

Investment Market Update No. 1

30 July 2003

Editorial

Welcome to the first of our monthly investment market updates. We aim to provide relevant commentary about current issues in the domestic and global economy.

In this issue we cover:

- reasons for why we think the RBA will not lower interest rates in the short-term;
- the importance of insurance; and
- provide some information on the upcoming Australian reporting season.

We welcome your feedback and comments. If you would prefer to receive future versions by e-mail, please contact Corrine by e-mailing corrine@therock.com.au.

From the team at The Rock Investment Planning, here's wishing you a prosperous 2003/2004 financial year.

David French
Head of Financial Planning & Business Solutions

Paper Scissors Rock

Since we opened our doors two year ago we are now looking after around \$25 million for clients. It's been a difficult time in investment markets, one where preserving value has been as important as increasing it. The fact that clients have weathered the storm very well is testimony to the skills of our staff and to our fee for service philosophy. That is, because you are paying us to look after your financial affairs, our only concern is to make sure we live up to your expectations.

One area where we can improve is in providing timely statements to clients. To that end we are implementing our own Portfolio Administration System. The system will allow for much better reporting, and improved decision-making. Many clients who are currently in the Macquarie system will be contacted regarding moving their portfolios over the next few weeks. Other clients have already been loaded into the system and will receive reports imminently.

Fixed Vs Variable

People are asking what to do with their home and investment loans – fix the rate or keep it at the variable rate. For those waiting for rates to fall, well you may have missed the boat. For the first time since December 2001 lenders (including ANZ, NAB, CBA, St. George and Westpac) have raised fixed rates. (source: The AFR, 23/7/2003).

Insurance

When we bring up the subject of insurance, many people roll their eyes and start thinking of the bad old days of the Life Insurance Agent – you remember, the person who would turn up at your door, briefcase at the ready, and not leave until you'd purchased a policy for yourself, your spouse, and your children.

Thankfully things have changed. Consider these real-life claims from Zurich in 2001.

A 37 year old company director took out \$500,000 life insurance in June. He had been married for two years. Eight weeks after the policy commenced he saw his doctor complaining of stomach pains he'd been experiencing for three weeks. Within another six weeks he had died from bowel cancer.

A 44 year old sales manager took out \$300,000 of life insurance in March. A month later, on Easter Sunday, he was driving his family to their holiday destination in their new 4WD when it ran off the road without braking. Tragically he and an eight year old girl were killed in the accident. Although the family was suffering emotionally, they were not disadvantaged financially.

No one can predict with any certainty when they will die or if they will be badly injured. Insurance is all about being prepared for these events and easing the burden if you are unfortunate enough for these events to befall you. If you have substantial debt, or limited assets, we think personal insurance is a must.

Interest Rates

There has been much talk recently about the direction of interest rates. Whatever happens in the short term, in the long term we are sure of one thing – they will rise.

Interest rates are relatively low at the moment because the Reserve Bank of Australia (RBA) is attempting to stimulate demand in the Australian economy. September 11, the Bali bombings, and the wars in Afghanistan and Iraq have left consumers (especially in the USA) feeling uncertain about the future. The result is they have not been spending.

Given the US economy accounts for such a large proportion of the world's economy this has implications for everyone. By reducing interest rates the RBA (and other central banks around the world) are encouraging investment by business and consumers. Low interest rates (and the increased competition in the home loan market) mean that the cost of obtaining finance is low.

This has in part been the fuel that has sustained the housing bubble. Basic economics dictates that markets work in cycles. There cannot be boom, boom, boom, without a bust. The RBA is aware of this and should the housing boom continue, will need to raise interest rates to cool down the Australian economy. It is doubtful whether this will occur in the next six months due to other pressures we are facing.

Largely because of the strength of the housing boom, interest rates in Australia are already generally higher than those in other western countries. The relatively higher interest rates attract an inflow of foreign currency and therefore an increased demand for Australian dollars. The increase in demand drives the dollar up. We have seen this over the past few months with the AUD reaching US\$0.66 or more.

Although a rising AUD is good for the Australian psyche the reality is that it makes exports increasingly uncompetitive. Australia is a trading economy and so this dampens the demand for our exports. A sustained high dollar will lead to lower economic growth, higher unemployment, lower inflation and lead to calls for an interest rate cut.

Notwithstanding the above, it is unlikely that interest rates will fall. A decrease in interest rates is likely to prolong the housing boom. People who otherwise

would have waited say twelve months before buying a house would decide to buy now.

You can see the dilemma the RBA faces. Keeping interest rates where they are appears to be the most likely scenario. When further evidence of the recovery in the US occurs, we would expect interest rates to increase.

Investment Implications

Bond like instruments, including reset preference shares and convertible notes perform well when interest rates are falling. Stronger economic growth, which is a precursor to rising interest rates, would normally see shares perform better than bonds. Over the next few months we will be looking at including more share based assets where clients have large diverse portfolios or where clients are not living off the income generated by their investments.

The Australian Reporting Season

Whether you have shares, managed funds or bond-like instruments in your portfolio, the upcoming profit reporting season will provide an insight into the health of the economy. In addition shareholders are looking for some guidance as to how their investments are performing.

Already many companies have nominated their reporting dates and brokers have been quick to respond with their profit forecast. If the trend from the USA over the past week is followed then those companies that miss their forecast earnings will be punished with substantial falls in their share price.

For example Lexmark fell 19.2 per cent after reporting Q2 earnings of 77 cents per share that missed expectations of 78 cents per share (even though this was up on the previous corresponding period of 67 cents per share).

Whether investing through managed funds or direct investments it pays to know what factors impact on the price of a security. We like to recommend stocks that appear cheap, and which have something of interest in the pipeline.

The Australian Gas Light Company (AGL) is attempting to purchase 35% of the Loy Yang power facility in Victoria. The power station is an important

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low cost producer and allows AGL to make money whether customers buy gas or electricity. The deal appears disliked by the ACCC for the same reason it is embraced by AGL – pricing power.

Stronger economic growth is good for resources stocks. In that environment **BHP Billiton** and **RIO** are worth looking at. Chinese iron ore imports are rising strongly for the fourth consecutive year, and the price of many base metals is starting to increase. These are good signs for resources stocks.

Paperlinx Limited (PPX)

Paperlinx should be able to benefit from any improvement in the paper market if its proposed acquisition of the Buhrman Paper Merchandising Division (BPMD) goes ahead. The market for paper is also sensitive to economic growth.

A reporting schedule of twenty-five stocks representing various industries follows along with forecast profits and current and target share prices.

2003 Reporting Schedule

Company	Share Price	Target Price	Year Ended	Report Date	Type	Profit PCP (\$m)	Forecast Profit (\$m)	% Variation
<i>Perpetual Trustees</i>	32.46	37.4	Jun	6-Aug	Fin	58.7	67.2	14.4
<i>Paperlinx</i>	4.77	5.4	Jun	14-Aug	Fin	123	130	5.7
<i>Leighton Holdings</i>	9.69	10.75	Jun	15-Aug	Fin	169.2	179	5.8
<i>Amcor</i>	8.49	10	Jun	21-Aug	Fin	280.5	375	33.7
<i>Aust. Gas Light</i>	10.75	11.58	Jun	21-Aug	Fin	247.1	318.1	28.7
<i>Qantas Airways</i>	3.21	4	Jun	21-Aug	Fin	433.7	454.4	4.8
<i>Woolworths</i>	12.49	13.56	Jun	26-Aug	Fin	523.2	609.4	16.5
<i>Foster's Group</i>	4.25	4.9	Jun	27-Aug	Fin	560.7	569.5	1.6
<i>Publish. & Broad.</i>	9.95	10.6	Jun	28-Aug	Fin	266.2	322.8	21.3
<i>National Foods</i>	3.79	4.09	Jun	1-Sep	Fin	51.1	60.5	18.5
<i>John Fairfax</i>	2.9	3.6	Jun	9-Sep	Fin	90.2	116.5	29.1
<i>Coles Myer</i>	7.34	8.77	Jul	3-Oct	Fin	308.3	404.5	31.2
<i>Crane Group</i>	10.5	12.1	Jun	29-Jul	Fin	33.6	46.1	37.2
<i>Onesteel</i>	1.99	2.2	Jun	19-Aug	Fin	47.1	95	101.7
<i>Origin Energy</i>	4.26	4.5	Jun	20-Aug	Fin	128.7	158.6	23.3
<i>Ridley Corporation</i>	1.57	1.7	Jun	26-Aug	Fin	32.1	39.3	22.2
<i>Adelaide Bank</i>	8.38	9.37	Jun	28-Aug	Fin	41.2	50.7	22.9
<i>Transfield Services</i>	3.16	3.5	Jun	2-Sep	Fin	19.4	25.5	31.7
<i>Southern Cross Brd.</i>	8.7	9	Jun	4-Sep	Fin	31.3	34	8.7
<i>Nufarm</i>	4.23	4.75	Jul	9-Oct	Fin	56.8	62.5	10
<i>Bank of Qld.</i>	8.7	8.94	Aug	17-Oct	Fin	33.2	41.1	24.1
<i>Rio Tinto</i>	30.85	37	Dec	31-Jul	Int	707.5	676.5	-4.4
<i>Santos</i>	6.13	5.5	Dec	20-Aug	Int	143.7	175.5	22.1
<i>Woodside Petrol.</i>	13.15	15	Dec	21-Aug	Int	289.6	270.7	-6.5
<i>BHP Billiton</i>	9.29	10.5	Jun	28-Aug	Fin	1934	1833.7	-5.2
Source: Macquarie Equities	Type	Int : interim dividend Fin : final dividend	PCP	Previous corresponding period				

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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