



Equity and property markets

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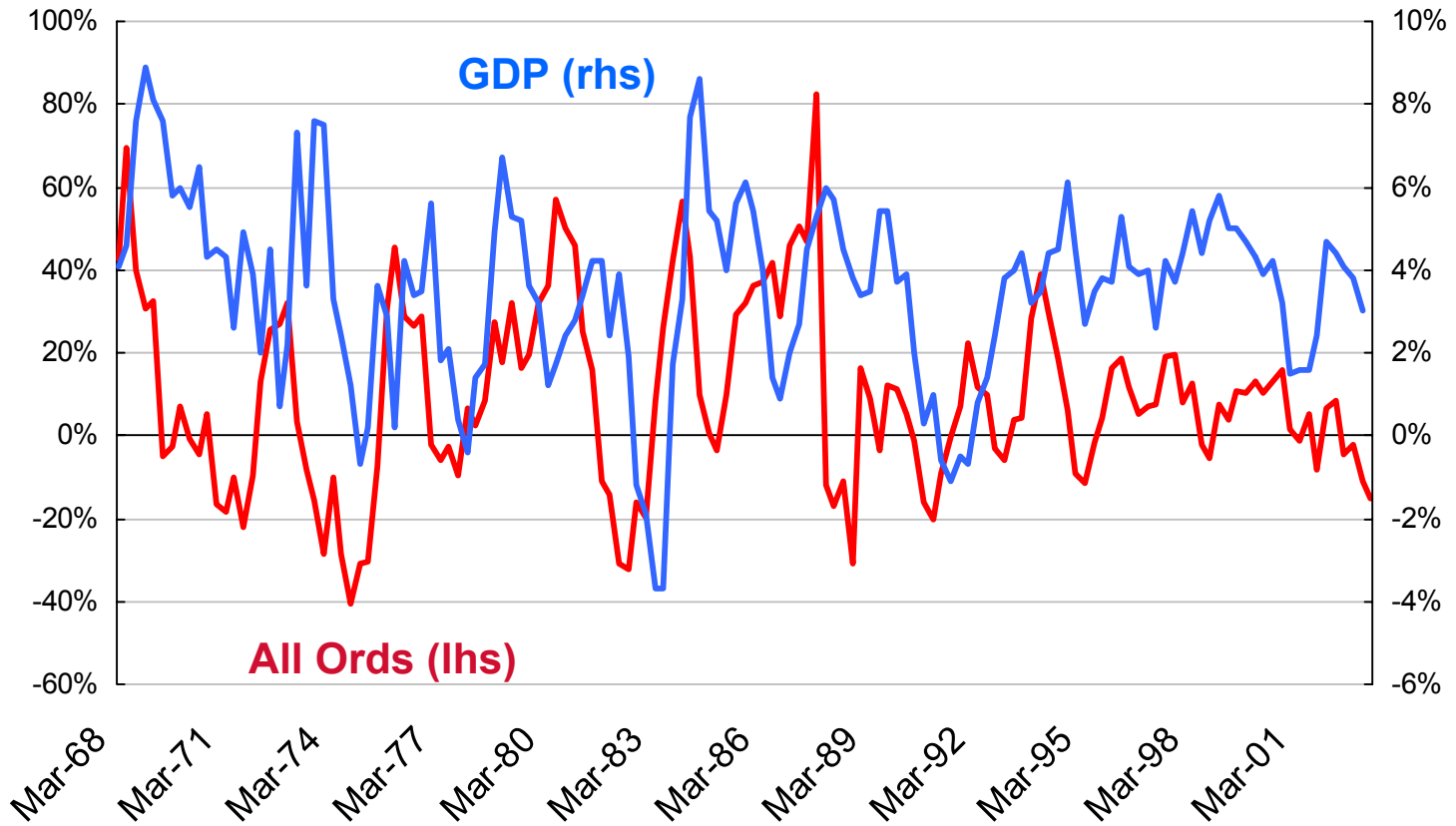
The economy - the sharemarket driver

- Australian economy to remain strong
- Official interest rates on hold - next move ?
- Budget surpluses, tax cuts
- Construction, investment buoyant
- Employment - robust
- International risks
 - Global recovery
 - Deflation

Sharemarket - good news/bad news

Australia - Shares lead the economy

Annual % Change



Source: IRESS

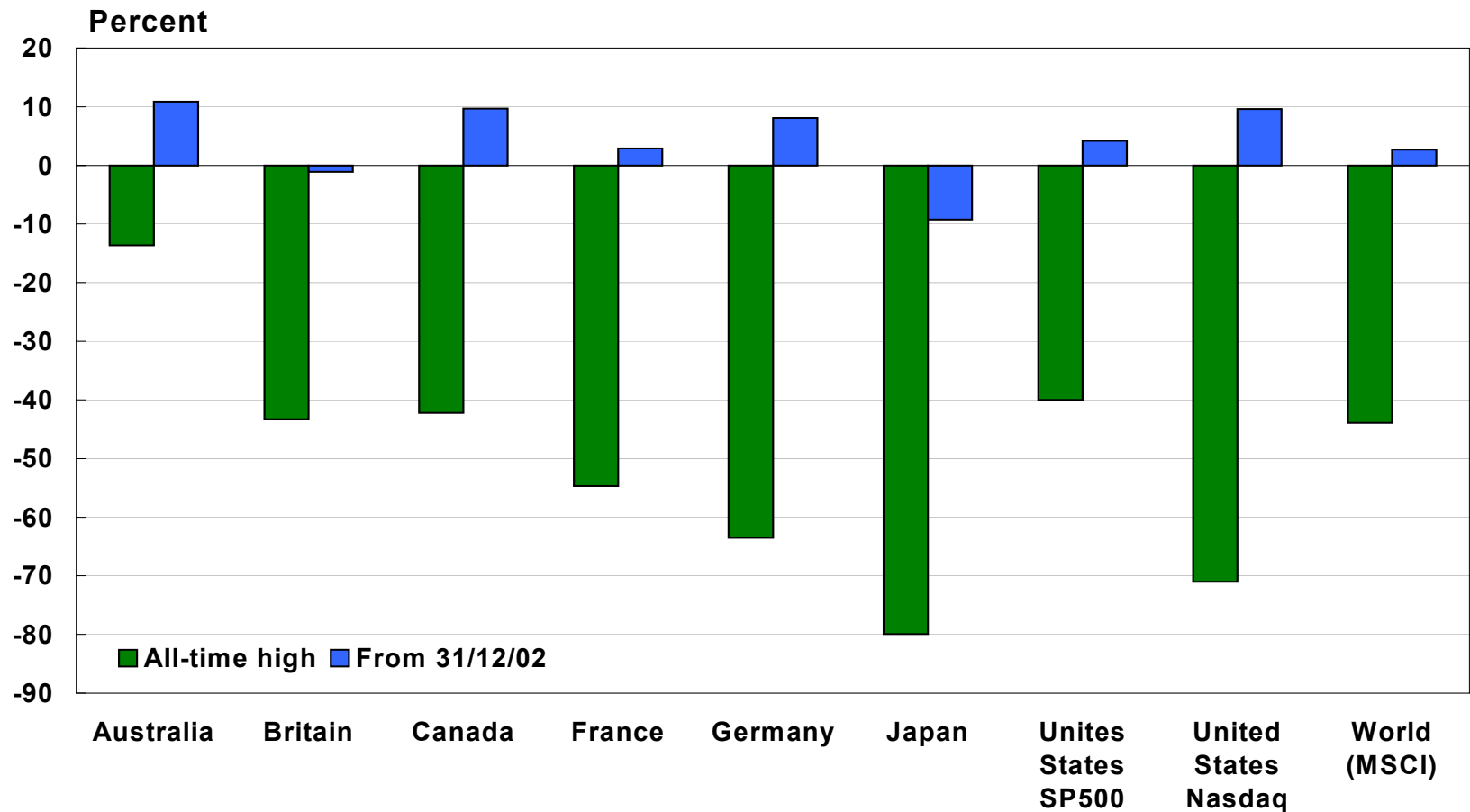
S&P 500 Index



S&P 500 Index



Sharemarkets % Change



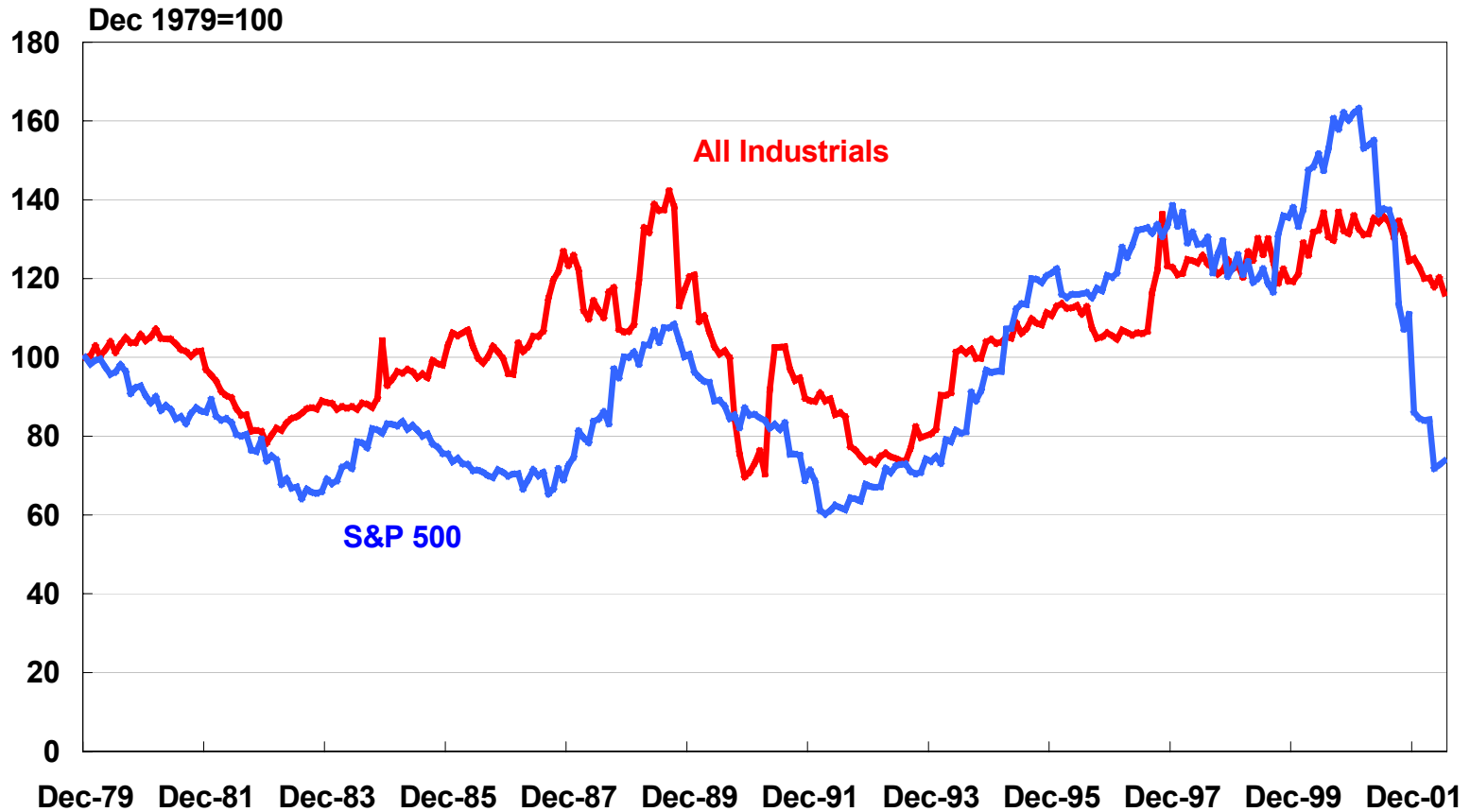
Sharemarket conundrum

- Huge wealth reduction
- Investment response of baby-boomers (major holders of wealth) ?
- Is 1987 comparable?
- Is the 1990s decade repeatable?
- Implications for other asset classes (eg. property)
- ***Consider the drivers of sharemarket performance***

Equity markets: Future sources of performance

- Dividends
- Inflation
- Profit growth (earnings per share - EPS)
- PE multiples (What \$1 of profit is worth)
- Since 1979:
 - Average return to All Industrials index: 16.6% pa

Real Earnings per Share: All Industrials and S&P 500

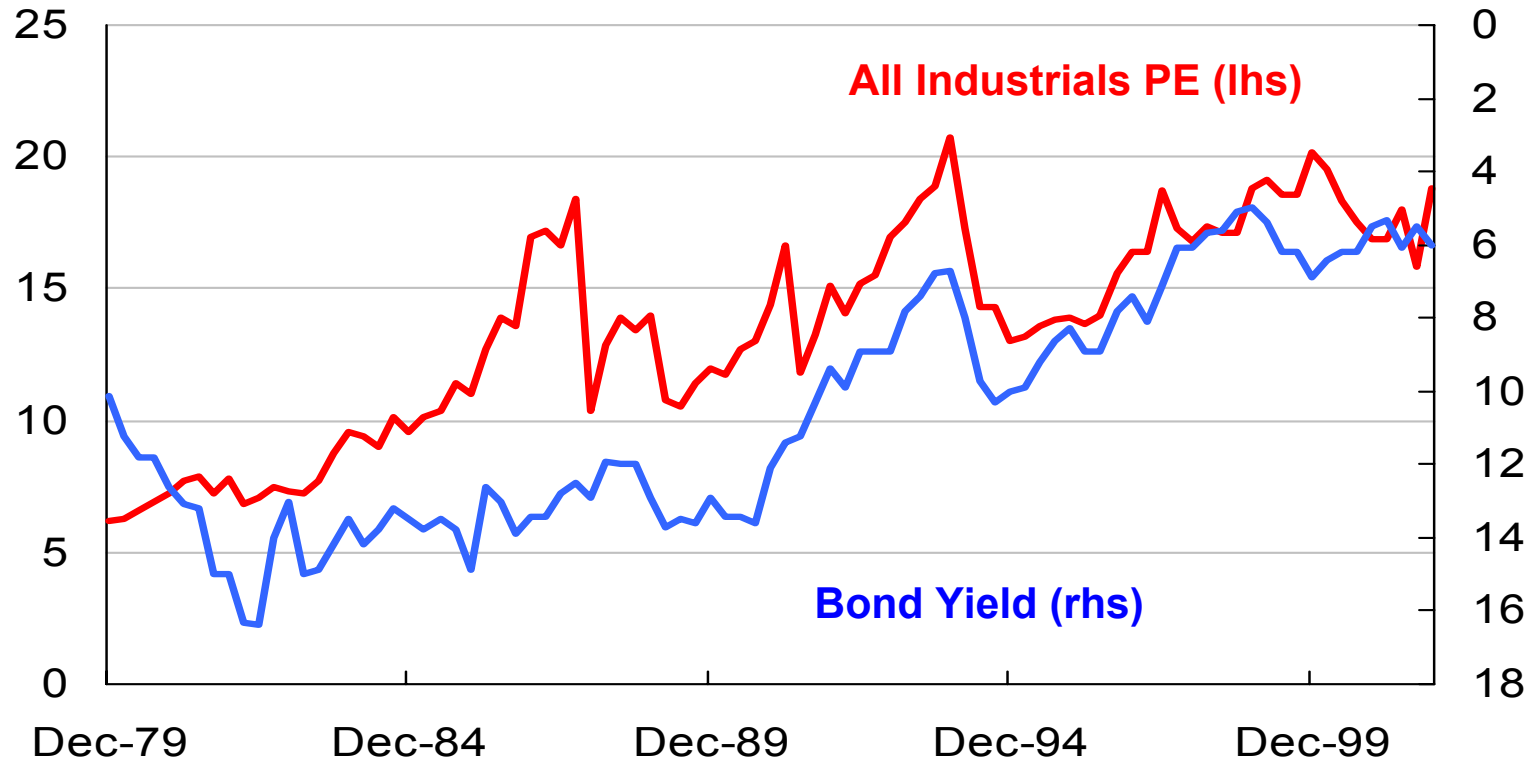


ASX Industrial Index PE Multiple



Source: Commonwealth Research, IRESS

ASX Industrial Index PE Multiple and 10-Year Bond Yield



Source: Commonwealth Research, IRESS

Equity markets:

Four sources of performance

- Dividends
- Inflation
- Profit growth (earnings per share - EPS)
- PE multiples (What \$1 of profit is worth)
- Since 1979:
 - Average return to All Industrials index: 16.6% pa
- Of which:
 - Dividends 4.2% pa
 - Inflation 5.1% pa
 - EPS growth 0.7% pa
 - PE shift 5.0% pa
- ***The key question - What is the outlook for the future?***

The broad market drivers 1980-2003 ...

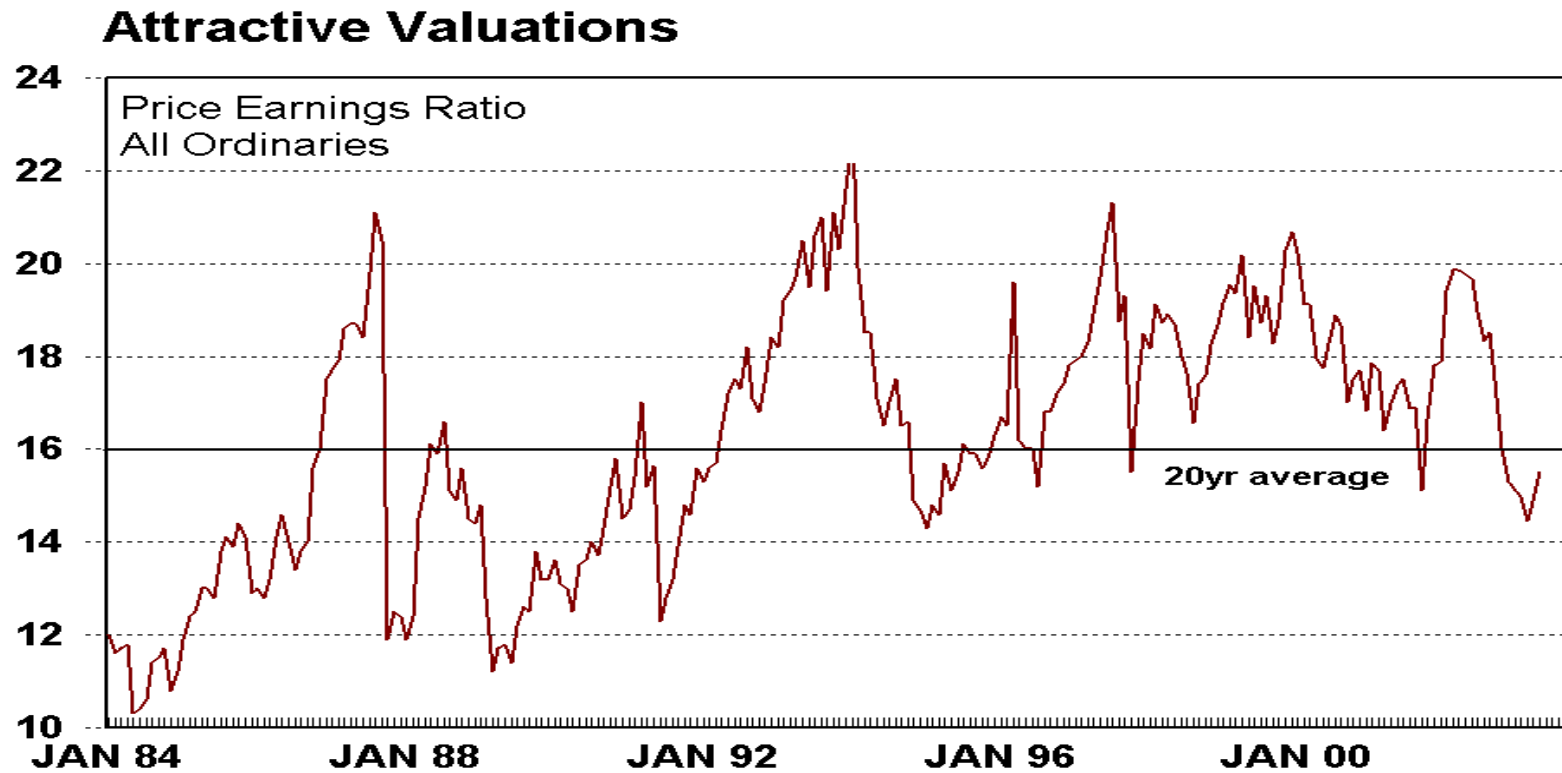
- Falling inflation
- Falling interest rates
- Falling corporate tax (49% 1986-88)
- Rising PE multiples (7x to 17x)
- Financial and industrial deregulation
- Globalisation
- Productivity growth

Which of these factors will apply over the next ten years ?

Sharemarket - Long term perspective

- The PE shift was a one-off
- Inflation in 2% to 3% band
- Earnings growth and dividend yield will be the keys to performance
- Earnings growth was strong through 1990s
- Long term sharemarket returns - say, EPS growth 3% plus dividends 4% plus inflation 2.5% =9.5% benchmark

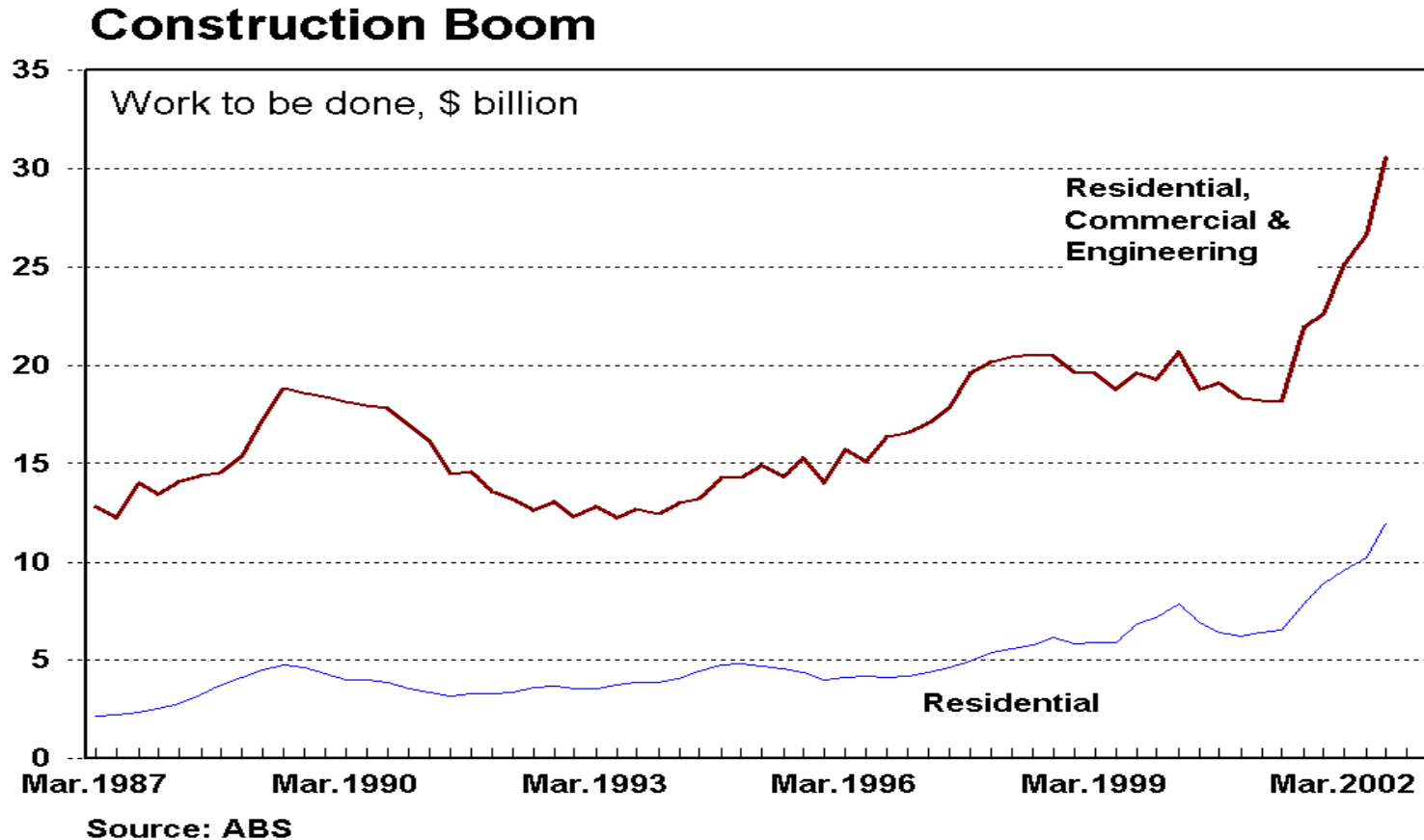
Shares Offer Value



Source: Iress

Property - the big portfolio shift

Supply increases - a key factor?



Property - the big portfolio shift

- Portfolio shift from equities?
- Residential, direct commercial property and LPTs are different assets
- Commercial property has historically outperformed
- A re-rating - lower yields, value uplift - a permanent shift
- Why should it happen now?

Property - the big portfolio shift

- Residential - a soft landing
- Preferred commercial property sectors - retail and industrial
- Supply pressure is an issue in selected locations for both commercial and residential
- Remember - property yields (like dividend yields) are “real” not nominal - like an inflation-indexed bond
- Property is still a location, location, location asset

Cruise control or changing gear?

- Structural shifts are behind us.
- Micro, not macro, factors will become more important - deregulation, technology, competition policy, corporate governance etc.
- The investment climate will be tougher in the future
- The usual rules of investment apply - no quick fix

Sharemarket - Short term perspective

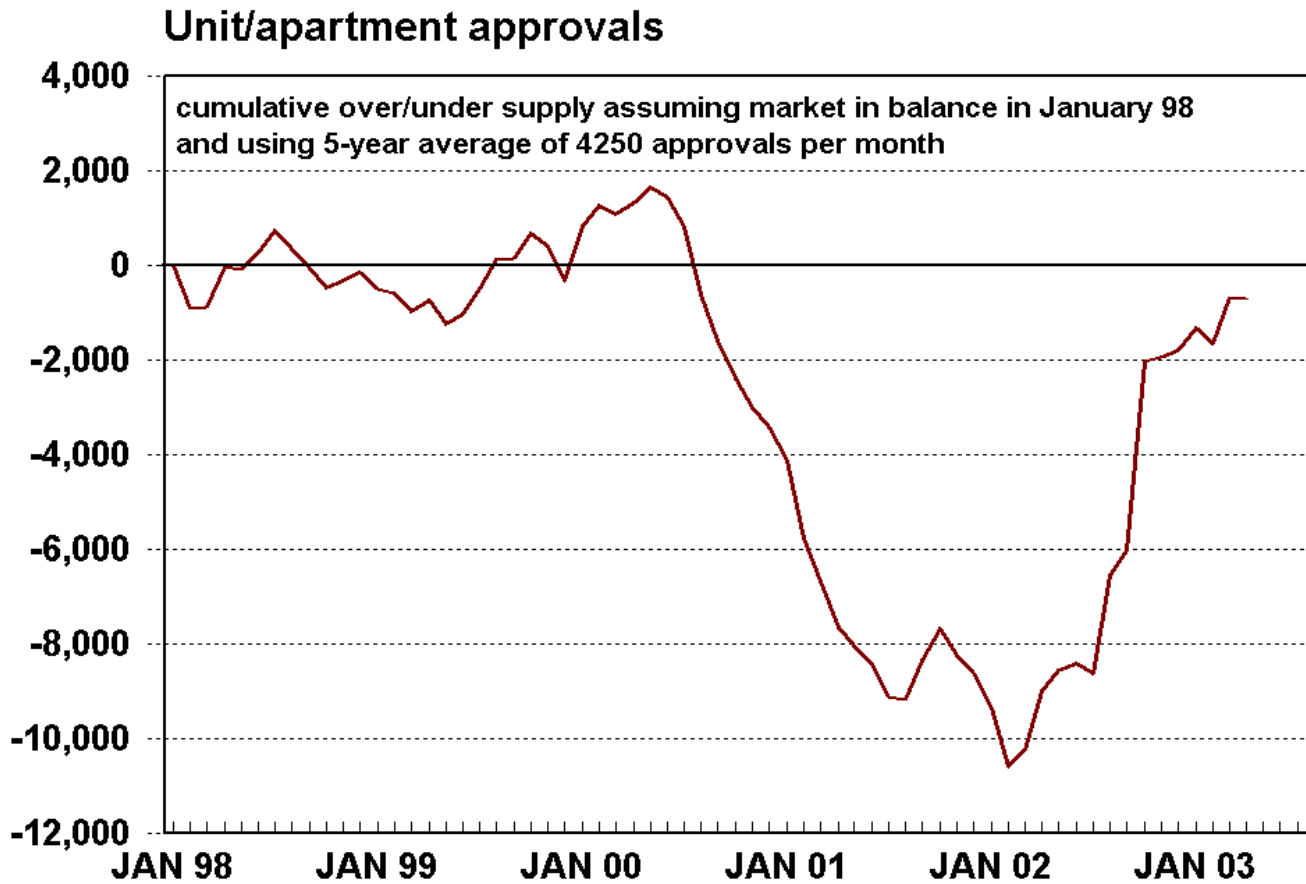
- Recovery in investor confidence post Iraq
- “Fair value” on PE basis
- Year end All Ordinaries index 3175 - too low?
- Sectors of interest:

Positive	Neutral	Negative
<ul style="list-style-type: none">• Media	<ul style="list-style-type: none">• Resources	<ul style="list-style-type: none">• Real Estate
<ul style="list-style-type: none">• Construction	<ul style="list-style-type: none">• Utilities	<ul style="list-style-type: none">• Telecommunications
<ul style="list-style-type: none">• Consumer Staples		<ul style="list-style-type: none">• Health Care

Asset classes - pick the underperformance?

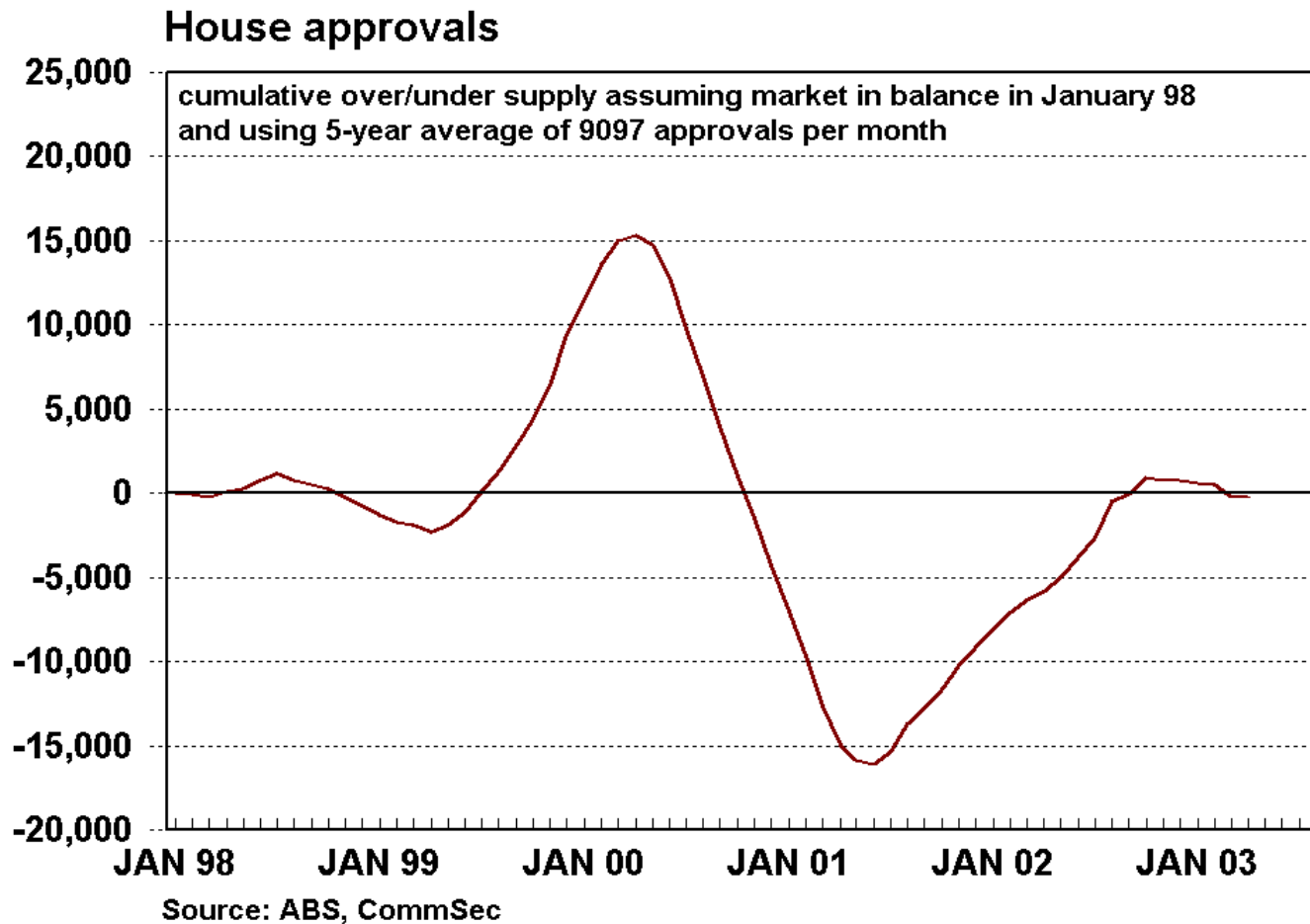
	Cash	Australian Direct Property	Australian Fixed Interest	Australian LPTs	Australian Equities	Overseas Fixed Interest	Overseas Equities	Annual Inflation Rate
Dec-86						13.88%		9.77%
Dec-87					-9.04%			7.14%
Dec-88						-11.47%		7.60%
Dec-89				0.67%				7.83%
Dec-90					-16.65%			6.85%
Dec-91		-11.60%						1.51%
Dec-92		-10.11%						0.28%
Dec-93		0.22%						1.95%
Dec-94						-18.42%		2.55%
Dec-95		5.81%						5.05%
Dec-96						-1.46%		1.52%
Dec-97	4.48%							-0.25%
Dec-98	4.07%							1.58%
Dec-99			-11.02%					1.80%
Dec-00							0.95%	5.80%
Dec-01							-11.04%	3.12%
Dec-02							-28.76%	3.03%

Apartments - oversupply?



Source: ABS, CommSec

Housing - oversupply?





The Economy, equity and property markets

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