# Investment Market Update

Issue 44 - Spring 2011

### Movement at the station

It's been a big quarter for CIPL with the move of the Rockhampton office taking place at the end of September. We are now ensconced at 2nd floor, 34 East Street, so feel free to drop in and have a look at our new digs. We did suffer from some telephony related issues during the move, on account of Telstra recording a line left in place by the previous tenants. During that time we had a chance to test disaster recovery arrangements, with the result that internal internet and email was maintained, along with a limited phone service. We apologise to those clients who could not access their portfolio on-line for a few days, but be reassured that the data is actually held quite separate from what you see on the screen – whatever you can see, the data is still there. Coincidentally, the Tamworth office will also be moving in October and now that we know the drill with Telstra, it's bound to be smooth.

### Reduce your fees

Did you know that you can pay your ongoing fees in advance? CIPL has had that arrangement in place for about a year now, with a number of clients taking up the opportunity. Prepaying means that you know what the fees will be for the entire year and entitles you to a 10% discount.

**David French**
Managing Director
Senior Investment Advisor

## Global issues still the main game

### European and US economic worries continue to batter our market

Investing in the stock market used to be a relatively simple affair: do some research on a particular company of interest, keep an eye on industry developments and watch out for any budget-day nasties announced by the Treasurer which might negatively impact your investment.

Investing today however now appears to require a new skill – being an expert on European and American politics, where the overnight pronouncements by foreign leaders can push the Australian market up or down by billions of dollars. It's one of the by-products of globalisation and is a factor which is becoming increasingly important, at least in the short term.

The September quarter was a particularly clear example of the impact of global events on the Australian market. Renewed concerns over the possibility of a Greek Government default, coupled with uncertainty surrounding the US debt ceiling negotiations conspired to push stock markets lower across all regions.

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|---|---|
| ASX 200 Index | -13.01% |
| Dow Jones | -12.09% |
| UK FTSE 100 | -13.74% |
| Chinese Composite Index | -14.59% |

Source: IRESS

Despite the Australian economy being recognised as one of the most robust in the world, our stock market was also caught up in the general malaise, losing just over thirteen percent over the quarter.

***Profits up, stocks down***

The recent market weakness coincided with the 2010/11 profits reporting season and provided an interesting contrast. On the one hand we had many Australian companies reporting significant increases in profits and dividends, while at the same time their share prices were falling by 5% or 6% a week. There are of course a number of sectors of the Australian economy which are struggling; retail, travel and tourism and those sectors which are penalised by a strong Australian dollar, but on the whole corporate Australia is in a relatively strong position.

This strength hasn't been reflected in the share prices of Australian companies however, with even a stalwart like BHP Billiton falling 20% over the past three months, despite announcing a record profit of US$23.6 billion during that period. This disconnect between corporate profitability and stock prices has been a feature of the recent market volatility, although it can present opportunities for patient investors.

***Political crisis***

In many ways the current stock market volatility is more of a political crisis than an economic one, in particular a political leadership crisis. Unlike the depths of the GFC in 2008, the economic problems we face are well understood, and we also know the solutions to those problems.

We know that the problem is simply too much sovereign debt (particularly with regards to the Mediterranean members of the euro) and we know that the solutions to this crisis, while painful, are also relatively simple. The problem however, is that it requires an effective wealth transfer from countries such as Germany and France to almost-broke neighbours such as Greece and possibly even Italy and Spain. In essence Germany and France will need to guarantee the debts of the highly-indebted euro members, or else they must accept that the euro cannot continue in its present shape.

Politically however, such a strategy is unpalatable, as German (and to a lesser extent, French) taxpayers are firmly against bailing out the profligate members of the euro, a fact which German and French politicians are well aware. No doubt the German Chancellor's and the French President's advisers have briefed them on the need for action, but it appears that the political fallout is the problem, rather than the lack of a solution.


**Greece: in reality no laughing matter**

Source: econmix.wordpress.com

The situation across the Pacific is equally concerning, where both Democrats and Republicans were happy to use the US debt ceiling negations as an opportunity to score political points. Delaying an agreement to increase the debt limit to the very last few hours was highly irresponsible and reflected very poorly on American leadership on both sides of the political spectrum. Unsurprisingly stock markets reacted by tumbling sharply, sending a clear message to policy makers that the economy was not to be used as a political football, a point that will no doubt be lost as we head into a US presidential election in 2012.

***Looking ahead to the rest of 2011***

Unfortunately there is little reason to believe that the rest of 2011 will be any less volatile than that which we have experienced in recent months.

A successful resolution to the European sovereign debt crisis will go a long way to restoring investor confidence, although such a solution may still be some time away. With regards to the US, avoiding a double-dip recession is key and any recovery in the housing market or a reduction in unemployment would be welcome, although such positive developments are again unlikely to materialise in the very near future.

To some extent the continued strong economic growth of China, now our largest trading partner, has helped to insulate the Australian economy from anaemic economic growth in the rest of the developed world. However, China has taken steps to slow its growth as it battles to halt rising inflation, and this slowing growth will translate into less demand for our resources.

On the domestic front the Australian economy continues to perform satisfactorily, with the economic recovery from the devastating floods in early 2011 largely complete. A number of key indicators do point to flagging economic growth however, with small but noticeable rises in unemployment and continued weakness in the retail and manufacturing sectors. At this stage an interest rate cut of 0.25% in November looks a better bet than trying to pick the Melbourne Cup winner, although a lot will depend on inflation figures for the September quarter, due to be released at the end of October.

During this volatile period our approach has been to carefully go through client portfolios, removing exposure to those stocks which we believe possess inferior investment characteristics, and to build up cash levels as required. As long-term investors, we are willing to be patient in making investment decisions and we are open to taking contrarian positions, a strategy which will reward clients over the medium to long term.

Justin Baiocchi
Financial Advisor

## Superannuation Update

### Transition to retirement pension and salary sacrifice

Once you reach the age of 55, you may commence drawing from your superannuation while you are still working. There are several advantages in doing so and the major benefit is tax savings within superannuation. Combining a Transition to Retirement pension with salary sacrifice may also result in personal tax savings.

Until you turn 60, part of the pension payment will be treated as taxable income, although you will receive the benefit of a 15% tax offset which reduces the actual tax paid. If your marginal tax rate is 31.5% including

Medicare (income between $37,001 and $80,000), the offset would reduce tax payable on the taxable part of the pension drawdown to 16.5%.

As an example, a person under 60, whose gross salary is $75,000 and who has $350,000 in superannuation, could save around $4,600 every year in a combination of personal tax and superannuation tax. After 60, the personal tax savings increase.

Contact us if you would like us to investigate this strategy on your behalf.

### Government co-contribution

If you earn less than $61,920 per annum from salary, you may be eligible to receive a contribution of up to $1,000 into your superannuation fund, through the government's co-contribution scheme. To qualify, you need to make an after-tax contribution of $1,000 to your superannuation fund during the financial year. This can be made as a one-off contribution, or could be by payroll deduction of $38.50 each fortnight.

The actual co-contribution is assessed on a sliding scale according to salary, and a person who earns less than $31,929 per annum would receive the full $1,000 contribution after their annual tax return is submitted to the ATO.

Sue Dunne
Financial Advisor

## Insurance Matters

### Shock therapy

Imagine this; you have just taken the advice of your financial advisor. A 30 year plan if you will, given my age. We have established we will pay off our house in 10 years, our goal is to own a new car in 5 years time, an overseas holiday when our youngest child turns 10. We want to have $80,000 in today's dollars to live off in our retirement, as well as buy a yacht and cruise the entire coast of Australia. My wife wants to shop at Tiffany's in New York, just to say she has bought something from there. All of these things cost money, some of them quite a bit.

Now whilst the going is good these goals for us are not unachievable. We both have very good jobs that reward us quite well, and we are not living outside of our means.

Then I start to get headaches, blurred vision, I forget simple things like putting the bins out, or where I work, what my phone number is. We fob it off at first to having a bad day, but then the day turns to a week, turns to a fortnight. Suddenly we worry and I go and see a doctor. We describe the symptoms and immediately I am in for a CT scan, I call my wife in a panic, "Hurry", I say "get here, something is seriously wrong". I am in the waiting room for what seems an eternity. Two weeks later I get the news that I have a melanoma; it is ok though it can be removed, I shouldn't lose my sight, and it should not affect my cognitive skills. My life should go on as normal...

As normal as what?...

I am out of work for 12 months, specialist's bills, hospital bills, private travel for my family to spend time with me. Our annual income has halved, our children don't understand why they can't do weekend sports or go to the Crazy Joker.

Suddenly our 30 year plan has turned from 30 years to looking like losing our house in the next 3 months, our car is struggling by, and our yacht, well we are lucky now to be able to afford the tender.

All of a sudden as luck would have it, I remember, I should speak to my adviser; we did some insurance where I made sure if something happened all of our dreams would still be taken care of. My advisor tells my wife, leave it to me, your insurances should cover most things, we will contact you should we require anything further. Three months later, my advisor drops over a cheque for $300,000 for my trauma insurance payment due to the cancer, they then tell me and my wife my income protection insurance will commence in the next 14 days.

All of a sudden our lives are back on track, its Tiffany's again instead of Amies, it's our mortgage repaid in 10 years instead of the bank asking for the keys back. I can relax and recover knowing nothing in my circumstances changes. Our future is still looking bright.

Jason Fagg
Life Risk Advisor

## Investment Briefs

### From the Share Trading Division

### Here are some stocks we are currently looking at:

<u>Crown Limited (CWN)</u>
Crown is one of Australia's largest entertainment groups with core business activities focused on gaming. The two largest and most diversified investments are Crown Entertainment Complex in Melbourne and Burswood Entertainment Complex in Perth. Melco Crown (33.4% Crown) is a joint venture between Crown and Hong Kong listed Melco and is involved in development and ownership of casinos and resorts

principally in the Macau market. Crown has a 50% interest in the JV betting exchange Betfair and in several other gaming operations worldwide.

For the full year to 30/6/11, net profit came in at $340m, up to 18% on a 5.3% increase in revenue. A final dividend of 19c franked to 50% is payable on 14 October 2011.

Crown Melbourne was the standout performer, posting 10% revenue growth while Burswood posted a 5% fall due mostly to regional competition. The company plans to spend $543m on its Australian casinos in FY12 and $777m in total over the period FY12-14. It is expected that the redevelopment program, particularly as it relates to VIP facilities, will strengthen spending patterns and overall turnover. The DCF-based target price is $9.77 and the stock is currently trading at $7.60. It carries a 'buy' recommendation.

Ruralco Holdings Ltd (RHL)
Operating under its own brands, the company specialises in rural merchandise, livestock, wool, grain, seed, stock feed, fertiliser, irrigation, water, real estate, risk management, insurance and financial services. Some notable brand names and suppliers are:

**Rural Supplies** – CRT, Growforce, Tasmania Farm Equipment, Roberts & Rodwells. CRT has in excess of 330 outlets.

**Stock Feed & Grain** – Monds & Affleck and Tasmanian Grain Elevators both of Tasmania.

**Real Estate** – CRT Real Estate and Roberts Real Estate. The CRT operation stretches from WA to Victoria, NSW, QLD and NT.

**Wool & Livestock** – Primaries of WA, Stevens Egan Johnston, SA Livestock and Rodwells & Co.

Following the impressive first half 2011 result when EBIT improved 39%, the company is tracking well to cover a forecast EBIT of $35.7m (+24%) in full year 2011 and $37.6 in full year 2012. Positive seasonal conditions across eastern Australia, recent rainfall in WA and high soft commodity prices continue to drive demand for agricultural products and services. The company is expected to benefit, in particular, from agricultural input and general merchandise, grain marketing (a big winter cereal crop), and higher wool and livestock prices. Looking beyond 2011, the market sees Ruralco as well placed to deliver sustainable growth over the medium term by:

- Expansion of the store network
- Leveraging the network to grow earnings from new and acquired business streams; and
- Improving business efficiency.

The stock presently trades at $3.10 with a 12 month target of $4.00. It carries a 'buy' recommendation.

Hastings Diversified Utilities Fund (HDF)
The company is an investment vehicle focused on energy infrastructure management and managed by the Westpac Banking Corporation through its subsidiary Hastings Funds Management. Its target investments are gas transmission and distribution assets, electricity generation, transmission and distribution assets, water and other essential utilities, hydro and wind power generation assets.

HDF maintains a 100% interest in Epic Energy which consists primarily of three major natural gas pipeline systems including the Moomba to Adelaide Pipeline System (MAPS) which is one of Australia's largest and provides gas transmission to Adelaide and SA regional centres. In the first half of 2011 Epic Energy increased EBITDA by 9% to $55m on revenue growth of 10% enabling free cash flow growth of 30% and the payment of distributions of 5.0c (unfranked). Growth capex was held at $166m against a forecast of $249m with the shortfall contributing to a reduction in net debt. The company estimates it has $230m cash available to it. The forecast for EBITDA is growth compounding at about 15% p.a. between 2010 and 2016. The share has a DCF-based target of $1.84 and is presently priced at $1.60. It carries a 'buy' recommendation.

Bradken Limited (BKN)
Founded in 1922, Bradken was first listed in 1949 and was acquired by ANI in 1982. In 2001, it was acquired by a private consortium of CHAMP private equity, ESCO and Bradken Management. The company relisted in August 2004. Bradken manufactures and supplies consumable products, capital equipment and related services to the resources and freight line industries. The company services its markets through five strategic divisions:
Mining, mineral processing, rail, industrial, power and cement.
It has a network of 20 manufacturing facilities across Australia, NZ, UK and China. An EBITDA of $196.1m and a normalised NPAT of $90.1m were in line with expectations for full year 2011 and were achieved despite unfavourable currency movement, wet weather and a number of other market forces. The company declared a final dividend of 21c per share (fully franked). Key elements to guidance for the full year 2012 are:

a. 25-30% growth in EBITDA
b. 35-40% growth in NPAT

Post the recent acquisitions, it is estimated that consumable products will represent 70% of group sales and sales to international markets 50% both achievable through strong proactive management. A target price of $10.15 is maintained on a 'buy' recommendation. The stock is trading at $6.70.

Bob Stewart
Senior Advisor

## Client Services Update

### Is your next client review due?

Would you like to make an appointment with your Financial Advisor? It's as simple as phoning the office on free call 1800 679 000 and speaking with our friendly staff. You will receive a call closer to your client review due date but if you are limited with time or have plans over the next few months it may be worth jumping in first to secure a time that best suits you.

Your service level and number of client reviews will have been negotiated with your Advisor. But please keep in mind that we are always happy to meet with you if your circumstances have changed or you need to discuss something important that can't wait for your next review, so please feel free to call the office at any time.

Rose Sladden
Client Services Manager

## Tell your friends

At CIPL we always appreciate it when our clients recommend our services to their friends or family. As a small but growing firm, client referrals are important to us, and if you know of friends or family in need of financial advice we would appreciate it if you mentioned our name. We are always open to new clients, big or small and are constantly striving to provide the highest level of service possible.

## Rockhampton and Tamworth office moves

### Rockhampton office has moved

Due to the redevelopment of our former office site in Archer Street, we have moved just around the corner to the Suncorp building. Our new office address is Suite 1, Level 2, 34 East Street.

We have had some technical difficulties during the move with our telephone connections, which for unforeseen circumstances were down for over a week. We sincerely apologise if this caused any inconvenience and assure you all systems are now back up and running as normal and all staff can be contacted at the Rockhampton office on 07 4920 4600.

### Tamworth office move

The Tamworth office is also moving to a new location due to leasing changes at Tamworth Regional Council. As from Monday 24 October our new office will be at Level 1, 462-464 Peel Street, next door to the library and the NRMA office. Telephone contact details remain the same, being 02 6766 9000.

The office will be closed for Thursday and Friday the 20th and 21st of October as we relocate to our new premises, but should you have any matters or queries that require attention please feel free to contact the Rockhampton office on 07 4920 4600 or 1800 679 000.

## Annual portfolio reports

The annual tax statements will be prepared as soon as we have all the information that is required. It is usually not until toward the end of October before we receive the information from the fund managers that we require before we can prepare your tax reports. As soon as we have this information we begin the task of printing, posting and emailing the reports. Thank you for your patience.

*The content of the newsletter constitutes general advice and does not take into account your particular needs. Please seek appropriate advice before acting on anything contained herein.*

## CIPL STAFF

### Rockhampton Office


**David French**
Managing Director


**Sue Dunne**
Financial Advisor


**Bronwyn Large**
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**Bob Stewart**
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**Kathy Donaghey**
Portfolio Administrator


**Ben Scott**
IT Manager


**Lachlan McKenzie-McHarg**
Equities Advisor & Dealer


**Rose Sladden**
Client Services Manager


**Delvean Steadman**
Front Office Administrator

### Tamworth Office


**Justin Baiocchi**
Financial Advisor

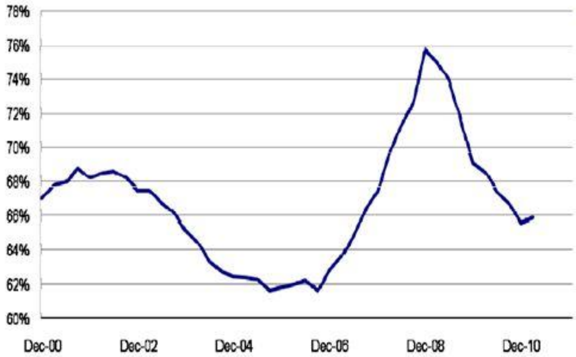

**Annette Darlington**
Senior Administrator


**Nigel Campbell**
Trainee Financial Advisor

## CHART PACK

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

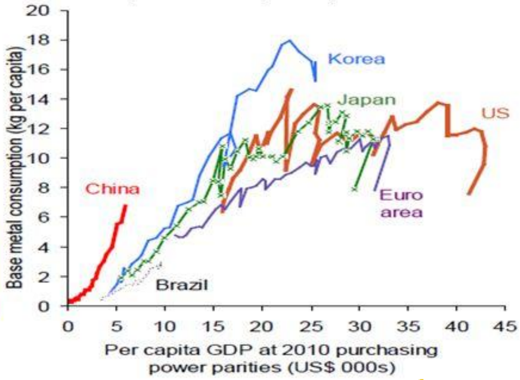
**US non-financial company's credit as a % of net-worth** - US companies have repaid down debt in recent years




**Fixed Asset Investment in China** - Less spending on infrastructure, more on manufacturing, which is a good sign for sustainability


**Australian Interest Rate Expectations** - Market expectations of an interest rate cut are high, possibly as soon as November


**Base Metal Cosumption per GDP** - Chinese demand for base metals is increasing faster than ever previously recorded

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