

Overview

- Continued tightening of monetary policy in December by the Reserve Bank of Australia set a more bullish tone for the Australian equities market. The Australian sharemarket posted a strong monthly return of 3.7%, pushing the ASX 200 Accumulation Index to an annual return of 37%.
- The last year was largely characterised as a beta-led recovery. However, with PE ratios currently trading at a premium to historical averages, investors are questioning whether stocks are over-valued. We believe with earnings growth of more than 20% expected for 2011, current valuations look fair.

December 2009

FOR PROFESSIONAL INVESTORS ONLY

ING INVESTMENT MANAGEMENT

Australian Equities Update



MARKET REVIEW

It is widely held that the Australian sharemarket typically rallies towards the end of the calendar year. The market held true to form in 2009, with the S&P/ASX 200 Accumulation Index posting a return of 3.7% for the month of December and an annual return of 37.0%. This represented a significant premium to the 2.0% average monthly gain that it achieved over the previous 15 corresponding periods.

Australian Equities Index Returns as at 31 December 2009

Indices	1 Mth Return	3 Mth Return	1 Yr Return	3 Yr Return (pa)
S&P/ASX 300	3.7%	3.4%	37.6%	-0.8%
S&P/ASX 200	3.7%	3.4%	37.0%	-0.7%
S&P/ASX 100	3.6%	3.2%	36.2%	-7.5%
S&P/ASX Small Ords	4.3%	4.9%	57.4%	-4.8%

S&P/ASX Accumulation Indices

Source: Datastream

Investors became increasingly bullish following the Reserve Bank of Australia's decision to tighten the official cash rate by 25 basis points on 1 December, from 3.5% to 3.75%, implying a vote of confidence on the health of the Australian economy.

Sentiment with regard to the financial and broader economic outlook was bolstered by significantly better than expected job creation data for November. Compared to market expectations for a gain of 5,000, a total of 30,800 full-time jobs were added over the month. The result produced a slight decline in the unemployment rate, which fell from 5.8% to 5.7%. Importantly, the strengthening in the job market is taking place against a backdrop of moderation in the pace of wage increases. This bodes well for corporate sector profit growth as 2010 unfolds.

All sectors recorded a positive return in the month, with the strongest performers being Information Technology (+7.3%), Industrials (+7.0%) and Healthcare (+4.3%). The IT sector continued to build on its strong run in 2009 and ended the year up 51.8%, second only to the banks (+53.5%). The weakest performers in December were Telecommunications (+1.0%), Consumer Staples (+2.0%), Property (+2.0%) and Banks (+2.3%). On an annual basis, the Telecommunications and the Property sectors were the only sectors to record a negative return.

S&P/ASX200 Sector Performance as at 31 December 2009

Sectors	1 Mth Return %	3 Mth Return %	1 Year Return %
Banks	2.3%	-3.1%	53.5%
Information Technology	7.3%	2.8%	51.8%
Materials	4.3%	13.7%	46.9%
Finance (ex Property)	3.6%	-1.9%	42.2%
Resources	3.6%	9.8%	42.0%
Consumer Discretionary	2.9%	0.4%	37.0%
Energy	3.1%	-2.5%	27.1%
Consumer Staples	2.0%	4.6%	26.1%
Industrials	7.0%	3.6%	19.6%
Health	4.3%	0.1%	1.9%
Utilities	3.3%	3.6%	0.3%
Property	2.0%	-6.4%	-0.2%
Telecoms	1.0%	3.4%	-9.0%

S&P/ASX 200 Accumulation Indices. Source: RBA, Bloomberg, IRESS

Banks underperformed the broader market again this month due to concerns about funding costs in the sector. This was highlighted by Westpac's decision to raise its standard mortgage rate by 45 basis points compared to the RBA rate rise of 25 basis points. This was followed closely by mortgage rate increases by CBA (37 basis points) and ANZ (35 basis points) well above the official rate rise.

On a more positive note the four major banks reached a settlement in their collective dispute with the New Zealand tax authorities over the treatment of structured finance transactions.

Commodities were the winners in 2009

In December the CRB index rose by 2.2% with the largest moves in the gas sector (+14.9%), Corn (+2.9%) and Oil (+2.7%). Gold on the other hand underwent a correction, falling by 7% over the month to finish just under US\$1,100 /oz. Gold started the month positively setting a new record price of US\$1216 /oz before falling dramatically in response to a strong rally in the US dollar on the back of better US economic news. Oil too, was impacted negatively by a strong US currency, however it recovered as investors became more confident about economy recovery in 2010.

Gold



Source: Chicago Board of Trade, London Metals Exchange, FactSet

At the individual stock level the major news highlight was Macarthur Coal's announcement that it had agreed to pay \$1.2 billion to acquire the Hong Kong-based Noble Group's Australian coal assets, which include Gloucester Coal.

All in all, commodities markets had a very strong year in 2009. Global demand for all of the major base metals and bulk commodities started the year at heavily discounted prices. As the effects of the financial crisis took hold, this resulted in significant manufacturing cuts and therefore a running down of inventory levels. However, by March 2009, China's enormous fiscal stimulus program led to an increase in industrial production and this set the platform for a strong recovery in commodities markets, especially base metals.

Consolidation in finance sector continues

In mid December NAB announced that it had made an offer to AXA Asia Pacific (AXA_AP) to acquire AXA_AP's Australian and New Zealand businesses for A\$4.6 billion. NAB's proposal was a counter-offer to AMP's offer for the AXA_AP business in November. This reflects the level of competitiveness in the finance sector, noting that earlier in the year NAB also outbid AMP as well as Macquarie and Tower for the Aviva wealth management business. NAB's proposal is subject to a number of conditions and regulatory and other approvals. Combining AXA Australia and New Zealand with NAB's existing MLC business would establish a market leader in the Australian and New Zealand life insurance and wealth management sectors. This would significantly grow NAB's number of aligned advisers as well as enhance their relationships in the external financial adviser (EFA) market.

ANZ also continued its acquisition program with the announcement of its purchase of Landmark Financial Services' \$2.4 billion loan book from AWB in December.

Capital Raisings hit \$96 billion for the year

During the month the announcement that Woodside Petroleum (WPL) planned to raise \$2.5 billion in fresh capital brought full year company capital raisings on the ASX to \$96 billion. WPL plans to use the funds to support its natural gas development projects.

Major Capital Raisings in 2009

Company	Month	Industry	Deal Value A\$m
Rio Tinto	Jun	Materials	3,553
Santos	May	Energy	3,000
Westfield	Feb	Real Estate	2,900
ANZ Bank	May	Banks	2,850
ANZ Bank	Jul	Bank	2,200
Wesfarmers	Jan	Consumer Staples	2,800
NAB	Jul	Banks	2,750
Asciano	Jun	Industrials	2,000
Stockland	May	Real Estate	1,980
GPT Group	May	Real Estate	1,700
Amcor	Aug	Materials	1,611
Bluescope Steel	May	Materials	1,413
Goodman Group	Aug	Real Estate	1,278
Mirvac Group	Jun	Real Estate	1,100
Suncorp-Metway	Feb	Financials	1,046
Oil Search	Oct	Energy	895
Alumina	Apr	Materials	770
Boart Longyear	Aug	Industrials	756
Transpacific	Jun	Industrials	736
ING Industrial Fund	Pct	Real Estate	700

Source: Dealogic, Bloomberg, JP Morgan

OUTLOOK

Having reached a nadir in early March, the sharemarket has since rallied strongly. Excess liquidity, economic recovery (both locally and globally), healthier corporate balance sheets and a growing demand for commodities are factors which have continued to support the Australian sharemarket. However, against a backdrop of rising interest rates, investors now appear to be pondering whether valuations have reached a premium.

The average 12 month forward P/E ratio of the S&P/ASX 200 index at 31 December was 17.3. This is at a premium to the historical average of 14.2 and is indicative of improving investor sentiment. However, in our opinion, current valuation measures generally appear fair, given that earnings growth of more than 20% is anticipated in 2011A conservative earnings outlook by a number of companies during last year's annual reporting season has underplayed the potential rebound by a number of companies leveraged to the economy recovery. It appears that only a modest expansion in margins is currently factored into earnings expectations, whereas we believe that there may in fact be significant earnings upside.

The next major test of how earnings are faring will come during the next reporting season, commencing in February. In the event that investors perceive that earnings growth will eventuate more slowly than anticipated, it is likely that broadly based upward momentum could be replaced by profit-taking and sector rotation.

Reflecting the current focus on earnings, it is likely that stock-specific factors will be the major near-term drivers of share price performance, as opposed to the more top-down focus that characterised 2009. In this regard, merger and acquisition activity is likely to play an increasing role, reflecting the improvements made in companies' capital positions over recent months. More broadly, micro-economic reform may become more prominent in 2010, as the global financial crisis has spurred the political will to undertake regulatory change.

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