Investment market update March 2010 *(Prepared by FSS Trustee Corporation)*

Uneven global recovery continues…

Broadly speaking, the global economy continues to improve, although the improvement has been quite uneven. In the advanced economies, the recovery to date has been relatively weak, while in Asia – particularly China – the bounce back has been much stronger.

Global output grew by around 3% over the final nine months of 2009, international trade is showing signs of recovery and confidence has improved.

As a result, many commentators are predicting global growth of around 3.5% to 4% during 2010 – a much better outlook than predicted a year ago.

One reason for the improvement is the stimulatory policies of governments and central banks – including very low interest rates – which have had a positive effect on consumer confidence. But the big question is what can we expect as these policies are unwound and we return to "business as usual"?

Looking forward, this "two-speed recovery" is likely to continue for some time yet. In the advanced economies, while growth appears to be improving, both consumption and investment are still weak, with individuals and businesses remaining cautious.

The picture in Asia is very different. Unemployment is falling and inflation is starting to increase, in contrast to the advanced economies. The recovery has been strongest in China, with the economy growing by almost 9% last year. This strong growth has also provided a boost to many other economies in Asia and beyond.

In Australia…

Stronger growth in Asia is good news for the Australian economy. Around 70% of our exports now go to Asia and the region's strong growth has supported higher **commodity prices**.

[A quick note on why commodity prices are so important to our economy. Australia is one of the world's leading exporters of coal, bauxite, iron ore, lead, zinc, silver, uranium, industrial diamonds and mineral sands. Australia is the world's 6th largest black coal producer and is one of the largest exporters of coking and steaming coal. Iron ore reserves, mainly in the Pilbara, are the largest in the world and should help Australia maintain its position as the 2nd largest exporter of iron ore, behind Brazil. Our huge bauxite reserves are likely to keep Australia as the world's No. 1 producer and exporter of bauxite for the immediate future. High levels of exploration in the gold sector could promote Australia from its current position as the world's 3rd largest producer of gold behind South Africa and the United States.]

Australia's comparatively strong economic performance during the global financial crisis has produced better-than-expected **employment numbers**. It appears the unemployment rate has peaked below 6% and is now improving. Job security is stronger and this has supported consumer confidence, which in Australia is currently comfortably above the [national] long-run average.

On the **property front**, rising interest rates and the phasing out of the more generous first homeowners grant could slow down price movements but the market remains strong nonetheless. The simple facts that housing demand still outstrips supply and the population is growing strongly will tend to support house prices.

So where does this leave **interest rates**? According to Reserve Bank Governor Glenn Stevens, Australia has emerged from the global financial crisis "better than most", a sign that higher interest rates could still be on the RBA's agenda. Recent positive news including stronger consumer confidence, surging house prices, and falling unemployment supports this view. Many commentators are predicting a series of rate rises in coming months that could push cash rates to a more "normal" level of 5% by the end of 2010.

But overall, the Australian economy finds itself in a much better position than many other advanced economies. We have come through the global downturn better than expected and our employment levels continue to improve. And we are benefiting from the higher commodity prices flowing from growth in Asia.

For investors, our share market looks set to have a reasonable year, but there will be ups and downs. What else would you expect? The resources sector is expected to once again be a driving force, as it was in 2009. Risks, of course, remain, both in the advanced economies and in Asia. But the short-term outlook for Australia is positive.

Implications for First State Super's investment approach

While economic conditions have improved, financial markets are still grappling with the legacy of the last few years – namely, high government debt (as demonstrated by the difficulties that face Greece and the UK) and the winding back of fiscal and monetary stimulus.

Bouts of market volatility are likely to continue and consequently, we are taking a cautious approach to our long-term investment strategy. Holding strategic allocations in sound liquid companies is currently a key feature of this strategy.