

Australian Equities

Optimism tempered by realism

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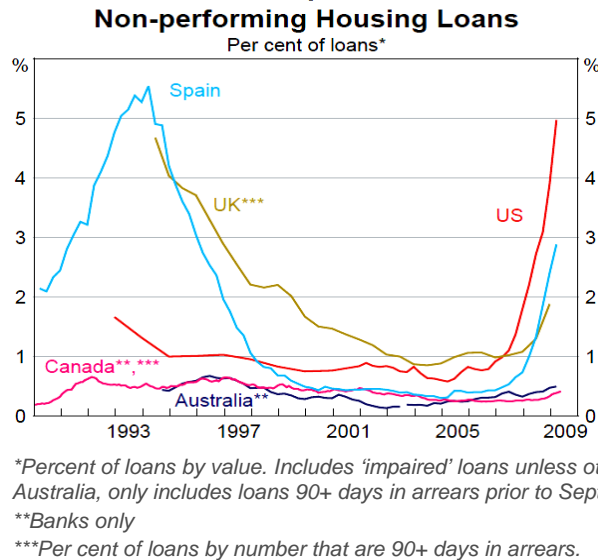
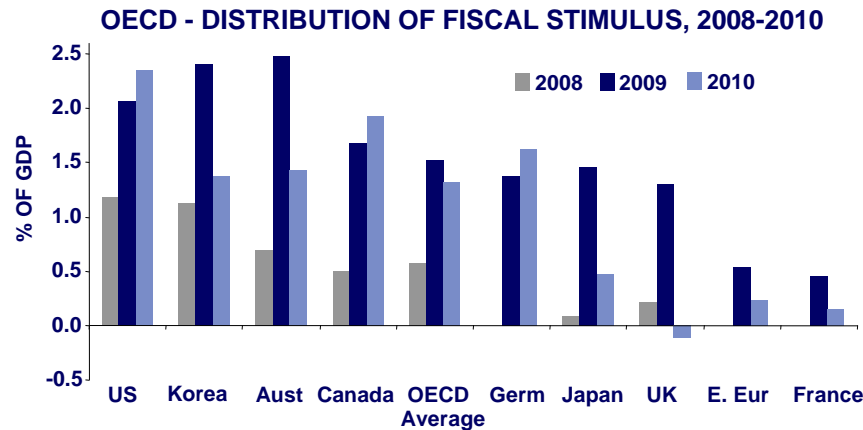
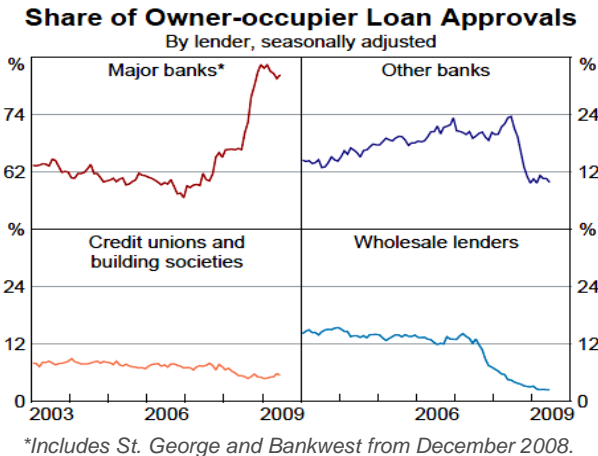
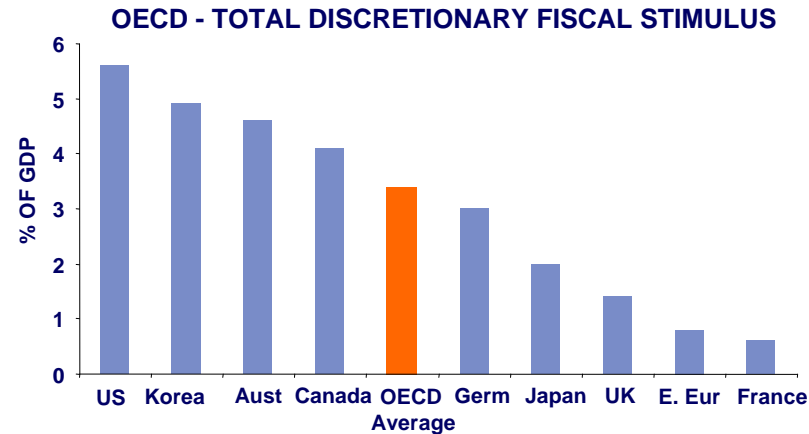
INVESTMENT MANAGEMENT



SIX reasons to feel good about Australian Equities

1. Large fiscal stimulus program has gained traction
2. Public sector spending is taking up the slack caused by household & corporate deleveraging
3. Earnings expectations currently factor in modest margin expansion – more upside?
4. Current valuation metrics look fair – not demanding in our view
5. Strong AUD and foreign fund flows may prove supportive
6. Remediated balance sheets and micro-economic reforms may stir M&A activity

Historic domestic & global stimulus supported by a healthy Australian core banking system

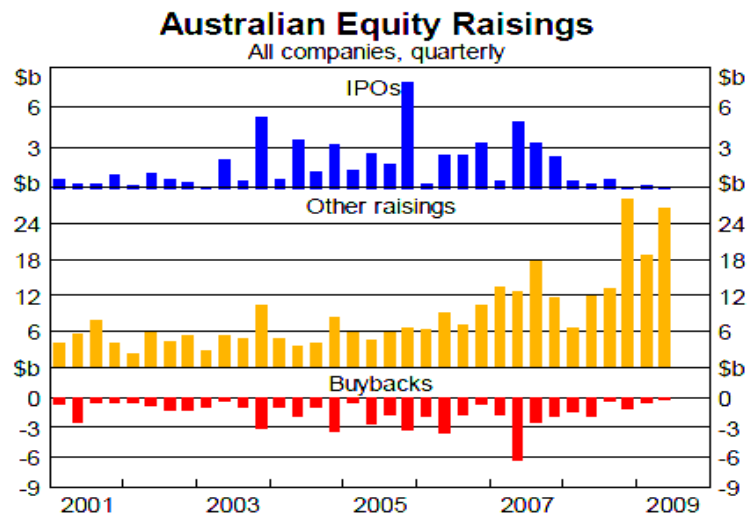


Sources: OECD and the Reserve Bank of Australia



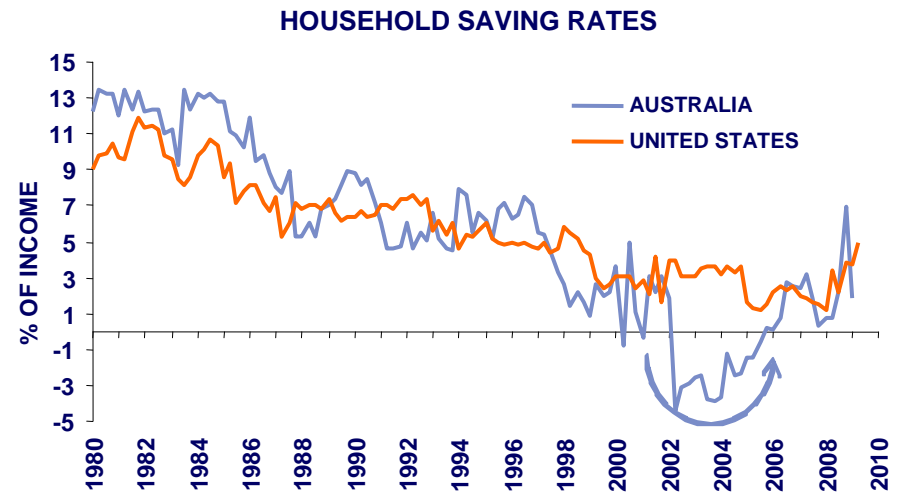
Deleveraging of corporate and personal balance sheets - a key theme in 2009

Corporate deleveraging –
moving from survival mode



Source: Reserve Bank of Australia and Australian Bureau of Statistics

Consumer deleveraging –
an economic growth engine at risk?



Source: Australian Bureau of Statistics



Normalisation of credit markets has taken place as illustrated by:

a narrowing in the TED spread.....and tightening of the iTRAX CDS index



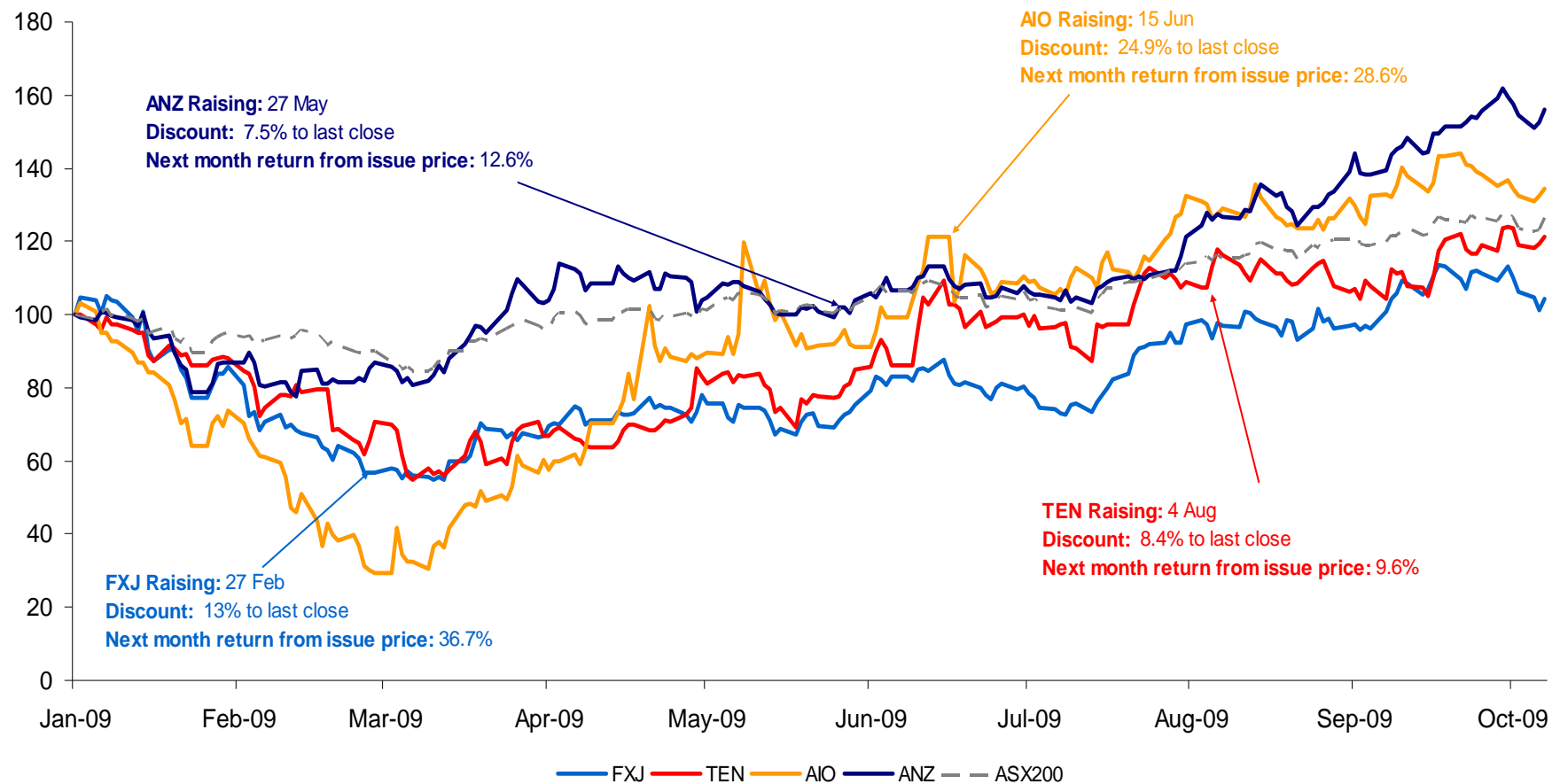
Source: Bloomberg



Source: Bloomberg

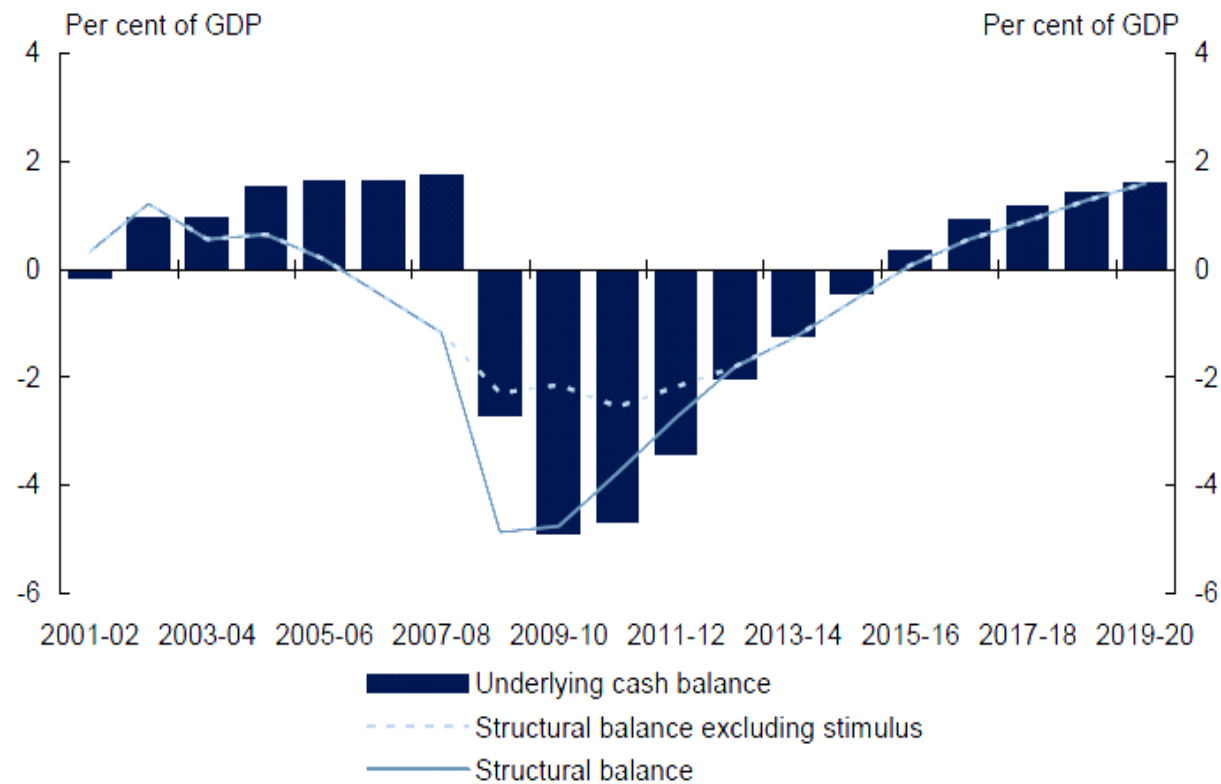


Markets rewarding companies that have de-risked and transitioned from survival mode to opportunism



Switch from private sector to public sector debt may have implications for Australian interest rates

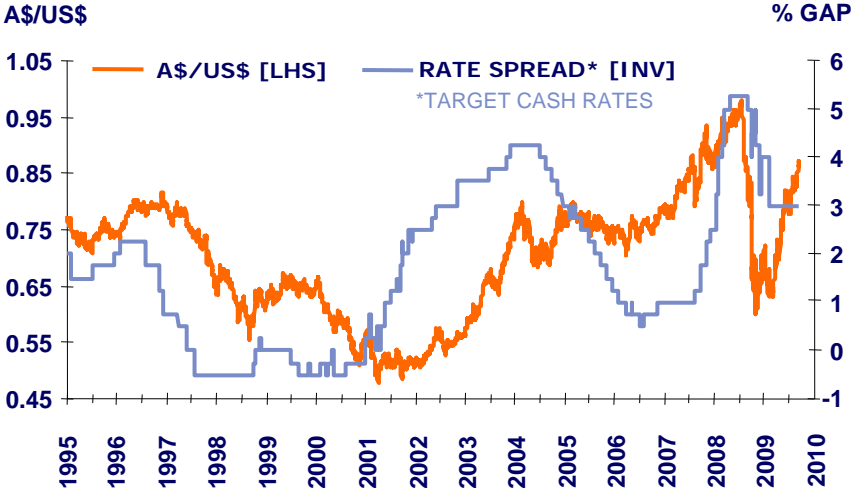
STRUCTURAL BUDGET BALANCE



Source: Federal Treasury <http://www.budget.gov.au/2009-10/content/bp1/html/index.htm>

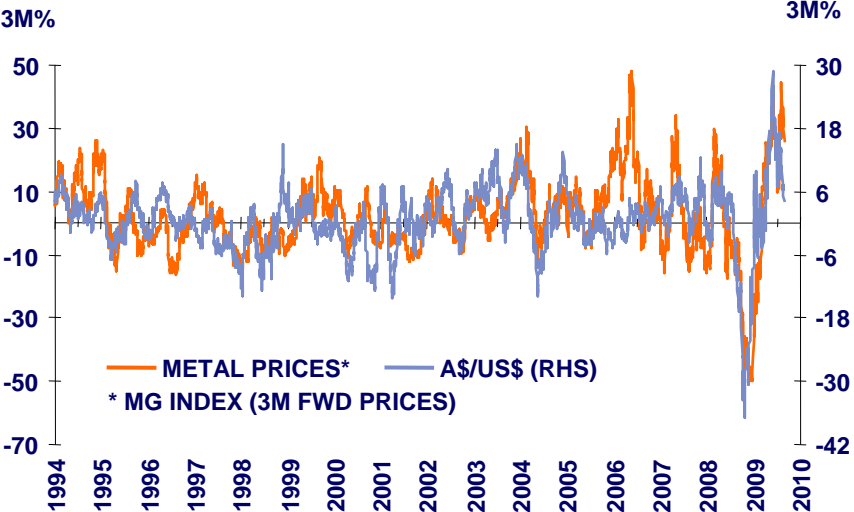
Rising \$A and interest rates but.... commodities outlook and China remain key

A\$ AND INTEREST RATE SPREAD



Source: Reserve Bank of Australia and Bloomberg

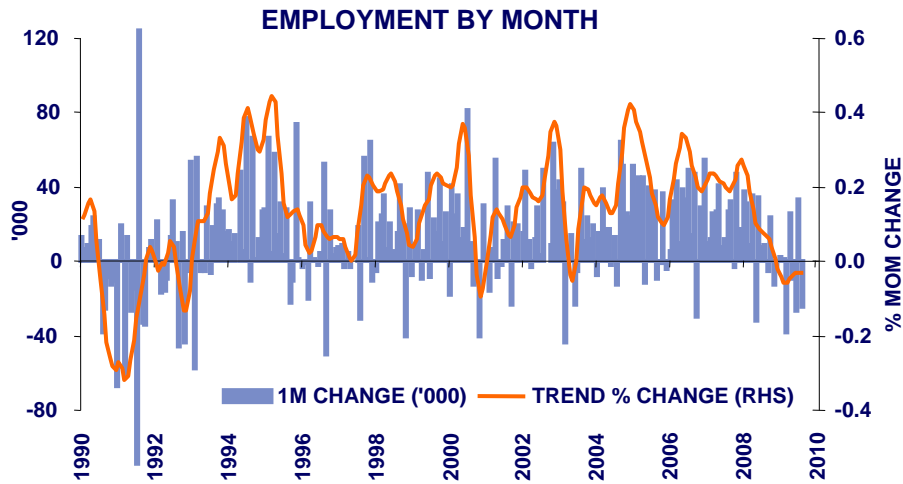
A\$/US\$ AND METAL PRICES



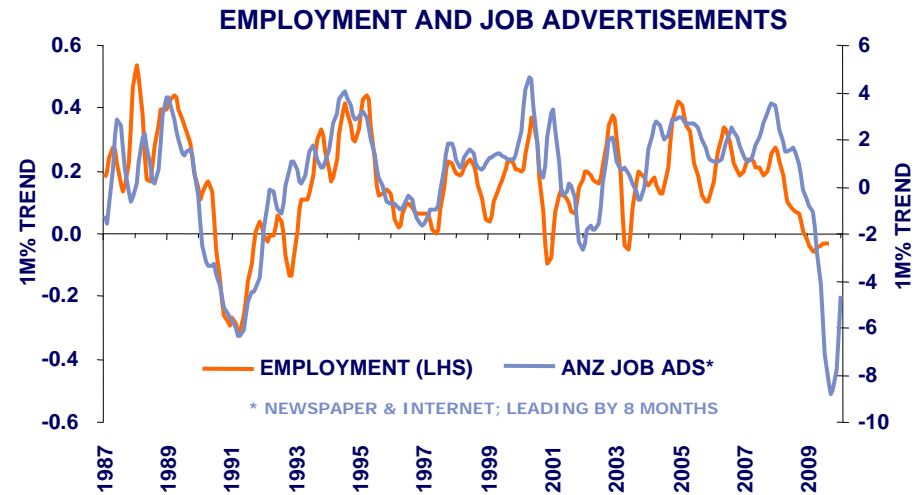
Source: Bloomberg, DataStream, Metallgesellschaft (MG)



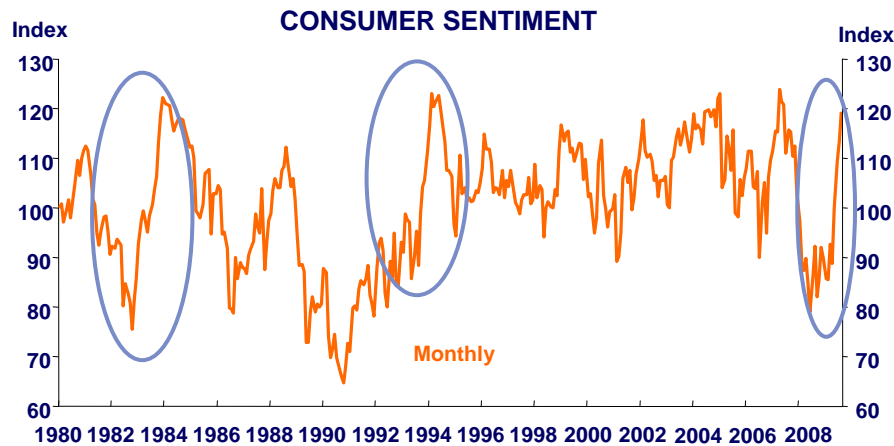
Employment outlook is improving – supported by robust consumer spending



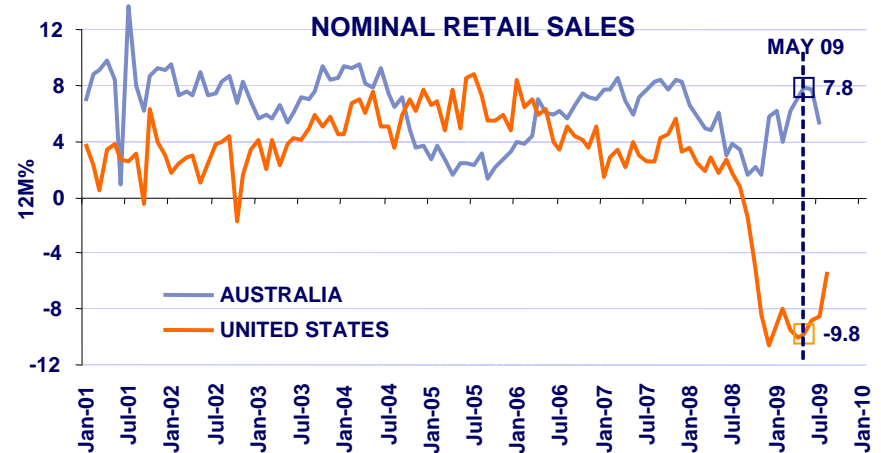
Source: ABS



Source: ABS, ANZ Bank



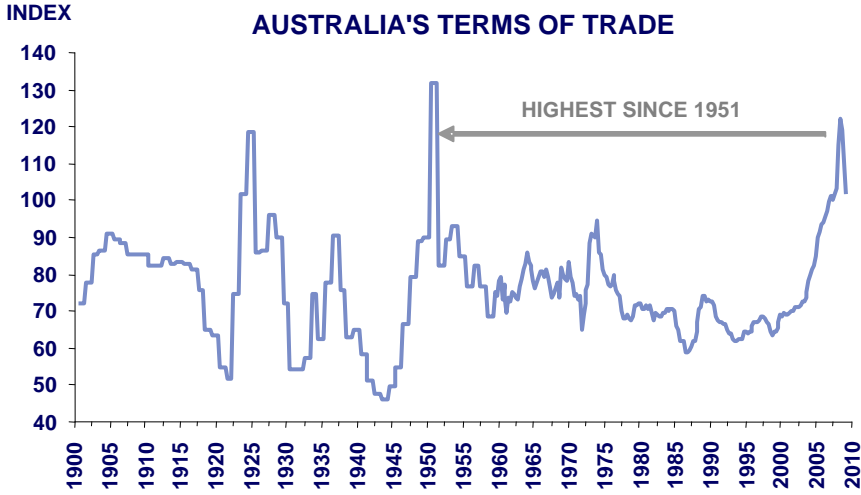
Source: Macquarie Research



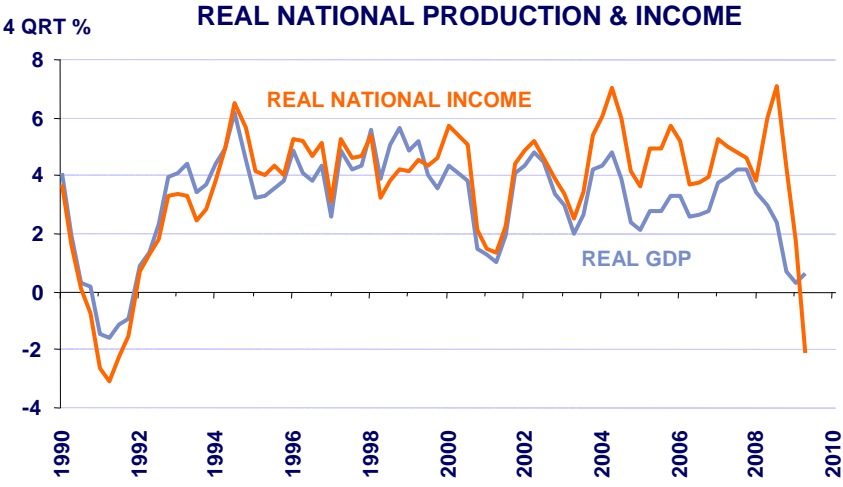
Source: ABS, RBS



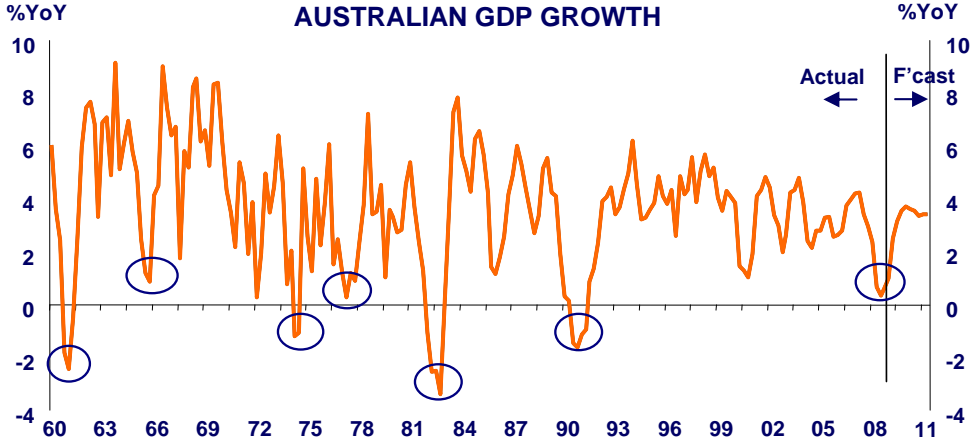
GDP Outlook remains relatively robust



Source: ABS



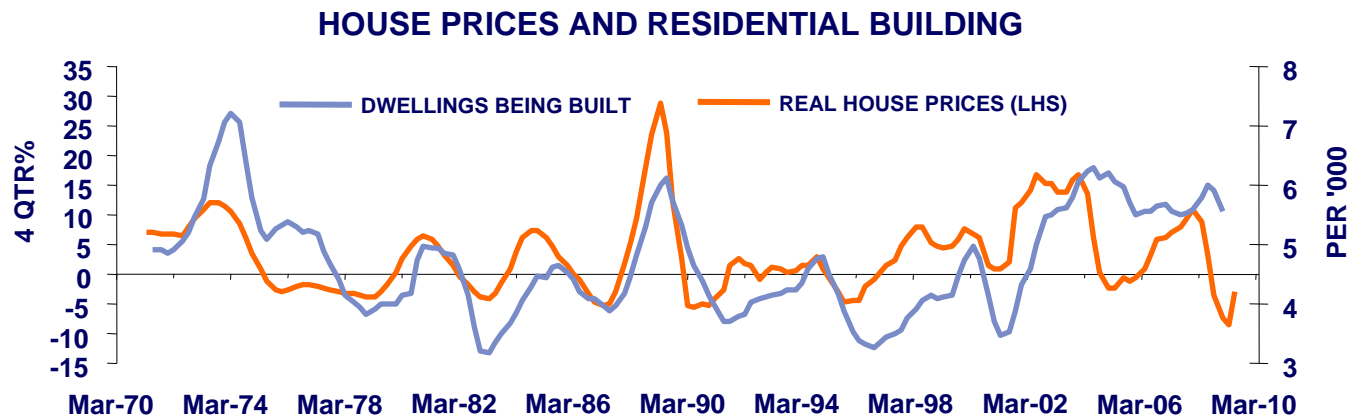
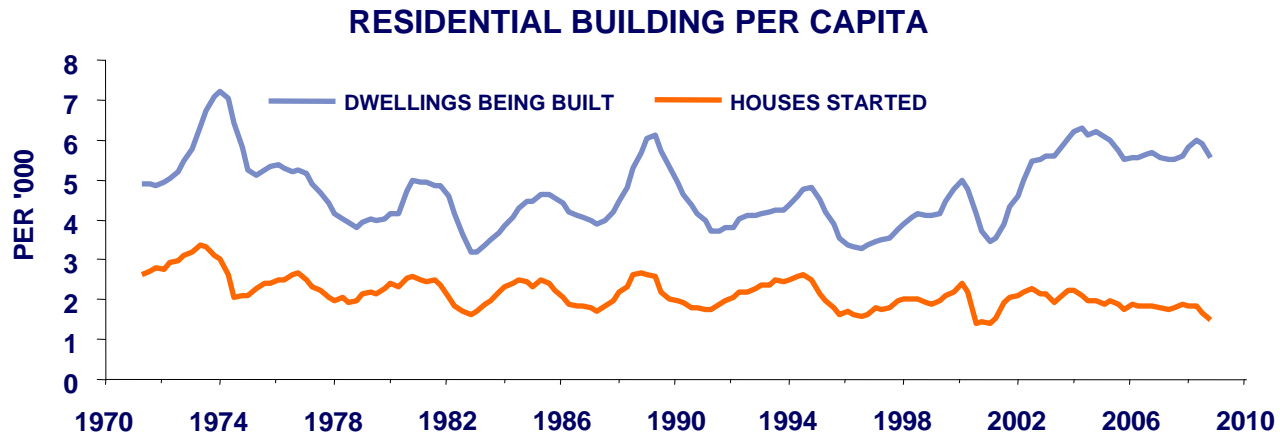
Source: ABS



Source: Macquarie Research

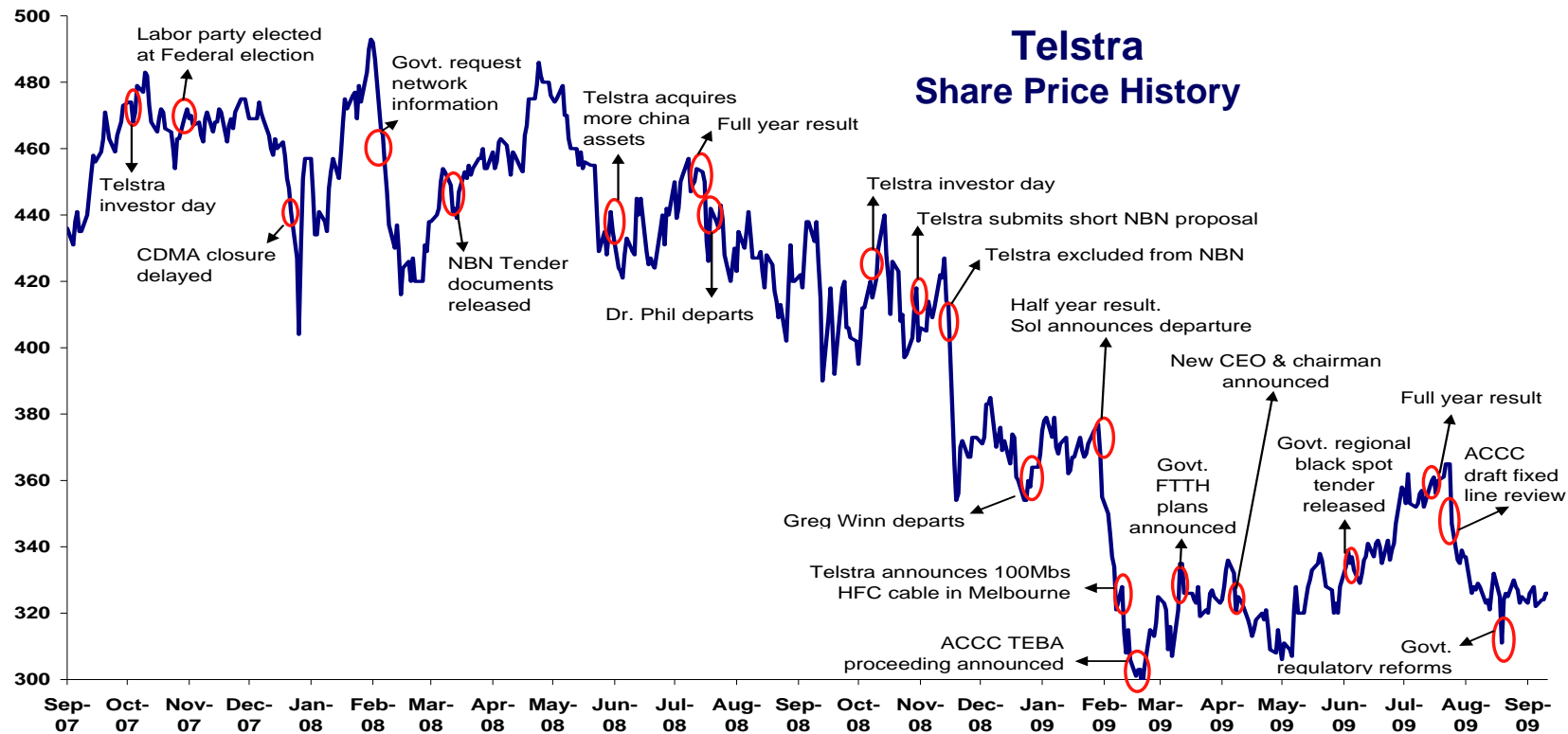


House prices are being protected by supply-side fundamentals & RBA's softer approach to rate tightening



GFC has provided opportunity for micro-economic reform

- Bank regulatory capital and lending practices
- National broadband network – communications regulation
- Retail sector concentration



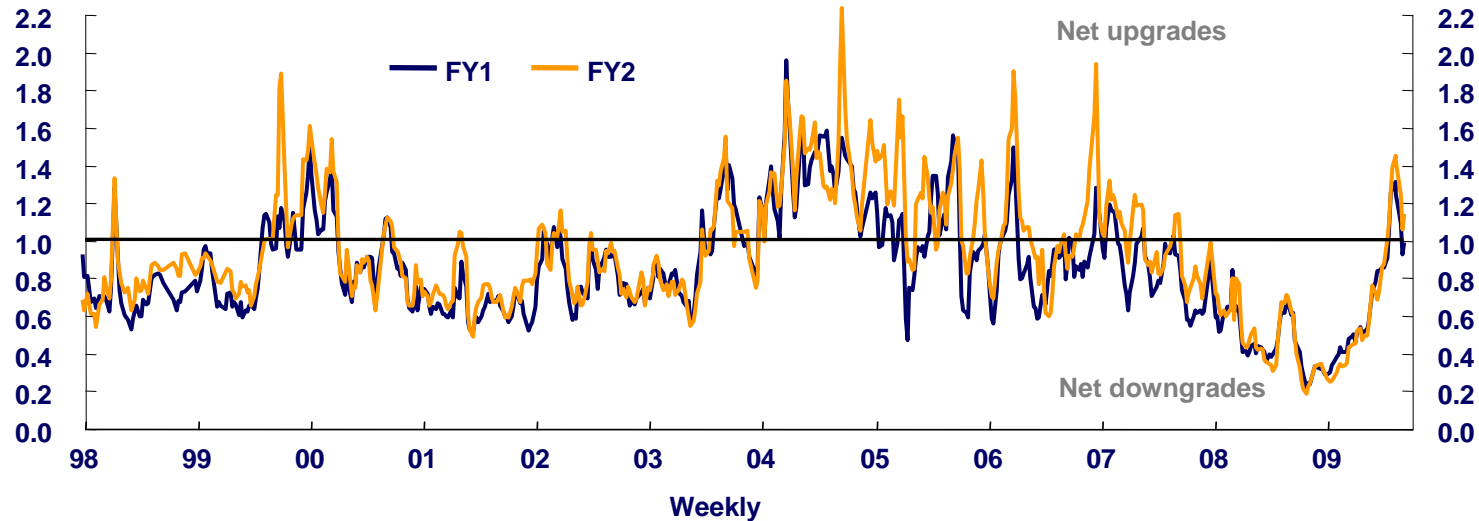
Source: IRESS



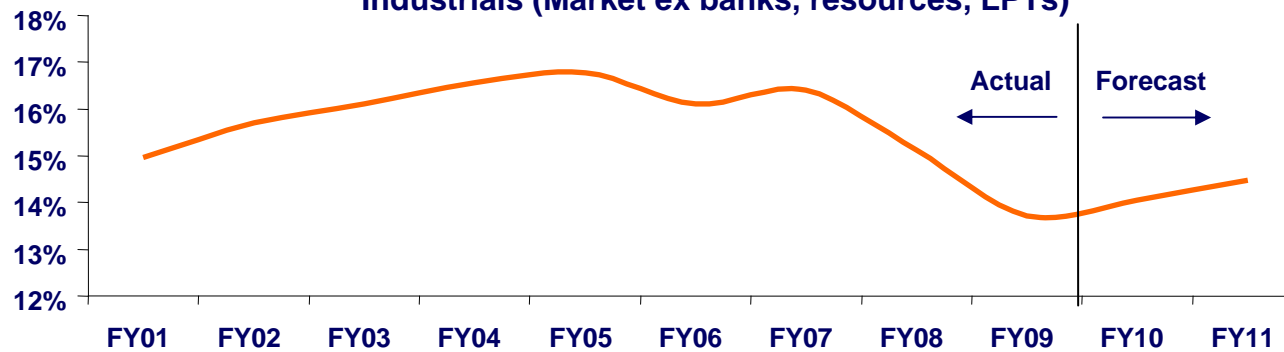
Earnings expectations appear to be focussed on top-line growth – margin growth expectations appear modest

FY1 & FY2 earnings revisions ratio

EARNINGS EXPECTATIONS

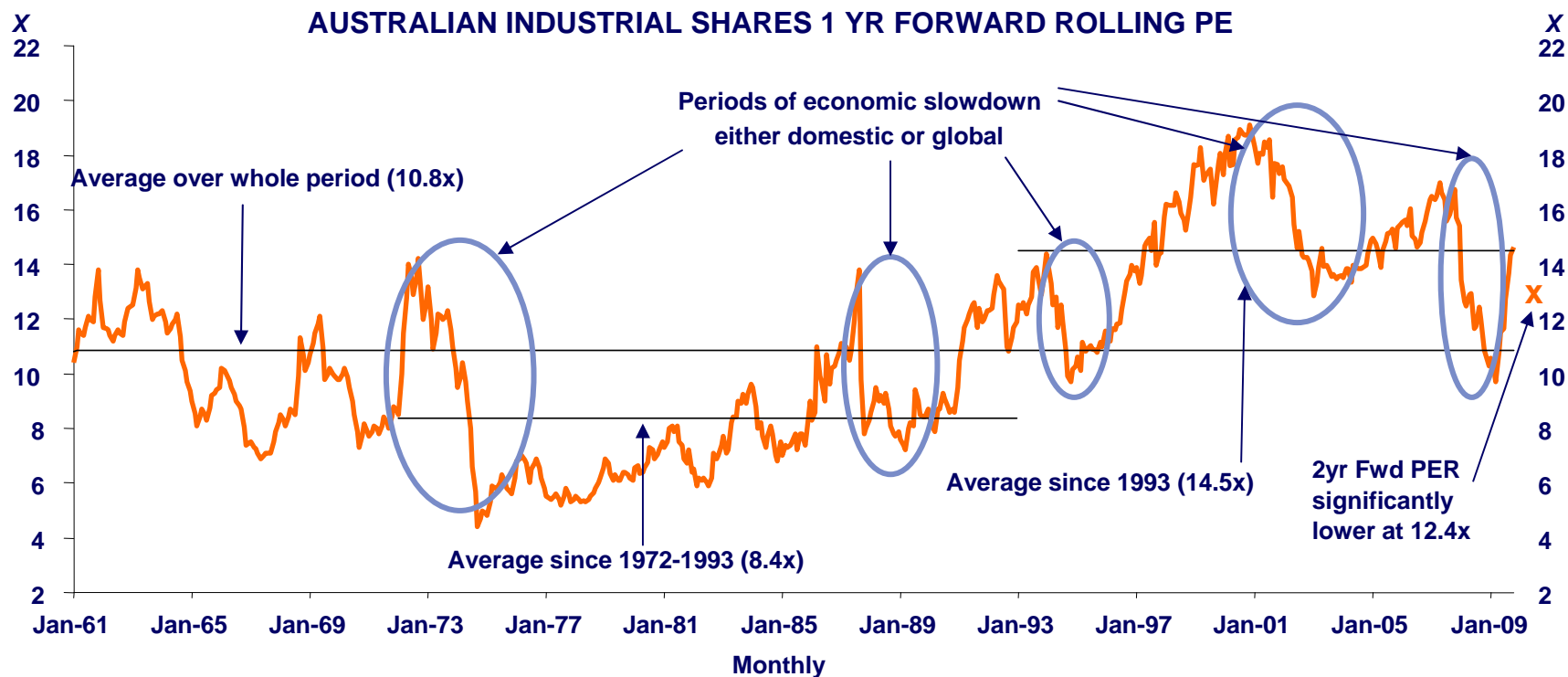


EBITDA MARGINS
Industrials (Market ex banks, resources, LPTs)

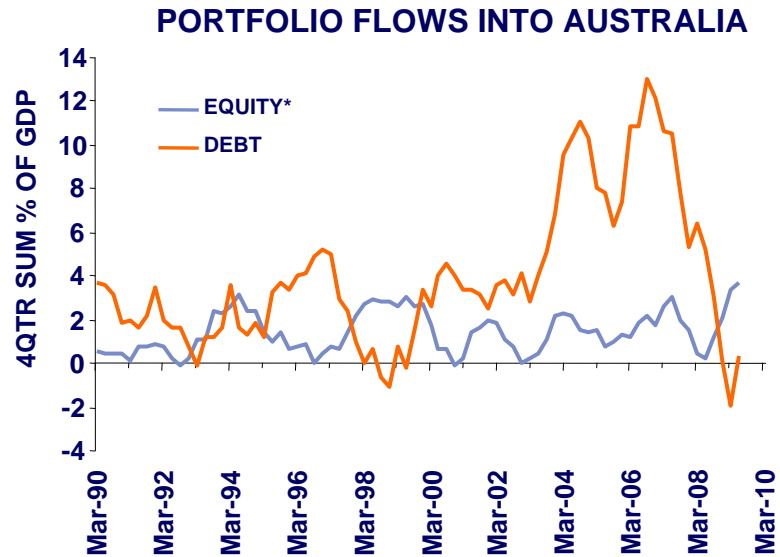


In our view, valuations do not appear to be stretched

- Current Industrial P/E is near 15 year average of 14.5x
- 2-Year forward industrial P/E is ~12.4x

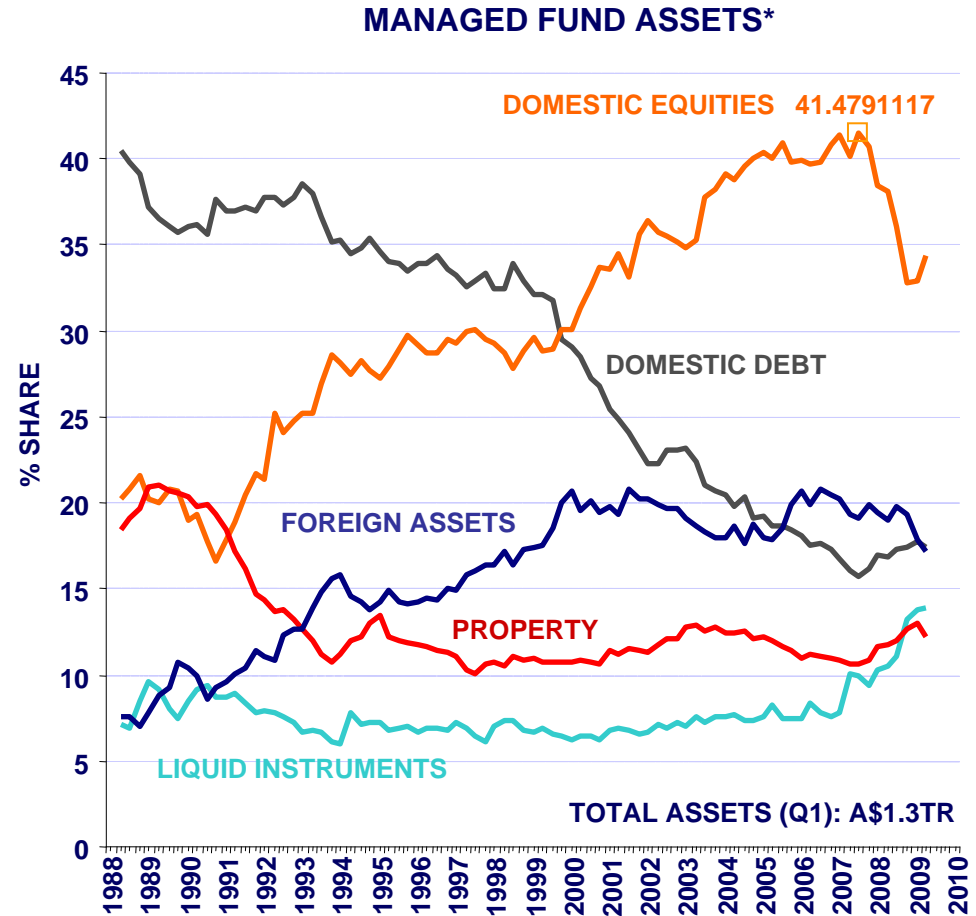


Plenty of support from \$A international fund flows & release of liquid asset balances



* ADJUSTED FOR NCP DOMICILE CHANGE

Source: ABS



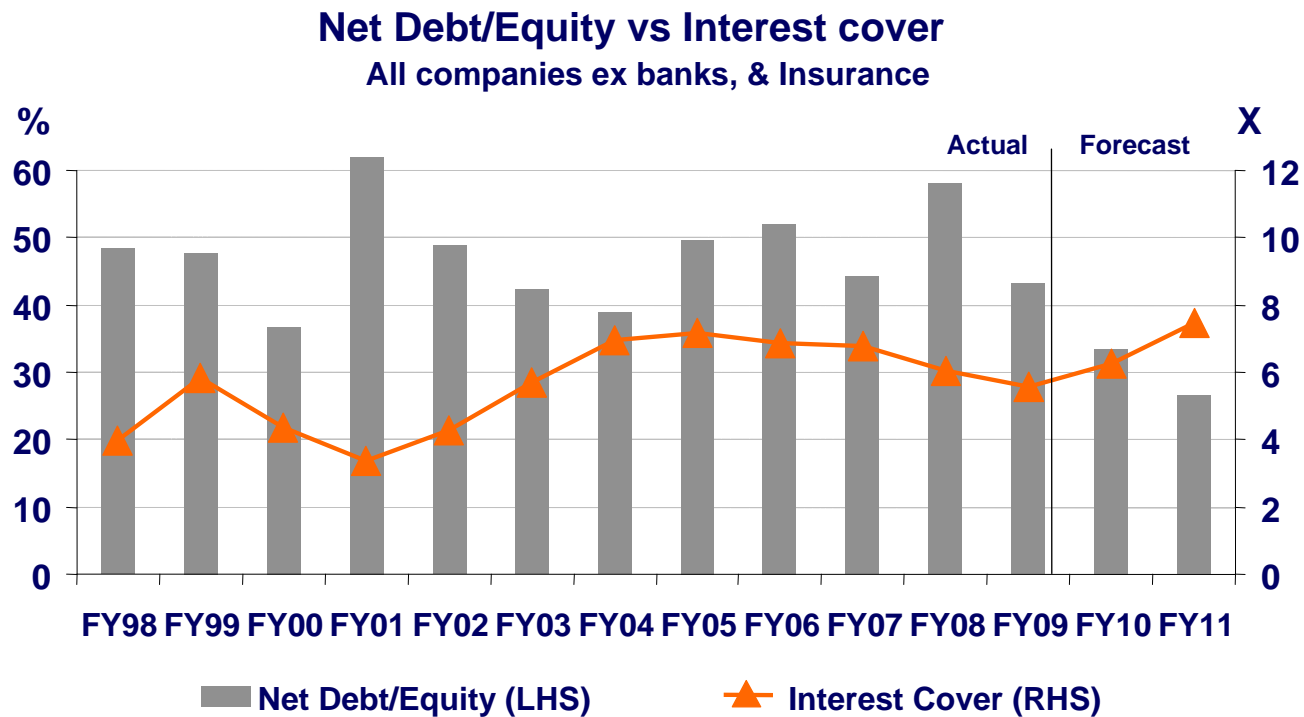
* LIFE, SUPER, CASH MANAGEMENT TRUSTS, UNIT TRUSTS

Source: Morgan Stanley Research



M&A – An emerging theme for 2010?

- Remediated balance sheets and micro economic reform may bolster corporate appetite for M&A



Source: Macquarie Research



Conclusions

- Domestic & global investment environment has improved materially over past 8-10 months. We believe this has been driven by:
 - Stimulus support
 - Corporate & personal deleveraging
 - Credit markets have moved to a more normalised stance
 - The Australian banking system which appears to have weathered the GFC and appears in good shape
- Impact of policies
 - Increasing public sector debt
 - Rising interest rates and \$A
 - We believe the GFC has created a political opportunity to undertake aggressive micro-economic reform

Conclusions

- Reasons for **optimism**. In our view:
 - Markets are rewarding companies pursuing prudent capital management
 - Current valuation metrics appear to be fair and earnings growth estimates factor in only modest margin growth
 - Rising \$A, foreign fund flows and the release of liquid assets are supportive factors for a robust equity market market
 - Remediated balance sheets and micro-economic reforms could spur M&A activity in 2010
- Tempered by **realism**. We are cognisant of the risks of:
 - Delays in achieving medium-term earnings expectations which could lead to a “pause for breath” or sector rotation
 - A more jaundiced growth outlook for China which may place pressure on commodity prices and stocks
 - Rising interest rates which could subdue domestic consumer sentiment

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