McGregor Asset Consulting

Economic and Market Commentary
February 2013

Improving investor sentiment and more stable investment markets globally has under pinned a strong start to 2013. The concerns of a major correction caused by the US deficit and fiscal issues has been diminished and deferred until May with market concerns dissipating. The US is undergoing a broadening economic recovery although from a low base fuelled by cheap funds (cash rates close to 0% and 10 year bonds 2%), improving consumer sentiment, improving housing and construction market and access to affordable energy all providing a lift in confidence. The US fiscal issues remain a hurdle to be overcome with politicians being required to still address the significant debt issues within coming months.

Deleveraging over the past five years and an aggressive US Fed Reserve (quantitative easing) programme has contributed significantly to the change in sentiment. The US unemployment rate is a major focus for the Fed and has remained stubbornly high around the 8% region but with the housing sector recovering this should provide a welcome boost to employment. The Fed is targeting a 6.5% unemployment rate before reducing its stimulatory stance.

The European Central Bank has been proactive in providing a support mechanism to the region in the form of a bond purchase program, Outright Monetary Transactions (OTM) that allows member countries to off load distressed bonds to the ECB. This action has improved investor sentiment and confidence in the short term. This is assisting in the management of the Greek crisis and avoiding a calamity although the Greek austerity measures imposed by the ECB and IMF is creating social unrest.

Spain, Portugal, Italy and UK 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 Italian elections to be held at the end of this month (25 February) are likely to see a move away from the stricter austerity measures implemented by Mario Monti the technocrat that has been stabilising the economy after Berlusconi who is running again. .

Despite the US fiscal issues 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. The potential positive for the US is the strong state of the energy market which is anticipated to add 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 become a net oil exporter by 2030.

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. The Chinese leadership change and transition appears to be proceeding better than expected with the corruption issues now being dealt with. Xi Jinping, President elect, is already implementing structural change, prioritising the urbanisation process and seeking to balance an infrastructure investment spending focus with consumption spending led transition. Growth has now stabilised around 7.5 - 8% and there is greater confidence in the reacceleration of the economy. This is likely to have a significant positive impact on the Australian economy in the medium term as it should provide a base for our exports. Social unrest is identified as a major issue confronting China over the coming years.

The Japanese Prime Minister Shinzo Abe is embarking on a strong growth strategy. He has formally adopted a 2% inflation target in conjunction with the Bank of Japan and is implementing a monetary easing stimulus of ¥10.3 trillion Yen (US$116 billion) aimed at driving up economic growth. Forecast growth for 2013 has been increased to 2.3%. The aim is to drive down the currency and boost export earnings which should also be supportive for the equities market. The Yen has already dropped 15% and is starting to have the desired resultt.

The Australian share market has rebounded strongly over the past four months and the current companies reporting period has started strongly with over 70% of companies reporting better earnings and providing positive guidance for the coming period. This should provide support for the market as funds move out of cash and term deposits into growth investments. Resource companies have also stabilised and provide a base for a stronger market environment. The announcement of the election date for 14th September has now focussed the politicians on better articulating their policies which should provide for better decision making by the business sector.

A major headwind for the Australian market continues to be 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. With close to zero interest rates in the US, Europe and Japan large capital flows have entered Australia chasing higher yields. The devaluation of the Yen is also another factor in keeping the A$ hat these high levels. With the high A$ and resulting lower cost of overseas travel Australian tourism industry is now suffering a net outflow in tourism dollars.

The RBA's action in cutting interest rates in December to 3.0% has provided a catalyst for the equities market which has responded to a more confident world environment. Volatility in markets has reduced recently and is providing greater confidence to investors. The lower short term interest rates is reducing the attractiveness of term deposits and is starting to stimulate flows into higher yielding equities with sustainable or growing dividends. Bank shares are currently offering in the region of 5% yields before franking. the high returns last year from fixed interest is becoming harder to achieve as cash rates are generally at well below long term levels and opportunities are now difficult to find. Return expectations for fixed interest should be reduced to the 5-6% region for the year ahead.

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 uncertain. Overall the environment calls for a well-diversified investment portfolio of both risk assets and defensive assets.

- **International shares: [Overweight]** Sentiment in global equities markets is improving which provides opportunities for international shares to outperform over the coming year. An overweight position is appropriate for the sector with the US, Asia and emerging markets being the preferred regions.
- **Australian shares: [Overweight] Australian Small Caps: [Neutral]** Opportunities are likely to arise from a stronger investment climate in Asia and the US. Investors who have been holding cash are likely to consider equities during the year as the return profile has become more attractive. **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 investors need to be selective in this sector.
- **Fixed Interest: [Underweight]** With interest rates at historically low levels both 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.

Risks

- The risk of sovereign debt defaults continues to remain 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 continues to face major challenges in managing member countries, especially Greece in near collapse, also Spain, Portugal, Italy and UK with large debt issues and the lack of discipline to control the predicament.
- A potential risk ahead for the global economy is the mismanagement of the unwinding of the QE stimulus programs currently in place and its repercussions on bond markets.
- Social unrest in Europe, Africa and the Middle East is becoming an increasing concern for governments.
- With large US debt levels (US$16 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 politicians continue to defer making tough decisions.
- Increased social unrest within China maybe an issue with the increasing urbanisation of the country.
- Poor policy decisions by the Australian Federal government in the lead up to the election may result in lower growth for the Australian economy.

Global Opportunities

- The Asian region continues to generate satisfactory GDP growth 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.
- The rise of the US energy industry to a point of becoming an exporter of energy (gas) within 3-4 years and oil by 2030 provides a platform for optimism.

Australia

- Opportunities should continue as China and India evolve into stronger economies over the coming decade and demand for resources should be under pinned over the longer term.

Fixed Interest and Property

- Opportunities for higher returns from traditional fixed interest have largely disappeared with interest rates at low levels. The market has already factored in the lower rates and the risk now is for capital loss if rates rise. Increased opportunities may arise in the lower grade credit markets although caution in this sector is required.
- The listed property trust sector is in better shape to participate in an improving property cycle.

Monthly Share Market Performance over the last Thirteen Months

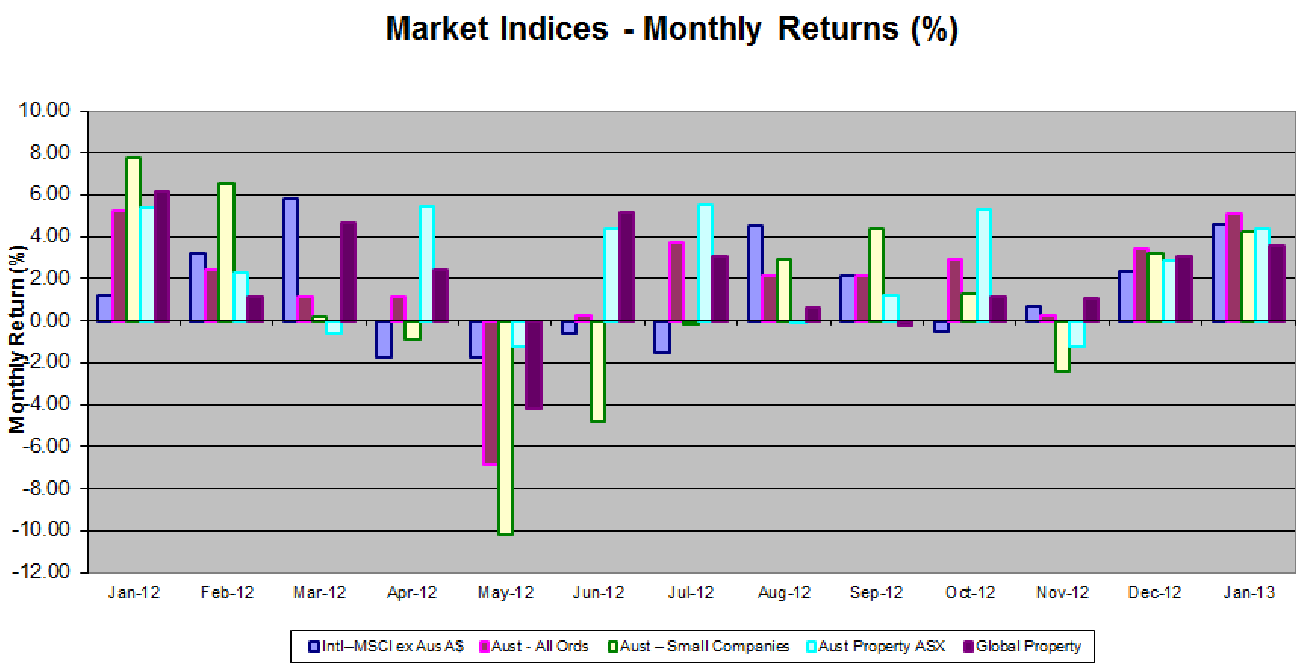
Market Indices	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13
Intl–MSCI ex A A$	1.17	3.24	5.80	-1.73	-1.76	-0.62	-1.56	4.50	2.11	-0.52	0.67	2.34	4.59
Aust - All Ords	5.23	2.41	1.15	1.10	-6.90	0.25	3.74	2.12	2.13	2.97	0.27	3.43	5.08
Aust – Small Coy	7.75	6.51	0.19	-0.92	-10.22	-4.78	-0.19	2.95	4.37	1.31	-2.43	3.23	4.20
Aust Property ASX	5.40	2.25	-0.59	5.42	-1.24	4.34	5.55	-0.13	1.20	5.32	-1.28	2.86	4.41
Global Property	6.17	1.11	4.63	2.45	-4.22	5.15	3.08	0.60	-0.21	1.11	1.03	3.09	3.58

Annual Share Market Performance

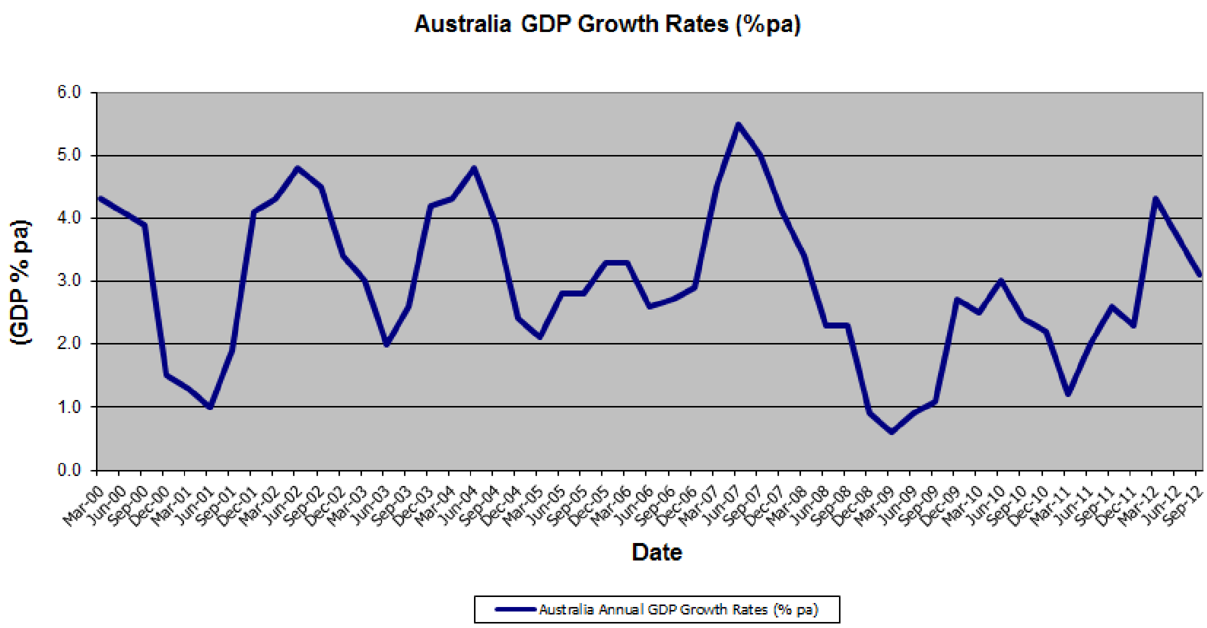
Markets Index	1 Year to 31 Dec 10 %	1 Year to 31 Mar 11 %	1 Year to 30 Jun 11 %	1 Year to 30 Sep 11 %	1 Year to 31 Dec 11 %	1 Year to 31 Mar 12 %	1 Year to 30 Jun 12 %	1 Year to 30 Sep 12 %	1 Year to 31 Dec 12 %	1 Year to 31 Jan 13 %
Intl–MSCI ex A A$	-2.40	0.64	2.66	-4.52	-5.34	0.69	-0.50	13.59	14.14	18.00
Aust – All Ords	3.31	4.80	12.17	-8.43	-11.43	-6.27	-7.04	13.36	18.84	18.68
Aust – Small Coy	13.05	13.49	16.41	-12.11	-21.43	-8.57	-14.61	3.83	6.58	3.07
Aust Prop – ASX	-0.68	4.74	5.87	-6.29	-1.56	1.67	10.98	28.90	32.79	31.54
Global Property	26.15	24.78	36.60	1.06	1.94	8.40	6.93	30.54	26.29	23.21

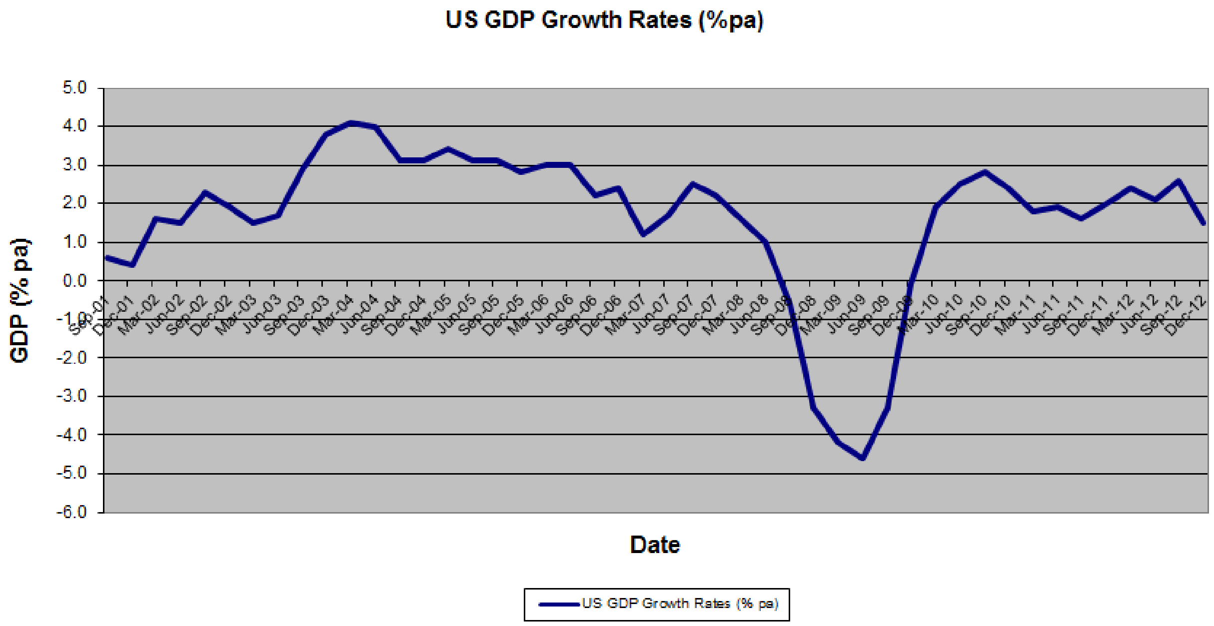
Best Performing Asset Sectors for twelve months ended 31 January 2013

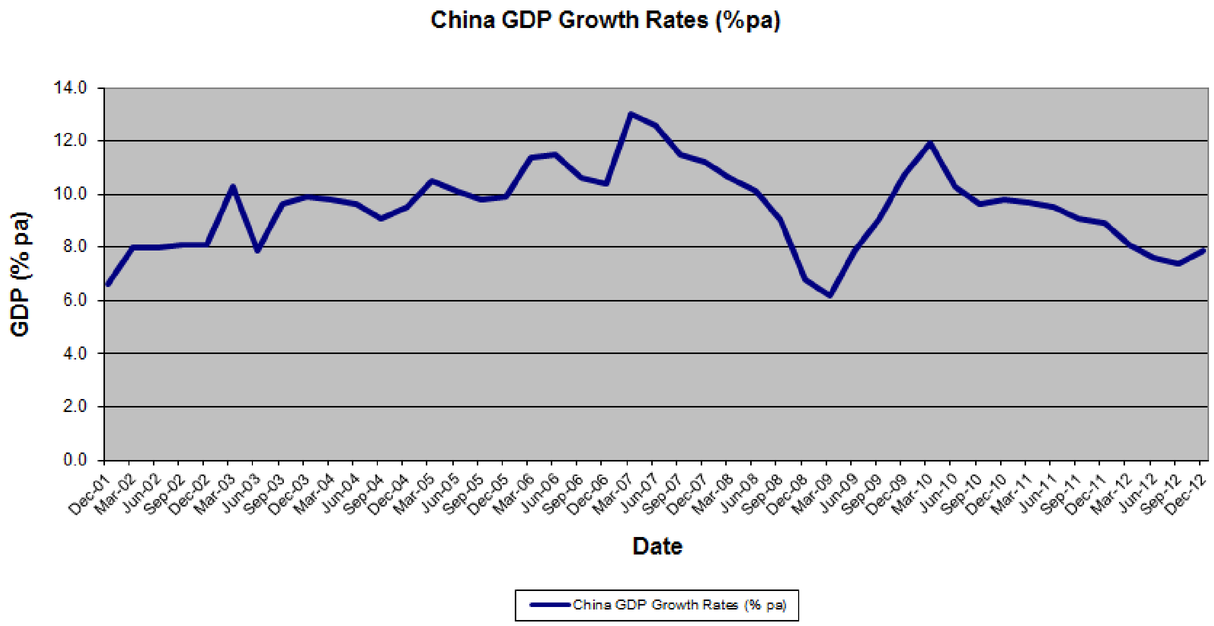
Sector	Market Index	Return
Aust Listed Property	S&P/ASX Property Trusts Accum Index	31.54
Global Listed Property	UBS Global Real Estate Inv Ex Aust Idx Hedge $A	23.21
Australian Shares	S&P/ASX All Ords Accum Index	18.68
International Equities Unhedged	MSCI World Ex Aust Accum Index A$	18.00
International Equities Hedged	MSCI World Accum Index Hedged A$	17.18
Australian Fixed Interest	UBS Warburg Composite 0 + Years	7.31
International Fixed Interest Hedged	JP Morgan Gov Bond Accum Index Hedged $A	6.63
Cash	Australian 90 Day Bank Accepted Bill	3.84
Australian Smaller Companies	S&P/ASX Small Ordinaries Accum Index	3.07

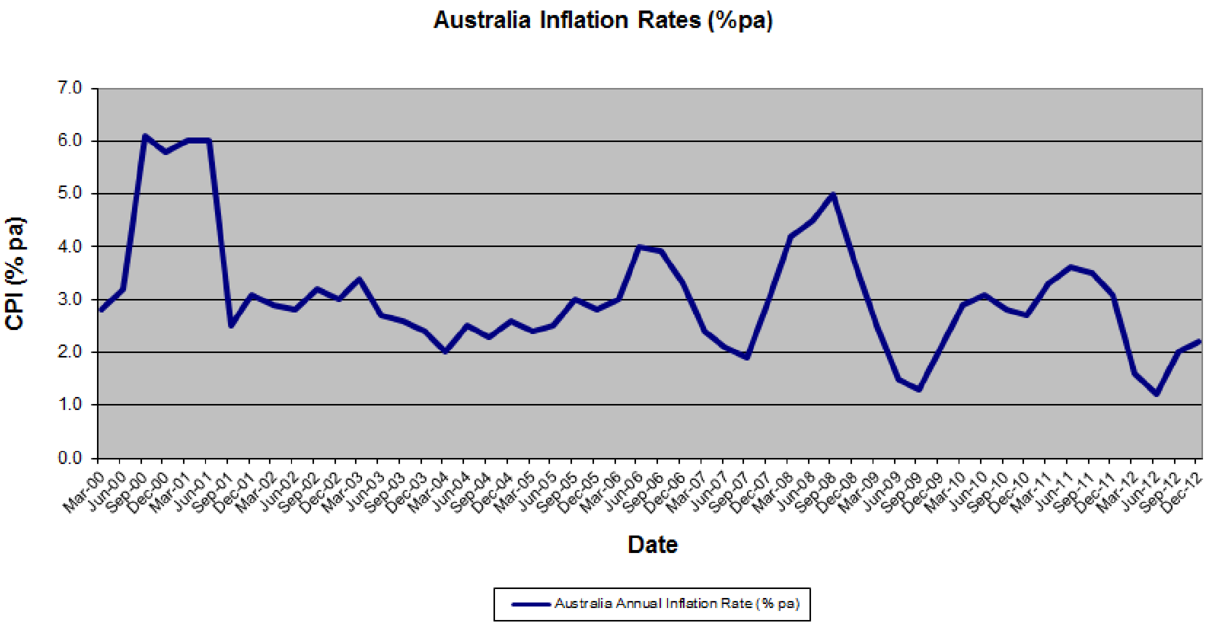


Major Economic Indicators

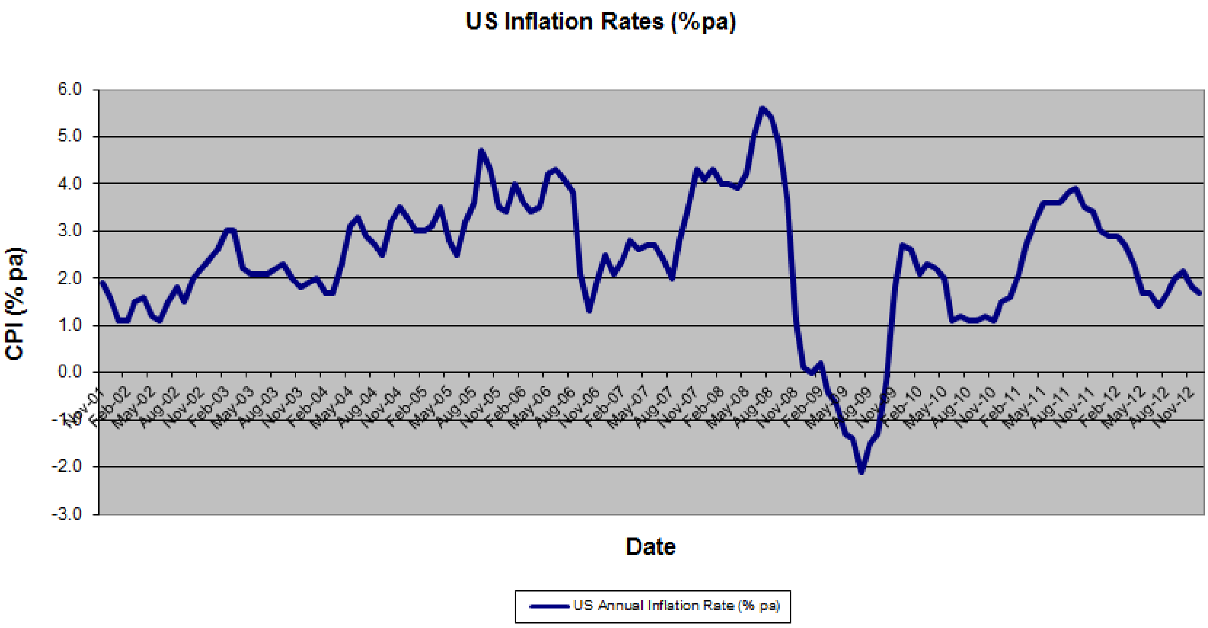



US GDP Growth Rates (%pa)
GDP (% pa)
5.0
4.0
3.0
2.0
1.0
0.0
-1.0
-2.0
-3.0
-4.0
-5.0
-6.0
Date
US GDP Growth Rates (% pa)

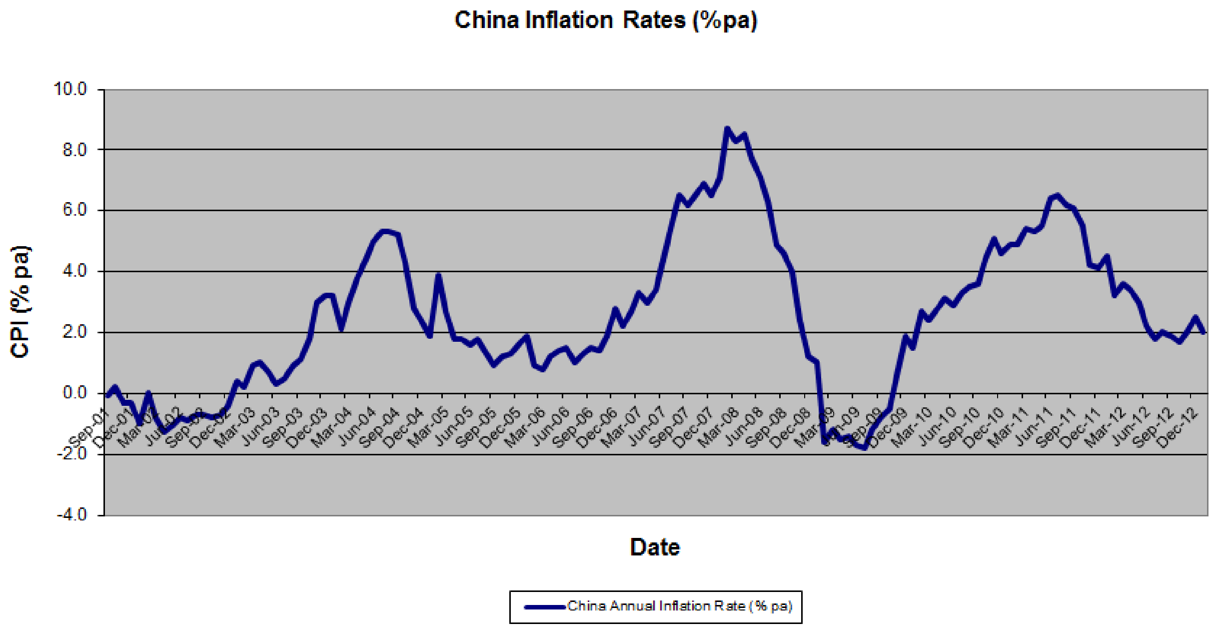

China GDP Growth Rates (%pa)
GDP (% pa)
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
Date
China GDP Growth Rates (% pa)

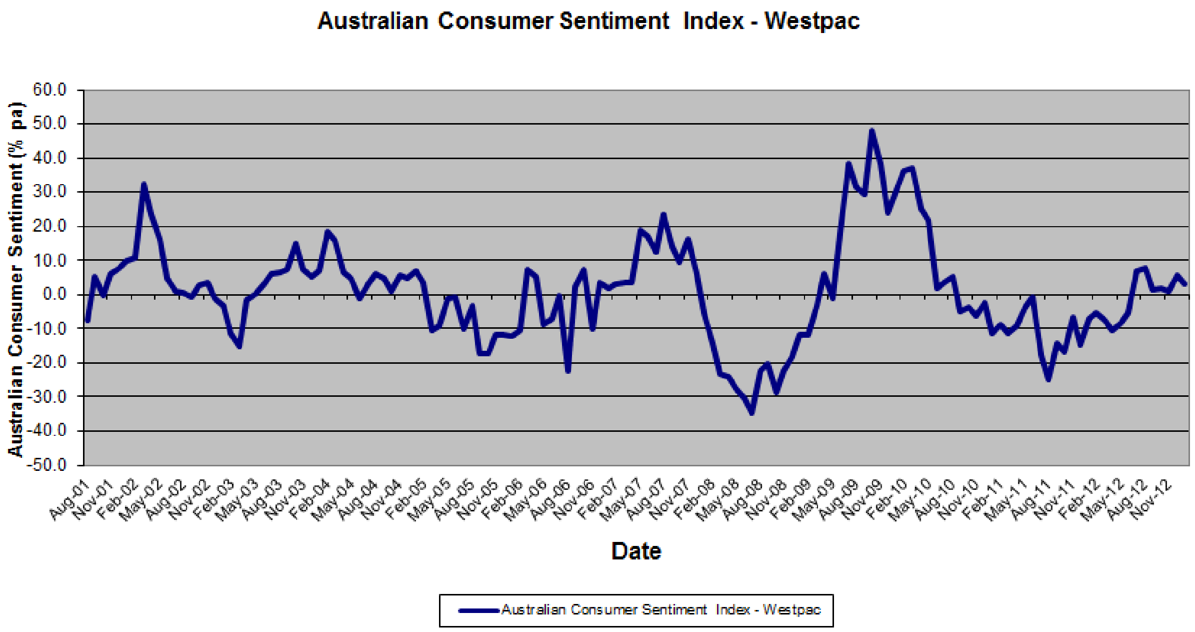


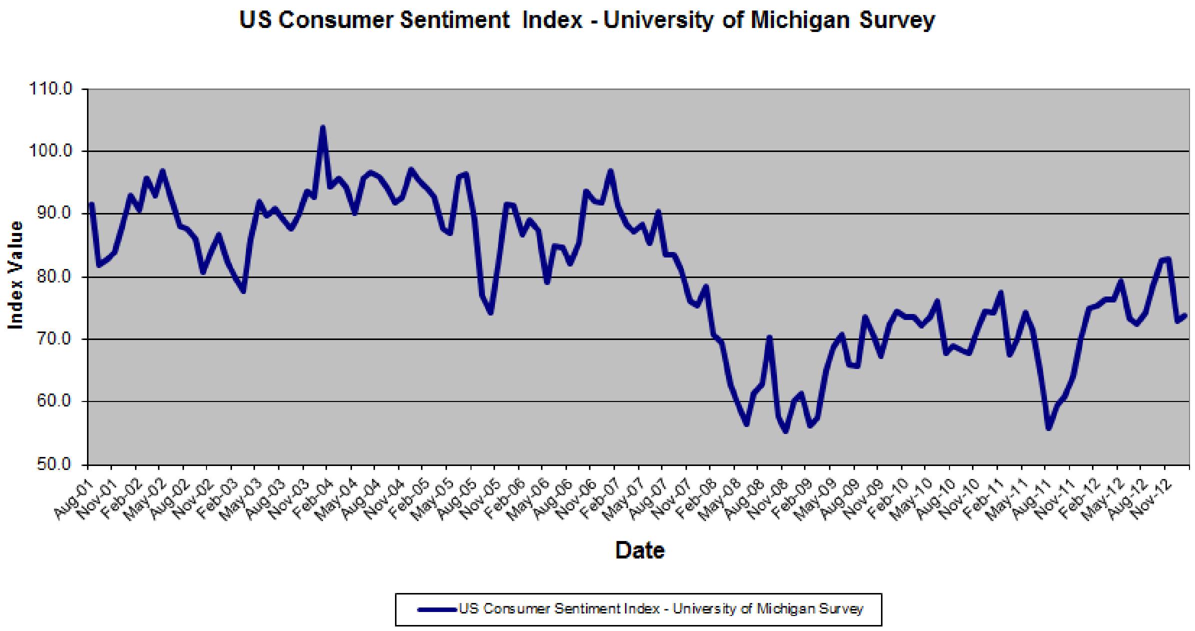
Australia Inflation Rates (%pa)
CPI (% pa)
Date
Australia Annual Inflation Rate (% pa)



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

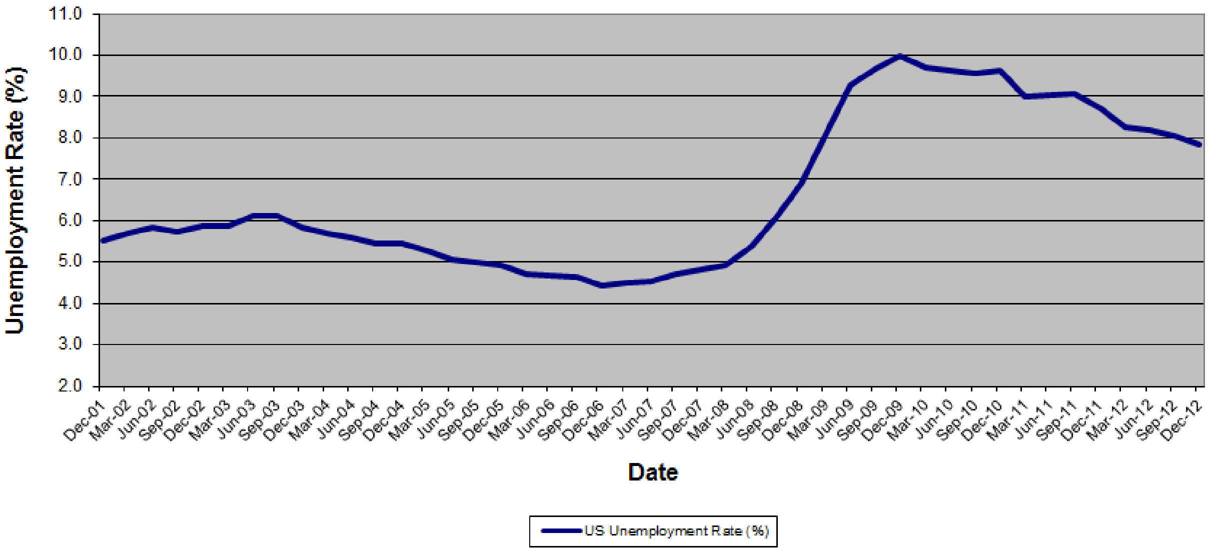

China Inflation Rates (%pa)
CPI (% pa)
Date
China Annual Inflation Rate (% pa)


Australian Consumer Sentiment Index - Westpac
Australian Consumer Sentiment (% pa)
Date
Australian Consumer Sentiment Index - Westpac

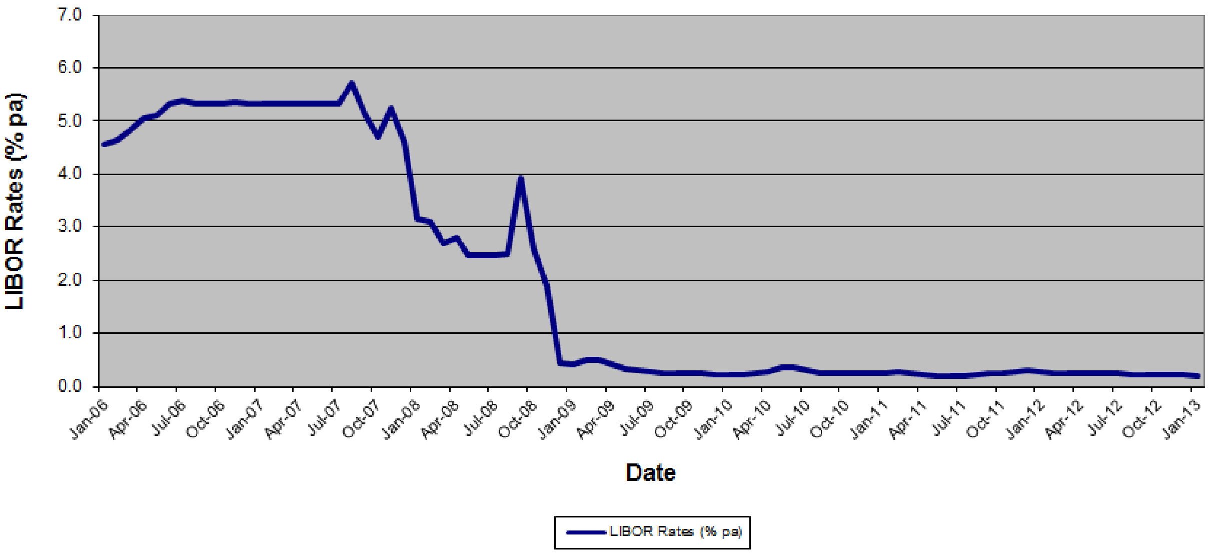

US Consumer Sentiment Index - University of Michigan Survey
Index Value
110.0
100.0
90.0
80.0
70.0
60.0
50.0
Aug-01
Nov-01
Feb-02
May-02
Aug-02
Nov-02
Feb-03
May-03
Aug-03
Nov-03
Feb-04
May-04
Aug-04
Nov-04
Feb-05
May-05
Aug-05
Nov-05
Feb-06
May-06
Aug-06
Nov-06
Feb-07
May-07
Aug-07
Nov-07
Feb-08
May-08
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
May-12
Aug-12
Nov-12
Date
US Consumer Sentiment Index - University of Michigan Survey

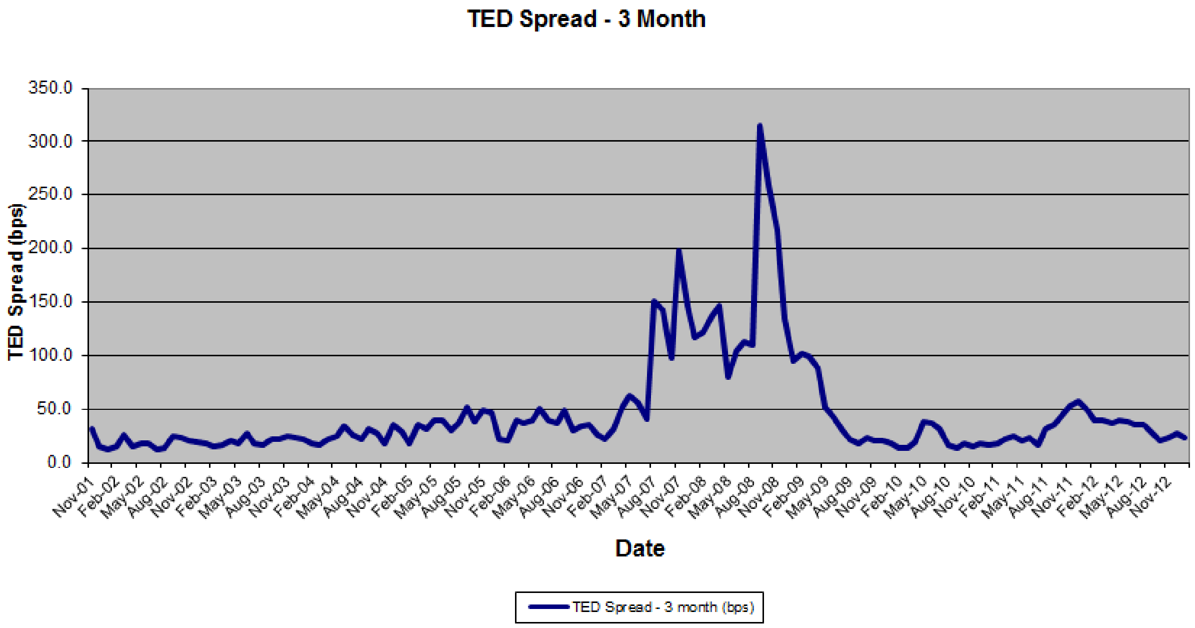

China Retail Sales Value (%pa)
Retail Sales (% pa)
25.0
20.0
15.0
10.0
5.0
0.0
Sep-01
Dec-01
Mar-02
Jun-02
Sep-02
Dec-02
Mar-03
Jun-03
Sep-03
Dec-03
Mar-04
Jun-04
Sep-04
Dec-04
Mar-05
Jun-05
Sep-05
Dec-05
Mar-06
Jun-06
Sep-06
Dec-06
Mar-07
Jun-07
Sep-07
Dec-07
Mar-08
Jun-08
Sep-08
Dec-08
Mar-09
Jun-09
Sep-09
Dec-09
Mar-10
Jun-10
Sep-10
Dec-10
Mar-11
Jun-11
Sep-11
Dec-11
Mar-12
Jun-12
Sep-12
Dec-12
Date
China Retail Sales Value (% pa)

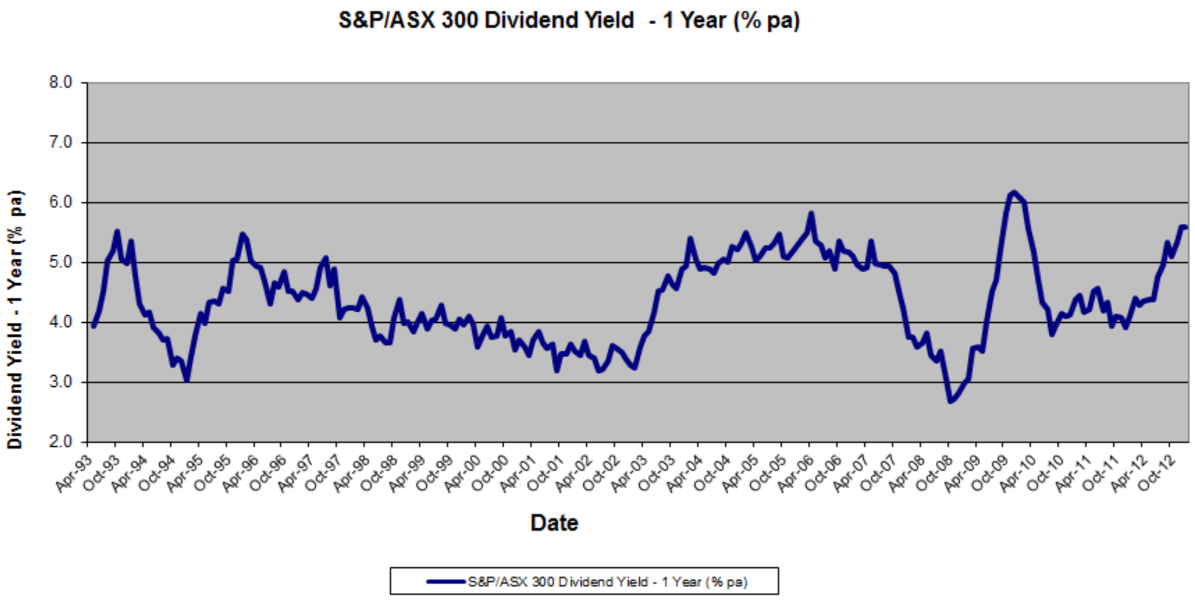
US Unemployment Rate (%)



LIBOR Rates (%) - 1 Month



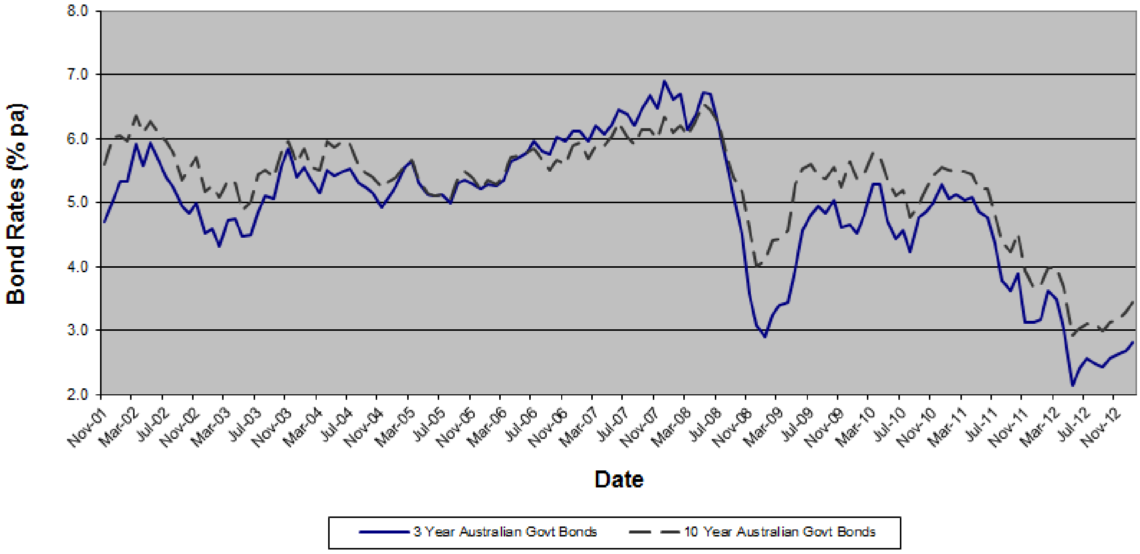

TED Spread - 3 Month
TED Spread (bps)
350.0
300.0
250.0
200.0
150.0
100.0
50.0
0.0
Nov-01 Feb-02 May-02 Aug-02 Nov-02 Feb-03 May-03 Aug-03 Nov-03 Feb-04 May-04 Aug-04 Nov-04 Feb-05 May-05 Aug-05 Nov-05 Feb-06 May-06 Aug-06 Nov-06 Feb-07 May-07 Aug-07 Nov-07 Feb-08 May-08 Aug-08 Nov-08 Feb-09 May-09 Aug-09 Nov-09 Feb-10 May-10 Aug-10 Nov-10 Feb-11 May-11 Aug-11 Nov-11 Feb-12 May-12 Aug-12 Nov-12
Date
TED Spread - 3 month (bps)

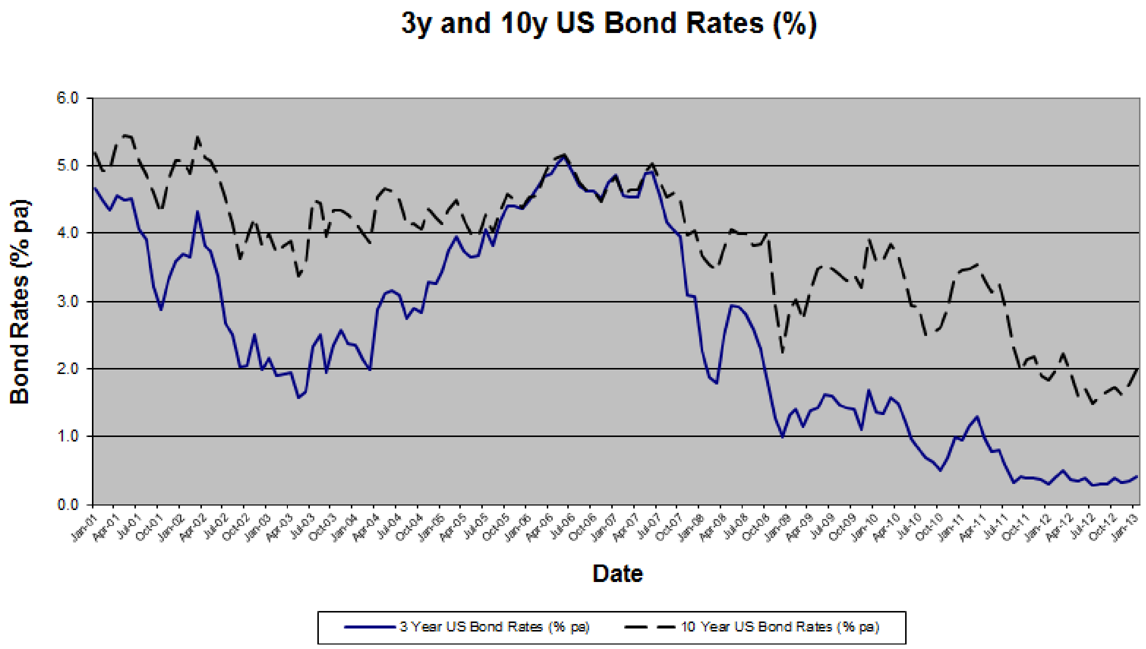

S&P/ASX 300 Dividend Yield - 1 Year (% pa)
Dividend Yield - 1 Year (% pa)
8.0
7.0
6.0
5.0
4.0
3.0
2.0
Apr-93 Oct-93 Apr-94 Oct-94 Apr-95 Oct-95 Apr-96 Oct-96 Apr-97 Oct-97 Apr-98 Oct-98 Apr-99 Oct-99 Apr-00 Oct-00 Apr-01 Oct-01 Apr-02 Oct-02 Apr-03 Oct-03 Apr-04 Oct-04 Apr-05 Oct-05 Apr-06 Oct-06 Apr-07 Oct-07 Apr-08 Oct-08 Apr-09 Oct-09 Apr-10 Oct-10 Apr-11 Oct-11 Apr-12 Oct-12
Date
S&P/ASX 300 Dividend Yield - 1 Year (% pa)

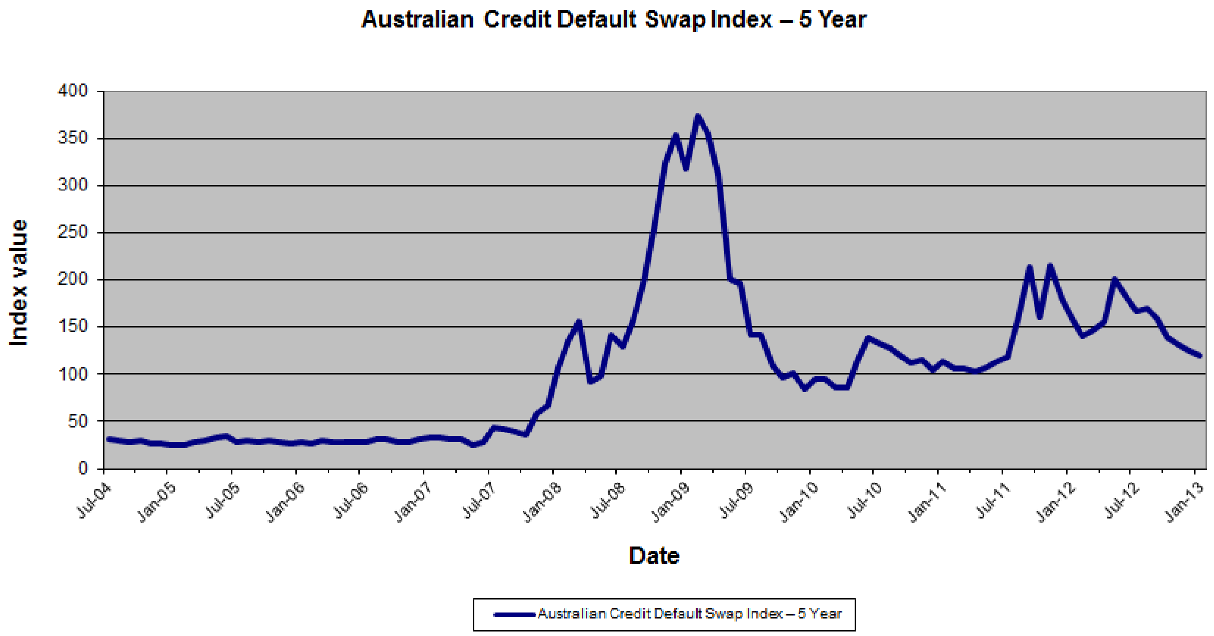
Australian Sharemarket Valuations (X)

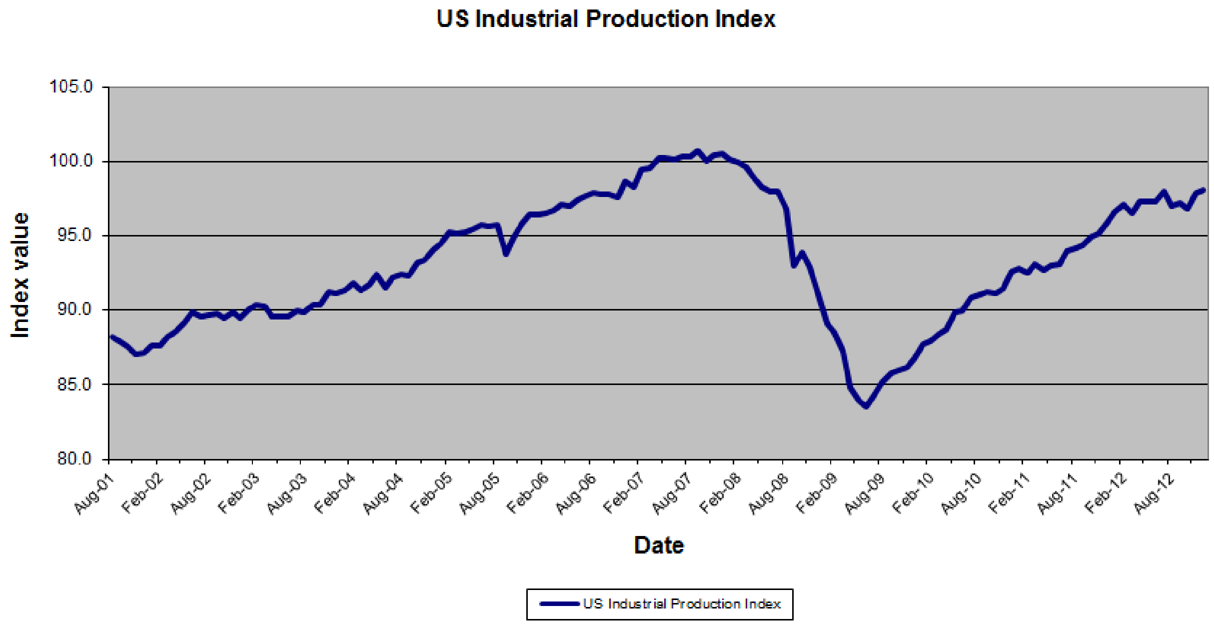
Source: UBS Australia and Reserve Bank of Australia as at 14 February 2013.

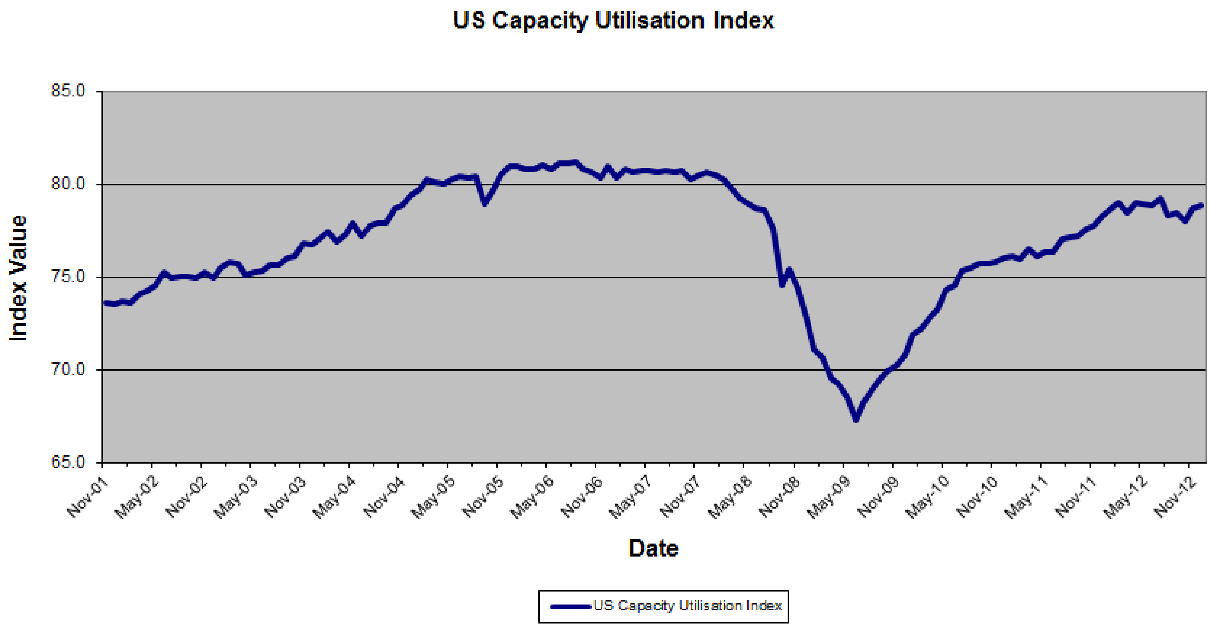
3y and 10y Australian Bond Rates (%)



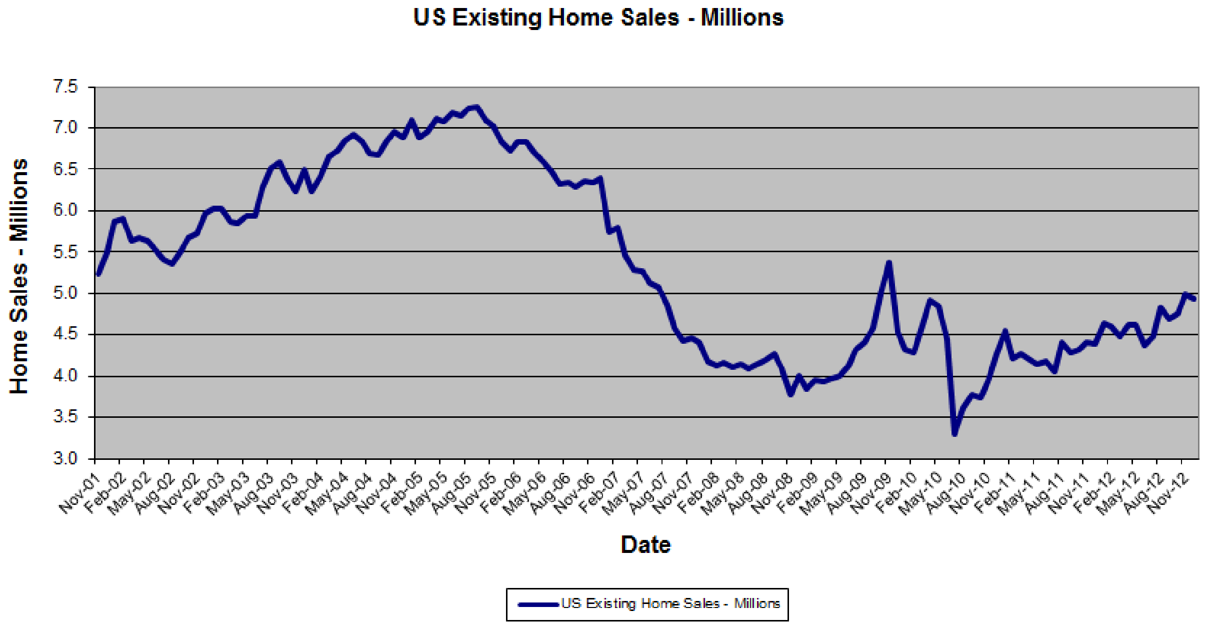

3y and 10y US Bond Rates (%)
Bond Rates (% pa)
Date
3 Year US Bond Rates (% pa)
10 Year US Bond Rates (% pa)

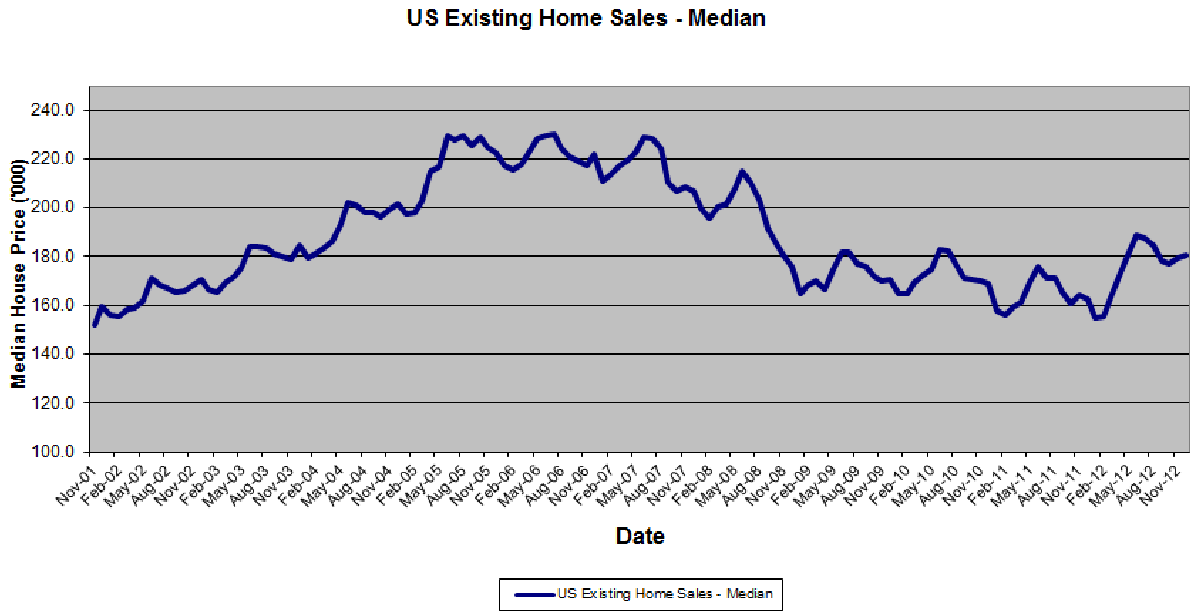

Australian Credit Default Swap Index – 5 Year
Index value
Date
Australian Credit Default Swap Index – 5 Year

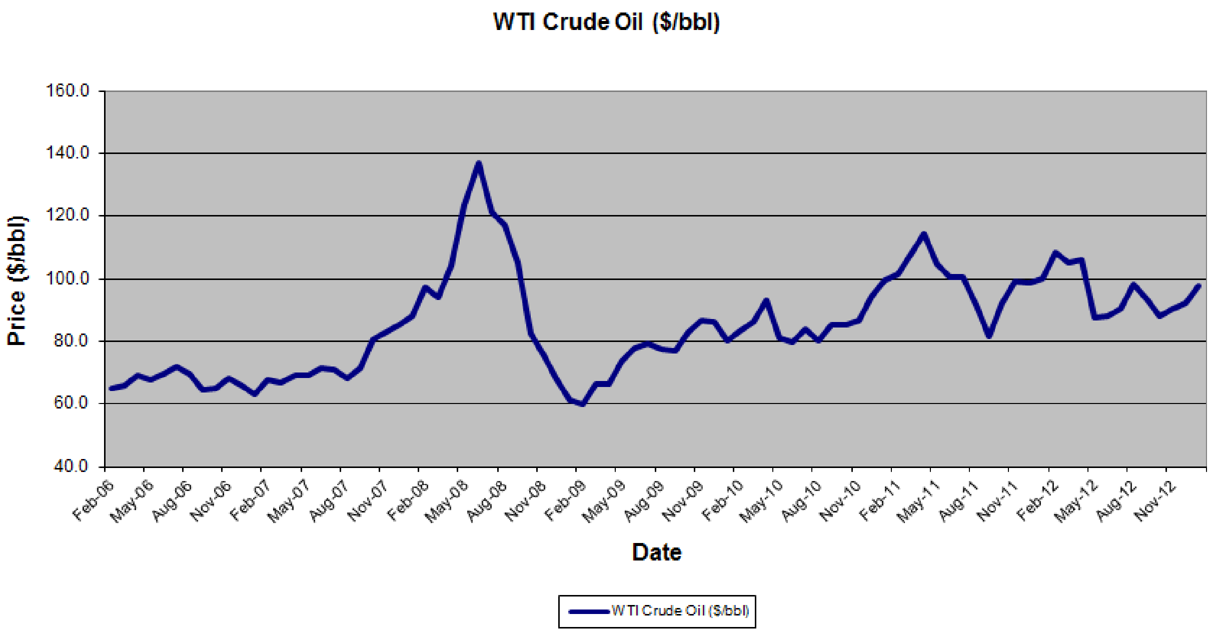

US Industrial Production Index
105.0
100.0
95.0
90.0
85.0
80.0
Index value
Aug-01
Feb-02
Aug-02
Feb-03
Aug-03
Feb-04
Aug-04
Feb-05
Aug-05
Feb-06
Aug-06
Feb-07
Aug-07
Feb-08
Aug-08
Feb-09
Aug-09
Feb-10
Aug-10
Feb-11
Aug-11
Feb-12
Aug-12
Date
US Industrial Production Index

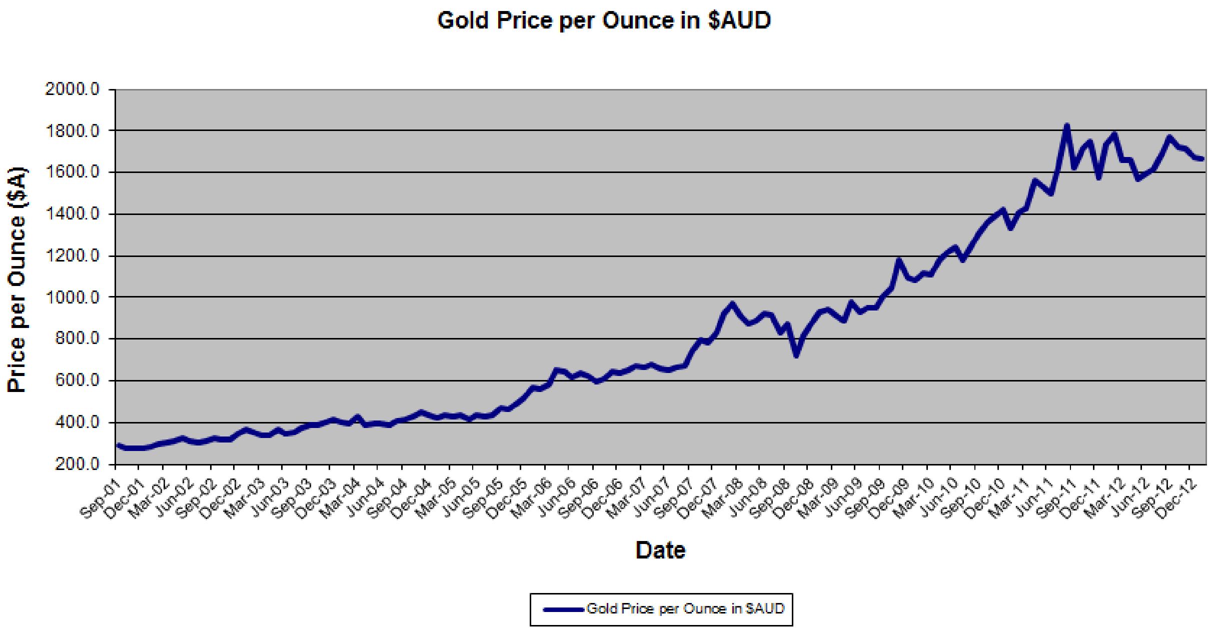

US Capacity Utilisation Index
85.0
80.0
75.0
70.0
65.0
Index Value
Nov-01
May-02
Nov-02
May-03
Nov-03
May-04
Nov-04
May-05
Nov-05
May-06
Nov-06
May-07
Nov-07
May-08
Nov-08
May-09
Nov-09
May-10
Nov-10
May-11
Nov-11
May-12
Nov-12
Date
US Capacity Utilisation Index

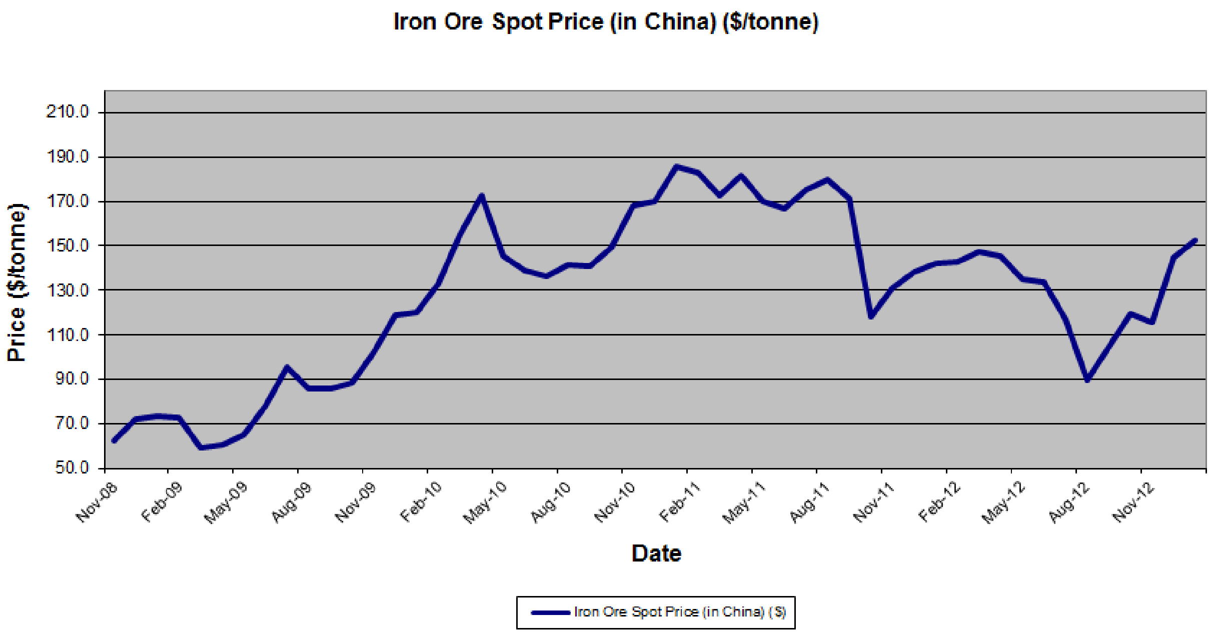

China Purchasing Managers Index (PMI)
Index Value
65.0
60.0
55.0
50.0
45.0
40.0
35.0
Feb-05
May-05
Aug-05
Nov-05
Feb-06
May-06
Aug-06
Nov-06
Feb-07
May-07
Aug-07
Nov-07
Feb-08
May-08
Aug-08
Nov-08
Feb-09
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
May-12
Aug-12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

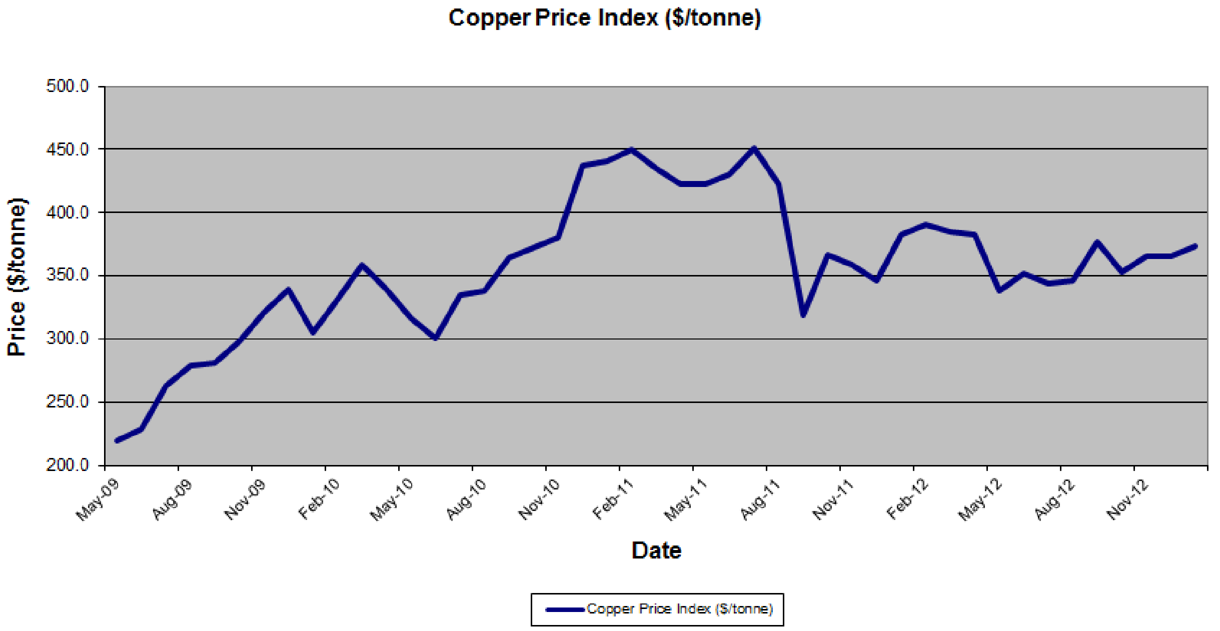

US Existing Home Sales - Millions
Home Sales - Millions
7.5
7.0
6.5
6.0
5.5
5.0
4.5
4.0
3.5
3.0
Date
US Existing Home Sales - Millions

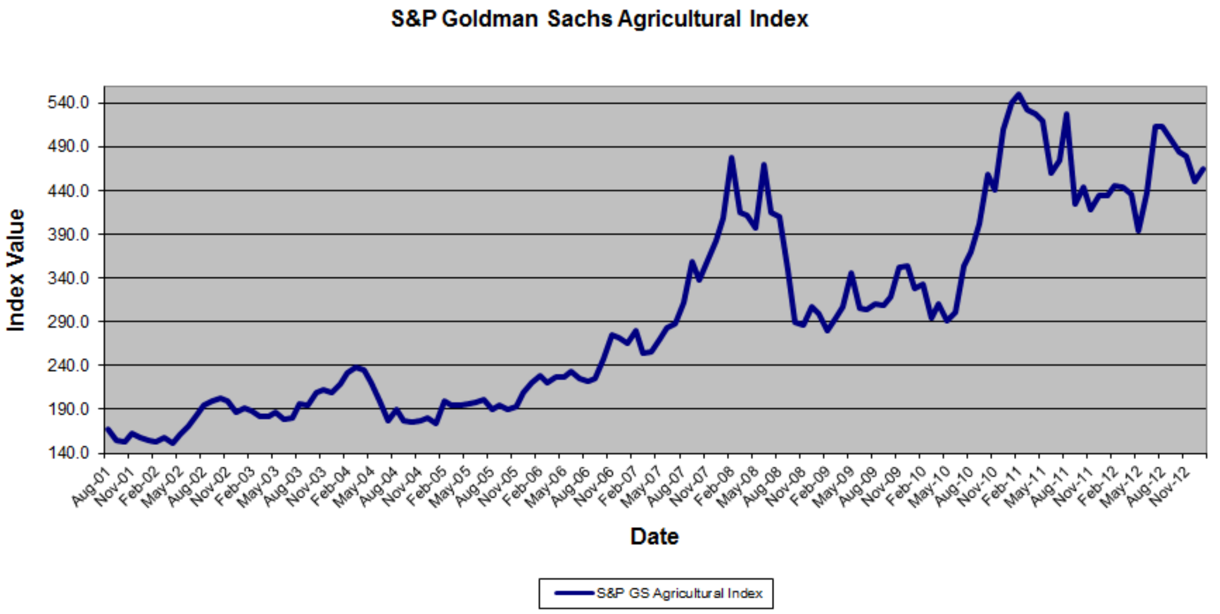

US Existing Home Sales - Median
Median House Price ('000)
240.0
220.0
200.0
180.0
160.0
140.0
120.0
100.0
Nov-01 Feb-02 May-02 Aug-02 Nov-02 Feb-03 May-03 Aug-03 Nov-03 Feb-04 May-04 Aug-04 Nov-04 Feb-05 May-05 Aug-05 Nov-05 Feb-06 May-06 Aug-06 Nov-06 Feb-07 May-07 Aug-07 Nov-07 Feb-08 May-08 Aug-08 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 May-12 Aug-12 Nov-12
Date
US Existing Home Sales - Median

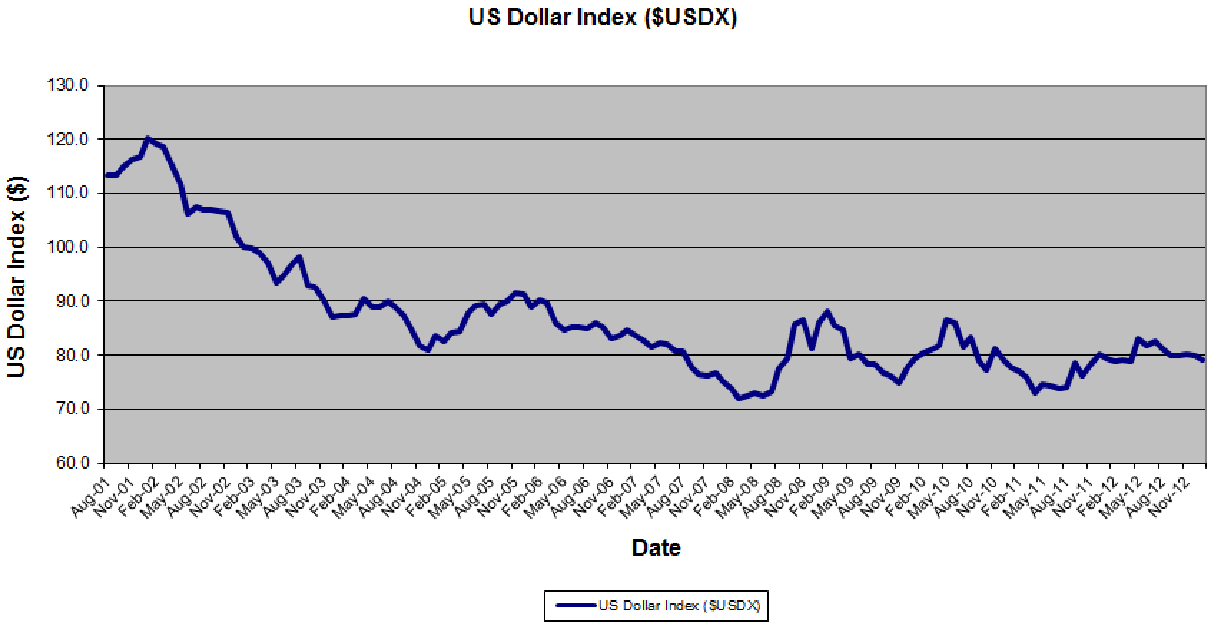

WTI Crude Oil ($/bbl)
Price ($/bbl)
160.0
140.0
120.0
100.0
80.0
60.0
40.0
Feb-06 May-06 Aug-06 Nov-06 Feb-07 May-07 Aug-07 Nov-07 Feb-08 May-08 Aug-08 Nov-08 Feb-09 May-09 Aug-09 Nov-09 Feb-10 May-10 Aug-10 Nov-10 Feb-11 May-11 Aug-11 Nov-11 Feb-12 May-12 Aug-12 Nov-12
Date
WTI Crude Oil ($/bbl)


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
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
May-12
Aug-12
Nov-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
May-12
Aug-12
Nov-12
Date
Copper Price Index ($/tonne)


S&P Goldman Sachs Agricultural Index
Index Value
540.0
490.0
440.0
390.0
340.0
290.0
240.0
190.0
140.0
Date
S&P GS Agricultural Index



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%).