

How have investment markets performed?

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Investment commentary

Australian shares

The Australian equity market fell 2.7% in the December quarter after the market hitting an all time high in November. The downturn was partly due to a technical correction in the US market and the Reserve Bank of Australia (RBA) raising rates by 0.25%. The effects of the credit crisis really hit home in December when Centro Property Group said they were having difficulty in refinancing debts, sending property stocks and interest rate sensitive sectors such as financials, lower.

Profit forecasts were downgraded in the quarter as a result of the strong Australian Dollar which hit a 23 year high in October. Tighter credit market conditions saw a reduction in merger and acquisition activity as funding costs increased. The resources sector remained active, with BHP Billiton's approach to Rio Tinto the most notable event in the period. Foreign capital flows continue to be a key driver in the market. The best performing sectors over the quarter were information technology, telecommunications and consumer staples. The Federal election took place in November, with little change in economic policies expected under a Labour Government.

International shares

In Australian dollar terms, the MSCI World (Ex-Australia) Accumulation Index fell by 1.60% over the course of the quarter. The US markets began the period optimistically as the Federal Reserve cut rates in October, in line with expectations. However, investor fears were reignited in November as the severity of the credit crisis became and its toll on banks' balance sheets became more apparent. Credit markets locked up once again and volatility returned to financial markets. Fears of a credit squeeze and economic downturn in the US fuelled a sell-off in global stock markets.

Overall expectations have risen; global monetary policies will remain on hold or loosen until the credit crunch passes. In December, a disappointing US third quarter reporting season combined with a smaller than hoped for interest rate cut saw markets decline.

Investment market returns

How investment markets have performed annually over the past 5 years (to 31 December)

| Year | Shares | | | Fixed interest | | |
|------|--------------|----------------------------|--------------------------|----------------|--------------------------|--------|
| | Australian % | International (Unhedged) % | Listed property trusts % | Australian % | International (Hedged) % | Cash % |
| 2003 | 14.96 | -0.76 | 8.80 | 3.05 | 5.57 | 4.90 |
| 2004 | 27.92 | 9.94 | 32.01 | 6.96 | 8.98 | 5.62 |
| 2005 | 22.45 | 16.84 | 12.50 | 5.80 | 7.55 | 5.74 |
| 2006 | 24.51 | 11.49 | 34.03 | 3.14 | 3.92 | 6.02 |
| 2007 | 16.22 | -2.60 | -8.41 | 3.46 | 7.03 | 6.73 |

Listed property trusts

The Listed Property Trust (LPT) sector slumped over the December quarter, posting a total return of -13.1% (S&P/ASX200 Property). The property sector significantly underperformed the broader equity market, which returned -2.7% over the same period. The property sector has delivered a total return of -8.4% for the 12 months December 2007.

The slump in the LPT sector is attributable to concerns about the US recession, falling asset values in the UK and US property markets and a banking crisis around the Centro group of companies. It was a "perfect storm" for the sector. The LPT sub-sectors were all sharply lower over the period. Diversified was strongest at -7.3% for quarter due to solid performances by Stockland and DB Reef Trust. The Office sector (-7.3%) emerged relatively unscathed, with most investors taking comfort in the long lease terms in the Office sector. Retail (-15.1%) was battered although most of the weakness is attributable to the banking crisis surrounding the over-leveraged Centro group: Centro Property Group (-88%) and Centro Retail (-42%). Concerns about Centro also spilled over into the Industrial sector, with the Goodman Group down (-28%) over the quarter.

Fixed interest securities

Australian bond yields moved substantially higher in the December quarter as the economy remained robust despite the worsening global credit conditions. The 3-year bond maturity rose to 6.88% and the 10-year rose to close at 6.33%.

In early November, the RBA hiked the cash rate to 6.75% to contain inflationary pressures. The RBA at its December meeting noted that greater weight was given to the increased global uncertainty and worsening credit conditions as factors that will likely retard world growth back to trend levels (the original view was for an above trend pace). The RBA raised the inflation forecast to above 3% and noted that "...growth in aggregate demand will, nonetheless, need to moderate if inflation is to be kept to 2-3% in the medium term ..."

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