

Profit reporting season and earnings expectations

After the Australian equity market rose 37% in the 2009 calendar year, the market has begun the 2010 calendar year with a negative return in January. Investment sentiment has been volatile as investors digest the release of global macro economic data and try to interpret what impact the removal of global government fiscal (Chart 2) and monetary (Chart 1) stimulatory measures may have on economic growth and corporate earnings. The major moves are summarised in the following charts:

Chart 1: Major Countries' Policy Interest Rates

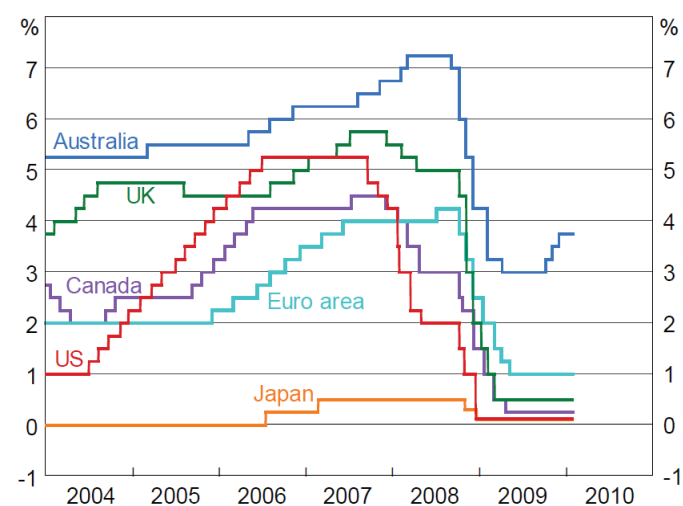
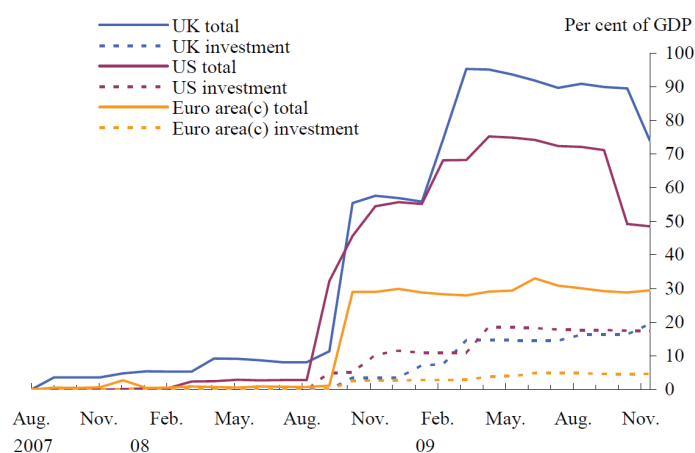


Chart 2: Public sector interventions during the financial crisis



Even though the major developed economies are showing clear signs of improvement, growth needs to trend higher in a sustained manner. More recently, China's government introduced measures to reduce lending and control economic growth. This should be seen within the context of low double digit growth being reduced to sustainable high single digit growth, as per the country's officially enunciated "5 year plan" objectives.

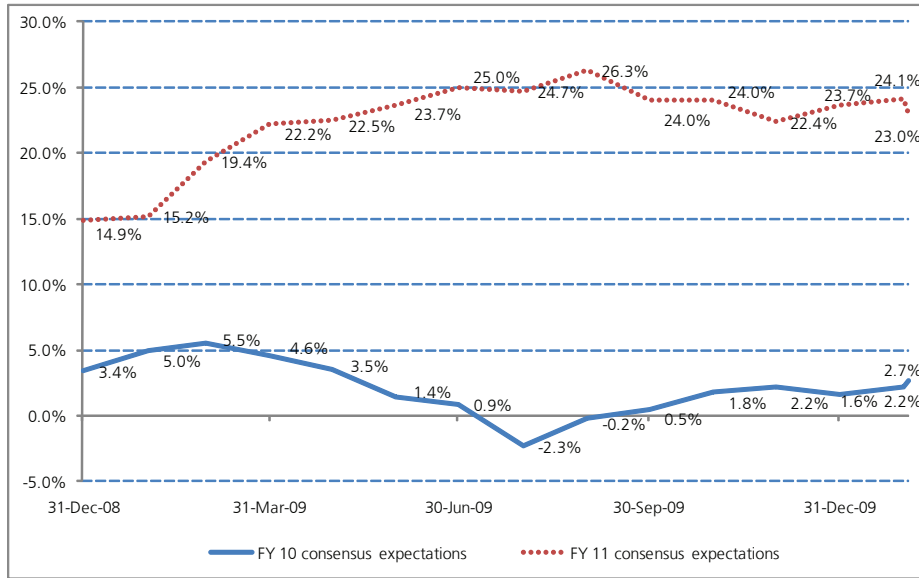
From a market valuation perspective, the Australian equity market has historically traded on a forward P/E multiple of ~14.5x. Within this context, Table 1 below suggests that the Australian equity market currently represents reasonable value at a PE multiple of 12.5x for the 2011 FY forecast. Additionally, Chart 3 illustrates the improvement in earnings trend for the market. Ausbil considers the 2010 FY earnings growth forecast of +2.7% to be conservative and we would expect to see this growth rate trend to increase over coming months. As a result, we feel that the prospect of improving earnings will also be supportive of current valuations.

Table 1

As at 02 February 2010	PE FY 2010(E)	PE FY 2011(E)	EPS Growth FY 2010(E)%	EPS Growth FY 2011(E)%
Market	15.3x	12.5x	+2.7	+23.0
Banks	13.5x	11.0x	+12.7	+23.4
REITS	13.0x	12.6x	-30.1	+3.3
Industrials	15.2x	13.1x	-5.5	+15.5
Resources	19.3x	13.4x	+21.3	+44.2

Source: Ausbil calculation based on consensus broker earnings forecasts.

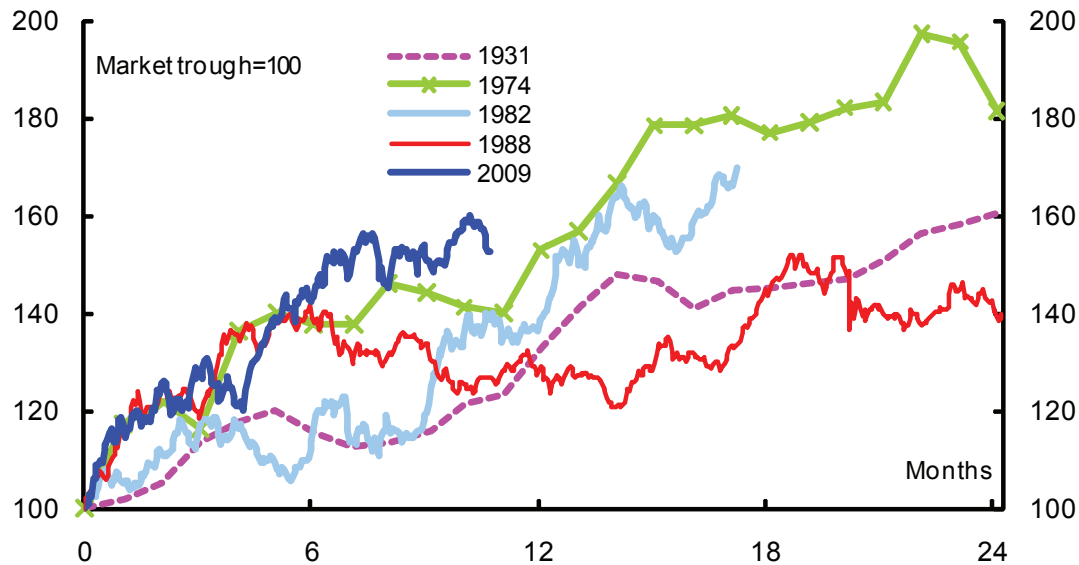
Chart 3: EPS Growth



Source: Ausbil calculation based on consensus broker earnings forecasts.

Sharemarkets rarely recover in a straight line. As illustrated in Chart 4, history has shown that the market will 'correct' during a market recovery from a trough. This usually occurs during periods when investors wait for earnings to support prices.

Chart 4: Recovery from largest falls in the Australian equity market



Source: IRESS, Wren Research, ASX, Deutsche Bank

Obviously, the 2010 February profit reporting season will be an important milestone for Australian equity market investors. In our view, we believe that the Transport, Construction Materials, Diversified Metals & Mining, Banks, Media, Retail and General Insurance sectors may surprise the market with better than expected earnings results. However, we also believe that there will be greater dispersion in earnings results within sectors and therefore stock selection will also be an important factor. There is a risk that earnings do not meet expectations, however we believe this risk is low and as a result retain Portfolio settings consistent with an anticipation of earnings recovery.