

politics of last resort rattle sharemarkets

November was a hard month for sharemarkets as investors lost confidence in the ability of European policymakers to resolve the sovereign debt crisis.

The month began with ongoing civil and political problems in Greece, including a referendum that threatened October's Greek bailout package. This saw global sharemarkets fall after a brief rally in October. Investor concern soon spread to other European economies, in particular Italy. Yields of Italian 10 year government bonds rose to over 7.0%, which is 3.0% higher than five months ago. The increased costs of borrowing created new fears surrounding the sustainability of Italy's sovereign debt.

While the situation in Europe is very fluid, economic data across Europe is generally poor. A contraction in growth for the Euro area is likely, but its intensity and length is hard to forecast. The outcome will be influenced by political developments and the response by the European Central Bank (ECB).

By the end of the month, Greece and Italy had new governments. These governments are led by well credentialed, pro-European economists and businessmen. The new Prime Minister of Greece, Lucas Papademos is a former ECB vice-president. Italy's new Prime Minister Mario Monti is a distinguished economist and served as a European Commissioner between 1995 and 2005. In addition, the more financially stressed countries of Portugal, Ireland and Spain have all undergone government changes.

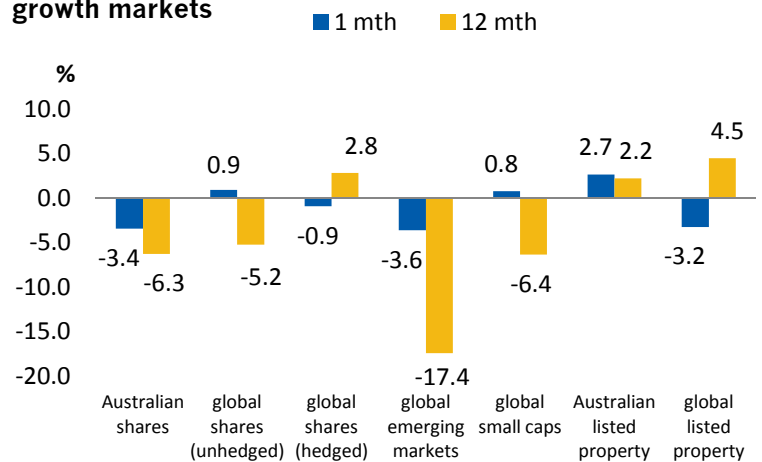
While there remain difficulties for European policy makers to reach a consensus, the new governments have already shown a stronger commitment than their predecessors towards implementing necessary reforms and committing to the European Union as a whole.

As European policy makers have shown greater signs of coordinating a resolution, the ECB has indicated that it is firmly committed to taking stronger action, supporting troubled bond markets and the financial system. The ECB also said it would support a fiscal union. While new policy initiatives will take time to implement and significant challenges remain, the new faces and progress in Europe is encouraging.

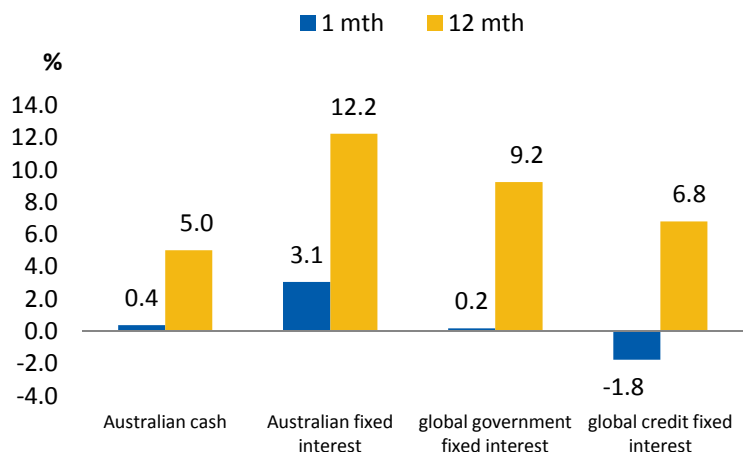
in brief

- ~ Sovereign debt issues in Europe hurt sharemarkets and pushed bond yields higher in countries like Spain, France and in particular Italy, where 10 year government bond yields rose above 7%.
- ~ In the US, overall profit growth for corporates listed in the S&P 500 was up 18% year-on-year. The September quarter earnings season saw 70% of corporate in the S&P 500 beat expectations.
- ~ In Australia, September quarter gross operating profits rose 4.8%, above the forecasted 3.0%.

growth markets



debt markets



Australian shares

In November, the S&P/ASX 300 Accumulation Index fell 3.4%. Investors were concerned that risks surrounding Europe's sovereign debt crisis would impact global growth, prompting a cut back in the demand for Australia's goods and services.

While negative newsflow surrounding the global economy overshadowed investor sentiment, corporate earnings in Australia outperformed. According to the Bureau of Statistics in the September quarter gross operating profits rose 4.8%, above the forecasted 3.0%.

In the quarter, profits for mining companies rose 5.0% and construction jumped 21.7%. The earnings of financial and insurance services companies surged 36.1%. On the other hand, the profits of manufactures fell 3.0% and the earnings of retailers declined 2.9%. Cautious consumers and a strong \$A has negatively affected these sectors.

global shares

The MSCI World ex Australia Index (hedged \$A) fell 0.9% and the MSCI World ex Australia Index (unhedged) rose 0.9% in November. The fall in the value of the \$A impacted returns. Economic and corporate activity in the United States and China showed signs of strength. However, investors were greatly influenced by a worsening of the sovereign debt problem in Europe.

November was another volatile month. The chart opposite shows the widening of daily price movements of the S&P 500 in the last four months.

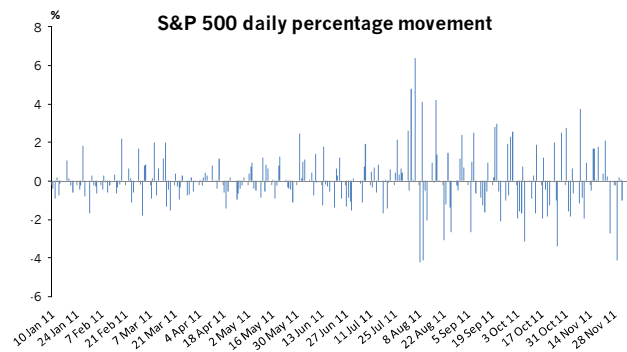
In November the S&P 500 fell 0.5%. While the month saw excessive amounts of negative newsflow from Europe, the US sharemarket was underpinned by a strong corporate earnings season and a stable domestic economic backdrop.

Overall profit growth for US corporates was up 18% year-on-year as at November. The September quarter earnings season saw 70% of corporate in the S&P 500 beat profit expectations. In addition, the US economy expanded at a moderate pace, led by gains in manufacturing and consumer spending.

Holiday purchasing helped sales at electronics stores increase 3.7% the most since November 2009, according to the US Commerce Department. In addition, sales for online retailers and mail-order companies, rose 1.5%, the most in nine months. Holiday hiring also helped the US unemployment rate fall 0.4% to 8.6%. This was the best result in over two years.

In China, data suggested a consistent level of economic growth around 9% and a moderation in inflation levels. Inflation cooled to 5.5% in November down from 6.1% as at end of September quarter, and a peak of 6.5% in July.

Throughout the year Chinese policy makers have focused on stabilising growth. China's central bank has risen interest rates three times in 2011 and lifted the reserve requirement ratio for banks six times. This has cleared the way for monetary easing and the implementation of growth policies if the situation in Europe should decline.



source: Bloomberg as at 31 November 2011

Data in the month showed signs of sustained consumer demand in China. Retail sales, imports and fixed asset investments remained strong. However, industrial production and export growth slowed, largely due to the pessimistic outlook for overall global demand due to Europe's debt problems. This saw the sharemarket in China fall 8.3% in local currency terms.

listed property

In Australia, the S&P/ASX 300 A-REIT Index rose 2.7% in November. Globally, Australia was the top performing region in the month. The 0.25% reduction in the official cash rate in the month boosted the performance of listed property securities that garner profits from residential and retail sales such as Stockland Group (+ 7.3%) and Westfield (6.5%).

The UBS Global Property Investors Index (hedged in \$A) fell 3.2%. The worst performing regions were Hong Kong (-7.7%) and Continental Europe (-6.0%).

debt markets

The Barclays Capital Global Government Index (hedged in \$A) fell 0.2% in November and the Global Credit Fixed Interest Index fell 1.8%. Investors were less confident in government debt and corporate issuers given increased worries about the potential impacts of Europe's debt crisis on the global economy. In response to developments in Europe, central banks across the world announced a coordinated agreement on 30 November to lower the cost of short term financing for the global financial system.

Sovereign debt issues in Europe pushed bond yields higher in countries like Spain, France and in particular Italy, where 10 year government bond yields rose above 7%. This rise in yields means investors are signalling the lack of confidence in the near term economic outlook for countries like Italy. Increased borrowing costs also means the task of deficit reduction becomes harder, making sovereign debt burdens less sustainable.

In Australia, the Reserve Bank of Australia (RBA) reduced interest rates by 0.25% in November and December. The official cash rate is now 4.25%. The RBA said they revised down inflation forecasts. The RBA has plenty of room for further rate adjustments if the situation in Europe deteriorates. The RBA also said its GDP growth forecasts for the next year is 3.25%, up from Australia's GDP growth ending September 2010, which was 3.1%.

economic indicators

gross domestic product (annual rate %)	current	previous	1 year ago
World	5.9	5.9	0.1
Australia	1.4	1.0	3.1
China	9.1	9.5	9.6
European Union	1.4	1.6	2.1
United States	1.5	1.6	3.5

inflation (annual rate %)	current	previous	1 year ago
Australia	3.5	3.6	2.8
China	6.1	6.4	3.6
European Union	3.0	2.7	1.8
United States	3.9	3.6	1.1

official interest rates (%)	current month	3 months ago	1 year ago
Australia	4.50	4.75	4.75
China	3.43	3.35	2.13
European Union	1.25	1.50	1.00
United States	0.25	0.25	0.25

bond yields (%)	current month	3 months ago	1 year ago
Australia 3 years	3.12	3.77	4.98
Australia 10 years	3.93	4.37	5.41
United States 2 years	0.25	0.20	0.45
United States 10 years	2.07	2.22	2.80

exchange rates	current month	3 months ago	1 year ago
AUD/USD	1.0273	1.0710	0.9591
AUD/EUR	0.7631	0.7438	0.7367
AUD/GBP	0.6532	0.6577	0.6158
AUD/JPY	79.7493	81.8955	80.3396
AUD/SGD	1.3162	1.2876	1.2677

sharemarket analysis

sharemarkets (in local currency)	5 yrs (% pa)	3 yrs (% pa)	1 yr (%)	3 mths (%)	1 mth (%)
Australia : ASX 300 Accum	-1.4	8.1	-6.3	-3.0	-3.4
Germany : DAX	-0.7	9.3	-9.0	5.3	-0.9
Japan : Nikkei	-12.3	-0.3	-15.1	-5.8	-6.2
United Kingdom : FTSE 100	-1.9	8.7	-0.4	2.1	-0.7
United States : S&P 500	-2.3	11.6	5.6	2.3	-0.5
global emerging markets : MSCI in AUD	-1.8	6.2	-17.4	-5.9	-3.6

Indices:

Australian shares: S&P/ASX 300 Accum Index

International Shares (Unhedged): MSCI World Ex Australia Index in AUD

International Shares (Hedged): MSCI World Ex Australia Index (Hedged) in AUD

Global Emerging Markets: MSCI Emerging Markets Index in AUD

Australian Listed Property: S&P/ASX 300 A-REIT Index

Global Listed Property: UBS Global Investors Index (Hedged) in AUD

Australian Cash: UBSA Bank Bill Index

Australian Fixed Interest: UBSA Government/Treasuries

Global Government Fixed Interest: Barclays Capital Global Aggregate Govt (Hedged) in AUD

Global Credit Fixed Interest: Barclays Capital Global Aggregate Credit (Hedged) in AUD

sector summary

Australian share sector returns	5 yrs (% pa)	3 yrs (% pa)	1 yr (%)	3 mths (%)	1 mth (%)
Consumer Discretionary	-10.7	8.3	-13.3	1.2	-3.6
Consumer Staples	5.3	10.8	1.7	0.9	-1.9
Energy	5.7	4.9	-12.7	-1.5	-4.3
Financials	-4.5	8.4	-1.5	0.3	-3.7
Financials ex Property Trusts	-2.4	10.2	-2.3	0.0	-4.9
Healthcare	2.9	0.4	-7.7	1.6	1.8
Industrials	-6.8	7.2	-4.8	1.1	0.4
Information Technology	-3.5	9.1	-20.1	-3.4	-0.1
Materials	3.0	11.5	-15.5	-11.9	-6.2
Property Trusts	-13.6	-0.5	2.2	1.7	2.7
Telecommunications	3.7	0.8	22.1	3.9	1.8
Utilities	-1.7	6.8	7.7	0.2	1.3

MSCI World sector returns (in local currency)	5 yrs (% pa)	3 yrs (% pa)	1 yr (%)	3 mths (%)	1 mth (%)
Consumer Discretionary	-4.0	15.9	-3.7	0.3	-2.5
Consumer Staples	3.3	9.2	7.3	3.4	1.7
Energy	0.4	7.0	7.6	4.3	1.0
Financials	-16.9	-1.8	-15.9	-5.9	-5.9
Healthcare	-1.5	7.1	7.0	1.7	0.5
Industrials	-4.5	9.1	-5.6	0.2	-0.9
Information Technology	-0.6	17.1	2.9	4.5	-2.1
Materials	-1.0	12.8	-10.7	-5.6	-1.4
Telecommunications	-3.2	2.6	-1.5	0.7	-1.1
Utilities	-6.1	-3.5	-4.5	0.8	-0.2

Notes:

1. GDP and inflation rate is most recent data available.

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