

The Australian

Australian Expat Investment & Taxation News

A new month and issue of **The Australian** from Imperium Capital.

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Stock Market Update

It was a down financial year for the Australian stock market with the All Ordinaries Accumulation Index (XAOAI) falling by 6.8% for the year. And, as we are all too keenly aware, the last several weeks were pretty dreadful as a combination of European woes, concerns about slowing Chinese growth, and a late bout of tax selling – punctuated with an interest rate cut – conspired to make it one of the more miserable periods in recent stock market history. The bulls have grown stale and the bears enjoyed some growling success. The market did however keep that “invisible line of support” at 4000 where yield and value tend to kick in with solid buying support.

Despite the dismal mood we did not see any significant panic selling. Although with Greek exit woes and Spanish bond auctions, and US, UK and German bond yields at historic lows, share markets were sorely tempted.

It wasn't all bad. The composition of the All Ordinaries was noteworthy with yield related shares like Telstra and the property and infrastructure sector (GPT, AGL) going up in price along with offshore earners like NewsCorp and CSL rising strongly as well.

There is another handbrake on our own market and that is that international fund managers have given us a wide berth since the announcement of a Resource's Rent tax a couple of years ago. I suspect that this will not dissipate until the prospect of a change of Government in 2013 starts to loom.

The All Ordinaries is trading at a forward Price to Earnings ratio of just over 11 times. This is well below its long term average – but as we are aware there is a higher degree of risk than normal. A recent quote from a Macquarie manager sums it up. “The markets have turned into these macro-obsessed trained animals..... It doesn't really matter what valuations are doing” I did attend an interesting presentation by market

analyst Sayijat Das in Perth a few weeks ago. The meeting was hosted by Sean Russo of Noah's Rule (Helping companies live by Noah's Rule, "Predicting rain doesn't count; building Arks does.")

Das, who did predict the GFC, presented a pretty bleak outlook for global markets premised mainly on the huge levels of debt that are still being racked up at bond auctions around the globe. His main predictions: a continuation of the Euromess, don't rely on China to get us out of it ("it has all been built – using dodgy credit from the State controlled banking sector"), a global shortage of capital as banks firewall their balance sheets given the deterioration in credit quality etc. etc. You get the picture. It was a courageous speech to an audience of grizzled resource veterans in Western Australia and it begged the obvious question : How does one invest in this climate of long term, Japanese-style stagnation? I.e. What does an uber Bear's portfolio look like? The answer was interesting because it was not to keep cash under your bed. It was first a mixture of cash ,fixed interest, quality government and corporate bonds. He allowed for shares in higher yield companies along with tactical holdings in the energy and healthcare sectors. He also noted the prospect of "fat tails" – a trading expression for "non normal" runs and rallies in various sectors. And Gold, as an alternate store of value as paper currencies decline in relative value.

So there you have it: even Bears own shares as part of their overall strategic asset allocation and they are prepared to actively trade in certain rally situations. The key area to watch is whether his prediction of a strong Chinese slowdown is matched by reality.

Certainly many commentators have underestimated the infrastructure requirements of central and western China as the country attempts to balance its recent successes on the Eastern Seaboard. Watch China data closely over the next few months to see whether the market has over discounted the resources requirements here. Certainly some analysts are already pointing the recent strength of the Australian dollar as an important lead indicator for a recovery in our resources sector. And BHP and RIO -our two major diversified resources companies -have been bouncing after a major pullback over the last several months.

Our own view is that we see China recovering sharply over the next year.

In broad terms our House market commentator, Ian Huntley, can see a major low appearing over then next few months – but not much below the 4000 level. He sees resources stocks as being too heavily discounted and Australia's four major banks offering value and healthy fully franked yields.

In the short term, Goldman Sachs see the market continuing to consolidate for the next few months: "

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But what may well help the market to slowly meander its way out of the vortex of uncertainty and lead to a cautious move higher, could well be the upcoming August reporting season.... We are expecting a poor season and many share prices are already factoring this in so ...we could see a rise from August”.

My own view is that this is a classic “Accumulate and Diversify” market. Stick to the overall Strategic Asset Allocation plan and, with regard to the equities component, use these uncertain times to pick up and add to quality companies across all sectors. Why all sectors.? Well despite the fact that the resources sector has grabbed all the headlines with its contribution to Australia's healthy bottom line, this has not been reflected in the stock market. The sector has been the relative underperformer. And guess which sector has outperformed over the recent year? Property and Infrastructure.

Top picks in the current market?

- Banking: ANZ at 9 times forward earnings and 6.3% fully franked yield;
- Industrials: Primary Healthcare (PRY) – medical and related services;
- Property related: Lend Lease (LLC) has recently been added to a couple of conviction lists after its recent profit upgrade. My favourite way of accessing the core sector is still the State Street Listed Property Fund (SLF) which has a current sectoral yield of 5.88%;
- Small cap Top Buy: Maca Ltd (mining services);
- And “Diggers Buy”: Northern Star Resources Ltd (NST) for gold production increases, Resource upgrades and acquisition opportunities. Please let me know if you have any queries or would like to discuss opportunities in the market.

I will leave you with another classical quote for our times : “The Budget should be balanced, the treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered and controlled, and the assistance to foreign lands should be curtailed, lest Rome become bankrupt. People must again learn to work instead of living on public assistance” - from Cicero in 55BC.

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Currency View

Base Currency	AUD	GBP	EUR	JPY	SGD
AUD	-	Neutral : AUD has rallied off important lows but has peaked for at least the medium term	Bullish/Neutral : AUD is challenging all time highs & long term trend is still up so some limited upside possible	Neutral: AUD bounced off 2010 & 2011 lows suggesting downside is limited but no upward trend is evident	Neutral: AUD has recovered after testing 2011 lows but is likely to remain in the current 12 month range
GBP	Neutral : GBP has bottomed but UK fundamentals remain poor so upside will be limited	-	Bullish/Neutral : Weak upward trend remains in place so some further upside possible	Neutral: GBP has bounced off long term lows, downside risk is limited but big gains also unlikely	Bearish/Neutral: GBP still stable near record lows but GBP fundamentals remain poor & ultimately Asian ccy will be strong
EUR	Bearish/Neutral : Trend is still down & has fallen to all time lows, some limited downside possible	Bearish/Neutral : Euro trend is down but weak, further falls possible	-	Bearish/Neutral : Euro testing lows again & trend is down but a big fall against JPY is unlikely	Bearish : Euro trading at new lows & more downside possible
SGD	Neutral : SGD has bottomed against AUD for now & a further period of ranging likely	Bullish/Neutral : Holding near '11 highs & has scope to break above that level as UK fundamentals are poor	Bullish : New highs suggest SGD is still in an upward trend & has more upside scope	Neutral : SGD remains in a broad range that has lasted 3 1/2 yrs	-

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