



Investment Market Update

Issue 35 - Winter 2009



Welcome...

In this 35th edition of CIPL's Investment Market Update. We focus on the increasingly evident economic recovery, and weigh the positives against the negatives.

In our view we are in a period of uncertainty while the masses look for "proof" that the worst is over. Unfortunately "proof" is not available – just careful analysis of the facts.

CIPL finalised the acquisition of Griffin Financial Services in Tamworth and we wholeheartedly welcome Tamworth clients to the fold. CIPL also relaunched its life insurance brokerage, and we are offering discounted rates for CIPL clients and their extended families.

We hope you enjoy the newsletter. If you have any comments or suggestions we would be happy to hear them.

Regards

David French

Managing Director

Senior Investment Advisor







GREEN SHOOTS...

Signs abound that the worst may have passed

As we enter into the new financial year, we detect a growing note of optimism among financial commentators – an emerging consensus that perhaps the stock market and the free-fall in global growth bottomed in early 2009.

The most visible sign of this optimism is the recent performance of stock markets around the world, as investors rediscovered their appetites for risk and began moving from defensive investments into more risky asset classes.

The table below shows the performance of a number of key global markets over the past 12 months:

		Yearly Change %
Dow Jones		-24.9
FTSE		-23.7
Shanghai		8.7
ASX 200		-24.2
Bombay Sensex		9.7
Nikkei		-26.1

There has, however, been a significant improvement since March:

		% Change since 1 March 2009
Dow Jones		19.60
FTSE		10.90
Shanghai		42.10
ASX 200		19.38
Bombay Sensex		63.00
Nikkei		31.50

The much-discussed 'green shoots' are actually a number of varied and diverse economic and business indicators.

VIX : When volatility goes wild

One of the more widely followed indicators is the Chicago Board Options Exchange Volatility Index (or VIX). The VIX is commonly used as a proxy for the risk tolerance within the US financial markets – in times of crisis or financial stress, the VIX increases in value, decreasing when times are good and there is less concern about the financial system (you can think of the VIX as a *fear* index).

The index peaked at a record high in the second half of 2008 as investment banks and global organisations began toppling like dominoes. More recently however, the VIX has returned to more normal (if slightly higher) levels, signifying renewed investor confidence in the economic recovery.

The chart below shows the unprecedented jump in the VIX last year, and the corresponding decline to near-normal levels.



(source: CBOE)

The US Housing Market

As the financial crisis started with the US property market, another closely watched index is the US Pending Home Sales Index.

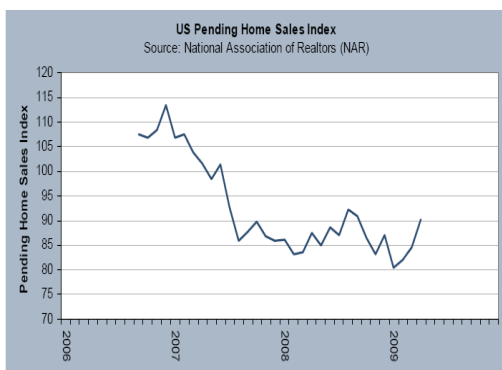


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Incorporating Griffin Financial Services

Some commentators believe that we're unlikely to see real improvement in the global economy until the US housing market has stabilised. Notwithstanding that and while not conclusive, the Pending Home Sales Index does show an upward trend, which may reflect increased homebuyer confidence.

An improvement in the housing market can be expected to have a positive impact on spending by US consumers, who have been responsible for driving much of US GDP growth in recent years.

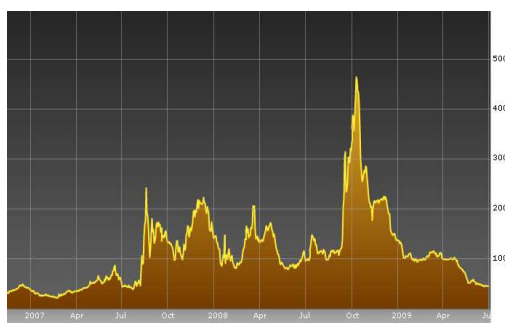


(source: Shaw Stockbroking)

The TED Spread

The TED spread is simply the difference between interest rates on interbank loans and short-term US government debt (T-Bills, which are considered to be the safest asset on earth).

Similar to the VIX, when there is concern about the state of the financial system, specifically the risk of default on loans, the TED spread will increase (i.e. you have to pay a much higher interest rate to borrow as compared to the rate offered by US government T-Bills).



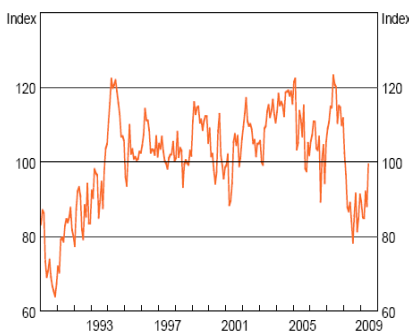
(source: Bloomberg)

The chart shows the unprecedented blowout in the TED spread as fear for the global financial system reached a peak in late 2008. Importantly however, credit spreads have returned to pre-crisis levels, which is a positive development for global credit markets.

Consumer Confidence

A closely watched Australian indicator is the Consumer Confidence Index, jointly developed by Westpac Bank and The Melbourne Institute.

After falling to a level not seen since the early 1990's, the index has recovered somewhat to be just below the long term average. The usefulness of the index as a leading indicator is debatable however – look at the confidence of consumers in late 2007, immediately prior to the global economic crisis!



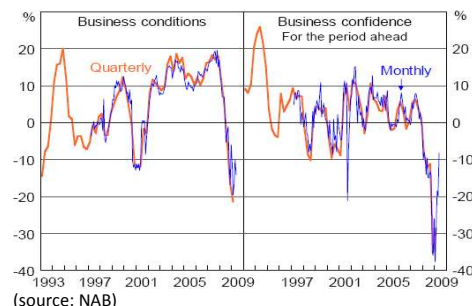
(source: Westpac, Melbourne Institute)

Nonetheless, an improvement in consumer confidence does have important implications for the economy in general – confident consumers are more likely to spend more, eat out more regularly, go on holidays, renovate their homes, borrow to invest or to build and a myriad of other individual activities which are collectively responsible for driving economic growth.

Business Confidence

In a similar vein, National Australia Bank publishes a monthly business survey, the highlight of which is the measurement of the change in business confidence and conditions.

The survey attempts to provide an indication of future conditions, asking business managers for their assessment of likely business conditions for the month and quarter ahead.



The 'take-home' message from the business confidence survey is that, while conditions are bad and many businesses are currently struggling, there is an expectation that the economy is improving and conditions are expected to ease as we move through 2009.

...OR JUST WEEDS?

Not everybody is convinced we're out of the woods just yet

For every financial analyst or commentator who believes that good times are ahead, it is easy to find another who disagrees.

As with most things, the truth probably lies somewhere between the two opposing viewpoints – while we may have seen the worst, it will still take some time for the global economy to work through the shocks of the past two years.

A worrying development, particularly for export-focused economies, is the rapid reversal of the American consumer from big-spender to miserly saver.

The perfectly normal response of the average American, faced with a slumping economy and increasing unemployment, has been to tighten the belt, cut back on spending, and reduce debt.





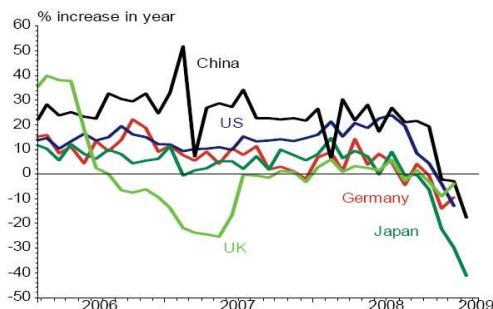
While this may be good news at an individual level, it is bad news for the global economy, as the American consumer has been a driving force behind much of the global growth in the past decade – essentially Americans used the wealth tied up in their homes to fund an astonishing spending spree, buying as many fridges, cars, TV's, computers, mobile phones and other items as China, and other exporting nations could produce.

Australia was an indirect beneficiary of this spending spree, as China demanded increasing amounts of raw materials to build the factories and infrastructure needed to meet the demands of the American consumer.

However, as the US consumer saves more and spends less, there will be less demand for the goods produced in factories across China and other Asian exporting nations in particular, leading to less demand for the raw materials which Australia provides.

This is evident in recent Japanese trade figures, which can only be described as having completely collapsed. It is also apparent to a lesser extent in other major trading nations.

The chart below shows the percentage increase of export volumes among key nations, illustrating the slowdown of global trade. (source: Lloyds TSB)



The conclusion to be drawn is that while there have been improvements in some key indicators, and a minor recovery in stock markets, there are still challenges ahead. Importantly however, progress has been made in stabilising the financial system and a total systemic collapse has been averted.

The second half of 2009 may not see the end of this crisis, but it will be better than what we have already experienced.

2009/10 FEDERAL BUDGET CHANGES

More tinkering with the system

Never a believer in the old saying "if it ain't broke, don't fix it", the Federal Government outlined a number of changes to the superannuation system in its recent budget.

While the changes were not as wide-reaching as were expected (the forthcoming Tax Review may bring the real surprises), there were still one or two important changes to the legislation.

The most significant of these was a reduction in the annual superannuation concessional contributions cap from \$50,000 to \$25,000 (and from \$100,000 to \$50,000 for those aged over 50 until 2012). It appears that the government is concerned that the concessional contributions allowance has been exploited in order to avoid or lower income tax payable.

The government is guilty of sending out mixed messages here: they want to encourage the greater use of superannuation as a means of relieving the burden on the Age Pension, but they don't want you putting too much into superannuation in a manner which lowers tax revenue.

The government has also reduced the maximum amount payable as a co-contribution based on an individual's

non-concessional (after-tax) contribution to superannuation.

Previously, individuals who made a non-concessional contribution to superannuation and who earned less than \$30,342 would qualify for a government co-contribution of up to \$1,500. This has now been reduced to \$1,000 for a temporary period, ending 2013/14.

The Age Pension was increased for both singles and couples, being a weekly increase of \$30.00 and \$10.14 respectively.

Offsetting this was a surprise announcement that the Age Pension age would be increased – anyone born after 1 January 1957 will not be eligible for the Age Pension until they reach age 67.

People born between 1 July 1952 and 1 January 1957 will also have to wait longer, the eligibility age increasing from age 65 to 67 depending on the exact year of birth.

As mentioned, the Tax Review which was announced in May is likely to have an impact on retirement planning, spending and other financial matters. The final report is due to be presented in December 2009.

THE BUSINESS

Beef Capital to Country Music Capital

Many of you will be aware that CIPL has been working to find a suitable acquisition for several years. We are pleased to announce that effective 30 April, Griffin Financial Services in Tamworth became part of CIPL. We would like to formally welcome all Tamworth clients to the fold.

People ask why it's necessary to get bigger. It's true that financial planning is a personal business, and relationships and trust are what really matters. But those relationships and that trust are

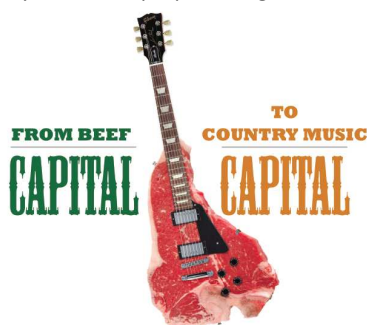


based on us being able to fulfil our commitments to you. The resources necessary to do that are expensive. By getting bigger, we spread the cost over more clients. That is especially important in such bad markets as experienced recently.

With the acquisition, we obtained three excellent administrative staff, and the services of Ray Griffin – a noted financial planner and financial commentator.

Please don't be disturbed if you get calls from staff in one or the other of the offices – we are sharing jobs round to take advantage of the increased expertise that we now have in the group.

Do you like our proposed logo?*



*just kidding!

Life goes Live

CIPL has decided to breathe some new Life into the business. Jason Fagg has been appointed as our new Personal Risk Advisor, Jason's role is to assist our existing CIPL clients in offering the best available cover through our suite of 6 Risk Insurance companies. The opportunity doesn't end there – all CIPL clients and their extended families are being offered a 10% discount ongoing on any new Risk Insurance business introduced to CIPL.

Given the rise in household debt and the fall in asset values, the lack of insurance savings is creating an increasingly vulnerable society where, should the unthinkable happen, most Australians don't have enough money to fulfil their financial commitments. With this scenario in mind most people would have

to turn to government welfare, they may have to sell assets in a depressed market, or worst still rely on family.

Interestingly, for every home that is destroyed by fire, there are 4 homes forced to be sold through death and 48 homes forced to be sold through disablement.

Most people would say their biggest asset is their home. Actually it's the ability to earn an income. In saying this 83% of people can say they have adequate insurance for their own home, however only 31% can say that they have insurance that protects their ability to earn an income.

I encourage all CIPL clients to come in and see us with regards to their life insurance, as we mentioned we are offering a 10% across the board discount on any new life insurance business that is introduced to CIPL. We'll shout Jason a jumper and send him to Tamworth on demand.

It is our goal to ensure that more people have financial security in these difficult times so if the worst happens, they can focus on their treatment and recovery, not having to pay the bills.

PORTFOLIO STRATEGY

Opportunities and maintenance

We continue to work through client portfolios, making recommendations for new investments, and pruning some investments that we do not feel will live up to expectation.

We are almost at the end of the list in this round, and will be working with Ray to undertake fresh reviews of Tamworth Portfolios.

The aim of the recommendations is to increase portfolio income and better position the portfolios for recovery. Buying assets at depressed prices will

mean a greater boost to asset values as markets recover.

We are also planning to undertake some formal research visits over the next few months to identify opportunities and to help prevent problems.

In addition to that we have been busy updating Centrelink information to extract maximum value for clients, and rearranging superannuation affairs to gain additional tax advantages.

Our outlook is for a gradually improving investment outlook, and with that in mind we believe that the RBA will not further reduce interest rates. More likely we are at the bottom of the interest rate cycle, and for that reason, recommend locking in rates for at least 3 years.

INVESTMENT BRIEFS

Here are some trading ideas for non-portfolio clients:

Metcash Limited (MTS)

Formerly Metcash Trading, the company is a marketing and distribution operation in the food and fast moving consumer goods industries.

It has emerged as a strong third force in the grocery market and has strong financials. Full year 09 revenue rose 9.3 per cent to \$10.97B and profit before significant items rose 13.8 per cent to \$219.7M.

Given reasonable economic conditions, earnings per share could grow 7 – 10 per cent in the full year 2010. Independent grocers serviced by MTS continue to hold their own against the competition and MTS management has consistently demonstrated its ability to maintain relevance in a market dominated by Woolworths and Coles.

The shares have a high forecast yield of 5.6 per cent fully franked and a target price of \$5.10. The current market price is \$4.25.



Toll Holdings Limited (TOL)

The company is an integrated logistics provider in the SE Asian region and operates an extensive transportation network throughout Australia, New Zealand and Asia.

It reported 30 per cent revenue growth for the first half 09 and is forecast to achieve a 20 per cent growth level for the full year 09, recognising current economic conditions. The company has the ability to generate strong cash flows and is well capitalised with a gearing level of only 20 per cent.

The full benefits of several acquisitions managed in the past 18 months have yet to be brought to account. With a market price of \$6.00 and a target of \$8.50, some good capital gains are in prospect.

Transfield Services Limited (TSE)

TSE is an international provider of operations, maintenance, asset management and project management services. Areas of operation are Australia, New Zealand, US and Asia. Recent reports from the company have been mixed:

- * The loss of the Melbourne Tram contract.
- * The renewal of the Chorus NZ contract.
- * The proposal to sell-down its wind-farm portfolio.
- * The strong foothold established in the Middle East.
- * The sizeable workflow coming from the Commonwealth Public Housing and Schools projects
- * An oil price recovery having a significant effect on revenues from oil and gas projects.

Despite these generally positive influences, there is some uncertainty about near-term earnings and price weakness has resulted. Regardless, TSE trades at a discount to its peers and has an attractive PE of 6.8X.

A high proportion of earnings are recurring in nature and it has low contracting risk. It is expected that its exposure to the global oil and gas industry will be a major catalyst to

earnings growth. The stock is being recommended as a buy at \$2.25.

Westpac Banking Corporation Limited (WBC)

WBC is Australia's oldest bank operating a significant banking franchise in Australia and New Zealand. It has an excellent, proven management team which has led the group through the financial crisis successfully.

The capital structure of the company is robust and conservative with a tier 1 capital adequacy of 8.4 per cent, well above regulatory requirements. The company has benefited from increased market power as foreign banking competition has withdrawn.

It has 100 per cent of its asset base exposed to the Australian and NZ economies and shares a strong market structure within those economies. It has substantial leverage to an improving world economy.

The forecast yield of 6.1 per cent is fully franked (8.7 per cent grossed-up) and is highly competitive. The target price is \$20.40.

Arrow Energy Limited (AOE)

Arrow Energy is an emerging global participant in coal seam gas development with an expanding presence in Australia, China, India, Vietnam and Indonesia.

It recently announced an alliance with Royal Dutch Shell whereby \$776M is to be appropriated for the advancement of its coal seam gas to liquified natural gas strategy. AOE is an integrated energy company involved in power generation, gas sales and exploration into areas which are close to key domestic markets.

For the quarter ended March 09, gas production was up by 17.30 per cent and electricity sales were up by 56 per cent. Other announcements of importance at that time were:

- * Gas production from the Surat Basin continued to ramp-up.

* A potential major gas resource was flagged in the Fort Cooper area of the Bowen Basin.

* The commissioning of the new 450MW Braemar No.2 power station is scheduled for Dec 09 and will add significantly to electricity sales.

At \$3.50, the stock is trading at an 8.70 per cent premium to the target of \$3.22, but it continues to deliver and surprise on the upside.

You are advised to seek advice regarding your particular situation before acting on anything contained herein.



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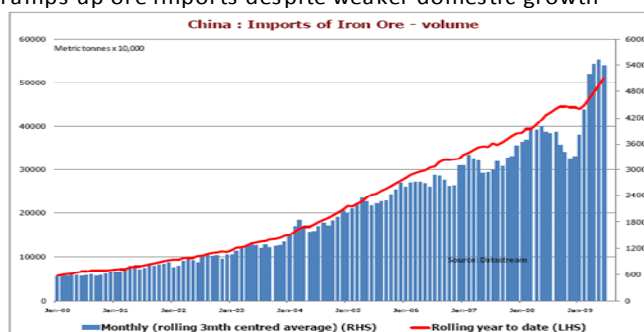
CHART PACK

Information at a glance (sources: RBA, Evans & Partners)

Consumer Prices - a slowing economy shows up in the prices we pay for fuel, food and other consumables



Chinese Iron Ore imports - rumours of stockpiling as China ramps up ore imports despite weaker domestic growth



Chinese Electricity Production - growth in electricity output falls as factories sit idle



Exchange Rates - parity with the US\$ is again a possibility as the AUD recovers from its lows in late 2008

