

Special market update: 10 May 2010

Greece, Australian banks and miners, and a technical blip in US markets?

As the past week has seen significant share market volatility, we have put together a quick update covering some of the major themes driving markets at present. These are trying times for investors – as always, please contact us if you have any questions or concerns regarding your portfolio.

Last week was one of the most eventful of 2010 so far. It saw a sell off across all major equity markets, a rise in bond yields, and the cost of insurance against protection from defaults soar to new short term highs. In Australia, the share market lost 6.8% of its value. Volatility has clearly swept back into markets, and a flight to quality, which appears to include the USD at present, is taking play.

Technical glitch?: At 2:45pm (US time), on 6 May 2010, the NYSE stock exchange was the victim of ‘unusual trading activity’ when an apparent error set off automated trading systems across the broader stock market. While the index recovered most of the losses by the close, those five minutes of panic mirror what we are seeing across broader global markets.

Greece: Greece has been facing a significant liquidity squeeze, and had it not been for the saving hand of the IMF and euro-zone, a crisis may have resulted. European policy makers this morning unveiled an unprecedented loan package worth almost \$1 trillion and a program of bond purchases as they spearheaded a global drive to stop a sovereign-debt crisis that threatened to shatter confidence in the euro. The 16 euro nations agreed to offer financial assistance worth as much as 750 billion euros (US\$962 billion) to countries under attack from speculators. The European Central Bank will further counter ‘severe tensions’ in ‘certain’ markets by purchasing government and private debt. Australian share markets opened stronger this morning pointing towards some renewed confidence. We would also expect to see further stabilisation across other markets over the short term.

Australian banks: One of the major concerns stemming from the Greek crisis, is what contagion impact it may have on credit markets. This is important for the Australian banking system, as these credit markets are a major source of their overseas funding. While these events will place some stress on their funding costs, our research indicates that Australian banks are adequately positioned given their AA rating and the underpinnings of a strong Australian economy.

Australian miners: BHP and Rio fell the most in 3 months after the government announced a proposed super tax on the sector on 2 May, 2010. If legislated, the 40% tax on resource profits would start from 2012 and raise A\$12 billion (US\$11 billion) in its first two years. The move may reduce BHP’s earnings by 17 percent and Rio’s by 21 percent in 2013, UBS AG said in a report. The ‘super tax’ is one of several recommendations stemming from the Henry review. It is not yet legislation and in our view, the market is currently pricing in the worst case scenario.

We believe there are major headwinds ahead for both financial markets and real economies. For this reason, our objective is to remain conservatively positioned, and to analyse news and data as it comes out. Our underlying investments, specifically those with exposure to Europe and credit markets, are being closely monitored.

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