

THE AUSTRALIAN EQUITIES MARKET TIME TO RE-ENTER?

EXECUTIVE SUMMARY

Global growth – and importantly sentiment – continues to be negatively impacted due to the ongoing credit crisis. Over the past few weeks, G7 actions appear to be progressively leading to a relative calming in financial markets, as government actions together with significant rate cuts show signs of restarting the flow of money and credit.

Global growth will nevertheless continue to slow, with the outlook weakening into the first half of 2009. We believe however that global growth should recover in the second half of 2009, boosted by the tailwinds of resurgent credit markets, rate cuts, fiscal stimulus, lower oil price and Chinese pro-growth moves.

Despite possessing a financial system far better positioned than global counterparts, the Australian market has been sold down savagely to levels lower than March 2003 in valuation terms. On inflation adjusted terms, the market is at a level not experienced for over 30 years!

Bottom up consensus earnings numbers sourced from our broking panel does suggest that some adjustments still need to be made in certain sectors, however aggregate earnings expectations for 2009 have been

lowered considerably since the reporting season and are now approaching more realistic levels.

At current valuations, it appears that these downgrades are more than priced into valuations, with the market discounting forward earnings expectations very heavily. Our central view is therefore that the Australian equity market has been considerably oversold.

Markets, by their nature, are forward looking beasts, but can in the short term be swept up in short term sentiment. We believe they will soon begin to look beyond the current malaise and will increasingly re-price in an eventual recovery, which we believe will occur in the second half of 2009.

In our view, the Australian equities market provides as compelling value as has been experienced in our professional lives. Whilst horror stories, economic data points and press coverage will continue to cause short term shocks to near term sentiment, we are of the view that the market is now experiencing a bottoming phase and represents compelling value to long term investors who have been building up cash reserves in anticipation of re-entering the market.

THE CURRENT FINANCIAL CRISIS

It is generally acknowledged that the current global financial crisis is the gravest since the 1930s. Over the past few months there have been a number of policy responses from the US, UK and Europe, but unfortunately they have failed to calm markets. Over the weekend of the 11th and 12th October in Washington the G-7 Finance Ministers and Central Bank Governors formulated a coordinated action plan.

The finance chiefs of the Group of Seven major advanced economies announced on 12th October that the current situation calls for urgent and exceptional action. The G-7 ministers agreed to continue working together to stabilise financial markets and restore the flow of credit to support global economic growth.

THE AUSTRALIAN EQUITIES MARKET: TIME TO RE-ENTER? Ausbil Dexia Limited – November 2008

They agreed to :

1. Take decisive action and use all available tools to support systemically important financial institutions and prevent their failure.
2. Take all necessary steps to unfreeze credit and money markets and ensure that banks and other financial institutions have broad access to liquidity and funding.
3. Ensure that banks and other major financial intermediaries, as needed, can raise capital from public as well as private sources, in sufficient amounts to re-establish confidence and permit them to continue lending to households and businesses.
4. Ensure that respective national deposit insurance and guarantee programs are robust and consistent so that retail depositors will continue to have confidence in the safety of their deposits.
5. Take action, where appropriate, to restart the secondary markets for mortgages and other securitised assets. Accurate valuation and transparent disclosure of assets and consistent implementation of high quality accounting standards are necessary.

The US Treasury Secretary, Henry Paulson, said in a separate statement:

"This action plan provides a coherent framework that will direct our individual and collective policy steps to provide liquidity to markets, strengthen financial institutions, protect savers, and enforce investor protections."

He also stated: *"it is critical for governments to continue to take individual and collective actions to provide much-needed liquidity, strengthen financial situations, enhance*

market stability, and develop a comprehensive regulatory response."

The above agreements, statements and actions from the G-7, albeit in our view this should have happened a lot earlier, will lead to the eventual calming of the global financial markets. This, we believe, will be the step, together with further global interest rate cuts, that will restart the global flow of money and credit.

Signs have started to emerge that the credit markets are thawing. We see this as a key early stage catalyst in any recovery, not just from a sentiment perspective, but also as a necessary condition of businesses again doing business.

One sign of improvement has been the reversal of the "TED Spread", after having reached dizzying highs. The TED Spread measures the difference between the three-month T-bill interest rate and three-month LIBOR.

A rising TED spread often foreshadows a downturn in the U.S. stock market, as it indicates that liquidity is being withdrawn. Whilst still high, the change in direction does indicate an important increase in liquidity.

LIBOR rates (in Aus BBSW rates) are used as benchmarks for funding costs for corporates. We take particular solace in the fact that the overnight LIBOR and 3 month cash rate have fallen sharply from October 10 peak. Another promising sign is that US commercial paper market is showing signs of improvement.

Indications are pointing toward the worst being over and the efforts of central banks and governments are starting to revive the previously frozen credit markets.

GROWTH TO SLOW

The IMF now estimates that economic growth in all major regions of the world will slow, driven by a marked slowdown in Industrialised countries. There is no escaping the fact that the credit crisis has negatively impacted global

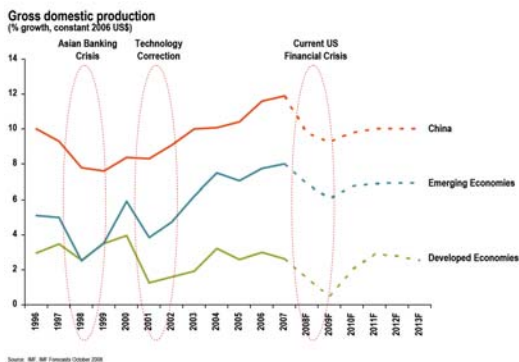
growth. It is likely that global growth will remain weak into 2009.

We are optimistic, however, that the current coordinated actions of the G-7 and now the

THE AUSTRALIAN EQUITIES MARKET: TIME TO RE-ENTER?

Ausbil Dexia Limited – November 2008

G-20 will lead to global credit markets functioning. This, together with likely further global interest rate reductions, the fall in oil prices and the pro-growth messages the Chinese are likely to announce, should ensure growth to recover in the second half of 2009, as highlighted in the following chart:



Australian Implications

The RBA's financial Stability Review notes that "while the Australian financial system has not been completely insulated from developments abroad, it is weathering the current difficulties much better than many other financial systems."

Australian banks have not had to make the massive loan write-downs seen in the US or Europe and their high rating has helped them to continue to access capital markets, even if this has been at a higher cost.

Despite the RBA's actions there has been a squeeze on liquidity, making it difficult for credit-worthy borrowers. This will have a negative impact on economic growth over Q4 2008 and possibly in Q1 2009.

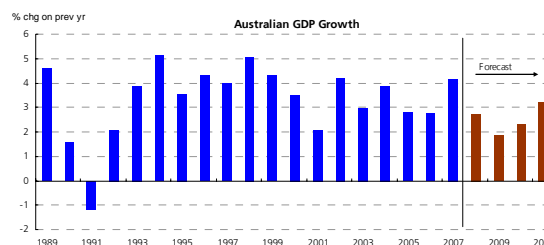
In addition, the outlook for Australian commodity prices is now less favourable. Spot iron ore and coal prices have fallen

sharply in recent weeks as Chinese steel production forecasts have been lowered. Spot prices are now lower than Australian contract prices. This suggests that contract prices are unlikely to increase next year (expectations were for 1 April 2009 prices to increase by 10%-15%), but rather achieve rollover -10/15%. Spot thermal coal prices also have fallen in recent weeks and in China inventories at utilities are being rebuilt.

Given the deteriorating global economic backdrop and downside risks to the terms of trade, confidence and financial conditions, Australian economic growth is at risk of falling further in early 2009 before recovering in the second half of 2009.

It is likely that the easing cycle will be greater than first anticipated, with rates falling below 5% before mid 2009. The recent fiscal stimulus package will also help boost GDP, and have a significant effect on the retailers and gaming stocks unless the handouts are used to pay off debt and the consumer continues the recent conservatism mindset shift.

The following diagram highlights our expectations for the rebound in Australian GDP growth.



P/E AND EARNINGS: WHAT IS ALREADY PRICED IN?

Globally, major equity markets have fallen by greater than 42% its November 2007 high, and in Australia's case, by over 35%. At their lowest point, markets had fallen by around 50% from November 2007!

It would appear that the worst of the negative

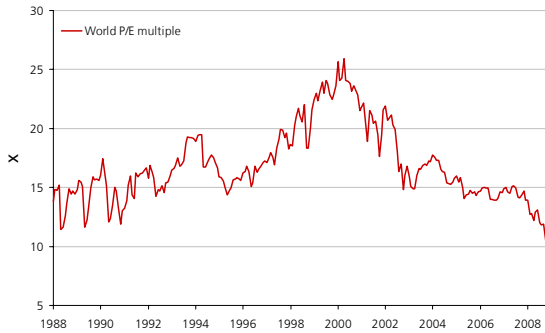
impacts of the current global credit crisis is reflective in current share market prices.

Indeed, should sentiment change, which in our view is likely due to the now coordinated actions of the G-7, the market could recover sharply from oversold levels.

THE AUSTRALIAN EQUITIES MARKET: TIME TO RE-ENTER?

Ausbil Dexia Limited – November 2008

The following chart cites the current global P/E multiple at 8.7x.



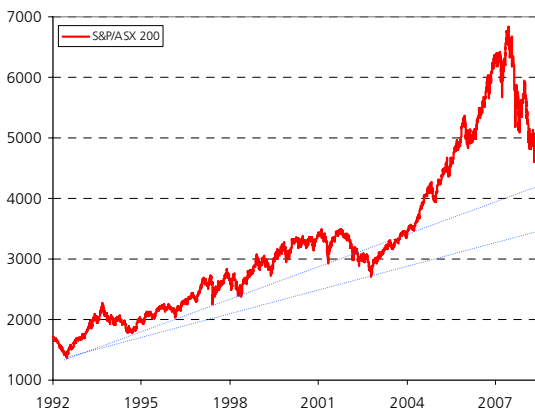
Source I/B/E/S

This figure suggests the market is pricing in a consensus earnings miss of over 50% in the next year!

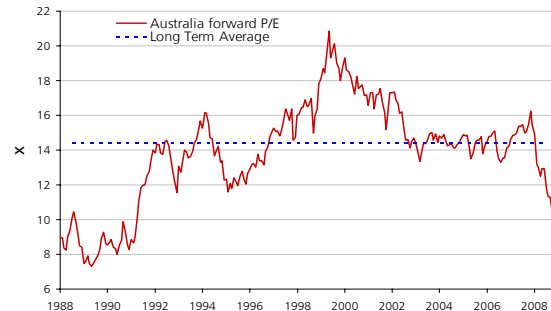
Our central view is that the Global Authorities will take whatever action is necessary to ensure credit markets will restart, particularly interbank and money market deposits. Presently global bond markets, US Treasury yields, credit market spreads and equity markets appear to be priced at maximum pessimistic levels.

This, together with cash levels at near record highs, the Chicago Board Options Exchange Volatility Index (VIX) reaching a level over 80 (at an all time high using the modern format which goes back to 1990), and equity market valuations being at generational low levels, all support the view that equity markets are oversold.

In absolute terms, the Australian market is back at longer term support levels.

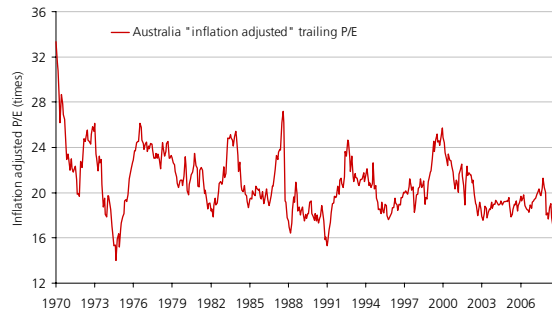


Based on forward earning estimates, the market is now considerably cheaper than it was at its low point of March 2003 and heading back to valuations seen in the late 80's and early 90's, as seen below.



Source I/B/E/S

Taking a longer term view, and adjusting for inflation provides additional evidence for the market's apparent cheapness.



Source I/B/E/S

Current valuations suggest that market is discounting forward earnings expectations very heavily.

Market earnings consensus sourced from our panel of brokers are similarly at single digits however bottom-up aggregate earnings estimates suggest that there is still some forward adjustments that need to be made.

The following table highlights current market consensus numbers, as well as a 'most likely' and 'worst case' adjustment we have applied to the figures.

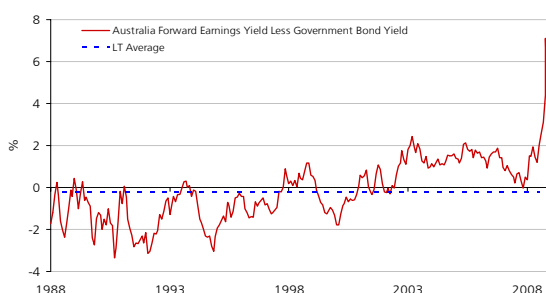
| 4 November 2008 | PE 09 (e) | PE 10 (e) | EPS 09 (e) | EPS 10 (e) |
|---------------------------------|-----------|-----------|------------|------------|
| Current market | 9.8x | 8.5x | +18.2% | +15.4% |
| Adjusted market (likely) | 10.5x | 9.5x | +10.1% | +9.9% |
| Adjusted market (worst) | 11.9x | 11.3x | -3.3% | +5.9% |

THE AUSTRALIAN EQUITIES MARKET: TIME TO RE-ENTER?

Ausbil Dexia Limited – November 2008

We have adjusted the earnings estimates to allow for a fall in the currency, oil price and commodities, as well as for generally lower top line sales growth. On this basis, we expect EPS growth in 2009 to be in the 10% to -3% range (from likely to worse case) and in 2010 to be in the 10% to 6% range (again from likely to worst case). On these lower numbers, the market in valuation terms still remains very attractively priced.

From a relative yield perspective, the market is well above the historical average for the past 20 years.



Taking a look at various sub-sectors:

Financials

| 4 Nov 2008 | PE 09 (e) | PE 10 (e) | EPS 09 (e) | EPS 10 (e) |
|-------------------|-----------|-----------|------------|------------|
| Current | 10.8x | 9.9x | +2.3% | +9.3% |
| Likely | 11.3x | 10.6x | -2.6% | +7.4% |
| Worst Case | 13.5x | 12.9x | -18.5% | +4.9% |

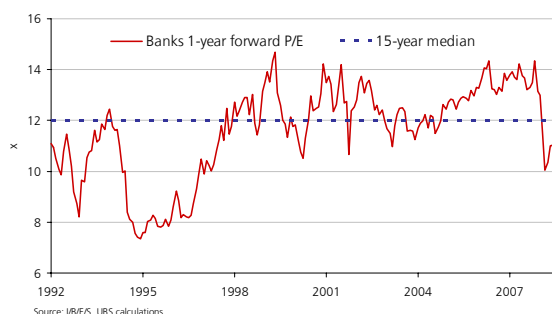
The market has adjusted earnings expectations significantly, particularly for the Banking sector. The market appears far more realistic about bad debts, but slowing volume growth could place some additional earnings pressure on banks.

We expect continued and long-term repercussions from the credit crunch, with de-leveraging and ongoing re-capitalisation likely to negatively impact growth, bad debts and ROE over coming years. However, local and global banks had been priced for a disaster scenario, and this is now less likely following coordinated global reforms.

Importantly, Australia has led the way globally by offering to guarantee bank paper, effectively elevating all of our banks to AAA-rated entities for the purposes of funding.

This should ensure that Australian businesses and consumers continue to have access to credit at an acceptable price, thereby preventing a doomsday scenario for our economy and banks.

From a relative price earnings perspective, the sector is now far more attractive than has been over the past 10 years.



Furthermore, the bad debt profile of the banks is considerably removed from that experienced in the 1990s. In the 90s, a key source of bad debts for the banking sector was derived from the commercial property market.

Over the past 10 years, the risk of commercial property has been transferred into the REIT market, and the pain currently being experienced in commercial property is now being felt by equity holders in these vehicles. Whilst the banking sector will experience an uptick in bad and doubtful debts, these will be minor when compared historically.

Furthermore, residential property has suffered from a considerable underbuild over the past five years. This deficit is likely to be ongoing and should provide a floor under residential property prices, thus partially protecting that part of the banks loan book.

REITS

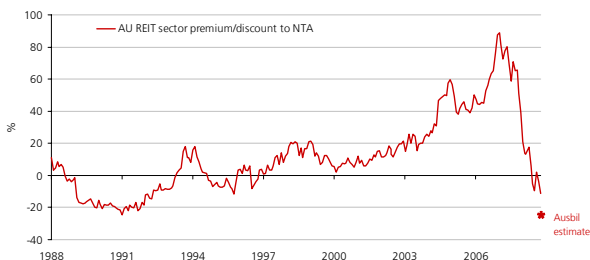
| 4 Nov 2008 | PE 09 (e) | PE 10 (e) | EPS 09 (e) | EPS 10 (e) |
|-------------------|-----------|-----------|------------|------------|
| Current | 8.4x | 8.2x | -5.7% | +2.0% |
| Likely | 8.9x | 8.8x | -11.9% | +2.1% |
| Worst Case | 10.4x | 10.1x | -24.0% | +2.3% |

Whilst earnings expectations have been lowered, risk still remains as NTA valuations

THE AUSTRALIAN EQUITIES MARKET: TIME TO RE-ENTER?

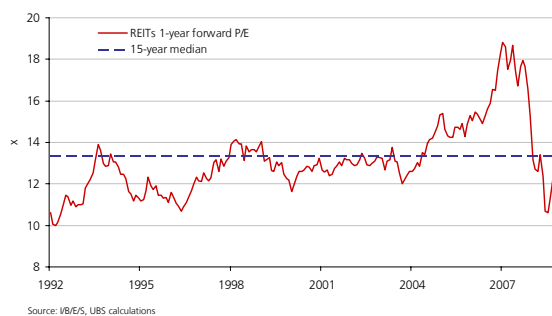
Ausbil Dexia Limited – November 2008

remain high, there is no real price discovery or forced asset sales to date. By our estimates, REITs as a sector are still overvalued compared to 'true' NTA, as highlighted in the following chart:



In addition, given rising refinancing costs and likely dilutions from capital raisings the sector could remain under pressure.

The sector has experienced a dramatic de-rating, as highlighted below:



Following this de-rating, selective opportunities are however starting to appear in the pricing of recapitalisations, as evidenced by the likes of GPT and Goodman Group. We are starting to selectively re-enter this sector.

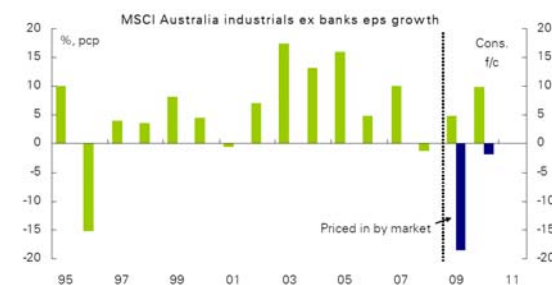
Industrials

| 4 Nov 2008 | PE 09 (e) | PE 10 (e) | EPS 09 (e) | EPS 10 (e) |
|-------------------|-----------|-----------|------------|------------|
| Current | 12.4x | 11.0x | +4.7% | +12.4% |
| Likely | 12.8x | 11.6x | +1.2% | +10.5% |
| Worst Case | 13.8x | 13.1x | -6.5% | +5.2% |

Earnings expectations now appear to be far more achievable than previous expectations of +10% growth.

Groups such as CSL, Woolworths, Telstra, QBE Insurance, Leightons, Worley Parsons, AGL Energy, ASX, Toll Holdings and Wesfarmers should ensure that a positive EPS growth rate is achieved. Currency upgrades will also begin to filter through, given Australian corporates (in aggregate) earn 40% of their earnings offshore.

Despite still optimistic bottom-up earnings forecasts, the market has significantly discounted the sector.



Source: Datastream, Deutsche Bank

This indicates that our reduced expectations shown above are a more realistic expectation of what the market truly expects. P/E multiples have certainly fallen close to 10x forward earnings, but stock selection remains paramount in this sector particularly, as ongoing macroeconomic impacts will continue to effect the earnings outcomes of individual companies. This will certainly be the case for those with weaker competitive positioning and/or poor margins.

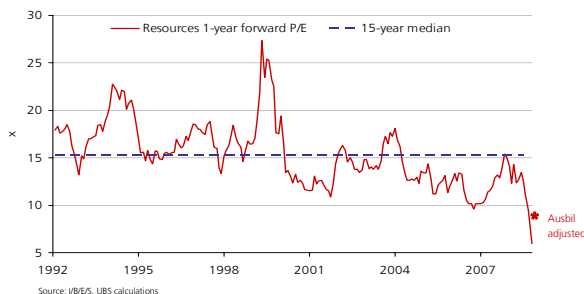
Resources

| 4 Nov 2008 | PE 09 (e) | PE 10 (e) | EPS 09 (e) | EPS 10 (e) |
|-------------------|-----------|-----------|------------|------------|
| Current | 7.1x | 5.6x | +65.2% | +25.4% |
| Likely | 8.0x | 7.0x | +46.0% | +13.3% |
| Worst Case | 9.1x | 8.4x | +28.0% | +8.0% |

Resource valuations, particularly Diversified Metals & Mining and Gold companies, are at historically low valuation levels. The valuation either suggests that forward commodity prices are about to crash further or these stocks are absolute outstanding compelling value. We are in the compelling value camp.

THE AUSTRALIAN EQUITIES MARKET: TIME TO RE-ENTER? Ausbil Dexia Limited – November 2008

The following chart highlights the current P/E of the sector in a historical context. Even having adjusted the earnings expectations as done above, the sector is at historically cheap levels.



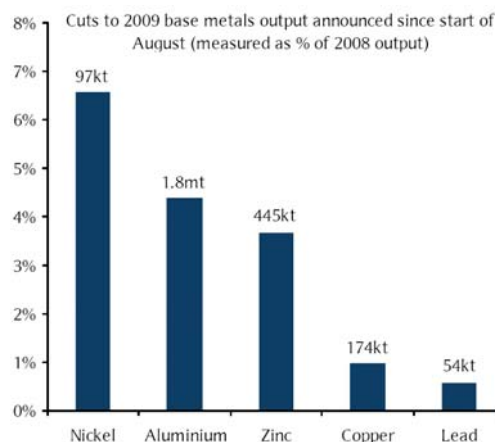
Clearly, given recent movements in commodity prices and the exchange rate, adjustments to earnings expectations in the Resource sector will need to be made to reflect these changes. In fact, ex BHP and RIO – the forecast for Diversified Metals & Mining is for EPS of -52% in 2009. Quite a sharp difference !

Commodity markets have also fallen by over 40% as represented by the CRB Index. It is interesting to note that most commodities have experienced a uniform sell-down of 40%-50% and divergence at individual commodity levels is minimal. This may reflect general liquidation in commodities rather than discerning analysis of which commodities have relatively better fundamentals.

These price falls are starting to impact the supply of key commodities. Based on recent estimates, the following portion of key commodity production is now cash negative:

- 50% aluminium
- 30% nickel
- 15% zinc
- 5% copper

This will lead to a very rapid supply response. The following chart highlights the cuts already announced:



Source: Reuters, Barclays Capital

When demand does however recover, markets will tighten very quickly and we would expect to see a reversal in many of the commodity price curves..

Despite the recent sell-off, we remain of the view that longer-term fundamentals for the commodities markets (ie. emerging markets demand growth and supply-side constraints) remain positive.

Consensus commodity price forecast will be subject to downward revisions, but a natural offset is a weaker Australian dollar.

An example is if you mark to market BHP 2009 earnings using spot prices earnings would increase by around 2% compared with consensus. In US\$ terms, earnings would need to fall by around 5%.

THE AUSTRALIAN EQUITIES MARKET: TIME TO RE-ENTER?

Ausbil Dexia Limited – November 2008

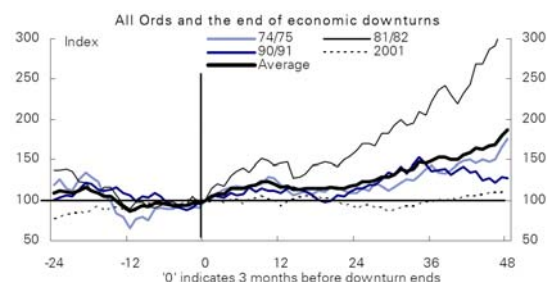
SOME FINAL THOUGHTS

A weak US financial system and a global lack of liquidity destabilised global equity/credit markets has seen government and other authorities globally addressing issues through interest rate cuts and fiscal stimuli.

We believe these should facilitate an improvement in global growth in the second half of 2009.

Based on current valuations, Australian and international equity markets have become 'overly pessimistic', with P/E based valuations at generational lows and market dividend yields at their highest level in over a decade.

Markets are forward looking beasts. History has shown that markets recover in anticipation of economic lows, as the following chart attests.



Source: ABS, IRESS, Datastream, Deutsche Bank

Most indicators suggest we are approaching a low point in the share market cycle and that the market currently offers compelling value, possibly more compelling than seen in many decades.

We are of the view that for those who have been tactically holding cash, now is a particularly attractive time to re-enter the domestic equity market.