Economic Briefing January 2013 Australia

Expert Panel Reduces Global Bond Allocation

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Executive Summary

Value Harder to Find

Morningstar's Expert Asset Allocation Panel held its first meeting of 2013 on 16 January, and its discussion focused heavily on valuation issues. In the quarter leading up to the meeting, cash rates had remained extremely low, and the US Federal Reserve had announced that ultra-easy monetary policy was now likely to be maintained all the way out to 2015. Although bond yields had picked up a little in some of the major markets, they remained at very low and generally unattractive levels. And equities, including listed property, had risen strongly virtually everywhere in the last weeks of 2012. With cash and bonds paying very little as a running yield, bonds vulnerable to capital losses if the world economy strengthened, and shares on now more expensive valuations, where did the investment opportunities lie?

On the equities front, members felt that there had been some positive developments since the Expert Panel's previous meeting last October. The US economy had continued to grow at a modest rate, and the Obama administration and Congress had, just, managed to avoid falling off the fiscal cliff. The Chinese economy, which had looked as if it risked slowing down from its previous breakneck rate of growth, had picked up steam again in recent months. And a new government had taken office in Japan with an agenda of prodding the Bank of Japan into more vigorous action against deflation, and of spending more on infrastructure projects to get the economy growing faster. There were still some important headwinds: clearly the US fiscal cliff negotiations had not covered all the issues, and there could still be "a sting in the tail", as one member described it; economic conditions in the Eurozone remained very weak; in Australia the economy was in the middle of a transition from the previous resources boom; and in the background there was still the longer-term post-global financial crisis issue of over-indebted households and governments having to get their affairs into better order, which would weigh on growth prospects for some time yet. Overall, though, recent data had somewhat reinforced the Expert Panel's pre-existing view that the world economy would continue to grow at a decent though not strong rate, without being derailed by financial shocks, and from that perspective the outlook for equities appeared to have brightened a bit.

The main issue, though, was that the strong rise in equities that had occurred in late 2012 may have already factored in all of this expected improvement. As one member said, that is how markets work. At first, apparently supportive policy initiatives may be discounted by investors, as they remain in doubt about whether the initiatives will be carried out and whether they will be effective. (He instanced the case of the need for the Fed to introduce a whole series of quantitative easing programs when the first ones did not appear to have done the trick.) At some point, however, investors shift from doubt to belief that stimulatory policy will be effective, as they appeared to have done in late 2012 as they started to believe that the previously depressed US housing market was turning for the better, and that a moribund Japanese economy was going to get more of a kickstart. The actual improvement in the 'real' (non-financial) economy tends to happen after the financial markets have already anticipated it.

Members discussed whether growth assets could continue to 'kick on', or whether, at current valuations for growth assets, all the potential upside for the global economy had already been incorporated into growth asset prices. The upshot was that the Expert Panel opted to maintain a modestly overweight allocation to international equities, the conversation focusing on whether to hold at the current level or increase it. While a somewhat improved outlook for global business activity might have warranted an increased allocation to growth assets, the Expert Panel was not sure that current, more expensive valuations supported a larger overweight allocation than the portfolio already carried. Some members felt that conditions were ripe for higher valuations, and that (for example) price/earnings ratios could rise further in an environment where actual and expected inflation is low and growth is picking up. Some pointed to the likelihood of more confident investors progressively increasing their allocations to equities, which would also tend to boost share valuations. Others, however, felt that shares had already become fully-priced, and that in a relatively subdued world, it was not realistic to expect shares to move to even more expensive levels. It was also noted (as it had been at the group's previous meeting) that some of the recent rise in asset prices represented a possibly temporary 'liquidity pulse' running through markets from the very loose monetary policies being run by the big central banks, and that it could be risky to continue to rely on this indefinitely. On balance, the Expert Panel preferred to hold its existing modest overweight allocation to international shares.

There was also extensive valuation-based discussion about an appropriate allocation to international and Australian fixed interest. All of the members of the group were concerned about the value on offer, particularly from government bonds: while the pick-up in yield from hedging overseas currencies back into local dollars helped returns a bit, and the credit spreads from corporate bonds were acceptable, although significantly less attractive than previously, overall the running yield was barely adequate. Importantly, if the world economy picked up a head of steam, there was the risk of ultra-low government bond yields rising, causing capital losses. "They could back up quite a bit. It's not imminent, but it can happen, and it can happen quicker than you think. You don't want to be there", as one member put it. From the point of view of the overall tactical portfolio, however, bonds continue to provide insurance against downside risks to the global economy, and central banks are still minded to keep interest rates (including bond rates) low for some time yet. The existing slight overweight allocation to international fixed interest was however looking rather anomalous, and the Expert Panel decided to take this back to neutral, and transfer the one percent into what looked like a lower-risk, higher-yielding option, Australian listed property. But it was a close call even to continue to hold a benchmark allocation, members very much on the alert to the risk of long-term interest rates rising. A number of members noted that in the interim, their firms were managing the associated risks by concentrating on shorter maturities (which lessen the scale of any capital loss if bond yields were to rise), and on the relatively better returns from corporate debt.

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Table 1: Morningstar Australian Strategic and Tactical Asset Allocations

Asset Class	Strategic Asset Allocation %	Tactical Asset Allocation Range %	Tactical Asset Allocation October 2012 %	Tactical Asset Allocation January 2013 %	Tactical vs Strategic January 2013 %
Australian Cash	12.0	–	11.0	13.0	+1.0
Australian Fixed Interest	12.0	–	11.0	12.0	–
International Fixed Interest	6.0	–	10.0	6.0	–
Australian Property	8.0	–	3.0	8.0	–
International Property	3.0	–	3.0	1.0	-2.0
Australian Equities	23.0	–	22.0	21.0	-2.0
International Equities	36.0	–	40.0	39.0	+3.0
Total Income Assets	30.0	20.0 – 40.0	32.0	31.0	+1.0
Total Growth Assets	70.0	60.0 – 80.0	68.0	69.0	-1.0
Total Onshore Assets	55.0	–	47.0	54.0	-1.0
Total Offshore Assets	45.0	–	53.0	46.0	*1.0

1. Australian Fixed Interest and Cash

Review

Short-term interest rates fell during 2012: 90-day bank bill yields ended 2011 at 4.50 percent, and finished 2012 at 3.07 percent. The drop was due to a succession of interest rate cuts from the Reserve Bank of Australia – 0.50 percent in May 2012, and three lots of 0.25 percent each in June, October, and December.

Longer-term interest rates ended up slightly lower for the year: the 10-year Commonwealth bond yield started 2012 at 3.67 percent and finished at 3.27 percent. There was a strong correlation throughout the year with offshore bond yields, and hence with the state of global investor confidence. When investors had been most worried, global sovereign bonds were bought heavily, and local Commonwealth bonds were no exception, the 10-year yield hitting a low of 2.70 percent in July when worry levels were high about the prognosis for Eurozone debt and global economic activity. Bond yields have been rising again more recently as investors have regained some confidence. Global sharemarkets, for example, have been on the rise since the middle of last November, global bond yields have risen correspondingly, and local yields have followed them up, from 2.95 percent on 15 November 2012 to 3.36 percent as the Expert Panel met on 16 January 2013.

Outlook

The Expert Panel did not have any issues with the financial markets' assessment of where short-term interest rates might go next. The futures market was at the time of the Expert Panel's meeting expecting one more 0.25 percent cut from the Reserve Bank, 90-day bank bills expected to be 2.76 percent at the end of this year, down from 2.99 percent in mid-January.
A further small reduction in cash rates would mean that the banks' interest rate 'specials' would continue to be competitive relative to the running yield from local fixed interest, and the Expert Panel therefore maintained its slightly overweight tactical allocation to cash.
The Expert Panel spent little time distinguishing between local and international fixed interest, as the two have been moving in close tandem and were expected to continue to trade in parallel, and opted to take the same approach to both – a benchmark allocation, as some insurance against any setbacks to the global economy – and with the same risk mitigants of keeping to shorter maturities and focusing on the better income yields from corporate debt.

Australian Dollar

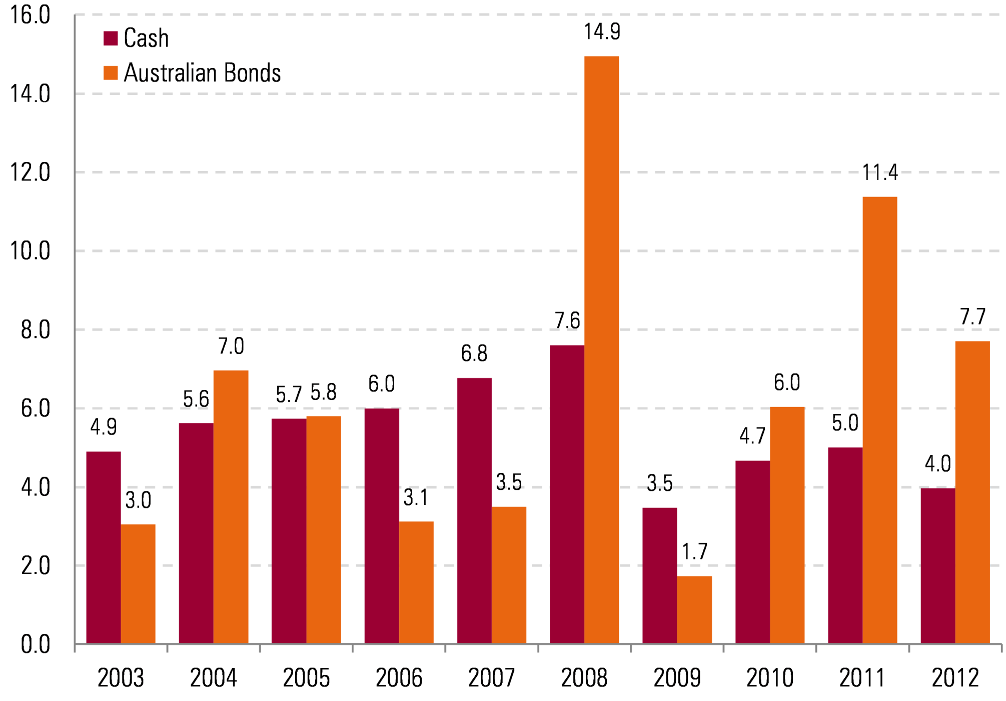
Review

The Australian dollar strengthened against the $US over the past quarter, up 2.70 percent from $US1.019 to $US1.046. This mostly reflected the global weakness of the $US, which lost 2.10 percent in overall value, according to the Fed's index. The $A, on the other hand, gained a modest 0.50 percent in overall trade-weighted value for the quarter.

Outlook

Panellists did not have a strong view on the outlook for the $A. Some factors pointed to appreciation, such as the recent firming of resources and energy prices, while others pointed more to a weaker currency, such as the likelihood of lower domestic interest rates and international investors deciding that there were better opportunities elsewhere. Overall, members felt that if anything, there were more downside than upside risks to the $A. While the tactical portfolio allocations were not designed explicitly to take a strong currency position, in the event the portfolio is aligned towards a greater probability of a lower $A, with an overweight allocation to foreign currency assets.

Figure 1: Calendar Year Returns from Australian Cash and Bonds, 2003 – 12



Source: Morningstar Direct™

2. Australian Property

Review

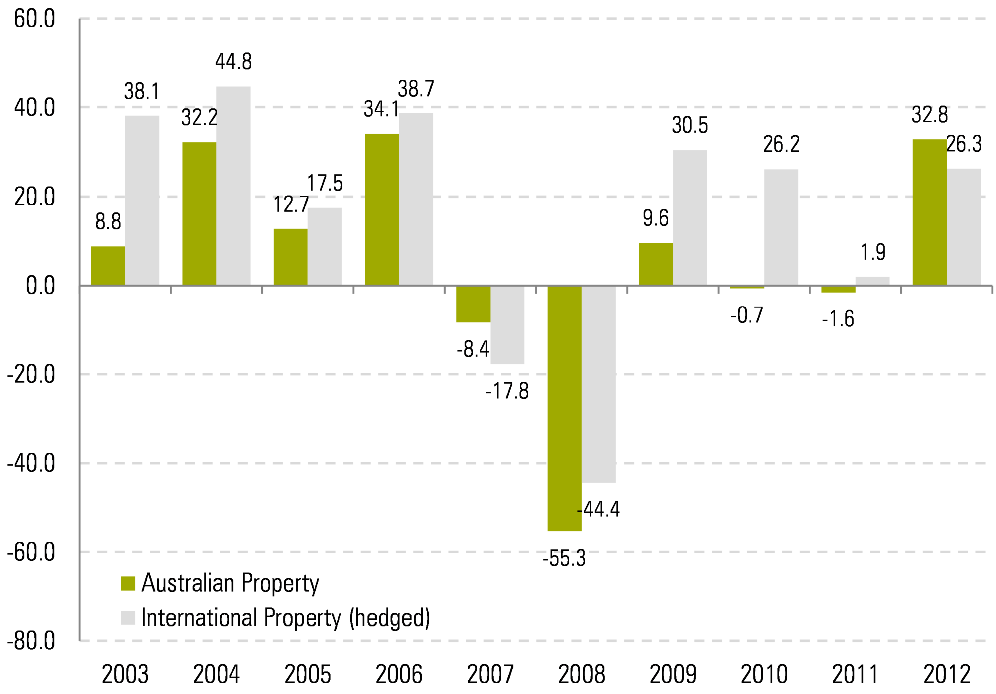
Australian listed property had a very strong year, up 25.20 percent in capital value and providing a total return including pre-tax income of 33.0 percent. The sector also offered relatively low volatility compared to equities more generally, the S&P/ASX200 A-REIT Accumulation Index making steady ground throughout the year.

Outlook

The Expert Panel increased the tactical allocation slightly, taking the sector back to a benchmark allocation. The rationale was the combination of "low beta" (relatively low volatility compared to other equities) and the yield of 5.0 - 5.50 percent, which remains attractive, even more so in the current 'low cash and low bond rates, for even longer' environment. The present period of persistently low interest rates also works in the property companies' favour by enabling them to replace their existing debt on better terms when it rolls over, and by lowering cap rates (the interest rates used to value the properties they own), boosting their value.

The current slowdown in overall economic growth is not the best of news for the sector. As the latest (March 2013 quarter) Property Council of Australia/ANZ Property Confidence Index Survey showed, property owners are expecting slower national economic growth, although industry confidence has picked up on the latest reading, due principally to improved confidence in the resource-rich states of Western Australia and Queensland, where confidence had previously been falling in line with world commodity prices, but has now risen as prices have picked up a bit again. A slowing economy means that any property price appreciation is likely to be modest. The PCA/ANZ survey showed a mixed bag, only retirement properties expected to bank good capital gains. Industrial owners expected modest gains, but there was likely to be little or no capital growth in the office and hotel sectors, and outright declines in retail property reflecting ongoing cautious spending by households. Overall, property values looked to hold steady, with not a lot of downside risk (beyond retail-focused trusts).

Figure 2: Calendar Year Returns from Australian and Global Listed Property, 2003 – 12



Source: Morningstar Direct™

3. International Property

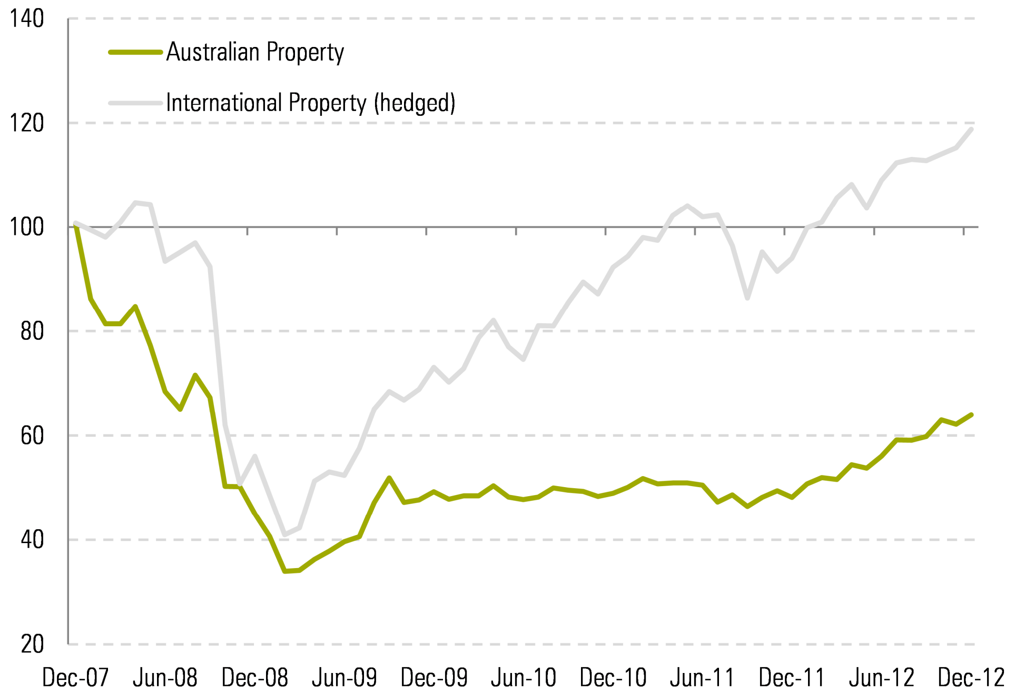
Review

Global listed property also had an excellent 2012. The EPRA/NAREIT Global Index of listed property turned in a very strong 28.70 percent gain in $US terms for the year, while Morningstar's preferred benchmark for the sector (the EPRA/NAREIT Global ex-Australia Index hedged into $A) produced an even better 32.0 percent return. Like domestic property, the returns were steady, the market making consistent progress all year. The stars of the show were the Asian markets (+45.50 percent in $US terms), Japan turning in a remarkable 68.20 percent rise (in yen). Japanese listed property prices surged towards the end of the year, reflecting the incoming Liberal Democratic Party administration's focus on economic reflation in general and infrastructure spending in particular. Virtually all the other main markets also chipped in with good gains, ranging from 18.0 percent (in $US) from the US, to 25.90 percent (in euros) in Europe ex-United Kingdom, and 29.90 percent (in sterling terms) from the UK itself.

Outlook

The Expert Panel has been wary of international property, which means that the tactical portfolio missed out on the strong rise in 2012. However, the outsized gain also vividly illustrated the Expert Panel's main issue with the sector, which was a flood of money chasing a rare pocket of relatively attractive yield. This was particularly true in the US, by far the largest component of international property share indices, where heavy buying has resulted in the yield on US REITs offering only 3.50 percent, a return that can be bettered by many non-property equities. The economic outlook in a strengthening global economy is helpful for property, as is the likelihood of extended low yields from cash and bonds. But valuation issues are now even more problematic, both in the US and Japan, where investors banking on the 'you scratch my back' relationship between the incoming Liberal Democratic Party government and the construction industry have sent the shares of construction and development companies into the stratosphere. The Expert Panel maintained its underweight allocation.

Figure 3: Investment Growth of Australian and Global Listed Property, Five Years to 31 December 2012



Source: Morningstar Direct™

4. Australian Equities

Review

Australian shares also had a good year, the S&P/ASX200 Accumulation Index gaining 16.40 percent. As with international shares, a good deal of the rise was concentrated in the last six weeks of the year, the index gaining 8.90 percent between 16 November and year-end. The more defensive 'widows and orphans' end of the market paid off best: the financials sector returned 21.70 percent and consumer staples (things people have to buy irrespective of the economic cycle) was up 21.0 percent. The resources sector missed out, the S&P/ASX300 Metals and Mining Index down 2.10 percent for the year to 31 December 2012, all of this racked up in the first half of the year when doubts about global economic activity in general, and Chinese commodity demand in particular, were greatest. Resources stocks performed better in the second half as investor confidence became more robust, and right at the end of the year, previously falling commodity prices started to improve.

Outlook

Panellists opted to continue with a modestly underweight allocation to Australian shares, partly on broad macroeconomic grounds, and partly for reasons related to the sharemarket itself, where members felt that performance would be rather patchy.

On the broad outlook for business activity, it was clear that the economy is in a transition phase, overall economic growth slowing down as the resources sector cools a bit, while the more domestic sectors have not picked up enough of the slack. Consensus forecasts for GDP growth in 2013 are currently around the 2.80 percent mark (after growth that was probably about 3.50 percent in 2012), but these forecasts are likely to move a bit lower in coming months (the National Australia Bank's latest pick is two percent, for example). An improvement is likely in 2014 – Expert Panel members pointed, for example, to the progressively growing impact of easier monetary policy – but in the meantime, the economy is going through a sluggish patch, with consumer confidence steady (rather than perking up on the back of interest rate cuts), business confidence generally weak, leading indicators pulling back (as the latest Westpac/Melbourne Institute reading showed), and the labour market softening, with a small loss of jobs in December. The recent pick-up in commodity prices has steadied the ship for the resources sector – the Reserve Bank found that commodity prices increased 0.90 percent in $A terms in December – but even so, 2013 looks like a more difficult year for corporate profit growth than 2012 was.

This makes for a reasonably difficult backdrop for Australian shares in the aggregate: "can companies achieve the 10.0 – 12.0 percent rise in earnings that people are currently expecting? I'm agnostic about that", was one comment. Members did however believe that some sectors could do better than others. "Last year was dominated by the defensive sectors, and the resources missed out. This year, it's also a mixed story, mining still doing it tougher, and some of the more domestically-oriented stocks are having a pretty mediocre time", one Panellist said. "Defensives have done their dash [in 2012], but the cyclicals can still make a run from here, and there are considerable opportunities for growth stock-oriented funds," was another's assessment. Members felt, in sum, that there could be selective opportunities in the market, particularly outside the most defensive sectors that had been investors' favourites in 2012, but were reluctant to commit a full benchmark allocation to the market.

Figure 4: Calendar Year Returns from Australian Shares and Australian Small-Caps, 2003 – 12

Source: Morningstar Direct™

5. International Fixed Interest

Review

As with international shares, the story of international fixed interest in 2012 was one where the reasonably benign headline result concealed some strong undercurrents. For the record, the overall result was positive, the Barclays Capital Global Aggregate Index banking a 4.20 percent gain in $US terms over the year to 31 December 2012. But the overall result was made up of very different sub-trends.

Government bonds as a whole returned only 1.50 percent, thanks to a combination of very low running yields and a small rise in yields (entailing modest capital losses) at the end of the year. Despite this late rise in yields, 2012 closed with 10-year maturity bonds in the major countries still offering historically tiny income streams – 0.70 percent in Switzerland, 0.75 percent in Japan, 1.50 percent in Germany, 1.90 percent in the US, and two percent in France and the United Kingdom. While sovereign bonds overall did little more than preserve capital – a benefit nonetheless arguably worth having in a year of considerable financial uncertainty – some countries paid off handsomely. Investors disillusioned with the yields on offer in the major developed economies turned to the debt of the emerging economies, and the resultant bidding up of their prices saw emerging market sovereign bonds return 18.70 percent for the year. And for those brave enough to hold them, Greek, Portuguese, and Irish sovereign bonds generated very large capital gains as their yields fell (from 34.0 to 11.80 percent, 13.60 to seven percent, and from 8.50 to 4.50 percent respectively).

The big payoff in international fixed interest (the emerging markets and more indebted European nations excepted) came from corporate bonds. The Barclays Capital Global Corporate Index returned 11.10 percent for the 2012 year. As with government bonds, within the overall corporate bond sector the really big returns came from the riskier end of the spectrum, 'high yield' (low credit quality) corporate bonds returning 20.40 percent in the US and 26.70 percent in Europe.

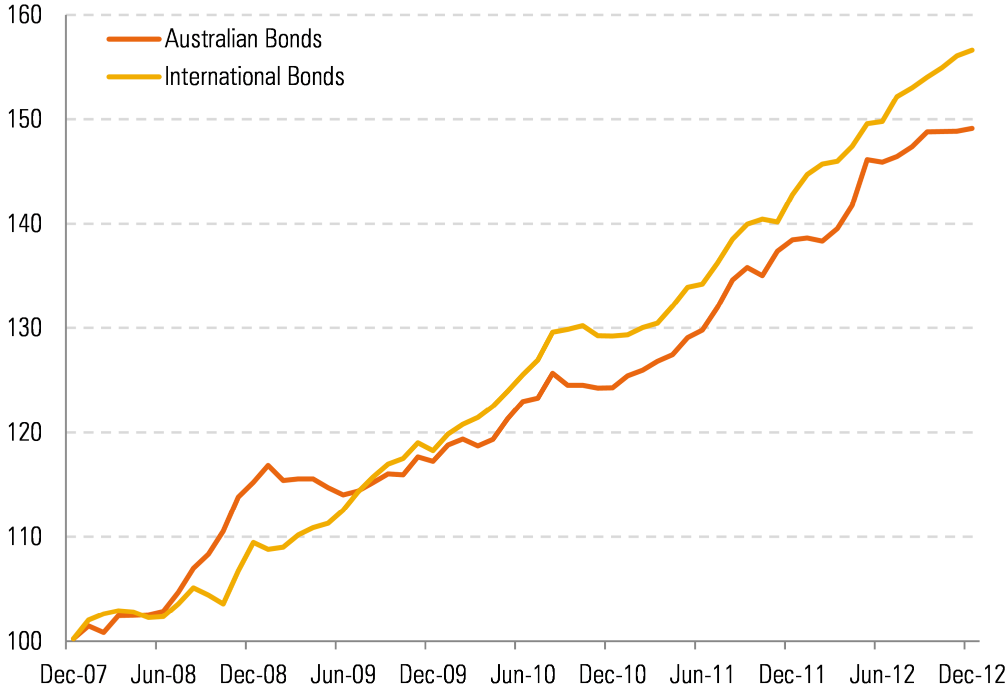
Outlook

The Expert Panel talked through the principal issues relating to international fixed interest at some length. On the positive side, members noted the foreign exchange hedging pick-up in yield from international bonds, which improved their relative attractiveness, and the greater depth and range of corporate credit available from overseas markets. Members also favoured the income stream from corporate credit, even if it is now lower: "credit spreads are definitely tighter, and the outsize returns you got from the corporate credit trade over 2009 - 12 are over, but even so you are getting okay compensation for the credit risk. It's not a situation like 2007, when the returns for holding credit imploded", as one member put it.

The asset class does also have its problems, particularly around government bonds: "if this isn't a grossly inflated bubble in government bonds, what is?", as one member rhetorically asked. Others agreed. One said: "I'm very mindful that there has been a big bull run in bonds by both institutions and retail investors, and I'm very, very cautious about valuations in fixed interest". Another could buy the running yield argument, and the currency hedge pick-up, but was nervous about the issue of potential capital loss as and when government bond yields rise again. One member also pointed out that the risk of holding government bonds was increasing, because the duration (time to maturity) of government bond indices was getting longer, meaning that an index holding of government bonds would be more vulnerable than before to rising interest rates.

Despite these issues, the Expert Panel concluded that bonds in current circumstances warranted a benchmark exposure in the tactical portfolio, largely for insurance value: "bonds act as a hedge against inflation, and they act as a hedge against the risk of anaemic growth, and those are risks that investors still need to factor in", as one member said. Members also noted that central banks, and in particular the US Federal Reserve, were looking to keep interest rates low for even more extended periods into the future, and felt that current investors in government bonds were not yet ready to sell out of their holdings. While the risk is that government bonds' next big move will be back up, this did not look like happening over the next quarter. Several members were managing the potential risk by keeping maturities short, and continued to strongly favour corporate credit over government debt.

Figure 5: Investment Growth of Australian and Global Bonds, Five Years to 31 December 2012



Source: Morningstar Direct[TM]

6. International Equities

Review

While world sharemarkets overall had a good year in 2012, the MSCI World Index up 13.10 percent in overseas currency terms, there were some qualifications to the story. A good slab of the performance occurred very late in the piece, in the second half of November and in December: the MSCI World Index rose 6.30 percent between 14 November and the end of the year. Investors needed to be fully-exposed to two markets in particular to bank the full benefits – Germany, where the DAX Index rose 29.10 percent, and Japan, where the Nikkei was up 22.90 percent. Local currency appreciation also clawed back a bit of the overseas share price gains, the $A up 1.70 percent in overall value for the year.

Germany and Japan led the field among the major developed markets, followed by France (+15.20 percent). The emerging markets also did quite well (+13.90 percent), India among the larger emerging economies performing strongly (the Mumbai Index was up 25.70 percent). The Chinese sharemarket was very weak for virtually all of 2012, but finally turned around in December and eked out a marginal 4.40 percent gain for the year in yuan terms. US shares did reasonably well, the S&P500 Index up 12.90 percent, as did European shares overall (both the MSCI Europe and FTSEurofirst 300 Indices were up 11.80 percent for the year). The clear laggard among the major overseas markets was the United Kingdom, where the FTSE100 Index gained only 5.80 percent in calendar 2012.

Outlook

The Expert Panel maintained its existing small overweight tactical allocation to international shares. Part of the reasoning related to likely flows into shares from more confident investors, and part related to an improving outlook for global economic activity.

A number of Panellists pointed to the fact that following the global financial crisis, both institutional and retail investors had radically cut their allocations to shares and increased their allocations to cash and bonds. With the latter now offering much lower income yields, and investor confidence improving, it was likely that shares would benefit from reawakened interest. This did not necessarily mean that sharemarkets would be deluged with inflows of new money: "money is starting to move, but it's not all into equities necessarily. Investors are buying things like corporate subordinated debt and hybrid issues, property has benefitted more than it might have, and to the extent that the sharemarket has been getting it, it has been the more defensive equities rather than the market as a whole", as one member of the group stated. Another agreed: "we're not going to see the sorts of equity holdings that we saw pre-GFC. It's not as if people have nothing better to do with their money… It's more spotty than that – good companies with comparative advantage will find a tailwind behind them, companies with longer-term issues will struggle, and your average stock will do a bit better."

As one example, the latest (November) data from the UK's Investment Management Association, the industry body for the UK's retail managed funds, showed that retail investors have indeed started to change their investment patterns. Net sales of share funds have been picking up strongly, to the highest level since April 2011, while net sales of bond funds have dropped sharply. As the Expert Panel noted, it is not a simple case of investors deciding 'everything into equities', but nonetheless demand for equities is picking up and demand for other asset classes is diminishing.

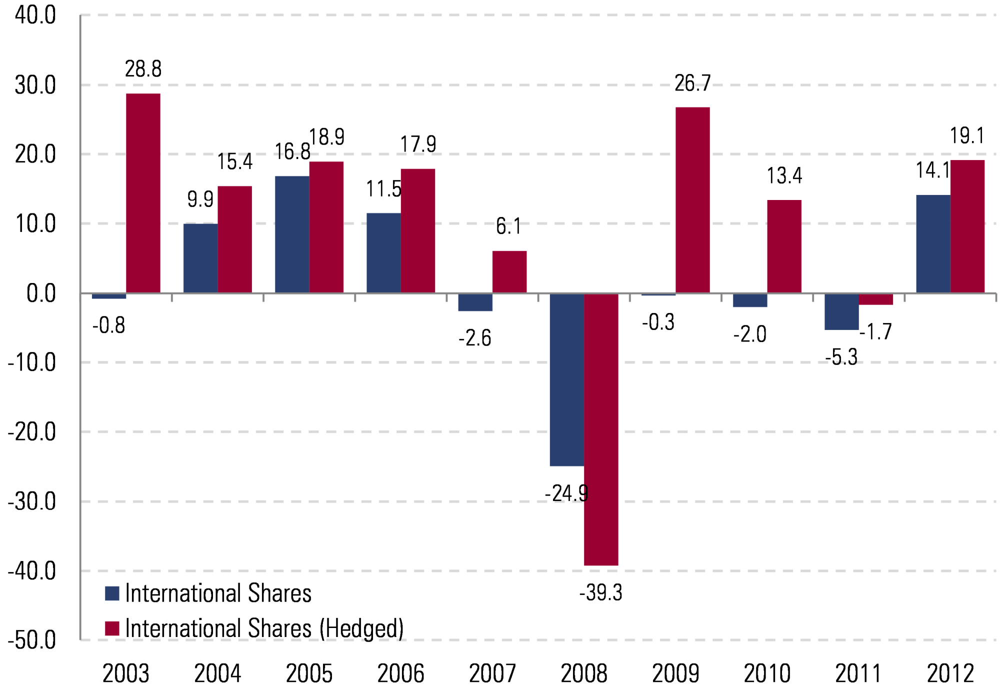
On the economic front, the news on balance has been getting better. At the October meeting, one member had advised keeping a close watch on the US housing market, which he felt could be in the process of delivering an unexpected positive surprise, and indeed it did. US housing starts rose by 12.10 percent in December alone, the most robust level of housebuilding since July 2008, and were up a very strong 36.90 percent on a year ago. Housing will be making a strong contribution to ongoing US GDP growth, and in the latest (January) forecasts from the large panel of economists surveyed by the *Wall Street Journal*, the US economy is expected to pick up from two percent growth in 2012 to 2.30 percent this year and 2.90 percent in 2014. This is not a startlingly strong performance, but is enough to create about 160,000 new jobs a month and to chip away gradually at the still-high unemployment rate, bringing it down to 7.40 percent by the end of this year and to seven percent by the end of next year. The US still faces some risks: as a number of Panellists observed, the fiscal negotiations between the Obama administration and Congress could hit potholes, and even if a political deal is reached on issues such as the debt ceiling and the level of government expenditure, it will mean some degree of fiscal policy tightening (albeit not as severe as falling off the fiscal cliff would have entailed). That said, the US looks set for a gradual acceleration in business activity.

There was also good news in the rest of the world. Members were particularly encouraged by the most recent data out of China, which had looked as if it had been heading for a period of slower growth. One of the most up-to-the-minute readings on what is happening to Chinese economic activity – the HSBC Composite Purchasing Managers Index, which covers both the Chinese manufacturing and services sectors – picked up further in December, and is now showing four months of steadily increasing growth rates. "This is genuinely new information, and it looks as if China is at a transition point to faster growth," was one Panellist's take, while another said that: "There are clearer signals that at the very least the Chinese economy is bottoming out. It's a mixed story, depending on which numbers you look at, but at a minimum it looks as if the growth rate has stabilised, and it could well be expanding again." At the time, the Expert Panel did not have the benefit of the official Chinese GDP statistics, which appeared after the meeting, but the published numbers confirmed the upbeat view, year-on-year GDP growth accelerating from the 7.40 percent of the September 2012 quarter to 7.90 percent in the December quarter.

The prospect of faster economic growth in Japan was also a plus, although members had nuanced views about this. While the latest consensus forecasts still have the Japanese economy likely to grow by only 0.70 percent this year, this relatively downbeat view may have been left behind by the latest events. "There has been quite a dramatic effect on Japan's financial markets, reflecting the policies of the incoming government", one member noted. "It looks very much as if people in Japan believe in the rhetoric of the politicians, and that their policy measures might well succeed". Some Panellists, however, were less impressed with an already debt-encumbered government's plans to ease fiscal policy and engage in more, probably unproductive spending on infrastructure: "half of what they do looks sensible, and half makes me want to cringe", one member said.

It has not been all one-way traffic for economic news. In the Eurozone, in particular, business conditions have remained grim. Only Germany of the four large Eurozone economies looks to be recovering, slowly, from falling output in the December quarter, while the other three – France, Italy, and Spain – look to be continuing in recession, with the best that can be said being that the rate of decline seems to be slowing. And as the past four years have repeatedly shown, financial market squalls – or storms – can materialise with little warning. Even so, a combination of more sharemarket-friendly buying demand from investors, and better economic prospects, while set against noticeably more expensive valuations than before, led the Expert Panel to continue with an overweight tactical allocation. M

Figure 6: Calendar Year Returns from Hedged and Unhedged International Shares, 2003 – 12



Source: Morningstar Direct™

Table 2: World Sharemarket Returns to 31 December 2012

Index	Currency	1 Mth %	3 Mth %	6 Mth %	1 Yr %	2 Yr %pa	3 Yr %pa	5 Yr %pa	10 Yr %pa
World ex-Australia	AUD	2.34	2.49	7.66	14.14	3.95	1.91	-4.55	0.93
	Local	1.85	2.78	8.40	15.51	4.60	6.51	-1.49	6.03
S&P500 (USA)	AUD	1.40	-0.21	4.61	14.55	8.15	5.69	-1.69	0.75
	USD	0.91	-0.38	5.95	16.00	8.84	10.87	1.66	7.10
NASDAQ (USA)	AUD	0.94	-2.49	2.37	15.98	7.24	5.99	0.26	1.25
	USD	0.45	-2.65	3.68	17.45	7.93	11.19	3.68	4.37
Nikkei 225 (Japan)	AUD	5.48	5.62	5.16	8.03	-2.99	-2.77	-5.79	-1.03
	JPY	10.05	17.19	15.42	22.94	0.81	-0.48	-7.45	1.94
FTSE100 (UK)	AUD	2.51	4.25	10.11	13.59	5.01	1.85	-5.25	1.65
	GBP	0.58	3.40	7.61	9.97	3.72	6.61	2.03	7.96
CAC40 (France)	AUD	4.42	11.68	17.64	19.17	-0.59	-6.88	-10.05	0.92
	EUR	2.51	8.80	14.69	18.83	0.92	0.47	-5.04	4.86
DAX (Germany)	AUD	4.71	8.28	21.69	29.43	3.36	0.57	-6.37	6.01
	EUR	2.79	5.49	18.64	29.06	4.93	8.51	-1.15	10.16
NZX50 (NZ)	AUD	1.43	5.51	21.22	29.68	13.20	7.33	-1.82	6.20
	NZD	0.41	6.06	19.61	24.18	10.86	7.98	0.12	7.73
BRIC40	AUD	6.02	6.12	11.67	11.99	-3.95	-3.40	-6.33	9.23
	Local	5.51	5.95	13.10	13.41	-3.33	1.33	-3.14	12.52
MSCI China A	AUD	18.09	10.00	2.39	8.11	-8.71	-11.24	-12.50	5.96
	CNY	17.59	8.87	1.68	8.37	-10.67	-9.69	-12.35	9.49
MSCI India	AUD	0.47	0.65	14.52	24.39	-11.60	-6.05	-10.30	11.02
	INR	0.71	4.38	13.82	29.96	-1.52	4.07	-0.93	19.61
MSCI World Small	AUD	3.65	3.73	9.14	16.08	2.73	5.31	-0.91	5.09
	LCL	3.34	4.35	10.25	17.81	3.52	9.93	1.99	10.00

Source: Morningstar Direct™

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General Advice Warning

Limited Financial Services Guide

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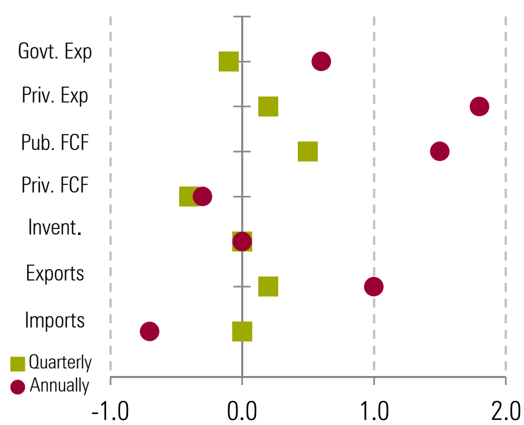
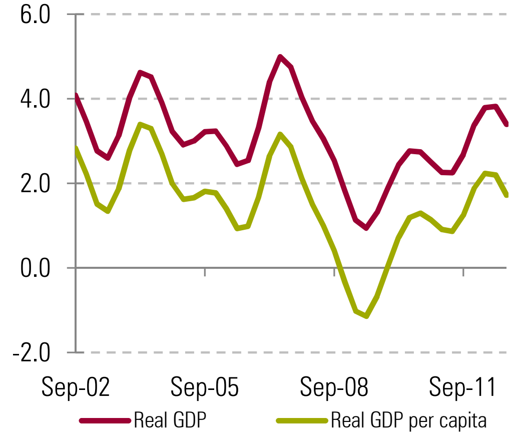
Components of Real GDP Growth, % change



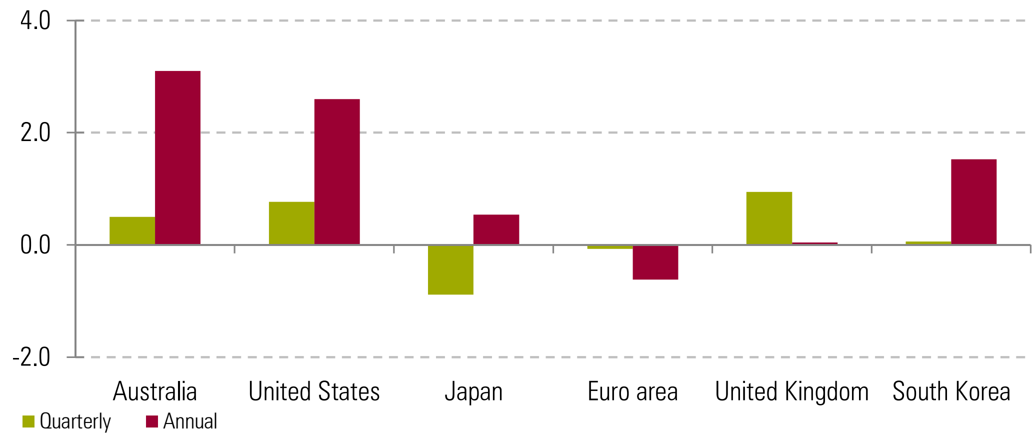
Source: ABS, seasonally adjusted

Real GDP Growth, annual % change, trend



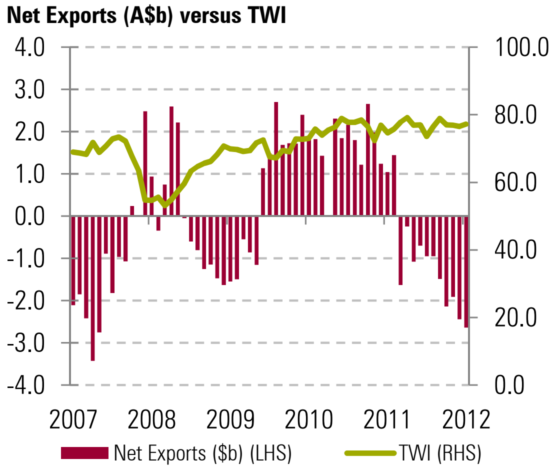
Source: ABS

Real GDP Growth, International Comparison, annual % change, seasonally adjusted



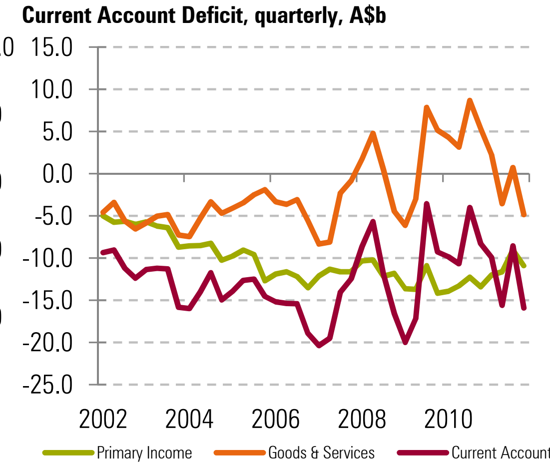
Source: ABS, RBA

Net Exports (A$b) versus TWI



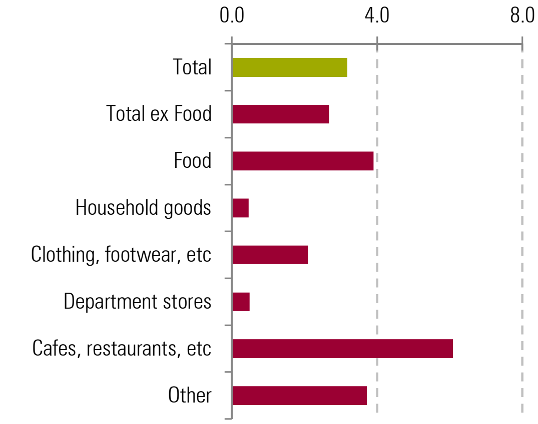
Source: ABS

Current Account Deficit, quarterly, A$b



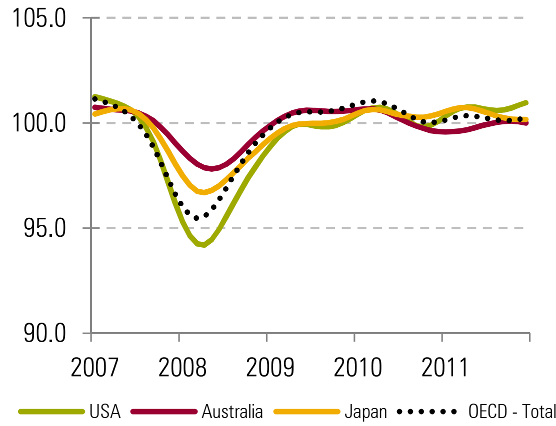
Source: ABS

Retail Sales Growth, annual % change



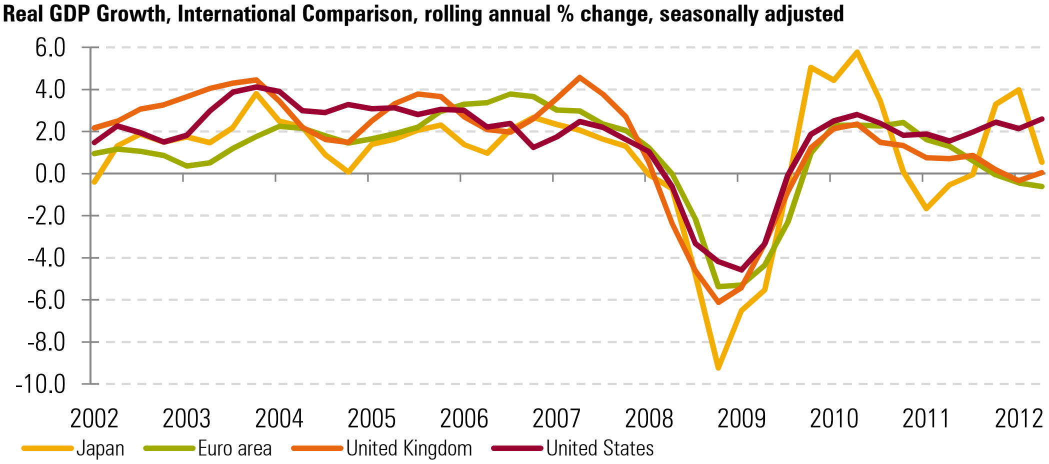
Source: ABS

OECD Composite Leading Indicator



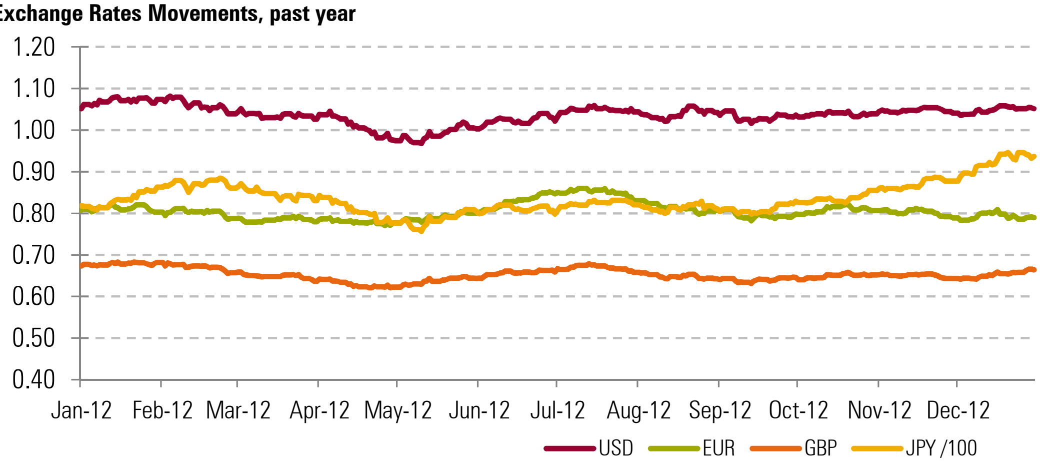
Source: OECD

Real GDP Growth, International Comparison, rolling annual % change, seasonally adjusted



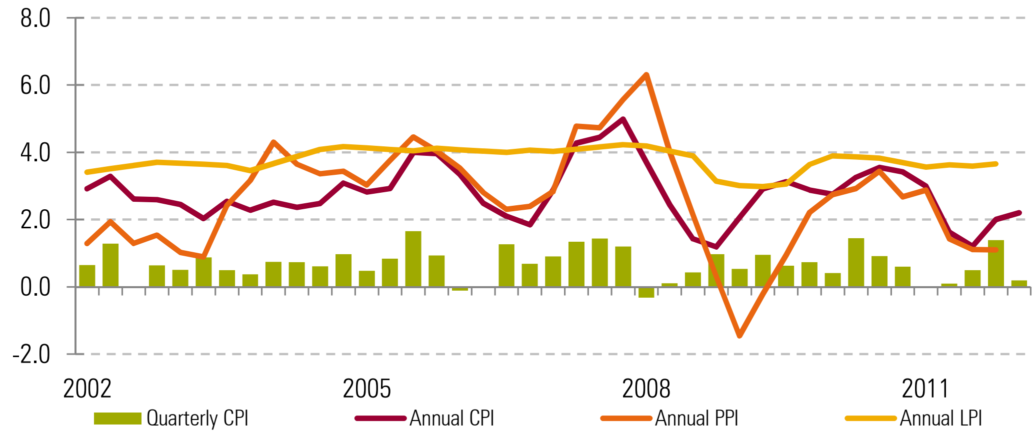
Source: ABS, RBA

Exchange Rates Movements, past year



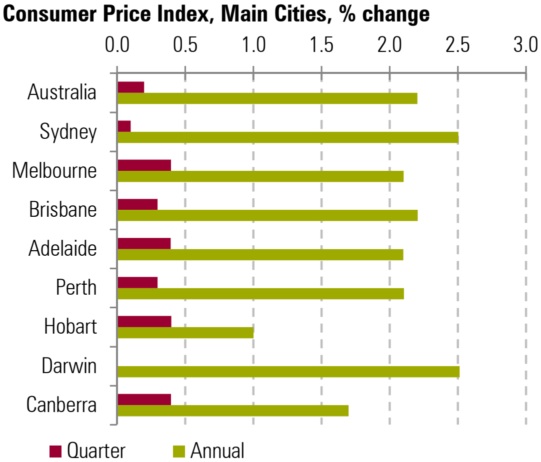
Source: RBA

Consumer Price Index, Producer Price Index, Labour Price Index, % change



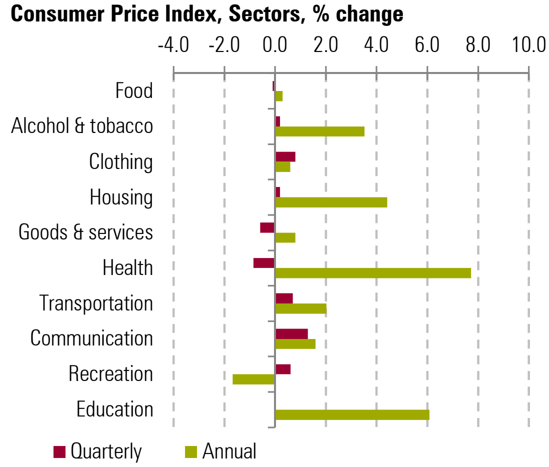
Source: ABS

Consumer Price Index, Main Cities, % change



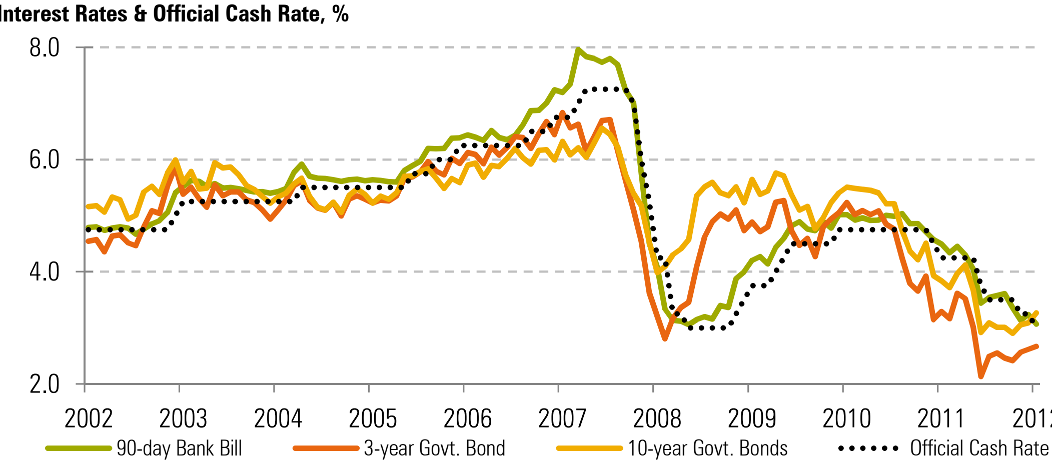
Source: ABS

Consumer Price Index, Sectors, % change



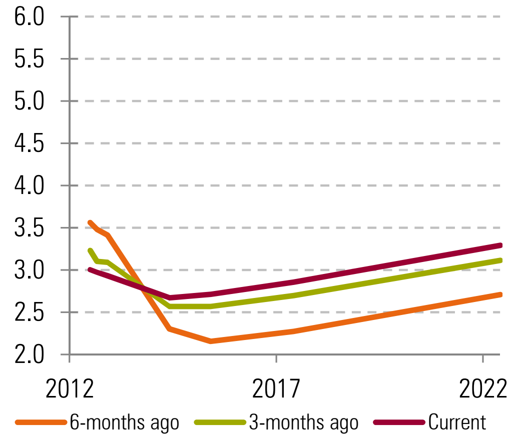
Source: ABS

Interest Rates & Official Cash Rate, %



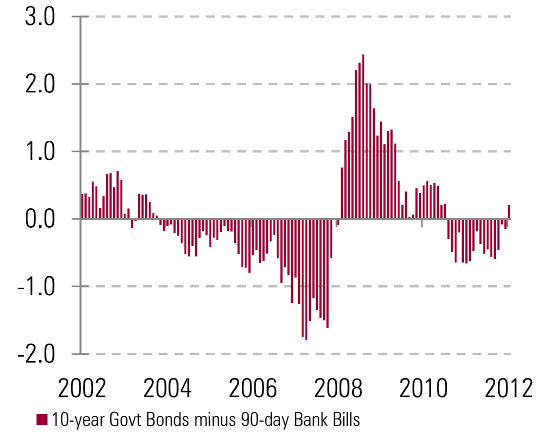
Source: RBA

Yield Curve, current versus last two quarters



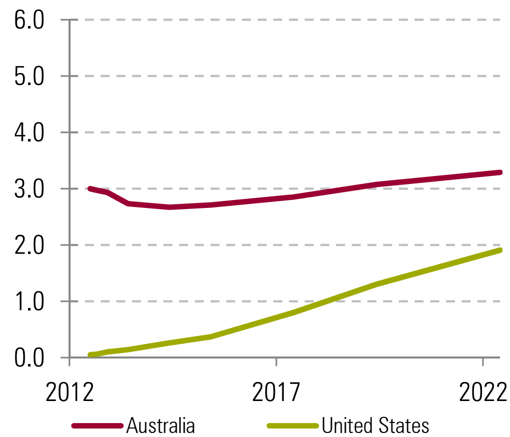
Source: RBA

Term Premium, % difference



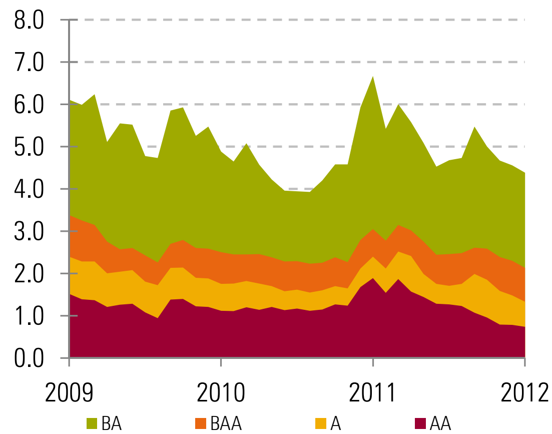
Source: RBA

Yield Curve, Australia & United States



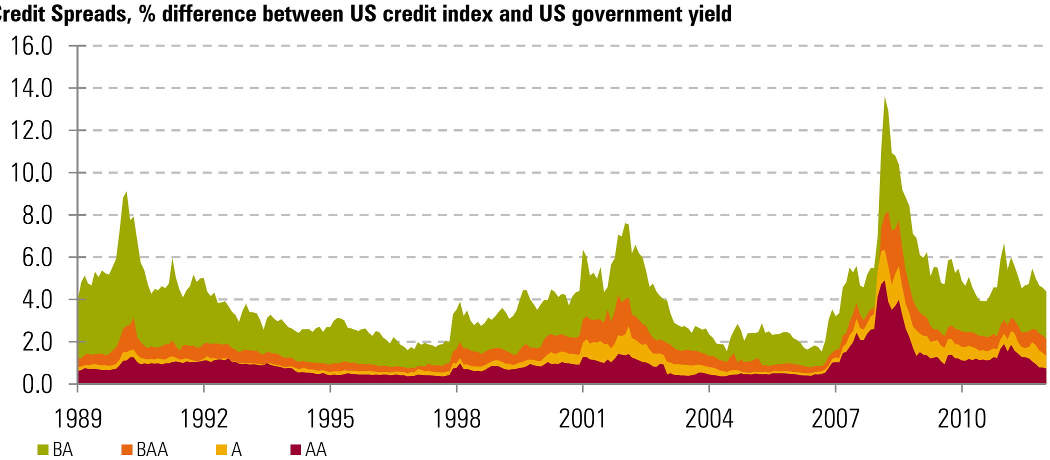
Source: RBA, US Treasury

Credit Spreads, three years



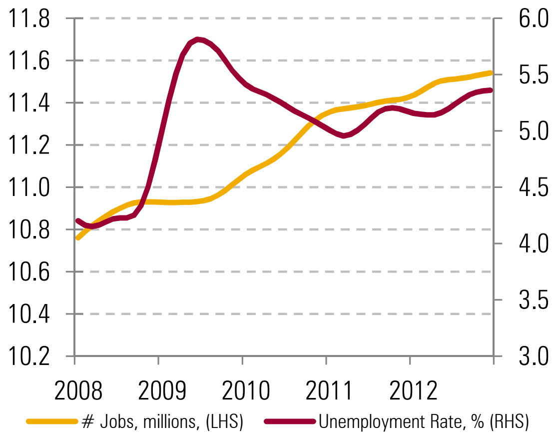
Source: Barclays Capital

Credit Spreads, % difference between US credit index and US government yield



Source: Barclays Capital

Australian Labour Market

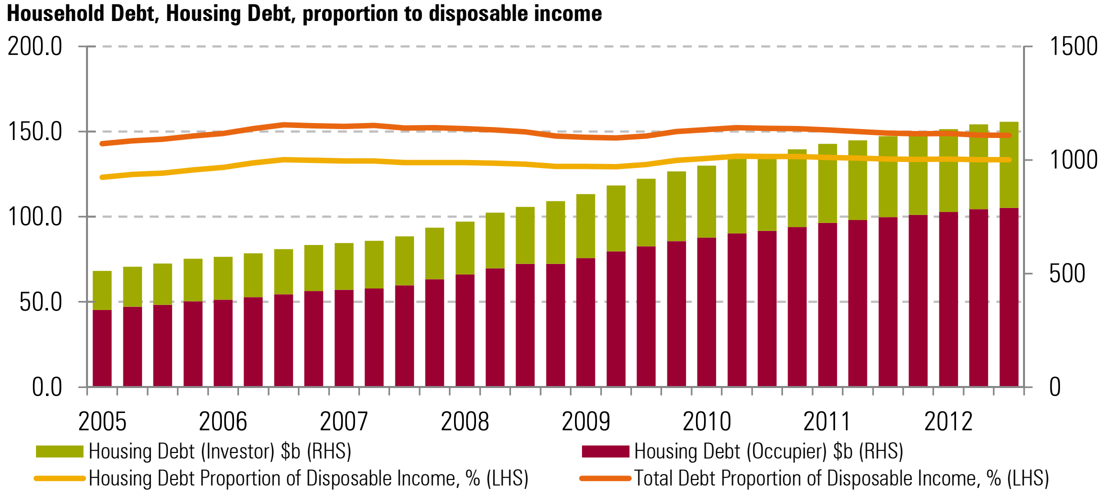


Source: ABS

Unemployment Rate, International Comparison, %

Source: RBA, data most recent available, *prev mth, `prev qtr

Household Debt, Housing Debt, proportion to disposable income



Source: ABS