



**ENERGY INDUSTRIES®**  
SUPERANNUATION SCHEME

# JULY/AUGUST 2011

## Chris Drew Investment Analyst

In his role as Investment Analyst, Chris closely monitors fund managers in terms of performance, operational activities and compliance as well as performing internal analytics on the fund.



## July 2011 – What happened?

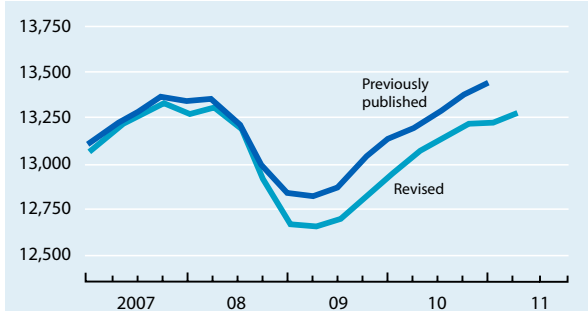
There is rarely a single identifiable event that precipitates the kind of volatility that financial markets experienced during July. That said, several factors contributed to the falls in share markets around the world.

During July, the outlook for the US economy, which was widely predicted to rebound in the second half of 2011, deteriorated significantly.

On July 14, Standard & Poor's (S&P) warned that the US could lose its prized AAA debt rating if it was not convinced that the actions the US government was taking to stabilise its economy would be successful.

On July 29 the US revised its Gross Domestic Product (GDP) figures down. Economic growth from January 2011 to March 2011 was revised down from 1.9% to 0.4% and GDP expanded at an annualised rate of 1.3% from April 2011 to June 2011, well below market expectations. The July ISM survey of manufacturing activity fell to 50.9, its lowest level since July 2009 and well below expectations.

### US real GDP



Source: Bureau of Economic Analysis

Also in the US, political actions (or lack of them) had taken their toll on financial market confidence. The political process was, in fact, one of the major factors cited by S&P in considering whether or not to downgrade the long term US government debt from AAA to AA+.

Within Europe, the debt crisis had been slowly building for over a year, but every apparent 'resolution' has proved to be very short-lived. The market seems to be concerned at the 'piecemeal' approach of the European Union to solving these problems, and the slow-moving bureaucratic nature of European politics.

In Australia, the annual inflation rate jumped to 3.6%, its highest level since 2008. Fruit prices rose by 26.9%, driven by a 138% spike in the cost of bananas, due to shortages attributed to Cyclone Yasi. Petrol rose by 4%, furniture jumped up by 6%, and medical services were up by 3.4%. Clothing and footwear climbed by 2.5% while transport costs rose by 1.2%.

Investors viewed the higher inflation numbers as all but eliminating the chances of an interest rate cut in the near term. Consequently the Australian Dollar rose above \$US1.10 on the expectation that the RBA would soon raise interest rates, due to the higher than expected inflation rate.

However, the Reserve Bank of Australia decided to leave interest rates unchanged at 4.75%, comfortable with its view that "the current mildly restrictive stance of monetary policy remained appropriate".

July 2011 Investment Market snapshot	
Investment type	July performance
Australian Equities	-3.97%
International Equities (Unhedged)	-4.29%
Australian Listed Property Trusts	-6.59%
Australian Government Bonds	1.85%
International Government Bonds	1.28%

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## Monthly economic e-news



## August 2011 – Market review

August saw negative equity (share) market returns in Australia of -1.91%. The market continued to be weighed down by the combination of the downgrade of the United States' debt rating, slowing economic growth and the continuing European debt crisis.

Global shares fell for the fourth straight month, with the MSCI World Index falling by -4.77%. Europe was particularly hard hit with the Stoxx Europe 600 Index falling by approximately 14% in August.

In fixed income markets, Australian government bonds returned 2.23%, while global government bonds returned 2.3%, on a hedged basis.

Once again the Reserve bank of Australia (RBA) elected to keep interest rates unchanged at 4.75%. In its decision, the RBA acknowledged that, while financial year-end inflation was high, the pace of global economic recovery has slowed and that "it is still not clear how persistent this slower growth will be". On balance, the RBA decided that it was "prudent to maintain the current setting of monetary policy, particularly in view of the acute sense of uncertainty in global financial markets over recent weeks".

## Economic news

During August, equity markets around the world swung from losses to gains on an unprecedented scale. For example, in the US the S&P 500 fell by 6.7% on August 8 following the US downgrade, only to rise by 4.7% the next day as the US Federal Reserve announced that it will keep interest rates between 0% and 0.25% until mid-2013.

Bonds beat shares in August, as share market returns were negative, for the reasons highlighted above. These factors drove investors into US Treasuries, the world's biggest and most liquid bond market.

Despite agreeing on a plan to tackle the nation's deficit and raise the debt ceiling, Standard and Poors (S&P) decided to downgrade US long-term debt from AAA to AA+. S&P cited the weakening "effectiveness, stability and predictability of American policy-making and political institutions" as the reasons for the downgrade.

Weak economic data also contributed to investors retreating from shares. Poor consumer sentiment and slow employment growth affected market sentiment in the US. Meanwhile in Europe, economic prospects are deteriorating as national governments cut spending in an attempt to narrow deficits and tackle the debt crisis.

### August 2011 Investment markets snapshot

Investment type	August performance
Australian Equities	-1.91%
International Equities (Unhedged)	-4.77%
Australian Listed Property Trusts	3.12%
Australian Government Bonds	2.23%
International Government Bonds	2.30%

## What should I do?

In view of the bad news and market volatility should investors sell growth assets such as shares?

It is important to remember that while market prices are often a reasonable estimate of a share's fair value, there are times when markets prices reflect swings between extreme optimism and extreme pessimism.

This does not mean, however, that we should ignore the market. Market fluctuations can indicate that something has changed and deserves our attention. That said, as investors we should seek to profit from market folly rather than participate in it. The fact that markets can be driven more by mood swings than by rational thought presents patient investors with buying and selling opportunities. If the market is unreasonably high, then patient investors have the opportunity to sell. On the other hand, if it is unreasonably low, then they have the opportunity to buy.

The important thing is that patient and careful investors always make decisions based on analysis and reason rather than emotions such as greed or fear.

For some investors selling out of growth assets or shares at current levels could mean potentially crystallising losses, forgoing potential gains should markets rebound. It may also mean that investors miss an opportunity to invest in growth assets such as shares at discounted prices.

Rest assured, EISS is continually reviewing the current world situation to ensure the Fund is positioned appropriately.

This is general advice from a funds management perspective only and does not constitute personal advice as it does not take into account your personal objectives, financial situation or needs. Prior to making any investment decision you should consult your financial planner.