.56%
Global	BarCap Global Aggregate Index	-3.33%	4.19%	0.88%	1.66%
	BarCap Global Ag. Index Hedged	11.02%	9.97%	8.03%	7.56%

The traditional safe havens of cash and fixed interest fell through September; with the exception of international fixed interest that was hedged back to Australian Dollars.

The BarCap Global Aggregate Index Hedged $A gained 0.2%, while the equivalent unhedged index fell 5.92% in September.

Australian dollar (AUD)

The rise in risk appetite saw the USD weaker during September, with the AUD gaining 8 US cents to end September at 97 US cents. Also supporting the stronger AUD was an increase in commodity prices.