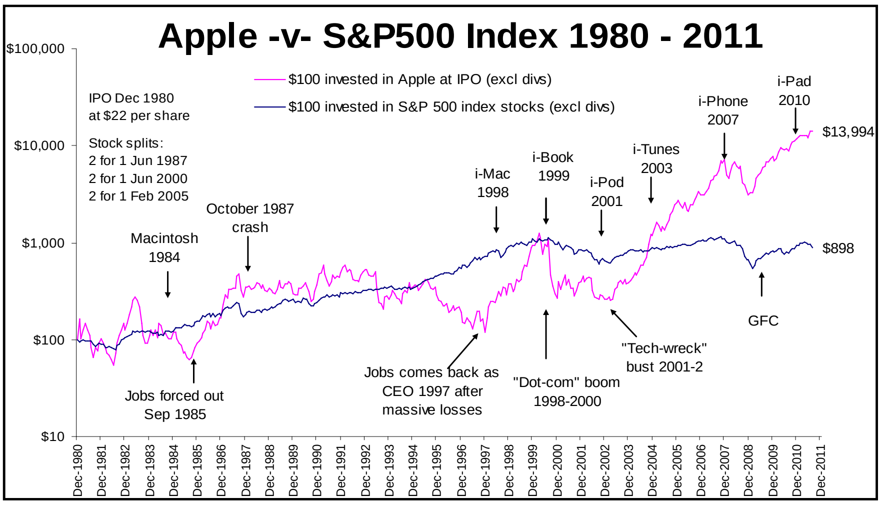
MONTHLY MARKET MONITOR – End August 2011

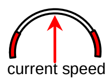
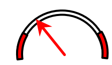
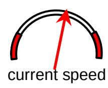
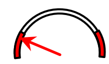
Chart of the Month: The rise of Apple Inc



In August, Apple became the most valuable listed company in the world, briefly overtaking Exxon-Mobil. The chart shows that $100 invested in the Apple float in 1980 would have grown to $14,000 today (excluding dividends), but if $100 was invested in the broad S&P 500 index of US stocks it would have grown to just $900 over the same period (excluding dividends). The US market peaked in mid-2000 and hasn't recovered since, but Apple has grown 10-fold since then.

Since the Apple float, the broad US index has returned 7.3% pa excluding dividends, and a little over 9% pa including dividends. Over the same period, Apple shareholders have received returns of 17.3% pa excluding dividends, and 17.5% pa including dividends (Apple paid dividends between 1987 & 1995).

Despite the high returns, the ride has been extremely volatile for shareholders. The share price has collapsed by more than 75% on 5 occasions before the 60% fall in the GFC. It is an incredible story of how one man, Steve Jobs, completely changed how society interacts with technology globally, and built the biggest company in the world in just one generation. His impact on global society and the corporate world is on a par with Henry Ford and Thomas Edison. Steve founded the company in 1976, was kicked out of his own company in 1985 (and sold all of his shares except one at the bottom of the market), built another business, "Pixar", which transformed the animated movie industry, and then was brought back in to rescue Apple in 1997 after years of directionless leadership and disastrous losses. Since his return he has launched the i-Mac, i-Book, i-Pod, i-Tunes, i-Phone, i-Pad, and i-Cloud, and battled cancer along the way. Sadly the battle with cancer forced his retirement as CEO in August. The challenge for investors is to find the next Apple, because it is out there waiting to be found.

		Economies – August 2011	Current position	Current Direction/ Trend	Current pace of growth
Economies	Australia	The high dollar, nervous consumers and very low levels of consumer and business confidence have slowed the local economy. Business large and small are under pressure from rising input costs, rising wages, high lending margins, restrictive lending conditions, and stifling layers of regulation. The Reserve Bank recently announced that it had reduced the growth estimate for the current financial year for the Australian economy from 4.25% to 3.25%. It was met with shock-horror headlines in the media as if it was a disaster, but it would merely reduce growth to its average growth rate since federation. In reality, 3.25% is still optimistic but lower growth or even recession should not worry investors, since there are a range of assets that can make money for investors in different types of conditions.	Average growth rate	Growth flattening	
	US	The US economy remains weak, with high unemployment and falling house prices keeping consumer confidence at low levels. The government has few policy levers left to stimulate the economy – with monetary policy exhausted (it can't reduce interest rates below zero), and fiscal policy also exhausted (politically it can't raise taxes nor borrow much more). All Fed Chairman Ben Bernanke can do is promise to keep the target cash rate near zero for longer, and keep hopes alive for another round of "quantitative easing". There are some positives:- falling long term interest rates are reducing mortgage repayments for home-owners, and also reducing interest rates for corporate borrowers. Commodities prices are also falling, especially for fuel, and retail sales and auto sales have picked up encouragingly (unlike in Europe, where interest rates and borrowing costs are rising, slowing growth even further).	Below average growth rate	Recovery remaining slow	
	China	The Chinese economy continues to power ahead. While the levels of aggregate output and income for the US economy are still smaller than they were four years ago before the GFC, the size of the Chinese economy has grown by 40% over the same period. Exports are still high and trade surpluses are being invested in US & European government bonds. Despite this, the Renmimbi rose another percent against the US dollar in August. The government has thus far managed to avoid a hard landing, but inflation continues to edge higher toward levels that could see further outbreaks of food riots and civil unrest if not contained.	Strong growth	Growth slowing	
	Japan	The Japanese economy has been contracting since the tsunami in March. Exports are down significantly (but still in surplus) due to slowing demand from US & Europe, together with power cuts as a result of the nuclear crisis, and the soaring yen. The yen reached an all time high against the US dollar during August. Japanese government debt suffered another credit rating downgrade during the month which, as with the US downgrade, was positive for bond returns as yields fell further. The outlook for the next quarter or so is brighter, as the reconstruction effort gains pace. Prime Minster Naoto Kan resigned and was replaced by Yoshihiko Noda, and this is igniting fears in China and Korea of rising Japanese nationalism.	Chronic recession, deflation	Remaining weak	

		Asset Classes – August 2011	Current position	Long term returns (1)
Shares	Australian Shares	As foreshadowed in last month's report, the market continued to weaken in August. Despite the general pessimism over global growth and falling share prices, Australian listed companies posted a good set of numbers in the reporting season for the June financial year. For the largest 50 or so stocks, top line revenues grew by more than 15%, with more than 40% of companies reporting revenue growth of more than 10% on last year. Earnings per share grew by around 15%, with around 2/3 of companies growing earnings per share, including 45% of companies growing earnings per share by more than 10% on the previous year. Dividends also increased strongly:- up around 18%, with nearly half of all companies increasing dividends, and nearly 30% of companies increasing dividends by more than 10%. About 1/3 of companies reported better than expected results, another 1/3 below expectations and the remaining 1/3 on par with expectations. Aside from the well-documented poor results from Leighton, OneSteel, BlueScope, Downer EDI, Harvey Norman, David Jones, JB Hi-Fi and Goodman Fielder (all relatively small companies), the rest of the market did well, so the good results weren't just confined to miners. Most companies are better placed to handle the next round of the GFC, with stronger balance sheets, more cash holdings and lower debt levels.	Around fair value	Average long run returns
	US shares	The broad US stock market fell 5% in August, or around 3% for Australian investors given the AUD fall against the US dollar. The US market is now back to square for 2011 to date, which makes it the best stock market in the world this year (apart from Indonesia, Thailand, Philippines & Sri Lanka, which are all up around 4% for the year) – despite the anaemic US economy, the crippling political crisis in Washington, the debt downgrade, debt crises at Federal, State, and municipal levels, high unemployment levels and falling house prices. But company earnings continue to grow strongly, led by booming sales to emerging markets, low interest rates and productivity improvements. Ultra-low interest rates should encourage share buy-backs which would entice investors back in soon, as would an announcement of "QE3", which is reasonably likely.	Above long run fair value	Below average long run returns (2)
	Emerging markets	Nearly all emerging markets fell in August (except Sri Lanka, Mexico and South Africa) as hot money was pulled out of so-called "risky" markets and returned to the perceived "safety" of government bonds (as bonds were downgraded and governments lurch toward default!). Of the major markets, Russia was hit as oil prices fell 7%, India and Brazil suffered mainly due to escalating political corruption crises with more ministers being caught up in corruption scandals. The Chinese markets held up relatively well, but Hong Kong, Korea and Taiwan continued to suffer effects from Japanese factory disruptions. Many emerging markets are looking decidedly cheap following the recent falls.	Around fair value	Above average long run returns (2)
Fixed Income	Australian Gov't bonds	Australian bonds had another very good month of returns as yields on bonds of all maturities fell sharply in August with the local economy slowing and foreign money continuing to chase our relatively high yields here, particularly after the US credit downgrade and another Japanese downgrade. The NSW government has announced a plan to issue bonds aimed at the retail investor market to fund infrastructure spending. The interest rates offered are less attractive than those on bank TDs or on existing State government bonds and, as tax-payers, we are always be wary of governments coming up with new ways to get into debt.	Yields below (prices above) long run average level	Below average long run returns
	Bank Term Deposits	Thanks to their super-high term deposits rates over the past couple of years, bank deposits now make up 60% of bank funding in Australia, which is back to the levels of the late 1990s before local banks went on their wild, foreign debt-fuelled lending spree in the 2000s boom. In August, banks reduced term deposit rates by around ¼ to 1/3 of a percentage point as bond yields fell, but there are still opportunities to lock in relatively good interest rates as banks are slow to reduce rates.	Yields above long run average	Above av. long run returns
	Global Bonds	Global government bonds continue to generate good returns as yields fall with slowing growth outlooks in the US, UK, Europe and Japan. Returns on US treasuries were given a boost when their credit rating was downgraded by S&P on the 5th August. Likewise with Japanese bonds after another credit downgrade there. Even prices of French government bonds rose despite rising fears of possible default on French bonds. The European Central Bank is artificially supporting the prices of Spanish and Italian government bonds (bringing yields down from around 6% to around 5% over the month), but this cannot last long as it is severely testing the patience of German tax-payers & voters.	Yields below long run average level	Below average long run returns (2)
Cash	Australian target cash rate	The Reserve Bank has shifted its stance from a rate-rise bias to a more neutral stance, and now appears ready to cut rates if the local economy and global economy slows further. However, if growth in China, US and Europe all remain positive (as is the likely immediate future outlook) and the European banking crisis remains contained, the RBA will still probably need to raise interest rates further to bring local inflation under control.	Cash rates below long run average level	Variable, rising over medium term
Real Estate	Australian commercial property	The listed property sector showed a positive 3% return for the month including distributions (compared to a 2% loss for listed shares), but it is still down 3% for the quarter to date. While the office market continues to recover, retail, residential, industrial and tourist markets remain burdened by slow consumer spending, high household debt levels and the high dollar. On the positive side, most trusts are increasing distributions (except Westfield distributions are flat and Bunnings & Commonwealth Office reduced distributions slightly), and several are under-taking buy-backs (eg Stockland, GPT, Investa Office and Charter Hall Retail), which should support prices.	Around long run fair value	Around average long run returns
	Australian residential	House prices fell again in all major markets across Australia. While fears of interest rate rises are now abating, they have been replaced by pessimism over slowing economic growth, weak consumer & business confidence, lack of government leadership and confusion around new taxes. Australian houses prices are still the highest in the world (on a number of measures) and household debt levels are also the highest in the world, and we don't see house prices rising significantly for some time.	Varies by market	Average long run returns
Australian Dollar		The AUD started August at $1.10 USD but fell quickly against all currencies (except the Indian Rupee), especially against the stronger Euro and Yen. The AUD and commodities prices are falling due to lower global growth outlooks, and interest rate differentials may contract if interest rates are cut here. Being un-hedged has cushioned falls on foreign equities for Australian investors. We continue to prefer being un-hedged for foreign equities, but hedged for foreign bond holdings.	AUD Above fair value	Below average long run returns

(1) Expected "long term" returns refers to periods of 10+ years (looking through economic cycles) starting from the current position
(2) Returns for non-Australian assets are in local (foreign) currency terms – ie hedged to AUD but excluding any profits/losses from hedging