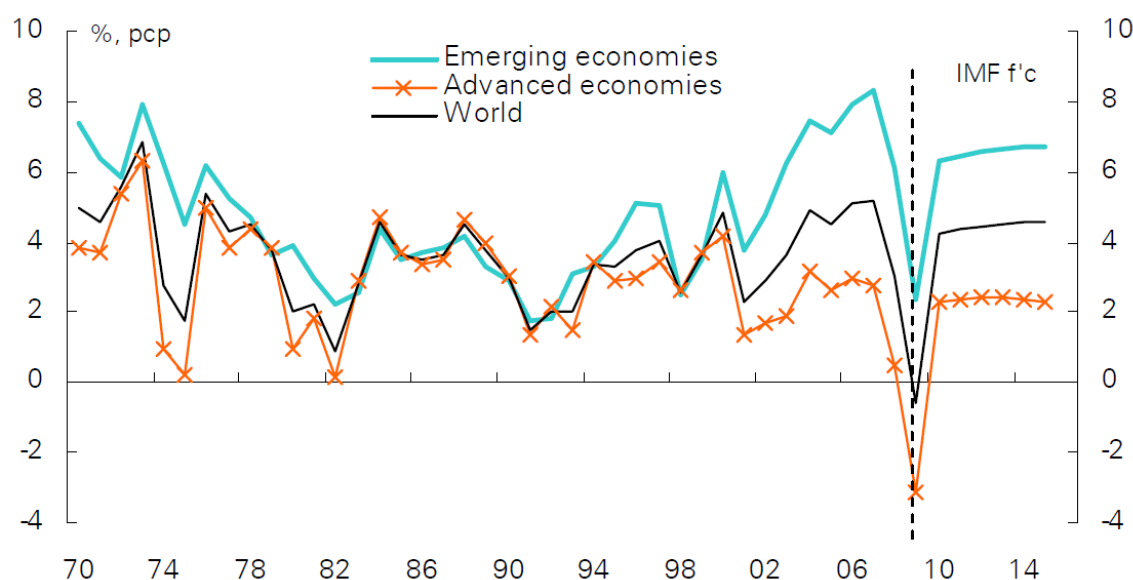


Significant dispersion of stock valuations is creating opportunities

Global share markets continued to lack confidence during the last month of the domestic financial year. Even though the global economy is showing signs of improvement, recent economic data suggests the pace of growth may be slowing, while the uncertainty regarding European sovereign debt continues to overhang the European economy. In Australia, the Federal Government's Resources Super Profits Tax ('RSPT') proposal and the public advertising battle with the Mining industry has not assisted with market confidence. This uncertainty has led to falls in equity market share prices and has resulted in a significant dispersion of stock valuations.

The Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) continue to point to economic expansion, albeit at a different pace across countries and regions. Economic activity continues to improve in the US, Japan and notably China. Market impressions regarding China's growth prospects most recently oscillate between unsustainable and slowing. We expect China GDP growth to slow from low double digit to high single digit growth. Meanwhile, the weaker Euro economies remain under pressure with the fiscal spending cuts aimed in addressing outstanding sovereign debt likely to result in positive, albeit lower GDP growth. Germany is an exception, with the weaker euro dollar assisting their export competitiveness. Overall, the rate of global GDP growth is likely to slow. The Chart below illustrates the continued level of GDP growth and the extent of the potential slowdown.

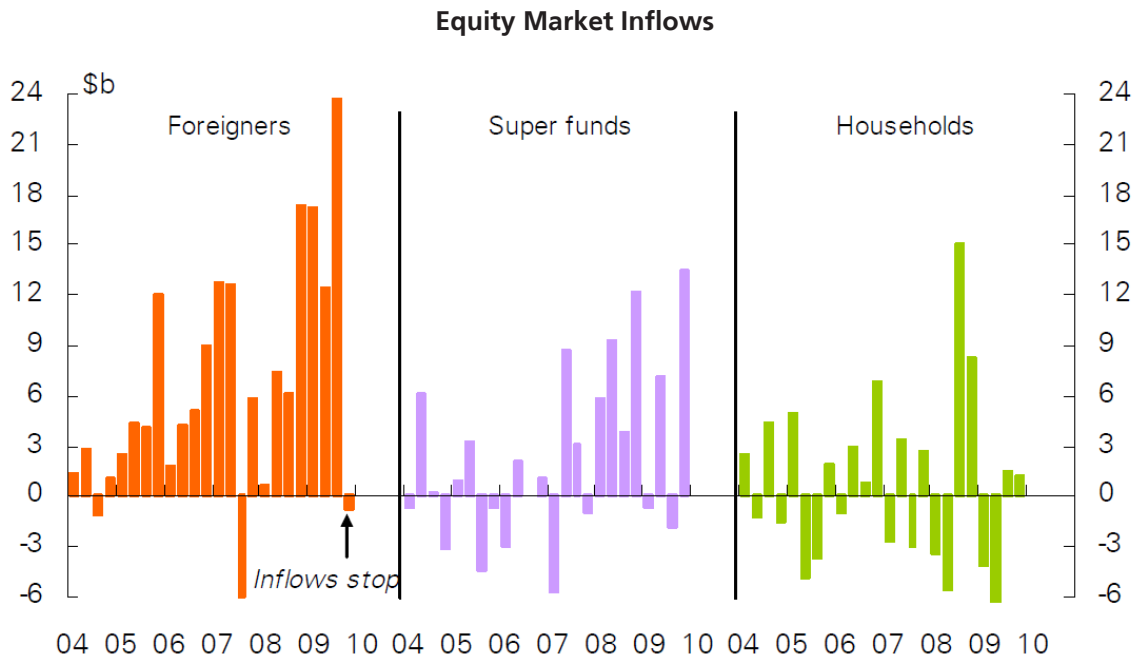
World GDP Growth



Source: IMF

In Australia, the announcement of the proposed 'RSPT' in late April was anticipated by the market but the punitive parameters were a surprise for all investors, especially international equity investors. Anecdotally, this has resulted in an increased domestic political risk premium. There was additional anecdotal evidence from our discussions with market participants that international equity investors sold out of Australian shares as a result of this political uncertainty.

The chart below illustrates how international investors were already withdrawing from Australia prior to the 'RSPT' announcement. As a result of the proposed RSPT, the public relations battle between the Federal Labour Government and the Mining industry resulted in the sensational replacement of Prime Minister Kevin Rudd. However, at the time of writing this report, the new Gillard Government had agreed to a compromise with the mining industry.



Source:ABS

The slowdown in global GDP growth has in some instances led to equity market earnings revisions. In addition, the equity market volatility has also led to a magnified dispersion of sector PE relative valuations. The share prices of companies that display defensive earnings characteristics currently trade on a PE relative multiple that suggests a 40% premium to market. Conversely, cyclical industrial stocks are trading at share prices that reflect a 20-30% PE relative discount to market, while selective REITs are trading at share prices below conservative net tangible asset valuations. However, the most significant discount is seen in the Resources sector where share prices have been adversely impacted by global GDP growth concerns, China growth concerns, and by the proposed 'RSPT'. This PE relative discount ranges from 40% to 60% to market, with smaller resources stocks displaying the largest discounts.

In summary, global equity markets are concerned with the rate of global GDP growth and there is increased anxiety about a possible double dip recession scenario – an event which we still view as being less likely. The Australian equity market has been influenced by the softening macro economic environment and by the political concerns regarding the introduction of the 'RSPT'. However, the Australian Federal Government seems to have found a resolution to the proposed tax with the Australian mining industry. Due to this macroeconomic and political backdrop, we find that there are significant valuation dispersions across the market that are creating attractive medium to longer term investment opportunities in a number of sectors.