Investment Market Update

Issue 33 December 2008

Welcome...

In this 33rd edition of CIPL's Investment Market Update we reflect on 2008 and ponder what 2009 may bring.

It goes without saying that the past twelve months have been difficult for both us at CIPL and yourselves. We would like to thank you for your loyalty and trust. We remain committed to continually improving the service we provide to you and we take very seriously the responsibility you have given us.

Rest assured that we will be working harder than ever in 2009 to improve your financial affairs.

I hope that you all have a very Merry Christmas, a Happy New Year and an enjoyable break.

David French
Managing Director
Senior Investment Advisor

ANNUS HORRIBILIS

A year to remember

A Latin swearword? No, but expect to see the term 'annus horribilis' used frequently when describing 2008's dreadful financial markets.

The correct translation of Annus Horribilis is 'horrible year'. While I could never work out the mystery the tabloids saw in the phrase, readers will recall Queen Elizabeth II used it in November 1992 to describe her family's year of disaster. That included events such as Windsor Castle catching fire, Charles and Diana separating and the appearance of photos of a topless Sarah Ferguson in an intimate moment with an American businessman's toes.

We think that 2008 is a year to remember, rather than one to forget, as there are valuable lessons to be learnt from events over the past 12 months.

Easy money and over-leveraging

Without rehashing the subprime phenomenon and the global credit crunch, it is relatively simple to see (with hindsight) how the easy availability of 'cheap' money set the stage for the meltdown in financial markets in 2008.

An unsustainable boom of consumption, construction and securitisation was made possible by lax lending standards perpetuated by everyone from mortgage brokers to banks. Regulators seemed to be behind the curve, and in hindsight it seems incongruous that basic tenets of economics and finance were forgotten until it was too late.

As outlined in our December 2007 newsletter, we were concerned that the market had reached a peak – there were some signs. But we were drowned out by the chorus of cheerleaders shouting 'stronger for longer', 'commodity super-cycle', and 'this time it's different'. Even the Reserve Bank of Australia kept up a mantra that China will keep Australia strong.

The one giveaway was that the Reserve Bank of Australia had implemented 12 consecutive interest rate rises. This and similar rate rises around the world, was essentially the catalyst that brought things undone. We were prepared for a pullback, but we clearly did not foresee just how wrong things would go.

MEA CULPA

What we got right and what we didn't

At CIPL we don't claim to be perfect. We do however use every resource available to ensure that we are making the best decisions for our clients. Notwithstanding, we readily admit that the severity and ferocity of the financial meltdown took us by surprise.

In December 2007 we undertook some changes to most portfolios, with a greater emphasis on fixed interest securities. We also conducted deeper and more thorough research into some of the companies we were recommending. We even visited senior management of some companies that we had questions about.

Unfortunately these actions were largely negated by at least four things:

- The widening of credit spreads (the price of borrowing by non-government entities compared with the non government sector).

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- The government bank deposit guarantee caused large falls in the values of fixed interest securities, as people sold down managed funds and put their money into guaranteed deposits.

- What we think are downright lies and 'butt covering' by some of the companies on the stock exchange. Over the year many announcements were made only to be directly contradicted within a day or two.

- Frenzied media speculation and commentary which we feel nearly led to a run on the banks.

For a time it is probably fair to say that, normal financial theory no longer applied as markets collapsed world-wide.

We managed to avoid most high-profile corporate failures such as ABC Learning and MFS, but were blindsided by the events surrounding Allco Finance Group, and perhaps even Babcock and Brown. We held what we believed were the safer securities issued by these entities, but in the event, that does not appear to have counted for much. On the other hand, diversifying the portfolios meant that the pain has been kept to manageable levels.

We were correct, in our belief that commodity prices and the mining boom were largely unsustainable. This gives us no joy however, as we know that as a result of past employment, some clients hold significant stakes in large mining companies such as Rio Tinto and BHP Billiton.

WHERE TO FROM HERE?

2009 – The Year of the Ox (a close relative of the bull?)

The good news is that 2009 is the Chinese Year of the Ox; the bad news is that it doesn't promise an exciting year:

"Ox years show stability and slow but steady expansion. Although not great years for innovation, old ways will work fine. Agricultural endeavours will be the most rewarding. Sufferers of arthritis, rheumatism, and bone related diseases will most likely suffer much during this period."(source:http://www.lifeinkorea.com/culture/astrology/Ox.cfm)

While we can't comment on whether or not the astrologists have got it right with respect to arthritis sufferers and the rewards promised by agricultural endeavours, we do agree that 2009 may well be a year of stability and slow and steady expansion.

Unprecedented fiscal and monetary policy actions by governments and central banks in most nations around the world are likely to begin to have a noticeable impact within the next 6 to 12 months. Expect the share market to pre-empt that.

New governments in most major economies is also a positive development, as there are likely to be no sacred cows as governments use every lever to limit the severity of a global recession.

Backtracking on promises made in the height of the economic boom has already begun (the emissions trading scheme and maternity leave seem the most likely candidates), which should see the axe fall on some of the more costly and unproductive spending proposals.

With regards to your investment portfolios, we believe that 2009 will see some improvement, although volatility levels are likely to remain high.

The market has fallen to a point where many companies are now offering compelling value – some ridiculously so. Interest rate reductions, increased government spending, the lower world value of the $A and falling oil and commodity prices all signal that things might begin to improve.

It is also important to remember that generally speaking, the income generated by your portfolio is not directly affected by falls in the market value of the investments. Slowing economic growth may cause some companies to freeze or even cut dividend payments, but it would be unusual for that to be widespread.

Furthermore, most portfolios contain a significant proportion of fixed interest securities which carry an even greater certainty of dividend payments than ordinary shares

We are monitoring developments as they occur and any possible impact on your portfolio. If dividend declines do occur, we will make recommendations to help offset those declines. In this market there are many such opportunities.

We keep updated lists of the income expected for each portfolio. If you do have any concerns about the ability of your portfolio to meet your income requirements, please feel free to call the office and arrange an appointment where we can discuss available alternatives.

Similarly, if you have questions about the composition of your investment portfolio, would like further information on your investments, or just want to discuss your financial situation in general, we are always happy to see you. We have excellent staff and resources, and they are provided for your benefit.

CIPL - A YEAR IN THE OFFICE

2008 has been a busy year for CIPL; floods, falls and fun, we've had it all

Aside from our obvious disappointment at the performance of the stock market, 2008 has been a significant and productive year for CIPL. While the performance of the market is out of our control, we have worked hard to improve the services we offer to you and to expand the depth and range of our skills and abilities.

It was a wet start to the year with a flash flood washing through the office – an omen perhaps? Although a committed effort by staff ensured that the damage and disruption was minimal.

CIPL also increased the number of its staff over the year as we aimed to both position the business for future growth and to improve our services to our clients.

A significant development has also been the establishment of the Capricorn Investment Property Fund, which will, once launched, allow investors an opportunity to invest in local property and infrastructure assets.

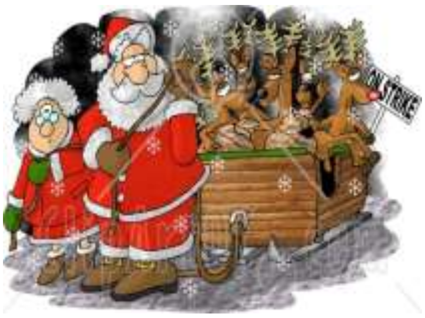
The rollout of our new Portfolio Administration System (PAS) represented an important milestone for CIPL. PAS is now a major resource which you would normally expect only to find in large, national organisations. Continued development of PAS will allow us to further enhance the services we provide to our clients.

Interest has been expressed by a number of clients in receiving some training in using the reporting functions available through our website. We expect that this training will occur sometime in January, so if you are interested please let us know.

We have also embarked on a significant step in expanding our business, with the raising of funds to purchase a Financial Planning business in Tamworth. If you have chosen to participate in the share offer, then we welcome you aboard and look forward to a long and successful journey together.

Just for the record, CIPL is nothing like and has nothing to do with the high profile financial planning collapses, such as Opes Prime and Storm Financial.

We've got no real comment on those businesses, except to say that CIPL is really a cross between a financial planning business and a traditional stockbroking house. It's staffed by intelligent and thoughtful individuals, has no ongoing debt and its investment strategies are not based on fads.



CHRISTMAS HOLIDAYS

CIPL will remain open over the festive season, though with only a skeleton staff

Note that from the 22nd of December to the 2nd of January there will only be a skeleton staff at CIPL (and we will be closed on public holidays and Friday the 2nd of January).

INVESTMENT BRIEFS

Here are some ideas to consider before the holidays:

Our final recommendation for the year is that you invest in some well deserved Rn'R. Buy that book you've had your eye on, hit the beach, or spend some time with a line in the water. Cheap flights and hire cars are everywhere. There are also some real accommodation bargains around.

It's probably worth pausing to remember, that as bad as the market has been, it will recover and incomes are generally covered by portfolio earnings. Over time the financial holes will be patched, so they should not be your major concern. Keep that in mind, and do the things you want to do.

If you let the market dictate your life, one day things more valuable than money might get taken from you. There is no going back from that point.

From all the staff at CIPL, we wish you a safe and prosperous Christmas and New Year!

You are advised to seek advice regarding your particular situation before acting on anything contained herein (except the bit about rest and relaxation – just do it)

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