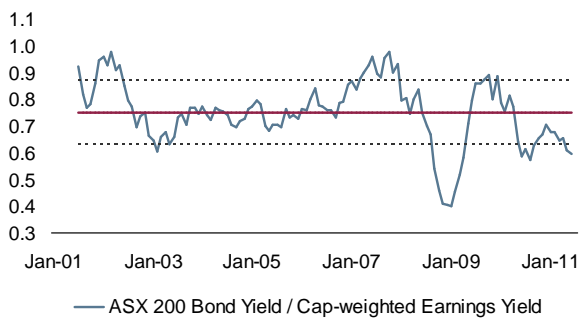


JUNE 2011 - OUTLOOK SUMMARY

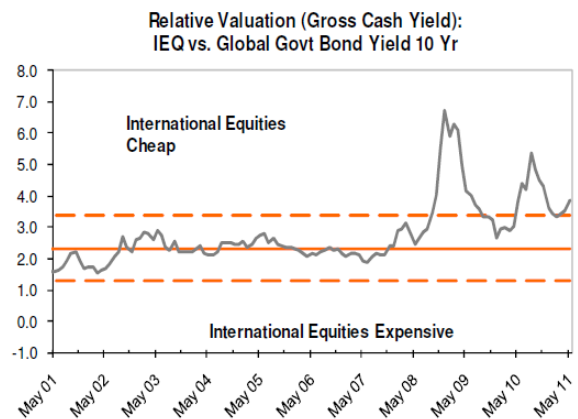
- Recent weak global economic data and equity market performance is expected to be reversed somewhat in the next six months but major structural issues such as European government debt remain a source of volatility.
- The Australian economy has been weaker than expected with both business and confidence declining. This means that cash rate increases are likely to be delayed by the Reserve Bank of Australia (RBA) but considered again as growth accelerates and underlying inflation rises. Assessment of the carbon tax may be a factor for markets in the short-term.
- We do note consumer sentiment remains subdued and the household savings ratio is at a 20-year high. To further dampen the tone locally we note that the second quarter of falling capital residential property prices is likely.
- Continuing our position from recent quarters, we expect the Australian sharemarket to be 'range bound' in the near term. However on a longer term view, we believe that valuation fundamentals are in place for the market to move materially higher at some point in the next 12-18 months. Recent dismal performance in the June quarter has obscured a decent financial year performance by Australian equities (S&P/ASX 200 Accumulation Index +13.42%). The market appears relatively cheap compared to bonds, assisted by resources and banks where earnings expectations are high.

Australia: Bond Yield to Earnings Yield



Source: Credit Suisse

Global Equities Cash Flow Yield relative to Bonds



- In local currency terms, global equities performed strongly over the financial year (MSCI World Ex Australia Accumulation Index +22.28%) but once the rally in the Australian dollar is taken into account, returns were a more modest 2.66%. Valuation compared to bonds (see chart above right) remains relatively attractive but there is some market uncertainty about earnings estimates.
- Based on these assumptions, we are leaving our tactical asset allocation to equities unchanged until there is more certainty in company earnings expectations. However we are increasing our allocation to property by 2% and funding this by reducing our exposure to hedge funds by 2%. Our bullish view on commercial property since the depths of the GFC in late 2008 has been vindicated with opportunistic buying that has generally seen substantial outperformance in returns. We see continued buying opportunities for another 12-18 months before the cycle moves into a more mature phase. Strong employment and forecast GDP, with limited new supply, will all contribute to future short-term tightening of capitalisation rates.

AUSTRALIAN EQUITIES

The S&P/ASX 200 index declined by 4.8% over the June quarter to 4,608, with the accumulation index (which includes dividend income) declining by 4.0%. The S&P/ASX 200 index fell below 4,500 in June, a level it had not fallen to since September 2010 though it

remained well clear of the 4,200 level which it had approached during 2010's mid-year correction. The index remains firmly within the trading range that has characterised the last seven quarters.



During the quarter stock markets were hit by the same concerns which prompted a sell-off in the June 2010 quarter - a faltering US economy and the European sovereign debt crisis. The ASX200 was one of the weaker developed world benchmarks (S&P 500, -0.4%; FTSE 100, +0.6%; Nikkei 225, +0.6%), partly a reflection of concerns over policy tightening in China (Shanghai Composite index -5.7%).

Domestic macroeconomic drivers were unsupportive, with the RBA continuing to flag inflation risk over the medium term while data suggested a softening in activity. Corporate news also offered little support, with a number of companies downgrading guidance. Downgrades from retail and media companies pointed to a subdued domestic economy. Leighton Holdings (LEI) warned of lower profits due to problematic projects and Woodside Petroleum (WPL) flagged a significant cost over-run at its Pluto-1 investment. A proposed merger of ASX Ltd and Singapore Exchange was blocked by the government due to the risk of loss of control of the country's clearing and settlement systems. Tabcorp (TAH) and Foster's (FGL) completed the demerger of their casino and wine operations respectively, which began trading as Echo Entertainment Group (EGP) and Treasury Wine Estates (TWE). Post FGL's demerger, the board rejected a bid from SAB Miller valued at \$9.5b or \$4.90 per share, an 8.2% premium to the previous close price.

At a sector level, the mining-heavy Materials sector underperformed (-5.5%) and the sharp decline in the Energy index (-11.1%) made this a bad quarter for Resources (-7.0%) which saw consecutive quarters of underperformance for the first time since 2006. Sharp underperformance in May, as investors became nervous over the strength of the domestic economy, also saw the Banks sector lag (-4.4%) and defensive sectors outperform, notably Utilities (+3.2%), Telcos (+3.1%) and Consumer Staples (+2.1%).

In summary, market sentiment turned decidedly cautious over the last quarter. While earnings growth may prove softer than first anticipated, it remains positive, and market pricing has more than factored this in. Macroeconomic issues dictate sentiment (eg Greek debt, US economic data, Australian carbon pricing regime) and could do so for some months ahead. We expect a range bound Australian sharemarket to continue in the near term. However, by late calendar 2011/early 2012, valuation support is in place for the S&P/ASX200 to move higher.

GLOBAL EQUITIES PERFORMANCE AND ECONOMIC NEWS

The RBA maintained its cash rate target of 4.75% for the second consecutive quarter. Though the RBA's statements continued to stress the demand stimulus of the commodity boom, and the 2Q11 Statement of Monetary Policy forecast that inflation would exceed the 2-3% target range by the end of 2013 on the policy settings implied by market prices. However the tone of economic data softened over the quarter. Employment numbers were disappointing with the gain of 31k for the year to May comparing poorly with 158k for the five months to December. 1Q11 GDP fell 1.2% qoq, the largest decline in 20 years, but this reflected the effect of flooding on exports as domestic final demand increased 1.3%. The Westpac-Melbourne Institute consumer sentiment index fell from 104 in March to 101 in June, and the NAB business confidence index dropped from an 11-month high of +14 in February to +6 in May. The RBA's core measure of CPI inflation, the trimmed mean, printed at 2.3% yoy in 1Q11 (versus expectations of 2.1%). The FY12 Budget statement contained few policy surprises but reiterated the government's aim of a return to surplus by 2012-13.

The tone of US releases also softened over the quarter with job gains slowing and business and consumer sentiment falling. The Federal Open Market Committee (FOMC) retained its funds target range at 0%-0.25% and continued its QE2 buying of Treasury bonds. 1Q11 GDP printed at just 1.9% qoq annualised (4Q10, 3.1%) and sentiment surveys retreated: the ISM manufacturing index dropped from 61.4 in February to 53.5 in May, the non-manufacturing measure from 59.7 to 54.6 and the Conference Board consumer confidence index from 72.0 to 58.5. Monthly gains in non-farm payrolls averaged +160k from February to May (+152k in the previous three months) but May's +54k was disappointing and the unemployment rate was the highest since December at 9.1%. CPI accelerated over the quarter with higher commodity prices pushing the headline rate from February's 2.2% to 3.6% in May and core (ex-food and energy) inflation picking up from 1.1% to 1.5%. Standard & Poor's placed its AAA rating of US federal debt on negative outlook on concerns over the budget deficit; Moody's and Fitch threatened the same. Congress agreed on budget measures to avert a government shutdown but continue to wrangle over the raising of the debt ceiling which looks likely to be reached in August.

The S&P 500 declined 0.4% for the quarter. After a bright start in April, the S&P 500 index fell for six consecutive weeks and only narrowly avoided posting seven falls for the first time since 2001. Corporate news was mostly supportive with a strong 2Q earnings season and plentiful M&A activity. However the macroeconomic picture dominated: weaker releases undermined confidence in the economy's momentum and the Eurozone fiscal crisis added to caution. The VIX index of implied volatility reflected the nervousness of investors, spiking from less than 15 at end-April to a high of 23 mid-June, but finished at 16.5 for the quarter.

The Eurozone debt crisis intensified with political instability in Greece and tensions within the region's leadership adding to uncertainty. Portugal applied for 'bail-out' funding from the European Financial Stability Facility in April; nonetheless the benchmark ten-year yield rose from 8.3% at the end of March to 10.6% at the end of June. Ten-year Greek bond yields rose from 12.7% to 16.0%. Protests cast doubt over the Greek government's ability to drive through austerity measures but these were eventually passed through Parliament. French and German institutions agreed to let Greece repay its debt more slowly. Standard & Poor's downgraded Greek sovereign debt from B to CCC, one step away from a default rating. In April the European Central Bank raised its key rate by 25bps to 1.25%.

The People's Bank of China raised its key lending rates in April, the fourth hike since it began tightening in November, taking the one-year benchmark lending rate to 6.31%. It also raised banks' reserve requirements three times in 50bp increments to 21.5% for major banks. The effects of tightening were apparent in bank lending growth which by May had slowed to 17.1% yoy from 17.7% in February. However consumer price inflation accelerated from 4.9% to 5.5%, and post quarter to 6.4%, the highest for three years.

Despite the recent weakness of leading economic indicators for the US and China, the outlook for global economic growth still remains solid. Global growth is expected to run above

4% this year and at around 4.5% next year, driven by emerging economies as advanced economies (US, Europe and Japan) continue to face a number of structural challenges.

For Australia, economists now expect growth around 1.5% - 2% this calendar year which implies strong quarterly growth rates in the September and December quarters. The outlook for 2012 is c.4% if the global economy holds up, resource driven business investment eventuates and households benefit from wage increases. The strength of the economic recovery also depends on the impact of any interest rate increases and the carbon tax which at the time of writing, has just been formally announced by the Commonwealth government.

BONDS & CURRENCIES

Australian long bonds rallied solidly in the June quarter with the help of some mixed economic data. Despite RBA warnings that inflation risk remains, short rate futures removed most of the tightening that they had anticipated at the start of the quarter - the December 2011 bank bill future was pricing a rate of 4.87% at the end of June, down from 5.05% at end-March. However US Treasury yields fell even further (-31bp), suggesting that global growth concerns and risk aversion might have had a greater impact than local influences. US bonds showed little sign of the impending end of the Federal Reserve's QE2 bond buying programme.

The June quarter began with a continuation of the US dollar weakness of 1Q. However in May and June the US dollar found support from heightened risk aversion and the worsening tensions over European sovereign debt. The Australian dollar broadly followed this pattern with an end of April post-float high of USD1.097 followed by a correction, though most of the damage was done in early May. The Australian dollar held onto gains for the quarter against the USD (+3.5%), euro (+1.3%) and sterling (+3.4%) despite growing doubt over economic strength. If these levels are sustained, Australian exporters and companies with foreign earnings should come under further earnings pressure.

COMMODITIES

Crude oil prices had a volatile June quarter (-11.2%) which began with a continuation of the strength seen in the March quarter in response to unrest in the Middle East North Africa region. Growing evidence of a global slowdown then contributed to a sharp correction, and in June the International Energy Agency's (IEA) decision to release 60m barrels of oil from its reserves sent prices lower again. Another symptom of market volatility was the record high in the WTI-Brent spread of \$22.79/bbl in June.

Spot gold (+4.9%) hit its best levels for the quarter in early May with the help of US dollar weakness, but also set a new record in euro terms later that month. However bullion failed to make more headway in either currency despite growing risk aversion and the sovereign debt crisis in Europe. Base metals were mostly weaker as a soft global growth outlook and China's monetary tightening weighed on sentiment. Spot iron ore prices were down slightly (-3.2%) as supply disruptions (including Australian flooding) offset slowing demand (Apr/May Chinese imports -1% on pcp).

Financial Market Metrics

Interest Rates	Yield 30-Jun-11	Yield 31-Mar-11	Change (pts)
Australian 90 Day Bill	4.99	4.92	+0.07
Australian 10 Year Bond	5.16	5.44	-0.28
US 10 Year Bond	3.18	3.47	-0.29
US Federal Reserve Funds Rate	0.25	0.25	-

Commodity	Price 30-Jun-11	Price 31-Mar-11	Change (%)
Gold (USD / oz)	1,510	1,439	+4.9%
Oil (USD / bbl)	94.77	106.72	-11.2%
Copper (USD / ton)	9,301	9,400	-1.0%
Nickel (USD / ton)	23,125	26,080	-11.3%
Aluminium (USD / ton)	2,509	2,600	-3.5%

Currency	Price 30-Jun-11	Price 31-Mar-11	Change (%)
AUD/USD	1.0706	1.0342	+3.5%
AUD/EUR	0.7384	0.7287	+1.3%
AUD/GBP	0.6669	0.6452	+3.4%
AUD/JPY	86.4617	85.7104	+0.9%
AUD/NZD	1.2963	1.3558	-4.4%

Sharemarket Indices	Price 30-Jun-11	Price 31-Mar-11	Change (%)
S&P / ASX200	4,608	4,838	-4.8%
S&P 500	1,321	1,326	-0.4%
FTSE 100	5,946	5,909	+0.6%
DAX	7,376	7,041	+4.8%
Nikkei 225	9,816	9,755	+0.6%
Hang Seng	22,398	23,528	-4.8%