

Economic and Market Commentary

November 2012

Financial markets have reacted cautiously to the re-election of Barack Obama and the uncertainty around how he will deal with the fiscal cliff which needs to be addressed by end of December. The ECB has been proactive in providing a support mechanism to the region of a bond purchase program that allows member countries to off load distressed bonds to the ECB. This action has improved investor sentiment and confidence in the short term.

The problem for Europe is the rapid decline of the Greek economy and its inability to meet austerity measures imposed by the IMF and ECB. Greece defaulting on debt repayments is likely to be an issue in early 2013 which would be unsettling for markets and other Euro member countries. Spain, Portugal, Italy and Ireland continue to deal with weakening economies, high debt burdens and high unemployment levels. These uncertain conditions are all leading to a long period of recession and low growth for the region and dominates decision making. The Euro currency is likely to remain under pressure as the market forces impact and sentiment remains uncertain.

In addition to the ECB's initiatives the US Fed has been pro-active in providing it's economy with a further stimulus via QE 3 which is aimed at buying mortgage backed securities over an unlimited period. US short term interest rates are now anticipated to be pegged at close to zero out to 2015. The US is awash with cheap funds and is providing a boost to the housing market which is showing good signs of recovery with housing construction starts hitting a four year high (pre GFC) with flow on affects across the economy. The positive with Obama's election win is that it was decisive and provides a stronger base for negotiations with the Republicans who control Congress. In addition Obama does not need to be held captive to his voter base as he is in his last term of office and should be able to govern more decisively in this term. US unemployment has remained stubbornly high in the 8% region but with the housing sector starting to recover this should provide a welcome boost to employment.

The underlying US economy continues to produce positive growth although at low levels (in the region of 2%) and a more upbeat corporate and banking sector. US corporates continue to underpin the economy. Another positive for the US has been the strong state of the energy market which has added the equivalent of 1.4 billion barrels of oil to the economy and the gas sector moving to an exporter (currently an importer) of gas by 2015. it is anticipated that the US will overtake Saudi Arabia as the world's leading oil producer by 2017 and will become net oil exporter by 2030. US consumer confidence is improving from a low base while inflation in the US is not an issue at this stage [although with inflation in the region of 2% and 10 year bonds around 1.7% producing a negative real return which cannot be maintained].

The emerging world is in better shape and is likely to account for much of the global growth in the year ahead. China remains key to world growth and is presently undergoing a slowdown. Exports have been impacted by the slowdown in Europe. Commodities have taken a substantial slump with iron ore now around \$120 per tonne off from the high of \$180 per tonne. This is likely to have a significant impact on the Australian economy in the medium term as it impacts the budget and spending programs of the government. The Chinese leadership which is going through a process of change and transition appears to be encountering a much more difficult path than previous leaders as it seeks to reign in the imbalances of a country that has had 10%pa growth for a decade and is faced with managing a country that is adjusting to the huge urbanisation that has taken place. Social unrest is likely to be a major issue confronting China over the coming years. China is well placed to adjust from the infrastructure focus to a more consumption led transition. This is likely to create a slowing in export trade from Australia so an adjustment is likely to be required in Australia. There appears strong consensus that the new Chinese leadership are focussed on delivering in the region of 6 - 8% GDP which should still provide an underpinning for world growth.

The Australian economy is currently dealing with the uncertainty created by a slowing in the resources sector with major cut backs in a wide range of large resource projects due largely to the lower commodity prices and higher labour costs. Demand for resources appears to be coming off and forecasts suggest the peak in volume of exports may occur earlier which should impact GDP growth over the coming years. Political uncertainty is also making business decisions more difficult.

A major headwind for the Australian market is the strong A\$ making it difficult for manufacturers, exporters, retailers and tourism. The A\$ has been supported by strong Australian bond purchasers by foreign investors seeking AAA government credit ratings.

This action has supported the A\$ as commodity prices have fallen which in the past would have been a major disconnect. Substantial investment continues to be made into the gas and energy sector which should underpin the growth rate.

The RBA has held the cash rate at 3.25% and markets are looking for a further rate cut in December and another in the first quarter of 2013. The lower short term interest rates is likely to reduce the attractiveness of term deposits and stimulate flows into higher yielding equities with sustainable or growing dividends. Bank shares are currently offering in the region of 6% yields before franking. With the strong rally in Australian bonds, valuations for equities are becoming increasingly attractive.

Managers with good stock picking skills should outperform in this environment. 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 now offering better value and long term investors are re-entering the market. More interest is emerging in the listed REIT space as investors seek higher yielding investments although the outlook for the housing market remains soft. Overall the environment calls for a well-diversified investment portfolio of both risk assets and defensive assets.

- **International shares: [Overweight]** A strong Aust\$ v US\$ provides opportunities for international shares (unhedged) 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 becoming more compelling. The focus should be on quality large cap companies with strong income streams in this environment. Consider a benchmark weighting appropriate on a three-year outlook.
- **Australian Listed Property: [Neutral]** **Global Listed Property: [Neutral]** Quality listed property securities delivering solid yields are likely to benefit from the focus on yield and suggest a neutral weighting to this sector. Quality direct property is also showing signs of recovery although likely to be slow as access to funding remains difficult.
- **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. An underweight for the sector is appropriate. A cautious approach to global sovereign debt is required with opportunities for corporate bonds preferred.
- **Cash: [Underweight]** The risk return profile of Cash and Term Deposits is becoming less attractive. Use for defensive purposes in this volatile environment.

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 Spain, Portugal, Italy and Ireland with large debt issues and the lack of discipline to control the predicament.
- Social unrest in Europe and the Middle East is becoming an increasing concern for governments.
- With large US debt levels (\$15 trillion), strong political will is required to enact the necessary measures to reduce the debt levels. This is likely to be difficult as the US fiscal stimulus winds down at the end of the year with the Bush tax cuts ending.
- Increased social unrest within China maybe an issue with the large urbanisation of the country.
- Poor policy decisions around the Federal budget target of a surplus in the coming financial year may be detrimental to growth in the Australian economy.

Global Opportunities

- The Asian region 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 China's 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.

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 although currently experiencing a decline. 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. The market has already factored in lower rates. 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	Oct-11	Nov-11	Dec-11	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12	Sep-12	Oct-12
Intl-MSCI ex A A\$	0.85	0.93	0.21	1.17	3.24	5.80	-1.73	-1.76	-0.62	-1.56	4.50	2.11	-0.52
Aust - All Ords	7.17	-3.43	-1.57	5.23	2.41	1.15	1.10	-6.90	0.25	3.74	2.12	2.13	2.97
Aust - Small Coy	7.87	-3.71	-4.30	7.75	6.51	0.19	-0.92	-10.22	-4.78	-0.19	2.95	4.37	1.31
Aust Property ASX	3.78	2.65	-2.55	5.40	2.25	-0.59	5.42	-1.24	4.34	5.55	-0.13	1.20	5.32
Global Property	10.22	-3.90	2.77	6.17	1.11	4.63	2.45	-4.22	5.15	3.08	0.60	-0.21	1.11

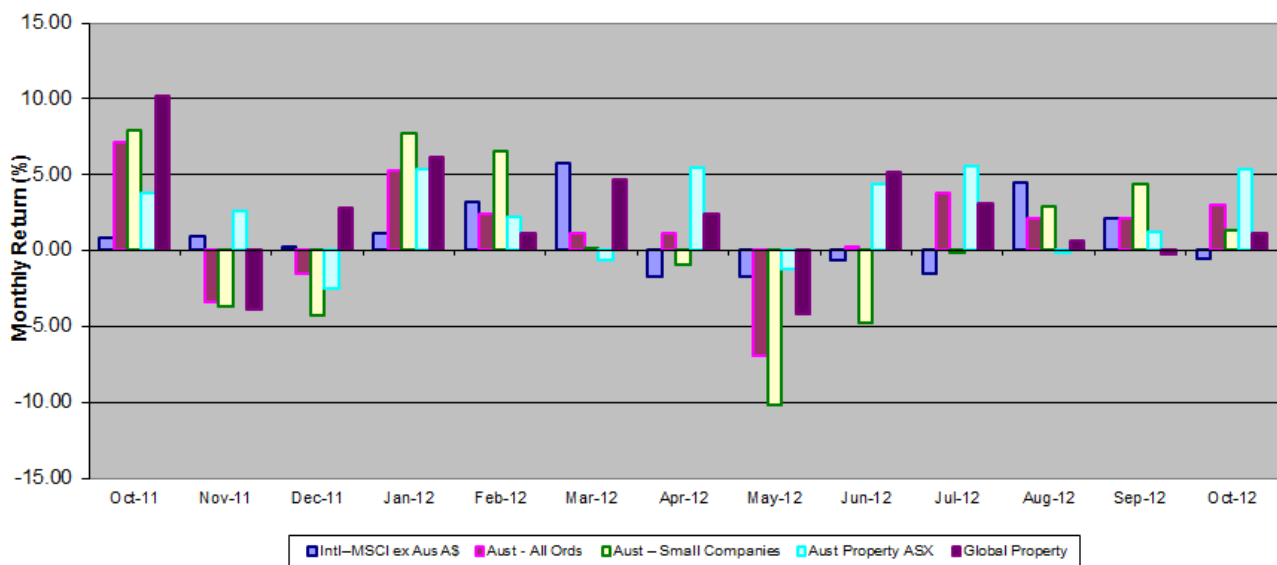
Annual Share Market Performance

Markets Index	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 %	1 Year to 30 Jun 12 %	1 Year to 30 Sep 12 %	1 Year to 31 Oct 12 %
Intl-MSCI ex A A\$	-2.79	-2.40	0.64	2.66	-4.52	-5.34	0.69	-0.50	13.59	12.06
Aust - All Ords	1.73	3.31	4.80	12.17	-8.43	-11.43	-6.27	-7.04	13.36	8.91
Aust - Small Coy	6.63	13.05	13.49	16.41	-12.11	-21.43	-8.57	-14.61	3.83	-2.49
Aust Prop - ASX	-4.52	-0.68	4.74	5.87	-6.29	-1.56	1.67	10.98	28.90	30.81
Global Property	24.88	26.15	24.78	36.60	1.06	1.94	8.40	6.93	30.54	19.75

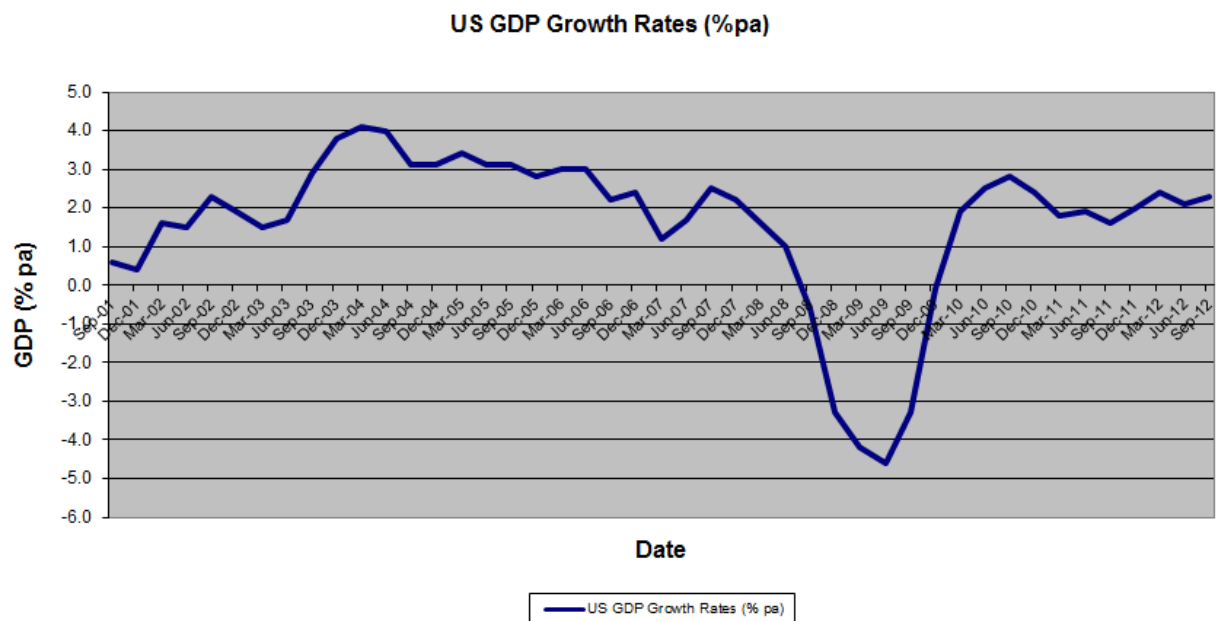
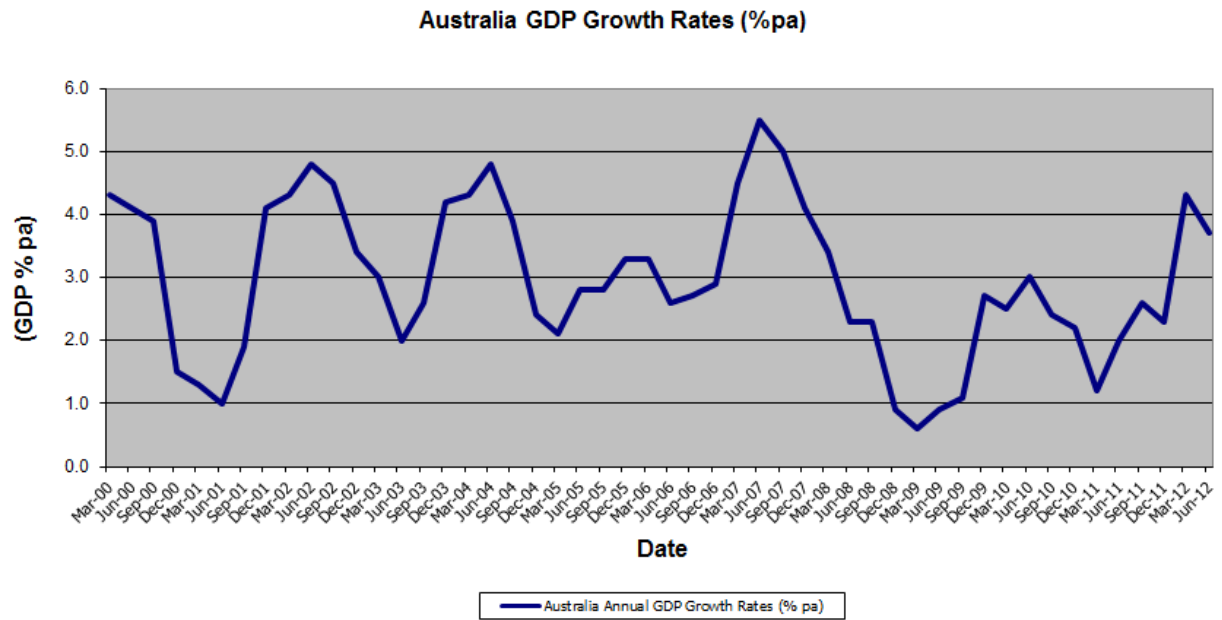
Best Performing Asset Sectors for twelve months ended 31 October 2012

Sector	Market Index	Return
Aust Listed Property	S&P/ASX Property Trusts Accum Index	30.81
Global Listed Property	UBS Global Real Estate Inv Ex Aust Idx Hedge \$A	19.75
International Equities Unhedged	MSCI World Ex Aust Accum Index A\$	12.06
International Equities Hedged	MSCI World Accum Index Hedged A\$	11.58
Australian Fixed Interest	UBS Warburg Composite 0 + Years	10.22
International Fixed Interest Hedged	JP Morgan Gov Bond Accum Index Hedged \$A	9.30
Australian Shares	S&P/ASX All Ords Accum Index	8.91
Cash	Australian 90 Day Bank Accepted Bill	4.23
Australian Smaller Companies	S&P/ASX Small Ordinaries Accum Index	-2.49

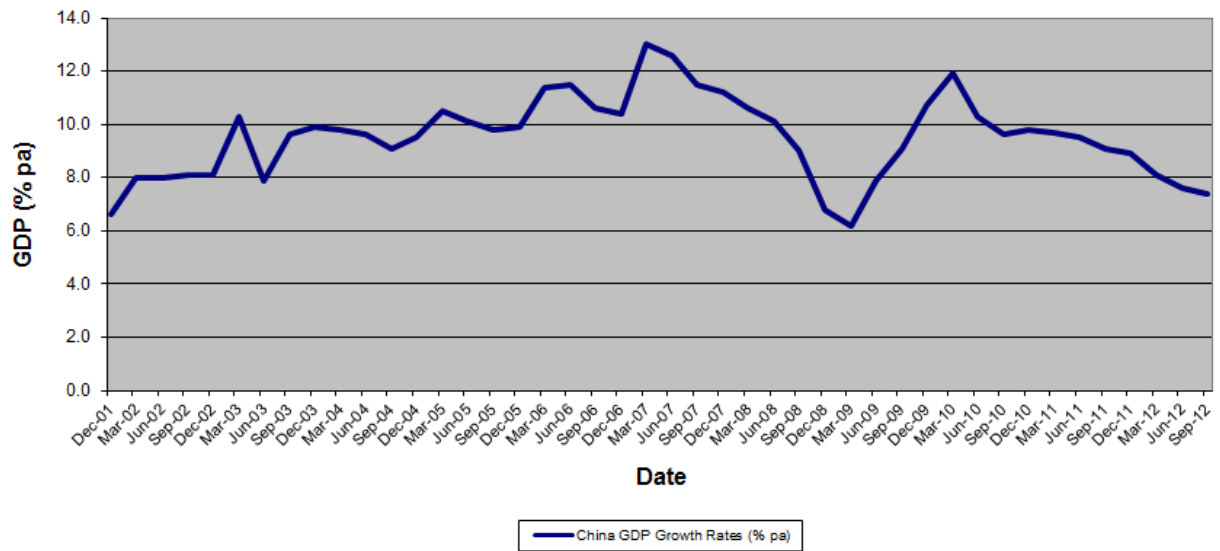
Market Indices - Monthly Returns (%)



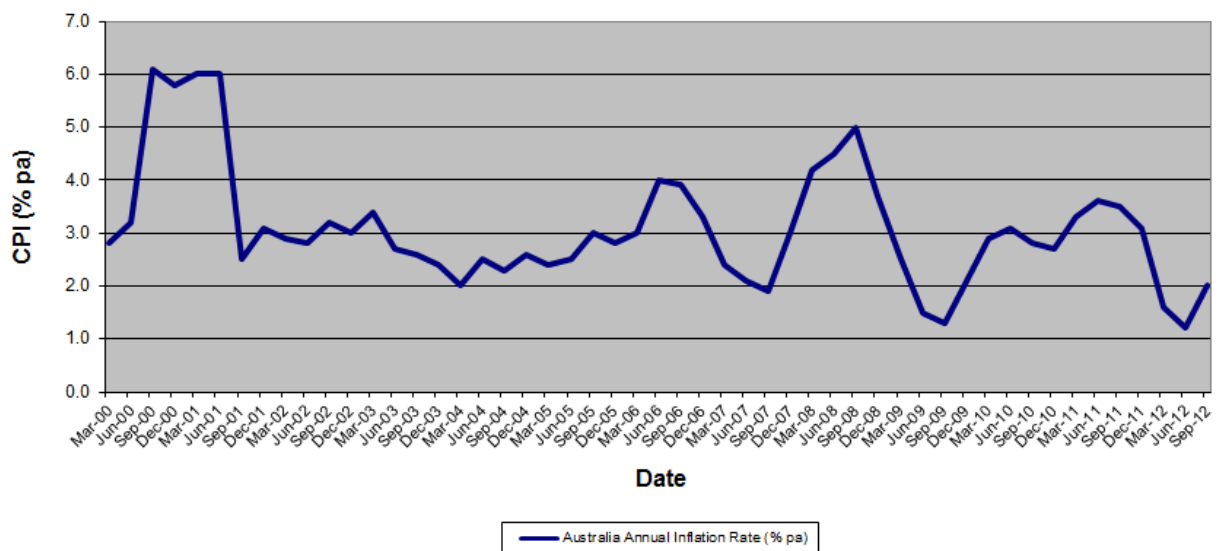
Major Economic Indicators

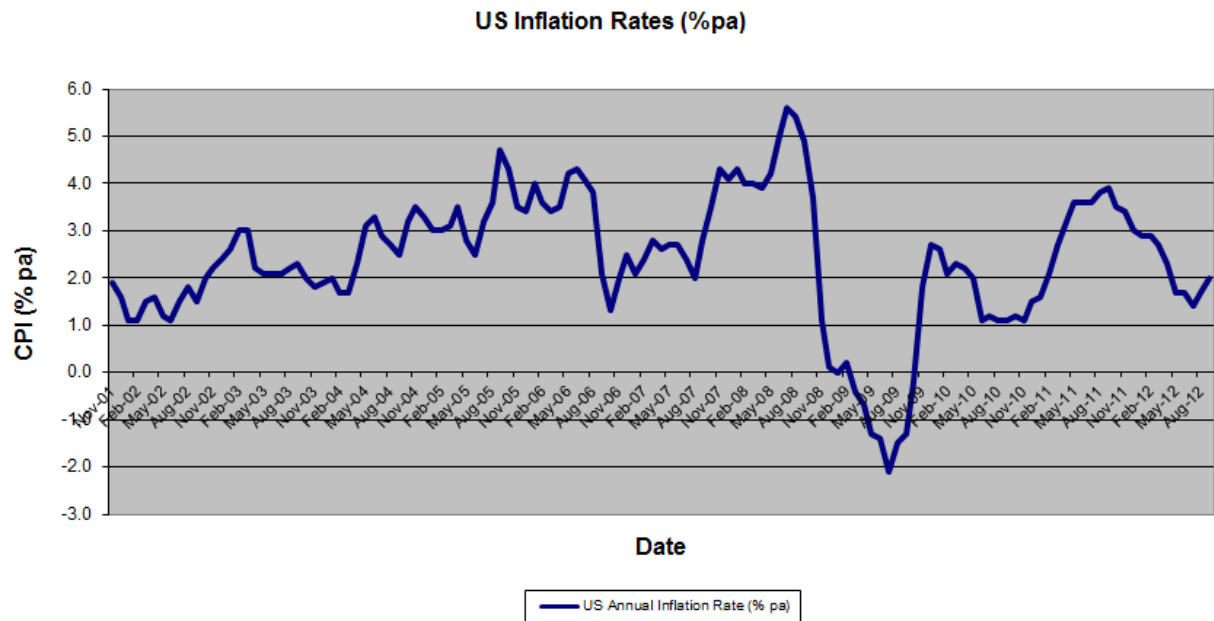


China GDP Growth Rates (%pa)

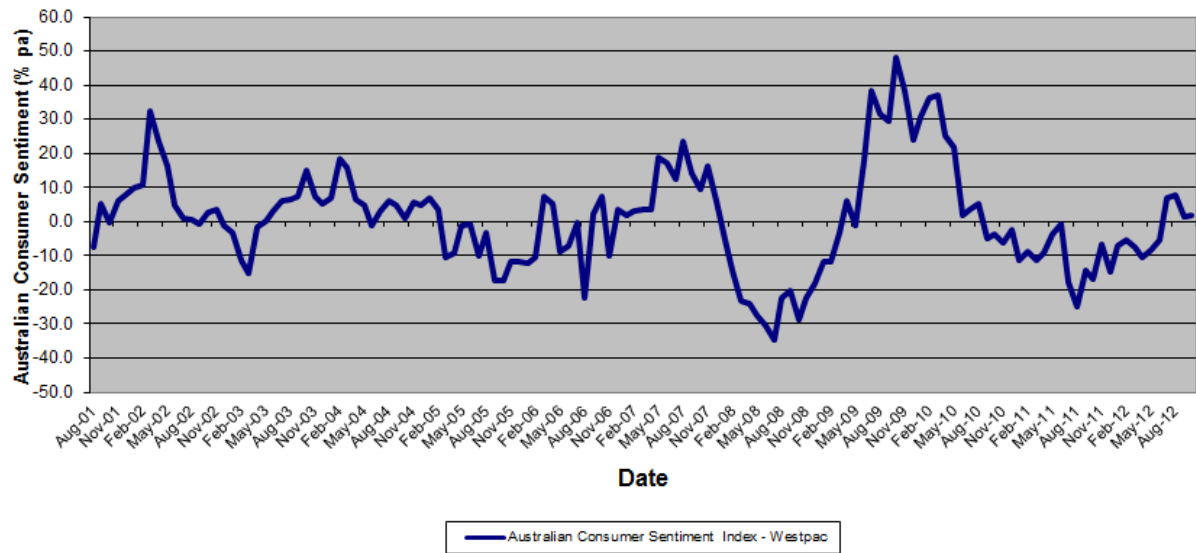


Australia Inflation Rates (%pa)

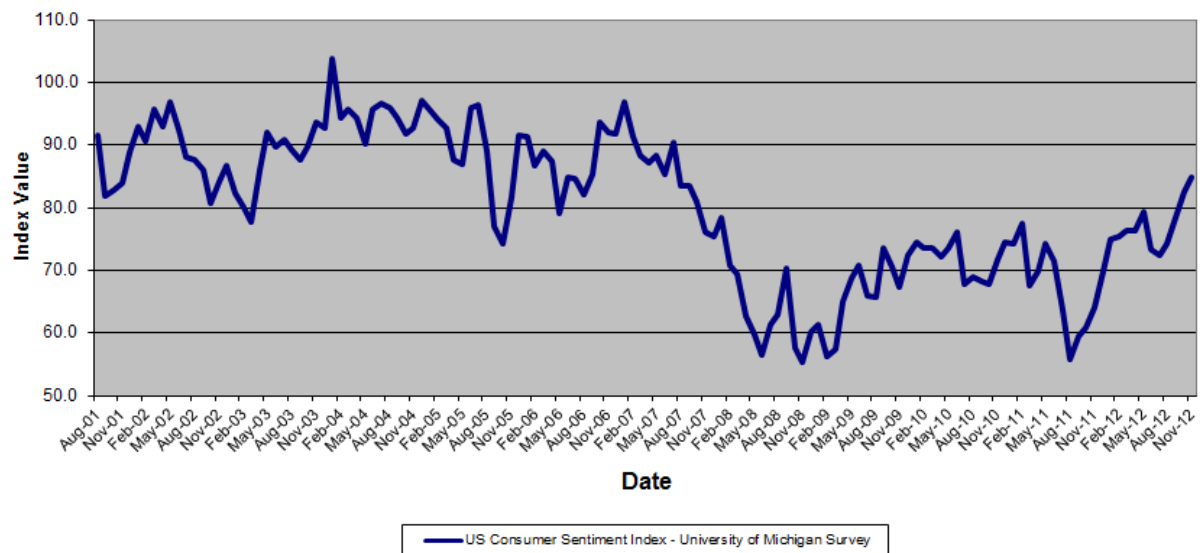


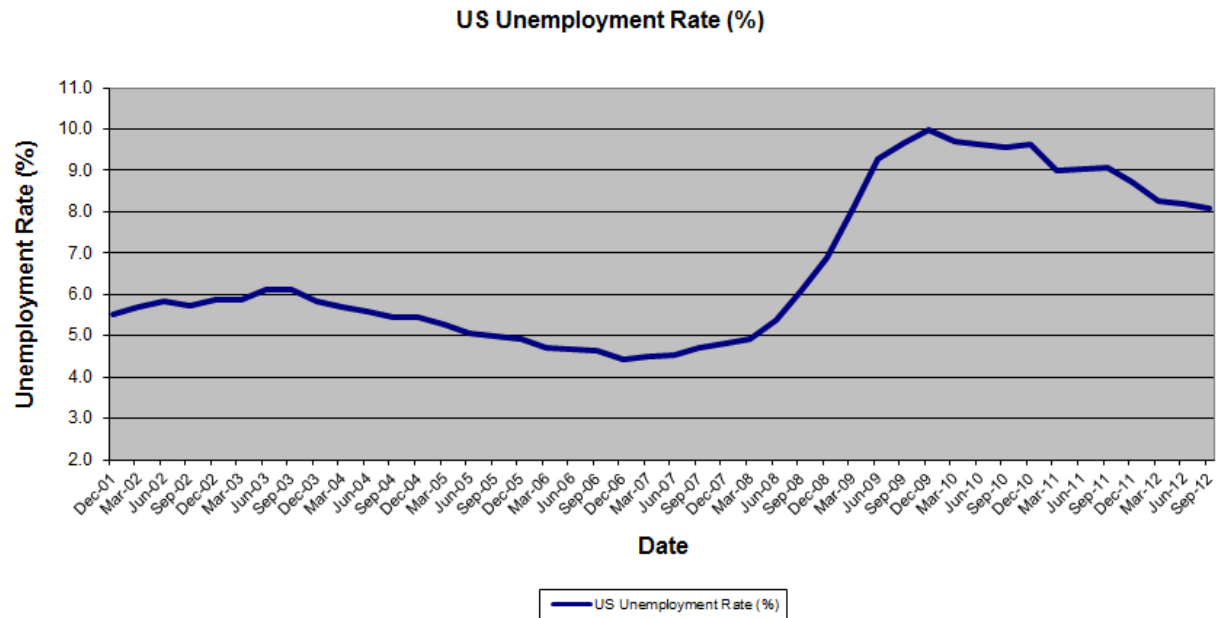


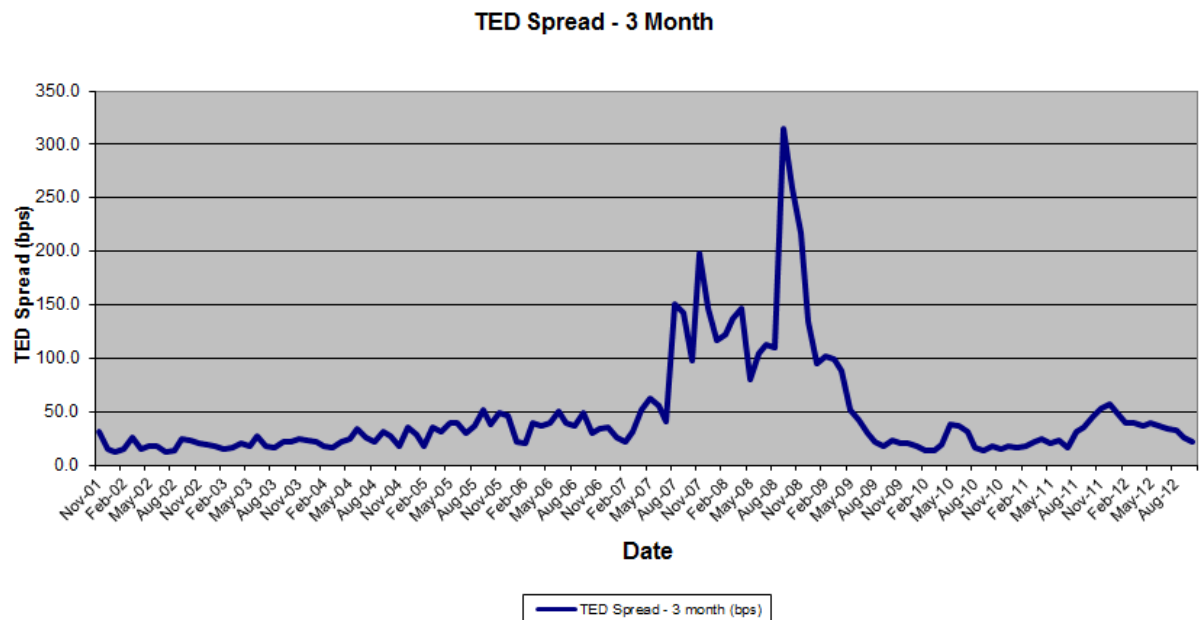
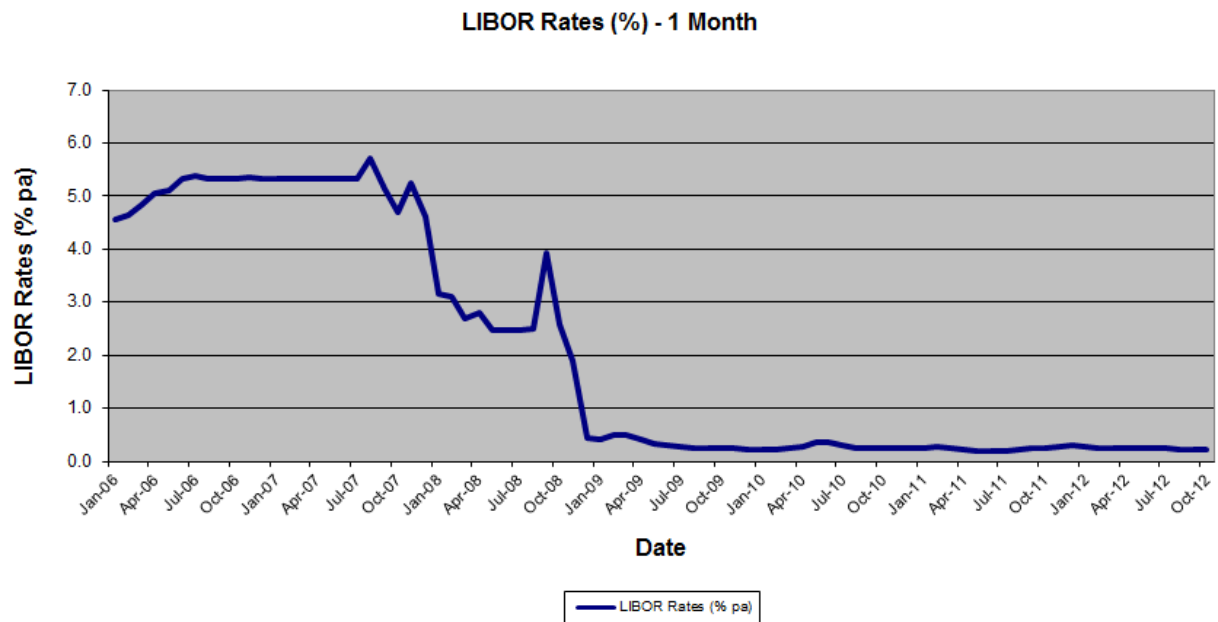
Australian Consumer Sentiment Index - Westpac

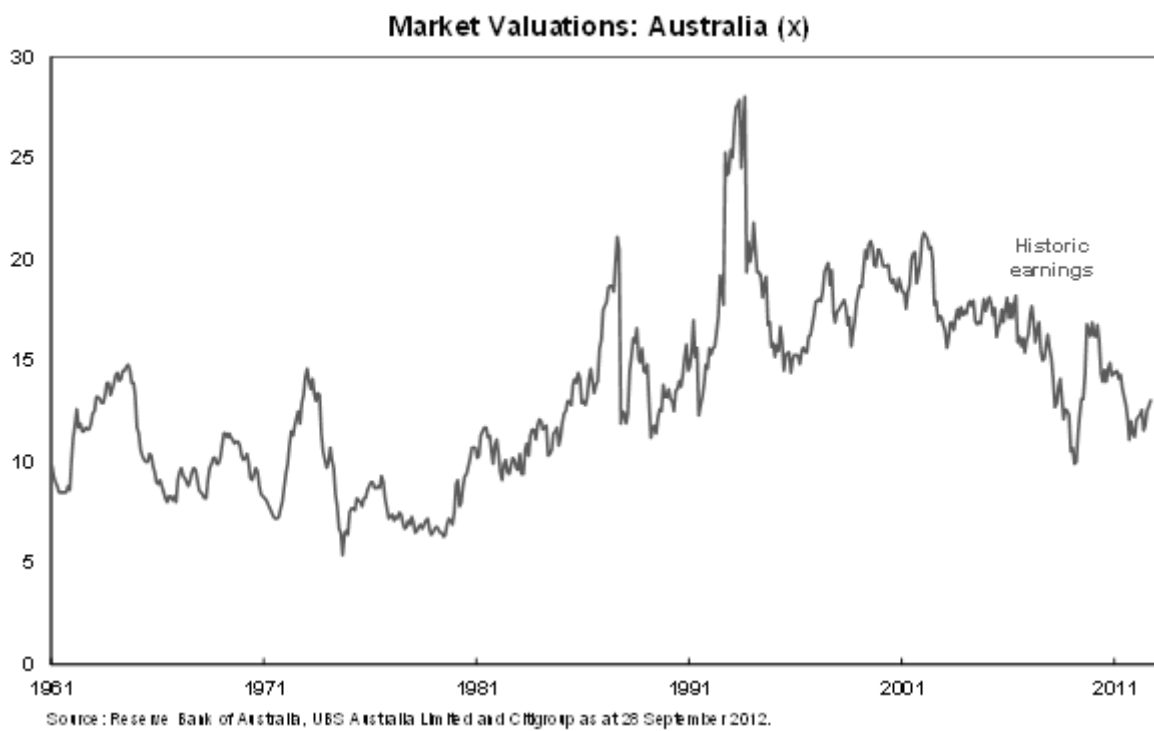
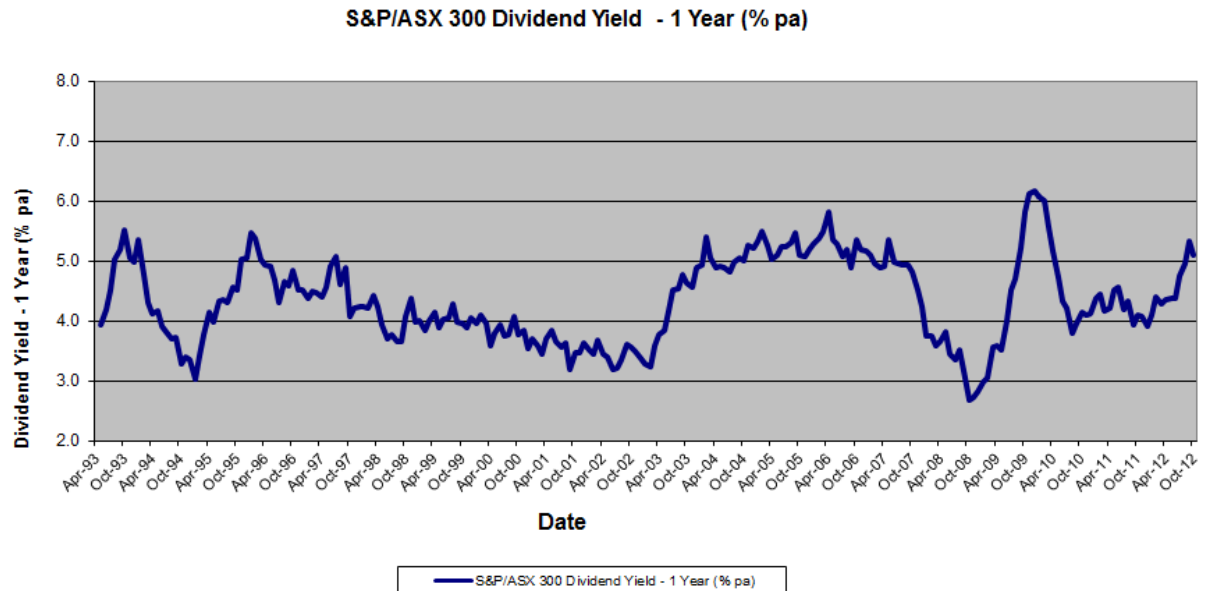


US Consumer Sentiment Index - University of Michigan Survey

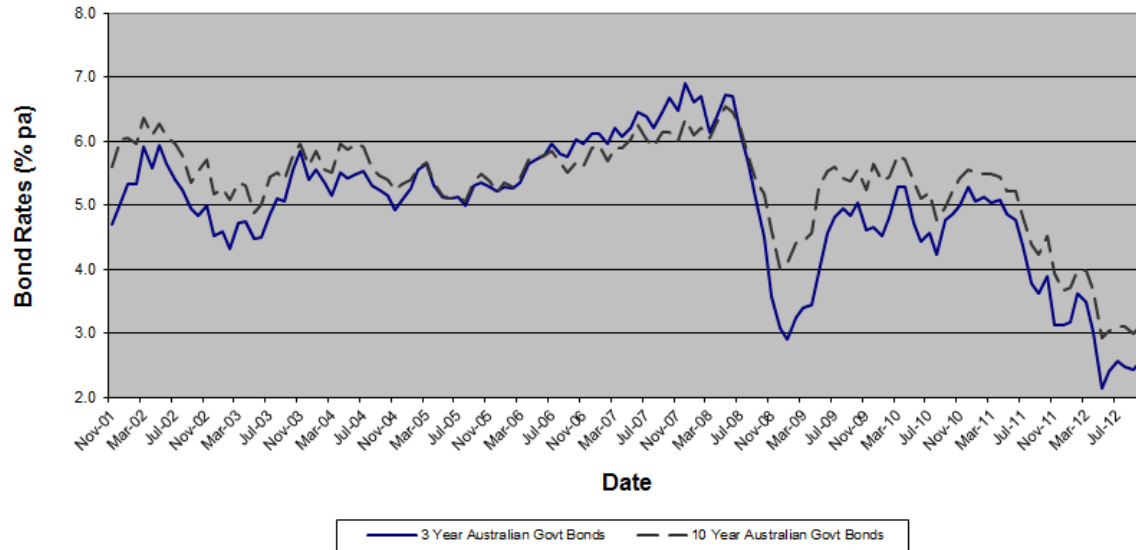




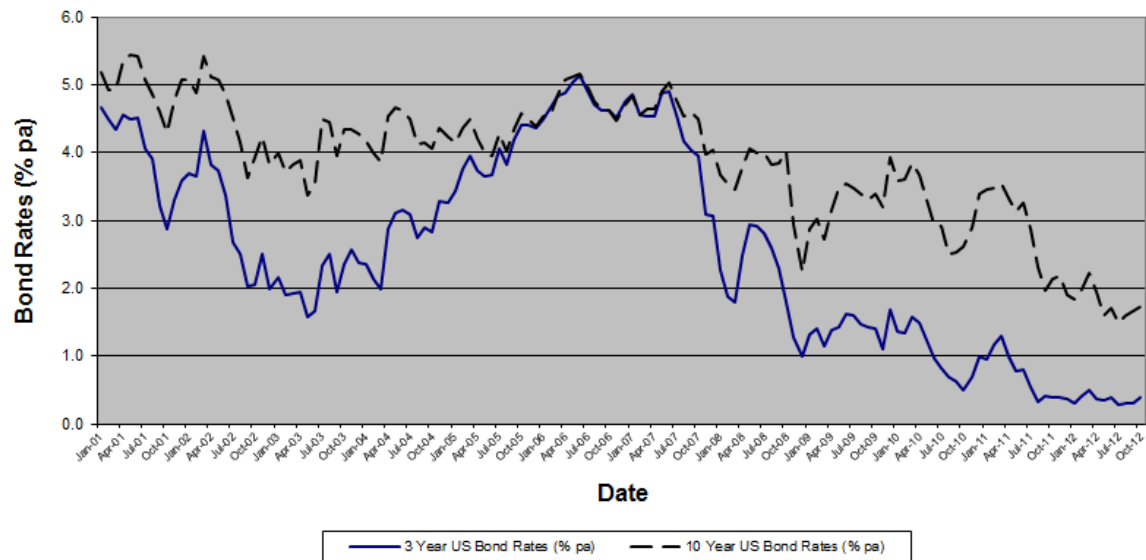


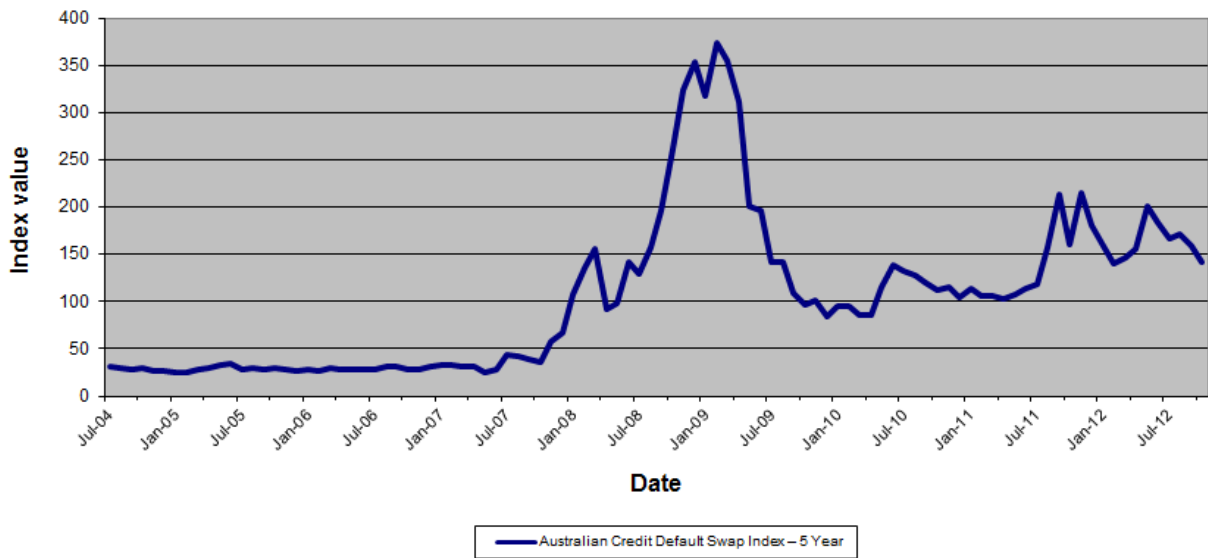
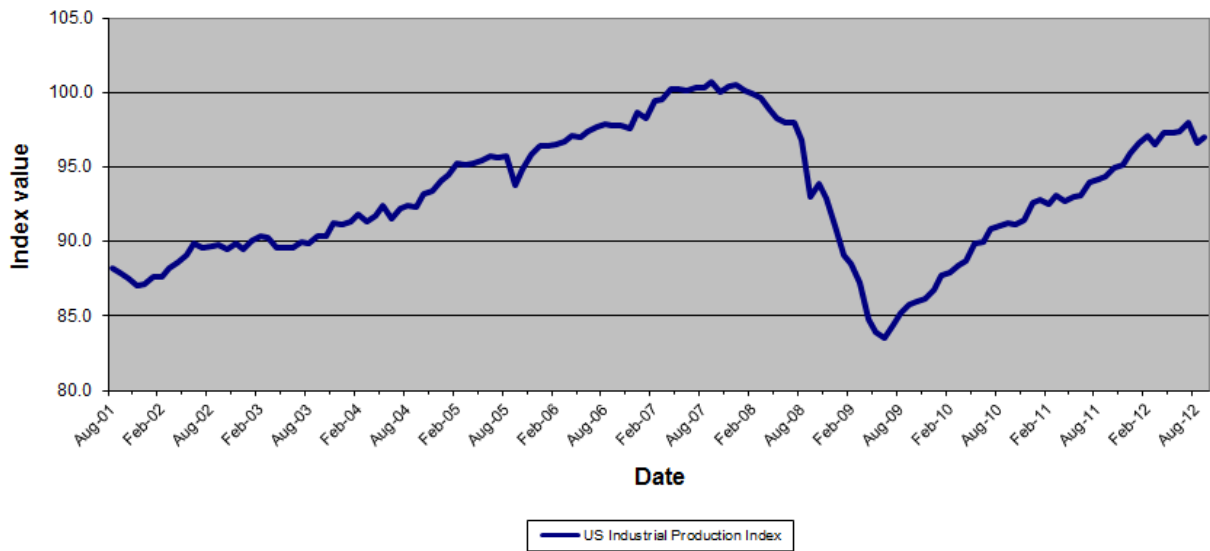


3y and 10y Australian Bond Rates (%)



3y and 10y US Bond Rates (%)

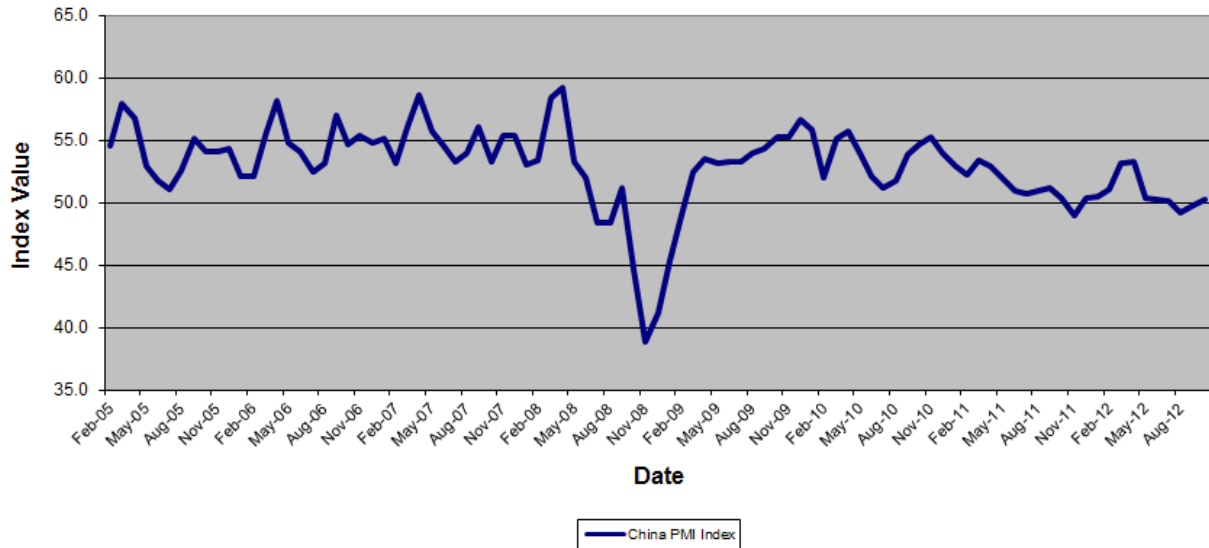


Australian Credit Default Swap Index – 5 Year**US Industrial Production Index**

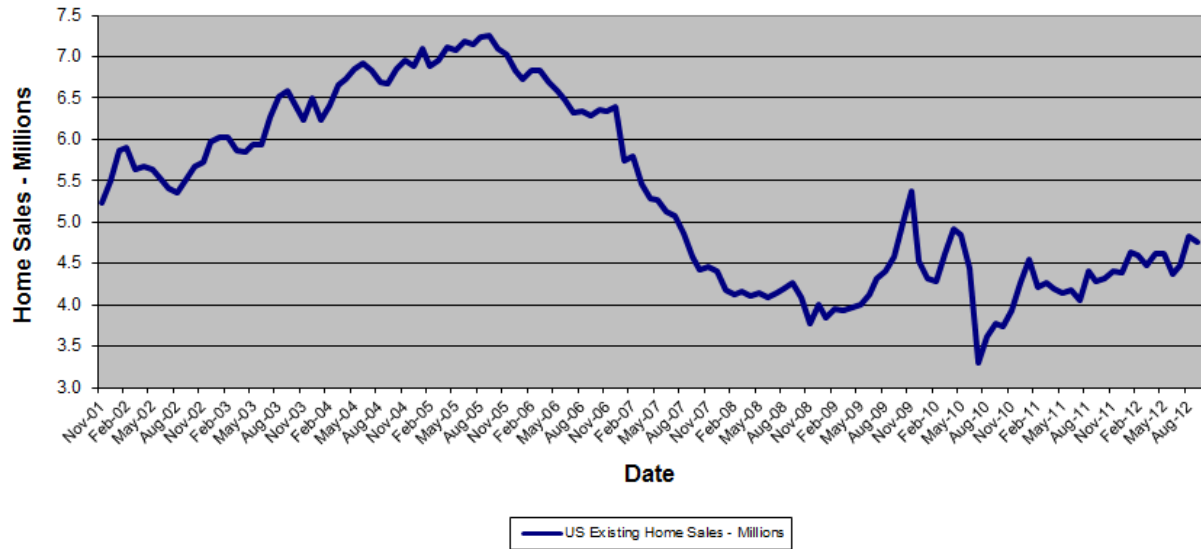
US Capacity Utilisation Index



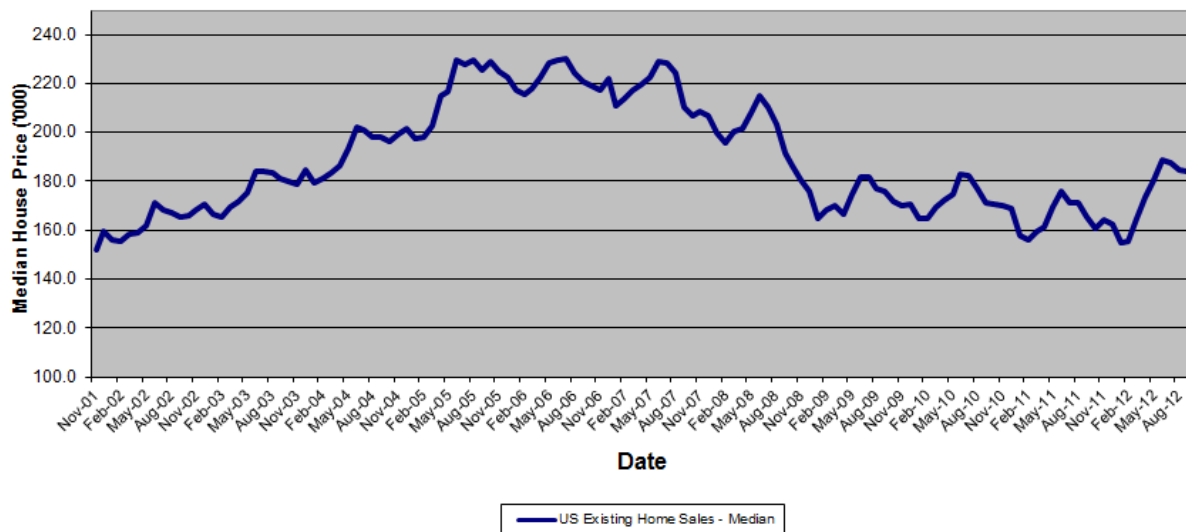
China Purchasing Managers Index (PMI)

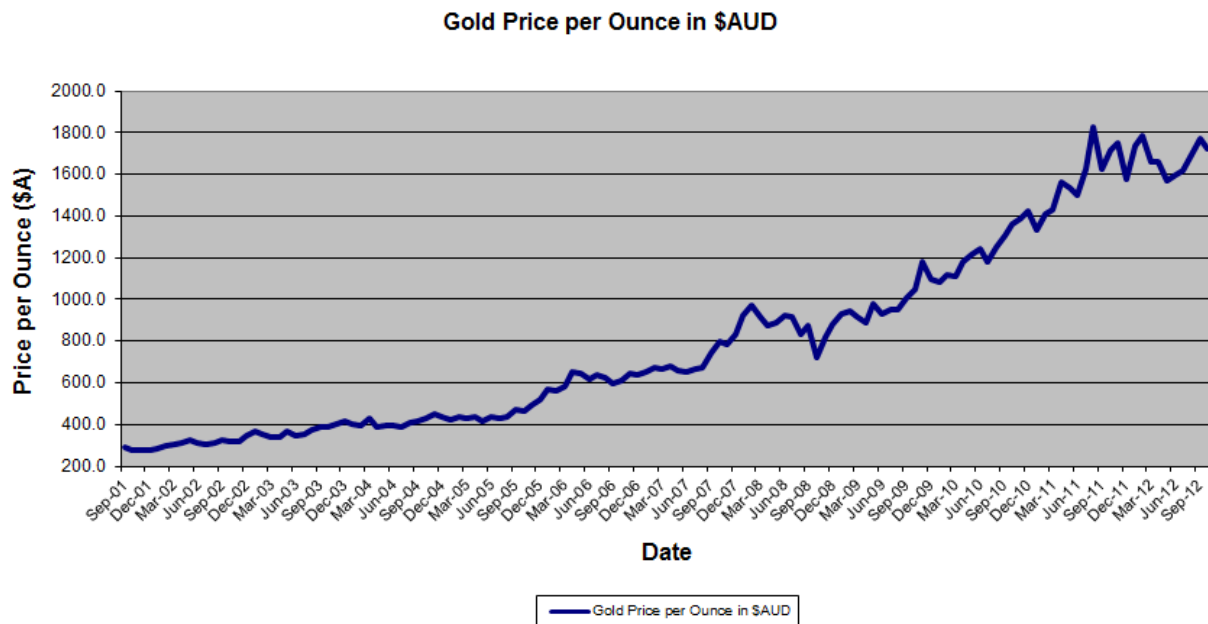
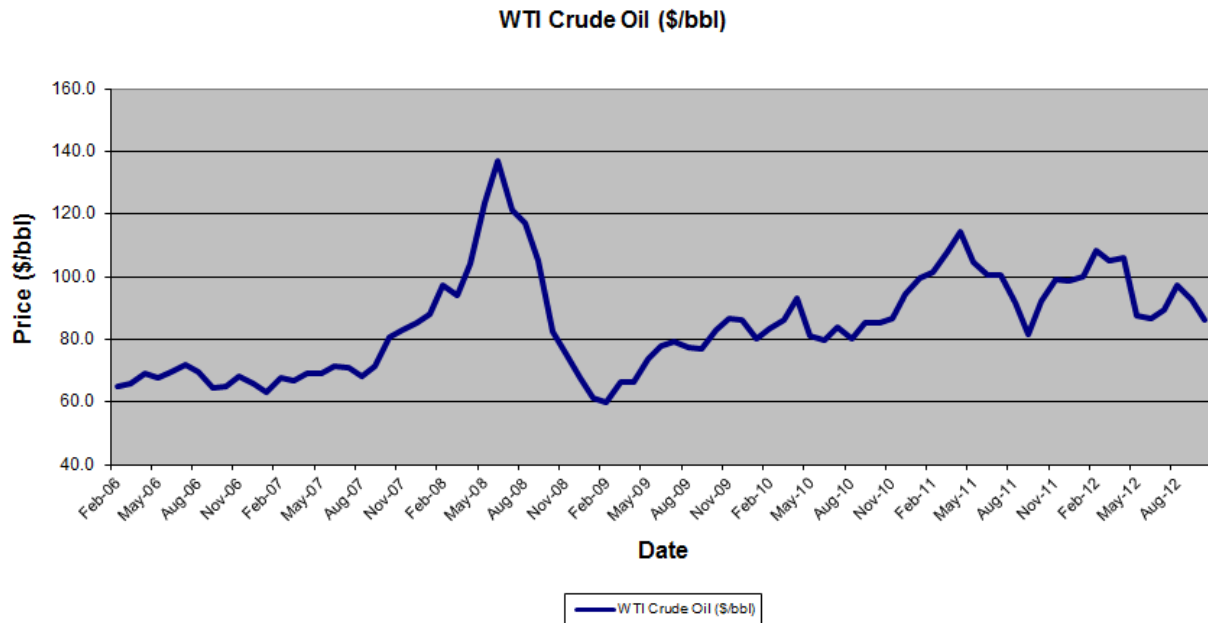


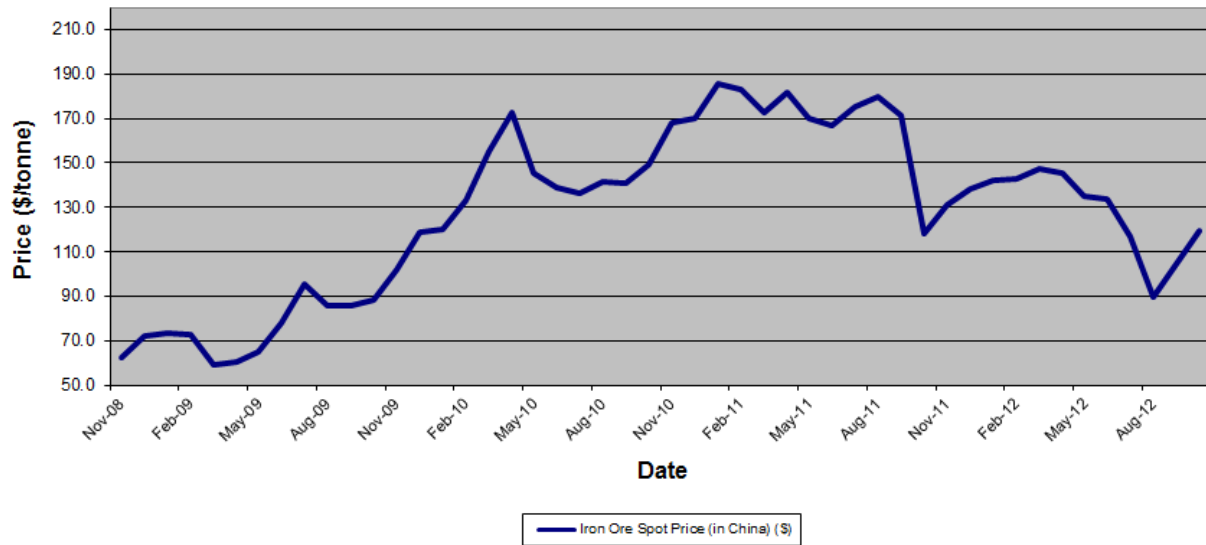
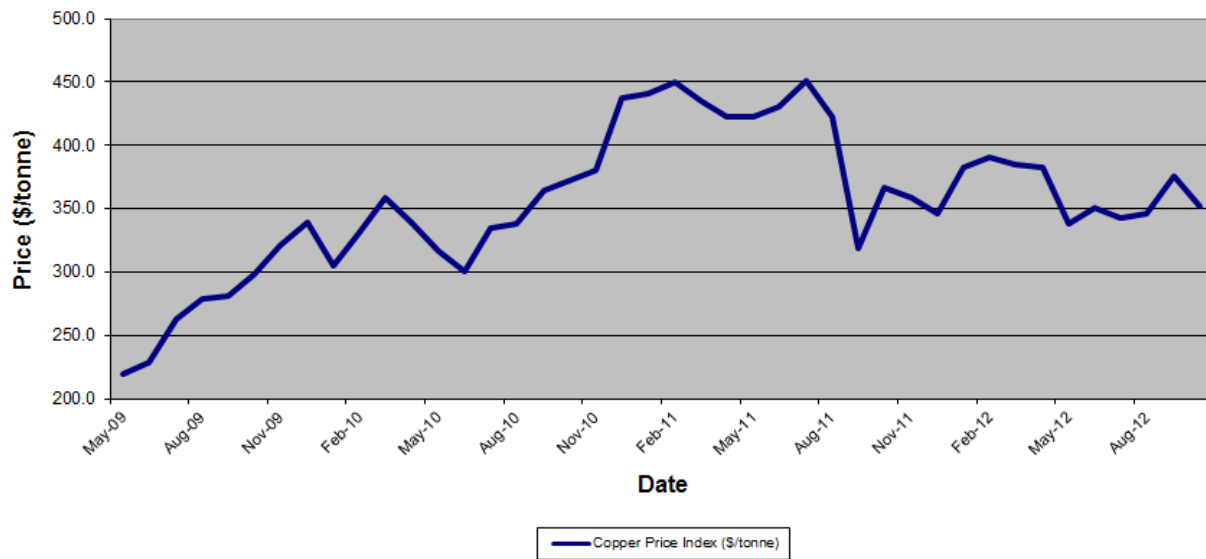
US Existing Home Sales - Millions



US Existing Home Sales - Median



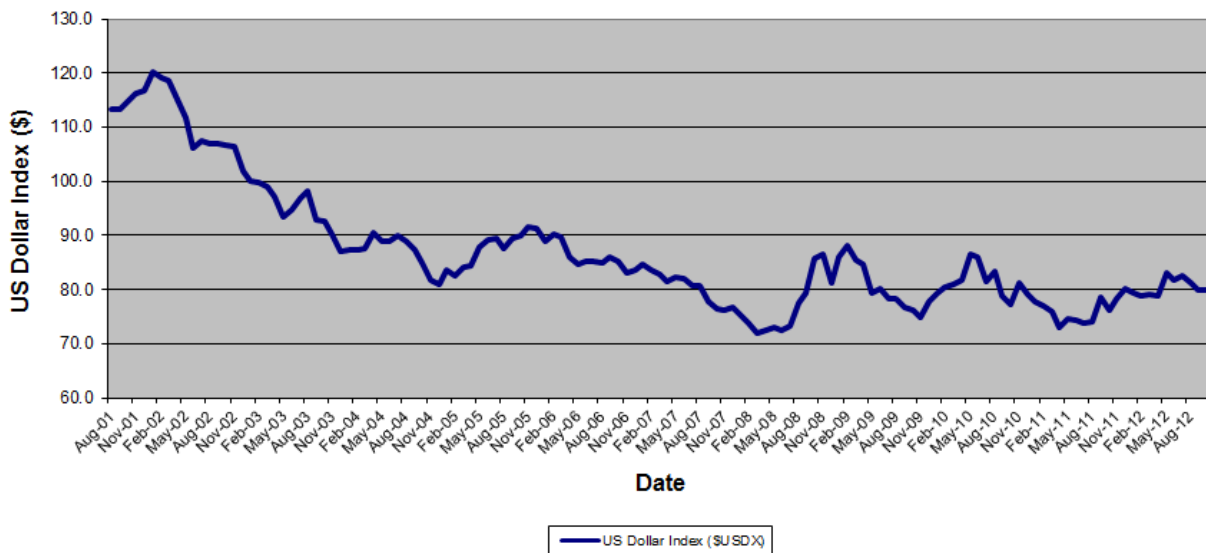


Iron Ore Spot Price (in China) (\$/tonne)**Copper Price Index (\$/tonne)**

S&P Goldman Sachs Agricultural Index



US Dollar Index (\$USDX)



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%).