# Lyfords ecomomic commentary

24 April 2009

Lyfords brings you this summary of investment markets over recent weeks. Please contact your Business Development or Relationship Manager if you have any questions or require further information.

## Key Market Developments

US stocks lifted off new lows early in March and these gains have extended into April. The market is now more than 27% off those lows but led by some of the previously worst performing stocks - the so called “dash for trash”. So far, bank earnings results have been broadly consistent with optimistic comments, posted by CEOs early in March that banks had better results in the first quarter of this year, before write-downs and provisions.

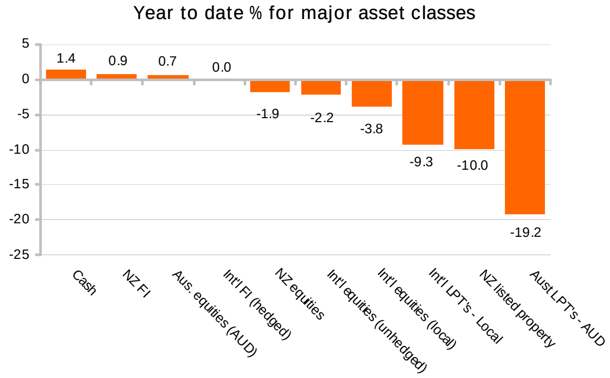
The US Federal Reserve said it will buy US$300 billion in Treasury securities and increase its purchases of mortgage and agency debt as part of its “quantitative easing” policy. The Federal Reserve will purchase up to an additional US$750 billion of agency mortgage-backed securities to help improve conditions in private credit markets.

The details of the Obama administration Financial Stability plan were well received by equity markets. The plan is aimed at financing as much as US$1 trillion in purchases of illiquid mortgage backed securities, using US$75 billion to US$100 billion of the Treasury’s remaining TARP funds. The Public-Private Investment Program (PPIP) will be instrumental in setting the price at which “troubled assets” can be removed from bank balance sheets. The program will rely on Federal Reserve financing and Federal Deposit Insurance Corp. debt guarantees.

As part of the plan, US banks will be stress-tested to determine how much additional capital may be required to ensure bank solvency. The aim of the stress tests is to shore up investor confidence, but they come with a risk that the results could cause further instability. Furthermore, the test methodology could be called into question if the results are much better than expected. The results are due to be released early in May.

As markets made new lows, investor “fear” did not return to last year’s extremes. This implies that investors are now absorbing negative news and less willing to bet against policy makers’ actions to restore financial stability. However, in the absence of further evidence that the recession is coming to an end, it is unlikely that equity markets will continue to perform as strongly as they have been.

Some of our signposts to recovery have indicated some improvement. In the US, new and existing home sales rose in February and boosted optimism that the housing market might be stabilising. Manufacturing intentions are still contracting, but at a lesser pace, while weekly jobless claims fell in April, adding to optimism that the pace of contraction will slow.




## Regional Economic Summary

### United States

- The US economy shrank at a 6.3% annual pace in the fourth quarter, the worst performance since 1982, and jobless benefits reached 5.56 million. However, economists remain hopeful that the Federal Reserve’s aggressive action will support a recovery later in the year.
- The jobless rate increased to 8.5% from 8.1% in February. Fed chairman, Ben Bernanke, has conceded joblessness could top 10% under a worst-case scenario.
- The Institute for Supply Management’s factory index climbed to 36.3 in March, a third consecutive monthly improvement. Another government report showed that orders for durable goods rose 3.4%. The improvement in confidence may be attributable to the need for purchasing managers to rebuild rapidly depleted inventory levels if demand does not decline as rapidly as it has in the past two quarters.

- The Conference Board's index of leading indicators, a gauge of the US economy's direction over the next three to six months, fell 0.4% in February, less than forecast.
- The Reuters/University of Michigan final index of consumer sentiment rose to 57.3 from 56.3 in February. The gauge, reached a 28-year low of 55.3 in November.
- Data showed that housing activity improved in February, attributable to lower prices and borrowing costs. Purchases of existing homes rose 5.1% and new homes rose 4.7%; however, the median price slumped 15.5% from a year ago, the second-biggest drop on record, and distressed properties accounted for 45% of all sales.

### Europe

- Economic commentators are becoming increasingly concerned about economic momentum in the Euro region. Gross domestic product fell more than estimated in the fourth quarter last year (-1.6% QoQ) and unemployment rose to 8.5%, the highest level in almost three years.
- The recession has forced companies across the continent to cut output. Industrial orders for the region fell 17.3% from the year earlier.
- The Purchasing Managers' Index in the Eurozone, a leading indicator of manufacturing activity, rose to 33.9 from 33.5 in February, although still significantly below 50, the dividing line between contraction and expansion.

### United Kingdom

- The Bank of England left the benchmark interest rate unchanged at 0.5% and agreed to continue the three-month program to purchase £75 billion (US$110 billion) of government bonds. The bank noted that it had completed over £26 billion of asset purchases since the last meeting and would take another 2 months to complete the program.

### Australia

- In April, the Reserve Bank of Australia cut the overnight cash rate target by 0.25% to 3%, after a government report showed that the economy had contracted in the fourth quarter last year. Reserve Bank Governor, Glenn Stevens, said borrowing costs are at a historic low and that there was only scope for a "modest adjustment".
- Australian home-building approvals rose in February for the first time in eight months. The number of permits granted to build or renovate houses and apartments rose 7.8% from January.
- Australia's unemployment rate rose to 5.7% in March, from 5.2% in February, which was higher than economists had anticipated.

### New Zealand

- Local data released during the month confirmed the on-going struggles of the New Zealand economy. Fourth quarter GDP printed at -0.9%, the fifth consecutive quarterly contraction in local activity.
- The current account deficit widened to a record NZ$16.07 billion in the 12 months ended December 31. The deficit makes New Zealand vulnerable to international market turmoil because of its dependence on foreign funding.
- Early in the month the Reserve Bank of New Zealand surprised investors by only cutting the benchmark interest rate by 50 basis points to 3%, a record-low. Reserve Bank Governor, Alan Bollard, highlighted the country's dependence on foreign borrowing as a reason not to undermine the value of the currency.
- New Zealand home-building approvals rose for the first time in three months in February, a sign that falling interest rates may be starting to kick-start the property market.
- NZ Institute of Economic Research showed that headline business confidence remains very weak. The majority of activity indicators within the survey have deteriorated, in some cases to record lows, highlighting that the economy continues to struggle.

## Monthly Sector Summary

*As at 31 March 2009*

### International shares

The MSCI World Index rose 6.4% in local currency terms over the month of March – the largest one-month rally since April 2003. Returns to unhedged New Zealand-based investors were down 5.6%, with the NZ dollar rallying strongly versus the weaker US dollar over the month, up 10.4% on a trade-weighted basis.

March began with ongoing concern over the health of large financial institutions dominating market news. Insurance giant AIG announced the largest corporate loss in US history (US$62 billion) and required yet another government bailout. Citigroup fell below US$1 per share and Lloyds TSB announced it would cede 75% control to the British government in return for guarantees covering £260 billion of risky assets.

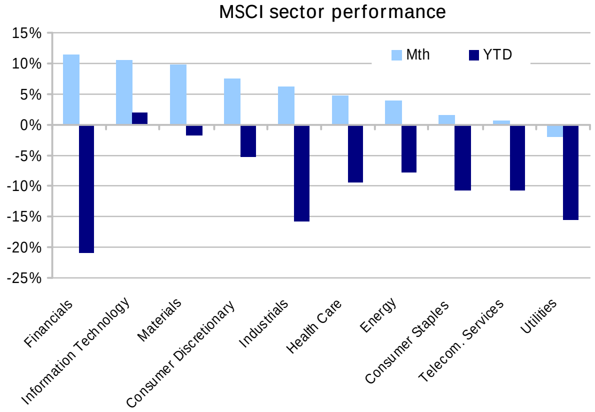
Then, Citigroup, JP Morgan and leading European banks announced they were performing strongly in the opening months of 2009 in terms of earnings before provisions and writedowns. This led to sentiment quickly improving, and it was the financial sector that led a steep three-week rally to the end of March.

Economic data generally printed on the weak side, but some key indicators (ISM, US housing) at least showed signs of bottoming and exceeded expectations. The US continued to lead the way in terms of implementing unorthodox policy measures to spur growth and announced quantitative easing plans whereby the US Treasury will purchase up to US$300 billion of long-term government bonds.

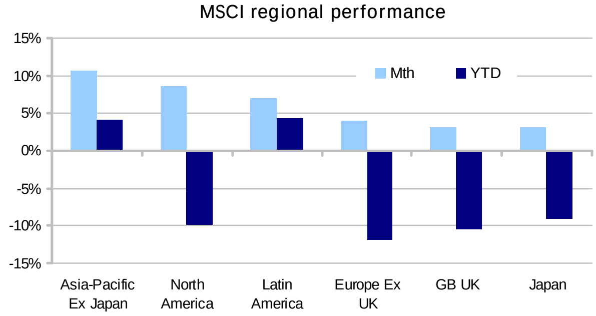
Towards the end of the month, US Treasury Secretary, Tim Geithner, unveiled the much-awaited details around the plan to rid banks of their "toxic", hard-to-value assets. While there was criticism from some quarters, the plan was generally well received by the market. Geithner's Private-Public Investment Program (PPIP) will make up to US$1trillion (including leverage) available to finance purchasing of distressed assets by a number of pre-approved investment funds.

Outside of financials, companies in the S&P500 have reported year-on-year earnings growth of -16.7%. A recovery in earnings growth from what will be a very low base is now being pushed out to the fourth quarter of 2009 according to most analyst forecasts.

Cyclical sectors outperformed the more defensive sectors for the month of March. All sectors with the exception of utilities (-2.0%) were up, with financials (+11.5%) and information technology (+10.6%) leading the way. The first quarter earnings for the banks and US Treasury 'stress tests' on US banks are both due at the end of April and will give a clearer indication as to whether further capital injections will be required. The materials sector outperformed, with oil up over 10% to US$50 a barrel and the Reuters/CRB Commodities Index up 4% for the month after eight successive monthly declines.




All regional markets rose in March, with the developing regions of Asia-Pacific Ex Japan (10.6%) and Latin America (7.0%) again outperforming the developed regions. Both these regions are now in positive territory year-to-date. Japan (+3.1%) underperformed other regions, with trade data showing exports in February were 46% lower than one year ago.



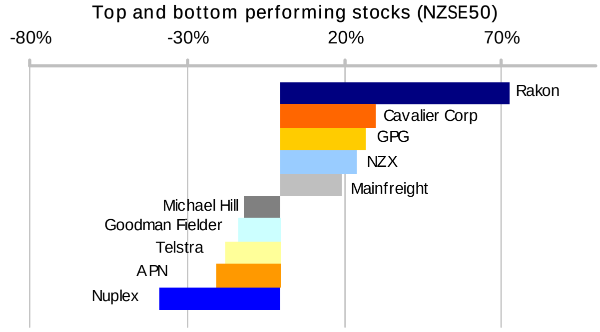

## New Zealand shares

The New Zealand sharemarket rose 3.2% during March. Early in the month, the NZX50 index tested late November lows, but a general improvement in sentiment saw a rebound in both international and domestic shares throughout the remainder of the month, particularly in financial stocks.

The domestic rebound has, however, been more muted than the global recovery, with the NZX50 Index underperforming the MSCI World Index (which rose 6.4% in local currency terms).

Capital raisings continued through March. Nuplex sought $133 million in a pro rata rights issue to reduce debt as it had breached some of its covenants. The news was not well received by the market and the share price fell 39% for the month. Rakon was the best-performing stock in the index, partially due to an improvement in global sentiment.

However, the stock rose 54% in just one day, prompting a "please explain" notice from the NZX. In response, Rakon said it had no information to disclose that would explain the price volatility.




## Australian shares

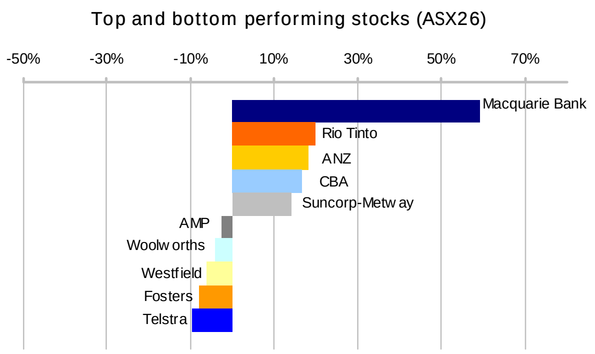
The Australian market (ASX 200 Accum Index) recorded a gain of 8% in March, its first positive month since August 2008. As a result, it narrowly missed the indignity of equalling the record for consecutive down months, from March to September 1974. In NZD terms, the ASX performance was less stellar producing only 3% for the month.

Corporate news was dominated by acquisition activity. Uncertainty regarding Foreign Investment Review Board approval of the proposed Chinalco-Rio Tinto deal seems to have been outweighed by the view that alternatives for Rio Tinto are looking increasingly plausible.

BHP's raising of US$3 billion in the bond market only added to speculation that BHP might emerge as an alternative buyer of the Rio Tinto assets. Australian Treasurer, Wayne Swan, blocked the AU$2.6 billion takeover offer by China Minmetals for OZ Minerals, in its present form, as it includes the firm's Prominent Hill mining operations, which are situated in a military zone.

Transpacific Industries Group – the company who bought Waste Management Ltd in 2006 – suspended trading in its shares and engaged in talks with lenders and potential investors as it seeks a waiver of a debt covenant breach. TPI has around AU$2.2 billion in debt.

Both Industrials (+7.5%) and Resources (+9.5%) performed well in March. However, a widespread move from defensive to cyclical sectors provided accentuated relative performance. Consequently, the typically defensive sectors such as healthcare (-7.1%), telecommunications (-4.8%) and consumer staples (-0.4%) were sold down in preference of cyclical sectors such as consumer discretionary (+12.9%) and transport (+16.4%).

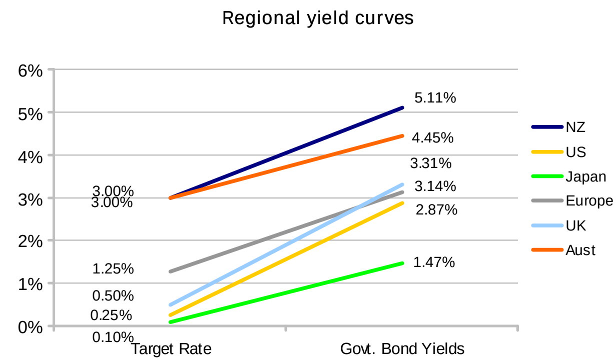



## International fixed interest

Global bonds hedged into NZD returned 1.14% for the March month and have gained 11.39% over the last year.

US yields were volatile over the month, at one stage 10-year yields fell to 2.54% as the Fed announced its plans to ramp up its purchases of longer term US debt, before firming to 2.66%, down 35bp on the month. While still pointing to a very weak economy, US data releases were generally a little better than feared.

Australian ten-year yields continued to drift up from their mid-January low, reaching 4.60% at the end of March. The Reserve Banks decision to leave rates on hold surprised the market (the consensus expectation was for a cut of 50bp).

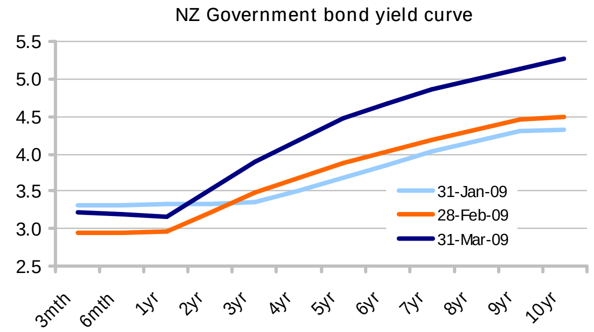



## New Zealand fixed interest

The New Zealand Government bond market returned -1.98% for the month, underperforming Cash, which returned 0.27% over the same period. The NZX All-Swaps Index returned -3.17% for the month, while the NZX Corporate A-Grade Index returned -2.83%.

New Zealand cash and bond yields ended higher over the month after a less dovish RBNZ Monetary Policy Statement on 12 March. Longer dated yields also climbed, with the 2017 Government bond up 74bp to 5.25%. As well as following global yields higher, New Zealand yields were also marched higher on the back of aggressive term borrowing from banks, which saw swap rates and swap spreads surge higher as the banks looked to offset mortgage book term-borrowing risk through paying in the swaps market.

Credit spreads also continued to widen over the month as global credit fears showed little sign of abating.




## New Zealand listed property

The New Zealand Property Index (gross) returned -1.41% in March, underperforming the broader equity market (NZX50 gross), which had a gross return of 3.2%.

The sector returns during March were characterised by the smaller property vehicles outperforming larger listed property trusts. APT, KIP and GMT all announced portfolio valuation declines of more than -10% and cap rate increases of 0.94%, 0.75% and 0.73%, respectively.

News flow was dominated by the revaluation announcements, which while in line with expectations, resulted in an increase in the sector's gearing to 33%. Other news flow included asset sales by KIP and ING, and KIP also announced that Stage One of its Plaza Shopping Centre in Palmerston North was open for business.

## Australian listed property

The S&P/ASX 200 Property Accumulation Index ended flat in March after a roller-coaster ride, which at one point saw the sector down -15% after the first week of the month. The sector underperformed the broader equity market by 8% during the month, and on a rolling 12-month basis, the sector has underperformed by a very disappointing 20.5%.

While the sector's performance ended the month flat, it was characterised by increased risk appetite and rotation out of the larger defensive names, particularly those that have performed well during the last six months.

## International listed property

Finally – a month of positive returns for global real estate stocks – and the broad market. Global real estate stocks in the UBS Investors ex-Australia and New Zealand Index produced a total return of +3.2% in the month, in local currency terms.

Since the market trough in early March, the UBS Index has recovered by more than 17% as market conditions stabilised and the bulk of the world's markets recovered.

Capital adequacy continues to be a prime focus for most real estate companies, and a number of global real estate companies have accessed and are accessing the equity and debt markets, even at the cost of earnings dilution. Companies in the UK, Australia, and the US have been most active thus far. Dividend reductions and the use of stock dividends remain liquidity strategies.

## Currency

The overriding theme in March was a weakening US dollar as investors weighed up the impact of US quantitative easing, and as rising equity market sentiment encouraged investors to establish risk positions. Economic data out of the US, on balance, failed to upset already pessimistic investors. The shift in global growth expectations helped commodity-based currencies such as the NZD and AUD. The NZD advanced 11.7% against the USD, 13.3% against the JPY, and 10.4% on a trade-weighted basis.

## Number of the month: 11.01

Despite the recession, Apple is still proving to be quite profitable, with international markets accounting for 46% of their sales. However, while their computer sales are down by 3%, iPods and iPhones are still in strong demand having sold 11.01 million iPods and 3.79 million iPhones during their second quarter. This was a three percent increase from one year ago. "We are extremely pleased to report the best non-holiday quarter revenue and earnings in our history," said Peter Oppenheimer, Apple's CFO, adding that Apple still has approximately US$29 billion in cash and marketable securities on their balance sheet. Furthermore, Apple shares have increased 46% in the past year and have been trading above $120 for the past week.

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## INGNZ Asset Allocation

| Asset Class | Relative Position | Rationale |
|---|---|---|
| International Equities | – | The many measures undertaken by policy makers go some way towards laying the foundation for an improved stability in financial markets and there has been some early signs that the pace of the decline in economic growth is marginally slowing. Furthermore equity market valuations are very attractive. However the second round effects of the credit crunch are going to be with us for some time. The de-leveraging of financial institutions and households will be a slow process. Falling profits, capital raisings and corporate defaults will continue to weigh on equity markets. |
| Domestic Equities | – | The New Zealand equity market's characteristics such as high dividend yields and limited exposure to financial stocks have made it more defensive than global equities. However, NZ shares will struggle to make ground against the headwinds of deteriorating economic conditions and dysfunctional global financial markets. Even though monetary conditions are significantly more accommodative, corporate NZ will be capital constrained for a time yet. |
| Domestic Listed Property | 5 | The sector is trading at a significant discount to NTA, more than compensating for the likely decline in asset values as cap rates rise. In addition, long lease terms, high occupancy rates and under-renting bode well for rental growth, even in a slowing economy. Dividend yields are extremely attractive especially as cash rates are set to fall. We expect the NZ LPT market to behave more defensively amid the uncertain global environment, although higher gearing levels in Australia remain a risk for the sector. |
| Global Property | 6 | Listed entities are still trading at a significant discount to NAV, even though NAVs have declined substantially over the past year. Dividend yields are now very attractive relative to interest rates. However, the sector is suffering from deteriorating fundamentals and difficult credit conditions. |
| International Fixed Interest | 6 | Global government bonds will continue to be the safe haven destination in times of crisis, declining inflation and monetary easing. Over the medium-term, the outlook for government bonds is less attractive as government deficits rise. Global credit offers attractive yields and is pricing in well above average default activity. However, defaults will rise sharply, particularly in the high yield space. |
| Domestic Fixed Interest | – | NZ government bonds have similar attributes to global bonds in this economic climate, but overall our expected returns are slightly higher. |
| Cash | 5 | Expected returns from NZ cash are unattractive over the next 12 months with short term interest rates expected to remain low for some time. This increases the relative attractiveness of other income-generating asset classes. For now, however, it remains a source of stability of returns. |
| NZ Dollar | 6 | Short-term movements will continue to be driven by fluctuations in the US dollar. However, over the medium term, slowing global growth, narrowing interest rate differentials and a large current account deficit, particularly in an environment where funding will be hard to come by, are negatives for the NZ dollar. This justifies hedging levels below benchmark with a medium-term view. |

Key: – Neutral 5 Overweight 6 Underweight

# At a glance as at 31 March 2009

## Indices

| | Level | 1-month % change | YTD % change | 1-year % change | 3-year ann. % change | 52-week high | 52-week low |
|---|---|---|---|---|---|---|---|
| Index Close as at: | 31-Mar-09 | 28-Feb-09 | 31-Dec-08 | 31-Mar-08 | 31-Mar-06 | | |
| MSCI World Index (G) | 1939 | 6.4% | -9.9% | -37.0% | -13.8% | 3457 | 2797 |
| Asia Pacific | | | | | | | |
| MSCI AC Asia ex Japan (G) | 621 | 10.6% | 4.2% | -36.1% | -3.3% | 856 | 623 |
| NZSX50 (G) | 2590 | 2.7% | -4.6% | -25.4% | -11.2% | 3681 | 2411 |
| ASX200 Accum. | 24310 | 8.0% | -2.0% | -29.5% | -7.2% | 38434 | 21298 |
| Nikkei 225 | 8110 | 7.1% | -8.5% | -35.3% | -22.0% | 14601 | 6995 |
| Americas | | | | | | | |
| Dow Jones | 7609 | 7.7% | -13.3% | -38.0% | -11.9% | 13137 | 6470 |
| S&P500 | 798 | 8.5% | -11.7% | -39.7% | -14.9% | 1440 | 667 |
| Nasdaq | 1529 | 10.9% | -3.1% | -32.9% | -13.2% | 2551 | 1266 |
| Europe | | | | | | | |
| MSCI Europe (G) | 3285 | 3.7% | -11.4% | -36.8% | -13.9% | 5937 | 4677 |
| FTSE100 | 3926 | 2.5% | -11.5% | -31.1% | -13.0% | 6377 | 3461 |
| France CAC | 2807 | 3.9% | -12.8% | -40.4% | -18.7% | 5142 | 2465 |
| Germany DAX | 4085 | 6.3% | -15.1% | -37.5% | -11.9% | 7232 | 3589 |
| Property | | | | | | | |
| NZX Property (G) | 1749 | -1.5% | -6.6% | -20.3% | -4.4% | 2309 | 1664 |
| Aust LPTs (G) | 13618 | 0.0% | -24.4% | -57.6% | -25.1% | 33665 | 11200 |
| Int'l LPTs (USD) (G) | 251 | 7.1% | -22.2% | -56.6% | -22.4% | 733 | 502 |

** Note: returns are in local currency, except where designated* *** Excludes imputation credits* *(G) = Gross, all other indices are capital.*

## Currency

| | Rate | 1 month chge | YTD chge | 1 year chge |
|---|---|---|---|---|
| AUD+ | 0.6927 | 7.4% | -1.7% | -24.2% |
| EUR+ | 1.3229 | 4.0% | -5.2% | -16.3% |
| GBP+ | 1.4299 | -0.3% | -1.9% | -28.0% |
| JPY+ | 99.4 | -1.4% | -9.4% | 0.5% |
| NZD+ | 0.5683 | 12.6% | -3.1% | -27.8% |
| NZD/AUD | 0.8204 | 4.9% | -1.4% | -4.7% |
| NZD/GBP | 0.3975 | 4.6% | -1.2% | 0.1% |
| NZ TWI | 57.30 | 10.4% | 2.0% | -18.3% |

+ *vs USD (positive % represents a rise against the USD)*

## Economic data

| | GDP qtr on qtr | GDP yr on yr | CPI yr on yr | Unemploymt rate |
|---|---|---|---|---|
| US | -1.6/-6.3 ann. | -0.80 | 1.80 | 8.50 |
| Japan | 0.40 | 1.50 | 0.00 | 4.40 |
| Germany | -2.10 | -1.70 | 1.40 | 8.10 |
| Euro | -1.60 | -1.50 | 1.60 | 8.50 |
| UK | -1.60 | -2.00 | 2.50 | 4.30 |
| Australia | -0.50 | 0.30 | 2.20 | 5.70 |
| NZ | -0.90 | -1.90 | 2.00 | 4.60 |

## 10-year bonds

| | Yield | 1 month chge | 1 year chge |
|---|---|---|---|
| Australia | 4.42% | 0.02% | -1.63% |
| Germany | 2.99% | -0.12% | -0.91% |
| NZ | 5.27% | 0.78% | -1.13% |

## Central bank target rates

| | Rate |
|---|---|
| NZ | 3.00% |
| US | 0.25% |
| Japan | 0.10% |

LYFORDS ASSET MANAGEMENT

| | | | |
|---|---|---|---|
| UK | 3.17% | -0.46% | -1.18% |
| US | 2.66% | -0.35% | -0.75% |
| Japan | 1.35% | 0.07% | 0.07% |

| | |
|---|---|
| Europe | 1.25% |
| UK | 0.50% |
| Australia | 3.25% |

*Source: Bloomberg*