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Commonwealth Financial Services

Quarterly Market Commentary as at 30 June 2010*

Market Indices	Returns as at 30 June 2010						
	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	-2.56	-11.14	-9.93	13.15	-7.85	4.52	6.95
International Shares							
MSCI World Ex Aust (AUD) Net	-4.15	-4.81	-3.75	5.22	-11.47	-2.16	-4.56
Australian Fixed Interest							
UBSA All Maturities Composite Bond Index 0+ Yr	1.37	3.60	4.90	7.86	7.67	6.06	6.37
International Fixed Interest							
Citigroup World Govt Bond 100% Hdg (AUD)	1.10	3.53	5.66	9.19	9.78	7.09	8.03
Property							
S&P/ASX 200 A-REIT	-0.84	-1.34	-2.83	20.41	-23.80	-8.04	2.94
Cash							
UBSA Bank Bill Index	0.40	1.12	2.15	3.89	5.56	5.77	5.55
Currency							
Australian Dollar ($A/$US)	0.70	-7.98	-6.08	4.48	-0.15	2.07	3.47

Australian Shares

Australian equities struggled in the June quarter, with the S&P/ASX 200 Accumulation Index declining 11.1%. Questions over the stability of the banking system in Europe and concerns about the fragility of the global economic recovery dampened investor sentiment towards share markets both domestically and overseas.

The other major factor which dominated attention for Australian equity market investors was the proposed introduction of the Resources Super Profits Tax. Uncertainty surrounding the implications of the new tax regime resulted in substantial volatility in the market, particularly in the Materials and Energy sectors as analysts and other observers debated the potential earnings impact of the proposal.

Debate around the tax highlighted the lack of support within the Government for Prime Minister Kevin Rudd and, in a dramatic series of events in June, Mr Rudd stood down as the leader of the Australian Labor Party. He was replaced by his former deputy leader, Julia Gillard, who in early July announced changes to the miner's super tax after consultation with the major mining companies.

In company news, Telstra and the Australian government owned company, National Broadband Network Co. signed an agreement for Telstra to provide access to Telstra facilities and progressively migrate Telstra traffic onto the National Broadband Network, while Newcrest Mining was successful in its takeover bid for Lihir Gold.

International Shares

The MSCI All Countries World index fell 12.2% in USD and was down 4.5% when measured in AUD. Over 12 months, the index returned 7.0% in AUD terms and 11.8% in USD. Over the quarter, falls in the Australian dollar assisted returns for local investors with the Australian dollar falling from US 0.9179 cents to US 0.8447.

International sharemarkets lost value in the June quarter as investors moved towards safer investments such as US Treasuries and gold. While the global economy is expanding, there are some evidence raising concerns of a soft patch in coming quarters. The major economies recorded positive GDP growth rates in the Q1 with growth recorded at 0.7% in the US, 0.2% in Europe, 0.3% in the UK and 1.2% in Japan but these growth rates may become difficult to match later in 2010.

In the US, company profits have recovered sharply, rising 34% for the 12 months to March 2010. This is an important theme for the US economy and indicates that businesses cut costs and improved efficiency. The next step should include capital expenditure and employment, both of which would drive the US economy forward. Continue tight lending headwinds have many businesses highlighting the difficulty of attracting credit as an impediment for growth. The US government is progressing with tightening its financial regulations, however, with continued downturn in investor sentiment, this could provide negative headwinds for the economic, investment and business markets. Over the quarter, the Dow Jones Industrial index fell 10.0%, the S&P 500 was down 11.9% while the NASDAQ fell 12.0%.

Markets in Europe were mixed and reflected the different economic performance between economies. Germany has been a clear winner from a weaker euro, with strong export growth and industrial production data. The DAX index fell 3.1% in the quarter. This is in contrast to falls in France (-13.4%) and Spain (-14.8%). The equity market in Greece fell 29.5% with government debt issues, civil unrest and strict Budget cuts. The UK FTSE fell 13.4%. The UK economy has shown signs of recovery, due to a stricter than expected government deficit reduction program, following a change in government in May 2010.

Asian markets were mixed with Japan falling after gains in the prior quarter. Some improvements in economic activity are occurring and have been driven by very strong intra-Asia trade. Japan also had a change in Prime Minister over the quarter. The Nikkei fell 15.4% and is now down 5.8% in 12 months. Hong Kong (-5.2%), Singapore (-1.8%) and Korea (+0.3%) provided mixed returns.

Australian Fixed Interest

In Australia, focus remains on the pace of tightening of the official cash rate by the RBA, the pace of economic growth and the announcement of the Federal Budget in May. The 2010/11 Budget announced by the Rudd government clearly showed Australia's relative fiscal strength. The key focus for budget policy shifted to the medium term restoration of surpluses and debt reduction. A budget surplus of $1bn was projected for 2012/2013 and a peak in net debt of just 6% of GDP in 2012/13. The centrepiece of the 2010/11 Budget was the previously announced Resource Super Profit Tax (RSPT), triggering a heated and ongoing debate with the mining industry. This was solved in early July following a change in Prime Minister and consultation with the mining industry. This resulted in a small loss of government revenue forecasts, but was offset with changes to the promised reduction in the corporate tax rate, now lowered to 29% rather than 28%.

The earlier return to surplus was driven by underlying improvements in the domestic economy. It also resulted in lower projections of Commonwealth Government Securities (CGS) on issue. In the Budget released in 2009, CGS on issue was expected to peak at $A 300bn, this has now been lowered to around $A200bn.

For the better part of the quarter, risk appetite was low as the sovereign debt crisis in Europe intensified. Riskier asset classes were sold off, while Commonwealth government bond yields fell in all maturities across the curve. 3-year Commonwealth Government bonds yields rallied by 83bps and finished June at 4.45%, while 10-year yields fell by 69bps ending June at 5.11%.

International Fixed Interest

There was a marked difference of performance among the major global bond markets during the June quarter. This was driven by a flight to quality with investors searching out perceived safer investments as concerns escalated over sovereign risk in Europe and the pace of economic growth. Softer economic data in the second half of the quarter saw markets and economist push out expectations of central bank tightening in the US, UK and Europe into 2011.

In the US, 10-year Treasury bond yields trended higher early in April, almost touching 4% after strong employment and manufacturing data results. However, yields fell back towards March-end levels by the end of April, on the back of flight to quality amidst the continued uncertainty surrounding Europe. 10-year yields traded in a range of 3.1% to 3.3%from mid May to mid June, but weaker data and the rise in risk aversion resulted in yields closing the June quarter below 3%, a level not seen since April 2009. The downward trend remains strong and the momentum could push yields even lower in the near-term, given the stress in the banking system, tightening financial markets regulations and lack of inflationary pressures.

In Europe, the most notable theme was the continued elevated spread between Greek and German bonds. Germany has largely been seen as a safe haven for investors, and resulted in 10-year German Bund yields falling from 3.09% to 2.58% over the quarter. In contrast, Greek yields rose from 6.53% to 10.43% but spiked as high as 12.45% prior to the announcement of the EU stabilisation package. Portugal, Italy and Spain also saw yields rise as credit ratings were reassessed by the major rating agencies. In the UK, government bond yields also fell sharply, from 3.94% at the end of March to 3.36% at the end of June on flight to quality and concerns over economic growth as a tough emergency Budget was announced after the change in government.

Australian Property (including Listed and Direct)

There was a fair degree of volatility in the share prices of listed property companies in the June quarter, although prices were little changed in the period as a whole. In the three months to 30 June 2010 the S&P/ASX 200 Property Accumulation Index declined 1.3%.

There was some variability of returns from different sub-sectors of the market. The retail sub-sector was the best performer, adding 1.4%, reflecting the buoyancy of retail sales growth. Office (+0.1%) was the only other sub-sector to register a positive return; diversified and industrial lost 4.8% and 3.3% respectively.

The outlook for listed property trusts has undoubtedly brightened in recent months and there have been several encouraging signals that property valuations have stabilised. Transaction activity has also picked up from the low levels of 2009, which is an important step in restoring investor sentiment towards the asset class. Share prices in the sector rose nearly 24% in the second half of 2009, however, so a period of modest share price performance has not been surprising.

Overseas property stocks didn't perform as well as their Australian counterparts, with the UBS Global Investors Index declining 4.8% in Hedged Australian dollar terms. Economic growth expectations in key region such as the US and China did little to support investor sentiment towards global property securities.

Cash

The UBS All Maturities Composite Bond Index returned 3.60% in the quarter and 7.86% over 12 months. In the shorter end of the market, the UBS Australia Bank Bill index returned 1.12% in the quarter and 3.89% over 12 months. The returns from this index reflect interest earnings on short term money market securities and reflect the recent low level of the official cash rate. Ninety day bank bills trended higher over the quarter, beginning the quarter at 4.49% and ended it at 4.92% with the RBA lifting the official cash rate twice in the quarter. The average ninety day bank bill yield during the quarter was 4.75%, compared with 3.16% a year earlier.

New inflation figures released in Australia in April indicated that headline inflation was picking up pace with the expansion in the Australian economy and low spare capacity. The Consumer Price Index rose 2.9% for the 12 months to March 2010, up from its low of 1.3% for the 12 months to September 2009 and 2.1% for the 12 months to December 2009. Underlying inflation remains elevated at 3.1% down from recent highs. The RBA has acknowledged that underlying inflation will remain in the upper half of the target zone over the next year, while headline inflation could be above 3% due to the effects of increases in tobacco prices and significant increases in utilities prices.

As we look into 2010, yields will be affected by further of RBA tightening interest rates, the pace of growth in the Australian economy and the speed at which capacity constraints are faced.

Currency

The AUD fell in the June quarter with global financial market uncertainty, some signs of softer data in Australia and an "on-hold" in the latter half of the quarter. The AUD finished the quarter at US0.8447 cents, a loss of 8.0%. Falls came despite commodity price gains for Australian exports (predominantly iron ore and coal) and a domestic economy that was outperforming most peers.

The AUD fell 4.5% against the sterling and 9.2% against the Yen. The Australian dollar also depreciated 4.6% against the New Zealand dollar. Gains were made against the euro, rising 4.6% as the European economy faces the headwinds of large government debt levels and very strict fiscal consolidation plans.

At the end of June 2010 the AUD was buying 1.2285 New Zealand dollars, 88.44 yen, 0.5658 UK pence and 0.6907 Euros.

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