

Market Update

August 2010

- **Markets bounce back as confidence in European banks improves**
- **China's GDP slows but outlook remains positive**
- **Australian Dollar jumps as commodities rebound**

What's inside?

p2 Equity markets

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The pulse

- ↑ **Consumer confidence**
11.1% in July
- ↑ **Australian exports**
7% in June
- **Interest rates**
Steady at 4.5%
- ↑ **Australian unemployment**
0.2% to 5.3%

July market performance

Equity Markets – Price Indices	Index	At Close 31/7/10	% Change 1 Month	% Change 12 Months
Australia	All Ordinaries	4507.44	4.22%	6.07%
Japan	Nikkei	9537.30	1.65%	-7.91%
Hong Kong	Hang Seng	21029.81	4.48%	2.22%
UK	FTSE 100	5258.02	6.94%	14.10%
Germany	DAX	6147.97	3.06%	15.30%
US	Dow Jones	10465.94	7.08%	14.11%
EMU*	Euro 100	2187.47	4.84%	10.01%
World**	MSCI - Ex Aus (Gross)	807.20	5.69%	7.70%

Property – Price Index	Index	At Close 31/7/10	% Change 1 Month	% Change 12 Months
Listed Trusts	ASX A-REITS	851.83	0.98%	11.06%

Interest Rates	At Close 31/7/10	At Close 30/6/10	At Close 31/7/09
Aust 90 day Bank Bills	4.78%	4.92%	3.20%
Australian 10 year Bonds	5.21%	5.09%	5.71%
US 90 day T Bill	0.14%	0.18%	0.18%
US 10 year Bonds	2.91%	2.93%	3.48%

Currency		At Close 31/7/10	% Change 1 Month	% Change 12 Months
US dollar	A\$/US\$	0.9053	7.68%	8.34%
British pound	A\$/STG	0.5760	2.40%	15.20%
Euro	A\$/euro	0.6933	0.89%	18.27%
Japanese yen	A\$/yen	78.31	5.30%	-1.02%
Trade-weighted Index		69.40	3.12%	5.63%

* Top 100 European stocks trading on the FTSE ** Source: www.msci.com
Source: Iress Market Technology
Past performance is not a reliable indicator of future performance.

Global economies

We're now well and truly into the second half of the year and much to everyone's relief, financial markets are now showing signs of improvement.

One of the main reasons behind these improved conditions is the growing confidence investors have that governments and central banks in Europe will be able to do enough to keep their sovereign debt issues under control.

This renewed confidence has been strengthened by two major boosts: the large € 750 billion bailout package agreed in May and the positive reception to the European banks' stress tests results, released 23 July.

These 'stress tests' involved looking at a range of adverse economic scenarios and assessing how the banks would fare should these scenarios occur.

The European Banks were tested in the extreme scenario of a sovereign debt crisis and a double-dip recession in Europe. With only 7 banks out of 91 failing the test, this has gone a long way to improving investor sentiment.

Over in the US, recent economic data has been mixed. While there appears to be some decline in manufacturing, the private sector continued to generate jobs through to the end of July, the housing market seems to be getting close to the bottom and business investment has been rising.

NAB economists aren't convinced this data means a double-dip recession is on the cards. It does however, point to the potential for slow growth for the US economy.

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In China, recent surveys suggest manufacturing is slowing down, which ironically, is actually viewed as a positive. This is because, as you may recall in earlier updates, there was increasing concern China's economy was at risk of over heating, with unsustainable levels of growth. These latest manufacturing results indicate policy measures adopted to prevent this over heating appear to be doing the job.

On the home front, the Reserve Bank of Australia (RBA) refrained from increasing the cash rate at its early August meeting, keeping it at 4.5%. This decision was based on the following key factors: inflation remains within the RBA's target range of 2% to 3% and key indicators, especially housing and retailing, suggest the Australian economy is slowing somewhat.

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Australian equities

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 Acc.	10.04%	-6.05%	4.86%	9.88%
	S&P/ASX 50 Acc.	10.78%	-4.41%	5.43%	10.02%
	S&P/ASX Small Ordinaries Acc.	7.30%	-12.43%	3.02%	8.96%

There was good news on the local front with the Australian market solid in July, bucking the downward trend of the previous three months.

This result was supported by generally strong domestic data, as well as ongoing strength in China, despite some signs of a slowing economy with a fall in Gross Domestic Product (GDP). China's GDP was 10.3% year on year in the June quarter and while down from 11.9% in the previous quarter, it was still a strong result. Adding to this, June monthly data for industrial production showed growth of 13.7% year on year.

The S&P/ASX 300 Accumulation Index rose 4.48% for the month. The S&P/ASX Small Ordinaries Accumulation Index outperformed the larger cap stocks with a monthly gain of 5.21%. Small cap returns were lower than their large cap counterparts over the 12 months ending July 2010.

Sector	1 Mth	3 Mths	1 Yr
Energy	4.0%	-6.1%	-3.7%
Materials	4.9%	-2.4%	10.8%
Industrials	7.1%	-11.7%	7.2%
Consumer Discretionary	3.9%	-8.3%	8.6%
Consumer Staples	1.8%	1.2%	10.3%
Health Care	1.0%	-3.3%	6.5%
Financials	6.4%	-10.0%	14.9%
Info Tech	-2.8%	-12.9%	3.6%
Telcos	-0.6%	0.8%	-3.2%
Utilities	3.1%	-3.2%	4.6%
Property	1.1%	-4.2%	18.9%

Property/A-REITS and G-REITS

	Index/Benchmark	1Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 A-REIT Acc	18.87%	-22.81%	-8.54%	-1.42%
Global	UBS Warburg Global Real Estate	36.64%	-8.93%	-1.09%	7.18%

On the domestic property front, the S&P/ASX 300 A-REIT Accumulation Index was unable to match the gains of the broader Australian market with a gain of just 1.10% for the month.

In contrast to the local A-REITS, global REITS (G-REITS) enjoyed stellar performance in July by not only outperforming global shares, but all other asset classes too. The UBS Global Real Estate Investors Index gained 7.83% for the month.

Equity markets

On the back of improving investor sentiment, global sharemarkets posted strong gains during July.

While these improved returns have brought welcome relief, an uncertain economic outlook means markets are likely to still remain volatile in the short term.

An interesting and important way to gauge the level of risk appetite investors have is through the volatility index (VIX) which measures the implied volatility of the S&P 500 Index.

Over July, the VIX fell by 28% to an index level of approximately 22. While it still remains elevated compared to readings of around 15 before the sovereign debt crisis, it's well below the high of 46 on 20 May 2009. This indicates an improvement in risk appetite.

You can keep track of implied volatility by visiting the following website: www.cboe.com/micro/vix/introduction.aspx

Big movers in July

Going up this month

- ↑ Industrials 7.1%
- ↑ Financials 6.4%

Global equities

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Global	MSCI World Ex Aus Acc. (\$A)	0.53%	-10.28%	-2.75%	0.30%
	MSCI World Index Hedged (\$A)	10.05%	-10.28%	-1.08%	3.85%
	MSCI World Small Cap (\$A)	10.07%	-8.09%	-1.35%	4.05%
Emerging	MSCI Emerging Mkts Free	10.13%	-3.35%	9.13%	13.18%
	MSCI AC Far East Free (ex Japan)	4.15%	-4.43%	6.73%	9.47%

While the US economy is recovering at a moderate pace, ongoing weakness in both housing and the labour market persists.

In the US, equity markets had a solid month in July with the Dow Jones Industrials Index rising by just over 7%.

Helping equity markets back into a positive direction was the release of a number of good corporate earnings results during the second half of July and broader European concerns easing somewhat.

It should be noted though, that while the US economy is recovering at a moderate pace, ongoing weakness in both housing and the labour market persists. As a result, we're unlikely to see the Federal Open Markets Committee (FOMC) move from its very accommodating monetary policy stance in the near future.

Indeed, the FOMC has even discussed the possibility of further policy stimulus should the economic outlook 'worsen appreciably'.

On a regional basis, emerging markets outperformed Far East Asia with the MSCI AC Far East (ex-Japan) Index delivering a -0.67% return compared with the broader MSCI Emerging Markets Index which was up 1.07%.

The MSCI World Index Hedged \$A gained 5.84% during July, with the strength of the Australian Dollar (AUD) favouring hedged international equity exposures.

Bumper returns out of the UK and US helped offset the impact that the rising Australian dollar had on unhedged investments, with the MSCI World (ex-Australia) Index \$A in positive territory with a monthly gain of 0.73%.

Fixed interest

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	UBS Composite 0 + Years	7.81%	7.53%	6.02%	5.94%
	Australian 90 Day Bank Bill	4.16%	5.49%	5.77%	5.72%
Global	BarCap Global Aggregate Index	-2.44%	5.32%	2.28%	1.30%
	BarCap Global Agg. Index Hedged	11.07%	9.80%	7.52%	7.82%

In debt markets, Australian and global bond yields have fallen considerably since they peaked at the end of March 2010, with the US 10 year bond yield falling to around 3% and the Australian 10 year bond yield to around 5%.

A couple of reasons for the low US 10 year bond yield are the ongoing talk of a double-dip recession and deflation concerns, assisted by core US inflation falling to its lowest level since 1961.

The Barclay Capital (BarCap) Global Aggregate Index Hedged \$A gained 1.14% for the month while the unhedged index, suffering the effects of a strong Australian dollar, fell 3.52% for the month. On the domestic front the UBS Composite Bond Index ended the month marginally higher by 0.27%.

Australian dollar (AUD)

In contrast to the NAB economists' view that current data doesn't support a double-dip recession, there was still some fear amongst traders which resulted in the US Dollar (USD) falling sharply in July.

This, coupled with a rebound in commodity prices and better economic news from Europe, helped propel the AUD/USD exchange rate from 83.18 on July 6 to 90.53 US cents by month end.

This jump in the AUD had a helping hand from the continuing strength of the Australian job market which also contributed to currency traders pricing in some chance of another RBA interest rate increase over the next year.

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