



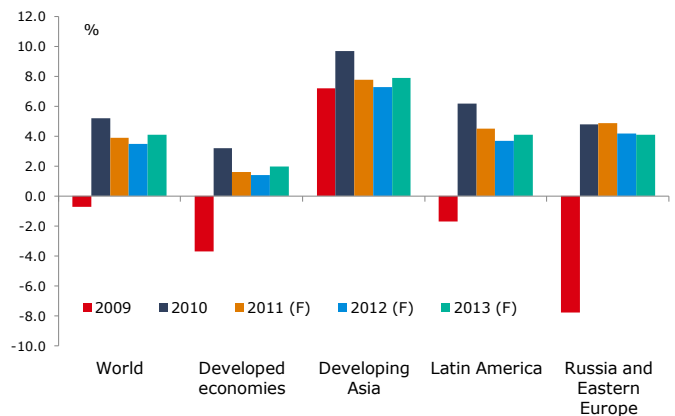
Latest monthly commentary from the Investment Markets Research team at Colonial First State, Global Asset Management

- The reigniting of sovereign debt concerns in Europe, signs of a weakening US economy and continued question marks over the pace of growth in China led to falls in equity markets in April, while government bond markets saw a flight to safety.
- In Europe, the focus switched to deteriorating economic activity. Spanish bond yields remained under pressure with a deteriorating economy and the need to implement austerity and growth initiatives.

Economic overview

The International Monetary Fund (IMF) released updated economic projections and world economic growth forecasts were upgraded to 3.5% for 2012 from 3.3%. The forecast for global growth in 2013 is 4.1%. See chart below.

IMF Global GDP forecasts (%)



Source: IMF

The IMF also upgraded growth forecasts for the US (2.1%), the euro area (-0.3%), Japan (4.0%) and China (8.2%).

In China, the expected slowdown became apparent with the release of first quarter GDP data. Growth slowed to 8.1% per year from 8.9% per year. There has been a slowdown in fixed asset investment with lower investment in property and infrastructure. See chart on next page for Chinese GDP growth.

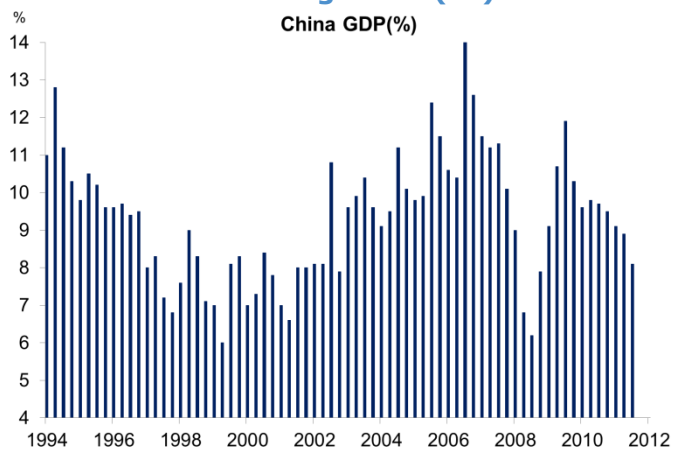
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China – Annual GDP growth (%)



Source: Bloomberg

Policy makers had already begun to ease policy and money supply growth has also risen.

Elsewhere in Asia, the Reserve Bank of India loosened monetary policy for the first time since 2009 as inflation eases and the global economic environment deteriorates.

First quarter GDP data in the USA disappointed expectations at 2.2% on a seasonally adjusted annualised rate, compared to 3.0% in the final quarter of last year. Weakness in business investment and the public sector contributed to the lower result, while consumption continued to improve over the quarter.

In March the US economy added 120,000 jobs which is less than expected. The unemployment rate fell to 8.2% from 8.3% as the participation rate continued to fall. Housing starts, new home sales and existing home sales all fell, indicating that the housing market remains slow. In contrast the ISM Manufacturing Index rose to the highest levels since June 2011.

The US Federal Reserve published updated GDP and unemployment forecasts. GDP growth for 2012 growth was upgraded from a range of 2.2% - 2.7% to 2.4% - 2.9%. Unemployment rate forecasts were revised down to 7.8% - 8.0% from 8.2% - 8.5%. Despite the improved outlook, the Federal Reserve reiterated its position that low rates of resource use and a subdued inflation outlook over the medium term are likely to warrant exceptionally low interest rates at least until 2014.

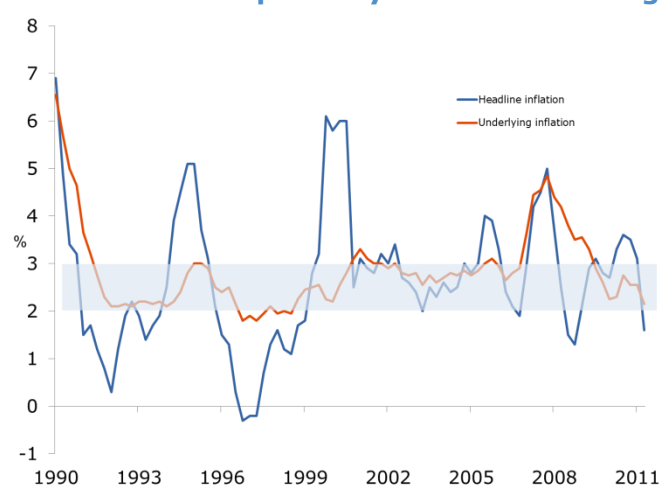
In Europe, economic data appears to be stabilising at low levels. Action by the European Central Bank has begun to rebuild confidence, although stress remains in some parts of sovereign funding markets. Standard and Poor's downgraded Spain to BBB+ from A on a deteriorating economic outlook and concerns the weak housing market will cause the government to provide further assistance to the Spanish banks.

The Spanish unemployment rate rose to 24.4% in quarter one while GDP growth was -0.3% per quarter, slightly better than expectations. Spanish Prime Minister, Mariano Rajoy has begun to refocus on growth initiatives and structural reform to boost confidence. Elsewhere in Europe, both the PMI Manufacturing Index and the PMI Services Index fell.

In Australia the focus in April was on the 1 May meeting of the Reserve Bank of Australia (RBA) Board. It delivered a 50 basis point cut to the official cash rate highlighting that "information received over the past few months suggests that economic conditions have been somewhat weaker than expected, while inflation has moderated". The official cash rate now stands at 3.75%, the lowest since February 2010.

A weaker inflation number allowed the RBA to ease policy. Headline inflation rose by a low 0.1% per quarter in the first quarter of 2012, taking the annual pace of inflation down to 1.6% from 3.1%. See chart below for details.

Australia CPI – quarterly and annual change



Source: ABS.

Underlying inflation also moderated in this quarter, rising by an average of 0.35%/qtr, with the annual rate down to 2.15% from 2.55%. The bulk of the weaker inflation is coming from strength in the Australian dollar and a weak consumer with lower fruit prices, clothing, furniture and travel costs. Education and health costs rose strongly. Elsewhere in Australia the focus remains on the labour market with the unemployment rate holding steady at 5.2%.

Australian shares

The Australian sharemarket recorded a fourth consecutive month of gains in April, with the S&P/ASX 200 Index adding 1.4%. Investors tended to favour stocks with a high yield, supporting demand for telecoms and healthcare stocks as well as Australian Real Estate Investment Trusts (A-REITs).

Most major companies in the energy and materials sectors issued quarterly production reports to the market. As anticipated, adverse weather conditions affected production volumes, both in Western Australia (oil, gas and iron ore) and on the Eastern seaboard (coal).

This had already been reflected in share prices, so these reports had little price impact.

Downgrades to earnings expectations from retailer JB Hi-Fi and media conglomerate Seven West Media highlighted that operating conditions remain challenging for some Australian companies and again highlighted the 'two-speed' nature of the economy.

The resources sector – as well as services companies which support it – continue to see strong activity levels, while conditions generally remain more subdued in other parts of the economy.

Lower-than-expected inflation for the first quarter of 2012 supported the case for an interest rate cut in early May. The major banks are not expected to pass on the full 0.50% to borrowers. In early May two of the four major banks lowered their borrowing rates by 0.32% and 0.40% respectively.

Listed property

The S&P/ASX 200 Property Accumulation Index rose 5.5% in April 2012, significantly greater than the broader Australian sharemarket. Investors tended to favour stocks which offered a relatively high yield, which supported demand for A-REITs.

In stock specific news, Westfield Group completed the sale of eight non-core US assets for more than \$1 billion, Centro Retail Fund outlined its strategy to sell up to a 50% interest in three regional shopping centres (Galleria, The Glen and Colonnades) and Dexis Group announced the sale of its central US industrial portfolio for US\$770 million.

The UBS Global Property Investors' Index (local currency) increased by 2.5% in April, with Australia the top performing region. Returns from overseas listed property securities were mixed, reflecting economic developments in the various regions.

The US and Canada added 3.0%, while underperforming markets included Continental Europe and Japan.

Global shares

With some notable exceptions, global equity markets posted losses in April, driven by investor outflows into safe haven government bonds markets (notably US and Germany), rising sovereign debt concerns in Europe and weaker economic data in the US.

The MSCI World Index fell 1.4% in US dollar terms and 1.8% in Australian dollar terms, although this masked considerable divergence between markets and industry sectors. The Australian dollar rose 0.8% to \$US1.0429 (although lost ground after the RBA cut the official cash rate in early May).

The S&P 500 Index fell 0.8%. The NASDAQ was also down 1.5%. This was despite a relatively strong start to the quarter one earnings season in the US. After the first week, profits were up 7% per year (excluding Apple it was +5% per year).

European markets were mixed with Spain down a sharp 12.5%. The German DAX fell 2.7%, the French CAC was down 6.2% in the lead up to the Presidential election and the Italian market fell 8.7%.

In the UK, the FTSE 100 declined 0.5% despite evidence that the UK economy has fallen back in to recession.

In Asia, markets were mixed with Japan underperforming (Nikkei -5.6%). Chinese markets were stronger (+7.8%) on expectations of renewed policy easing and other Asian markets were mixed, with Hong Kong (+2.6%), Singapore (-1.1%), Korea (-1.6%), and Taiwan (-5.4%).

Amongst the sectors, financials underperformed, while healthcare outperformed.

Global emerging markets

Emerging markets performed broadly in line with the broader global equity market, declining 1.9% in Australian dollar terms.

The Argentinean market fell 12.2% with the seizure of control of YPF SA by the government spooking markets. This spread to Brazil which finished 4.2% lower.

Elsewhere Czech Republic, Hungary, Poland and Russia all fell.

On the positive side the Philippines market finished 0.3% higher.

Fixed interest

In April 10 year US Treasury yields fell back below 2% due to renewed concerns about Eurozone sovereign debt risk, an economic slowdown in China and softer US economic data.

The resurgence in concerns over the viability of austerity measures in peripheral Europe and the related negative consequences on economic growth pushed Spanish bonds above 6% for the first time since January. Contagion fears

contributed to the weakening in the Italian bond market, which also spread to a lesser degree to the 'core' European countries of France and the Netherlands.

In response, 10 year German Bunds fell by 21 basis points to 1.58% in April as uncertainty forced European market participants to seek 'safe haven' assets. Spanish contagion spread to Italy, driving the 10 year benchmark sovereign bond yield higher. The Monti government announced an adjustment of its deficit target, just as Spain did a few weeks earlier. The objective of balancing the budget had to be pushed out to 2014.

The ECB left its official interest rate at 1.00% for a fourth consecutive month. There was no discussion regarding the need for further monetary policy easing at the meeting.

In the UK, the Bank of England left interest rates on hold at 0.5% acknowledging that the fall in UK inflation in recent months has been less than envisaged. The UK 10-year gilt yield decreased to 2.02%.

The Bank of Japan (BoJ) Policy Board wrapped up its April monetary policy meeting with a unanimous decision to expand its asset purchase program. The 10-year JGB yield declined by to 0.86%.

In Australia, Commonwealth 10 year bond yields declined to 3.67% at April month-end, having finished March at 4.08%.

The downtrend in 10 year yields resumed during the month, driven once again towards 60-year lows by risk aversion associated with renewed global growth and Spanish sovereign debt concerns.

Domestically, lower-than-expected March quarter inflation and a weakening Australian economic outlook heightened market expectations of an RBA cash rate cut in May, which was delivered.