Overview

- Australian investors showed their lack of confidence in local politics and global economic management leading to a third consecutive month of negative returns for Australian shares. There was nevertheless a marked disparity in sectoral performance.
- European sovereign debt issues continued to be the main inhibiting factor for global equity markets during June. This negative sentiment filtered through our local bourse, as did the negative sentiment surrounding the Federal Government's proposed resources tax bill. The month ended with a dramatic overthrow of the Prime Minister, Kevin Rudd, with Julia Gillard selected to lead the Government into the next election.

June 2010 **FOR PROFESSIONAL INVESTORS ONLY**

ING INVESTMENT MANAGEMENT

Australian Equities Update

MARKET REVIEW

Australian Equities Index Returns as at 30 June 2010

Indices	1 Month Return	3 Month Return	12 Month Return
S&P/ASX 300	-2.6%	-11.2%	13.1%
S&P/ASX 200	-2.6%	-11.1%	13.2%
S&P/ASX 100	-2.5%	-11.2%	13.3%
S&P/ASX Small Ords	-3.7%	-11.6%	11.2%

S&P/ASX Accumulation Indices rounded to one decimal point.
Source: Datastream

The Australian sharemarket, as measured by the S&P/ASX 200 Accumulation Index, declined by 2.6% in June, delivering a return of -11.1% for the June quarter. This was the third consecutive month of negative returns in Australian shares.

Concerns over the sovereign debt situation in Europe and scepticism with regard to the sustainability of the economic recovery in the US weighed heavily on market sentiment, particularly during the early part of the period. Although debt auctions by a number of heavily indebted European nations met with a favourable market response, investors remained preoccupied with an International Monetary Fund (IMF) report, which advised European governments to increase the speed of their respective debt reduction programs in order to maintain financial market confidence. Meanwhile in the US, economic sentiment was undermined by the non-farm payrolls report for May falling well short of expectations, and a similarly weak result for new home sales.

As is customary within an uncertain environment, stocks with earnings streams that are not unduly influenced by economic developments tended to perform well. Telstra (+10.5%) was a case in point, as investors responded favourably to the company's signing of a non-binding financial heads of agreement on 20 June with NBN Co to participate in the rollout of the proposed national broadband network. As noted in Telstra's press release "the deal, if completed, would deliver to Telstra a post-tax net present value of approximately $11 billion". Telstra's gain underpinned the strong performance of the telecommunications (+9.5%) sector, with each of the utilities (+2.0%), consumer staples (+0.7%) and health care (+0.5%) sectors also ending the month in positive territory. Conversely, the industrials sector (-7.3%) was heavily sold off, with each of the financials ex REITs (-5.4%), consumer discretionary (-5.3%), energy (-2.6%), materials (-1.1%) and REITs (-0.8%) sectors also losing ground.

ASX200 Sector Performance as at 30 June 2010

Sectors	Monthly Return	12 Month Return
Telecommunications	9.5%	1.9%
Utilities	2.0%	9.1%
Consumer Staples	0.7%	15.9%
Healthcare	0.5%	2.4%
REITs	-0.8%	20.4%
Materials	-1.1%	15.0%
Info Technology	-1.1%	22.8%
Energy	-2.6%	-2.2%
Consumer Discretionary	-5.3%	14.6%
Financials (ex-REITS)	-5.4%	17.2%
Industrials	-7.3%	9.7%

Refers to sector returns from the S&P/ASX 200Accumulation Index
Source: IRESS, Datastream

On reflection, the 2009/10 financial year was a year of two halves. The first half showed plenty of promise following the successful capital raisings of a number of companies to get their debt levels under control, and a domestic economy that managed to avoid a recession. However, since February of this year, economic conditions have worsened in Europe; China has

undertaken efforts to slow its potentially overheating economy; the US has disappointed on a number of leading economic indicators; and the Federal Government's highly controversial resources tax has caused Australia's resources.

Change in PM a promising sign for resources

The ongoing battle between the Federal Government and the mining industry reached new levels in June after the mining industry undertook an aggressive advertising campaign highlighting its concerns (and opposition) to the proposed resources super profits tax (RSPT).

This took an interesting turn, when on the 24th June, the Labor party ousted Kevin Rudd in a leadership coup, with Julia Gillard announced as the new Prime Minister. The market viewed this as a positive step for the resources industry, further comforted by Gillard's comments that she was prepared to discuss and negotiate the terms of the tax with the mining industry.

This has now transpired with the Government announcing changes to the tax on 2 July. The key changes are:

- The Resources Super Profits tax (RSPT) has been replaced by a mineral resources rent tax (MRRT), which only applies to iron ore and coal.
- The MRRT tax will be capped at 30 per cent – down from the intended RSPT rate of 40 per cent.
- The hurdle rate for the tax will now be the 10 year bond rate plus 7 per cent, which in today's terms is around 12 per cent. Under the original proposal, the tax would have kicked in at a hurdle rate equal to the long-term bond rate of about 5 per cent.
- A separate Petroleum Resources Rent Tax (currently applicable to offshore oil and gas projects) will be extended to include onshore oil and gas projects.
- To offset revenue losses from the changes to the resources tax the Resources Exploration Rebate will no longer apply.
- The company tax reduction will be cut from 30% to 29% and not 28% as originally planned.

It is estimated that under the MRRT only 320 companies will be affected by the new tax, compared with the RSPT, which would have impacted around 2500 companies.

Banks under pressure

Banks globally have been weighed down by concerns over proposed regulatory reform which was discussed at the G20 Summit in Canada in mid June.

At the recent G20 Summit meeting there was general agreement that co-ordinated regulation of the financial system was required to create a much stronger financial framework in order to avoid or minimise global disasters like the global financial crisis. The aim is to introduce higher levels of capital and liquidity for banks by the end of 2012. By raising capital levels banks should be able to absorb market shocks much better and avoid relying on taxpayer support. The 2012 timeline should give banks sufficient time to adopt the tighter banking rules. However, the G20 was also open to phase-in arrangements whereby some banks would adopt the new rules at a later date depending on the health of their local economy.

Apart from the G20 agreement the UK government has also outlined reforms for the UK financial system which would give the Bank of England more power and eliminate the Financial Services Authority by bringing the FSA's supervisory infrastructure under the Bank of England. The UK government's view is that central banks are the lenders of last resort and therefore they need to be familiar with every aspect of the institutions that they may have to support. Previously a tripartite system, which gave the Treasury, Bank of England and Financial Services Authority (FSA) control over the financial system, was heavily criticised during the financial crisis. Many believed it was unwieldy because it was unclear as to who would take charge in a crisis.

In the US, President Barack Obama wants to put an end to risk practices by banks as he believes these practices were the underlying cause of the financial crisis. The US Government plans to limit the activities of banks by stopping them from investing in hedge funds, private equity funds or trades that are unrelated to their core activities. He is also trying to limit the consolidation of the financial sector and end the mentality of "Too Big to Fail."

Apart from the regulatory upheaval in the banking sector Australian banks were also feeling the indirect impact of sovereign stress in Europe by paying more for their liquidity needs. This is best explained by Westpac tapping the credit market to shore up its liquidity requirements. On 30 June Westpac raised $800 million for a five-year bond issues at a margin of 135 basis points above the bank bill swap rate. This was at a premium to 5 year credit default swaps.

Retailers impacted by fiscal fade and rate hikes

Key economic indicators such as retail sales slowing (up just 0.2% in May) and Building approvals (down 6.6% in May) considerably lower than market expectations are two factors contributing to lack-lustre spending in the retail market.

Fiscal fade is evident in these numbers. Two stimulus packages last year, firstly the $11 billion in May, and then a further $8.4 billion December led to a spike in retail sales in the following months, but the momentum has not been maintained and sales have fallen away dramatically. On top of that, home owners have been subject to a rapid succession of six interest rate hikes in this cycle, which has clearly dampened consumer spending as well as housing activity.

OUTLOOK

From a domestic economic perspective, the growth phase in Australia appears broadly intact, and hence remains supportive of the domestic sharemarket. However, there are a number of factors that may weigh on momentum in the months ahead.

Consumer spending is facing strengthening headwinds, amid the fading impact of the government's consumer stimulus measures and the rising trend in official interest rates. Amid speculation that rates could possibly go yet higher, early cyclical stocks may come under pressure, while a flattening of the yield curve could further squeeze bank margins that are already under pressure from higher wholesale funding costs. Furthermore, sentiment within the resources sector is likely to remain fragile, pending greater clarity with regard to the taxation arrangements for these companies.

There is also regulatory risk adding to investor concerns. In Australia we have seen significant regulatory reform in the gaming, healthcare, telecommunications and more recently, mining sector.

Further regulation is at play with the G20 agreement regarding tighter bank regulation, should the Labor government win a second term in office, there are concerns that a tax, akin to the resources tax, may be introduced for the Australian banking sector.

More broadly, deteriorating global economic sentiment is casting a lengthening shadow over the outlook for the sharemarket. In Europe, there are persistent concerns that Greece, and perhaps other heavily indebted nations as well, will be unable to meet their debt commitments and may require a re-scheduling arrangement. Meanwhile in the US, questions are being raised as to the sustainability of the country's economic rebound. Lack of momentum in the US housing market, weak consumer confidence and less than impressive unemployment numbers has hurt investor confidence. We recognise but do not entirely share these concerns, as low business inventories and rising levels of labour utilisation underpin the outlook for industrial production. This, in turn, bodes well for domestic companies with US exposure, or whose earnings are denominated in US dollars. Indeed, this remains a key theme of our present portfolio strategy.

We expect to see continued volatility in the second half of 2010 until investor sentiment starts to factor in positive news and there is a belief that it is sustainable. However, investors should note that the Australian sharemarket is now trading at a forward 12 month P/E of around 12.2x compared with a historical average of 13.5x. This represents a P/E that is 12% lower than average, suggesting there is room for upside.

For more information please contact:
ING Investment Management Limited
ABN 23 003 731 959
Level 21, 83 Clarence Street
Sydney NSW 2000 Australia

INVESTMENT MANAGEMENT

This document contains proprietary information of ING Investment Management Limited (INGIM) ABN 23 003 731 959 AFS Licence 233793 and is intended for the use of institutional clients only. This material is not to be construed as investment or financial product advice, and should not be replied upon as a substitute for professional advice. The opinions contained in the document may not be modified or otherwise provided, in whole or in part, to any person or entity without INGIM's prior written permission. The information in this document is provided by INGIM and is based on current information as at the date of publication. INGIM does not guarantee the repayment of capital or investment performance.