

Resources in 2010

The improvement in global economic indicators such as GDP growth, unemployment (lagging indicator), house prices, industrial production and manufacturing purchases suggest the global economic recession has bottomed or is near a bottom and that the macroeconomic backdrop is likely to improve. Within this context, developed economies are recovering which is supportive for commodity prices and equity valuations.

Improving World GDP growth

As seen in the chart below, global economic growth is expected to improve and remain positive throughout 2010, albeit lower than levels experienced prior to the global financial crisis. The exception is the emerging economies, which are likely to maintain their strong growth. China, in particular, is aiming to achieve economic growth of 8% p.a., driven by their need to build significant infrastructure – a commodity intense undertaking.

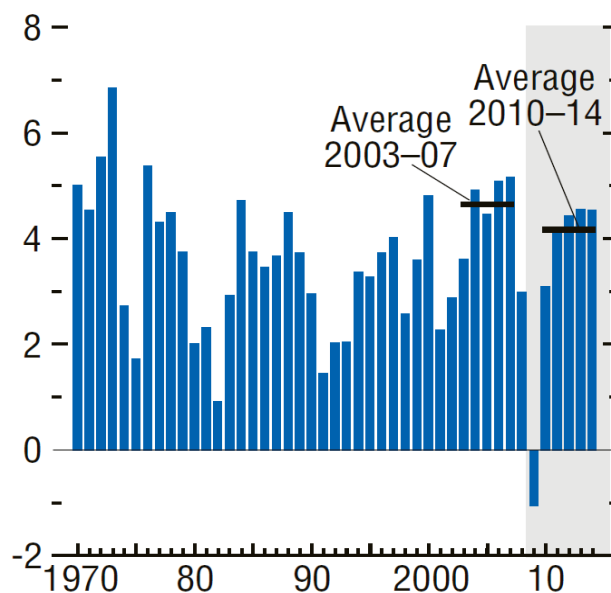
Not all commodity markets are the same

The supply side fundamentals for industrial metal commodities varies, with aluminium and nickel seeming weak as illustrated in Chart 2. In contrast, Ausbil's preferred industrial metals are supply constrained, namely platinum and copper. Aluminium appears to have weaker supply fundamentals but its demand fundamentals on a recovery scenario is strong due to the construction and transportation sectors.

A further factor for consideration has been the selling of USD for funding of hard asset purchases including terminal market traded commodities. Any indication of a bottoming USD is likely to lead to an unwinding of this trade, and resultant volatility in the price of exchange traded commodities (aluminium, nickel, zinc, copper, platinum, gold).

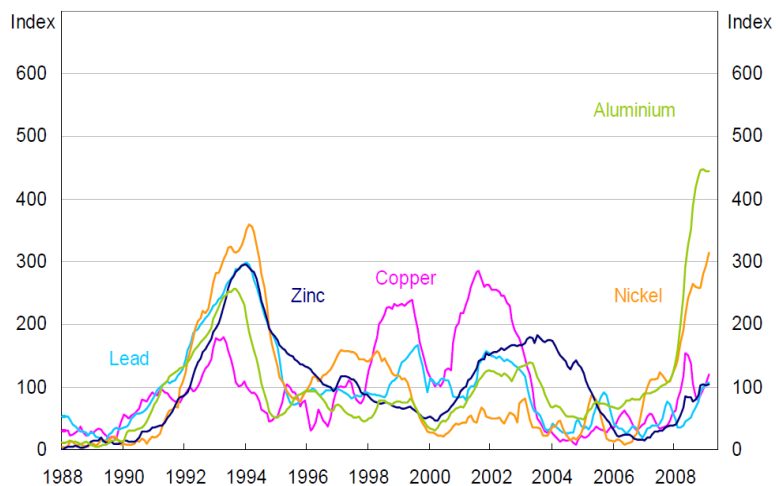
The supply demand fundamentals for bulk commodities is more closely aligned to emerging market economic growth due to the energy intensity of this growth and the importance of steel-making in the urbanisation process. Ausbil favours Hard Coking Coal and Iron Ore and in both instances, as illustrated by charts 3 and 4, their spot prices are well above the contract benchmark prices. We therefore expect upgrades to benchmark prices and flowthrough upgrades to resource company earnings forecasts.

Chart 1: World Real GDP Growth



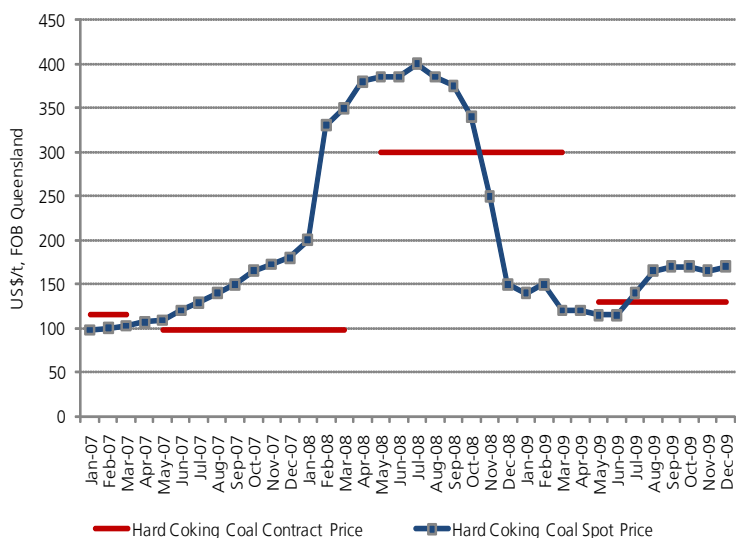
Source: IMF, World Economic Outlook, October 2009

Chart 2: LME Base Metals Inventories



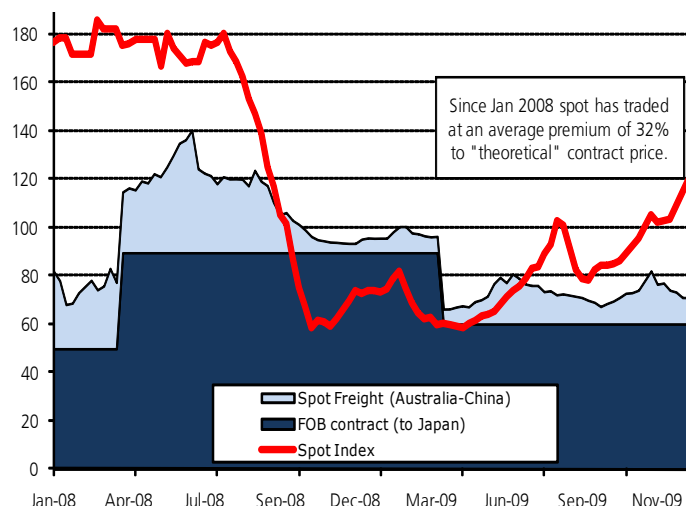
Volumes, LR Average=100
Source: Datastream, NAB Group Economics

Chart 3: Hard Coking Coal Prices



Source: CRU International, Goldman Sachs JBWere

Chart 4: Iron Ore: Spot versus Contract (US\$/t CFR China, 62% Fe)



Source: Reuters, Metal Bulletin Iron Ore Index, Platts, TSI, Goldman Sachs JBWere

How much of this information is priced into metals & mining company share prices?

As seen below, resource company multiples are more than justified by their expected strong (absolute and relative) earnings growth over the next two financial years. Further confirmation of commodity price strength is likely to further bolster this expected earnings growth.

	EPS Growth FY10	EPS Growth FY11	PE FY10	PE FY11
Market	2.0	23.7	15.8	12.8
Resources	17.1	47.2	20.8	14.2
Diversified Metals & Mining	14.9	42.5	18.2	12.8

Source: Broker consensus data, Ausbil 15th December 2009.

Furthermore, when examined within an historical context, Diversified Metals & Mining as a sector is trading around an average PE relative multiple, as illustrated in Chart 5.

Chart 5: Diversified Metals and Mining- Forward P/E Relatives



Source: Ausbil Dexia

Summary

The improving outlook for global economic growth is highly supportive for commodity prices, and in particular those commodities with favourable supply demand fundamentals. The risk to this outlook would be if the global economic growth momentum deteriorates, however, history suggests that this would require a significant government policy error and we believe that this is unlikely. The other risk is the potential impact a rising USD will have on commodity prices. Whilst the initial reaction may be a sell-off in exchange traded commodity prices as speculators rotate asset allocation, we believe that fundamentally a rising USD suggests an improving US economy, which over the medium to longer term provides further support to commodities.