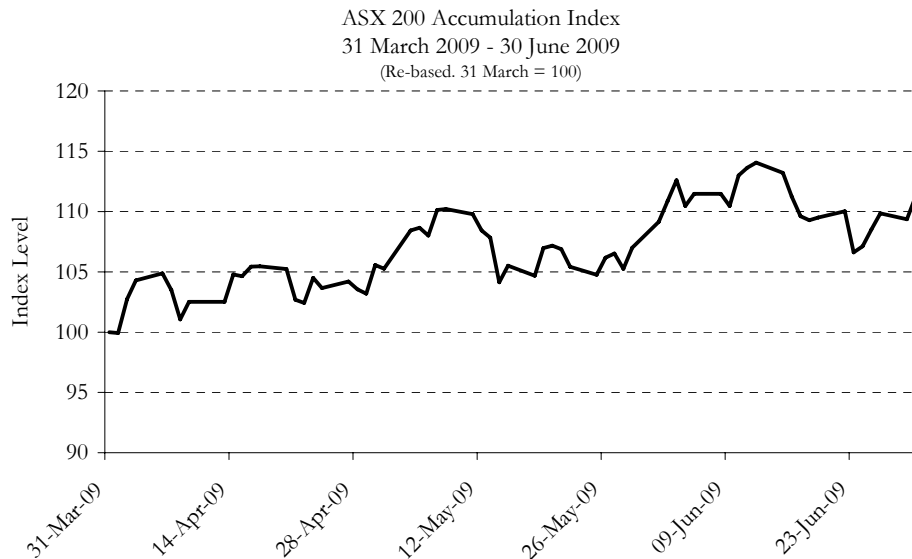


JUNE 2009 QUARTER ECONOMIC SUMMARY

Share Price Surge

Share prices around the world surged from 10th March. The June quarter was the best quarter's rise in the Australian share market in nine years. The ASX 200 Index (including dividends) rose 11.2%.



For the Australian share market it marked the end of:

- The worst financial year in 28 years (the All Ords was down 27.1%),
- The third worst financial year in at least 73 years, and
- Capped off the worst two financial years running ever.

After six quarters of strongly negative returns from share markets, the share market rally delivered enormous relief.

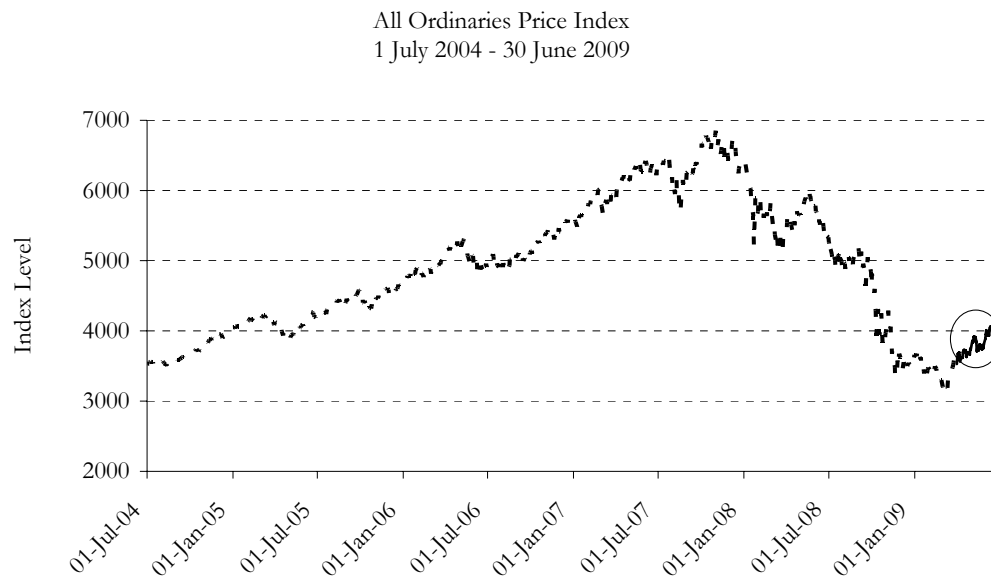
The rally itself will be the single largest support for much higher economic growth two to eight quarters down the track. The global share price rally will be particularly important for subsequent economic growth within the key US economy. Improved share prices improve companies' ability to access fresh capital to retire/re-finance debt, meet expenses and fund new investments at a competitive cost.

What Drove The Turnaround?

The turnaround was driven initially by speculators recognising US share prices were at exceptionally low levels relative to long term fundamentals. The initial fillip quickly helped lift business confidence. That improved confidence was then given a more solid foundation by a high level of capital raisings, which helped many companies repair their balance sheets.

The very beginning of the rebound coincided with the release of a report from US Treasury which set out a plan under which private investment partnerships would buy distressed / illiquid loans from US banks. But we discount much causality.

By early March 2009, many companies were desperate to raise more money from share holders yet could only responsibly do this if share prices were a little higher. The share price rally this quarter tended to offer most relief to those companies who were indebted enough to be worried, yet strong enough to have at least a good chance of surviving a long economic slowdown with the assistance of a little fresh capital. Thus the jumps in share prices in the first weeks provided a platform for capital-raising by already well-regarded companies.



By the final week of June, Australian companies had raised (or begun projects to raise) \$35 billion dollars in fresh capital. This included raisings of over \$2 billion each from Wesfarmers, National Australia Bank, Santos, Westfield, Westpac, ANZ Bank, Asciano and CBA. Rio group launched a massive US\$15.2b rights issue targeting both Australian and UK share holders. As a proportion of their market capitalisation, this was broadly in line with the exceptionally high level of capital raisings immediately following the 1990 recession. By the end of June, the new shares issued by Wesfarmers, Fairfax Media, Alumina and Macquarie Group had returned in the order of 50% to shareholders who took up their entitlement.

Observing that interest rates were already at low levels by historical standards, on 6 April, the RBA Board “judged that there was scope for a further modest adjustment to the cash rate” and cut it to 3%. By this time, share prices had been rallying strongly for a month.

A week later, in Australia, the NAB survey of business confidence suggested confidence was already improving.

On 4 May, data from the US Institute for Supply Management for April showed that the rate of slowdown within the US services sector was diminishing (service industries are generally less cyclical than manufacturing industries).

By 19 May, UK economists suggested the key UK interest rate for trading banks, the

London InterBank Offer Rate, or LIBOR, had finally returned to normal levels. This signalled that UK banks were prepared to lend to each other and facilitate each others' demands for liquidity as they had prior to the breaking of the crisis. At last there were a few signs that normality was returning to the financial sectors within developed economies.

Forbes and Reuters reported survey data for the second quarter on 21 May, suggesting that the rate of decline in the Eurozone manufacturing and service sectors had slowed significantly.

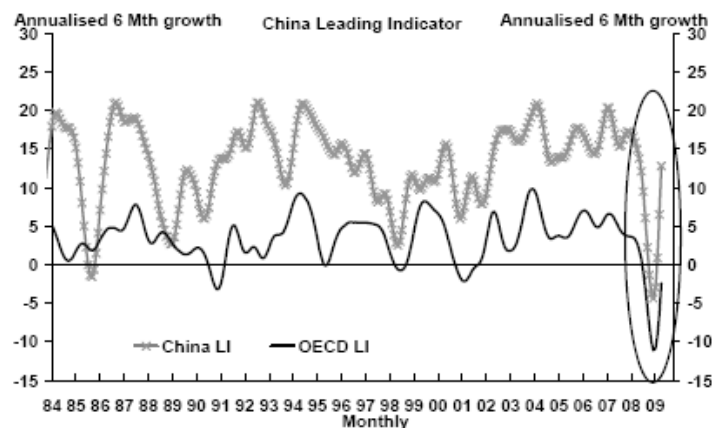
Australian GDP was up 0.4% in the March quarter, according to data released 3 June, surprising economists. Retail sales and building approvals had been stronger than expected. However business investment had been very weak.

On 9 June, JP Morgan Chase, Morgan Stanley, Goldman Sachs and seven other large financial institutions were granted permission to repay the US government US\$68 billion they had received through the Troubles Asset Relief Program (TARP). Repayment of the rescue funds will allow the banks to get out from their federal restrictions placed on them as part of the TARP.

On 18 June, the US Conference Board announced its index of leading economic indicators posted its biggest gain in five years in May. The index forecasts the level of US economic activity over the following three to six months. "The recession is losing steam," said Ken Goldstein, an economist with the Conference Board. "If these trends continue, expect a slow recovery beginning before the end of the year," he said.

Over time, it was also becoming increasingly apparent that the massive Chinese government fiscal stimulus was sharply lifting Chinese GDP. The Chinese government spent a discretionary 0.4% and 2.0% of China's GDP in 2008 and 2009, respectively, and plans to spend another discretionary 2% of GDP on stimulus in 2010. Much of this spending has been concentrated in transportation, power grids and post-earth quake reconstruction. This is estimated to boost Chinese GDP by up to 2.1% in 2009 and 1.4% in 2010. This impact is now evident in leading indicators from China and the OECD.

Chinese fiscal stimulus has led to a sharp economic recovery which is driving demand for commodities



Qualifications on the Rebound and Economies

In early April, it was reported that some 10% of Americans – 32.2 million people – had been receiving emergency food stamps by January. This is no ordinary recession for the US, for one. The release of the minutes of the US Federal Reserve on 8 April revealed it had been so worried about “downside risks” materialising and leading to a rising cycle of US unemployment that it had poured US\$1.2 trillion into the US economy.

On 20 April, with seven of Australia’s 10 most important trading partners in recession, Prime Minister Kevin Rudd acknowledged it was “inevitable that Australia [would be] dragged into recession”.

On 1 May (US time), the icon of the US automobile industry, General Motors, declared itself insolvent. Bond analysts had placed at least a 50% probability on this outcome for several years prior, as the company had vast unconsolidated liabilities within its employee pension and health care plans. As a consequence of the insolvency, the business will be significantly restructured and over 20,000 direct employees are expected to lose their jobs. Indirectly, the change of direction will ultimately trigger job losses many times this.

Chinese Premier Wang Qishan wrote in a commentary for The Financial Times on 7 May, “The world economy is going to get worse before it gets better, and the situation remains serious.”

Australian Federal Budget

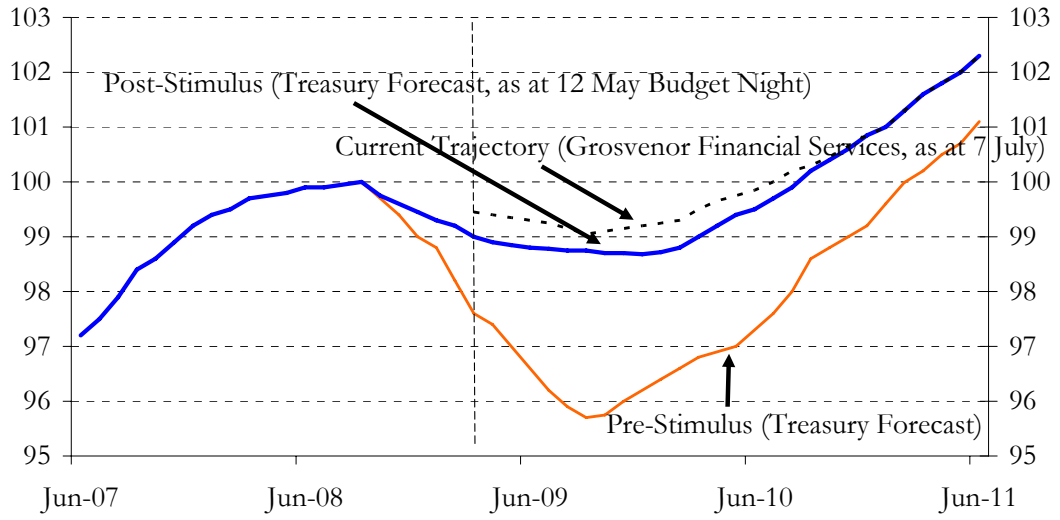
Australian Treasurer Wayne Swan delivered the Australian Federal Budget on the evening of 12 May. The Budget generally did not act as a platform for new initiatives. However it did clearly set out illustrations of:

- the impact the government’s fiscal stimulus packages had had,
- base case projections for the Australian economy over coming quarters, and
- longer term comparisons between Australia’s balance sheet and those of other major countries.

The Budget papers made the case vividly that the rapid response of the Federal Government in launching stimulus in the eye of the financial markets hurricane had averted a significant Australian recession taking hold from around October 2008.

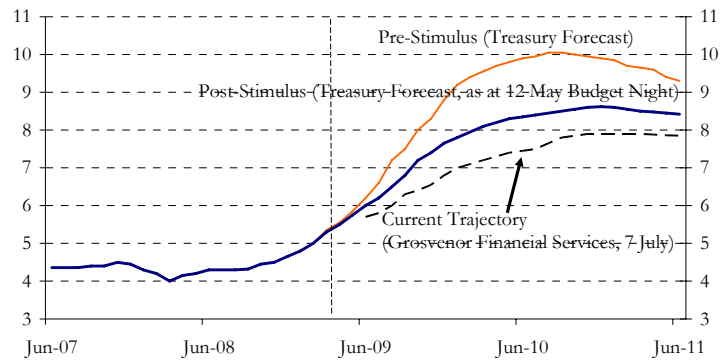
The support papers made clear that Australian household consumption is likely to consistently trend down from July 2009 till March 2010, indicating Australian economic growth would probably contract for at least 2 quarters and thereby meet the common definition of a recession (see chart, below). However since that time data on retail sales and employment have proved surprisingly resilient. The base case has now shifted to a milder recession than appeared most likely a quarter ago.

Australian Real GDP
Rebased Index (Sep 08 = 100)



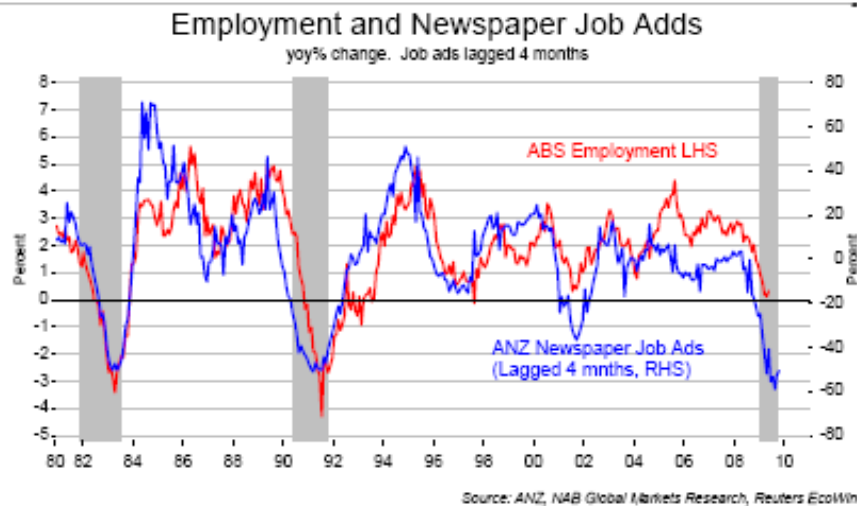
Budget projections of steadily rising Australian unemployment to c. 8.5 % by September 2010 from now were sobering (see chart, right). That projection was based on an assumption that the pattern of job losses which occurred over the last c.20 years would recur. There is evidence the workforce is more flexible nowadays, with employers preferring to hold on to better performing staff by cutting hours worked rather than headcount. If the marginal trend within the most recent data plays out, Australian unemployment may peak at c.7.75% around September 2010.

Australian Unemployment Rate (%)



The base case is, however, for unemployment to rise materially from here. You can see from the sharp decline in job ads a couple of months ago and the historical relationship with more recent ABS Employment numbers (see chart below) that Australian employment might be expected to decline to 4% below a year previous within a couple of months.¹

ANZ series signalling downswing in jobs



A budget “bright spot” was the comparatively strong state of Australia’s balance sheet both now and projected to the middle of the decade, compared with those of other developed countries. Australia (and its financial sector) is in relatively good shape.

Also during the quarter, ratings agency Standard & Poors raised concerns that the governments of developed countries may rapidly be running out of “fiscal flexibility”. It reduced the outlook for UK government debt from “AAA, stable outlook” to “AAA, negative outlook”. Should economic activity prove anaemic for a prolonged period for any reason, it seems likely the US government would lose its AAA rating.

¹ In response to a recent recommendation to buy shares in Fairfax Media, some clients expressed concern for the future of print media relative to online. To date, newspaper advertisements have proved a more reliable indicator of subsequent employment than online job advertisements.

In a reminder that the crisis originated from the financial system, on 19 June, the founder and CEO of AirAsia, Tony Fernandes, said “We’ve been through SARS, bird flu, tsunami, you name it. The only swine now are bankers.” Airlines are struggling to deal with banks that are unwilling to finance purchases of aircraft.

We anticipate corporate executives from all industries will echo this airline’s sentiment for several years, as banks progressively impose tighter covenants on higher risk forms of lending. Australian banks are tightening lending standards for loans to real estate developers for apartment construction, for example, with some banks reported as having lifted their required pre-sales for loan approvals from 60% to 100%. (In May, approvals for the construction of apartments and townhouses in NSW slumped to the lowest number since records were first kept in 1983. A mere 482 new dwellings were approved across the state, down 90% from peak monthly numbers.)

At Grosvenor, we see strong evidence that banks are requiring property syndicates to lower their loan-to-valuation ratios. For example, property syndicates which were viewed as very conservatively levered two years ago are increasingly viewed merely as having an acceptable low level of gearing. Syndicates which were viewed as having merely an acceptable level of gearing 2 years ago are under pressure to trim income distributions in order to improve their Loan-To-Valuation Ratios to meet new bank lending realities.

By 22 June, Spanish unemployment hit 18.1%. (Unemployment is usually considered a lagging indicator.) The White House announced it anticipated US unemployment would hit 10% in a few months. To help stimulate the Eurozone economy, on 24 June, the European Central Bank injected €442 billion in one year funds into money markets to spur lending. The move drove some borrowing costs to new lows. The IMF said Ireland’s recession was the deepest in the developed world by 25 June, projecting the economy would contract a whopping 13.5% in the three years through 2010, with unemployment likely to reach 15.5%. The Irish Finance Minister Brian Lenihan called the report a “balanced and realistic assessment”. These are “Great Depression” type outcomes for the worst impacted of these countries. Thus the positive news flow regarding Australia’s relatively good outcomes is likely to remain tinged by bad or subdued international news for an extended period.

In summary:

- The massive global share rally (should it consolidate) will itself prove massively supportive of global economic growth over the next couple of years, with very significant boosts to be expected even in the next few quarters. Higher share prices will also help some of the more financially distressed companies raise fresh equity to strengthen their balance sheets and this is already beginning to happen.
- China and other developing countries will prove critical pulling the world out of recession. Indications are that the Chinese economy will rebound fairly soon, selectively supporting commodity prices and volumes.
- Australian unemployment is very likely to rise over the next 15 months to peak at c.7.75 %. This is a sharp rise from current levels of c.5.75%. Underlying Australian household consumption is likely to reverse from recent high levels induced by unsustainably high government stimulus. It is expected to trend negatively from July 2009 until March 2010. After this government investment spending should act to help lift the economy. Business investment will likely

remain soft for the immediate future. “We are not [entirely] out of the woods yet.”

- All signs are that banks are massively trimming their riskier lending. This will most hurt more leveraged industries and industries exposed to more leveraged industries. Direct examples include airlines and property developers, with indirect exposures through hospitality, tourism and other discretionary expenditure. Property syndicates are commonly under pressure to reduce their Loan To Valuation Ratios.

Financial Market Metrics

Interest Rate	% Yield as at 31.03.09	% Yield as at 30.06.09	Change in Rate over Quarter
Australian 90 Day Bill	3.12	3.20	0.08
Australian 10 Year Bond	4.41	5.52	1.11
US 10 Year Bond	2.6647	3.53	0.8653
US: Federal Reserve Funds Rate	0-0.25	0-0.25	-

Commodity	US\$ as at 31.03.09	US\$ as at 30.06.09	% Movement over Quarter
Gold (Australian Bullion, US\$/ounce)	922.60	940.85	1.98
Oil (West Texas Intermediate per barrel)	49.67	69.31	39.54
Copper per tn	4003	5088	27.10
Nickel per tn	9755	16494	69.08
Aluminium per tn	1355	1662	22.66

Currency	Rates as at 31.03.09	Rates as at 30.06.09	% Movement over Quarter
US dollar AU\$/US\$	0.6873	0.8114	18.06
Euro AU\$/EUR	0.519	0.5751	10.81
Pound sterling AU\$/GBP	0.4804	0.4872	1.42
Yen AU\$/JPY	67.48	77.76	15.23

Share Market Indices (Excluding Dividends)	Close as at 31.03.09	Close as at 30.06.09	% Movement over Quarter
S&P/ASX 200 (Australia)	3582	3955	10.41
S&P 500 (USA)	797	923	15.81
FTSE 100 (UK)	3926	4340	10.55
DAX (Germany)	4084	4905	20.10
Nikkei 225 (Japan)	8109	9958	22.80
Hang Seng (China)	13576	18379	35.38

Where To From Here?

We are fast entering what is traditionally the weakest four month period for Australian share returns. Historically, Australian share returns have tended to be discernibly weaker from the tail-end of July to November/December.

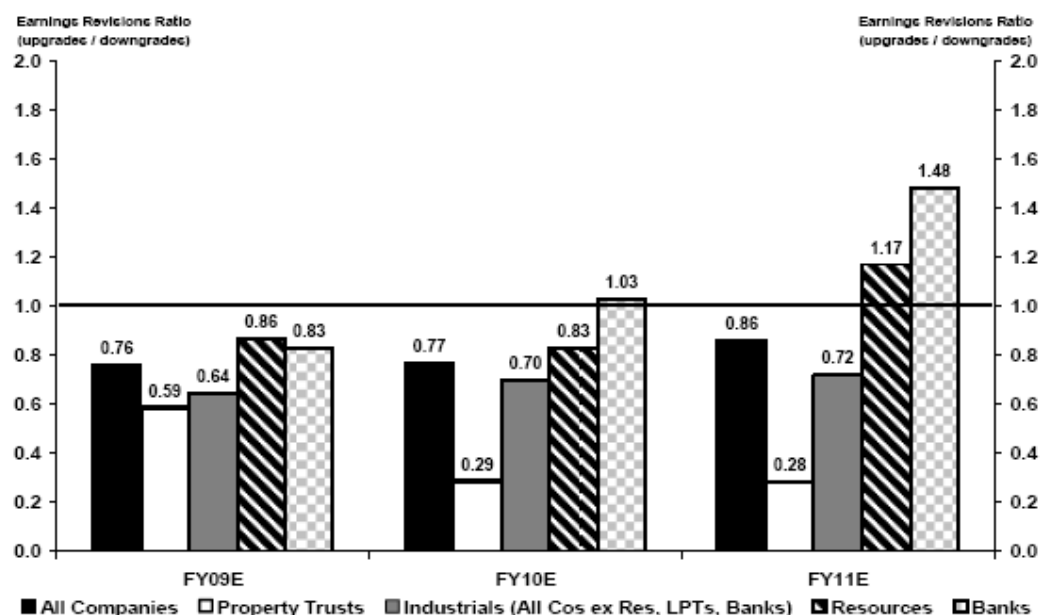
This year, after such a dramatic rise in share prices globally over the last 3 ½ months, our base case is that the traditional pattern of weak returns is most likely to recur at some points in the coming months.

We believe, however, that above-average returns will be enjoyed by most share and property investors between the third quarter and the following five (or so) years. At some point in that time frame, we suggest it is very likely that corporate revenues will approach an inflexion point, when demand strengthens without the need for on-going government support, Australian economic growth at above-trend rates will be occurring or within sight. The same may not be able to be said confidently for major international economies in the same time frame, but we would be surprised if the economic outlook was not much brighter for them.

Well before that point emerges, share prices are likely to anticipate the profit recovery and show stronger returns.

The improved outlook for FY11+ is evident in share analysts' EPS forecasts. Improved Earnings Per Share forecasts are more common for FY11 than FY10.

FY11 Earnings revisions ratio is now well ahead of FY09 and FY10, reflecting the earnings impact of the global economic recovery



Analogous return projections are not available for direct property markets, hedge funds or commodities markets.

In the last few months, we have focused on lifting clients' investment allocations to Australian shares by participating in generally significantly-discounted equity raisings. This has been a low-risk way to edge portfolios back towards a longer term weighting in Australian shares.

We are nearing completion of due diligence in relation to a wide variety of companies. All will be subject, should they be recommended, to strict buying price caps. In addition, we view a handful of the stocks already within our model portfolios as representing such strong value that we may suggest clients top-up. The timing of these recommendations will be tempered by our view of the short-term prospects for the market (at writing, a touch negative).

Information and opinions presented in this report were compiled from sources believed to be reliable by Grosvenor Financial Services Pty Limited (Grosvenor) at the time of writing. Grosvenor makes no representation as to the reports accuracy or completeness and accepts no liability for any loss sustained by any person or persons relying upon this report. The content of this report does not constitute personal advice or recommendation to any person. Grosvenor recommends that you obtain independent financial, investment and tax advice relevant to your own particular circumstances.