Quarterly Market Commentary as at 30 September 2009*

Market Indices	Returns as at 30 September 2009						
	1 mth (%)	3 mth (%)	6 mth (%)	1 yr (%)	3 yr (% p.a.)	5 yr (% p.a.)	10 yr (% p.a.)
Australian Shares							
S&P/ASX 200 Accum	6.24	21.50	35.21	8.34	1.66	9.99	9.50
International Shares							
MSCI World Ex Aust (AUD) Net	-0.94	7.07	10.88	-13.41	-9.90	-0.80	-2.32
Australian Fixed Interest							
UBSA Composite Bond Index 0+ Yr	0.72	1.76	0.41	7.07	6.29	5.88	6.23
International Fixed Interest							
Citigroup World Govt Bond 100% Hdg (AUD)	0.73	2.71	2.93	10.17	8.14	7.53	7.85
Property							
S&P/ASX 200 A-REIT	9.77	30.45	50.24	-23.73	-18.29	-4.41	4.47
Cash							
UBSA Bank Bill Index	0.28	0.80	1.59	4.31	6.16	6.01	5.67
Currency							
Australian Dollar ($A/$US)	4.69	9.17	27.02	11.89	5.75	4.03	3.06

Australian Shares

The Australian sharemarket rose strongly over the September quarter, with the S&P ASX 200 Accumulation Index up 21.5%. Overall, the Australian sharemarket rose by 8.3% over the 12 months cycle.

The Australian and major global sharemarket performances rose in the September quarter and were driven by the continued strong growth of the Australian sharemarket, the global economy showing signs of recovery, supportive initiatives out of the G20 meeting held in September and rhetoric from central bankers and world leaders over stimulus package handouts.

The Australian economy in the September 2009 quarter continued to show its resilience with second-quarter GDP rising above expectations by 0.6%. During this quarter, growth in domestic demand (such as private consumption and private investment) resulted from various government stimulus packages and business investment incentives. This took the annual pace of growth to 0.6%/yr, from 0.4%/yr in the first-quarter 2009, but well down from 3.0%/yr for the 12 months to June 2008.

Australian listed companies have raised additional capital of around A$100bn over the last 12 months. The Australian equities market also strengthened from the upcoming initial public offering (IPO) announced by Myer and Kathmandu also considering an IPO and a number of emerging merger and acquisitions activity, such as ANZ Banking Group and Macquarie Group announcing acquisitions.

The strongest performing sectors in the September quarter included Financials ex REIT (+33.2%), Industrial (+29.0%) and A-REIT (+28.0%). The major banks performed well over the quarter with some positive profit results and expectations that loan losses will be lower given the expected lower peak in the unemployment rate. Telecoms (-3.0%) was the worst performing sector as defensive companies tended to underperform given the increase in risk appetite.

Among the top 20 companies, top performers over the September quarter included Macquarie Group (+50.4%), ANZ Banking Group (+47.9%) and Brambles (+37.7%). The bottom performers over the September quarter were Telstra (+0.6%) following the government announcing its strong desire for its business to be split into two. Newcrest Mining (+5.1%) and CSL (+5.3%) were also underperformers, but still positive.

The Australian sharemarket has rallied sharply over past six months driven by realisation that the worst case scenario for the global and Australian economies did not eventuate, and that prospects of recovery for the global economy are improving. Share price gains are now starting to factor in substantial earnings growth over the next few years. For this to happen, private demand must return within the economy, allowing companies to grow revenues and expand operating margins to provide earnings growth. The big test will be when governments around the world begin to withdraw the large amounts of monetary and fiscal stimulus.

International Shares

The MSCI World ex Australia Net Index (AUD) rose 16.9% in $US and was up 7.1% when measured in $A. Over the 12 months, the index was down 13.4% in $A terms. During the quarter, the Australian rose sharply from US 80.75 cents to US 88.38 cents.

International sharemarkets were strong over the quarter. The global economy continues to show signs of strength with improving business and consumer confidence measures and improving manufacturing surveys. Some countries recorded positive second quarter GDP growth figures, including China, Korea, France and Germany, The US economy recorded a contraction of -0.7% annualised over the quarter, which was better than market expectations and an improvement on the -6.4% contraction in the first quarter 2009.

Over the quarter, the Dow Jones Industrial index rose 15.0%, the S&P 500 was up 15.0% and the NASDAQ index rose 15.7%. Over 12 months the Dow Jones Industrial index is down 10.5%.

Markets in Europe were also positive with some tentative signs of improvement in the European economy. In Germany, Chancellor Angela Merkel was re-elected, with a strong coalition, suggesting she would press ahead with tax cuts and labour market deregulation. Germany (+18.0%), Spain (+20.1%) and France (+20.9%) all rose. Over 12 months, Spain is positive, up 7.0%. The UK FTSE 100 rose 20.8% in the quarter. Unemployment across Europe continues to rise, however, reaching 7.9% in the UK, 18.5% in Spain and 7.7% in Germany.

Asian markets were positive but still experienced mixed performance. Japan's Nikkei index underperformed, up just 1.8%. Japanese voters elected the Democratic Party of Japan to power, the first time since 1955 that the Liberal Democratic Party has not held a majority in the Lower House. Elsewhere in Asia, China also underperformed, rising 1.7% with large falls in August on concerns over possible policy tightening. Singapore (+14.6%), Korea (+20.4%) and Hong Kong (+14.0%) all rose.

While the recovery in the global economy appears to be taking hold, it is likely to be fragile and slow. This was well recognised by a number of notable central bankers over the month. Chairman of the Federal Reserve, Ben Bernanke noted “Even though from a technical perspective the recession is very likely over at this point, it's still going to feel like a very weak economy for some time". Assisting confidence was an outcome of the G20 meeting and centred around ensuring fiscal and monetary stimulus was not withdrawn until growth takes hold.

Australian Fixed Interest

In Australia, the Federal Government released its final Budget outcome for 2008/09. The Budget deficit was A$27.1bn, or 2.3% of GDP, versus forecast of A$32.1bn or 2.7% of GDP. The better result was due to higher than expected tax revenues, especially from company profits. Revisions were also made to the Government’s net debt forecasts, upgrading the net asset position as at 30 June 2009 from A$4.7bn (-0.4% of GDP) to A$16.1bn (-1.3% of GDP) due to higher asset values.

The Australian Office of Financial Management issued a new Inflation Linked Bond in September, with a total of A$4bn raised. This was met by strong demand from the market. With revisions to the 2008/09 Budget Deficit, it is likely that total bond issuance will be substantially lower over the years ahead than originally forecast.

Ten year Australian government bond yields began the quarter at 5.52% and ended it at 5.36%, lower but still up from the low of 3.85% in mid January 2009. Bond yields fell on reassessment of the pace of global economic recovery, and partially due to the anticipated reduced supply. The return on the UBSA All Maturities Composite Bond index in the September quarter was 1.76% as bonds rallied. Over the 12 months to 30 September 2009 the return on the index was 7.07%.

International Fixed Interest

Internationally, the focus moved from central bank action to rhetoric about timing of withdrawal of stimulus. With the global recovery likely to be fragile, consensus among G20 nations is that stimulus will not be withdrawn until sustainable growth has re-emerged. This led to some changes to expectations fo lifts to official interest rates; the expectation by the market is that the Federal Reserve will stay on hold until the end of 2010. Despite increased supply of government bonds, bond prices rose (yields fell) over the quarter along with equity prices.

Over the quarter, US 10-year bond yields fell from 3.53% to 3.31%. They reached a high of 3.85% in early July, with markets factoring in a quicker US economic recovery and expectations that the Federal Reserve will consider lifting official interest rates. Late in the quarter, bond yields fell as a more realistic timeline emerged for economic recovery and stimulus withdrawal.

Elsewhere bond yields bond yields fell over the quarter. In Europe, 10 year bond yields fell from 3.39% at the end of June to 3.12% at end of September. In the UK, they fell from 3.69% to 3.36% and in Japan from 1.36% to 1.29%.

Australian Property (including Listed and Direct)

The Australian REIT sector rose 30.5% in the September quarter, although it is still down 23.7% over 12 months. The Mercers Direct Property Index fell 0.9% over the September quarter, to be down 13.1% over 12 months.

The sector has undertaken a large work-out programme over the past 12 months, raising capital and setting more realistic earnings expectations. The sector is also trading on a firm yield, which has started to prove attractive to investors with an improving domestic economy. Concerns are still held over the commercial property sector, with valuations still falling and tight access to credit remaining.

The industrial sector was the best performing sub-sector over the quarter, up 105.3%. The sector is still down 65.1% over 12 months. The diversified (+32.0%), retail (+25.6%) and office (+24.8%) sub-sectors all rose.

The better performers over the quarter were ING Industrial Fund (+157.1%), Goodman Group (+97.9%) and Mirvac Group (+57.1%). Commonwealth Property Office Fund (+14.5%), Dexus Property Group (+12.7%) and Bunnings Warehouse Property Trust (+7.1%) experienced more modest gains.

Cash

The UBS Australia Bank Bill index returned 0.80% in the quarter and 4.31% over the past 12 months. Ninety day bank bills rose slightly over the quarter, beginning the quarter at 3.19% and ended it at 3.38%, as expectations over the first official cash rate tightening rose. The average yield during the quarter was 3.27%, compared with 7.47% a year earlier.

The Reserve Bank of Australia (RBA) left official interest rates on hold at 3.0% over the quarter, but did signal that the next move in interest rates would be up. In leaving interest rates on hold, the RBA signaled some improved optimism for the Australian economy, stating “economic conditions in Australia have been stronger than expected, with consumer spending, exports and business investment notable for their resilience”. The RBA did note a change in risks t inflation, highlighting that the “likelihood of inflation being persistently below the target now looks low”.

Currency

The A$ rose in September quarter, closing the month at US0.8838 cents, a gain of 4.7% over the month on expectation that interest rates in Australia will be lifted before the end of the year.

In the September quarter the $A rose 12.5% against the UK pound with a pessimistic outlook for the UK economy and Budget situation. The $A fell 2.4% against the New Zealand dollar; was up 1.9% against the Japanese yen and 5.0% against the euro as the outlook for the economic recovery in Australia looks brighter than both Japan and Europe.

At the end of September 2009 the $A was buying 1.2205 New Zealand dollars, 79.25 yen, 0.5518 UK pence and 0.6035 euro cents.

***Source:** This commentary has been prepared by Colonial First State Investments Limited ABN 98 002 348 352 AFSL 232468 and is general information only.