

Market Update for July 2010

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Market Update – July 2010

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The month of July saw a reversal of recent share market weakness and an easing of market volatility. Oil prices rallied in line with stronger global share markets, bond yields were mixed and the Australian share market moved sharply higher following a positive lead from US and European markets.

At a glance

- Global share markets end a three-month losing streak
- Oil prices move higher
- The Reserve Bank keeps interest rates on hold for a second month in a row
- Prime Minister Gillard announces changes to the Resource Super Profits Tax
- The Australian dollar jumps almost 8%

Global share markets rally

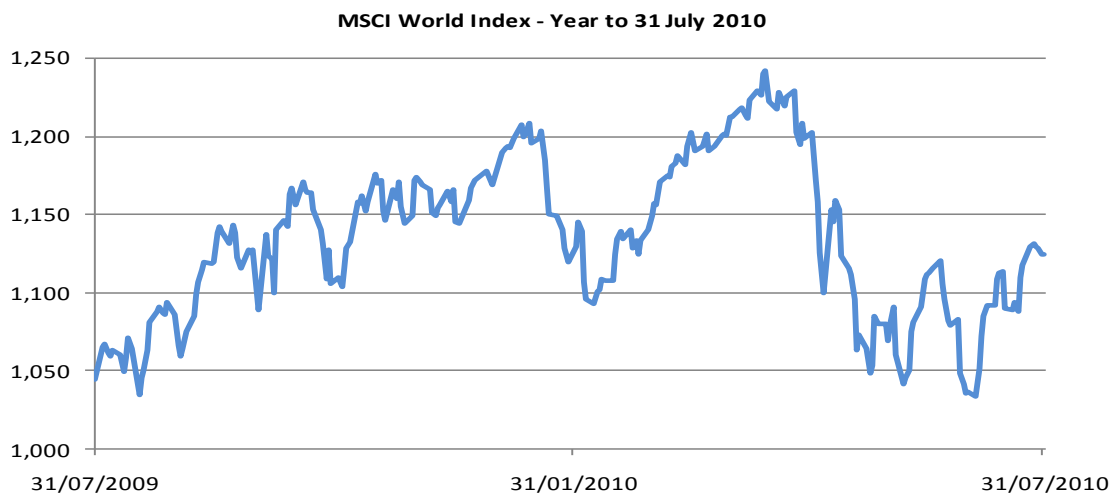
After three consecutive months of declines, global share markets rallied strongly throughout July amid some stronger-than-expected earnings results and a favourable outcome to European bank stress tests.

Despite all the doom and gloom leading into the latest reporting season, around 75%¹ of US companies and 60% of European companies have so far posted results that have exceeded analysts' expectations. Meanwhile, investors reacted positively to the outcome of stress tests on 91 European banks.

The tests stemmed from the fallout from the European debt crisis, and the results – 92% of banks passed – suggest that the European banking system is in much better shape than initially thought. Admittedly, the tests probably weren't as tough as they could have been, but that seemed to have little bearing on investor confidence.

In the US, the benchmark S&P 500 Index closed the month 6.9% higher while share markets in the UK (+6.9%²), Europe (+6.6%³) and Japan (+1.6%⁴) were also stronger. Globally, share markets closed July 8.0%⁵ higher (see following chart).

Source: Bloomberg



Source: Bloomberg

¹ As at 31 July 2010

² UK shares measured by the FTSE 100 Index

³ European shares measured by the Dow Jones Eurostoxx50 Index

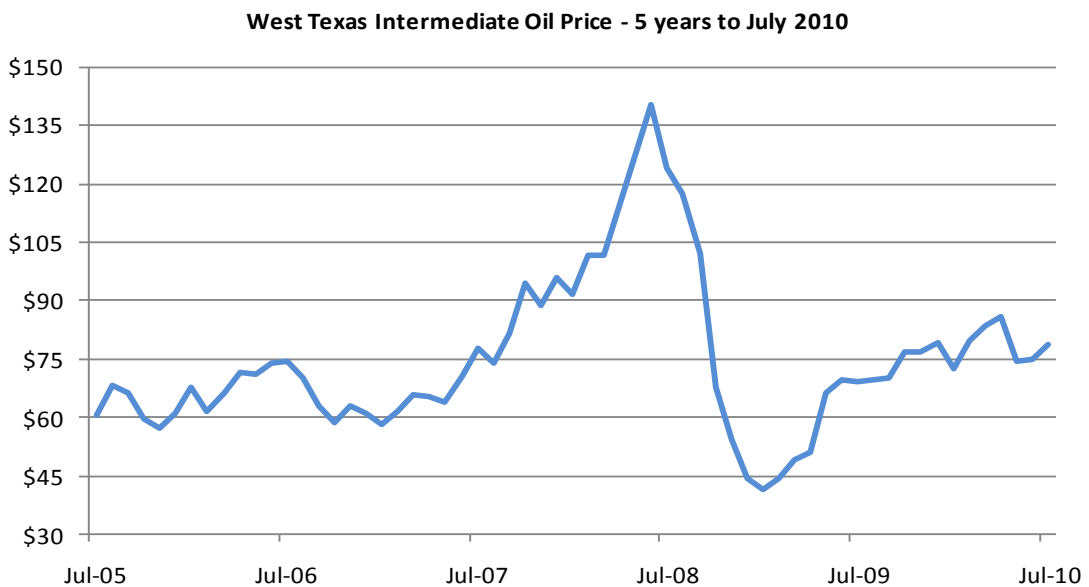
⁴ Japanese shares measured by the Nikkei 225 Index

⁵ Global shares measured by the MSCI World Index

Oil prices rally

Oil prices fell early in July on concerns about the outlook for global growth, but this trend was later reversed amid stronger US and European earnings results and a weaker US dollar. Prices were also buoyed by easing fears over the European debt crisis and threats by Venezuela's President, Hugo Chavez, to cut oil supplies to the US if Columbia launched any military action against his country. Venezuela is the world's fifth largest oil exporter.

Oil closed the month 4.9% higher at US\$78.95 a barrel and is now just 0.5% lower so far this year.



Source: Energy Information Administration

Bond yields mixed

Government bonds were mixed in July, with easing market volatility and risk aversion offsetting expectations of more moderate global growth. In the US, the yield on 10-year bonds fell¹ two basis points to close the month at 2.91% while in Australia the yield on our 10-year bonds went the other way, rising 11 basis points to close at 5.20%.

Interest rates on hold

As was widely expected, the Reserve Bank of Australia (RBA) left the official cash rate unchanged at 4.50% following its early July Board meeting. With interest rates now around their average levels of the past decade and Europe's sovereign debt issues having created some uncertainty over the outlook for global growth, the Bank considers the current level of monetary policy as appropriate. It was the second consecutive month that the RBA has kept interest rates on hold, and with the recent June quarter inflation numbers being relatively benign, expectations are that the Bank will keep rates on hold again in August.

Elsewhere, the European Central Bank (1.00%), the Bank of England (0.50%) and the Bank of Japan (0.10%) all kept their respective benchmark interest rates on hold. The US Federal Reserve didn't meet in July.

¹ Bond yields have an inverse relationship with bond prices, meaning that when yields fall, prices rise (and vice versa)

RSPT renamed MRRT

Early in the month, Prime Minister Julia Gillard announced a number of key changes to the Federal Government's controversial Resource Super Profits Tax (RSPT). Given that the introduction of the RSPT had contributed to the demise of her predecessor, it was only a matter of time before Ms. Gillard met with the mining community to work out a compromise.

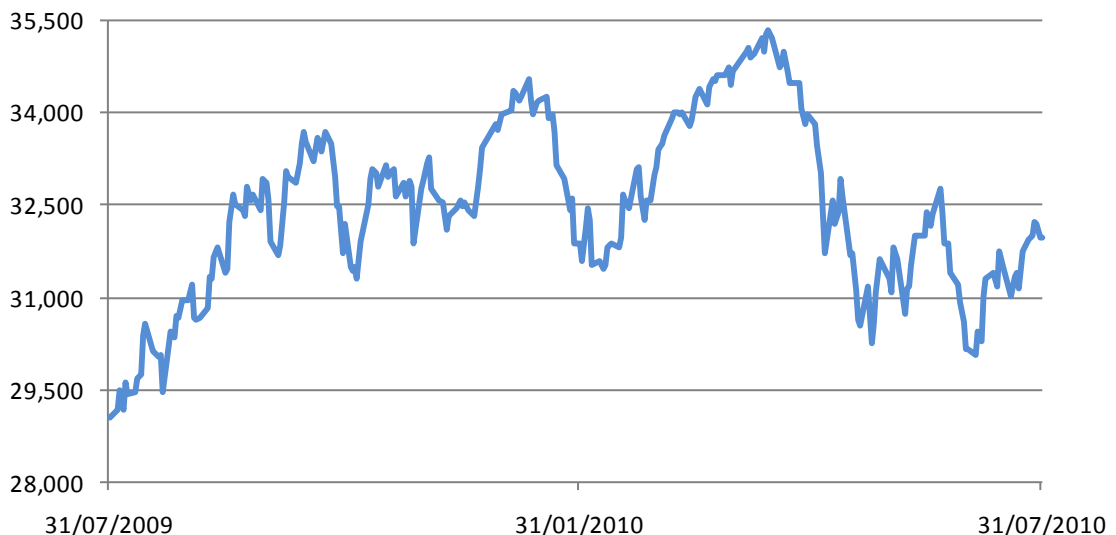
The upshot of the meeting is that the RSPT will now be known as the MRRT, or Minerals Resource Rent Tax, and will only apply to coal and iron ore (our two biggest exports). In addition, the MRRT will apply at 30% rather than the initial 40%, and smaller miners with profits of less than \$50 million per year will be exempt.

Australian market higher

The Australian share market ended the month higher, with the S&P/ASX 200 Accumulation Index jumping 4.5% on the back of a better lead from global share markets and strong gains from the likes of BHP Billiton and Rio Tinto (both of which flagged significant iron ore price rises).

Importantly, July's gain ended a run of three consecutive monthly losses for the Australian share market, though it remains 5.9% lower so far this year. This compares to -9.6% in Japan, -7.6% in Europe, -2.9% in the UK and -1.2% in the US. However, it is worth noting that global share markets, including our own, continue to trade well above the bear market lows they set back in March 2009.

S&P/ASX 200 Accumulation Index - Year to 31 July 2010



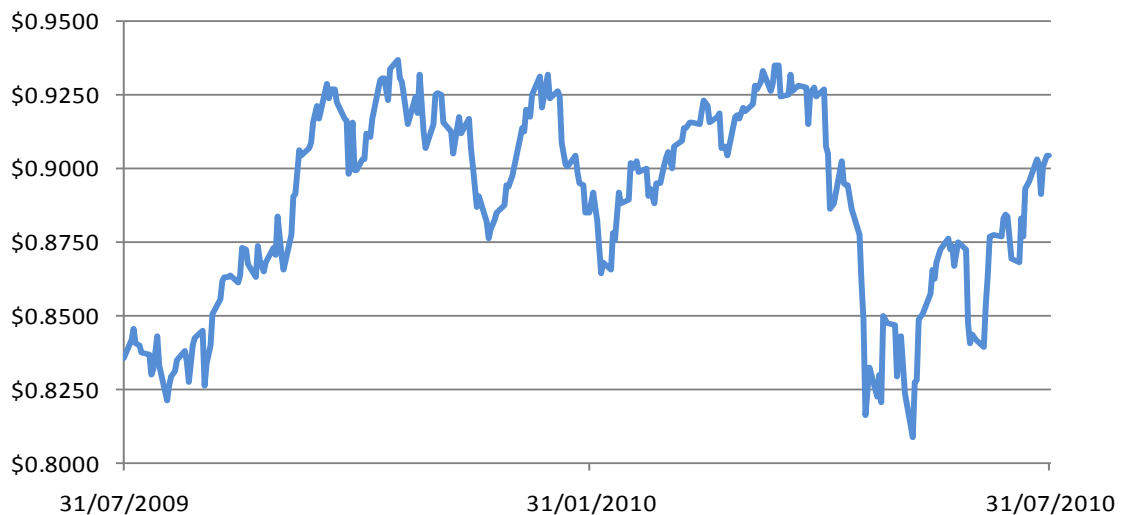
Source: Premium Data

Australian dollar rebounds

The Australian dollar (A\$) surged against its US counterpart in July as signs that the global economy is beginning to stabilise boosted demand for higher-yielding assets like the Aussie. Investors essentially regained their appetite for risk following stronger US and European earnings results and the fact that only seven of the 91 European banks subjected to stress tests actually failed. A series of positive domestic economic data, stronger global share markets and higher commodity prices also contributed to the gains. The local currency closed July 7.6% higher at US\$0.9040 cents – its highest level in almost three months.

The outlook for the A\$ remains fairly positive given that Australia still maintains a favourable interest rate differential against the major economies, and because Chinese demand for our commodities is expected to remain strong.

Australian dollar versus US dollar - Year to 31 July 2010



Looking ahead

Concerns about the European debt crisis have eased somewhat in the wake of this month's stress tests on European banks, and this has in turn boosted investor confidence not only in the euro-zone but in all the other major markets as well. That said, fears of a 'double dip' recession may persist for a while longer and this will likely result in further volatility in financial markets.

The Australian economy remains relatively well-placed compared to many of its global counterparts and should continue to benefit from strong Chinese demand for our resources. In addition, positive profit results in the US have helped underpin stronger gains in the local share market, with investors anticipating a similar outcome from the upcoming Australian profit reporting season.

In terms of domestic interest rates, expectations are that the RBA will remain on hold following its early August Board meeting. Easing inflation and the fact that previous rate hikes are beginning to have an impact on consumers means there's no real need for the Bank to rush into raising rates any time soon. However, the RBA does retain a tightening bias and further rate hikes by year-end are still possible.

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