The Rock
INVESTMENT PLANNING LIMITED

Investment Market Update No. 10

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Editorial

Interest rates are on hold in Australia for the time being, but are likely to increase in the USA. Meanwhile oil prices have reached record highs. We believe that the next few months will be lackluster for financial markets. The secret to successful investing in this type of market is in maintaining cash flows.

In this issue we cover:

1. Our investment philosophy;
2. Self managed superannuation funds;
3. Places to get more information;
4. Investment briefs.

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Our investment philosophy

There are as many different philosophies on investment as there are books and newspapers devoted to the subject. There are also many experts around that can give you advice on the next good thing. Dismissing any of this out of hand isn't wise, but neither is simply following the crowd.

TRIP's overall approach to investment is conservative, and focuses as much on preservation of capital as it does on growing portfolio values. Our first port of call is to assess client's cash needs. Our view is that if cash needs are covered, then clients will not have to sell assets to cover day-to-day expenses. The problem with having to regularly sell investments to fund living expenses is that you might be forced to sell when conditions are unfavourable. Selling assets at a relatively low price leaves the portfolio with less earning power, meaning that increasingly large asset sales have to be made in the future. Over the last couple of years, this has been the situation facing many retirees using retail allocated pensions.

From investment perspective, generating cash flow is also very important. Graphs comparing the all-ordinaries accumulation (which includes dividends) index and the all-ordinaries price index highlight both the compounding effect of re-investing dividends, and the smoothing effect that dividends have on fluctuations in the value of the portfolio. That makes sense – if you receive a 6 per cent return in dividends, then the value of the investments can fall by 6 per cent and you will still be square. Over time that can afford excellent capital protection. This logic is the reason we often put boring income-generating assets even in riskier portfolios.

Of course, we would not make the investments we do if we did not think that we could generate capital gains. Capital gains are however, unpredictable, both in time and in magnitude. We believe that our cash philosophy guides us toward investments that are likely to deliver capital gains with lower than average risk. Why would this be? Take franking as an example. To pay fully franked dividends, a company must have been consistently profitable. Companies that have lost money, normally offset their tax liability with tax losses, and so cannot frank their dividends. By looking for fully franked dividends, we are guided to robust companies. Amongst those companies some will look undervalued. Sometimes this is because investors have decided a stock is too boring, and sometimes market conditions will not favour a stock, through no fault of the company's. A current example of the former is Telstra, and example of the later is Amcor.

If the market continues to undervalue these investments, then corporate players will move in. This is often the case when the investment also has strategic value.

Over the past year client portfolios have benefited strongly from this investment approach. Currently General Property Trust is under takeover, adding a 15 per cent capital gain to the 7 per cent ongoing partially tax deferred yield that clients have been enjoying. Clients have also benefited from takeovers of Tabcorp, and Jupiters, and restructuring of AMP, Repco and Australand. And that's not including investments that have simply increased in value as the market has improved.

Our investment philosophy is never going to suit mad punters, but it is well suited to those people who understand basic principles of investing like compound returns and cash flow.

Self Managed Superannuation Funds

The Federal Government recently announced changes to legislation governing self managed superannuation funds. The changes are directed at people who have been abusing SMSF's to (in our opinion) avoid tax. Despite that fact that the ATO has always taken a dim view of practices such as forfeiting benefits and provisioning (both of which are used to get around Retirement Benefit Limits), some accountants and financial planners have elected to run the gauntlet. They've been caught and now they're bleating.

The legislative changes do not affect any existing TRIP clients. We might have to make some minor alterations to the recommendations we make for a minority of new clients to cope with the new superannuation pensions the government is proposing, but that's all in a day's work.

Getting more information

Do you take an interest in your investment portfolio? We consistently find that those clients who take an interest in their investments do better than those who simply leave us to it. It comes down to two heads being better than one.

If you are a novice to investing, but would like to know more, then here are some suggestions that might help you get up to speed.

- The Australian Financial Review. Jam packed with business related articles every day. Saturday's edition contains a large amount of information relating to personal investment;
- The Australian Stockmarket by Ron Bennetts – ABC Books. An excellent introduction to investment fundamentals, presented in a straightforward and sometimes amusing style.

If you are in Melbourne anytime, then get into The Educated Investor at 500 Collins Street. This shop holds probably Australia's best selection of investment books and can be accessed at www.educatedinvestor.com.au. Just a word of warning – steer clear of the get rich quick stuff!

Investment Briefs

Westfield Holdings (**WSF, WFT, WFA**): The merger of the three Westfield entities into the Westfield Group will result in a company with a capitalisation of $22m. We expect the courts to approve this scheme of arrangement later this month. The valuation of the existing Westfield Holdings unit, based on a small discount to DCF, is $16.00 reflecting a P/E of 16x.

Building Materials: The performance of the building materials sector is closely associated with the economy. First quarter 04 building results were mixed:

Engineering construction	up 3.1%
Public construction	up 3.2%
Private construction	up 0.4%
Residential construction	up 0.1%
Non-residential construction	up 2.0%
Total construction activity	up 1.0%

At least it's all positive. Meanwhile, the battle for Adelaide Brighton Cement (ABC) is on and Boral (BLD) has announced its intention to proceed with its bid despite protests from the ACCC.

St. George Bank (**SGB**): Chairman Frank Conroy will retire from the Board in December after having served as Chairman since 1996. The decision was taken for personal reasons and is not expected to detract from the Bank's outlook.

Rio Tinto (**RIO**): Think of alumina…think of Rio…think of China. Weipa is Rio's 100% owned bauxite resource in North Queensland. It supplies 100% of the requirements of Queensland Alumina Refineries (Rio owns 38.6% of QAR), Eurallumina (Rio owns 56.2%) and the soon to be commissioned Comalco Alumina (Rio owns 100%). With a mine life of 40+ years, production is being expanded from 12 to 16.6 million tonnes per annum to satisfy the additional off take by QAR. Rio expects 10-15% p.a. alumina production growth in China over the next 5 years. Rio is rated as a medium-risk buy with a target price of $43.00. (*Source: Citigroup Smith Barney*).

Woodside Petroleum (**WPL**): An area off Mauritania in East Africa with the mysterious name of Chinguetti is emerging as a most valuable income producing asset for Woodside. The initial cost of development of the oilfield is $600m, with potential for further expenditure of $150m. Drilling commences in the second half of 2004 with production targeted for March 2006 at an initial output rate of 75,000 barrels per day. Recoverable reserves are 120 million barrels per day. Other Australian listed companies involved in the venture are Hardman Resources (HDR) and Roc Oil (ROC). Woodside's target price is $18.80 per share. It is presently trading at $16.50 per share.

Qantas Airways (**QAN**): International passenger demand for Qantas/Australian Airlines jumped 25.1% in April 2004 over April 2003. Domestic passenger demand for Qantas/Qantas Link grew 11.8% in April 2004 against April 2003. Meanwhile, Jetstar has taken off with high expectations for achieving sizeable profits and maintaining a low cost budget.

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.