Market Update

May 2011

- **US AAA credit rating at risk**
- **RBA keeps cash rate at 4.75%**
- **AUD reaches $1.10 against USD**

What's inside?

p2 Equity markets
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The pulse

↑ **Gold**
9.2% to $1,563.70 per ounce

↑ **WTI Oil 3 Month Futures**
6.8% to $113.9 per barrel

April market performance

Equity Markets – Price Indices	Index	At Close 30/04/2011	% Change 1 Month	% Change 12 Months
Australia	All Ordinaries	4899.05	-0.60%	1.35%
Japan	Nikkei	9849.74	0.97%	-10.92%
Hong Kong	Hang Seng	23720.81	0.82%	12.38%
UK	FTSE 100	6069.90	2.73%	9.30%
Germany	DAX	7514.46	6.72%	22.47%
US	Dow Jones	12810.54	3.98%	16.37%
EMU*	Euro 100	2397.85	2.86%	7.24%
World**	MSCI - Ex Aus (Gross)	946.79	2.14%	9.20%
Property – Price Index	**Index**	**At Close 30/04/2011**	**% Change 1 Month**	**% Change 12 Months**
Listed Trusts	S&P/ASX 300 A-REITS	851.64	0.30%	-4.41%
Interest Rates		**At Close 30/04/2011**	**At Close 31/03/2011**	**At Close 30/04/2010**
Aust 90 day Bank Bills		4.92%	4.93%	4.63%
Australian 10 year Bonds		5.43%	5.50%	5.71%
US 90 day T Bill		0.04%	0.09%	0.16%
US 10 year Bonds		3.29%	3.47%	3.66%
Currency [3]		**At Close 30/04/2011**	**% Change 1 Month**	**% Change 12 Months**
US dollar	A$/US$	1.10	6.22%	18.69%
British pound	A$/STG	0.66	1.91%	8.44%
Euro	A$/euro	0.74	1.55%	6.61%
Japanese yen	A$/yen	89.07	3.73%	2.64%
Trade-weighted Index		79.10	3.67%	9.10%

1 Top 100 European stocks trading on the FTSE
2 Price Index – Source: www.msci.com
3 All foreign exchange rates rounded to two decimal places

Source: Iress Market Technology
Past performance is not a reliable indicator of future performance.

Global economies

Starting in the US, the two main talking points over the past month have been the outlook of the US credit rating and interest rates.

Firstly, on April 18 ratings agency Standard & Poor's (S&P) changed the outlook on the United States' AAA rating from stable to negative. This view initially shocked markets, resulting in big falls in equity markets and some brief strength in the USD as risk aversion increased.

In taking this view, S&P noted that unless policy makers agree on a plan by 2013 to reduce the budget deficit and US national debt, the AAA rating is at risk.

The Dow Jones fell over 200 points when the announcement was made, while the USD strengthened with investors looking to traditional safe havens. As a result, the AUD also briefly fell back below 105 US cents.

On the interest rate front, the US Federal Reserve (Fed) kept rates unchanged as expected in April, and maintained they would be kept exceptionally low for an extended period.

On top of this, the Fed also committed to complete the second round of quantitative easing (QE2), the $600bn of US Treasury purchases, by the end of June.

Aside from this, the suggestion the Fed is not thinking about tightening policy anytime soon was accepted favourably by the markets.

In the days following the Fed's meeting, US equity markets made strong gains while the USD weakened to a two and a half year low.

Offshore equity markets also moved higher on the US Fed news.

On the home front, the performance of local equity markets for the month lagged behind markets in the US and overseas.

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News of inflation rises and the expectation of future interest rate rises contributed to this underperformance.

At the May Board meeting, the Reserve Bank (RBA) kept the cash rate on hold at 4.75%, but its language was slightly more hawkish as expected.

Of some surprise however were China's first quarter Gross Domestic Product (GDP) and March inflation figures which were higher than expected.

China published quarter to quarter growth in GDP for the first time, showing growth of 2.1% in the first quarter. This suggests only a slight cooling in growth.

In annual terms, GDP was up 9.7% over the past year.

Driving China's inflation up to 5.4% during March was a combination of higher food and non-food inflation.

Following these releases, the People's Bank of China announced a further half percentage point increase in its reserve ratio. The central bank Governor Mr Zhou Xiaochuan said that monetary tightening will continue for some time.

Over in Europe, the European Central Bank (ECB) didn't disappoint markets in April by raising its main refinancing rate by 25 bps to 1.25%.

At the same time, it also increased its overnight deposit and lending rates by a similar amount.

The risks to inflation were described as being on the upside. With the ECB 'monitoring (the situation) very closely' it seems further rate increases will likely occur.

In Japan, more news is emerging of some economic fallout from the recent earthquake and tsunami.

As to be expected, data released in April was terrible. This was reinforced by the especially large hit to vehicle production which was down by a whopping 57.3% year on year in April.

Big movers this month

Going up

↑ Telcos 3.2%

Going down

↓ Industrials -3.5%

Other significant issues facing the country are shortages of power and worried consumers, which are both weighing heavily on Japanese growth prospects.

As a result of this dire situation, there were no changes from the Bank of Japan's Monetary Policy meeting in April to their virtually zero interest rate policy or to their asset purchase program.

However, the Bank of Japan cut their Fiscal Year 2011 growth forecast (year ended March 2012) to 0.6% from 1.6%.

Equity markets

Major equity markets were generally positive throughout April with the ASX 200 and the China 300 being the exceptions. The German DAX was the standout positive performer returning well over 6%.

Most currencies appreciated against the US Dollar in April which didn't help returns for unhedged overseas investments denominated in the US Dollar.

Australian equities

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 Acc.	4.87%	-0.45%	2.61%	9.71%
	S&P/ASX 50 Acc.	4.31%	0.45%	3.05%	9.85%
	S&P/ASX Small Ordinaries Acc.	10.50%	-2.92%	2.05%	9.37%

While global markets were rallying strongly in late April, domestic inflation data sent the local index the other way.

With first quarter inflation increasing the prospect of an interest rate rise by the RBA, the ASX 200 lost 108 points in the three trading days after the Easter/ANZAC Day long weekend to close 0.3% lower over the month.

Sector	1 Mth	3 Mths	1 Yr
Energy	-2.2%	4.7%	9.0%
Materials	-2.1%	2.7%	16.7%
Industrial	-3.5%	-2.0%	-2.6%
Consumer Discretionary	-1.8%	0.0%	-6.4%
Consumer Staples	1.0%	0.9%	9.7%
Health Care	-0.9%	-1.3%	7.3%
Financials	1.9%	4.5%	-1.4%
Info Tech	0.3%	-3.8%	-15.0%
Telcos	3.2%	7.2%	0.8%
Utilities	2.3%	2.0%	5.1%
Property	0.3%	1.6%	1.1%

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Global equities

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Global	MSCI World Ex Aus Acc. ($A)	0.45%	-5.61%	-5.14%	-0.03%
	MSCI World Index Hedged ($A)	11.78%	-2.47%	-0.42%	4.39%
	MSCI World Small Cap ($A)	5.88%	1.62%	-3.60%	3.25%
Emerging	MSCI Emerging Mkts Free	2.64%	-2.31%	2.09%	11.32%
	MSCI AC Far East Free (ex Japan)	5.02%	-0.99%	2.70%	8.35%

The US and European equity markets were strong in April, bouncing back after the Japanese earthquake and Libyan tensions which affected performance in March.

Middle-East tensions impacted less on markets in April. This led to a fall in the US equity volatility index (VIX) to levels last seen a year ago.

Most gains in offshore markets were made in the final week of the month, after the Fed indicated there was no rate rise on the immediate horizon. In the US, the Dow Jones gained 4% in April while the S&P 500 was up 2.8%.

European markets also gained strongly in April, with the FTSE up 2.7% and the German DAX up 6.7%. Most of these gains were also in the final week of the month.

The Chinese market softened in April, as more monetary tightening by the People's Bank of China in response to rising inflationary pressures kept equity markets subdued.

Property

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 A-REIT Acc	1.11%	-15.63%	-9.37%	-1.88%
Global	UBS Global Investors Index	6.61%	-6.37%	-6.02%	N/A

The S&P/ASX 300 A-REIT Accumulation Index nudged higher in April gaining 0.3% and slightly outperformed its global counterpart.

Over the longer term, the listed global property sector has significantly outperformed the listed local property sector. Over a five year period, global listed property outperformed by around 3.3%.

Fixed interest

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	UBS Composite 0 + Years	6.78%	7.54%	6.24%	6.15%
	Australian 90 Day Bank Bill	4.88%	4.72%	5.49%	5.52%
Global	BarCap Global Agregate Index	-6.05%	0.54%	-0.37%	0.93%
	BarCap Global Ag,. Index Hedged	7.81%	8.71%	8.12%	7.36%

Australian bonds rose in April with the UBS Composite Bond Index gaining 0.5%.

In April, global bonds further highlighted the strength and impacts of a rising Australian Dollar. The Barclays Capital (BarCap) Global Aggregate Index finished the month -2.6% lower with the hedged equivalent finishing 1.2% higher; almost a 4% difference in returns.

Australian dollar (AUD)

The Australian Dollar traded above 110 cents against the US Dollar to reach fresh 29-year highs.

While great for travellers, an AUD/USD above $1.10 would start to look clearly expensive on medium-term valuation criteria such as the terms of trade or current account balance.

NAB's long standing view is the average AUD/USD rate over a full cycle is shifting up to $0.90. This is compared to the $0.70 averaged in the twenty years after currency floated in December 1983.

Above $1.10, the AUD/USD is over 20% higher than NAB's estimate of the new long-term average exchange rate. For the AUD to remain at this level, cyclical drivers of the currency would need to persist and perhaps even widen by more than currently expected.

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