Investment Market Update No. 8

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Editorial

The Australian reporting season is coming to an end and this was one of the better one's in recent times. Corporate governance appears to be the big issue going forward and a number of companies are already struggling with this.

In this issue we cover:

1. Superannuation policy statements;
2. Changes at The Rock;
3. US fiscal policy; and
4. Investment briefs.

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Superannuation policy announcements

Recently both the coalition and ALP have released long-awaited statements on how they are going to reform the superannuation system.

The two biggest changes announced by the coalition are the introduction of growth complying pensions/annuities and the reduction from 100 per cent to 50 per cent in the assets test exempt status of complying pensions. The growth pension initiative is positive, as annuitants will be able to invest in shares and property, which may increase the length of time their annuity will last.

The asset test exempt status of complying pensions is going to fall from 100 per cent to 50 per cent. Currently you can invest $100,000 in an assets test annuity with the full amount being exempt from the assets test. Under the proposed rules, if $100,000 is invested in a complying pension only $50,000 will be assets test exempt. The remaining $50,000 will still be classed an asset. These changes are scheduled to be introduced from September 2004.

The main focus for the ALP is the '65 at 65' pitch. The aim is for retirees to receive 65 per cent of their wage at 65 and beyond. While admirable, it is reminiscent of the 'no Australian child will be living in poverty by 1990' policy under Hawke/Keating. To help achieve the 65 at 65 aim the ALP intends to reduce the contributions tax that applies to employer, self-employed (deductible) and salary sacrificed superannuation contributions from 15 per cent to 13 per cent over four years.

Unfortunately neither of the superannuation policy statements announced are of sufficient quality to warrant our endorsement.

Changes at The Rock

Mike Laffoley has recently resigned from his position as Managing Director of The Rock. His decision was for personal reasons and not due to any concerns about the financial stability of The Rock. The balance sheet remains strong and robust and all departments, including Investment Planning, are performing well.

The board of The Rock are in the process of searching for Mike's replacement and we will provide an update in a future edition once a replacement has been appointed. We wish Mike all the best in his future endeavours.

US fiscal policy

In a recent presentation by an Economist from a fund manager, the point was made that the US economy is growing and evidence of this is the increases in consumer spending. It was stated that part of the fuel for the spending increases has been from the stimulus provided by the latest round of personal income tax cuts (*source: BT Adviser Forum, 18/3/04*). Little mention was made of the potential impact on economic growth (both now and in the future) from the large increases in government spending.

At the moment the US government has a somewhat interesting fiscal position. On the one hand they are reducing their income through the introduction of tax cuts, but on the other, they are funding larger amounts of spending (through higher levels of borrowing) on their reduced income. Funding the budget deficit now represents 80 per cent of the total receipts from Federal income taxes (*source:http://news.bbc.co.uk/2/hi/business/3430565.stm#top*). This would be akin to a consumer spending 80 per cent of their wages on debt repayment leaving 20 per cent for living expenses like food.

Although the Bush administration argues the budget deficit is not a problem, the International Monetary Fund disagrees. To finance their spending the government must do what other people do, borrow. Most often the borrowings are from overseas.

The IMF estimates that within a few years the United States' net financial obligations (the amount they owe versus the amount owed it) to the rest of the world could be equal to 40 percent of its total economy (source:http://www.nytimes.com/2004/01/08/business/08FUND.html?ex=1080104400&en=2b2d3af61632dfa7&ei=5070). The danger here is that the large borrowings could push up global interest rates while having a negative impact on world economic growth.

The Bush administration has called the IMF report alarmist and pointed to their plans to halve the deficit over the next five years. At this stage it appears Americans have not drawn the conclusion about how this will be achieved - through higher taxes and/or reduced government spending. It is doubtful whether the Bush administration will be encouraging people to draw this conclusion in this, an election year. The Bush campaign is unlikely to be focused on economic issues.

Investment briefs

Telstra (**TLS**): Recently acquired The Trading Post for $636 million (approximately $136 million more than Fairfax were willing to pay). TLS are facing an ACCC investigation for offering its customers broadband internet prices at a lower cost than they are charging its competitors for access to the network. Ziggy and the board are facing renewed criticism and will have to do some work to convince the market of the management abilities.

National Australia Bank (**NAB**): As expected, the traders responsible for the $360 million foreign exchange losses have been sacked. The new boss is looking to change the culture at NAB to encourage both bad news and good news being passed up the chain. Leaked reports of boardroom discussions are a further embarrassment and can add additional worries for a company in the news (other recent examples include Coles Myer, AMP and NRMA).

Cochlear (**COH**): Are facing an investigation by the US Department of Justice. Following the announcement of the investigation, $180 million was wiped from the value of the company (this is about 2 ½ times more than the revenue they receive from the US government). These investigations can take years to resolve and often result in large cash settlements. We expect continued uncertainty to surround COH until either the issues are resolved or more information comes to hand.

Alinta (**ALN**): Have acquired the Australian assets of Duke Energy. The ensuing rights issue, which allowed investors to purchase the stock at $5.50, will hold the share price down for a while. The acquisition should be positive for ALN over the long run.

Promina (**PMN**): Have announced a $300 million issue of floating rate reset preference shares. Maximum yield of 7.15 per cent with no embedded call. This issue looks expensive.

Just Group: Better known as Just Jeans, but also part of the stable is Portmans, Jay Jays and Jacqui E. Looking to raise approximately $590 million from listing on the stock exchange (for the second time).

Qantas (**QAN**): Speculation that QAN is looking to expand into Asia with a low-cost airline. Likely target appears to be Malaysia's AirAsia. Locally, there has been some business backlash to the proposed flight scheduling of Jetstar's Rockhampton – Brisbane service. Business pressure in Tasmania forced Jetstar to offer more appropriate flight times and it will be interesting to see if the same happens here as the issues appear to be identical (first flight out is too late and last flight back is too early).

Parmalat: Have announced their intention to retain its Australian operations. While bad for the likes of National Foods who were keen to purchase the Pauls brand, it is a sign that the Australian operations are strong.

David Jones (**DJS**): Net profit after-tax increased by around 36 per cent. The dividend increased by 2cents to 5 cents per share and the company announced that in future the dividend payout would be a minimum of 75 per cent of net profit after tax, up from a minimum of 60 per cent. This was a better than expected result.

Sydney Aquarium (**SAQ**): Dividend unchanged at 13 cents per share. Although revenue was up 8.2 per cent compared to the previous period, net profit fell by 0.9 per cent. Visitors from the UK increased by 18 per cent over the year, due in part to the Rugby World Cup. SARS was apparently an issue for Asian travelers over the year, evidenced by the 21 per cent fall in Japanese visitor numbers. However, Korean visitors bucked the trend with patronage up by 16 per cent.