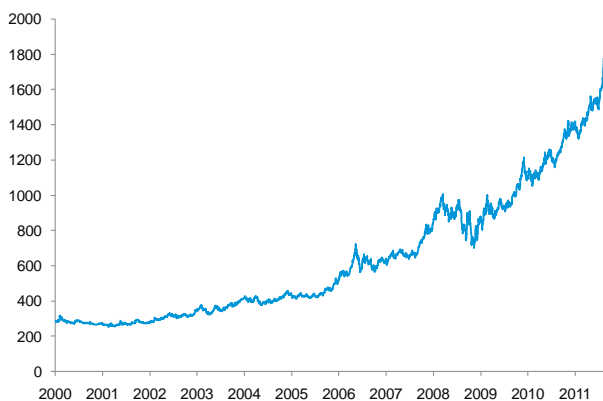


Monthly market view

August 2011

- The US credit rating downgrade, political uncertainty and financial market volatility dominated the month of August.
- Global economic growth forecasts were revised lower and were a key driver of volatility, led by downgrades in the US and Europe.
- Sharemarkets fell sharply, although finished off their lows on policy action by the Federal Reserve.
- Investors flocked to US government bonds on expectations of weaker economic growth, leading to sharply lower bond yields despite the credit rating downgrade.
- Uncertainty on the economic front and policy front saw the gold price record sharp gains, reaching \$US1887/ounce in August, before finishing the month at \$US1834/ounce, a gain of 13% (see chart below). The oil price fell 7.2% to \$US88.8/barrel.

Gold price \$US / ounce



Source: Bloomberg.

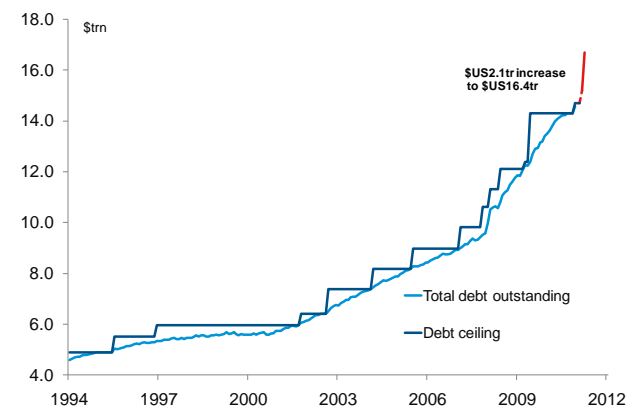
Economic overview

After months of negotiations a last minute deal was struck to lift the US statutory debt ceiling by \$US2.1tr on 2 August. In return for the debt limit increase, the budget deficit path over the next decade will be cut by \$US2.4tr. Initially the debt ceiling will be lifted by

\$US900bn, with the further \$US1.5tr to be decided upon by a bipartisan committee that is due to report by 23 November (see chart below).

This removed the immediate risk of default, but the limited size of the increase and the political debate and process surrounding the negotiations saw Standard and Poor's downgrade the US long-term sovereign credit rating from AAA to AA+, with a negative outlook. The long-term trajectory of US public debt against AAA sovereign peers also prompted the downgrade.

US Statutory Debt Ceiling (\$US trillion)



Source: Bloomberg, US Treasury.

Post the US debt downgrade and market volatility, attention turned to the Federal Reserve for renewed monetary policy easing. At the August meeting, a decision was made to strengthen the level of forward guidance on the US official cash rate, with expectations that given the current growth and inflation outlook, exceptionally low levels of interest rates would likely be warranted at least through to mid 2013. Further stimulus options remain on the agenda. Federal Reserve Chairman Bernanke highlighted that "most of the economic policies that support robust

economic growth in the long run are outside the province of the central bank”.

US economic data weakened in August, confirming the Fed’s review that downside risks to growth had accelerated. The main area of weakness continues to be the labour market, with unemployment currently at 9.1%. Housing market data is also weak, with existing home sales (-3.5%/mth), new home sales (-0.7%/mth), S&P Case Shiller home prices (-0.1%/mth) and housing starts (-1.5%/mth) all weaker. Inflation continued to accelerate, rising to 3.6%/yr for headline and 1.8%/yr for core inflation. 12 months ago these rates were 1.2% and 0.9% respectively.

In Europe, the focus was on liquidity issues surrounding Italian and Spanish government bonds. Economic data also weakened and political uncertainty remains high. 10 year government bond yields rose as high as 6.20% in Italy and 6.28% in Spain. Further packages to reduce government deficit were announced in these two countries to help bring down absolute bond yields. Italy now expects to have a balanced budget in 2013, one year earlier than previous announcements.

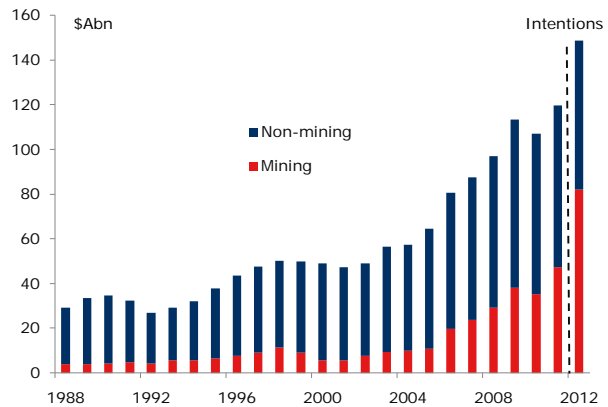
The sharp increase in yields prompted the European Central Bank (ECB) to buy Spanish and Italian debt for the first time to improve liquidity. Previously this program had been restricted to the bail-out countries; Greece, Portugal and Ireland. The announcement saw bond yields fall, finishing the month at 5.14% for Italian bonds and 5.04% for Spanish bonds.

In Asia the focus was on economic data given the weaker global environment. To date there have been no concrete signs of a slowdown in the region, with inflation continuing to be the main issue. Inflation data released included China (+6.5%/yr), Korea (+5.3%), India (+9.2%) and Hong Kong (+7.9%).

In Australia the focus was on the company earnings reporting season. Economic data of note included wages data, up 0.9%/qtr and 3.8%/yr. The mining sector remains the key driver of higher wages. Also confirming the strength in the mining sector was revised capital expenditure intentions. These were upgraded for 2012 to \$A149bn (was \$A140bn), with the mining sector accounting

for \$A82bn of the total (see chart below). Outside the mining sector, data remains weak with house prices down 0.1%/qtr and 1.9%/yr and consumer confidence falling 3.5% to the lowest level since May 2009.

The Australian dollar fell 2.5% against the USD, closing at 1.0712. The AUD also fell 2.7% against the euro and 1.6% against the sterling on lower risk appetite



Australian shares

The S&P/ASX 200 Accumulation Index declined by 1.9% in August, but this outcome masked an extraordinary level of volatility in the domestic share market. The Index traded in a range of nearly 20% during the month, reflecting the fragility of investor confidence in financial markets.

Investor attention was dominated by the financial stability of the euro zone and concerns over a deceleration in the pace of global growth. The extreme level of market volatility diverted attention away from company earnings data, which was released for the period ending 30 June 2011.

Several companies had provided fairly specific guidance prior to their formal announcements, so the reports held few major surprises. As a guide, approximately three quarters of companies reported earnings which were broadly in line with our expectations, a few surprised on the upside and fewer still genuinely disappointed. Share buybacks were a key feature of the month, with several companies announcing capital management initiatives.

Strong balance sheets also continued to support a level of merger and acquisition activity – August saw takeover bids for Coal

and Allied, Macarthur Coal and Minara Resources.

Defensive sectors tended to outperform against the falling market, with Utilities, Telecoms and Consumer Staples among the best performers. More cyclical sectors tended to underperform, as investors continued to question the outlook for Australian and offshore economic activity.

Global shares

Global equity markets fell sharply in August as investors moved out of risk assets and into US Treasuries on lower global growth expectations. Equity markets are now keenly watching and anticipating another round of quantitative easing by the Federal Reserve and reacting to each economic data release.

The MSCI World Net Index fell 7.3% in USD terms and 4.9% in AUD terms. The Dow fell 4.4%, the S&P 500 was down 5.7% and the NASDAQ fell 6.4%. The Dow Jones remains 16% higher than 12 months ago.

European markets were weaker, recording the sharpest falls since the collapse of Lehman Brothers in 2008. Volumes were sharply higher as investors repositioned portfolios. The German DAX recorded sharp falls early in the month in line with other markets but failed to recover, recording losses of 19.2% in August, the largest loss since September 2002. Germany did not introduce a ban on short selling. The DAX Index is now 2.4% lower over 12 months. Spain (-9.5%) and France (-11.3%) also experienced sharp falls. The Greek sharemarket fell 23.9% on concerns over its banking sector, leading to the merger of the second and third largest banks in Greece.

In Asia, markets recorded losses across the board. Japan (-8.9%), Hong Kong (-8.5%), Singapore (-9.5%), South Korea (-11.9%), Taiwan (-10.4%) and Malaysia (-6.6%) all recorded losses.

In terms of sector performance, the Financials sector (-10.1%) and Energy sector (-10.0%) were the worst performing sectors.

Global emerging markets

Emerging markets underperformed developed global equity markets in August with the MSCI Emerging Markets Index falling 9.2% in USD and 6.8% in AUD terms.

The largest falls in emerging equity markets occurred in Russia (-20.9%) due to sharply lower commodity prices, especially oil. Hungary (-14.6%), Turkey (-13.6%), Czech Republic (-10.8%), Poland (-10.5%) and Argentina (-10.2%) also recorded double digit losses. The Philippines fell 2.6% while Sri Lanka recorded gains, up 0.5%.

Brazil finished the month 4% lower and in early September official interest rates were cut by 50 basis points to 12%. This follows five consecutive rate hikes, indicating the emergence of risks to global economic growth and the potential impact on emerging economies. Brazil continues to face inflationary pressures, with the last data point showing inflation at 6.9%, versus a target of 4.5%.

Fixed interest

Global bond markets saw a sharp fall in bond yields in August. Already jaded by the US debt ceiling political debate in Washington, market participants became increasingly concerned about sovereign and financial system risks in Europe and the deteriorating global economic outlook.

In response, the 10-year US Treasury bond yield plunged through 2% to 1.97% mid-month, its lowest level since 1950, before finishing the month at 2.18%. Overall, 10-year Treasury yields declined from 2.80% at the end of July, the largest monthly drop since December 2008.

In Europe, the crisis enveloping the region ratcheted up a notch during the month. Pressures on Italy, Spain and France intensified in the wake of the Greek sovereign debt restructuring. Pressures on Italy, Spain and France intensified in the wake of the Greek sovereign debt restructuring. German 10-year bonds declined by 35 bps to 2.19% at August-end.

In the UK, the Monetary Policy Committee unanimously voted 9-0, the first time since May 2010, to leave the Bank of England rate at 0.5%, signalling a prolonged period of policy inertia. The UK 10-year government bond yield decreased by 26 bps to 2.60% at month-end.

In Japan, the 10-year government bond yield declined by 5 bps to finish the month at

1.03%. The Australian bond market also saw a sharp fall in yields driven largely by a deterioration of sentiment about the domestic economic outlook. Several market analysts have now predicted that the Reserve Bank of Australia (RBA) will start cutting rates over the coming months.

Furthermore, demand from overseas central banks and offshore institutional investors increased, lured by the developed world's highest government bond yields, strong liquidity and the relative safety of the Australian government bond market.

Australian 10-year Commonwealth government bond yields fell by 43 bps to 4.37% at August-end, having ended the previous month at 4.80%. Yields have now declined by 83 bps over the past two months, their largest fall since August-September 2008. The downward movement in 10-year yields tracked global market movements, which were driven by events in Europe and the US during the month.

Australian market participants also focused their attention on weaker domestic economic data releases during August.

The RBA left the overnight cash rate target at 4.75% at its meeting in August. The Board meeting minutes acknowledged that the downside risks to economic growth had become more pronounced due to 'the uncertainty that the EU and US public finances present to the economic outlook'.

The RBA also appeared to highlight that their 'mildly restrictive' policy stance was already exerting sufficient downward pressure on domestic demand, saying that a 'number of factors point to financial conditions being tighter than normal'.

Most market commentators interpreted this as a signal that the RBA is unlikely to increase interest rates for the remainder of 2011. Later in the month, RBA Governor Glenn Stevens gave a speech to the House of Representatives Standing Committee on Economics echoing the above comments but not entertaining market pricing for sharp cuts to the official cash rate.

Listed property

The S&P/ASX 200 Property Accumulation index was up 3.1% in August 2011, outperforming the S&P/ASX 200 Accumulation Index by 5.0%.

The UBS Global property investors' index (local currency) decreased 5.0% in August, with Australia the top performing region (+3.2%) followed by Japan (-1.1%). The worst performing regions were the UK (-11.0%) and Singapore (-6.9%).

During the month most A-REITS reported their full year result and outperformed the broader equity market through reporting season. The larger, more defensive stocks were the top performers throughout the reporting season, while more leveraged stocks tended to underperform. Outside of results the biggest stock news was the indicative bid for Charter Hall Office. A number of share buybacks were also announced in the sector. A number of stocks continue to trade at a discount to Net Tangible Assets.