The Rock
INVESTMENT PLANNING LIMITED

Investment Market Update No. 2

31 August 2003

Editorial

Welcome to our August investment market update. Thank you for the feedback on our first edition and we trust you will enjoy this one just as much. We also welcome our new readers.

In this issue we cover:

1. Office news;
2. The media and investments;
3. Insurance;
4. Early conversion of preference shares; and
5. Results from the Australian reporting season.

We welcome your feedback and comments. If you would prefer to receive future versions by e-mail, please contact Corrine by e-mailing **corrine@therock.com.au**.

David French
Head of Financial Planning & Business Solutions

We're Expanding!

Following from last month's update on the growth of The Rock Investment Planning, which is testimony to our fee for service philosophy and the quality of the work we perform, we are expanding. We have recently opened an office in Melbourne, will be opening an office in Cairns within the next two weeks, and have appointed a new planner to our Rockhampton office.

Following is an up-to-date list of our staff and their positions.

David French	Head of Financial Planning
Corrine Gyuris	Office Manager
Sue Matthews	Administration Assistant /Receptionist
Carmen Blanch	Portfolio Administrator
Meri Drake	Senior Investment Advisor
Zac Sorensen	Investment Advisor
Bryan Moss	Investment Advisor
Bob Stewart	Senior Investment Advisor (Equities)
Les Wigginton	Insurance Advisor
Angus Robertson	Senior Investment Advisor (Melbourne)
Sean Ryan	Senior Investment Advisor (Cairns)

Although you will normally have contact with one advisor, several individuals will be involved in looking after your affairs. That means whenever you pop in or call, someone will be able to assist with your enquiry.

The Block and Financial Planning

Roughly 53 per cent of Australians tuned into the final episode of The Block on Sunday night (17/8/03). There are a lot of fingers in this pie. Lets look at how the show affected the various participants:

- The contestants - two sets of couples have established home renovation businesses, after many years of trying, one has secured a recording contract with a major company, and now the contestants are appearing in TV commercials for the show's sponsors;
- The ATO - National Tax and Accountants' Association president Ray Regan said that anyone who made regular appearances in television programs, either as an artist or contestant, was liable to pay tax on their prizes (source: The Age, 11/8/03). There is a need for professional financial advice here;
- The building and home renovation industry – given the original state of the apartments, the $40,000 renovation budget and the sale price, this show may help extend the already overheating property market;
- The Nine network – with plans for a second series, record ratings (leading to increased advertising rates) and plans to sell the concept overseas (Fox paid $8m for the US rights to the show) they are onto a winner; and
- The sponsors – with all of the publicity they received during the show, I'm sure they think it was money well spent.

Investment Implications

The plethora of property related television shows is symptomatic of a peaking of the property market. Very low interest rates, the home owners/builders grant and a weak share market has increased demand for housing, and led to very large increases in the price of housing. At the same time we observe increasing vacancy rates for rental properties, and reduced home affordability. The two views of life cannot exist together – either property prices must fall, or incomes must rise. The latter does not appear likely, so we anticipate that falling rents in capital cities will attract people back to renting, resulting in a fall in property prices. Despite the press, the property market is like any other market – it follows its own cycle. When TV commentators, taxi drivers and dinner party guests all become experts in property or shares, you know a price fall is on the cards.

Inflation

The RBA has recently initiated a subtle shift in their policy. Previously the focus of the RBA was to limit price inflation to between 2 and 3 per cent per year. Now they are looking to target asset price inflation too (which includes house prices).

Lingering concerns about the state of the US economy would normally result in the RBA lowering interest rates to stimulate demand in the economy. Their recent action, or rather inaction, has kept interest rates higher than they would have otherwise been. Although low by historical standards, they are high by current international standards.

The expectation is that by keeping interest rates slightly higher than international circumstances dictate, the RBA can slow the growth of property prices and therefore reduce the impact of the eventual property crash (source: The AFR, 20/8/03).

Only time will tell whether the second series of The Block will deliver similarly strong returns to stakeholders if the heat has been taken out of the property market with higher interest rates.

Shareholders

Although not apparent at first glance, other winners from the property boom are shareholders. Boral and OneSteel, two of the major suppliers of materials to the building industry reported a 47 per cent increase in net profit and a doubling of earnings, respectively, for the financial year ending June 30, 2003 (source: The AFR, 20/8/03).

Interestingly, both companies also commented that they noticed a slowdown in the housing sector during the June quarter. If it wasn't for the success of The Block a logical conclusion to draw from these comments would have been that the boom may be coming to an end.

Finding Nemo?

In keeping with the unintended theme of this newsletter, being the impact of media on investments, Sydney Aquarium is expecting to reap the benefits from the new Disney animated film Finding Nemo.

The Aquarium expects the Rugby World Cup and Finding Nemo to bring an additional 20,000 visitors to the center this year. The Aquarium has already redeveloped its foyer in a Nemo fashion and has a six-meter shark from the movie on its roof (source: The AFR, 20/8/03). Given Finding Nemo is already the 10th largest grossing movie in the US, and is expected to do extremely well when it's released in Australia, this novel strategy seems well-placed.

Insurance

Somewhat unsurprisingly, cancer is the number one cause of trauma/critical illness claims in Australia. What is surprising however is that although cancer represents 39 per cent of claims for males, it represents 74 per cent of claims for females (source: NSW Cancer Council Fact Sheet – NSW Cancer Incidence and Mortality – 1999).

As the saying goes, the devil is in the detail, and this is especially true of insurance policies. Many people mistakenly believe that the cheapest policy is the best. Unfortunately that is not always the case. Reading and understanding the policy document and knowing under which conditions a benefit will be paid is far more important than cost.

Nothing would be worse than paying insurance premiums only to find out that the illness you've been diagnosed with is not covered under the terms of your policy.

When considering insurance, be sure to get your insurance adviser to fully explain the cover to you. If they can't answer a question about when a benefit will be paid, maybe a sale, rather than your financial security, is more important to them.

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Early Conversion of Preference Shares

Macquarie Bank recently announced the conversion of its preference shares to ordinary shares. We will be contacting clients who hold this asset regarding substitute investments.

Early conversion is one of the factors that needs to be considered when purchasing hybrid investments. This is one of the reasons we prefer to swap investments in financial plans, rather than paying too much for the investment originally recommended.

Opportunities sometimes exist to buy reset preference shares at below face value. In this case early conversion will result in a higher than forecast return. As an example, AMP reset preference shares were until recently trading well below face value. This will result in a higher than expected return if AMP chooses to convert their preference shares early.

Results from the Australian Reporting Season

The majority of results from the current reporting season have been positive, and this contributed to the Australian share market closing at a new 12 month high on August 19, 2003. Positive surprises have outweighed negative surprises 3 to 1 (UBS Investment Research, 20/8/03).

Commonwealth Bank

CBA delivered a net profit after tax of $2,539m, which is 3.2 per cent up on the previous financial year. Earnings per share increased by 3 per cent and the dividend for the year is $1.54 per share. Although a strong overall result, the underlying performance was a mixed bag:

- Banking profit up 8.8 per cent;
- Life assurance profit up 85 per cent; but
- Wealth management profit down 44 per cent.

The profitability of wealth management is tied to the performance of share markets. A recovery in shares is likely to see funds flow into the suite of CBA/Colonial managed funds leading to increased revenue. Colonial's master trust, First Choice, was the standout performer for the wealth management division.

The year saw expanding interest margins and strong growth in fee collections, while growth in operating expenditure was held at 5.4 per cent. Bad debt charges were much lower due to strong asset quality.

Consensus valuation is around $33, while target price is $35. A restructuring plan is being undertaken that should deliver $165m in annual benefits - $40m in revenue and $125m in cost savings. The restructuring is centered on increasing competitiveness and delivering efficiency gains.

Qantas

QAN again proved its strength by posting a net profit after tax of $485.4m (compared to $434.2m for the previous year). This was an excellent result given what the airline industry has endured of late – the lingering effects from the September 11 terrorist attacks, the Bali bombings, the war in Iraq, and more recently SARS.

Stronger revenues, lower selling and marketing costs and a successful fuel hedging management program all contributed to the result.

Qantaslink and Australian Airlines performed in line with expectations as did Catering, Holidays and Defence.

QAN has announced a $1bn 'Sustainable Future' program that is focused on cost recovery and segmenting its business units. Segmentation is seen as the key to maintaining domestic market share against Virgin.

After losing substantial value over the past twelve months the share price should improve (subject to international forces). The target share price is $3.70.

The Rock Building Society Limited

The Rock announced an 8 per cent fall in net profit after tax and an increased dividend of 0.5 cents per share (taking the dividend for the year to 18.5 cents). Home loan churning was the main driver for the fall in profits. The investment planning and insurance broking divisions are growing rapidly and will mature to profits over the next few years. This will form a strong revenue stream for The Rock, resulting in a more diversified and robust business.

The views expressed herein may not reflect the views of The Rock. You are advised to seek advice regarding your particular situation before acting on anything contained herein.