

Economic and Strategy Review

Monthly Report as at 31 August 2010

Concerns about the strength and duration of the global recovery re-emerged again. This time, the focus was on a run of soft US data which raised the spectre of a double dip US recession.

Economic and Policy Trends

Concerns about the strength and duration of the global recovery re-emerged again. This time, the focus was on a run of soft US data which raised the spectre of a double dip US recession. At the annual Jackson Hole conference, Bernanke noted that the US recovery had lost some momentum as the sources of growth were transitioning from the public to private sector. Their base case was for very modest growth in the US economy over the second half of 2010, lifting over 2011. Importantly for markets, Bernanke said the Federal Reserve was capable of delivering further stimulus, should it be required. Elsewhere, the German economy is recovering better than expected, with business confidence at high levels. In Japan, the BOJ, faced with a rising currency, called an emergency easing late in the month and announced further steps to ease monetary conditions.

In Australia, the RBA left the cash rate unchanged at 4.5% in early August. Subsequent economic data releases were mixed, ending the month on a stronger note. In particular, capital expenditure plans for 2011/12 rose strongly and other data pointed to a solid GDP growth in the June quarter and the likelihood of an upward revision to GDP growth of 0.5% over the March quarter. For the RBA, data flows are consistent with their expectations for a lift in growth and inflation over the medium term. Risks are tilted to further monetary tightening, not easing as suggested by current market pricing.

Equity Market Trends: Equity markets had a poor month, as focus moved on from a strong US reporting season to concern about the durability of the global recovery, following a run of weaker US data. In the US, the S&P 500 fell 4.7% and in Europe, the Euro Stoxx 50 fell 4.4% in local currency terms. Falls were greater in Japan where concerns about currency strength contributed to pushing the Nikkei down 7.5%. The MSCI World ex-Australia Accumulation Index in AUD fell 2.1% over the month, with currency moves boosting sector returns. As the Australian earnings season progressed, the tone improved with big

contributions from the Resources sector. Nevertheless, poor sentiment dominated with the S&P/ASX 300 Accumulation Index which fell 1.08%.

Bond Market Trends: Yields in both offshore and domestic bond markets fell over the month, benefitting from central bank buying; the decreasing likelihood of any near term tightening in monetary conditions; and, flight to quality flows during periods of equity market weakness. Yields on Australian three and ten year government bonds fell to 4.24% and 4.76%, levels not seen since early 2009. These moves underpinned a 1.9% gain in the UBSA Composite Bond Index. The Cash sector, as measured by the UBSA Bank Bill Index, returned 0.41%.

Investment Strategy

Tactical asset allocation detracted value over the month. Our valuation metrics continue to point to strong reward for holding equities and this signal is backed up by prospects for trend to above trend rates of growth over the next two years. We continue to remain tactically overweight Australian shares. The offset to this is a tactical underweight to Australian fixed interest. Current yields back at early 2009 levels are inconsistent with the RBA's growth and inflation forecasts.

**Frank Uhlenbruch,
Investment Strategist**

Tactical Asset Allocation Summary (as at 31 August 2010)

Asset Class	Multi Sector Funds*
Australian Shares	Overweight
Australian Fixed Interest	Underweight
Cash	Neutral
International Shares	Benchmark fixed
Australian Listed Property	Benchmark fixed
Global Property	Benchmark fixed
Global Fixed Interest	Benchmark fixed

* Multi-sector funds may have differing asset class weights, including no exposure to a particular asset class