

How have

investment markets performed?

Robert Swift, Head of Multi Strategies

BT Investment Management, September 2007

Investment commentary

Australian shares

The September quarter proved one of the most volatile in recent years. The market finished up a solid 5.7% closing at new highs, although at its lows in August it had fallen 12% from its July peak. The trigger for the initial sell-off was a break down in global credit markets triggered by the growing losses in sub-prime U.S. mortgages. Equity markets initially fell in response to this, on fears that it would trigger a credit crunch and in turn a meaningful global slowdown. The sharp recovery in equity markets resulted from the clear message by the U.S. Federal Reserve that they would support the economy through aggressive easing. This was demonstrated by the greater than expected cut in U.S. rates in mid September. Reinforcing the rally was evidence that Asian growth remained strong and was likely to be unaffected by a U.S. slowdown. Australia in particular benefited from the flight to the relative security of equities because it was more exposed to the resilient Asian growth story through its resource sector and had a more robust economy supporting earnings.

In amongst the global drivers of the market was a reasonably firm earnings season. Overall earnings growth is decelerating as the rise of resource profits slow. However growth rates remain firm for the 2007 fiscal year at 15% with the outlook for 2008 expected to be around the 10% level.

International shares

As the third quarter of 2007 drew to a close, financial markets began to show signs of stability after weeks of volatile trading and jitters stemming from the global credit crisis that hit markets in August. The MSCI World (ex Australia) Index fell 0.4% in local currency terms, but the strength of the \$A magnified this weakness seeing the \$A denominated index end 2% lower.

In response to the liquidity crunch, central banks around the world injected billions of dollars to keep financial systems liquid and help ease investor worries. In addition, the U.S. Federal Reserve Board lowered

its federal funds and discount rates, and central banks, including the European Central Bank and the Bank of England opted to keep interest rates unchanged. U.S. stocks were some of those hardest hit by the global selling over the past quarter, especially as companies with exposure to the sub-prime housing sector began to report losses. The valuation dispersion among sectors, industries, and companies continued to be quite narrow during the quarter.

Listed property trusts

The S&P/ASX 300 LPT Accumulation Index rallied strongly during the September quarter (up 5.2%). It was another busy quarter with the LPT sector for corporate activity: Goldman International bought a 9% blocking stake in ING Industrial. Centro successfully merged their listed trusts Centro Retail Group and Centro Shopping America Fund to create a new fund of \$10bn in assets and \$4bn in market cap. Additionally, Westfield announced the sale of a stake in their Doncaster Shopping Centre in Melbourne. This sale sets a new high in valuations of regional retail assets in Australia. In the office sector, the market is awaiting the expected sell down of the Investa and QIC office portfolios which could set new benchmarks for office asset valuations in the Australian market.

Fixed interest securities

Australian bond yields moved marginally lower in the September quarter mirroring global credit developments. The 3-year bond maturity fell by 1 basis point to 6.44% and the 10-year fell by 9 basis points to close at 6.16%. The Reserve Bank of Australia hiked rates by 25 basis points to 6.50% on August 8th. The RBA revised the growth outlook to 4.5%, highlighting a pick-up in the pace of growth in demand, strong global outlook, high commodity prices and a tight labour market. September quarter data releases revealed a labour market tight as a drum with a 4.3% historic multi-decade low in the unemployment rate. Business conditions and consumer confidence remain at elevated levels and the various measures of core inflation surged by 0.9% for the June quarter, well above consensus estimates.

Investment market returns

How investment markets have performed annually over the past 5 years (to 30 September)

| Year to March | Shares | | | Fixed interest | | |
|---------------|--------------|----------------------------|--------------------------|----------------|--------------------------|--------|
| | Australian % | International (Unhedged) % | Listed property trusts % | Australian % | International (Hedged) % | Cash % |
| 2003 | 11.78 | 0.51 | 6.23 | 5.51 | 6.79 | 4.89 |
| 2004 | 20.67 | 9.21 | 29.00 | 5.23 | 7.20 | 5.49 |
| 2005 | 31.73 | 12.37 | 16.51 | 5.75 | 9.09 | 5.68 |
| 2006 | 16.01 | 16.91 | 25.61 | 4.78 | 4.21 | 5.87 |
| 2007 | 32.70 | 1.37 | 20.06 | 3.47 | 5.05 | 6.54 |

How to find more information?

- Visit the web www.firststatesuper.com.au
- Email your enquiry to enquiries@firststatesuper.com.au
- Ring Customer Service on **1300 650 873** for the cost of a local call (unless calling from a mobile or pay phone) Monday to Friday 8.30am – 5.30pm (AEST).

This communication contains general information only and does not take into account your specific objectives, financial situation or needs. It is therefore important, before deciding whether to become a member of First State Super or to continue your membership that you consider the First State Super Product Disclosure Statement (PDS) having regard to your own situation. The PDS is available by visiting the website or by calling us. The information contained in this document is current as at October 2007. Prepared by FSS Trustee Corporation ACN 118 202 672, AFSL 293340, RSE L0002127, the trustee of First State Superannuation Scheme RSE R1005134 and BT Funds Management No. 2 Limited ABN 22 000 727 659, AFSL 233720. Past performance is not a reliable indicator of future performance and investment returns are volatile and future performance is not guaranteed.