

Market Review - October 2008

October saw further sharp declines in sharemarkets, and enormous volatility due to a further worsening in the credit crisis, weak economic data and growing fears of a global recession in 2009. Australian bonds rallied after the RBA's aggressive rate cut, (see below). Global bond markets were volatile and quite mixed, the US 10 year bond rose in yield over the month. Listed Property Trusts fell significantly with debt refinancing an ongoing concern

Significant Developments

- The Reserve Bank cut rates more aggressively than expected from 7% to 6%, partly due to the worsening global outlook and partly to ensure some relief to borrowers in view of the higher funding costs of the Australian banks.
- The Australian government announced a scheme to guarantee all Australian bank deposits for 3 years. This move was forced by similar guarantees internationally, (notably in Europe), which would have meant Australian banks rapidly losing interbank and wholesale market funds - it did not reflect any capital inadequacy or high level of troubled assets in Australian banks. The government also announced a \$10.4B fiscal stimulus package during the month.
- Domestic economic data was reasonably resilient, but confidence indicators weakened due to the turmoil in financial markets. CPI inflation remained quite high but the outlook is now for a decline in inflationary pressures over the next year.
- International central banks continued to cut rates during October as economic data continued to weaken and financial markets remained very difficult.
- A more important measure was the various support packages announced by Governments and central banks to preserve confidence in the financial system. These included capital subscriptions, nationalisation of some institutions, asset purchase programmes and explicit deposit guarantees. The US\$700B TARP programme in the US was the largest, and passed Congress at its second attempt after being initially rejected.
- US economic data was especially weak. GDP declined 0.3% in the third quarter and a steeper decline is likely in the fourth. Employment, retail sales and consumer sentiment all fell sharply. Manufacturing output, which had previously been supported by the low US dollar and offshore demand, was also down.
- Commodity prices fell sharply due to the worsening economic outlook and steel industry production cuts. The size and speed of falls has probably been exacerbated by the liquidation of substantial investments in physical commodities that had developed during the protracted boom of recent years.
- The price of oil fell 32% to US\$68 and virtually all commodities saw substantial spot price declines. Commodity weakness is a main cause in the very sharp fall in the Australian dollar to as low as US\$61c during the month.

The median returns of the Mercer Pooled Fund and Capital Stable Fund Surveys for October 2008 were -8.1% and -3.2% respectively.

▶ Australian Shares

The S&P/ASX300 fell 12.9% over October and is down 38.3% over twelve months. Small cap stocks, (-24.8% for the month), again underperformed. This is partly because smaller companies tend to be more economically sensitive businesses, and may have fewer financing options in difficult times. There has also been a degree of capitulation by investors, which can cause sharper falls in small caps, due to their limited liquidity. No sector actually recorded a positive return and resources were particularly hard hit by falling commodity prices. As noted above, Property Trusts were very weak and two major trusts announced large capital raisings. Healthcare, Utilities and Consumer Staples did comparatively well because their earnings tend to be much less sensitive to economic downturns.

▶ Overseas Shares

The MSCI World ex Aus index returned -16.6% in local currency terms, but with the Australian dollar falling 16.4% against the US dollar, losses were softened for unhedged Australian investors. The Dow Jones returned

-14.1%, the S&P 500 -16.8% and the NASDAQ -17.4% all in US\$ terms. In Europe the FTSE 100 (UK) returned -10.7%, the DAX (Germany) -14.5% and the CAC 40 (France) -13.5% in local currency terms.

Asian markets, and emerging markets declined sharply. The Hang Seng (Hong Kong) returned -22.5%, the Shanghai Composite (China) -24.6%, the Indian BSE 200 (India) -26.4% and the Nikkei (Japan) returned -23.8%, again all in local currency terms

► **Property**

Domestic listed property trusts (A-REITs) dropped by 25.4% over October. Large, discounted rights issues by Goodman and GPT contributed to the falls, together with financing concerns for any REIT's with substantial financial gearing. Domestic unlisted property returns were approximately flat for the month.

► **Fixed Interest**

After the RBA rate cut Australian ten year bond yields finished the month sharply lower, falling a further 24bps to 5.15% at month end. The UBS Composite Bond Index returned +2.0% for the month. Global bond yields were more mixed with the US ten year bond yield actually rising 14bps to 3.96% in October. The Citigroup World Government Bond Index and the Lehman Global Aggregate Bond Index returned +0.9% and -0.8% respectively, on a fully hedged basis.

► **Currency**

The Australian dollar fell sharply in October; by 16.4% against the US Dollar, 22.5% against the Yen, 7.7% against the Pound Sterling and 7.4% against the Euro. Weak commodity prices, falling interest rate differentials and general aversion to currencies perceived as riskier were contributing factors.

(Catholic Super wishes to thank Mercer Investment Consulting for this monthly Market Commentary)