

News Flash

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Global markets fall further

Market Update - Wednesday 17 September 2008

- **Lehman Brothers files for largest bankruptcy in history**
- **Bank of America agrees to buy Merrill Lynch**
- **Surviving banks agree to supply \$70 billion to bolster confidence**
- **After initial heavy fall, US markets stabilise on news of AIG bailout, then fall again**
- **Global markets fall further**
- **Impacts on Australia**

US

Late Sunday US time, Lehman Brothers - America's fourth largest investment bank - filed for Chapter 11 bankruptcy protection, signalling the largest bankruptcy in history.

On Monday, in Wall Street's worst day of trading since the 11 September 2001 terrorist attacks, the S&P 500 fell 4.7% to 1,192.70, the Dow Jones Industrial Average slid 4.4% to 10,917.51 and the Nasdaq Composite dropped 3.6% to 2,179.91. Among the surviving Wall St investment banks, Goldman Sachs fell 12.1% to \$135.50 and Morgan Stanley dropped 13.5% to \$32.19.

With Wall Street stalwarts Bear Stearns, Lehman Brothers and Merrill Lynch the latest to fall victim to the sub-prime crisis, investors understandably showed initial concern over rumours that American International Group (AIG), the largest insurer in the US, had asked the Federal Reserve for a \$40 billion bailout. Shares plummeted a total of 74% in response, to \$4.76. Despite AIG being given special permission to access \$20 billion of capital in its subsidiaries to free up liquidity, Standard & Poor's, Moody's and Fitch Ratings all issued credit ratings downgrades for the insurer.

On speculation the AIG would be bailed out by the US Government, (confirmed after the close of trading), the S&P 500 recovered 1.8% to 1,213.6 after having fallen as much as 2% on Tuesday morning. Each of the 10 main industry groups in the S&P 500 gained ground except for telephone companies and utilities. Merrill Lynch led a 6.2% rally in the S&P 500 Financial Index, which recovered some of the 10.6% ground previously lost. However markets fell again overnight.

Global markets remain suppressed with Russia falling 11.5% on Tuesday, Korea down 6.1% and Hong Kong down 5.4% - the top three negative movers.

Background

Lehman's collapse wipes out a company that had a market value of \$45.5 billion in February 2007. The company has about \$613 billion in outstanding liabilities, including about \$149 billion of corporate bonds, according to a 31 May company filing. Among Lehman's top unsecured creditors are Citigroup, Bank of New York Mellon Corp, Aozora Bank and Mizuho Financial Group Inc. The filing also said Citi and Bank of New York Mellon hold about \$138 billion of Lehman's bond debt as indenture trustees.

The two banks most interested in Lehman, London-based Barclays Plc and Charlotte, North Carolina-based Bank of America, balked at a deal unless the government would protect it from any losses on some of the hardest-to-value assets. The government, already shaken by criticism of its actions to support Bear Stearns, Fannie Mae and Freddie Mac, refused to budge and tried to persuade the CEOs of the biggest Wall Street firms to become involved.

Trading of Lehman shares was later halted on Tuesday afternoon on widespread reports that Barclays was either near to or had completed a deal to acquire the broker-dealer businesses of Lehman. The deal fell through and Lehman has filed for bankruptcy.

After hurried negotiations, Bank of America has agreed to acquire Merrill Lynch & Co for \$50 billion in an all-stock deal that will give the US bank the world's largest brokerage. Merrill's sale for \$29 a share, while about a 70% premium to Merrill's value on Friday, is still far below the company's \$86 billion market capitalisation in January 2007.

The demise of Lehman and Merrill Lynch, following on from the purchase of Bear Sterns by JP Morgan, means that Wall Street has radically changed in the past six months.

Fixed income and currency

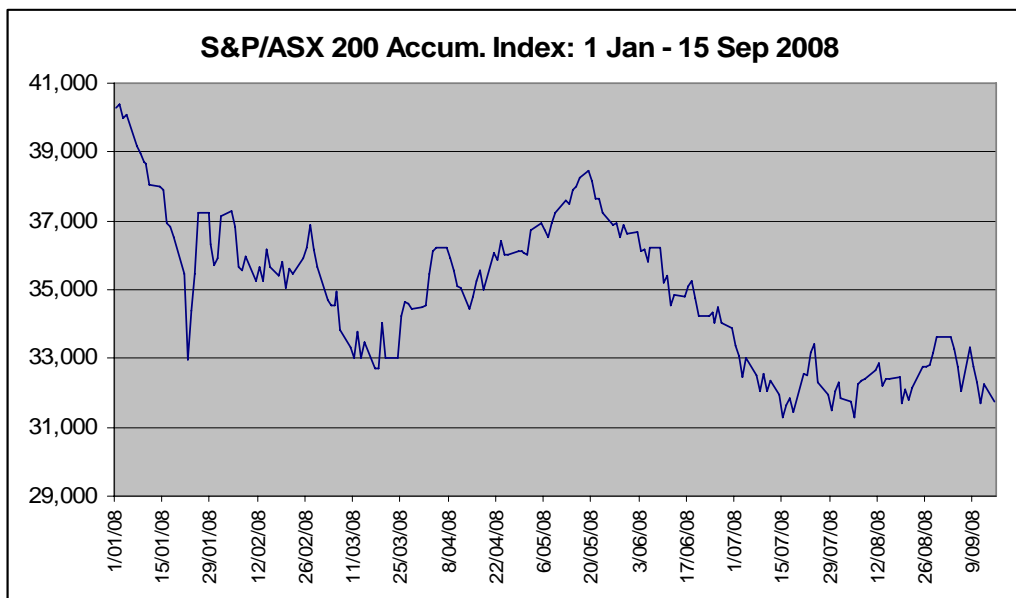
On bond markets, Treasury bond yields fell as investors fled to safe havens. Ten-year note yields dropped by 0.24% to 3.49% - more than the 0.22% decline on 17 September 2001. The Federal Reserve added \$70 billion in reserves to the banking system, the most since the September 2001 terrorist attacks, to reverse a surge in borrowing costs sparked by the Lehman collapse. High yield securities spreads blew out as investors de-risked.

Meanwhile, the US dollar traded near a two-month low against the yen on the speculation that the Fed will cut rates soon. (Note: on Wednesday the Fed maintained the 2% official rate.)

Australia

Australia has not escaped unscathed. The benchmark index, the S&P/ASX 200, shaved off 1.8% on Monday and a further 2.6% by Tuesday lunchtime, falling to its lowest point since December 2005. However, the market recouped some of its intra-day lows to close Tuesday 1.4% down*. The index has shed 26% so far this year.

This is a disappointing result after what had been a positive run for the Australian market in August. Last month it gained 4.1%, with virtually every sector outperforming its global counterpart in local currency terms.



Source: Datastream

Unsurprisingly the banks are coming under selling pressure – particularly NAB, ANZ and the Commonwealth Bank whose share prices fell due to concerns over the three being Lehman Brothers' creditors. Westpac issued a statement disclosing its exposure to be less than A\$10 million.

On Tuesday, NAB hit its lowest share price since 2000 with a fall of 4.9% to A\$21.71, while ANZ dived 5.7% to A\$15.91 and the Commonwealth Bank dropped 2.7% to A\$40.85. ANZ**, Westpac, NAB and AMP were among the most 20 actively traded financials on the ASX200 on Monday.

Babcock & Brown slumped 44% to a record low 89 cents, while Australia's second-largest oil and gas producer, Woodside Petroleum, fell 3.9% to A\$49.97 as the price of crude slipped under US\$100 per barrel.

Fidelity Australian Equities Fund

The Fidelity Australian Equities Fund outperformed its benchmark (the S&P/ASX 200 Index) by 0.73%*** during August. The manager's decision to sell a position in National Australia Bank made a significant contribution to performance, particularly in light of its recent downturn. Increasing the fund's position in Westpac in July also added to performance during August, considering that it is one of the stronger banks in Australia with healthy profitability growth. Westpac remains one of the fund's top ten overweights, while ANZ, which has a high exposure to Lehman, is one of the underweights.

Fidelity believes the Australian stock market remains reasonably valued and provides a good dividend yield with healthy earnings growth. Long-term factors, such as strong population growth, a low-cost and premium-grade natural resource base, the presence of good quality domestic and international companies and excellent corporate governance standards, bode well for the economy. Our positive long-term investment view remains unchanged.

* Standard & Poor's

**Market performance source: Bloomberg. Reference to companies is for illustration purposes and does not constitute a recommendation.

*** Total net returns have been calculated using mid-prices and are net of Fidelity's management costs and transactional and operational costs, and the calculation assumes reinvestment of distributions. No allowance has been made for tax. The return of capital is not guaranteed. Past performance is not a reliable indicator of future performance.

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