Investment Market Update

Issue 36 - Spring 2009

Welcome...

This is the 36th edition of CIPL's investment Market Update. We take a further look at the continued strong performance of the market, and the nascent economic recovery.

More and more people are beginning to believe that the "bad times" are behind us. We share that view while noting that each cycle has different characteristics. The biggest imminent concern relates to whether Governments will ease inflationary pressure by the gradual withdrawal of stimulus measures.

The integration of GFS in Tamworth continues on schedule, and the relaunched insurance brokerage has been well accepted. CIPL's final planned growth initiative – establishing a managed fund – came closer to fruition, with the granting of an ASIC licence authorisation. Such an authorisation is not easy to get. Success in this endeavour is a credit to the capabilities of the firm.

With markets on the mend, it is a very exciting time for CIPL. We hope you share our positive outlook. If you do have problems or concerns, Ray, Sue, Justin and myself are all here for your benefit.

Regards
David French
Managing Director
Senior Investment Advisor

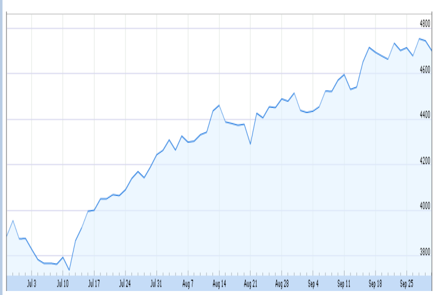
MARKET AND ECONOMIC NEWS

Continued improvement

The stock market has continued its strong run over the past quarter, with the rally since the lows of early March now into its 8th month. Since the beginning of the new financial year, the ASX All Ordinaries has risen by 20.95%, an exceptional performance.

The chart below shows the strong run over that period, with only a small pause in early July.

ASX All Ordinaries 1 July 2009 to 1 October 2009
(Source: www.google.com/finance?q=INDEXASX:.AXJO)

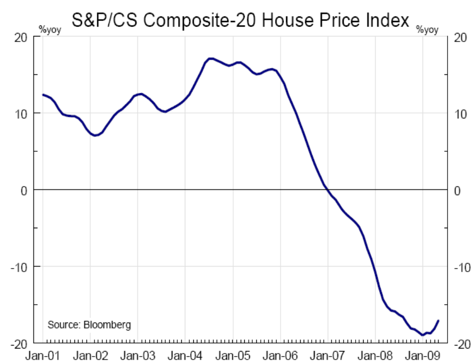


Similar strong index growth has been shown by markets around the word, with Wall Street and European exchanges leading the way. Surprisingly, the local market rallied off the back of the RBA's decision to raise rates, as investors took it as a sign that conditions in the real (as opposed to the financial) economy are improving.

Overall however, as we discussed in our previous newsletter, economic indicators are still mixed. It may be too early to yet make any definitive statement about the end (or even perhaps even the beginning of the end) of the global financial crisis.

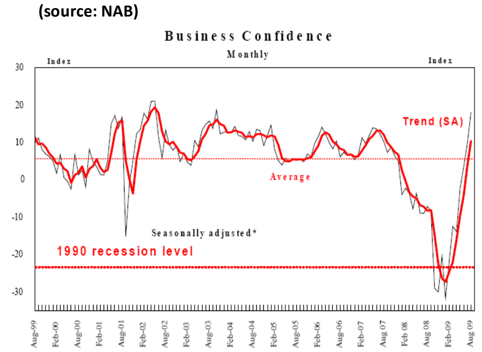
First, the good news. US housing prices, which we have pointed out must stabilise or increase prior to anyone calling an end to the GFC (as it is now known), are finally showing signs of growth.

US House Price Index to April 2009
(source: NAB)



Business confidence, an indication of business' willingness to hire, spend and invest, is still rebounding strongly from recession levels.

Business Confidence to August 2009
(source: NAB)



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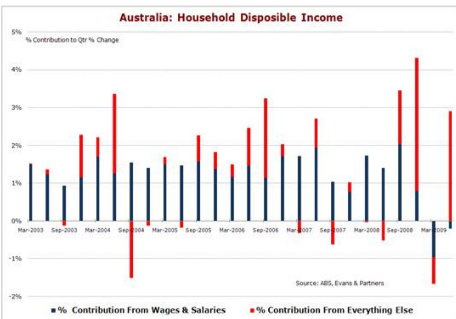
Australian household income has recovered to a more normal level after collapsing in the first quarter of 2009. This is an important measure as household spending accounts for roughly 60% of Australian economic activity. Without sustained growth in household consumption, GDP growth will struggle to match the levels in the years leading up to 2007.

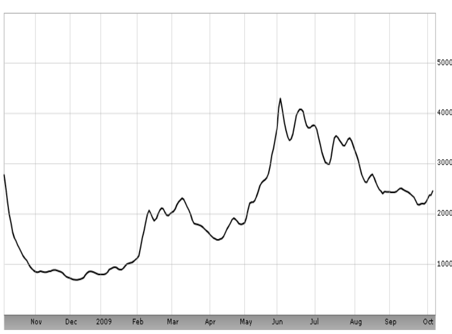
Quarterly change in Household Income **(source: Evans & Partners)**



Offsetting these positive signs, are a number of indicators which are still signalling that normal economic growth and activity is still some way away.

The Baltic Dry Index, which we discussed in our last newsletter, has taken a turn for the worse. From a promising position in June, demand for shipping has eased as global trade slows.

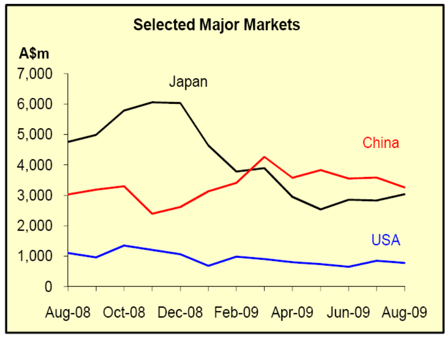
Baltic Dry Index
(source: Bloomberg)



Trade levels with some of Australia's key trading partners has also fallen and remains weak.

The Japanese economy is moving slowly off its base. As an aside, the growing importance of our trade with China is clearly evident.

Australian trade figures – key markets **(source: ABS)**



The overall message is not too dissimilar to that which we stated in the Winter newsletter – conditions have improved, global financial Armageddon has been avoided, but we're not in the clear just yet. However, we do expect 2010 to be a year of recovery not just for Australia but also for more seriously affected economies such as the US, UK and Europe.

As part of our ongoing management of your investment portfolio, we aim to position your portfolio to benefit from the eventual turnaround, both locally and globally.

PORTFOLIO STRATEGY

More than meets the eye

Clients understand that we monitor and manage portfolios on their behalf, but they might not know just how many times a portfolio is discussed and reviewed. Just because you don't hear from us, doesn't mean we are not considering your needs.

Our portfolio management process takes four angles:

First, Justin Baiocchi has an almost full time role in undertaking ongoing portfolio reviews.

He works with David, Ray and Sue on tailoring those recommendations to clients needs. Our system allows Justin to make recommendations, and they go to the advisors for comment and approval. In this way at least two people consider each recommendation.

For Rockhampton office clients we have just finished the first round of complete portfolio reviews since market conditions became clearer – a stocktake in effect. These reviews have added substantial value, in purging non-performing assets and taking the opportunity to gain exposure to stocks at severely depressed prices.

Second, David, Justin and Ray comprise the research team, and regularly discuss the pros and cons of retaining, selling or acquiring investments. The information we use comes from many sources, including the financial press, specialist subscriptions, telephone hook-ups on results presentations and research provided by our panel of stockbrokers. Where we are uncertain as to whether any action needs to be taken, we undertake company visits and meet with, typically, the finance director or CEO. In August we visited PaperlinX, ConnectEast and Hastings Funds Management. In October we are visiting Beach Petroleum and Elders.

Third, our system flags potential problems with client portfolios. Consistently low cash balances might mean that we need to pay more attention to dividend generating stocks, for example. Larger than expected portfolio share of any one stock, might mean we have to reduce exposure to a particular investment.

Finally, clients themselves initiate reviews, by asking questions and making suggestions. The best relationships are a two way street, so we encourage you to keep us up to date with your views and needs.

THE BUSINESS

Integrated growth

We are pleased that the integration of Tamworth has been going so well. We have integrated much of the IT, and tasks such as Centrelink. Staff have been particularly good at coming to grips with the changes.

Having specialist people take care of aspects of CIPL's service is very beneficial for clients and CIPL as a whole. For example, with the help of the Federal Member for Rockhampton, Kirsten Livermore, CIPL formed a relationship with Centrelink such that adjustments can be made quickly and accurately, and any problems addressed promptly.

This vastly reduced Centrelink related distractions, and freed up a lot of advisor time – time now available for other client matters.

CIPL already has specialists in research and portfolio construction and over the next few months Annette will take responsibility for administrative matters relating to self managed superannuation funds.

The next step in the integration of the two businesses will be to load Tamworth client's onto CIPL's portfolio administration system. This is expected to assist in portfolio monitoring, and contribute to efficiencies generally.

On another subject, CIPL has achieved a milestone in its ongoing development.

On 15 October, ASIC granted CIPL a licence to run a managed fund. This will allow CIPL to offer an alternative to the current portfolio service and will be especially suitable for clients with smaller portfolios.

It is also expected to provide cost reduction opportunities for larger clients.

THE DOCTOR WILL SEE YOU NOW...

Where finance and psychology meet

Behavioural finance is a relatively new field of expertise which is starting to impact on the broader financial industry. Don't be put off by visions of tweed-clad Oxford dons discussing Pavlov's dog and what it means for the stock market, there are a number of useful messages and findings for which behavioural finance can claim the credit.

Behavioural finance (and its older established cousin, behavioural economics), attempts to understand why investors and other individuals make decisions and the impact that these decisions can have on markets, prices and investment returns. It may come as some surprise, but as clever as we think we are, people are governed by a number of basic impulses.

Those impulses influence our decisions and our reactions to the consequences of those decisions. A predisposition toward emotions of either hope or fear has a significant effect on the decision investors make.

Emotional decisions can be irrational. For example, it has been proven that investors feel a loss twice as much (in a psychological sense) as a gain[1]. As far as the psychologists are concerned such a response is irrational – isn't a capital gain of $100 the same as a capital loss of $100? Not if you are like 99 per cent of society. Wanting to avoid a loss more than making an equivalent gain is known as loss aversion.

Loss aversion may sound obvious, but it is quite significant. Decisions like these, made by hundreds of people, introduce inefficiencies into the stock market. Astute investors may be able to use this to their advantage.

Loss aversion also leads investors into 'get-evenitis', where investors who hang on to shares that have fallen in value, in the sometimes vain hope that one day the share price will get back to the price at which they first bought it, allowing them to sell without incurring a loss.

We are not advocating that every share which falls in price should be sold off immediately, just that we need to be aware of falling into the trap of 'get-evenitis'. It is often said, very truthfully, that the hardest decision is not what shares to buy, but what to sell.

Another favourite of the behavioural finance crowd is *gambler's fallacy*, a neat name for the erroneous belief that the odds of a fixed odds event occurring increase or decrease depending on recent occurrences. For example, if we toss a coin 30 times and it lands on heads each time, you would be forgiven for thinking that there was a very high chance of it finally landing on tails on the next toss. Of course the odds are still no more than 50 per cent that it will be tails on the next toss.

Gambler's fallacy too has a role in the stock market, as people see (or think they see) patterns in price movements based on previous movements, and attempt to try and take advantage of the next perceived movement. Again this introduces inefficiencies into the market, which allows other investors to earn an excess return for taking an opposite position.

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We've included this article to highlight CIPL's role in helping to manage through difficult economic times, and to take advantage of better conditions. The media would have had clients sell everything last year. With markets now recovering it would have been the worst choice of all.

[1] Tversky, A. & Kahneman, D. (1991). Loss Aversion in Riskless Choice: A Reference Dependent Model. *Quarterly Journal of Economics* 106, 1039-1061.

STEPPED V'S LEVEL INSURANCE PREMIUMS

Which is best?

There are generally 2 ways to pay your life insurance premiums

1. A Stepped premium calculated each year in line with your age
2. A Level premium calculated based on your age when cover is commenced

Stepped premiums are generally lower the younger you are, but in later years Level premiums can be much more cost effective. It's a trade off between paying less now, and locking in a price for the future.

Just as you can opt for a combination of fixed and variable rate home loans you may want to split your insurance premium into Stepped and Level components.

As you build up more unencumbered assets you can then reduce your sum insured under the Stepped structure. As a result you end up paying Level premiums on most, if not all, of your insurance in the later years and benefit from the relatively lower premium costs associated with Level premiums at that time.

When choosing which option is best to use, it pays to keep in mind why you are insuring yourself. Generally insurance is taken out to protect your debts and income over the longer term. It can be sensible to make your insurance more affordable for the long term, so that you have the cover in place when you need it most.

Case study

Barry aged 35 took out life insurance cover of $1 million, Critical Illness of $500,000 and Total and Permanent Disablement of $500,000.

Although Barry has paid higher premiums in the early years, he chose Level premiums because he anticipated he would require the cover until he reached age 65.

Had Barry chose to pay Stepped premiums he would have paid between $1,333 and $39,927 pa for 30 years and incurred a total cost of $330,794.

However, Barry having chosen Level premiums over the next 30 years he would have paid premiums of $3,251 for a total cost of $97,530.

By having the foresight to select Level premiums Barry saved himself a total of $233,264. In the later years when cover was more likely needed it was far more affordable at $3,251 versus up to $39,927 at age 65.

ODDS AND ENDS

Interesting opportunities

Sometimes clients have unusual requests and we always try our best to add value in these circumstances. Right now three of our small business clients are looking to put in place succession planning measures. Do you have a son, daughter, friend or relative that might be interested in becoming involved in any of the following:

- A business servicing equipment on large ships. You must like hands on work, and be clever in a practical sense.
- A workplace training business, with excellent accreditations.
- A chain of retail stores in a seaside town.

Apologies for the vague descriptions, but it's important to preserve confidentiality. CIPL are not business brokers, but we are experienced in valuation, and integration of businesses, and we provide this service to clients as part of our normal commitment to them. We also do valuation and integration work when clients are looking to *buy* businesses.

CIPL is also looking for a Financial Planning Assistant to work from our Rockhampton office. You can view the advertisement on our website.

INVESTMENT BRIEFS

Here are some ideas for our trading clients:

Coca Cola Limited (CCL)
Coca Cola Limited is an Asian region anchor bottler for the Coca Cola Company.

It manufactures and distributes Coca Cola products throughout the Asia-Pacific region. The company's overall strength is based on a strong market position, a high return on invested capital, pricing power, strong cash flow and solid demand outlook.

82 per cent of group EBIT comes from the strong Australian economy and the balance from New Zealand and Indonesia, where economic recovery has started. While CCL has benefitted in a small way from the higher $A, it has been able to capture and secure market share through large investments in production capacity (Blue Tongue Brewery in NSW), warehouse and distribution facilities and retail site dispensing machines.

There are some risks for CCL however, with Kirin (Japan) entering the region through the acquisition of Lion Nathan.

For the full year 2009/10, brokers expect the stock to yield 4.4 per cent fully franked, with a target price of $11.00. It is presently trading at $10.40.

JB Hi-Fi Limited (JBH)

The company is a specialty discount retailer of branded home entertainment products – consumer electronics, car sound systems, music, and white goods.

The metrics around the JBH business are showing strength and momentum. Management has indicated that, while the economic environment remains unclear, they are encouraged by recent signs of strength in the Australian consumer market.

Guidance for FY2009/10 sales is for $2.8 billion, a 20 per cent increase on PCP. Stores sales for the 1st quarter 2009/10 have increased 8.4 per cent on PCP and are reflecting the opening of 7 new stores since 1 July. A further 8 openings are planned for the second quarter, taking the group's total store network to 137 by Christmas.

Brokers recently lifted the share price valuation to $19.54, and the target price to $22.31. The market price is $20.50.

AP Eagers Limited (APE)

This automotive retail group, provides full facilities for new and used motor vehicle sales, service, parts and consumer finance, throughout Brisbane, Darwin, Melbourne, Newcastle, the Hunter Valley and Sydney.

APE has given full year 2009 (Dec year end) guidance of $42 to $45 million net profit before tax. This is a big achievement for a group which has managed to reduce net debt by over 50 per cent, maintain its dividend, implement a share buy-back program, and deliver a record profit - all in a year when most in the industry suffered extreme financial pressure.

Clearly the result reflects stabilization in the motor industry, and some well executed management strategies.

Brokers recently lifted share price forecasts by 10 per cent for the full year 2009 and 2010, with a target of $15.12. The current price is $10.70.

Origin Energy Limited (ORG)

Origin is a vertically integrated energy company with operations covering exploration, development and production; power generation; energy retailing and trading.

The company is Australia's largest holder of coal seam gas reserves and is leveraged to potential export benefits.

A number of new gas projects will begin producing through 2015, and importantly, the company is well ahead of the curve in preparing for carbon regulation. It has invested in wind power, geothermal and solar energy, and most specifically in gas fired power generation.

Analysts expect cash flow and EPS growth of 10 to 15 per cent is expected with projections for 2009/10 as follows:

- EPS - 72.2 cents
- DPS - 50 cents

The 12 month price target is $18, and the current market price is $16.55.

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 within.

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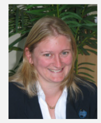

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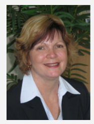

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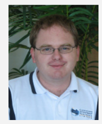

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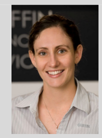

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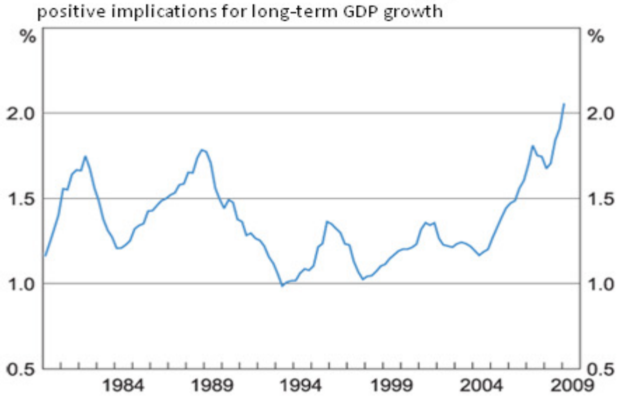
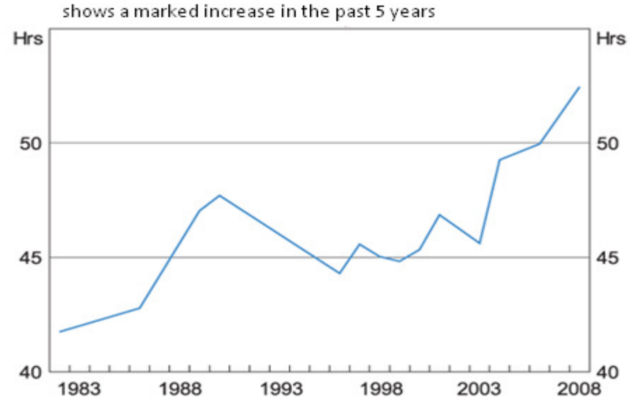
CHART PACK

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

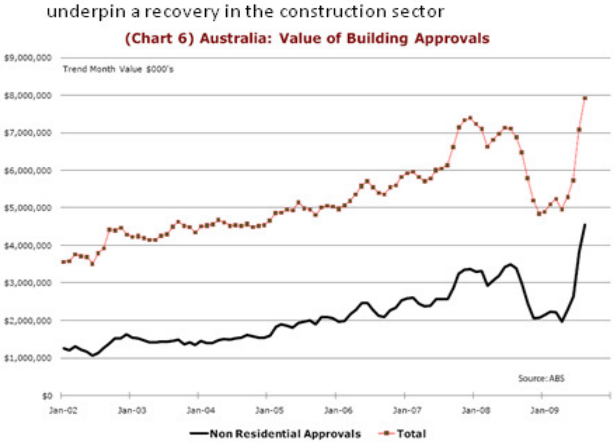
Australian Population Growth - An increasing population has positive implications for long-term GDP growth



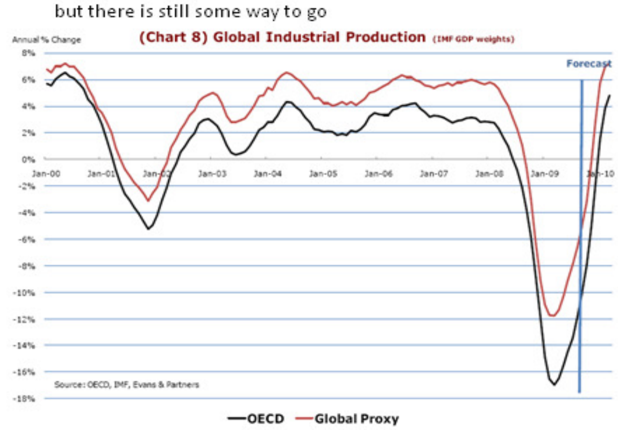
Feeling tired? - Weekly hours worked per Australian household shows a marked increase in the past 5 years



Australian Housing Market - The First Homeowners Grant helps underpin a recovery in the construction sector



A Wild Ride - A global sustained recovery appears to be underway, but there is still some way to go



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