

Market Update

January 2012

- **US employment showing positive signs**
- **Europe remains the biggest risk to the global economy heading into 2012**
- **RBA expected to cut rates further over the course of 2012**

What's inside?

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Global economies

As has been the same for much of last year, sharemarkets continued to be volatile with the influence of both political and economic news in the lead up to the end of the calendar year.

US Economy

Starting off with some positive news for investors, despite the ongoing global issues the US economy continues to gain traction with data showing some positive signs.

However the US debt ceiling, which created the political stand-off between the Democrats and Republicans causing markets to have one of the most volatile weeks in the past 3 years, is anticipated to be reached during January.

The debt ceiling is an amount set by Congress which establishes a type of 'borrowing limit' for the US Treasury.

While it isn't anticipated to have the same effect on markets an increase in the debt ceiling should be more orderly than that seen in July 2011, it's more than likely that US debt will be a political talking point throughout the year in the lead up to the elections to be held on 6th November 2012.

Elsewhere in the economy, recent data on the employment front saw an extra 200,000 people gain employment in

December market performance

Equity Markets – Price Indices	Index	At Close 31/12/2011	% Change 1 Month	% Change 12 Months
Australia	All Ordinaries	4111.04	-1.76%	-15.18%
Japan	Nikkei	8455.35	0.25%	-17.34%
Hong Kong	Hang Seng	18434.39	2.47%	-19.97%
UK	FTSE 100	5572.28	1.21%	-5.55%
Germany	DAX	5898.35	-3.13%	-14.69%
US	Dow Jones	12217.56	1.43%	5.53%
EMU*	Euro 100	2103.16	2.29%	-9.58%
World**	MSCI - Ex Aus (Gross)	833.65	0.54%	-7.27%

Property – Price Index	Index	At Close 31/12/2011	% Change 1 Month	% Change 12 Months
Listed Trusts	S&P/ASX 300 A-REITS	766.61	-4.13%	-7.49%

Interest Rates	At Close 31/12/2011	At Close 30/11/2011	At Close 31/12/2010
Aust 90 day Bank Bills	4.48%	4.60%	5.03%
Australian 10 year Bonds	3.67%	3.94%	5.51%
US 90 day T Bill	0.01%	0.01%	0.12%
US 10 year Bonds	1.88%	2.09%	3.29%

Currency***	At Close 31/12/2011	% Change 1 Month	% Change 12 Months	
US dollar	A\$/US\$	1.02	-0.67%	-0.15%
British pound	A\$/STG	0.66	0.44%	0.35%
Euro	A\$/euro	0.79	3.19%	3.26%
Japanese yen	A\$/yen	78.55	-1.62%	-5.41%
Trade-weighted Index		75.80	1.61%	0.00%

* Top 100 European stocks trading on the FTSE ** Price Index – Source: www.msci.com

*** All foreign exchange rates rounded to two decimal places

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

December which pushed the unemployment rate down to 8.5%.

Further supporting an improving economy, the positive Institute for Supply Management's (ISM) Non-manufacturing Index reading for November was slightly higher in December at 52.6 which continues to suggest expansion.

On the monetary policy front, the minutes of the Federal Reserve (Fed) December meeting revealed that the Fed will increase disclosure and transparency.

From January, the Fed will publish their forecasts for growth, inflation and unemployment as well as their forecasts for interest rates set by the Fed and views on quantitative easing.

Europe

While the US has provided some positive signs, Europe remains the key focus for global markets and presents the greatest risk to the global economy leading into 2012.

Suggestions that Europe will go into a recession, if it isn't already in one, ensured that investors remained cautious throughout the month of December.

Concerns over the capital adequacy of the regions banks have also increased of late with some banks looking at asset sales as opposed to raising equity.

An interesting development in late December and early January is the European Central Bank's (ECB) Eurosystem which offers credit institutions a marginal lending facility and a deposit facility.

Demand for ECB's marginal lending facility, which allows members to obtain overnight liquidity from the central bank against the presentation of sufficient eligible assets, seems to be continuing.

However, most of the 3-year money lent by the ECB to banks in December is back on deposit with the ECB which might imply that banks are reluctant to lend the money to other banks.

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Furthermore, the ECB has recently stepped into the market to purchase Spanish and Italian debt as Italian 10-year yields again breached the 7% mark which is a level considered unsustainable.

But there has been some good news in the region with Germany recently selling €3.15 billion in 5-year notes (after receiving bids for €8.97 billion) at a yield of 0.9% - lower than the 1.11% yield at the December 7 auction.

And despite signs of a slowdown in growth, Germany is still being considered the 'safe haven' in the region.

A recent 6 month note auction, which attracted an interest rate of -0.0122%, means that investors effectively paid the German government to take their money.

China

Despite the recent signs of slowing, China's economy is holding up relatively well.

The Manufacturing Purchasing Manager's Index (PMI), which is an indicator of manufacturing activity, was 50.3 in December which was up from 49 in the previous month.

While the level is slightly above a reading of 50 which suggests expansion, albeit at a sluggish pace, it exceeded expectations.

Furthermore, the HSBC Services PMI was steady at 52.5 compared to November which is still in expansion territory.

However, it's not all positive news with China's trade data coming in well below expectations and inflation seemingly continuing to cool.

This further supports the notion that China will shift to a more expansionary policy as growth cools in the economy which has been evident in the recent rate cut by the People's Bank of China.

Australia

On the domestic front, trade data was lower than expected in November but was virtually unchanged from October.

With both exports and imports being virtually flat, the worrying sign for the economy was the lower export volumes for most grades of iron ore and coal destined for China.

While volume levels are still relatively high, slowing global demand from Europe, which is China's largest trading partner, may be impacting the raw materials usage in China.

On top of this, retail sales in Australia remain weak despite positive signs in July and August last year, however lower consumer confidence and lower employment growth has resulted in

consumers continuing to restrain their spending.

On the positive side, the Australian economy is generally in a stronger position than other advanced economies around the globe providing more flexibility for both monetary and fiscal policy.

In December, the Reserve Bank of Australia (RBA) cut interest rates by 0.25% to 4.25%.

With the recently released residential building approvals for November exceeding market expectations, it's too early to tell whether the November rate cut played a large role in the bounce, although rate cuts should support demand in the months ahead.

While the RBA will not meet in January, a further cut to rates at its February meeting is on the cards with the market pricing rates to fall to around 3% over the course of the year.

However, given that market pricing expected a 0.40% increase over the course of 2011 in interest rates in order to curtail inflation, and rates were actually cut 0.50%, it's safe to say rates will be guided by what happens in both the Australian and broader global economy throughout the year.

Equity markets

Equity markets closed out the month mixed with thin trade volumes helping volatility between the Christmas and New Year period.

Big movers this month

Going up

↑ Telcos +5.1%

Going down

↓ Energy -5.1%

Australian equities

	Index/Benchmark (% pa)	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 Acc.	-10.98%	7.67%	-2.39%	4.39%
	S&P/ASX 50 Acc.	-8.97%	7.60%	-1.49%	4.92%
	S&P/ASX Small Ordinaries Acc.	-21.43%	11.83%	-5.18%	3.00%

In Australia, the All Ordinaries Index was around 2% higher after the first three trading days of the month to eventually close 1.76% lower. Over the year, the Index fell 15.18%.

The more 'defensive' sectors such as Telcos and Utilities performed well over the course of December and over the calendar year as both these sectors significantly outperformed the broader Australian market.

In contrast, Energy and Materials underperformed over December and the calendar year. Over the course of 2011, Consumer Discretionary and Info Tech also provided strong headwinds for investors.

Sector	1 Mth	3 Mths	1 Yr	Sector	1 Mth	3 Mths	1 Yr
Energy	-5.1%	-1.9%	-20.8%	Financials	0.6%	5.5%	-5.0%
Materials	-4.1%	-2.9%	-24.1%	Info Tech	-0.9%	0.9%	-24.9%
Industrial	-0.9%	6.4%	-7.8%	Telcos	5.1%	7.0%	29.2%
Consumer Discretionary	-3.9%	-0.6%	-17.1%	Utilities	3.8%	8.3%	9.5%
Consumer Staples	-1.3%	-2.9%	-0.4%	Property	-2.6%	3.8%	-1.6%
Health Care	1.7%	5.1%	-9.1%				

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Global equities

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Global	MSCI World Ex Aus Acc. (\$A)	-5.34%	-2.58%	-7.53%	-1.80%
	MSCI World Index Hedged (\$A)	-4.42%	9.41%	-4.05%	1.33%
	MSCI World Small Cap (\$A)	-9.07%	3.98%	-5.73%	0.06%
Emerging	MSCI Emerging Mkts Free	-18.44%	5.59%	-2.84%	6.21%
	MSCI AC Far East Free (ex Japan)	-14.79%	5.35%	-2.26%	5.11%

In the US, the Dow Jones continued to perform relatively well. The Index was well below the level it opened the month but bounced from the 19th December providing investors a pre-Christmas cheer to close out the month of December 1.43% higher.

Over the year, the Dow Jones has been the best performing major index posting a 5.53% gain and was the only major to close in positive territory over the calendar year.

European indices were mixed over the month of December with the German DAX providing investors with the biggest headwinds. In contrast, the UK's FTSE 100 gained over 1%.

Over the 12 months to 31 December, all of the major European indices were in negative territory with Germany's -14.69%, one of the biggest falls.

Hong Kong's Hang Seng was the best performing index over the month of December but performed poorly on both a relative and absolute basis over the year falling nearly 20%. Japan's Nikkei was also significantly lower over the year returning -17.34%.

Property

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 A-REIT Acc	-1.56%	2.32%	-15.19%	-5.71%
Global	UBS Global Investors Index	-1.05%	3.28%	-10.62%	N/A

The S&P/ASX 300 A-REIT Accumulation Index erased the gains in November by falling around 2.5% in December. Over the year to 31 December, Australian listed property fell around 1.6% significantly outperforming the broader Australian market.

Global property as measured by the UBS Global Investors Index outperformed its Australian counterpart by gaining 1.6% over December. Similarly over 1, 3 and 5 year periods, global listed property outperformed Australian listed property.

Fixed Interest

	Index/Benchmark	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	UBS Composite 0 + Years	11.37%	6.31%	7.41%	6.55%
	Australian 90 Day Bank Bill	4.85%	4.32%	5.31%	5.46%
Global	BarCap Global Agregate Index	5.63%	-6.75%	1.01%	1.70%
	BarCap Global Ag., Index Hedged	10.51%	9.27%	8.73%	7.53%

Australian bonds, as measured by the UBS Composite Bond All Maturities Index, was around 0.8% higher throughout December but underperformed hedged global bonds as measured by the BarCap Global Aggregate Index (Hedged) which returned 1.9%.

Australian fixed interest benefited from the global uncertainty over the course of 2011. While global bonds performed relatively well over the year, hedged global bonds by far outperformed their unhedged counterpart due to the fluctuations in the Australian Dollar which traded in a 15 cent range throughout the year.

Australian dollar (AUD)

The AUD lost some ground versus the USD over the month of December, but closed above parity.

Despite fluctuating, at times quite heavily, the AUD was relatively flat over the course of 2011. Throughout the year, the dollar reached highs of just above US\$1.10 and lows of around US\$0.95.

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