

in brief

As was **widely expected**, the Reserve Bank of Australia (RBA) **lifted** its official cash rate by **0.25%** to **4.50%** in May.

The **European Sovereign Debt** crisis intensified during the month. Higher rated **sovereign bonds rallied** as investor risk aversion increased, while **spreads in higher risk markets widened**.

Australian equities weakened in response to investor concerns over Europe's fiscal problems. The market was also unsettled by the government's announcement of the new **Resource Super Profits Tax**. In addition, investors feared that **China's economic policy tightening** could potentially impact on China's **growth prospects** and consequently **commodity demand**.

Australian Cash

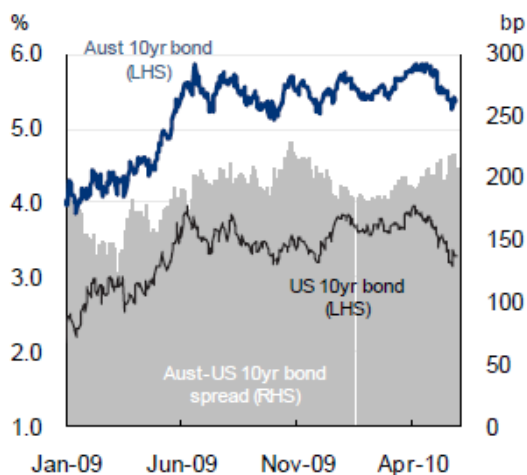
As was widely expected, the Reserve Bank of Australia (RBA) lifted its official cash rate by 0.25% to 4.50% in May. The RBA signalled a pause in the rate-rise cycle, noting there were signs that rate rises delivered to date were impacting on consumer activity.

At its most recent meeting on 1 June, the RBA left interest rates on hold for the first time in four months amid concerns about Europe's worsening sovereign debt crisis.

Australian Fixed Interest

Australian bond yields hit a low in May, following safe-haven buying. The UBSA Composite Bond All Maturities index rose 1.6%. Australian bond markets sold-off slightly over the last few days of the month, but still rallied significantly overall. Yields on 10 year government bonds fell to 5.37% in May (down from 5.71% in April).

The graph below shows the fall in 10 year government bond yields in May, and the spread between Australian and US 10 year yields.



Source: CBA. Data to 31 May

A barometer of monthly consumer prices, the TD Inflation gauge, rose 3.7% from a year earlier in May, faster than the 2.9% increase in April. The jump in inflation was mainly due to the 25% tobacco tax introduced in April. Excluding tobacco, the inflation gauge rose 3.3% in May. The RBA's inflation target range is 2-3%.

Global Fixed Interest

The Barclays Capital Global Aggregate index rose 1.2% in May. The European Sovereign Debt crisis intensified during the month. Higher rated sovereign bonds rallied for most of the month as the European story dominated the news whilst spreads in higher risk markets widened. In the middle of May markets briefly stabilised following IMF/EU bailout packages and an ECB intervention.

However, Sovereign debt concerns once again resurfaced in Greece, Spain, Ireland and Portugal by the end of the month.

The debt issue was centred on developed markets. In the G20's largest developed economies, sovereign debt burdens are now at about 100% of GDP (compared to debt in emerging markets, which represents around 40% of GDP).

Australian Listed Property

The S&P ASX 300 Property Accumulation index was down 4.3% in May, outperforming the S&P/ASX 300 by 3.2%.

Retail (-1.3%) was the top performing sector. Industrial (-11.8%) reversed the previous two months as the best performing sector, being the worst performing sector in May, followed by Commercial (-5.9%).

The top performing trusts for the month were CFS Retail Property Trust (0.5%) and Commonwealth Property Office Fund (-0.5%). Both trusts outperformed in a risk averse market. Investors' preferred domestic retail assets with low gearing.

The worst performing trusts for May were Charter Hall Group (-17.6%) and Ardent Leisure Group (-22.1%). Charter Hall Group underperformed as investor macro shocks made refinancing and attracting capital more challenging. Ardent Leisure Group's third quarter update was below expectations.

Global Listed Property

The UBS Global Property Investors' index (hedged, \$A) decreased 5.9% over May, with Australia the top performing region, despite still falling (-4.3%) followed by the US and Canada (-5.2%). The worst performing regions were Japan (-8.2%) and Continental Europe (-7.1%).

In Japan, the price index for residential, commercial and industrial land in the six major cities in Japan was down 3.5% from six months earlier (as of March 31). However, this represented a slower pace of decline for the second straight semi-annual period, suggesting an improvement in real estate transactions in central metropolitan areas.

In the US, at the International Council of Shopping Centres convention in May, owners anticipated a return to modest growth in leasing and retail sales in 2010-2011. Regional mall operators and higher-quality properties expressed the most optimism. This helped buoy the US market.

Australian Shares

The S&P/ASX 300 Accumulation index fell 7.5% in May. Events in Europe had a negative flow-on impact for the Australian market. Resources stocks were additionally unsettled by the government's proposed introduction of a Resource Super Profits Tax.

In addition, investors feared that China's economic policy tightening could potentially impact on China's growth prospects and consequently - commodity demand, adding to the negative sentiment towards the Resources sector.

Despite this, the outperformers in May included resource tax targets BHP, RIO and Woodside. Gold stocks, large REITs (Westfield) and some defensives such as Consumer Staples and Health care also outperformed.

Some switching to 'blue chip' names within sectors appeared to be an outcome of the heightened risk aversion. However banks (ex ANZ) fell as GFC fears resurfaced and some trading updates were poorly-received, as did Healthcare names Sonic and Primary (over difficulties recovering government funding cuts). Others that announced profit warnings (Spotless, Virgin) and steel, smaller resource names and contractors also suffered.

International Shares

Deepening concerns over Europe's debt crisis caused widespread selling of equities in May. The MSCI World ex Australia index (hedged, \$A) fell 7.9%. Initial investor relief over the bailout package gave way to worries over how the region would navigate the difficult road to fiscal recovery for countries such as Greece and Spain.

Germany rekindled GFC fears by placing naked short-selling bans on some securities. Markets also had to deal with China slowdown fears and more evidence of increasing sovereign risk - namely a global increase in mining taxes (led by Australia).

The surge in risk aversion caused investors to switch from 'risk' assets such as equities to 'safe havens' such as gold and the \$US. The selling was generally broad-based and not just confined to cyclicals or other high-beta sectors. In the US, BP's Gulf of Mexico disaster plus a 14% fall in the oil price saw energy names hit hard. Stockmarkets in

Europe also suffered major selling (UK -6.6%, France -8.1%, Spain -10.8%) with Spain's credit rating being downgraded. However, some strong stock-specific performance (autos), good company results and a somewhat safe-haven (fiscally-stronger) position in the region helped the German market to fall 'only' 2.8%. Asian markets fell significantly, especially Japan (-11.7%) and China (-10.8%) where fears over an economic slowdown persist.

Global Emerging Markets

Easing global growth and the effects of Europe's debt crisis on exports restrained emerging markets, but the MSCI EM index (hedged, \$A) closed 1.2% higher in May. Losses were mitigated by the view that China wouldn't be significantly hurt by the sovereign-debt problems in southern Europe because the nation's growth is largely driven by its domestic economy.

However, Europe is China's biggest export destination, making up 20% of total overseas sales, and investors were still concerned about the impact of a faltering Euro zone economy on China. European Union leaders unveiled an almost \$1 trillion loan package last month to halt the slide in the Euro after Greece's budget deficit expanded to almost 14% of gross domestic product, exceeding the EU's 3% limit.

China's purchasing managers' index showed manufacturing expanded at a slower pace than estimated in May, adding to concern that the world's third-largest economy may decelerate.

investment markets data

table 1 - investment market performance to 31 May 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	0.4	1.1	2.1	3.8	4.8	5.6	5.8
Australian Fixed Interest	UBSA Composite Bond Index	1.6	1.6	3.1	5.7	8.7	7.0	5.9
Global Fixed Interest	Barclays Capital Global Agg (Hedged) Index	1.2	2.6	4.2	11.4	10.1	9.2	7.2
Australian Listed Property	S&P/ASX 300 A-REIT Index	-4.3	-0.6	1.2	27.5	-21.0	-25.3	-7.3
Global Listed Property	UBS Global Investors Index (AUD Hedged) Index	-5.9	4.9	10.3	42.5	-14.8	-16.8	n/a
Australian Shares	S&P/ASX 300 Accum Index	-7.5	-3.5	-4.2	20.7	-7.5	-7.3	6.0
International Shares (Unhedged)	MSCI World Ex Australia (AUD Unhedged) Index	0.7	2.8	4.0	8.0	-8.3	-11.2	-1.3
International Shares (Hedged)	MSCI World Ex Australia (AUD Hedged) Index	-7.9	-1.1	1.7	18.7	-11.6	-10.1	1.6
Global Smaller Companies	MSCI World Small Cap (AUD unhedged) Index	0.3	8.0	15.2	22.5	-1.5	-8.9	1.2
Global Emerging Markets	MSCI EM in AUD (div reinvested) Index	1.2	6.5	7.2	16.8	-4.4	-1.2	11.4

table 2 - breakdown of Australian & global fixed interest market performance to 31 May 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	1.0	1.6	3.6	8.1	9.2	7.0	6.1
	UBSA Government/Treasuries	2.0	1.7	2.4	4.2	8.5	7.1	5.7
	UBSA Semi-Government	1.8	1.6	3.3	6.0	9.2	7.5	6.1
Global Fixed Interest	Barclays Capital Global Agg Credit (Hedged)	0.0	2.3	4.7	17.4	9.8	8.1	6.5
	Barclays Capital Global Agg Govt (Hedged)	1.6	2.7	3.9	9.2	9.9	9.3	7.2
	Barclays Capital Global Agg Securitised (Hedged)	1.3	2.8	4.4	11.8	11.1	10.3	7.9

table 3 – performance of major Australian shares market indices to 31 May 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	-7.6	-4.0	-4.3	22.4	-3.0	-2.2	8.5
S&P/ASX 50 Leaders Accum index	-7.5	-3.9	-4.2	20.9	-5.9	-5.6	6.5
S&P/ASX 100 Accum Index	-7.5	-3.7	-4.1	20.9	-6.6	-6.5	6.2
S&P/ASX 200 Accum Index	-7.5	-3.5	-4.1	20.8	-7.3	-7.1	6.1
S&P/ASX 300 Accum Index	-7.5	-3.5	-4.2	20.7	-7.5	-7.3	6.0

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

sector name	1 mth %	3 mths %	6 mths %	1 yr % pa	2 yrs % pa	3 yrs % pa	5 yrs % pa
Consumer Discretionary	-7.1	-2.7	-2.8	27.1	-6.7	-16.2	-2.8
Consumer Staples	-1.2	-2.5	-2.2	20.2	0.8	-0.1	9.8
Energy	-7.0	-0.5	-7.1	0.0	-11.8	4.4	15.2
Financials	-9.6	-4.6	-3.2	31.9	-2.9	-10.6	3.1
Financials Ex Property Trusts	-10.6	-5.3	-4.0	32.7	1.0	-7.1	5.4
Health Care	-4.0	-4.8	-2.7	10.5	-4.0	-0.7	12.1
Industrials	-11.4	-8.8	-6.8	23.2	-13.4	-17.2	-2.1
Information Technology	-8.2	-5.5	-0.5	23.2	4.5	-5.1	11.3
Materials	-5.8	-1.7	-4.7	16.7	-12.7	-0.9	14.4
Property Trusts	-4.3	-0.6	1.2	27.5	-21.0	-25.3	-7.3
Telecommunications	-7.2	-1.7	-9.9	0.9	-15.5	-10.4	-3.5
Utilities	-7.9	-5.4	-2.2	3.2	-12.2	-13.9	1.7

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

top 5 performing Australian shares in May 2010*

share	return %
Alumina Limited	7.69
Lihir Gold Limited.	4.46
Iluka Resources Limited	3.01
Foster's Group Limited	2.57
Harvey Norman Holdings Limited	0.88

bottom 5 performing Australian shares in May 2010*

share	return %
Transurban Group	-15.59
Awe Limited	-16.19
Boart Longyear Limited	-16.36
Nufarm Limited	-20.42
Sonic Healthcare Limited	-25.94

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

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

	1 mth %	3 mths %	6 mths %	1 yr % pa	2 yrs % pa	3 yrs % pa	5 yrs % pa
United States: S&P 500	-8.2	-1.4	-0.6	18.5	-11.8	-10.7	-1.8
Germany: DAX	-2.8	6.5	6.0	20.7	-8.3	-8.9	6.0
United Kingdom: FTSE 100	-6.6	-3.1	0.0	17.4	-7.4	-7.8	0.9
France: CAC	-8.1	-5.4	-4.7	7.0	-16.4	-16.9	-3.2
Japan: Nikkei	-11.7	-3.5	4.5	2.6	-17.5	-18.2	-2.8
Hong Kong: Hang Seng	-6.4	-4.1	-9.4	8.8	-10.2	-1.4	7.3

Note: All returns are calculated in local currencies.

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

sector name	1 mth %	3 mths %	6 mths %	1 yr % pa	2 yrs % pa	3 yrs % pa	5 yrs % pa
Consumer Discretionary	-7.5	4.4	9.9	25.9	-6.7	-12.1	-1.6
Consumer Staples	-4.3	-2.5	1.4	18.0	-3.2	-2.6	3.7
Energy	-10.4	-4.9	-6.7	0.3	-18.5	-7.7	2.8
Financials	-9.2	-3.1	-4.2	11.0	-20.9	-23.8	-9.0
Health Care	-6.3	-7.6	-4.2	12.3	-4.4	-7.8	-1.5
Industrials	-8.6	1.8	7.0	23.0	-14.8	-12.9	-0.3
Information Technology	-9.2	-0.4	2.4	22.4	-8.9	-6.5	0.9
Materials	-7.4	-1.3	-1.5	15.5	-16.8	-8.4	6.6
Telecommunications	-5.1	-3.2	-5.8	5.4	-13.4	-12.9	-2.3
Utilities	-6.2	-4.1	-4.1	1.3	-17.5	-13.1	0.0

* 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	0.8% (Mar 10)	3.3% (Mar 10)
United States GDP	3.0% (Mar 10, annualised)	2.5% (Mar 10)

inflation		
Australian CPI	0.9% (Mar 10)	2.9% (Mar 10)
United States CPI	0.0 % (Apr 10, annualised)	2.2% (Apr 10)

	latest	12 months earlier
unemployment		
Australian Unemployment Rate	5.3% (Apr 10)	7.5% (Apr 09)
United States Unemployment Rate	9.7% (May 10)	9.0% (May 09)

	31 May	30 April
official interest rates		
RBA cash rate	4.50	4.25
US Fed Funds rate	0.25	0.25

10 year bond yields		
Australian Interest Rates - 10 year bond yield	5.37	5.71
United States Interest Rates - 10 year bond yield	3.58	3.66

exchange rates		
AUD/USD Exchange Rate	0.8388	0.9309
AUD/EUR Exchange Rate	0.6836	0.7001
AUD/GBP Exchange Rate	0.5773	0.6081
AUD/JPY Exchange Rate	76.3556	87.5092

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