

Market Update – 23rd January 2008

The Australian market as measured by the S&P/ASX200 fell 394 points on Tuesday 22 January to 5187 which was a 7% fall. This is the largest one day fall in perhaps twenty years and takes valuations back to levels last seen in October 2006. This weakness follows large falls on the European markets overnight on concerns that global markets will follow the US into recession.

The US market then reopened last night following Martin Luther King Jnr day and it's mood was initially bearish, falling over 400 points until the Federal Reserve announced a 0.75% interest rate easing to 3.5%. The market regained ground and eventually the Dow Jones Industrial Index closed 126 points or 1% lower to 11,973, the lowest close since 2006. Whilst there was an evident rebound after the Federal Reserve's intervention, the sentiment remains essentially negative and further US rates cuts would appear necessary to stabilise markets.

With such pressure on the Australian market, which has now fallen by 25% from its November high, it would appear less likely that the Reserve Bank will tighten interest rates in February or any time soon. The 'loss of wealth' effect on consumers may well reduce the high levels of consumption.

Several factors are now influencing the negative direction and this includes heavy selling from international investors (including short sellers) and selling by leveraged investors who are subject to margin calls. This is essentially compounding the negative momentum.

Looking beyond the rises and falls, investors should keep in mind the following points:

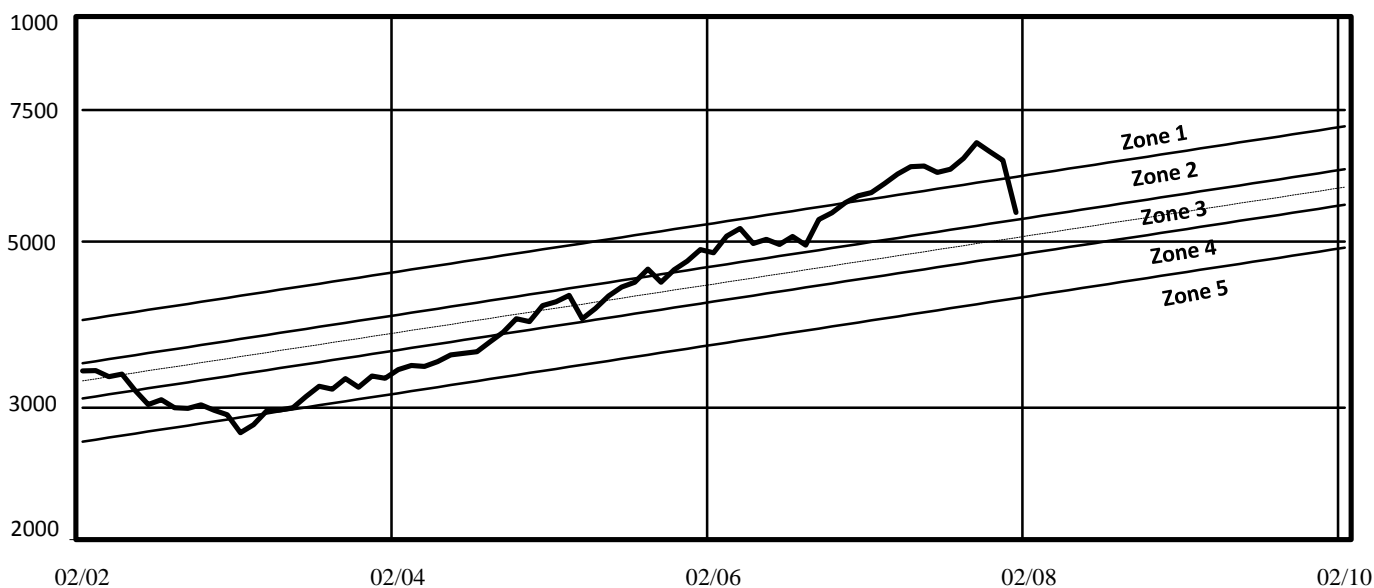
- The Australian economy remains fundamentally strong
- Australian sharemarket valuations are now very compelling on an historical basis with the current PE on 12.5x.
- Corporate balance sheets are generally conservatively geared. Any stocks with excessive debt are the biggest casualties of the current negativity and should be avoided.
- Company earnings growth, whilst slowing, remains robust at around 6-7% (about twice GDP). These earnings expectations need to be reinforced during the upcoming reporting season to confirm that the market is in fact very cheap.
- Demand for Australian resources remains strong
- The Federal Reserve in America has indicated that it will act to avoid a US recession by easing interest rates and the Australian market will continue to take its lead from the US market.

In terms of managing the current market correction investors need to keep the following points in mind:

- Do not panic. Investors who panic tend to crystallise losses rather than protect their capital.
- Share markets rise and fall – this is the nature of a market place. Market corrections in fact provide very good buying opportunities for long term investors. (Because of its inherent volatility, equity investing needs to be regarded as a long term proposition.)
- Sharemarkets follow a long term upward trend. Correction events, regardless of severity, are generally absorbed into this rising trend. This can be quite a quick recovery or can take a few years – the major point being that the effect of the crisis will fade and long term investors with well diversified portfolios can ride out the weakness and take advantage of the opportunities that such weakness presents.

- Maintain a well diversified portfolio and adhere to asset allocation policy. Both the initial impact and the repercussions of a global correction will affect each type of investment differently. Property, fixed interest, shares and currency may react differently. By investing in a number of different asset classes and markets, you reduce the effect a fall in one market has on your overall portfolio.
- IWM's recommended portfolios are constructed along asset allocation guidelines which incorporates solid exposures to lower risk asset classes that will have a tempering impact on total portfolio returns in such events.
- IWM recommends a diversified share portfolio of blue chip companies with strong fundamentals, market share and earnings. Generally speaking, these companies should continue to pay dividends regardless of the prevailing price of their equity. IWM clients adhering to strategies within their financial plans are unlikely to be in a forced sell situation and should be in a position to reweight their asset allocations by utilising cash reserves to rebalance portfolios.

Long term trend chart (as at Midday)



The long term trend chart shows that equities are currently in zone 2 following the early rebound to 5472 (at midday). This represents a long term buying opportunity for those long term investors who are currently underweight to Australian shares. Timing is an issue and we would be looking for some stabilisation (positive sentiment or news, central bank intervention etc) before returning to markets.

If you have any concerns or would like to discuss current investment opportunities, please do not hesitate to contact your adviser.

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