

in brief

The **Reserve Bank of Australia** surprised markets by keeping interest rates **unchanged** (at 3.75%) at its first meeting for 2010.

Global government bond yields generally drifted **lower**. But a **worsening fiscal situation in Greece** encouraged investors to be more **discriminating** across markets.

Australian shares were heavily **sold off** in January, as **investor risk aversion increased**, despite **strong local economic data**.

Australian Cash

The Reserve Bank of Australia (RBA) surprised markets by keeping interest rates unchanged (at 3.75%) at its first meeting for 2010. The market was expecting a 0.25% increase, following a host of positive economic indicators. The RBA cited the extent of increases by major banks as one of the reasons for holding back, however comments by RBA suggested more rate rises are likely in the future.

The outcome ended a run of three consecutive monthly increases that began in October. Inflation has risen recently as temporary factors that had been holding it down are now abating. Inflation is expected to be consistent with the RBA target in 2010.

Australian Fixed Interest

Australian bond markets rallied in January, with the UBSA Composite Bond All Maturities index up 1.3%. Investors focused on overseas developments rather than strong domestic economic indicators. Retail sales grew 1.4% month on month in November. Unemployment fell to 5.5% in December. Building approvals were also strong, up 5.9%. December quarter CPI rose to 0.5%, slightly above market expectations of 0.4%. Year on year, CPI rose 2.1%, slightly above market expectations (of 2.0%).

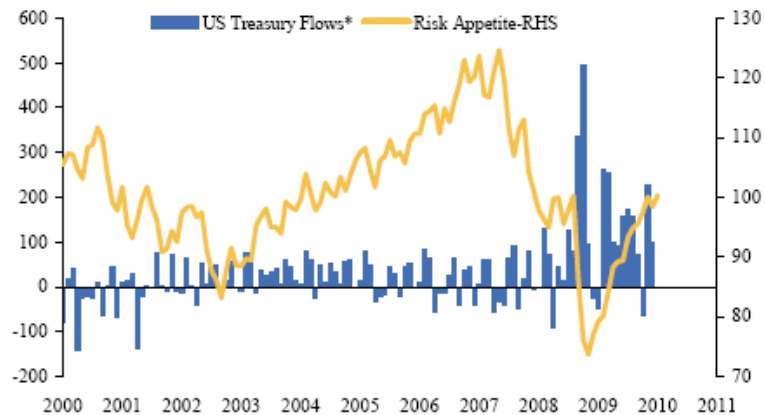
Global Fixed Interest

The Barclays Capital Global Aggregate index rose 1.4% in January. Global government bond yields generally drifted lower, benefiting from the rise in risk aversion following the worsening fiscal situation in Greece, whose deficit ballooned to an estimated 12.7% of GDP. This prompted concerns about sovereign bond default by Greece and a potential bailout by the European Union.

In addition, there was growing concern that the recovery will slow after China clamped down on borrowing. These events were supportive for bond markets, highlighting how bonds can respond if economic conditions do not improve as expected.

In the US, Treasuries returned 1.6% in January after posting a 3.7% loss in 2009. The graph in the next column shows the demand for US Treasuries rose as risk appetite dipped in January. The market is pricing in a less than 50%

chance of an interest rate rise before July. Inflation remains manageable and is allowing governments around the world to borrow at cheaper rates (meaning lower yields on government bonds).



Source: Morgan Stanley research. Data to 31 January 2010.

Australian Listed Property

The S&P ASX 300 Property Accumulation index was down 3.0% in January, outperforming the S&P/ASX 200 by 3.2%.

Over the month, Retail (0.1%) was the best performing sector. Industrial (-7.5%) was the worst.

The top performing trusts for the month were Westfield (0.8%) and CFS Retail Group (-1.6%). Westfield benefited from stronger US assets (off the back of a rising \$US), and both trusts benefited from their high quality domestic retail portfolios in a month when the Retail sector was strong.

The worst performing trusts for January were Abacus Property Group (-9.9%), Mirvac Group (-7.7%) and Goodman Group (-7.3%). Abacus announced asset revaluations in January. Fears of rising interest rates weighed on Mirvac Group. Despite no material news flow for Goodman Group, it was the worst performer among the "leaders" category in January, after being the strongest in December.

Global Listed Property

The UBS Global Property Investor's index was down 3.7% in January. Japan (2.5%) and Continental Europe (-0.6%) were the best performers. The UK (-6.8%) and Canada (-5.2%) were the worst performers.

In the UK, data released in January showed that office values in central London fell 50% in the two years to July 2009, more than most other European cities. This data coincided with the view that, despite an increase in UK house prices in January, many of the leading indicators within the housing market and the UK economy have generally started to lose momentum. Growing talk of pressure on earnings together with the threat of major cuts in public spending weighed on the property market through the month.

On a positive note, sales of UK commercial property doubled in the December quarter of last year as funds started purchasing buildings after a two-year hiatus. However this was not enough to prevent the UK property market being the biggest drag on performance in January.

Australian Shares

Australian stocks, which significantly outperformed other developed market equities in 2009, sold off in January. This came despite strong economic data, with the S&P/ASX 300 Accumulation index down 6.2%. Energy and Mining shares, which are more influenced by global factors, were the major drags on performance. Steel stocks and Resources contractors also suffered, the latter following a profit warning from Worley Parsons.

Consumer Discretionary stocks (David Jones, Myer, Harvey Norman) underperformed as increasing competition and margin pressure began to emerge. However, banks held up relatively well helped by a profit upgrade from CBA. Companies under M&A scrutiny (AXA, CSR, Suncorp), Macquarie Infrastructure Group (demerger from Macquarie) and Ramsay (acquisition) also remained buoyant. Flight Centre announced a profit upgrade, and analysts upgraded their expectations for Tabcorp, Toll and Westfield.

International Shares

Regulatory developments in the US and China saw an abrupt end to the Christmas rally in equity markets. The MSCI World ex Australia index (hedged, \$A) fell 3.2% in January.

China's decision to restrain excessive bank lending in response to higher inflation raised doubts over the market's hopes for a "V-shaped" recovery in the global economy. Disappointing US housing starts and unemployment data also contributed to the reversal in sentiment. Positive GDP data failed to turn this sentiment around.

US Financial stocks fell after some disappointing fourth quarter results (Bank of America, JP Morgan) and the surprise plan by the Obama administration to wean US banks off the high-risk activities that were exposed by the GFC.

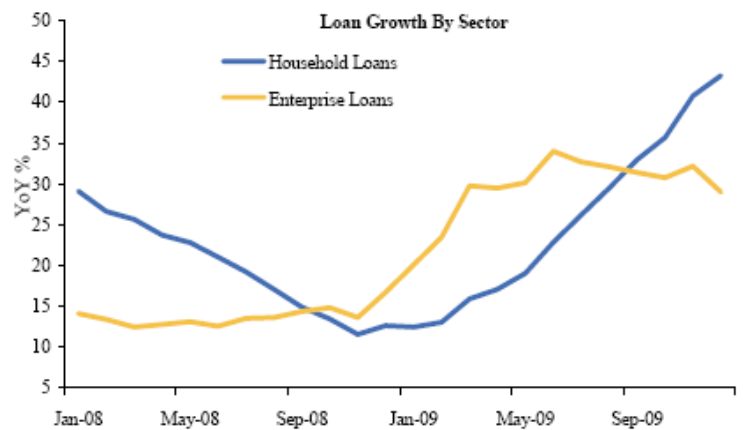
Negative earnings outlooks (Microsoft, Motorola) dragged the Telecommunications sector lower. Defensive Consumer Staples and Healthcare stocks held up the best, the latter helped by government plans for healthcare reform.

European sharemarkets also fell (France -5.0%, Germany -5.9%, UK -4.1%). Negative German data and Greece's fiscal problems were a drag on performance. Asian markets also fell (China -8.8%, Japan -3.3%).

Global Emerging Markets

Emerging markets fell 4.5% in January (MSCI EM index, \$A), dragged lower as risk aversion returned to markets. While the structural emerging markets story remains intact. The Asian emerging markets region experienced some pull-back from global investors in January as Asia was the first region to recover and is now the first region to see tightening by major Asian central banks.

A move by the Chinese government to clamp down on speculative behaviour by curbing new lending and restricting credit growth caused jitters. The graph below shows the increase in Chinese household loans, particularly in the latter part of 2009.



Source: Morgan Stanley

The Chinese government requested that lenders raise interest rates on some mortgages and demand larger down-payments. The People's Bank of China unexpectedly raised reserve requirements for large banks from 0.5% to 16%.

As a result, and in a reversal of a recent theme, investors sold out of developing nations, with much of the flows heading back to the perceived safety of larger markets like the US, where the economic recovery has gathered momentum.

The MSCI EM index, which soared 74% (from its lows) in 2009 amid growing optimism about a global economic recovery, has fallen since its 17 month high on 11 January.

investment markets data

table 1 - investment market performance to 31 January 2010

asset class	index	1 mth %	3 mths %	6 mths %	1 yr % pa	2 yrs % pa	3 yrs % pa	5 yrs % pa
Australian Cash	UBSA Bank Bill Index	0.3	1.0	1.8	3.4	5.4	5.8	5.9
Australian Fixed Interest	UBSA Composite Bond Index	1.3	2.5	3.9	1.7	8.2	6.9	6.0
Global Fixed Interest	Barclays Capital Global Agg (Hedged) Index	1.4	2.0	4.9	10.2	8.4	8.4	7.0
Australian Listed Property	S&P/ASX 300 A-REIT Index	-3.0	1.3	17.8	17.6	-25.5	-24.8	-8.2
Global Listed Property	UBS Global Investors Index (AUD Hedged) Index	-3.7	4.6	21.3	40.9	-17.0	-19.1	n/a
Australian Shares	S&P/ASX 300 Accum Index	-6.2	-1.0	9.9	35.7	-5.9	-3.5	6.6
International Shares (Unhedged)	MSCI World Ex Australia (AUD Unhedged) Index	-2.9	3.4	0.7	-3.3	-10.6	-11.7	-1.4
International Shares (Hedged)	MSCI World Ex Australia (AUD Hedged) Index	-3.2	4.0	9.1	32.5	-9.9	-8.1	2.2
Global Smaller Companies	MSCI World Small Cap (AUD unhedged) Index	-1.3	6.2	5.5	9.0	-5.6	-11.0	-0.3
Global Emerging Markets	MSCI EM in AUD (div reinvested) Index	-4.5	4.1	4.2	28.9	-5.0	-1.2	11.0

table 2 - breakdown of Australian & global fixed interest market performance to 31 January 2010

asset class	index	1 mth %	3 mths %	6 mths %	1 yr % pa	2 yrs % pa	3 yrs % pa	5 yrs % pa
Aust Fixed Interest	UBSA Corporate/Credit	1.1	2.5	4.7	5.5	8.5	6.8	6.2
	UBSA Government/Treasuries	1.4	2.3	3.5	-1.4	7.8	6.9	5.8
	UBSA Semi-Government	1.6	2.6	3.9	1.6	8.7	7.3	6.2
Global Fixed Interest	Barclays Capital Global Agg Credit (Hedged)	1.9	3.0	7.8	19.2	8.1	7.5	6.3
	Barclays Capital Global Agg Govt (Hedged)	1.0	1.6	3.6	6.6	8.1	8.5	7.1
	Barclays Capital Global Agg Securitised (Hedged)	1.7	2.3	5.6	11.8	9.7	9.5	7.6

table 3 – performance of major Australian shares market indices to 31 January 2010

index	1 mth %	3 mths %	6 mths %	1 yr % pa	2 yrs % pa	3 yrs % pa	5 yrs % pa
S&P/ASX 20 Leaders Accum Index	-5.9	-1.3	10.7	36.7	-1.2	1.3	9.7
S&P/ASX 50 Leaders Accum index	-5.9	-0.8	10.3	34.2	-4.2	-2.2	7.3
S&P/ASX 100 Accum Index	-6.1	-0.9	10.0	34.5	-5.2	-2.9	6.9
S&P/ASX 200 Accum Index	-6.2	-0.9	9.8	35.2	-5.8	-3.4	6.7
S&P/ASX 300 Accum Index	-6.2	-1.0	9.9	35.7	-5.9	-3.5	6.6

table 4 - breakdown of Australian shares market performance by sector to 31 January 2010*

sector name	1 mth %	3 mths %	6 mths %	1 yr % pa	2 yrs % pa	3 yrs % pa	5 yrs % pa
Consumer Discretionary	-4.9	-1.6	10.6	50.1	-15.0	-13.6	-3.8
Consumer Staples	-8.4	-5.4	2.9	21.2	-0.2	2.5	9.6
Energy	-9.8	-7.1	-4.5	26.1	6.6	10.7	18.5
Financials	-4.1	-1.7	17.9	50.6	-6.1	-8.0	4.1
Financials Ex Property Trusts	-4.3	-2.3	17.9	57.4	-1.7	-3.9	6.9
Health Care	-5.5	-1.5	6.9	-4.4	-2.3	2.1	12.8
Industrials	-4.6	0.9	18.2	36.8	-14.4	-12.1	-0.7
Information Technology	-1.1	2.3	13.4	64.5	15.2	2.5	10.9
Materials	-9.0	3.3	6.2	39.4	-6.6	5.4	13.9
Property Trusts	-3.0	1.3	17.8	17.6	-25.5	-24.8	-8.2
Telecommunications	-3.1	0.0	-3.2	-4.7	-7.2	-2.5	-0.9
Utilities	-3.6	0.8	2.3	4.7	-9.4	-12.4	4.0

* Based on S&P/ASX 300 Accum Indices (reclassified in accordance with the Global Industry Classification Standard "GICS").

top 5 performing Australian shares in January 2010*

share	return %
Macquarie Infrastructure Group	15.04
Macquarie Group Limited	3.64
Suncorp-Metway Limited	2.42
Fortescue Metals Group Ltd	2.03
Computershare Limited	1.40

bottom 5 performing Australian shares in January 2010*

share	return %
Lihir Gold Limited.	-15.55
Bluescope Steel Limited	-15.76
Transfield Services Limited	-15.76
Alumina Limited	-16.30
Worley Parsons Limited	-18.88

* Based on the universe of S&P/ASX 100 Index.

table 5 - breakdown of international shares market performance by country to 31 January 2010

	1 mth	3 mths	6 mths	1 yr	2 yrs	3 yrs	5 yrs
	%	%	%	% pa	% pa	% pa	% pa
United States: S&P 500	-3.7	3.6	8.7	30.0	-11.7	-9.3	-1.9
Germany: DAX	-5.9	3.6	5.2	29.3	-9.5	-6.2	5.7
United Kingdom: FTSE 100	-4.1	2.9	12.6	25.0	-6.1	-5.8	1.3
France: CAC	-5.0	3.7	9.1	25.7	-12.4	-12.6	-0.9
Japan: Nikkei	-3.3	1.6	-1.5	27.6	-13.4	-16.3	-2.2
Hong Kong: Hang Seng	-8.0	-7.5	-2.2	51.5	-7.4	0.0	8.0

Note: All returns are calculated in local currencies.

table 6 - breakdown of international shares market performance by sector to 31 January 2010*

sector name	1 mth	3 mths	6 mths	1 yr	2 yrs	3 yrs	5 yrs
	%	%	%	% pa	% pa	% pa	% pa
Consumer Discretionary	-2.8	5.5	7.9	41.8	-10.3	-12.7	-3.1
Consumer Staples	-1.0	3.8	9.7	20.5	-2.0	-0.6	4.2
Energy	-4.8	-1.2	6.7	14.3	-8.4	-2.4	5.3
Financials	-3.8	-2.6	2.9	38.7	-23.3	-22.9	-8.9
Health Care	-0.3	9.2	11.3	16.3	-2.8	-4.4	1.8
Industrials	-1.5	6.5	10.6	32.7	-14.5	-11.2	-1.0
Information Technology	-6.4	2.9	7.3	45.3	-6.4	-5.4	0.8
Materials	-7.9	5.2	6.9	43.7	-12.3	-4.9	6.0
Telecommunications	-6.0	0.1	1.5	7.6	-14.0	-9.7	-2.1
Utilities	-4.2	3.6	2.9	-0.4	-14.4	-8.9	2.0

* Based on MSCI World Indices (reclassified in accordance with the Global Industry Classification Standard "GICS").

Note: All returns are calculated in local currencies.

economic indicators

	quarter	year
economic growth		
Australian GDP	0.7% (Sept 09)	2.0% (Sept 09)
United States GDP	5.7% (Dec 09, annualised)	0.1% (Dec 09)

inflation		
Australian CPI	0.5% (Dec 09)	2.1% (Dec 09)
United States CPI	0.1 % (Dec 09, annualised)	2.7% (Dec 09)

	latest	12 months earlier
unemployment		
Australian Unemployment Rate	5.5% (Dec 09)	4.6% (Dec 08)
United States Unemployment Rate	10.0% (Dec 09)	7.4% (Dec 08)

	31 January	31 December
official interest rates		
RBA cash rate	3.75	3.75
US Fed Funds rate	0.25	0.25

10 year bond yields		
Australian Interest Rates - 10 year bond yield	5.38	5.64
United States Interest Rates - 10 year bond yield	3.59	3.84

exchange rates		
AUD/USD Exchange Rate	0.8889	0.8994
AUD/EUR Exchange Rate	0.6395	0.6268
AUD/GBP Exchange Rate	0.5547	0.5569
AUD/JPY Exchange Rate	80.5787	83.7250

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