

Lyfords economic commentary

June 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

The stock market has continued to advance, albeit at a slower pace. The gains were mostly buoyed by further evidence of economic stabilisation. However, investors are becoming increasingly concerned that the rally in equity and credit markets may be getting ahead of the fundamentals, and rising bond yields and oil prices could snuff out the early signs of economic recovery.

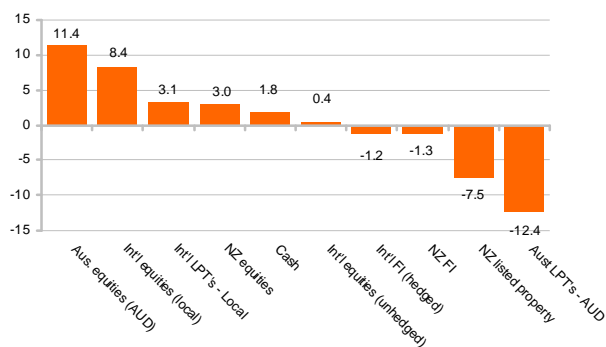
West Texas oil futures broke the \$70 per barrel mark this month. So far, the rise in oil has been an indication that economic conditions are likely to improve. However, too sharp a rise will have a "dampening effect" on the nascent economic recovery.

The yield on the benchmark 10-year Treasury note rose to 3.90 percent last month as volatility in government bonds hit a six-month high. Bond yields have risen sharply in response to the stabilising economic environment and as a result of increased supply, with governments around the world having to fund increased spending. U.S. fixed-rate mortgages jumped to 5.45 percent in May from 4.85% in April. The risk is that rising mortgage rates could destabilise recent improvements in US housing markets.

The Federal Reserve has not yet outlined whether it might step up its \$1.75 trillion quantitative easing program. The policy is aimed at reducing consumer borrowing costs by buying Treasury and mortgage bonds. Monetarists believe that the easy monetary policy and the overall quantitative easing programme is, in part, responsible for the rise in bond yields, as investors speculate that the increased supply of money will eventually lead to inflation. However, we contend that risk of inflation is low with the deflationary effects of deleveraging likely to persist for some time.

The Treasury has signalled confidence in some of the largest US banks by allowing them to repay capital provided to them through the Troubled Asset Relief Program. JPMorgan Chase & Co, Goldman Sachs Group Inc., American Express Co. and State Street Corp. are among those that have sold shares and debt unguaranteed by the government, demonstrating they can raise funds without federal aid.

Year to date % for major asset classes



Regional Economic Summary

United States

- While leading indicators continue to improve, the unemployment rate, which hit a 25 year high of 9.4%, is a stark reminder that the recovery will be slow to eventuate. However, non-farm payrolls fell by 345,000, much less than forecast, and consistent with the declining trend in weekly jobless claims. This is a sign that the worst of the contraction in labour markets may have passed. Still, we continue to believe it is too early to call an end to the slump. In the words of the head of the organisation responsible for dating economic cycles in the US, "Fear drives conservatism in consumer spending, and the biggest fear now is about losing jobs."
- The Institute for Supply Management's factory index indicated that companies are growing more confident that the slump will end this year. The index rose to 42.8 in May from 40.1 in April. The new orders component of the index, which is one of the better leading indicators of economic recovery, jumped to an expansionary 51.1.
- Retail sales rose 0.5 percent in May, the first gain in three months. The data series shows that the gains were almost entirely driven by auto-sales, as consumers take advantage of flailing automakers. Consumers, constrained by rising unemployment and falling home values, are unlikely to boost spending in big ticket items in any meaningful way. The result is indicative of a bottoming out process, rather than an indication of renewed demand.

Europe

- Economic data flow out of Europe has also offered a glimmer of hope that the pace of contraction is slowing. The ZEW survey of business confidence jumped to a three year high in May and the Euro-zone retail sales gained 0.2%, the first such gain in seven months.
- Like the ISM, the Euro-zone PMI indicated that the pace of contraction in Europe's manufacturing industry is continuing to ease, jumping to 40.7 from 36.8 in April. This is the biggest increase since the survey started in 1997 and confirms the gradual improvement evident in previous surveys.
- After cutting rates to a record low of 1% in May, the European Central Bank left rates unchanged in June causing speculation that the European Central Banks easing cycle is complete. The central bank has outlined a programme for the purchase of bonds to the tune of 60 billion Euro dollars.

United Kingdom

- The U.K. economy shrank 1.9% in the first quarter, the most since 1979. The Bank of England quarterly economic forecasts show growth resuming next year, while inflation slows as low as 0.4% this year.
- Key reports out of the UK added to evidence that the deepest recession in a generation may be past its worst. There are signs that the housing market slump is moderating, manufacturing intentions are improving and service industries are expanding. Consumer confidence rose to a six-month high in May.

Asia Pacific

- Chinese demand is helping prop up Asian growth however, Chinese exports fell 25% YoY in May, indicating that growth is primarily a function of domestic stimulus not rising global demand
- China's manufacturing industry expanded for a third month in May (PMI 53.1). New lending doubled, while industrial output and retail sales climbed more than economists expected.

Australia

- Even though Australia's economy was one of only a few, including China and India that grew in the first quarter, there is no doubt that many businesses and consumers will feel like they are in a recession. However, sentiment is improving as dataflow was indicative of stabilising economic conditions. Australian retail sales advanced for a second month, new home sales gained for a fourth month, and manufacturing contracted at a slower pace.
- The Reserve Bank of Australia left rates unchanged this month at a 49 year low of 3.0% The bank expressed concern that cutting interest rates too low could encourage some borrowers into debt they may not be able to afford when interest rates normalise. Key points from the commentary included : "picking cyclical turning points is notoriously hard," and, "the bank has scope to cut rates if needed".

New Zealand

- New Zealand is also starting to show evidence that the economy may be starting to recover from recession. Residential house sales and building consents climbed in April and business confidence picked up in May. While indicators suggest a cycle trough may have occurred, overall levels are still depressingly low.
- The Reserve Bank of New Zealand left the Official Cash Rate unchanged at 2.5% for the first time in a year. The Reserve Bank expects the economy to begin growing again toward the end of the year, but likely to be slow and fragile, and reiterated that it is likely to be some time before monetary policy support can be withdrawn. This is consistent with their assessment that recent developments point to lower inflationary pressure than previously projected.

Monthly Sector Summary

As at 31 May 2009

International shares

The MSCI World Index rose for the third straight month in May, up 5.8% in local currency terms to be up 5.2% year-to-date. Returns to unhedged New Zealand-based investors were down -3.1%, with the NZ dollar rallying strongly - up 7.5% on a trade-weighted basis - along with investors' appetite for risk.

The recovery that began in early March steamed on, virtually unabated for the duration of May, to continue one of the most vicious trend reversals in history. Economic data was far from positive, but the fact that it continued to print "less-worse" than expected - and less negative than earlier in the year - was all that mattered.

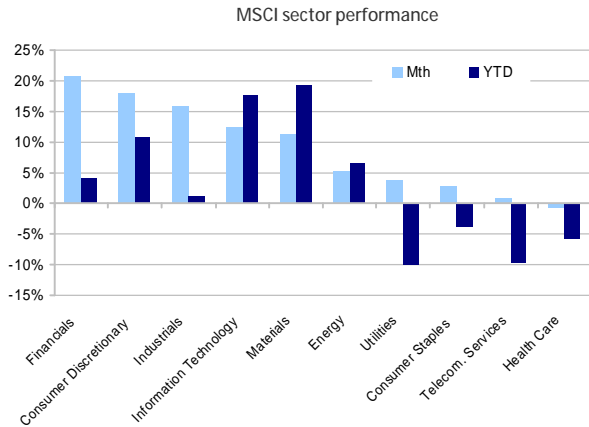
Early in the month, the keenly anticipated results of the US Government 'stress tests' on the large US banks were announced and led to a sharp relief rally for financial stocks. The results had been gradually leaked to the market prior to the announcement, and the capital shortfalls were less than initially feared.

By month end, some of the banks were negotiating to repay their TARP monies to free themselves of the government imposed constraints that accompanied the capital injections.

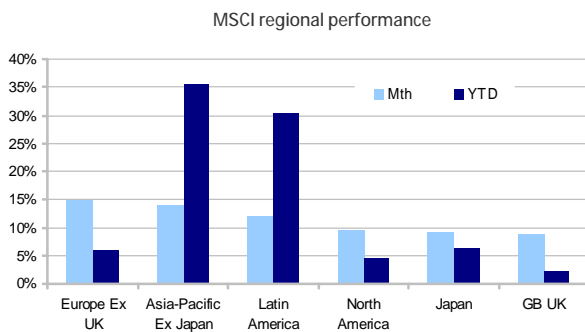
Improved sentiment on the back of policy efforts created positive feedback loops, and banks were able to raise capital to levels identified as sufficient to withstand a dire economic scenario.

May was a strong month for commodity linked sectors with energy (+9.8%) and materials (+9.1%) outperforming the broader market. The Reuters/CRB Commodity Index was up nearly 14% for the month and oil prices rose above US\$66 per barrel, having been below US\$34 per barrel as recently as mid February. Consumer discretionary (-0.7%) was the only sector not to

register a positive return for the month. The sector rotation theme that has been a feature of this rally is evident in the year-to-date performance. The more defensive sectors (consumer staples, healthcare, utilities and telcos) are still down from the end of last year.



All regional markets rose for the third straight month in May, with the developing regions of Asia-Pacific ex-Japan (14.2%) and Latin America (+11.5%) leading the way. The Asian region was buoyed by the results of the stimulus package in China and by election results in India. The ruling party's victory at the polls saw vicious rallies in the Indian stock market to the point where the exchange was forced to close for several days. The recovery in developed markets has been less spectacular with the four main regions all up year-to-date between 2% and 6.5%.

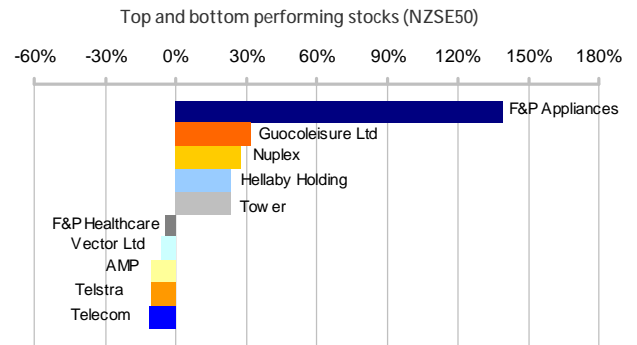


New Zealand shares

The New Zealand share market rose 0.9% during May, taking the calendar year-to-date return to 1.8%.

Company results announced during the month reflected the reality of operating in a tough macro environment during late 2008 and early 2009. A number of companies reported in May, with most announcing further downgrades to their 2009 and 2010 earnings forecasts. The majority of companies remain cautious, but are expecting to see some evidence of demand stabilisation in the latter half of this year. The main news on the corporate front was the \$201 million capital raising by AMP NZ Office Trust. This surprised the market and was not well received by the majority of investors.

Following sharp falls in previous months, F&P Appliances was the strongest performing stock during May, rising 139% after the announcement of a \$189m capital raising, with Haier introduced as a cornerstone investor. Nuplex, which has also fared poorly of late, was another strong performer, gaining 28% for the month. Telstra, AMP and Telecom were the weakest performers, all falling around 10%.



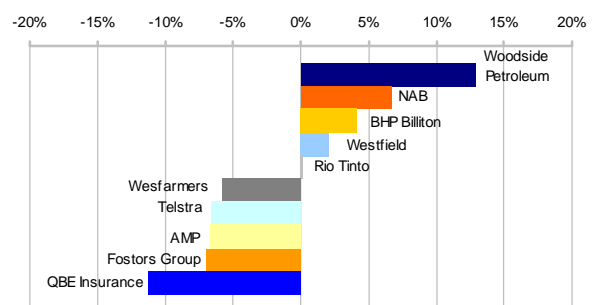
Australian shares

The Australian market extended its rally to three months, inching 1.35% higher in May and closing 22% up on its March low.

The Resources index gained 6.2% during May with support from stronger commodity prices, whilst Energy, on the back of a resurgent oil price, was the strongest sector (+6.4%). Banks (+0.8%) lagged for the second month in a row as the ANZ launched a \$2.85 billion capital raising, and both Westpac and Commonwealth Bank announced dividend cuts. Also of interest was the announcement that the ban on the short-selling of financial stocks would be removed on 25 May.

Deeply discounted equity issues accelerated during May as companies continued to deleverage balance sheets ahead of debt refinancing. In addition to ANZ, issuers of additional equity included Bluescope, Billabong, Macquarie Group, APN, Graincorp, Pacific Brands, Stockland and SPAusnet. This brings the total equity raised or announced year-to-date to approximately AUD\$37 billion.

Top and bottom performing stocks (ASX26)



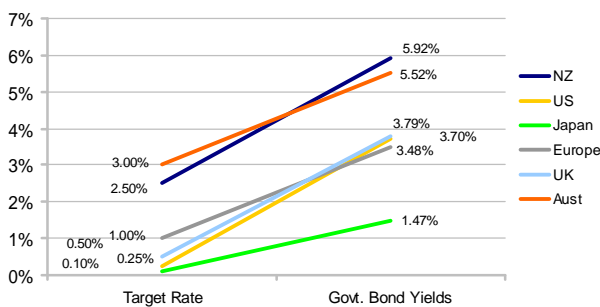
International fixed interest

Global bonds hedged into NZD returned -0.71% for the May month and have gained 12.03% over the last year.

10-year US Treasury notes were 3.46% at the end of May, compared to 3.12% at the end of April. German government 10 year bond yields rose from 3.18% at the end of April to 3.59% at the end of May. Long-term rates are being influenced by supply concerns and world growth forecasts. The improving global sentiment theme from March and April continued in May, and this led to investors trimming back “safe-haven” positions such as US Treasuries. Corporate bond issuance in the US is very strong, and the amounts issued year-to-date are already ahead of 2008 issuance. In addition, credit spreads are contracting (although are still wide). For the first month of this year, issuance of non-guaranteed financial institution debt has exceeded guaranteed debt by almost 2:1 according to Moody's.

The European Central Bank cut rates 25pts down to 1.0% in May, while other regions with rates already close to zero remained unchanged. With short rates remaining low or falling further, yield curves steepened in all major regions.

Regional yield curves



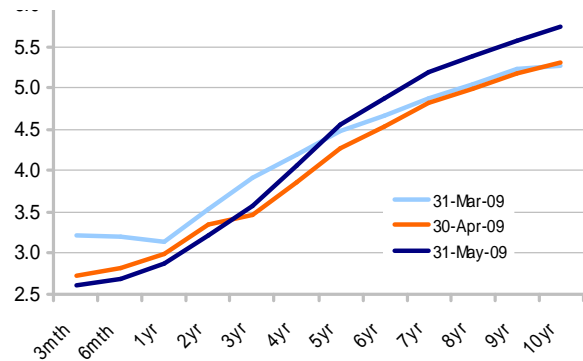
New Zealand fixed interest

The New Zealand Government bond market returned -0.87% for the month, underperforming Cash, which returned 0.25% over the same period. The NZX All-Swaps Index returned -1.06% for the month, while the NZX Corporate A-Grade Index returned -0.32%. Over twelve months, the New Zealand Government bond market returned 11.51%, the Cash index 6.68%, the All-Swaps index 16.85% and the Corporate A-Grade Index 12.00%.

The New Zealand Government released its budget in late May. Of particular relevance to fixed interest markets was that the budget is forecasting deficits requiring bond issuance of \$11.5 billion in 2010/11 and \$15 billion in the 2011/12 and 2012/13 fiscal years. Completed and announced bond issues amount to approximately \$3.2 billion for the year-to-date. Soon after the budget was released Standard & Poor's revised the NZ Government's outlook from negative to stable and Moody's also reaffirmed its stable outlook. Maintaining a solid rating is very important for attracting offshore investors, and this is critical because the Government's funding programme would otherwise overwhelm the limited demand from local investors.

Anecdotal evidence suggests that banks are reluctant to lend to corporate borrowers for terms beyond three years due to the uncertainty of banks' borrowing costs, deleveraging and general risk aversion. The retail bond market is proving a popular alternative for banks and corporate borrowers seeking funding beyond 3 years. For the past several months, government bonds and government guaranteed bonds have been preferred by investors seeking safety. However, there are now signs that risk appetites are re-emerging.

NZ Government bond yield curve



Currency

In May, the NZD/USD rode a rising tide of global relief. Investors continued to shift out of the relative safety of US dollars and into riskier assets such as the NZ dollar. By the end of the month, NZD/USD was already stretched at 0.6370, but would later extend as high as 0.6600.

The signs of economic stabilisation were popping up everywhere in May and investors were forced to give in to the possibility that this could be the start of something more sustainable.

Indications of stronger growth in China helped lift commodity prices and commodity based currencies. The rally in commodity prices was relatively broad based, although the upward moves were less obvious in terms of New Zealand's basket of exports. Dairy prices actually declined over the month with the US announcing subsidies for its dairy farmers, following the earlier lead in this respect by European counterparts. These developments, combined with a stronger NZ dollar, caused Fonterra to surprise markets by cutting their forecast payout to \$4.55.

Signs of recovery have been less obvious in New Zealand, and the rise in unemployment to 5.0% in Q1 from 4.7% in Q4 was little to cheer about. Nonetheless, it was better than the 5.3% the market was expecting and enthusiasm was further buoyed by the National Bank's Business Outlook Survey. The result was still very negative, but at least, well off the all-time lows seen earlier in the year. Housing market activity also continued to show signs of improvement – a direct result of low interest rates.

Aside from stabilising economic data and abating deflation fears, another factor weighing on the US dollar was heightened concern about the growing US fiscal deficit. When Standard & Poor's

downgraded the UK's sovereign debt rating, markets became concerned that the US would be the next to lose its AAA rating. This again called into question the status of the US dollar as the prime reserve currency.

This came at a time when a downgrade to New Zealand's sovereign debt rating was seemingly imminent and ahead of the annual budget release that was likely to be front loaded with plenty of stimulus for the flagging economy. The Government was well aware of the downstream effects of a downgrade to the country's credit rating and managed to deliver a budget that resulted in S&P restoring the rating outlook to "stable", sending the kiwi into orbit.

New Zealand listed property

The New Zealand Gross Property Index returned +2.14% in May, outperforming the broader equity market (NZX50).

The key event over the month was the announcement by AMP Office Trust (APT) of its intention to undertake a rights issue of approximately \$201 million. The size of the raising took the market by surprise given APT has bank covenant levels that are below the market average, plus it had headroom to these levels. The deep discount to the prevailing unit price at the time also makes it difficult for existing unitholders to not participate in the capital raising. Interestingly, APT is the only listed property trust (LPT) that hasn't sold a property and is instead relying on the capital raising to maintain its gearing at appropriate levels.

May was also a busy month for results in the sector with a number of the major LPTs reporting full year results for the year-ending March. While the valuation changes to the underlying property portfolios were largely pre-announced, the trend in underlying earnings was generally weaker due to higher debt costs. Dividend guidance for the year ahead reflected the softer economic conditions, increased debt costs, and the decision by a number of LPTs to move to a lower dividend payout rate more in line with underlying income.

Australian listed property

The S&P/ASX 200 Property Accumulation Index was up 3.8% in May, outperforming the broader markets for the second month in a row by a very healthy 2.4%. Unfortunately, the strong performance has not been enough to reverse the negative overall 12-month rolling and year-to-date returns, with the AREIT 200 underperforming the ASX 200 by 22% for each period.

Capital raisings were the key feature of the month with approximately AUD\$4 billion raised by the Australian Real Estate Investment Trusts (REITS) effectively doubling the amount raised year-to-date. Major LPTs to raise capital included General Property Trust (GPT) raising AUD\$1.72 billion and Stockland (SGP) raising AUD\$1.98 billion. Goodman Group announced that it had signed a new AUD\$300 million finance facility with Macquarie Bank to replace the impending expiry of existing banking facilities, and Westfield priced a US\$700 million debt issue into the US market at more favourable terms. The successful capital raisings and the opening up of alternative funding sources have reinvigorated investor appetite for the REIT sector triggering a strong rally across the sector

globally. Both of these events reduced the pressure on those LPT's to sell assets to satisfy bank and investor demands.

International listed property

Global real estate stocks produced gains in most markets in May as the scope of the world's financial challenges have become better understood. Stocks in the UBS Investors ex-Australia and New Zealand Index produced a total return of 3.5% in local currency terms. Year-to-date, global real estate stocks remain down -4.5%.

Public real estate companies have been actively raising equity, more than \$25 billion over the past seven months; the risk of severe financial distress has largely been eliminated for many of the companies. In addition, we have recently seen the opening of the unsecured debt market, another positive sign for global real estate securities. The corporate unsecured borrowing rate for the largest U.S. REIT, Simon Properties, has declined from more than 10% to less than 7% since March. This level of pricing for unsecured bonds, if sustained, could mean that companies with strong corporate credit ratings will be in a position to begin acquiring properties from entities in weaker financial positions.

Number of the month: US\$225 million:

The amount Real Madrid paid to sign Portuguese winger Cristiano Ronaldo (£80 million) and Brazilian playmaker Kaka (€68 million) from Manchester United and AC Milan respectively. This is likely to fuel further transfer spending sprees among the large European football clubs. The move by Real Madrid has caused some angst in Spain, as the country is suffering its worst recession in 60 years. Reports that Caja Madrid and Banco Santander are lending the majority of the funds for the transfers, while consumers and businesses are finding it harder to access credit, has brought criticism from business leaders and politicians.

At a glance as at 31 May 2009

Indices

	Level	1-month % change	YTD % change	1-year % change	3-year ann. % change	52-week high	52-week low
MSCI World Index (G)	2264	5.7%	5.2%	-31.9%	-8.1%	3614	2797
MSCI AC Asia ex Japan (G)	807	14.2%	35.5%	-21.8%	6.0%	916	623
NZSX50 (G)	2764	0.9%	1.8%	-23.7%	-8.5%	3487	2411
ASX200 Accum.	26012	1.4%	4.9%	-28.9%	-4.4%	35259	21298
Nikkei 225	9523	7.9%	7.5%	-33.6%	-15.6%	14470	6995
Dow Jones	8500	4.1%	-3.1%	-32.7%	-8.5%	12323	6470
S&P500	919	5.3%	1.8%	-34.4%	-10.0%	1367	667
Nasdaq	1774	3.3%	12.5%	-29.7%	-6.4%	2483	1266
MSCI Europe (G)	3884	4.7%	4.7%	-30.4%	-7.3%	6288	4677
FTSE100	4418	4.1%	-0.4%	-27.0%	-7.9%	5930	3461
France CAC	3278	3.7%	1.9%	-34.6%	-12.5%	4723	2465
Germany DAX	4941	3.6%	2.7%	-30.4%	-4.2%	6856	3589
NZX Property (G)	1717	2.1%	-8.3%	-24.1%	-5.4%	2268	1632
Aust LPTs (G)	14993	3.8%	-16.7%	-50.8%	-22.5%	30315	11200
Int'l LPTs (USD) (G)	340	12.6%	5.5%	-43.1%	-12.8%	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+	0.7997	9.7%	13.5%	-16.3%
EUR+	1.4119	6.9%	1.2%	-9.1%
GBP+	1.6154	9.3%	10.8%	-18.3%
JPY+	95.6	3.3%	-5.3%	9.4%
NZD+	0.6367	12.4%	8.6%	-18.8%
NZD/AUD	0.7964	2.5%	-4.3%	-2.9%
NZD/GBP	0.3942	1.1%	-2.0%	-0.2%
NZ TWI	60.34	7.5%	7.4%	-13.7%

† 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
	-1.4/-5.7			
US	ann.	-2.50	1.90	9.40
Japan	0.40	1.50	-0.10	5.00
Germany	-3.80	-6.90	1.80	8.20
Euro	-2.50	-4.80	1.60	9.20
UK	-1.90	-4.10	1.70	4.70
Australia	0.40	0.40	2.20	5.70
NZ	-0.90	-1.90	1.90	5.00

10-year bonds

	Yield	1 month chge	1 year chge
Australia	5.28%	0.71%	-1.25%
Germany	3.59%	0.41%	-0.82%
NZ	5.74%	0.44%	-0.72%
UK	3.75%	0.25%	-1.24%
US	3.46%	0.34%	-0.60%
Japan	1.49%	0.06%	-0.27%

Source: Bloomberg

Central bank target rates

	Rate
NZ	2.50%
US	0.25%
Japan	0.10%
Europe	1.00%
UK	0.50%
Australia	3.00%