

# Planning Matters

Autumn 2011

**Welcome**...to the Autumn edition 2011 of Planning Matters. It's been a tough start to the year with natural disasters, affecting people both directly and indirectly. In parallel, the ongoing impact of the global financial crisis has taken a similar toll on investment portfolios, however we are confident of the market's prospects in the year ahead.

## Economic Outlook

Improving economies and earnings, price appreciation, funds flow momentum and value should trump the drag from Chinese policy tightening and the European sovereign debt crises.

Here in Australia, the healthy terms of trade and mining-related capital investment are driving above-trend economic growth.

While shorter term in nature, it's worthwhile considering the impact of Australia's recent weather-related events. They will trim economic growth near-term, with farming and mining industries the hardest hit.

Inevitably there will be rebuilding, which will lift output in subsequent periods. There is a risk that the rebuilding work could add to inflationary pressures by driving up costs after a sudden lift in demand for labour and materials. All this being equal, over time this could compel the RBA to lift interest rates by more than it would have otherwise.

Profit growth for 2010 should settle somewhere around 2%. Current consensus expectations point to growth in 2011 of 19%. Healthy growth should be seen in consumer staples, energy and resources. Interestingly, more defensive sectors such as consumer staples and healthcare have continued to grow profits throughout the downturn.

## Equities strategy

There are three investment themes to consider at this point in the investment and economic cycles:

1. *Leveraging the US recovery* - recent data on manufacturing, international trade and consumer spending indicates that US growth continues to accelerate.
2. *Commodity supply/demand imbalance* - Capital expenditure by producers across the commodity spectrum is increasing rapidly. Global mining expenditure is expected to hit a new record this year. With the global economy expected to grow at 3.4% this year, demand for metals and oil should be more than enough to outpace supply. Key

commodities that will see price rises from these supply/demand imbalances include coal, copper, iron ore and oil.

As for precious metals, inflationary pressures stemming from easy monetary policy and quantitative easing programs should limit the downside risk for precious metal prices in 2011.

3. *Dividends come in handy* - With a modest index target for 2011 of 5,000 points, high yielding shares are likely to be important components of portfolios. Dividend payments have re-based at more sustainable levels. The reason for this include lower payout ratios, more conservative balance sheets (lower debt levels) and smaller likelihood of acquisitive activity by companies. This means that investors should find current dividend streams more dependable.

## Economic recovery more persuasive

At the heart of the economic improvement is the private sector's shift away from a defensive stance. This is evident in the robust rise in business spending over the last year.

While developments in manufacturing have dominated economic progress to date, we expect the turnaround in non-manufacturing sectors will provide a stronger underpinning to the recovery.

Support has also come through accommodative monetary policies. Typically growth-friendly official interest rates linger well into expansionary periods. Close to two years into the current expansion and central bank policy rates around the world remain near the most accommodative on record. Australia's Reserve Bank has been one of the most progressive central banks in attempting to normalise its cash rate, yet it still sits below the historical average.

It is the behaviour of policymakers, especially those in emerging markets, that will be fundamental to establishing further confidence in the expansion and the next meaningful move upwards in investment markets.

\*\* The above extract has been sourced from the Ord Minnett Research Strategy Bulletin March quarter 2011 and February Monthly 2011. Please refer to their disclaimer at the end of this document.

## Manager in the Spotlight

### Winton Global Alpha Fund

Winton Capital Management Limited (Winton) is a global investment management company, that focuses on achieving absolute returns through advanced statistical research into financial markets. Founded in 1997 by David Harding, Winton has become a market leader in the specialised field of managed futures and currently manages in excess of \$US12.18 billion as at 30 September 2009.

A large part of the system that Winton applies to the fund can be described as 'trend following'. That is, it uses statistical research to analyse market trends and to establish trading strategies that aim to profit from each trend. Accordingly, Winton is likely to perform better in strongly trending markets. Winton may be less likely to perform well in markets that constantly change direction and do not follow an identifiable trend.

The fund objective is to generate long-term returns from a specialist managed futures strategy.

#### What does Winton invest in?

Winton Global Alpha Fund can be expected to take long and short positions in over 100 individual futures and forwards markets worldwide across the following five broad categories:

Futures	Examples of markets traded
Soft commodities	Coffee, Corn, Wheat, Soybeans
Hard commodities	Gold, Natural gas, Copper, Crude oil
Share indices	DJ Euro Stoxx (Europe), Hang Seng (Hong Kong), SPI 200 (Australia), Nikkei 225 (Japan)
Interest rates/Bonds	Gilts (UK Bonds), NZ Bills, Treasury Bonds (USA), Korean Bonds (3 yr)
Currencies	Japanese Yen, Australian Dollar, Canadian Dollar, Swiss Franc

#### Distributions

June and December

#### Performance (%) as at 31/01/2011

Total return	3 mths	1 yr	3 yrs	Inception#
Fund (post-fee)	2.25	19.5	10.8	13.3
Index*	2.2	9.3	6.5	7.8
<b>Relative Performance (post-fee)</b>	<b>0.05</b>	<b>10.2</b>	<b>4.3</b>	<b>5.5</b>

\* Barclay CTA Index

#Inception is March 2007

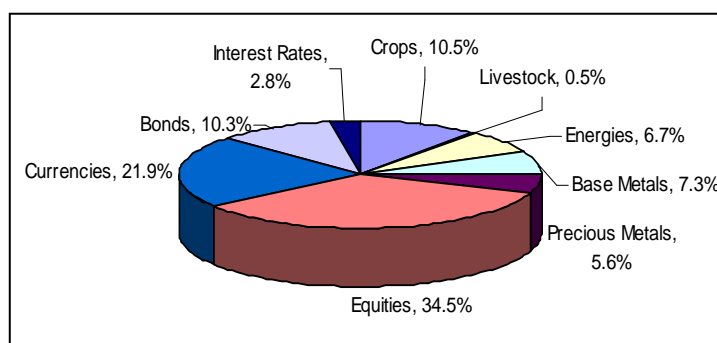
#### Management costs as at 31/01/2011

1.88% p.a.

#### Style Quality

Growth

#### Margin allocation by sector (as at 31/01/2011)



#### Index performance

The table represents returns across the major world indices for the past 12 months to 23 February 2011.

Index	Day (%)	Week (%)	MTD (%)	YTD (%)
S&P/ASX 200	-0.88	-1.51	2.16	2.35
ASX 200 Property	-0.77	-0.43	2.08	4.52
S&P 500 Comp	-2.05	-1.27	2.28	4.60
NASDAQ	-2.74	-2.16	2.09	3.90
Nikkei 225	-1.78	-0.76	4.17	4.26
Euro Stoxx 50	-0.96	-1.56	1.01	6.82
MSCI Wld \$US	-0.31	1.04	3.91	6.45
EPRA /NAREIT GI	0.12	0.61	1.94	3.80
Oil (WTI) \$US bl	8.55	10.33	1.50	2.40
Commodities US\$	1.92	2.05	0.65	3.72
AUD/USD	-0.41	-0.05	0.58	-1.84

~ Above Index Performance figures sourced from Advance daily report.

## Changes to legislation & technical update

### Flood Levy

The Government announced, on 27 January 2011, that it will introduce a flood levy for the 2011-12 income year to assist affected communities recover from the recent floods and rebuild essential infrastructure. The levy is based on an individual's ability to pay:

- Anyone earning under \$50,000 will not pay the levy
- Taxpayers in receipt of an Australian Government Disaster Recovery Payment for a flood event that occurred during the 2010-11 income year will be exempt
- People earning between \$50,000 and \$100,000 will pay 0.5% of taxable income in excess of \$50,000
- People earning over \$100,000 will pay 0.5% of taxable income in excess of \$50,000 and 1% of taxable income in excess of \$100,000.

### Paid Parental Leave (PPL)

As of 1 January 2011, the new Government funded PPL scheme makes life easier for new parents by offering up to 18 weeks of PPL at the national minimum wage, currently \$570 a week before tax. The leave can be taken any time within the first year after the birth and a new parent may be eligible if they:

- Are the primary carer of a newborn or recently adopted a child under the age of 16
- Are an Australian resident
- Meet the PPL work test before the birth or adoption (this includes having worked for at least 10 of the 13 months prior to the birth or adoption, and worked for at least 330 hours in that 10 month period). A person does not need to work full time to meet the test - they may be eligible if they are part time, casual, contractor, self employed, have multiple employers or have recently changed jobs
- As a primary carer, have received individual adjusted taxable income of \$150,000 or less in the previous financial year
- Are on leave or not working from the time they become the child's primary carer

In the case where an initial carer wants to return to work, the unused portion of their leave can be transferred to a partner.

Accepting PPL means families automatically forfeit their right to receive the Baby Bonus and certain tax benefits. As a result, families that are eligible for both payments will need to decide under which entitlement they will be better

off - a choice which often comes down to financial circumstances. The key differences between PPL and the Baby Bonus are as follows;

	<b><u>PPL</u></b>	<b><u>Baby Bonus</u></b>
<b>Payment</b>	Max \$10,258.20 over 18 weeks	\$5,294 over 26 weeks
<b>Tax treatment</b>	Taxable income	Non-taxable income
<b>Impact of other entitlements</b>	Can impact on Family Tax Benefit Part A and B, child support assessments, child housekeeper offset	No impact on other benefits
<b>Work test</b>	Carer must have worked at least 10 of the 13 months prior to birth or adoption and at least 330 hrs in the 10 month period	No work test
<b>Income test</b>	Individual adjusted taxable income must be \$150,000 or less in the year prior to date of birth or adoption or date of claim	Combined adjusted taxable income of the family must be \$75,000 or less in the six months following birth or adoption of the child

In the case of multiple births (such as twins or triplets) parents will be able to claim PPL for one child and the Baby Bonus for any subsequent children.

The Government estimates that 85% of families will be better off under PPL, receiving around \$2,000 more than if they chose the Baby Bonus. However in cases where parents are not eligible for the PPL, (e.g. where parents may have not worked the required period) or in instances where parents may be making a decision to return to work sooner than the 18 week period that the PPL is paid, the Baby Bonus remains an effective alternative.

To help decide which payment is more suitable, visit [www.centrelink.gov.au](http://www.centrelink.gov.au) for the PPL comparison estimator.

## Lending and Finance

### Banks declare war on Home Loan lending

We have seen in recent weeks a very public media campaign by the NAB & CBA in respect to meeting switching costs to attract each others home loan customers. Bank's are no different to any other business

and when home loan volumes reduce, Bank's need to find ways to grow market share in a limited Australian market.

Home loans and investment loans are particularly attractive to Bank's as they are inherently safer than commercial or business loans. The reason that they are more attractive to Bank's is twofold. Firstly, for every loan a Bank provides to a customer, it must set aside a small portion of capital to cover any potential loss in the future. Home loans attract a capital risk weighting which is 50% less than the capital set aside for commercial loans. The second reason is that history supports the fact that individuals go to far greater lengths to meet mortgage repayments on the family home compared to meeting repayments on business loans when things go wrong. That is why Bank's price commercial loans at a higher interest rate margin than mortgage loans to reflect the additional risk premium.

The RBA's increase in the official cash interest rate by 25 basis points on 3rd November 2010 to 4.75% was followed by the major Bank's passing on additional margin increases over and above the RBA's increase. The Bank's cited the increase in their wholesale funding costs and retail deposit costs as the major reason for passing on additional costs to consumers. In fairness to the Bank's this is true to the extent that wholesale funding costs have risen and clients holding cash deposits are certainly achieving better returns on term deposits and cash management accounts.

Why have the Bank's now intensified competition in the mortgage space? Is this due to Government criticism or is it for their own benefit?


We suspect the answer lies in the fact that the last round of interest rate rises in late 2010 had a significant impact on lending volumes. If customers are not borrowing to buy property then a Bank's income from home loans and investment loans will decrease as these loans are typically amortising over a 25 - 30 year term. These home loans and investment loans which are an asset in the Bank's balance sheet will therefore reduce on a month to month basis as home loan debt is repaid.

Therefore to counter this decline the Bank's are now attempting to win market share from each other. This is good news for consumers as pricing and switching fees are reduced.

If you are a shareholder in an Australian Bank either directly or indirectly via your superannuation fund the risk is that if the Bank's discounts the home loan rate then their Net Interest Margin which is a major driver and measure of their profitability income will decline. When ANZ last week announced quarterly earnings of ~\$1.4B, ANZ's share price was punished as their Net Interest Margin rose by only a couple basis points which was significantly lower than their peers.

Bank's will discount home loan and investment loans for a period of time to win market share and then progressively claw back the discounted margin over a period of time once the increase in market share has been achieved. The abolishment of exit fees by most Bank's does however suggest that Bank's will have to be careful not to upset their client base in future as it is becoming far easier to switch lending providers. If home loan interest rates are going to be cheaper for the consumer going forward, Bank's will seek to recoup these costs via fee increases in other areas of their businesses.

We all know changing home loans or investment loans is still a hassle, but at McLean Delmo we offer an obligation free review of your current home loan and investment loans. You may be surprised what you we can save by such a review and best of all we take all the hassles and frustration out of the process. We are accredited with over 30 different financial institutions and offer totally independent and unbiased advice.

 Please contact Jarrod Hodges on (03) 9018 4737 to discuss your current home loan or investment situation to ensure you are getting the best deal in the market.

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