



In The Know

The outlook for investment markets

Asset class	Short-term prospects
Listed property	Australian real estate investment trusts (A-REITs) have been severely beaten back from overvalued levels, reflecting the sector's high levels of indebtedness and complex financial engineering. Looming debt maturities and falling valuations continue to plague the sector, and further announcements regarding breaches of loan covenants are anticipated. Increased vacancies will also drag earnings down over the course of the economic slowdown. However, much of this bad news is known and has been priced in by the market, and many A-REITs have rallied hard from near-capitulation selling in March 2009. Quality A-REITs caught up in this vicious selling now offer good long term value for patient investors.
Residential property	Residential property has benefited from rising rents and an increase to the First Home Owner Grant, providing some support (distortion) for prices. Once government grants and stamp duty holidays are fully phased out this activity may slow as high house-price to disposable-income ratios continue to adjust.
Cash	The Reserve Bank of Australia (RBA) slashed interest rates from 7.25 to 3 per cent in a succession of quick moves as the credit crunch took its toll on the local economy. The RBA has subsequently raised cash rates twice by 25 basis points, leaving the official rate at 3.5per cent. More rises are imminent as the RBA begins to march towards neutral levels.
Bonds – Australian and international fixed interest	Yields remain attractive on high quality corporate debt, and Zurich Investments anticipates a degree of spread compression when confidence reverts to more normal levels. Until then, investors should closely monitor default rates in the sector. Government bonds also enjoyed good returns as rates were cut across the globe. However, rising yields may be the source of short-term pain when the rate cycle turns.
Australian shares	The Australian market has rallied more than 50 per cent off its March lows. While a correction of sorts cannot be ruled out after such a strong bounce, the market has been supported by improving economic conditions and a better than expected reporting season, primarily off the back of aggressive cost reductions. However, the share price rally of some companies should be treated with caution, given that the problems of highly leveraged balance sheets have not gone away. On the other hand, opportunistic companies, which have raised additional capital to the tune of \$90 billion in recent months, find themselves better placed. While our banks remain in relatively good shape, attention must be paid to bad loan provisions, although recent outlook statements from a few of the 'big four' banks suggest that this cycle may be close to peaking. Dividend cuts across financial shares are indicative of the need to preserve capital. Evidence of earnings stabilisation could provide a positive backdrop for shares for the remainder of 2009, albeit at a more subdued pace.
International shares	The green shoots of recovery have put a fire under global markets at a time when most investors were pondering how much further things could fall. From March lows, equity markets across all the major regions are up in excess of 40 per cent. The US recently reported GDP growth in the third quarter bringing their recession to an end, although unemployment rates have moved through the 10 per cent mark to a new 26 year high. US equities have all but completed their latest round of quarterly earnings, with the majority of corporates beating expectations. Global markets are factoring in a robust economic recovery, though Zurich's expectations are more subdued. It is possible that disappointing data could halt the market's march, along with any withdrawal of expansionary policies. Investors should continue to look to companies with strong market positions and that are capable of generating solid cash flows.