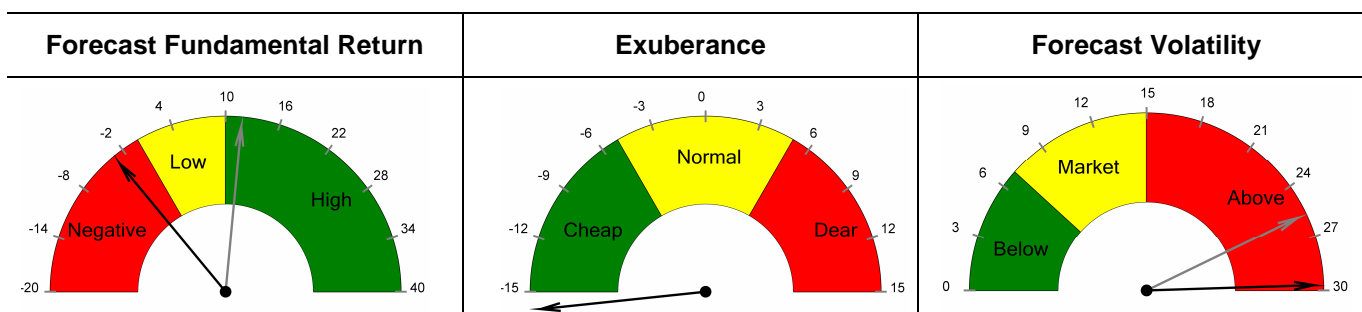


# Commonwealth Bank Agri indicators

11 March 2009

- The Agribusiness index continues to fall this month as more agricultural companies report their results. Despite some companies reporting interim profits and others posting guidance on forecast profits updates, the market continues to dwell on the negative. In line with broader market the Agribusiness sector fell by -8.2% last month. The S&P/ASX 200 accumulation index fell -7.3% during this time. On a year-on-year basis the Agribusiness sector has fallen -61.2% compared to -35.2% for the S&P/ASX 200.
- Downgrades to both forecast dividends and earnings continued this month for the Agribusiness sector. The serious case of pessimism in the market is reflected in the total expected return for the next 12 months to be -3.2% for the Agribusiness sector. Agribusiness is not the only sector with negative forecasts, Energy and Materials also have negative forecasts for the next 12 months. And, as a result, the Agribusiness sector is no longer expected to outperform the broader market which is expected to return 4.1% in the 12 months to March 2010. Despite this poor forecast, things may get better sooner than expected. Exuberance continues at extreme lows so the pent-up underpricing may result in a surge in the market when the market eventually takes off.
- As the market continues to focus on the negative, the forecast volatility has kicked back up and currently is 30% for the next 12 months. This month's forecast volatility is only slightly above the average volatility of all the sectors in the market. The slight increase from last month's value reflects the uncertainty within the market, and with the negative forecast returns investors should be hesitant to enter the market in the coming weeks.

**Table 1: Current indicators Commonwealth Bank Agribusiness sector**



Source: Investment Research, Reuters Knowledge

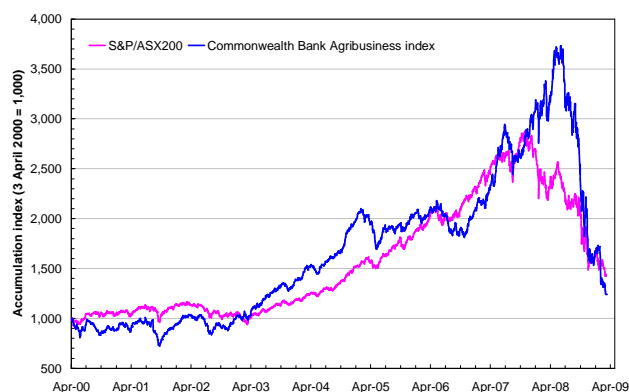
Note: The grey marker represents the previous month's dial value.

**Forecast Fundamental Return:** Forecast return (ignoring exuberance) for the sector over the next 12 months. Derived using our proprietary forecasting technique based on consensus forecasts of earnings and dividends for the individual stocks in the sector (sourced from Reuters Knowledge). Pricing bounds (eg negative, low and high) are relative to the S&P/ASX 200 and are the same across sectors to allow for comparison between sectors.

**Exuberance:** Proprietary measure of market mis-pricing. Defined as the ratio of the sector accumulation index to our estimate of fair value. Exuberance should be subtracted from the forecast fundamental return to derive an actual forecast from today's price. Experience shows that exuberance changes far more rapidly than our forecasts of fundamental returns. Pricing bounds (eg cheap, normal and dear) are sector specific and are based on the sector exuberance mean and standard deviation.

**Forecast Volatility:** Forecast volatility for the sector over the next 12 months. Derived using our proprietary methods of modelling realised volatilities, detecting changes in long-run levels (including at the end of the sample) and correcting for switchbacks and other correlation patterns in the data. Pricing bounds (eg low, normal and high) are relative to the S&P/ASX 200 and are the same across sectors to allow for comparison between sectors.

**Figure 1: Commonwealth Bank Agribusiness index vs. S&P/ASX 200 index<sup>^</sup>**



**Table 2: Total Shareholder Return (%) (including dividends)<sup>^</sup>**

	Commonwealth Bank Agribusiness index	S&P/ASX 200 index
Last month	-8.2	-7.3
3 months	-24.2	-10.9
6 months	-55.8	-33.2
12 months	-61.2	-35.2
Since April 00*	23.9	44.2

\* Start of the Commonwealth Bank Agribusiness index

<sup>^</sup> Data to 10 March 2009

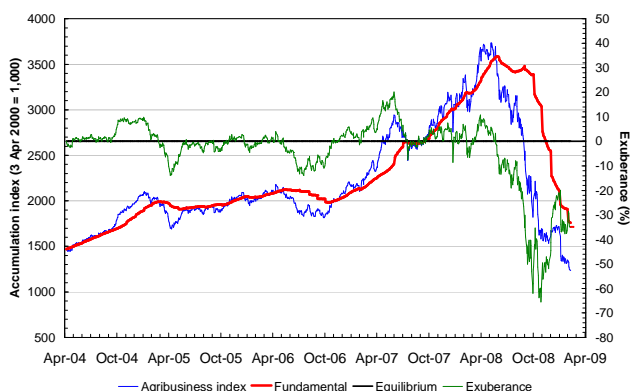
Source: Investment Research, PCS

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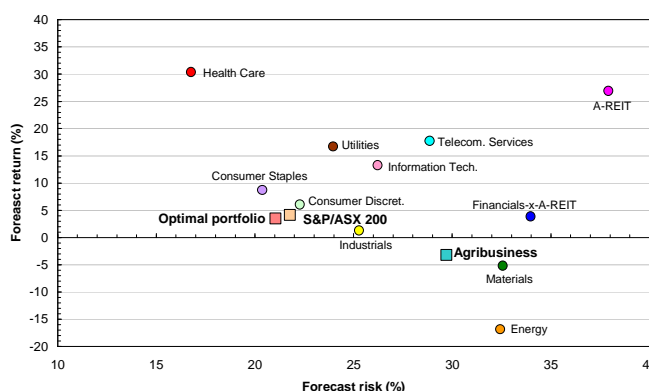
**Figure 2: Commonwealth Bank Agribusiness index, fundamental and exuberance**



Source: Investment Research, PCS

Note Figure 2: We show the relative pricing of the Commonwealth Bank Agribusiness index to 'fair value' in Figure 2. The fundamental of the Commonwealth Bank Agribusiness index is constructed using a proprietary method based on consensus forecasts of earnings and dividends (sourced from Reuters Knowledge) for the companies in the Commonwealth Bank Agribusiness sector. Exuberance is a proprietary measure of market mis-pricing, defined as the ratio of the index to the fundamental. Positive exuberance indicates over-pricing, while negative exuberance indicates under-pricing. We do not advocate using exuberance as a trading signal but as part of a 'scientifically' based market entry strategy.

**Figure 3: Forecast risk-return profile of Commonwealth Bank Agribusiness sector vs. S&P/ASX 200 sectors**



Note Figure 3: We compare the forecast risk-return profile of the Commonwealth Bank Agribusiness sector to the S&P/ASX 200 index and its sectors in Figure 3. The 'Optimal Portfolio' is the Maximum Sharpe Ratio portfolio in the efficient frontier optimisation of the S&P/ASX 200 sectors. This portfolio represents the best risk-adjusted return of all efficient portfolios. In the Optimal Portfolio we restrict sectoral weight to be between 0.5 and 2.0 times index weight. Allocation to the Commonwealth Bank Agribusiness sector is not included in the Optimal Portfolio. To be consistent with our other publications, forecasts of returns are quoted in simple terms while forecasts of risk are quoted in  $\ln(1+r)$  terms. Forecasts are for the next 12 months.

**Commonwealth Bank Agribusiness index details**

The Commonwealth Bank Agribusiness index measures the performance of the Commonwealth Bank defined 'Agribusiness' sector over time. The Commonwealth Bank Agribusiness sector currently consists of 16 rural-dependent companies: Australian Agricultural Company Limited (AAC), ABB Grain Limited (ABB), AWB Limited (AWB), Futuris Corporation Limited (FCL), Forest Enterprises Australia Limited (FEA), GrainCorp Limited (GNC), Gunns Limited (GNS), Great Southern Limited (GTP), Incitec Pivot Limited (IPL), Nufarm Limited (NUF), Primeag Australia Limited (PAG), Ruralco Holdings Limited (RHL), Ridley Corporation Limited (RIC), Select Harvests Limited (SHV), Tassal Group Limited (TGR), Timbercorp Limited (TIM). Companies previously included in the sector but since removed due to delisting or exiting the All Ordinaries index include Queensland Cotton Holdings Limited (QCH) and Auspine Limited (ANE).

The Commonwealth Bank Agribusiness index is a non-float adjusted, market-cap weighted index constructed using the same methodology as the S&P index series. To be considered for inclusion in the index, each stock must be a in the All Ordinaries index. The Commonwealth Bank Agribusiness index begins on 3 April 2000 which is the same date as the launch of the S&P/ASX index series in Australia. At inception there were 8 stocks included in the index. This number is currently 16.

**Table 3: Current Commonwealth Bank Agribusiness index membership and weights**

Code	GICS Tier 1	GICS Tier 2	Current Market Cap (\$mil)	Current index weight (%)
AAC	Consumer Staples	Packaged Foods & Meats	\$357	4.2
ABB	Consumer Staples	Food Distributors	\$843	9.8
AWB	Consumer Staples	Food Distributors	\$274	3.2
FCL	Consumer Staples	Agricultural Products	\$180	2.1
FEA	Materials	Forest Products	\$77	0.9
GNC	Consumer Staples	Agricultural Products	\$341	4.0
GNS	Consumer Staples	Forest Products	\$429	5.0
GTP	Materials	Forest Products	\$26	0.3
IPL	Materials	Fertilizers & Agricultural Chemicals	\$3,388	39.4
NUF	Materials	Fertilizers & Agricultural Chemicals	\$1,781	20.7
PAG	Consumer Staples	Agricultural Products	\$147	1.7
RHL	Industrials	Div Commercial & Professional Services	\$133	1.6
RIC	Consumer Staples	Agricultural Products	\$203	2.4
SHV	Consumer Staples	Agricultural Products	\$121	1.4
TGR	Consumer Staples	Packaged Foods & Meats	\$253	2.9
TIM	Materials	Forest Products	\$34	0.4

Source: Investment Research, IRESS

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