

Investment Market Update No. 6

31 January 2004

Editorial

After a well-earned break over Christmas and the New Year we welcome you to the first edition of 2004. We would like to welcome Kristy Dmitrieff to the Rockhampton team. Kristy has joined us on a Traineeship after completing Year 12 at Rockhampton Girls Grammar in 2003.

In this issue we cover:

1. The value of a government guarantee;
2. World interest rates;
3. Risk management; and
4. Investment briefs.

David French

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The value of a government guarantee

From time to time we hear of banks around the world going bankrupt and closing before depositors have had a chance to access their funds. Although not a common occurrence in Australia, they can and have occurred in the past. It is surprising the number of people who hold the misconception that if one of our banks goes under that the federal government will step in and rescue them. In fact there is no onus on the government to take any action to prevent a bank from failing (depending on the size of the bank it would be political suicide if no action were taken). The RBA can provide liquidity (that is, money) at its discretion to avert a banking disaster.

While it is common for governments around the world to take this approach to the banking (and for that matter other sectors) industry, the Japanese government has recently bucked the trend. In May 2003 the Koizumi government stepped in to prevent the closure of Japan's fifth largest bank (Resona) with a 2 trillion Yen rescue package. This was the catalyst that convinced investors the government was not going to allow the big banks to fail.

The worth of a government guarantee to the Japanese banking sector is roughly 330 per cent. If you had invested \$1 in each of Japan's four largest banks on April 28, 2003, that investment would now be worth approximately \$1,324! (source: *The AFR*, January 12, 2004). This represents a 330 per cent increase in the value of your investment.

If there had been no change to the fundamentals underlying the Japanese banking sector what then had changed? Perception. Specifically, the perception that investing in the big Japanese banks is in effect, a risk free investment. To further illustrate, consider the

largest and fourth largest bank in Japan, who were reportedly close to collapse last year. Their share prices have increased by 458 per cent and 498 per cent respectively since the bailout of Resona.

The profitability of the big Japanese banks looks set to improve this year, due in part to the banks selling their own shares as their prices have increased. It would still have to be a brave stock broker or investment adviser who recommends a Japanese bank stock to their clients.

World Interest Rates

While the Reserve Bank of Australia (RBA) has seen fit to increase interest rates twice recently, their counterparts in Canada have just announced a 0.25 per cent cut in official interest rates (down to 2.5 per cent).

Part of the rationale given by the Canadian central bank in lowering rates was that "(d)espite stronger global economic growth, the rapid appreciation of the Canadian dollar against the US currency has cut into the overall growth of aggregate demand for Canadian goods and services through weaker exports and increased imports" (source: www.bankofcanada.ca/fixed-dates/2004/rate_200104.htm).

This statement could easily have been made by the RBA as the high Australian dollar is having the same effect on our imports and exports as in Canada. With the next board meeting of the RBA to occur on February 3, it will be interesting to see the action taken. In view of the recent slowdown in housing sales there appears little economic justification for the RBA to raise interest rates, and we expect them to remain at 5.25 per cent in the short term.

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Risk management

With the recent furore surrounding the (apparently) unauthorised currency trades at the NAB showing no signs of abating we thought it would be prudent to cover some of the risk management tools The Rock Investment Planning has in place to protect your funds.

The first, but sometimes not the most obvious, tool available is yourself. After receiving your quarterly statement if you are unsure of a transaction that appears do not hesitate to contact us. We recommend you check the transactions that appear in your Cash Management Account statement match those showing in your Portfolio Administration Service reports and notify us of any discrepancy.

There is an Internal Audit Department at The Rock whose job is to monitor the activities of The Rock Investment Planning (and all other departments of The Rock). If you have a complaint that has not been adequately addressed by your Advisor, please contact The Manager, Internal Audit to voice your concern.

If you are still not satisfied with the response provided by The Rock, you have the right to refer your complaint to The Financial Industry Complaints Service Limited (FICS), of which The Rock Investment Planning is a member. This is an independent and external dispute resolution body.

Investment briefs

National Australia Bank (NAB): The cost to the bank from the rogue traders is expected to run between \$185 and \$600 million. The Australian Prudential Regulation Authority is now monitoring NABs foreign currency options activities on a daily basis.

Telstra (TLS): Has announced plans to shift 450 jobs to India as a cost-saving measure. This move will be fought by the unions. Don't bank the cost savings just yet.

Patrick Corporation (PRK): Faces up to \$2 million in fines after admitting to two criminal counts of using unsafe work practices (PRK have also been charged with three more counts of having using unsafe work practices).

Santos (STO): A fire at its Moomba plant is expected to decrease earnings this year. Offsetting this is an

agreement to supply \$800 million of gas to Indonesia's state-owned gas distributor, Perusahaan Gas Negara.

Coles Myer, Woolworths (CML, WOW): WOW has lost its competitive advantage over CML regarding petrol discounts as CML rolls out its deal with Shell across the country. The national rollout will occur ahead of schedule.

Seven (SEV): Seven broadcast a one-off special last year that involved psychics attempting to solve old murder investigations. This was a ratings success for the network. After commissioning the producers to develop a series, SEV let the options to the program expire and TEN swooped in and picked up the broadcast rights. An embarrassing blunder for SEV seeing they had begun advertising the series and selling advertising space for the program.

The three TABs (UTB, TAB, TAH): Negotiations continue.

BHP, Rio Tinto (BHP, RIO): Like other resource companies, high commodity prices continue to negate the effects of a high Australian dollar.

Virgin Blue (VBA): Performing well at present, but its on-going performance is expected to be affected by Jetstar (Qantas' budget airline). As more information is released about Jetstar (in particular its fare structure) the likely impact on the earnings of VBA will be available.

Qantas (QAN): Has acquired two landing slots into London's Heathrow Airport in a deal worth about \$A47 million. This should translate to increased flights into the UK. In keeping with the low-cost structure of Jetstar, the booking system of QAN and Jetstar are incompatible. This is likely to inconvenience travellers transferring from Jetstar to Qantas flights. This appears to favour Virgin as Jetstar passengers will still need to check in for their Qantas flights (just like Virgin passengers). Fare structure appears to be the sole differentiating factor between the two airlines.

RepcO (RCL): After a lacklustre debut on the ASX, RCL is now trading around its issue price.

Multiplex (MXGCA): This has been one of the more successful floats recently. After listing at \$3.08 MXGCA is now trading at \$3.59. This company has received favourable coverage from a number of research houses including UBS.

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.

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