

## Financial Advisors

5 April 09  
 Market Update

### Five things that make this rally different

Share markets moved up nearly 20% across the developed world during the month of March. Is this the start of another bull market, or just another bear market rally? We won't know for a while yet, but here are some things we are keeping our eye on....



### Investors are becoming more eager to hold equities

Shares in business are like anything else that is bought or sold. The key thing that determines the price paid is the balance of supply and demand. When demand for shares exceeds supply (more buyers than sellers) the price starts to rise. This is why share markets start to fall before a recession (or even when there is no recession) and why they can start to rise well before a recession ends. One of the ways we measure the eagerness of buyer demand in the sharemarket is the use of the Relative Strength Index (RSI), which shows how sensitive stocks are to changes in price at any one time.

Across developed markets, the Relative Strength Index has been falling in trend terms for over two years.

Over the month of March, across nearly all developed economies, share market RSI indicators broke this two year downtrend.

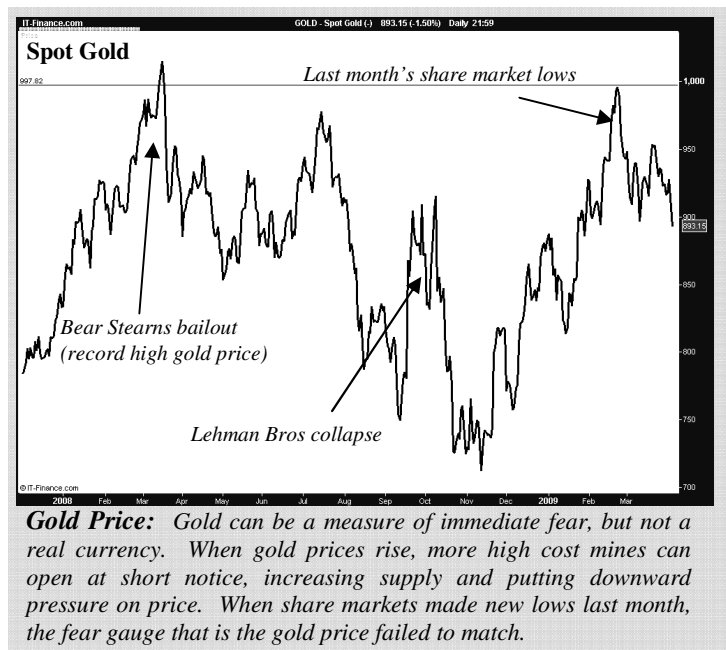
### Gold prices have stabilised

A traditional measure of global economic stability has been the gold price. Amongst doom merchants, gold is a much loved preserver of wealth in hard economic times. Amongst rational investors, gold is a commodity that is sometimes gets confused with a currency. The times it gets confused with a currency is when fear is great and rationality is scarce. As share markets made their recent lows in early March, the gold price failed to match its highs of mid way through last year, showing that whilst equity prices were lower, fear was abating. Gold is moving back to its status as an industrial and consumption based commodity.

### Volatility is easing (for the time being)

When share prices are low, traders take long positions in shares, and insure against further movements downwards by taking put options. The premium paid for this insurance is measured by the difference between the buy and sell price (called the "spread"). The measure of this spread over all put options in the US market is called the Volatility Index. When US markets made new lows at the beginning of last month the premium paid to insure these purchases (measured by the Volatility index) was less. This is an indication that buyers are becoming more confident in the fundamental underlying value of the shares they are purchasing.

We would caution that in our view this does not mark the end of a broader pattern of volatility we expect to see in share markets over the next ten years. We think that the process of capital and credit moving from property assets in developed economies to industrial assets in developing economies will create a pattern of volatility that will be with us for a generation, and will create opportunities and problems throughout this time.



*This information is of a general nature only and has been provided without taking account of your objectives, financial situation or needs. Because of this, we recommend you consider, with or without the assistance of a financial adviser, whether the information is appropriate in light of your particular needs and circumstances.*



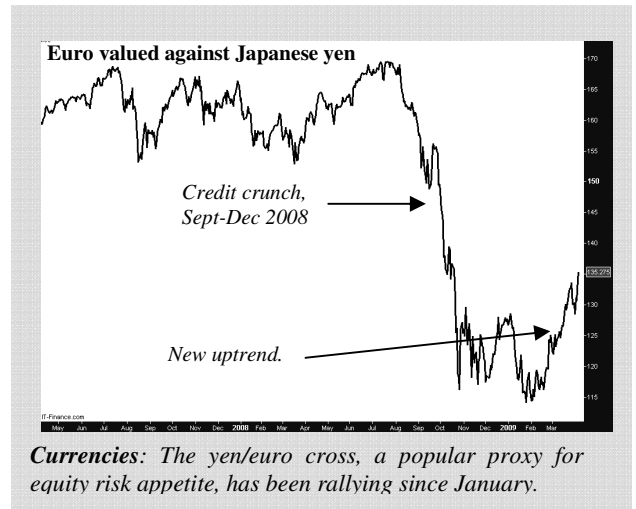
## Carry trades have resumed

Japan is the world's second largest economy, but has a much higher domestic savings rate than the US, so its power as an international investor is significant. A large driver of growth in equity prices has been the borrowing of money in low yielding currencies (such as the Japanese yen, which earns an interest rate of 0% as cash) and buying equities in high yielding currencies (such as the Australian dollar). For the same reason the yen/euro currency cross has become a proxy for equity market risk appetite. We have been noting the movements in this currency cross since December and think that this adds to the overall picture of increasing confidence in equity assets over other asset classes in the coming twelve months. The yen/euro cross made its lows in January of this year and has been rallying ever since. Other yen carry trades have been rallying as well.

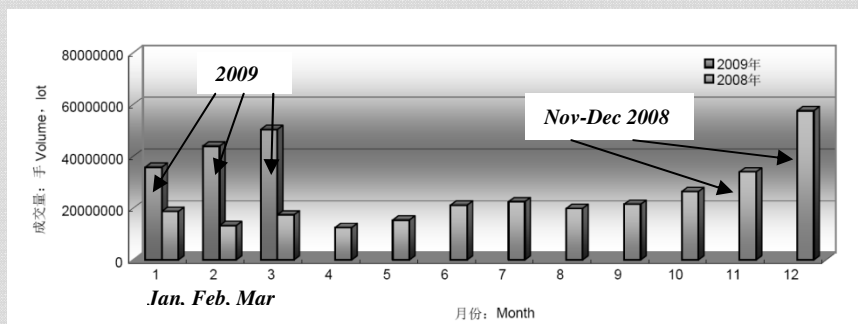
## But hasn't the Chinese Economy gone to hell in handbasket....?

We keep hearing this, and maybe its true.... but why do they keep buying all that stuff off us? Yes, Chinese growth figures are down on last year, but GDP figures are a lagging indicator, and the Chinese government had spent two years trying to dampen economic growth. We think the reporting of the subsequent story hasn't paid enough attention to hard and current data. Our suspicion is driven by two things:

1. The Shanghai stock exchange has been rallying since November last year;
2. Every time the price of a commodity falls, more of it is bought through the Shanghai Futures Exchange. Commodities contracts through the exchange are running at about three times the size of that of last financial year. Industrial metals and fuel purchase volumes are all up, particularly since the price of these commodities has fallen (as a result of declining consumption in developed economies).



## Shanghai (Commodities) Futures Exchange Monthly Volume 2008 vs 2009



**Chinese Commodity Buying:** Commodity volumes through the Shanghai Futures Exchange have been rising since late last year. In some cases volumes are four times the previous year's levels... Now you know why BHP is back above \$30!

## Does this mean the bear market is over?

We can't say for sure. What it does mean is that a lot of other investors think now is the time to increase holdings of shares and decrease holdings of other asset classes (such as bonds and cash). Whilst cash is our preferred defensive asset for the time being, it is possible to hold too much of a good thing, and miss out on attractive yields from a better thing. How much, when and how you invest in sharemarkets depends mostly on your own circumstances. Our job is

to see how best your life circumstances can fit in with the opportunities investment markets present for you at any point in the investment cycle. That's why we put the disclaimer at the bottom of the front page!

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