

A high AUD and the relevance for Australian equity investors

Money markets expect that the Federal Reserve will remain committed to keep its policy rate at “exceptionally low levels for an extended period”. More broadly, we expect a continued widening of interest rate differentials between Australia and the remaining G-20 economies (Chart 1.1), as the Reserve Bank of Australia continues to lift its official interest rate - we expect to around 5% by mid 2010- whilst the remaining economies (the US included) keep their official cash rates at record lows.

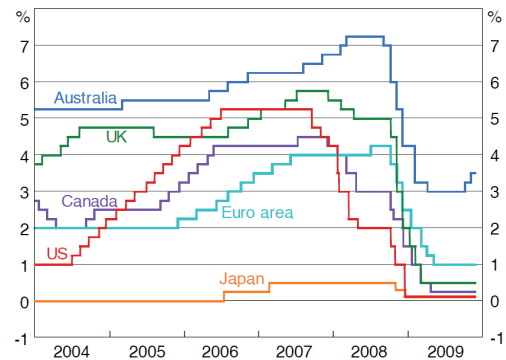
Economically, Australia is in a small group of out-performers among the Group of Twenty (G-20) economies. Overseas economic developments also remain an important influence on the Australian dollar, with regular bouts of investor concern about the strength of the global economic recovery - which has the effect of pushing AUD down – typically short lived. Commentators continue to upgrade their forecasts for Australia’s major trading partners in Asia, with this optimism validated by solid economic data (Chart 1.2).

The resilience in Asian economies has also pushed commodity prices higher, with many analysts (including Ausbil) of the view that the prices of key Australian export commodities are past their low point. As an example, and highlighted in the chart below, the commodity analyst at the Commonwealth Bank of Australia is forecasting a 25% increase in commodity prices over the two years to 2011.

Whilst we are optimistic about the Australian economy and the currency, the AUD will not track higher indefinitely. We anticipate the USD to start to rally against all currencies in the second half of 2010 when, reacting to an expected rebound in US economic activity, the US Federal Reserve commences raising rates.

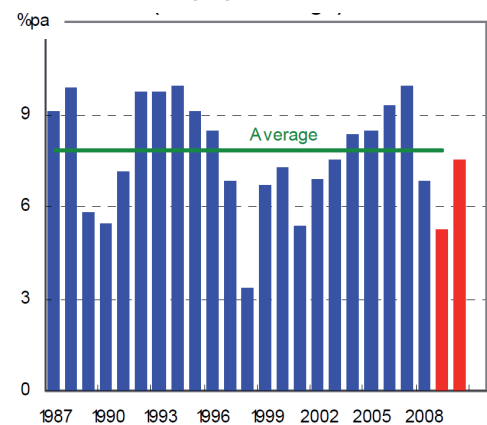
As investors, we need to consider the macro-economic influences on our equity portfolio and also understand the detail regarding the various approaches companies undertake to manage their respective currency risks. The sectors most sensitive to AUD/USD currency movements include Energy, Construction Materials, Diversified Metals & Mining, Gold, Global Media, Pharmaceuticals & Biotechnology, Health Care Equipment & Services, General Insurance and REIT’s. In setting our portfolio, these macroeconomic influences weigh on stock and sector valuations and, in anticipation of an inflection point in the AUD, will adjust the portfolio and accordingly take advantage of presented opportunities.

Chart 1.1 Major Countries’ Policy Interest Rates



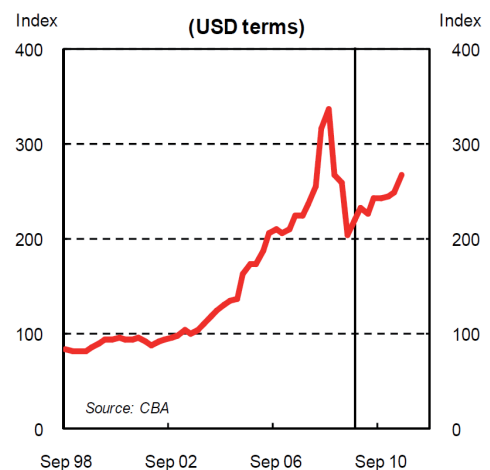
Source: RBA, Central Banks

Chart 1.2 Emerging Asia Growth (annual % change)



Source: RBA, Central Banks

Chart 1.3 CBA Commodity Price Index



Source: RBA, Central Banks