McGregor Asset Consulting

# Economic and Market Commentary
# April 2012

Investment markets in 2012 have reacted positively to the European quantitative easing program of Long Term Repurchase Operations (LTRO) with the Australian equities market (All Ordinaries) up 9% to the end of March and Global equities (MSCI unhedged) up 10.5%.

The ECB has implemented a game changer to deliver financial stability through a program of quantitative easing LTRO. This programme has provided considerable relief to stressed capital markets with the provision of more than EUR 1 trillion of additional loans to over 500 banks which should enable them to refinance their 2012 commitments. This has provided the catalyst in the short term for the equities rally and change in sentiment. Of significant concern is whether the politicians and bureaucrats can maintain the discipline to deliver an orderly restructure across the euro zone. European Union leaders have a significant challenge as the region moves into lower growth and recession and the general public (voters) start voting out governments. This is happening across the Euro zone with the Dutch government recently dumped and is also likely to happen in France with President Sarkozy likely to be removed in the upcoming elections during May. Social unrest is also likely to be a significant issue as 2012 unfolds with confidence remaining uncertain. The Euro currency is likely to remain under pressure as the market forces impact. Spanish and Italian bond rates remain volatile while sentiment is uncertain.

The US is now well into the election process with the republicans well down the path of selecting a candidate to run against Obama. The election process is likely to deflect major issues around the US economy and should see a focus on job creation to lower the unemployment rate which has now dropped to around 8.2%. The underlying US economy continues to produce positive growth although at low levels (in the region of 2%) and a more upbeat corporate sector. US consumer confidence is improving from a low base while US corporates are the bright spot for the economy, delivering solid earnings. They are generally well cashed up and have access to funding at very low rates (1-2%) and a weak US$. Inflation in the US is not an issue at this stage [although in the region of 3% and 10 year bonds around 2%]

The emerging world is in good shape and is likely to account for most of the global growth in the year ahead. China remains key to world growth and is presently undergoing a slowing in growth. Exports are showing clear signs of being impacted by the slowdown in Europe. The slowing is also a result of the Chinese leadership policies to restrain lending and reduce inflationary pressures in both goods and services, and property. The Chinese Yuan has slowly been allowed to appreciate against the US$ and this should assist in controlling the inflation level. There appears strong consensus that the new Chinese leadership which will take control towards the end of the year are focussed on delivering 7% plus GDP which should underpin world growth.

The Australian financial markets are also currently dealing with the uncertainty created by the two speed economy. Focus is now firmly on the Federal budget outcome to be released in early May and the impact from the implementation of the carbon tax which commences 1st July.

The positive for Australia is that it is now linked more and more into China and the greater Asian economies. This should provide opportunities in our financial markets over the medium to long term. China is not immune from the problems of the western world and is also being impacted by the slow-down which is having flow on implications for Australia in the short term, especially for commodity prices. China is likely to be confronted with more and more imbalances as the surge of urbanisation continues. There is now over 50% of the Chinese population urbanised and this is likely to create greater pressures for the leadership as the wealth of the population increases.

Some of the likely headwinds for the Australian market include the negative global sentiment emanating from the high debt levels, especially in Europe, the US and Japan. As well the strong A$ currency is making it difficult for manufacturers, exporters, retailers and tourism. There is also pressure building on business as the steel, automotive, aluminium and banking sectors all deal with job losses and union demands. In addition the political instability is creating a heightened level of uncertainty, especially within in the business community where capital spending decisions are being delayed.

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Energy and resource related companies within the Australian economy are likely to provide the lead for the coming year. Substantial investment is being made into the gas and energy sector which should underpin the growth rate. Although the resource sector is undergoing a commodity price readjustment from the high levels of a year ago there is a solid base supporting current levels, especially copper considered as a bell-weather for commodity prices. Other sectors of the economy have also slowed with retail and industrial being particularly weak largely as a result of the high A$. The recent drop in inflation is likely to result in the RBA resuming its interest rate easing policy with the market factoring in a number of 25 basis point reductions before the end of 2012. Cash rates are currently 4.25%.

Confidence is likely to be the key driver of equities and property markets over the coming year. The weak US$ is currently underpinning the strength of the A$ as well as the interest rates and commodity prices. Managers with good stock picking skills should outperform in this environment. Equities valuations appear attractive and well placed to generate satisfactory returns given the improvement in sentiment for risky assets. The focus on quality stocks along with dividends and high yield should ultimately reward equities investors over the medium term.

Commercial and retail property valuations are starting to offer better value and long term investors are likely to slowly re-enter the market over the coming year as the next cycle emerges. Access to funding is still the key restraint for the commercial and retail property markets.

- **International shares: [Overweight]** A strong Aust$ v US$ provides opportunities for international shares and an overweight position is appropriate for the sector. Asia and emerging markets remain long term growth regions. Stock and country selection is going to be much more important over the coming year as volatility remains high. Europe is likely to remain subdued, while the US offers opportunities.
- **Australian shares: [Neutral] Australian Small Caps: [Neutral]** Valuations are more compelling as the sentiment for growth assets improves. The focus should be on quality companies with strong income streams in this environment. Consider a benchmark weighting appropriate on a three-year outlook.
- **Australian Listed Property: [Underweight] Global Listed Property: [Underweight]** Property securities are likely to underperform equities on a three year outlook and suggest under weighting the sector. Quality direct property valuations are starting to show signs of recovery although likely to be slow as access to funding remains difficult. The listed property sector remains subdued.
- **Fixed Interest: [Underweight]** With interest rates at low levels globally and in Australia, opportunities for fixed interest are likely to be limited over the coming year. The market has already factored in lower rates in Australia. An underweight for the sector is appropriate. A cautious approach to sovereign debt is required with opportunities for corporate bonds preferred.
- **Cash: [Overweight]** The risk return profile of Cash and Term Deposits are attractive when compared to cash based funds and those fixed interest funds with an allocation to sovereign debt.

## Risks

- The risk of sovereign debt defaults remains high with the large deficits being run by many countries. They now need to manage carefully the wind back. Investors need to be selective.
- The European Union faces major challenges in managing member countries, especially Greece in near collapse, also Portugal, Italy, Ireland and Spain with large debt issues and the lack of discipline to control the predicament.
- Growing tensions in the Middle East, especially Iran, Syria and Egypt may lead to an escalation in the oil price.
- With large US debt levels, strong political will is required to enact the necessary measures to reduce the debt levels. This is likely to be difficult as the US goes to an election this year.
- China's policies, (especially in relation to currency management) and actions in doing business with the US and other major trade partners is likely to be a major influence on world markets.
- Increased social unrest within China maybe an issue with the large urbanisation of the country.
- Increased regulation of the financial system (banks) by governments is likely to add to the uncertainty of markets over the coming year.
- Poor implementation and execution of the carbon tax and mining tax could create a significant risk to the Australian economy and markets, especially if our international competitiveness is eroded.
- Poor policy decisions around the Federal budget target of a surplus in the coming financial year may be detrimental to growth in the economy.

### Global

- The Asian region including India continues to generate satisfactory GDP growth, although slowing and should continue to be a major driver of world growth. Asia should continue to create opportunities for Australian investors although with periods of volatility like we have been experiencing.
- A key factor for continued Asian growth is the increasing demand by Chinaôs consumers as they develop greater wealth and require ever increasing volumes of commodities and agricultural products, which should underpin the Australian resources and agricultural sectors over the longer term.
- With global uncertainty gold is playing a more dominant role.

### Australia

- Resources and energy remain key to the strength of the economy and should continue to play a leading role in the market direction during 2012. Significant capital expenditure is being committed to the energy (gas) and resources sector over the coming years.
- Opportunities should continue as China and India evolve into stronger economies over the coming decade and demand for quality Australian resource companies exporting to China and India should be under pinned over the longer term.

### Fixed Interest and Property

- Opportunities for higher returns from traditional fixed interest have been reduced with interest rates at low levels. Limited opportunities prevail in the lower grade credit markets.
- The listed property trust sector is now in better shape to participate in a stronger property cycle.

## Monthly Share Market Performance over the last Thirteen Months

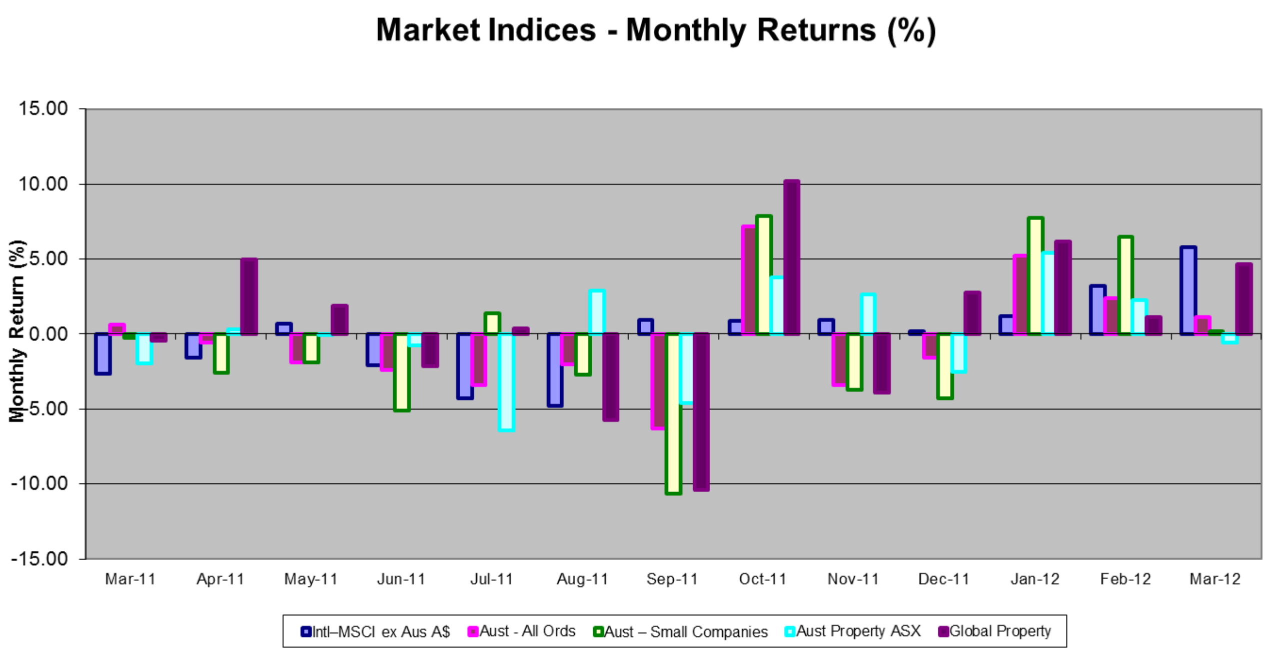
| Market Indices | Mar-11 | Apr-11 | May-11 | Jun-11 | Jul-11 | Aug-11 | Sep-11 | Oct-11 | Nov-11 | Dec-11 | Jan-12 | Feb-12 | Mar-12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Intlï MSCI ex A A$ | -2.63 | -1.55 | 0.70 | -2.07 | -4.29 | -4.77 | 0.95 | 0.85 | 0.93 | 0.21 | 1.17 | 3.24 | 5.80 |
| Aust - All Ords | 0.64 | -0.58 | -1.89 | -2.39 | -3.40 | -2.00 | -6.27 | 7.17 | -3.43 | -1.57 | 5.23 | 2.41 | 1.15 |
| Aust ï Small Coy | -0.26 | -2.61 | -1.89 | -5.09 | 1.40 | -2.69 | -10.61 | 7.87 | -3.71 | -4.30 | 7.75 | 6.51 | 0.19 |
| Aust Property ASX | -1.95 | 0.30 | -0.02 | -0.77 | -6.45 | 2.89 | -4.58 | 3.78 | 2.65 | -2.55 | 5.40 | 2.25 | -0.59 |
| Global Property | -0.44 | 4.95 | 1.90 | -2.12 | 0.35 | -5.72 | -10.41 | 10.22 | -3.90 | 2.77 | 6.17 | 1.11 | 4.63 |

## Annual Share Market Performance

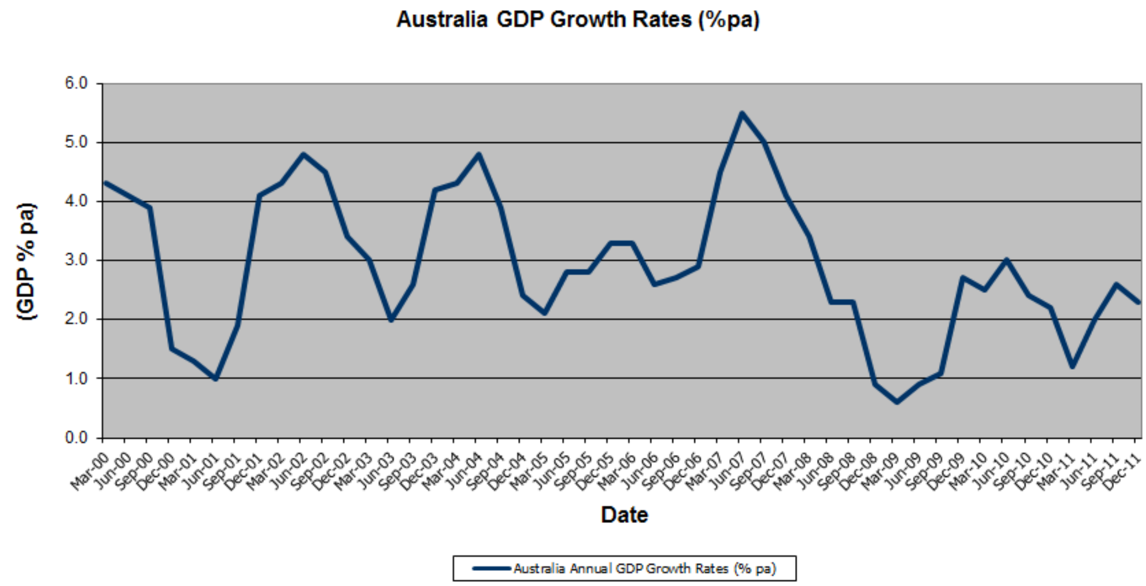
| Markets Index | 1 Year to 31 Dec 09 % | 1 Year to 31 Mar 10 % | 1 Year to 30 Jun 10 % | 1 Year to 30 Sep 10 % | 1 Year to 31 Dec 10 % | 1 Year to 31 Mar 11 % | 1 Year to 30 Jun 11 % | 1 Year to 30 Sep 11 % | 1 Year to 31 Dec 11 % | 1 Year to 31 Mar 12 % |
|---|---|---|---|---|---|---|---|---|---|---|
| Intlï MSCI ex A A$ | -0.30 | 14.47 | 5.22 | -2.79 | -2.40 | 0.64 | 2.66 | -4.52 | -5.34 | 0.69 |
| Aust ï All Ords | 39.58 | 44.01 | 13.78 | 1.73 | 3.31 | 4.80 | 12.17 | -8.43 | -11.43 | -6.27 |
| Aust ï Small Coy | 57.43 | 58.06 | 11.18 | 6.63 | 13.05 | 13.49 | 16.41 | -12.11 | -21.43 | -8.57 |
| Aust Prop ï ASX | 7.92 | 40.55 | 20.34 | -4.52 | -0.68 | 4.74 | 5.87 | -6.29 | -1.56 | 1.67 |
| Global Property | 32.17 | 88.44 | 43.86 | 24.88 | 26.15 | 24.78 | 36.60 | 1.06 | 1.94 | 8.40 |

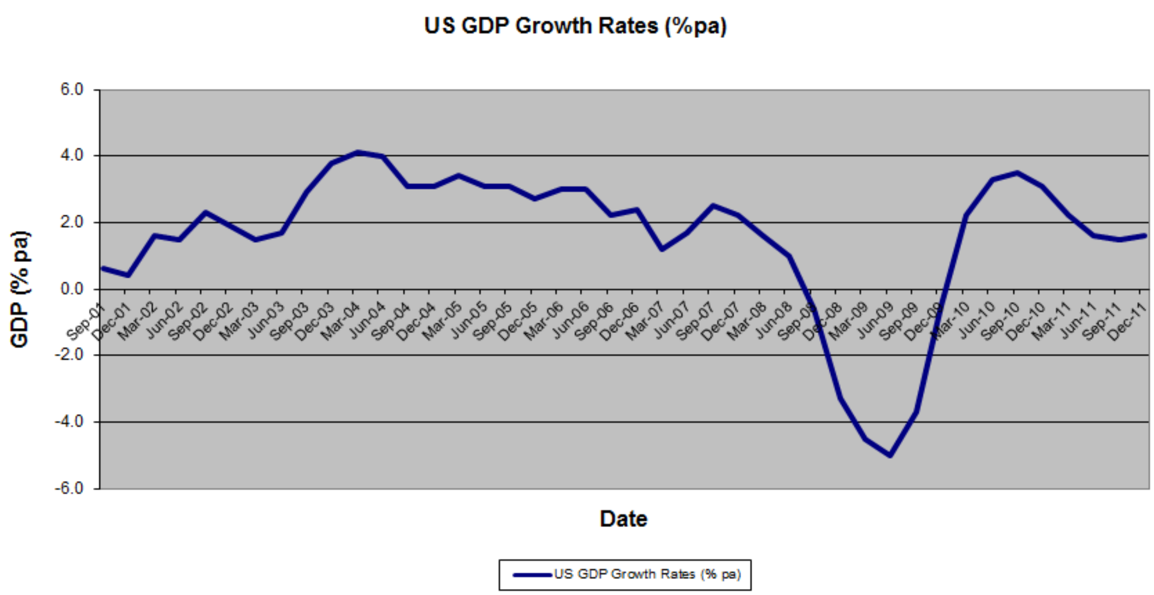
## Best Performing Asset Sectors for twelve months ended 31 March 2012

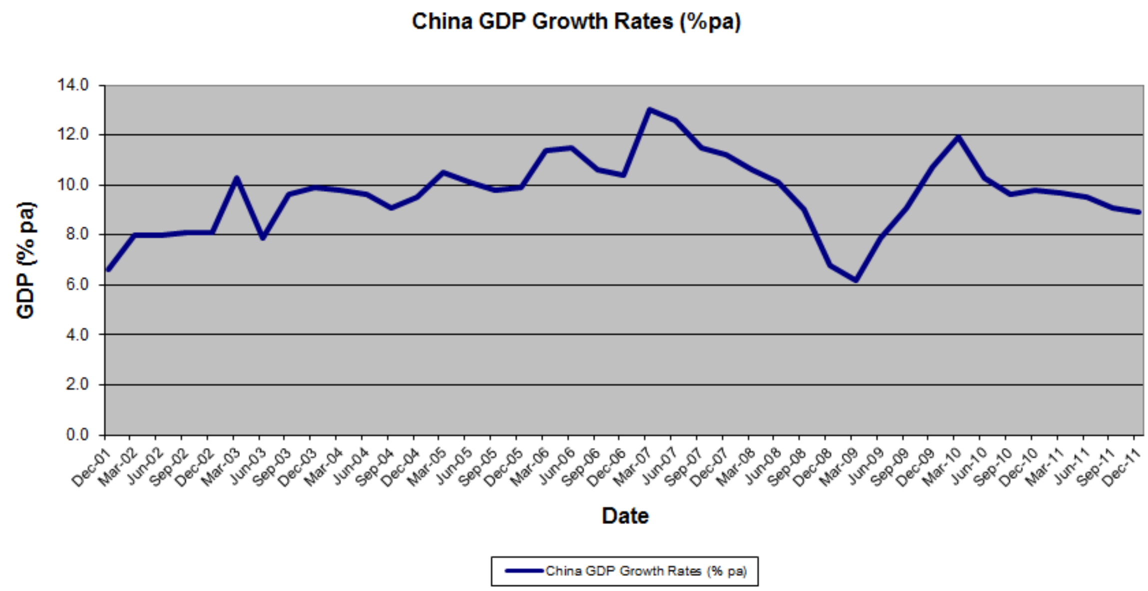
| Sector | Market Index | Return |
|---|---|---|
| International Fixed Interest Hedged | JP Morgan Gov Bond Accum Index Hedged $A | 12.08 |
| Australian Fixed Interest | UBS Warburg Composite 0 + Years | 10.00 |
| Global Listed Property | UBS Global Real Estate Inv Ex Aust Idx Hedge $A | 8.40 |
| Cash | Australian 90 Day Bank Accepted Bill | 4.89 |
| International Equities Hedged | MSCI World Accum Index Hedged A$ | 2.20 |
| Aust Listed Property | S&P/ASX Property Trusts Accum Index | 1.67 |
| International Equities Unhedged | MSCI World Ex Aust Accum Index A$ | 0.69 |
| Australian Shares | S&P/ASX All Ords Accum Index | -6.27 |
| Australian Smaller Companies | S&P/ASX Small Ordinaries Accum Index | -8.57 |

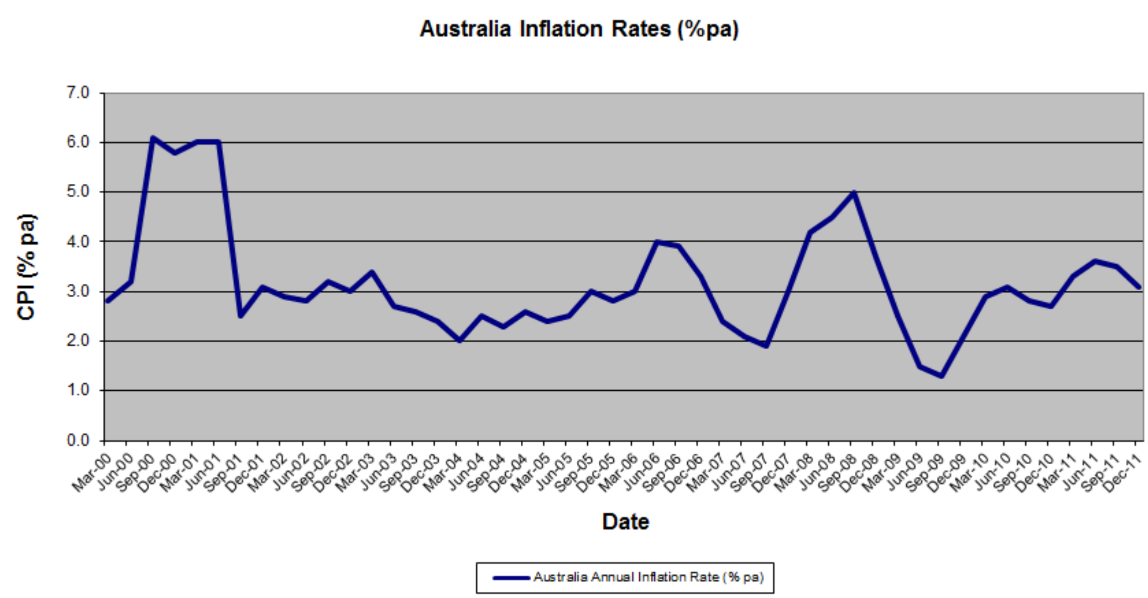


## Major Economic Indicators

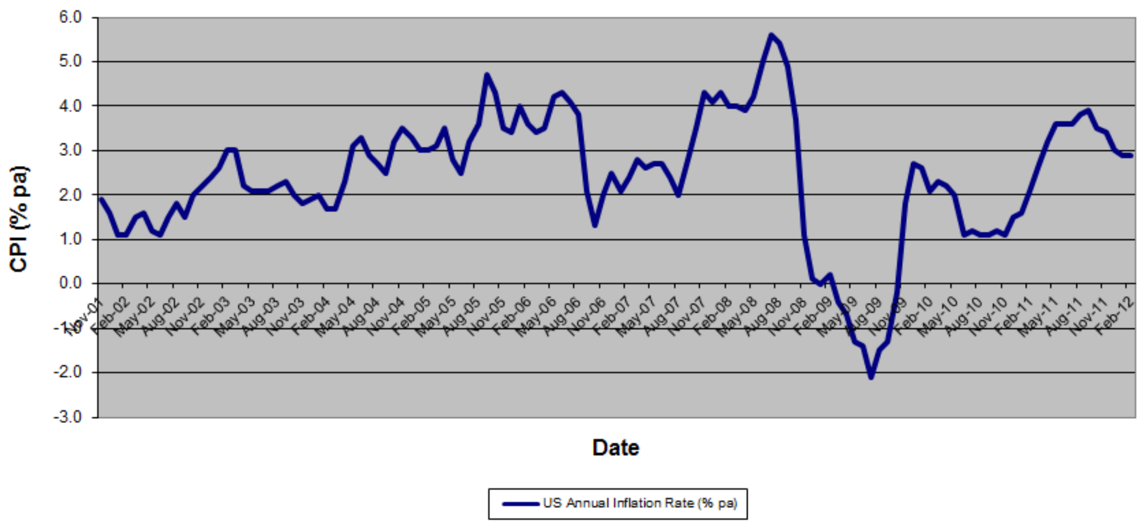


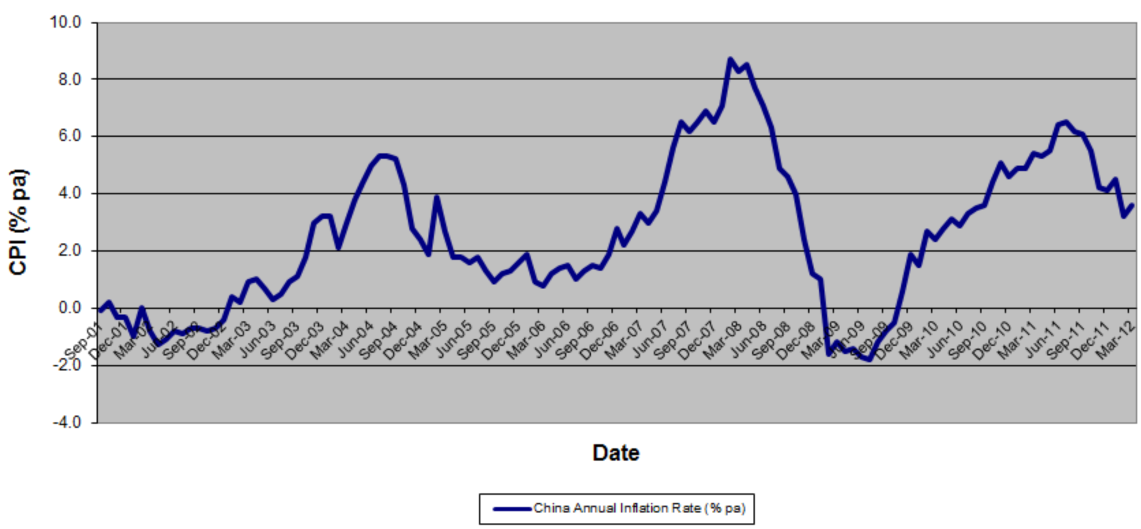

China GDP Growth Rates (%pa)
GDP (% pa)
Date
China GDP Growth Rates (% pa)

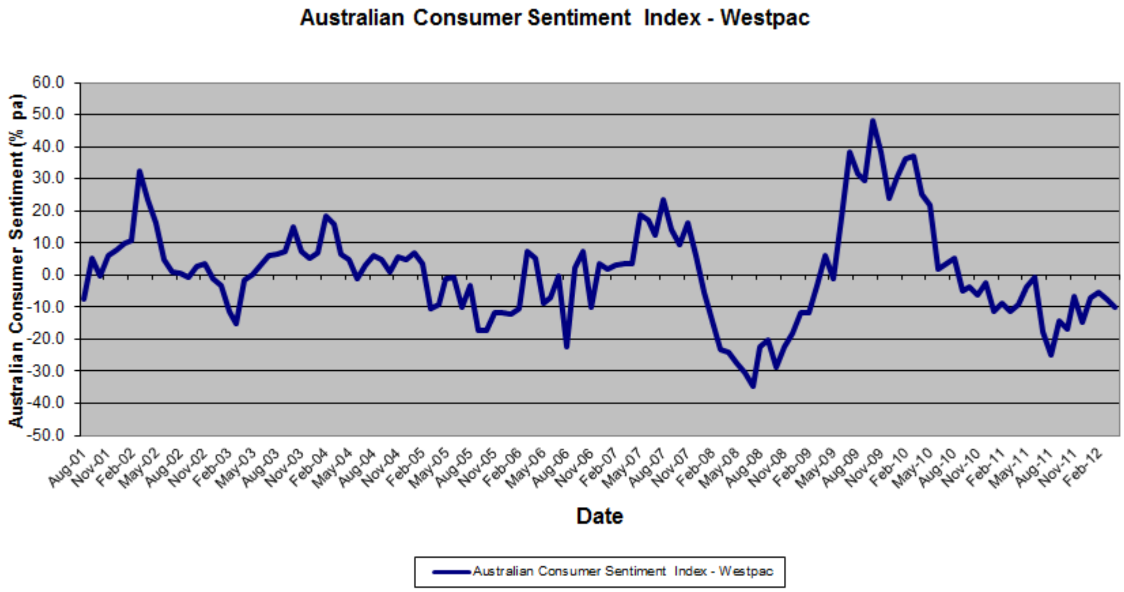

Australia Inflation Rates (%pa)
CPI (% pa)
Date
Australia Annual Inflation Rate (% pa)

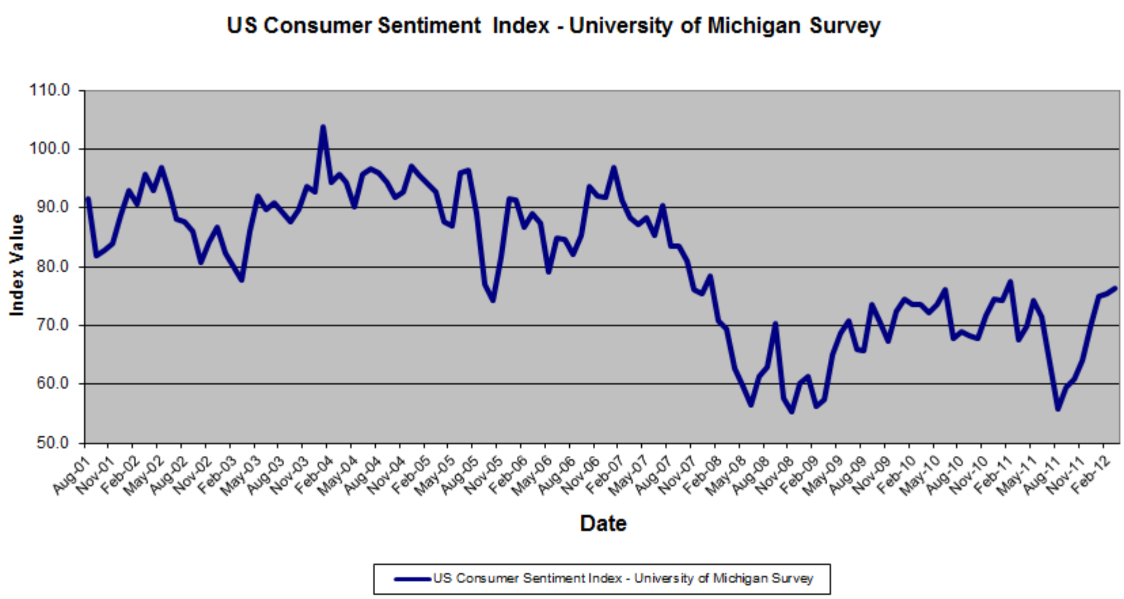
**US Inflation Rates (%pa)**




**China Inflation Rates (%pa)**




Australian Consumer Sentiment Index - Westpac
Australian Consumer Sentiment (% pa)
60.0
50.0
40.0
30.0
20.0
10.0
0.0
-10.0
-20.0
-30.0
-40.0
-50.0
Aug-01
Nov-01
Feb-02
May-02
Aug-02
Nov-02
Feb-03
May-03
Aug-03
Nov-03
Feb-04
May-04
Aug-04
Nov-04
Feb-05
May-05
Aug-05
Nov-05
Feb-06
May-06
Aug-06
Nov-06
Feb-07
May-07
Aug-07
Nov-07
Feb-08
May-08
Aug-08
Nov-08
Feb-09
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
Date
Australian Consumer Sentiment Index - Westpac


US Consumer Sentiment Index - University of Michigan Survey
Index Value
110.0
100.0
90.0
80.0
70.0
60.0
50.0
Aug-01
Nov-01
Feb-02
May-02
Aug-02
Nov-02
Feb-03
May-03
Aug-03
Nov-03
Feb-04
May-04
Aug-04
Nov-04
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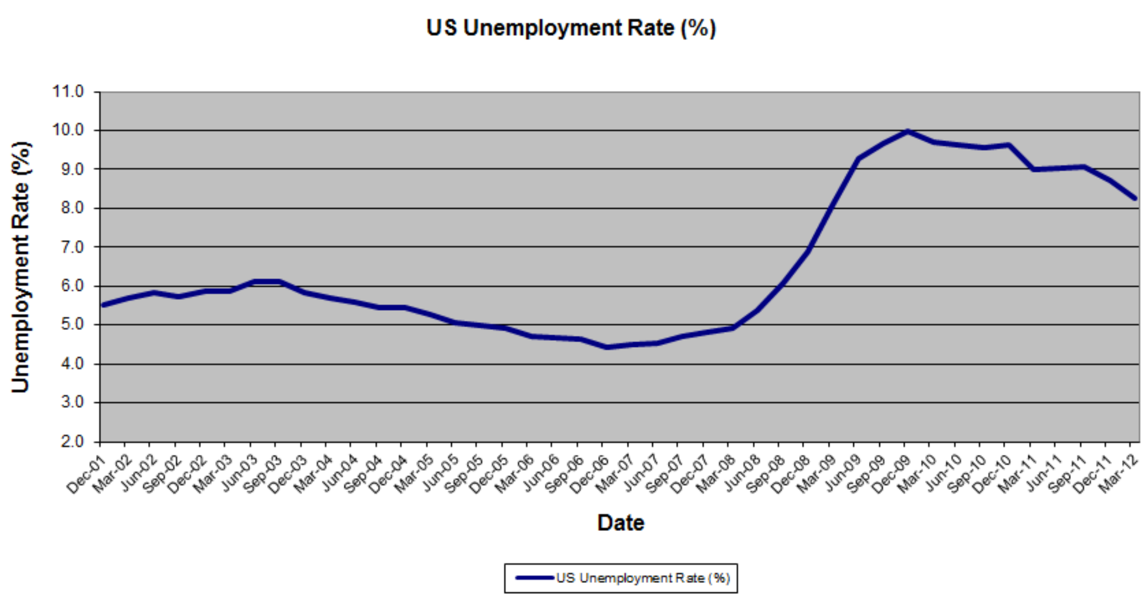
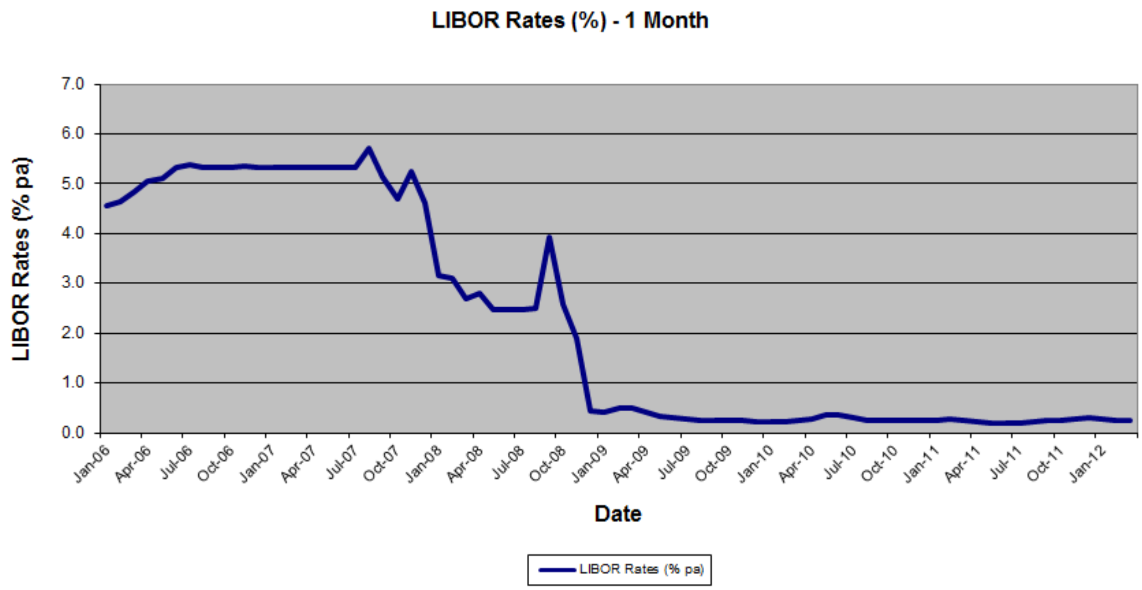
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
Date
US Consumer Sentiment Index - University of Michigan Survey


China Retail Sales Value (%pa)
Retail Sales (% pa)
25.0
20.0
15.0
10.0
5.0
0.0
Date
China Retail Sales Value (% pa)


US Unemployment Rate (%)
Unemployment Rate (%)
11.0
10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
Date
US Unemployment Rate (%)


LIBOR Rates (%) - 1 Month
LIBOR Rates (% pa)
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
Jan-06
Apr-06
Jul-06
Oct-06
Jan-07
Apr-07
Jul-07
Oct-07
Jan-08
Apr-08
Jul-08
Oct-08
Jan-09
Apr-09
Jul-09
Oct-09
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Apr-10
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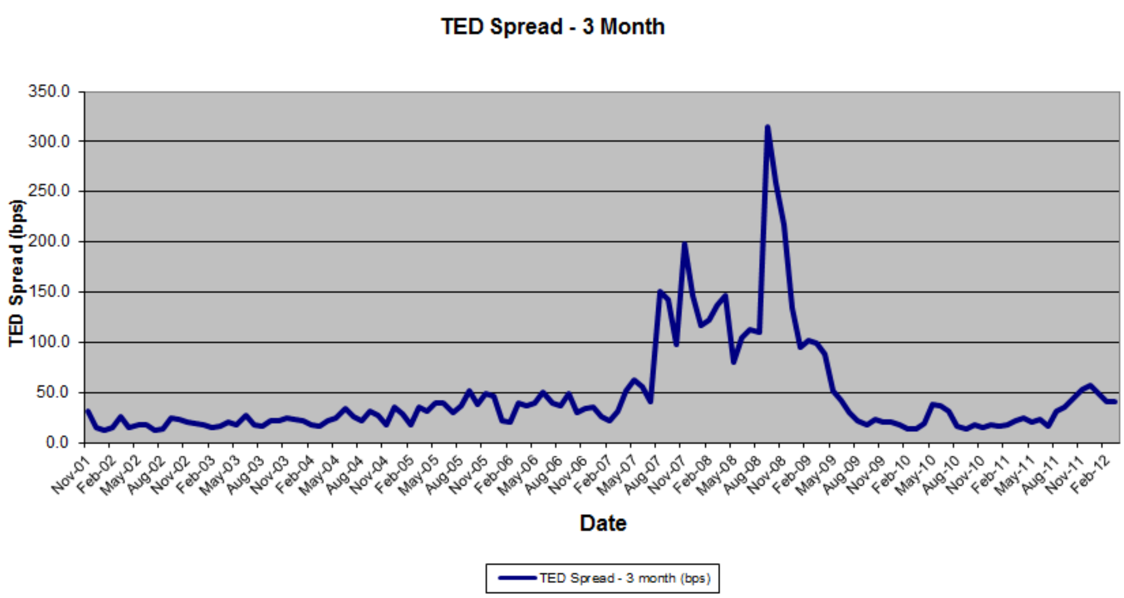
Oct-10
Jan-11
Apr-11
Jul-11
Oct-11
Jan-12
Date
LIBOR Rates (% pa)


TED Spread - 3 Month
TED Spread (bps)
350.0
300.0
250.0
200.0
150.0
100.0
50.0
0.0
Nov-01
Feb-02
May-02
Aug-02
Nov-02
Feb-03
May-03
Aug-03
Nov-03
Feb-04
May-04
Aug-04
Nov-04
Feb-05
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Aug-09
Nov-09
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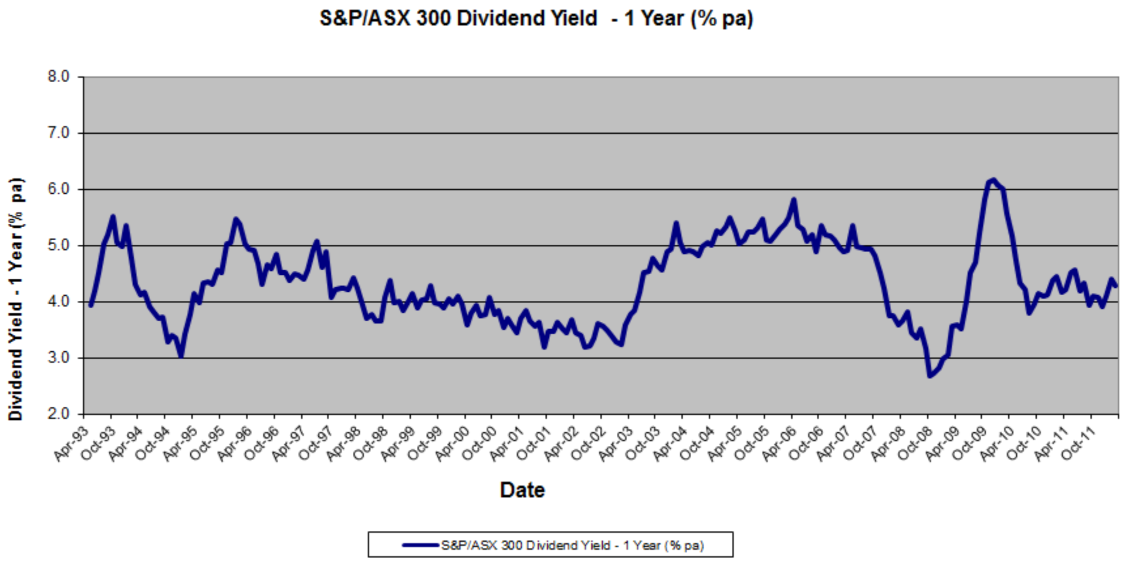
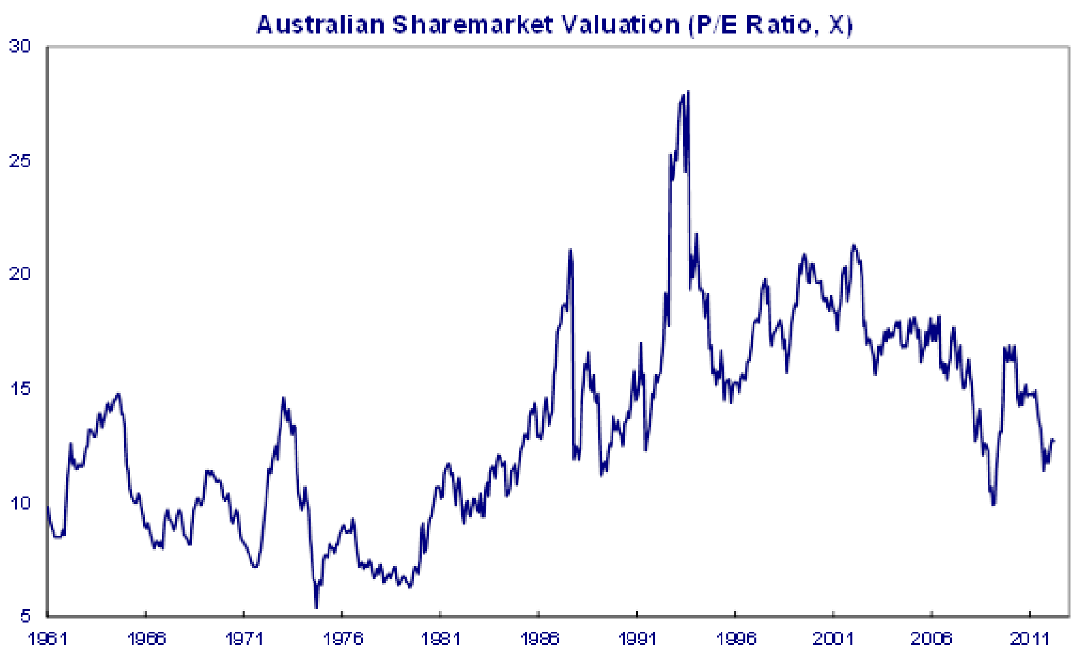
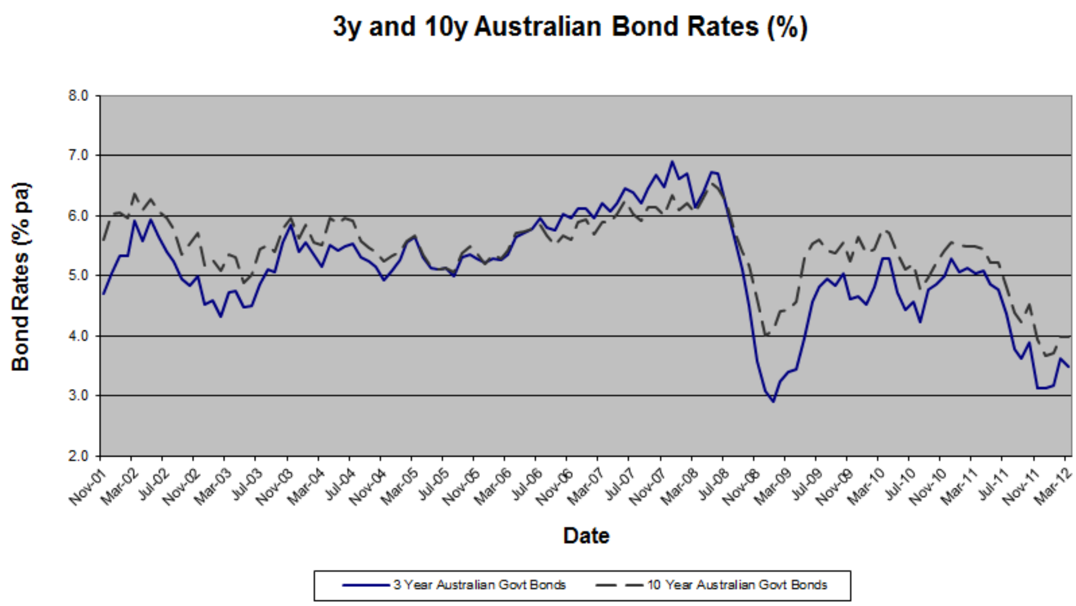
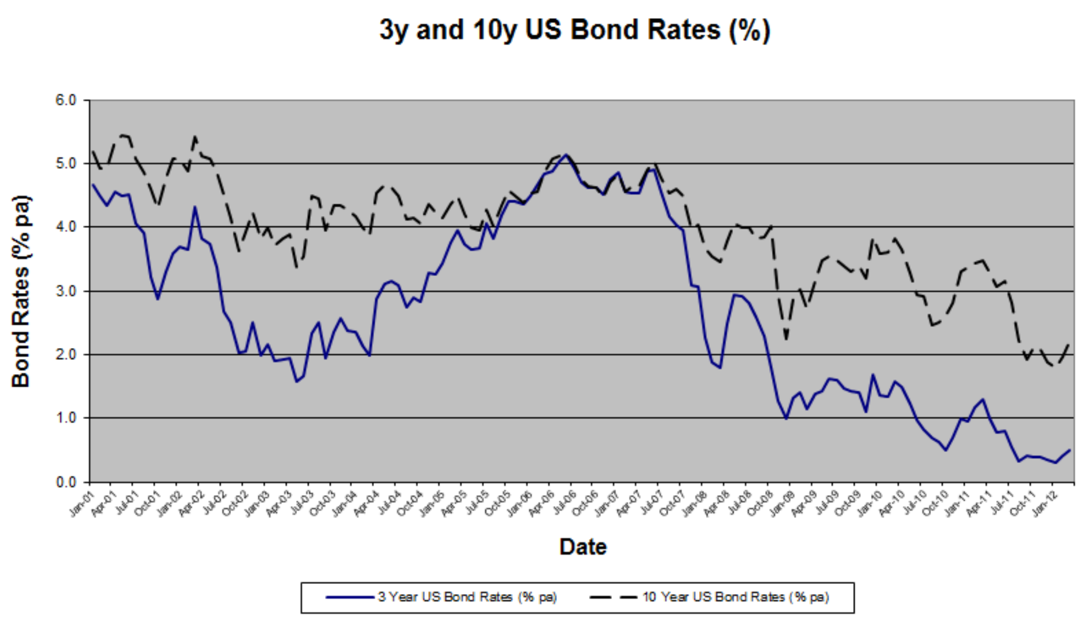
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
Date
TED Spread - 3 month (bps)

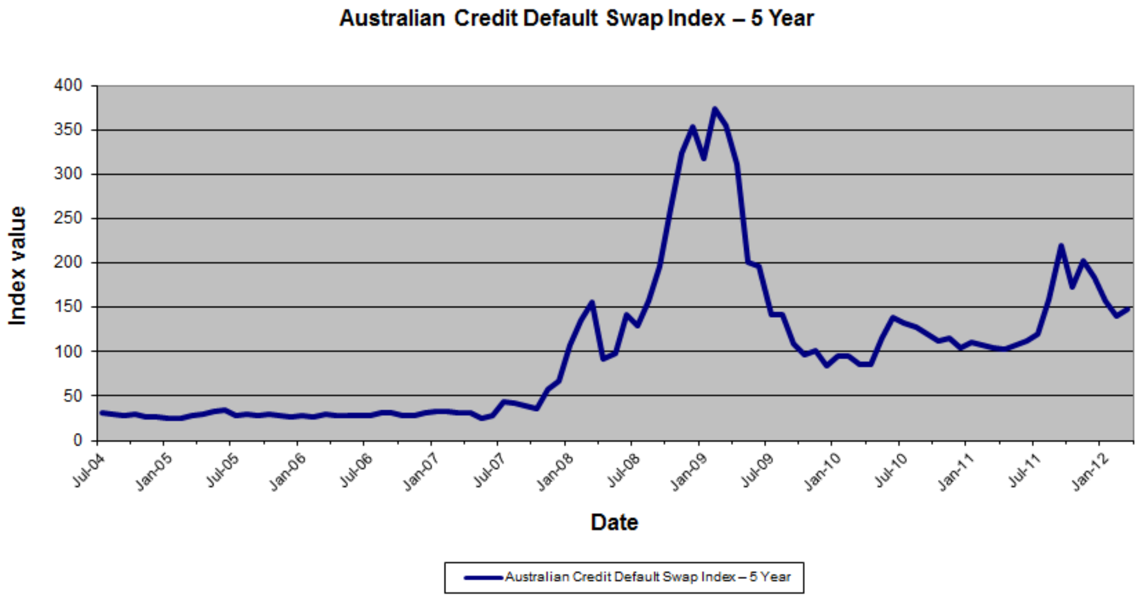


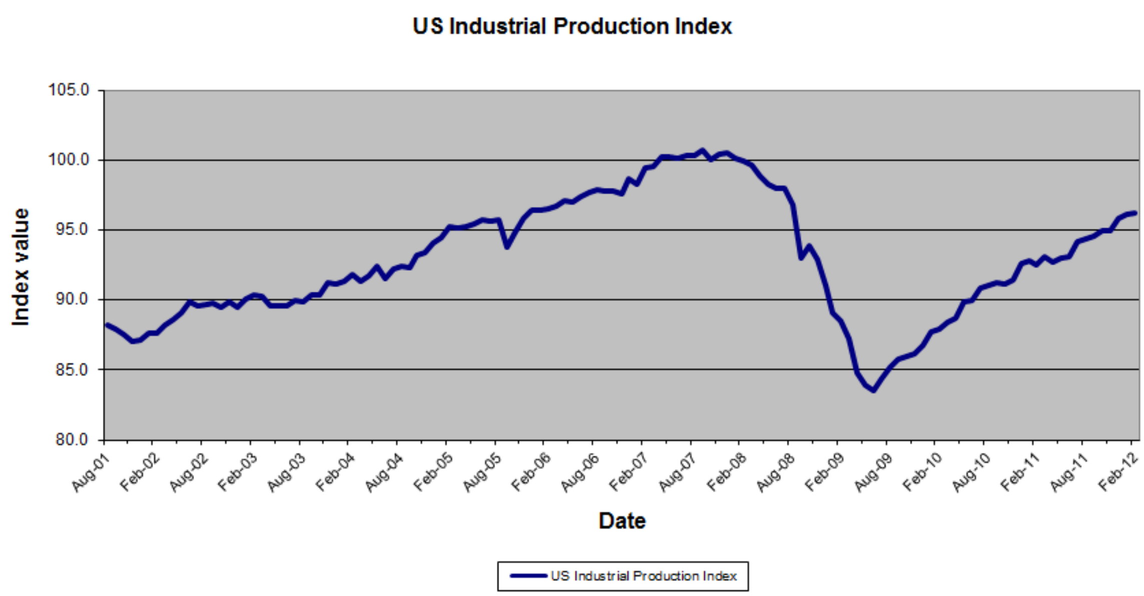



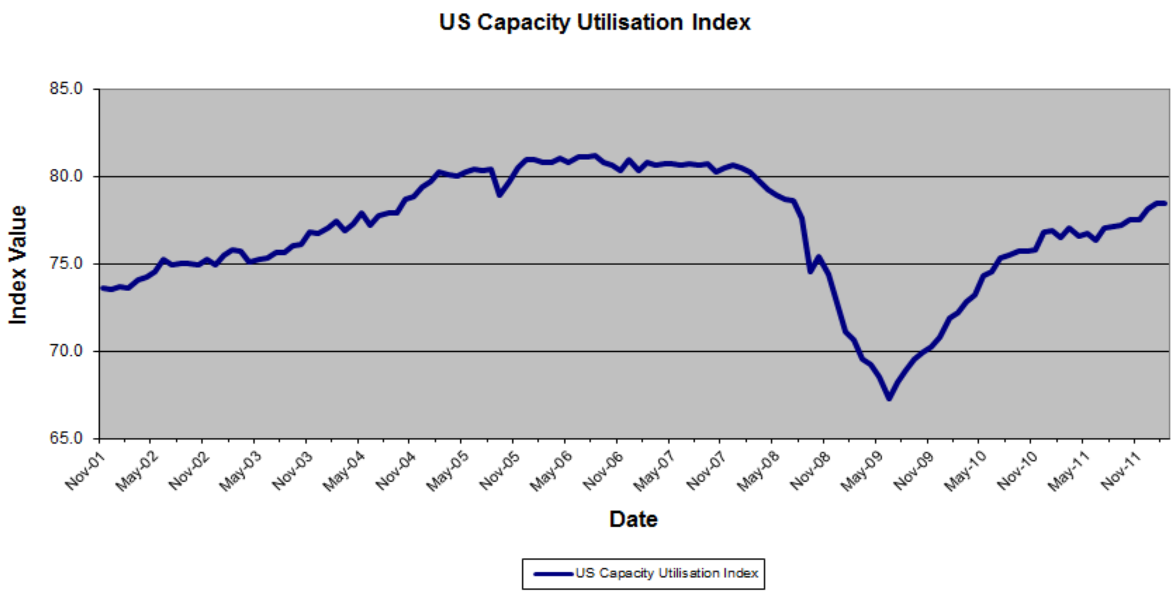

Source: Citigroup, IRESS and UBS Australia Limited as at 31 March 2012.


3y and 10y Australian Bond Rates (%)
Bond Rates (% pa)
Date
3 Year Australian Govt Bonds
10 Year Australian Govt Bonds

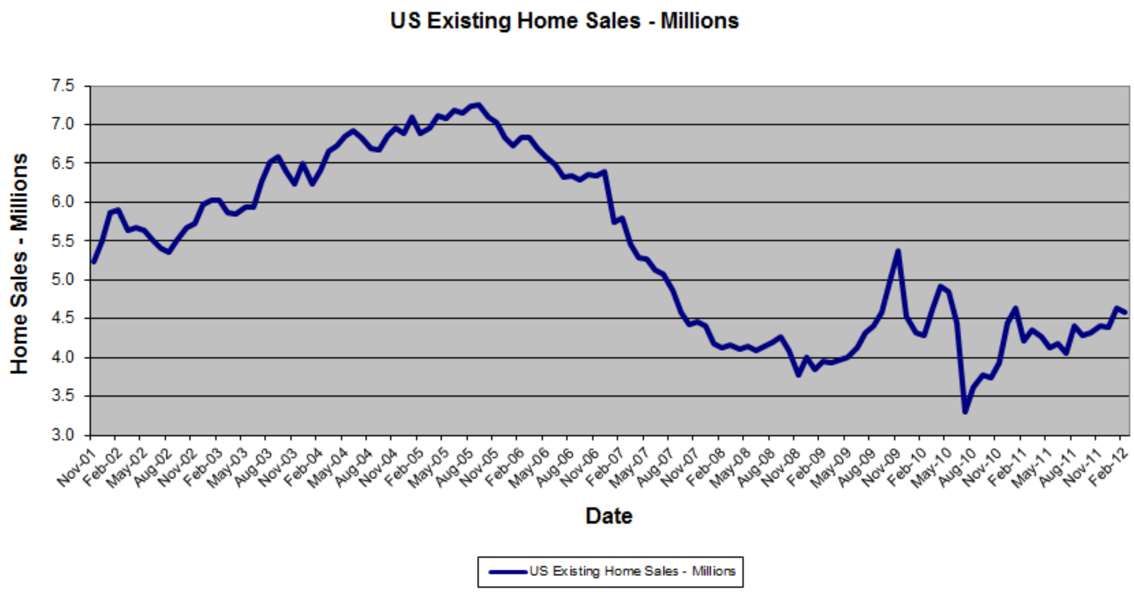

3y and 10y US Bond Rates (%)
Bond Rates (% pa)
Date
3 Year US Bond Rates (% pa)
10 Year US Bond Rates (% pa)


Australian Credit Default Swap Index – 5 Year
Index value
400
350
300
250
200
150
100
50
0
Jul-04
Jan-05
Jul-05
Jan-06
Jul-06
Jan-07
Jul-07
Jan-08
Jul-08
Jan-09
Jul-09
Jan-10
Jul-10
Jan-11
Jul-11
Jan-12
Date
Australian Credit Default Swap Index – 5 Year

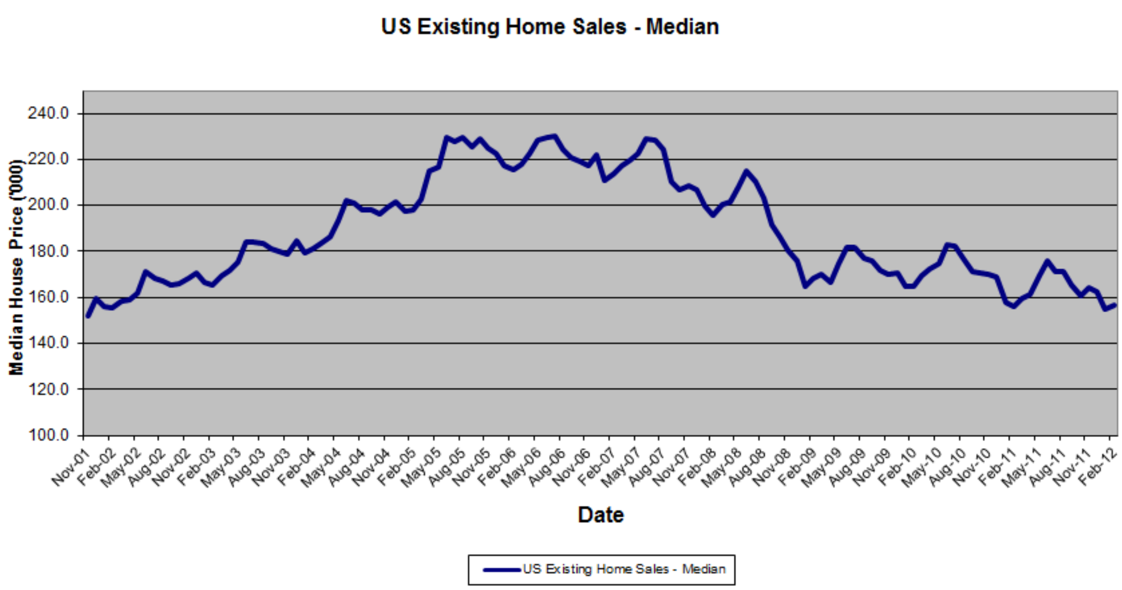

US Industrial Production Index
Index value
105.0
100.0
95.0
90.0
85.0
80.0
Aug-01
Feb-02
Aug-02
Feb-03
Aug-03
Feb-04
Aug-04
Feb-05
Aug-05
Feb-06
Aug-06
Feb-07
Aug-07
Feb-08
Aug-08
Feb-09
Aug-09
Feb-10
Aug-10
Feb-11
Aug-11
Feb-12
Date
US Industrial Production Index


US Capacity Utilisation Index
85.0
80.0
75.0
70.0
65.0
Index Value
Nov-01
May-02
Nov-02
May-03
Nov-03
May-04
Nov-04
May-05
Nov-05
May-06
Nov-06
May-07
Nov-07
May-08
Nov-08
May-09
Nov-09
May-10
Nov-10
May-11
Nov-11
Date
US Capacity Utilisation Index

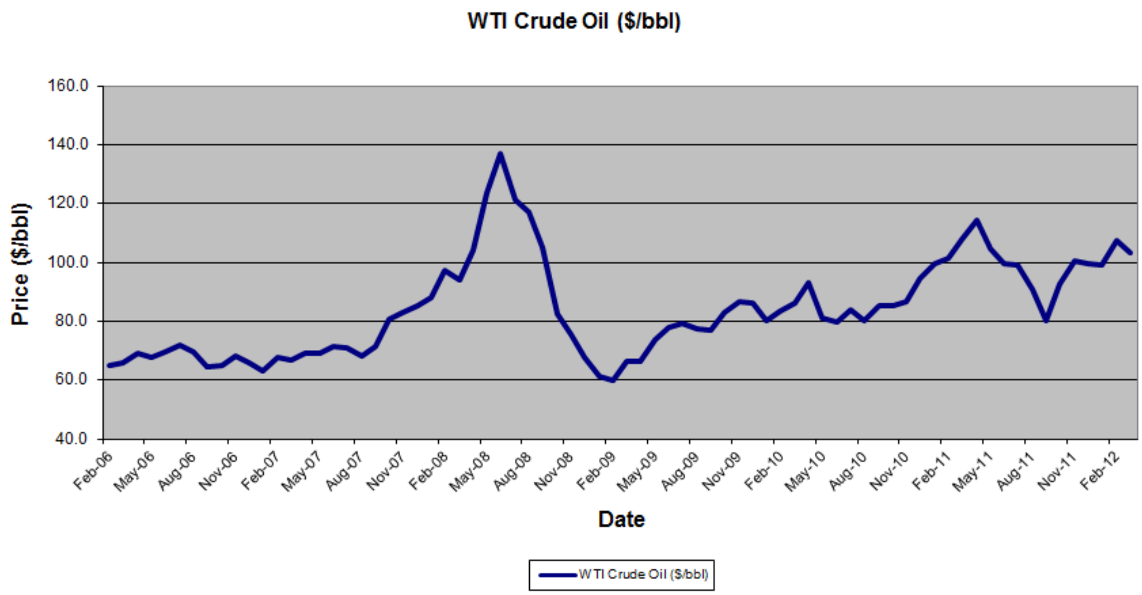

China Purchasing Managers Index (PMI)
65.0
60.0
55.0
50.0
45.0
40.0
35.0
Index Value
Feb-05
May-05
Aug-05
Nov-05
Feb-06
May-06
Aug-06
Nov-06
Feb-07
May-07
Aug-07
Nov-07
Feb-08
May-08
Aug-08
Nov-08
Feb-09
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
Date
China PMI Index



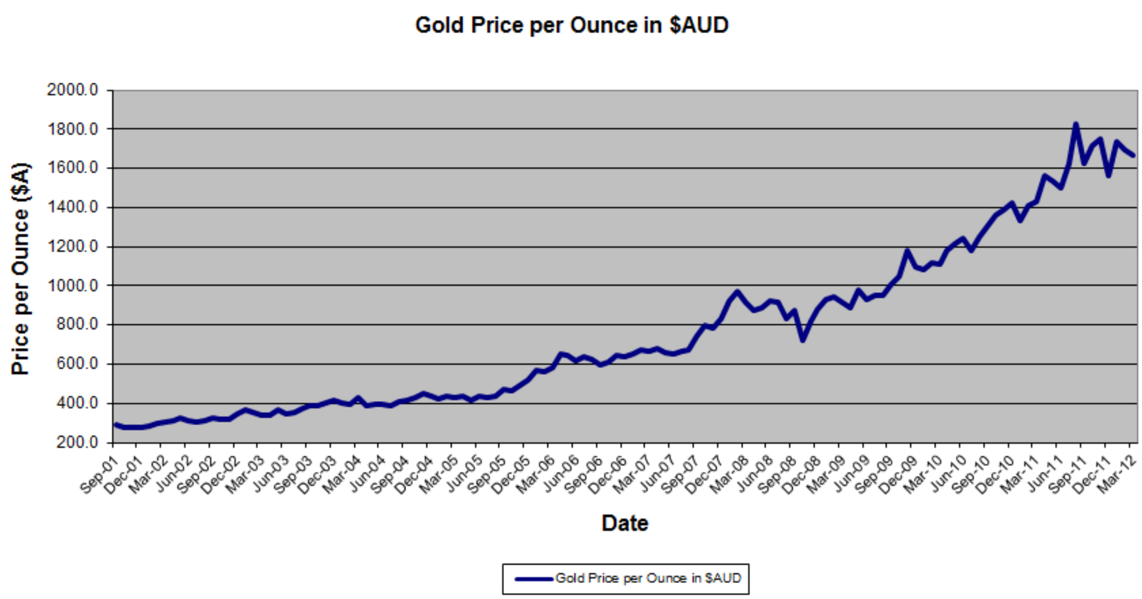
US Existing Home Sales - Millions
Home Sales - Millions
Date
US Existing Home Sales - Millions

US Existing Home Sales - Median
Median House Price ('000)
Date
US Existing Home Sales - Median



WTI Crude Oil ($/bbl)
Price ($/bbl)
160.0
140.0
120.0
100.0
80.0
60.0
40.0
Feb-06
May-06
Aug-06
Nov-06
Feb-07
May-07
Aug-07
Nov-07
Feb-08
May-08
Aug-08
Nov-08
Feb-09
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
Date
WTI Crude Oil ($/bbl)

Gold Price per Ounce in $AUD
Price per Ounce ($A)
2000.0
1800.0
1600.0
1400.0
1200.0
1000.0
800.0
600.0
400.0
200.0
Sep-01
Dec-01
Mar-02
Jun-02
Sep-02
Dec-02
Mar-03
Jun-03
Sep-03
Dec-03
Mar-04
Jun-04
Sep-04
Dec-04
Mar-05
Jun-05
Sep-05
Dec-05
Mar-06
Jun-06
Sep-06
Dec-06
Mar-07
Jun-07
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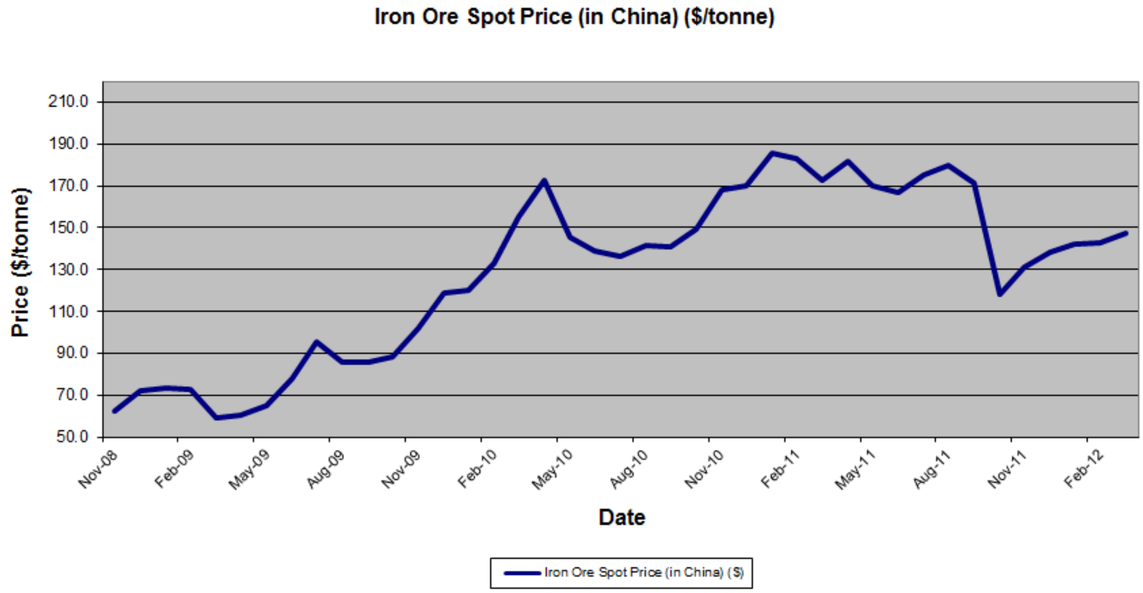
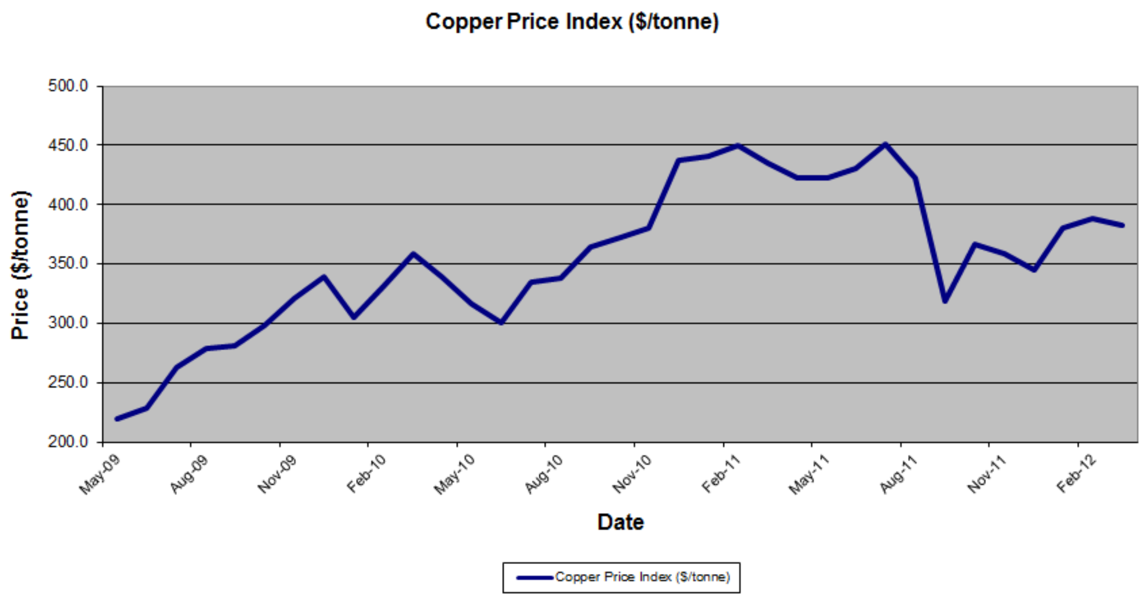
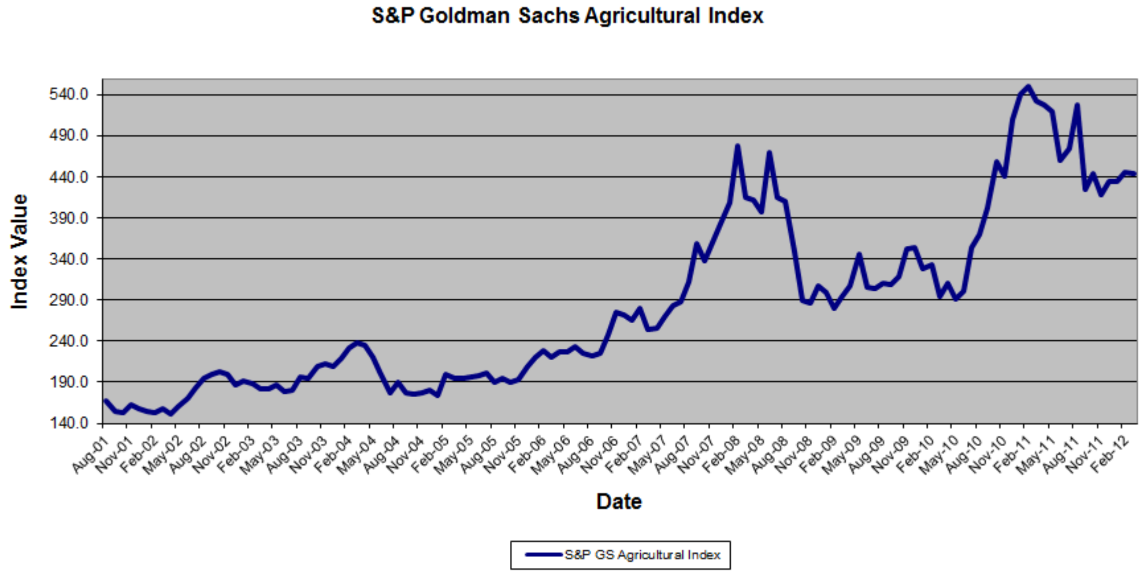
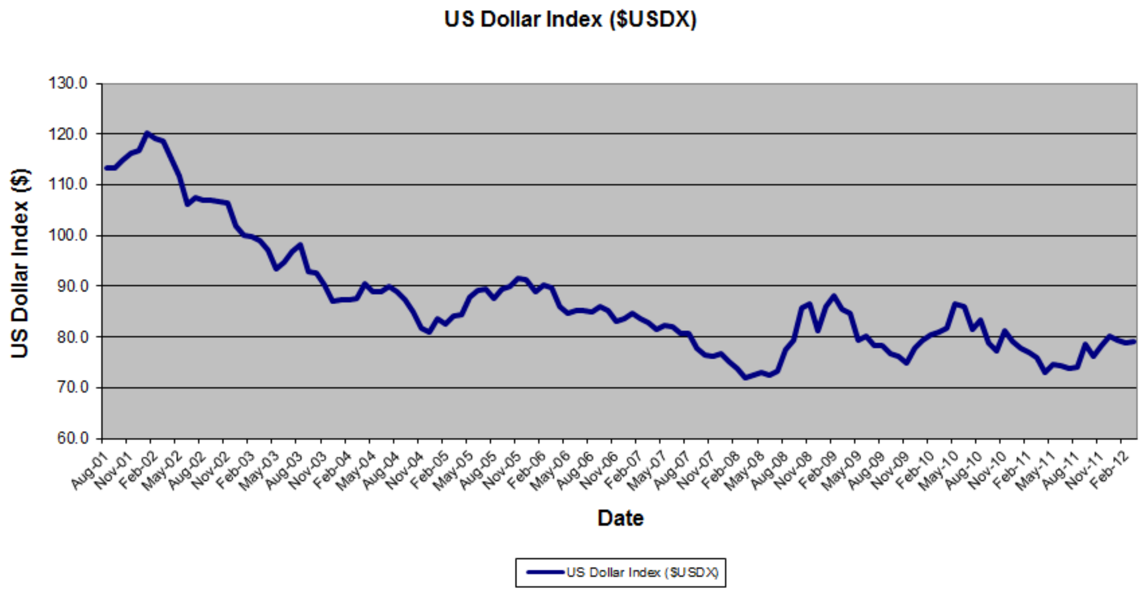
Jun-08
Sep-08
Dec-08
Mar-09
Jun-09
Sep-09
Dec-09
Mar-10
Jun-10
Sep-10
Dec-10
Mar-11
Jun-11
Sep-11
Dec-11
Mar-12
Date
Gold Price per Ounce in $AUD


Iron Ore Spot Price (in China) ($/tonne)
Price ($/tonne)
210.0
190.0
170.0
150.0
130.0
110.0
90.0
70.0
50.0
Nov-08
Feb-09
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
Date
Iron Ore Spot Price (in China) ($)


Copper Price Index ($/tonne)
Price ($/tonne)
500.0
450.0
400.0
350.0
300.0
250.0
200.0
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
Date
Copper Price Index ($/tonne)




The DXY is a weighted index of some of the major trading partners of the United States. The components of the DXY Index are (by weighting): Euro (57.6%), Japanese Yen (13.6%), Great Britain- Pounds Sterling (11.9%), Canadian Dollar (9.1%), Swedish Krona (4.2%), and Swiss Franc (3.6%).