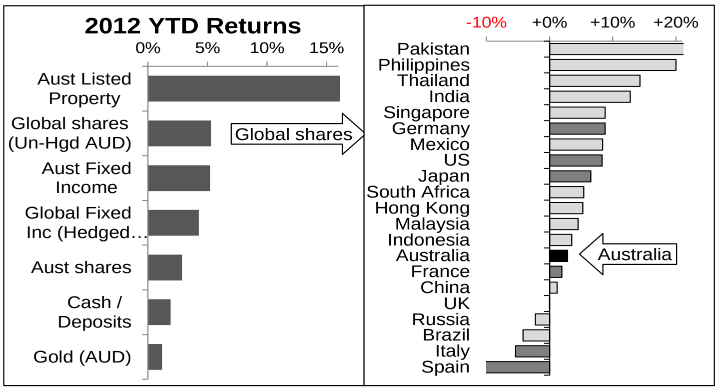
PHILO CAPITAL MARKET MONITOR – End June 2012

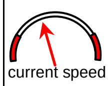
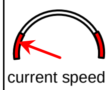
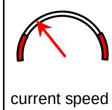
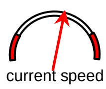
Chart of the month: A good year so far for all asset classes:



Our charts this month show that, despite the barrage of doom and gloom in the media about recessions, debt crises and bank bail-outs in Europe, high unemployment and faltering recovery in the US, the slowdown in global growth, and the possibility of a hard landing in China, all of the major asset classes were up for the half year to date, and all did better than cash deposits. Listed property was the star, beating local shares, as was the case last year.

The vast majority of global stock markets are up so far this year, and most are well ahead their historical average returns. The big industrial giants of the US, Germany and Japan were up solidly, despite their slowing domestic economies. Stock markets in most of our Asian neighbours were also up very strongly.

Even gold is up (only just) for the half year, but still well down from the highs reached late last year in the US budget deficit crisis.

		Economies	Current position	Direction / Trend	Pace of growth
Economies	Australia	This is as good as it gets for Australia: 4% economic growth, 5% unemployment, and 2% inflation. That's what the official numbers suggest anyway. Australia's economy is now overtaking Spain to become the 12th largest economy in the world, and our economy is still growing, while Spain's is contracting. Our population is half that of Spain, so our national output and income per person is twice as high. From July the new tax regime starts. The new carbon tax (at $23 per ton, compared to companies in other countries that pay for carbon credits at the market price of less than $10 per ton), and the new mining tax. On top of that we have Medicare surcharge increases, increases in superannuation contributions tax, cuts in maximum allowable concessional super contributions, cuts to the private health insurance rebate, and cuts to medical expenses offsets. These extra taxes are funding family tax benefits and tax cuts to low paid workers. Plus there is the $5b for low income households and welfare recipients, and $15b in cash hand-outs to the big polluters.	Below average growth rate	Growth flattening	
	Europe	The crux of the problem in Europe was best summed up in a comment in June by Bundesbank board member Andreas Dombret: "You don't give somebody your credit card if you don't know what he or she is going to do with it !". German tax-payers have worked hard and saved hard for half a century, and have tried to put the sins of Germany over the previous half century behind them. But thousand year old conflicts across Europe are never far below the surface. The major developments in June were the Greek election, the Spanish bank bail-out and the 28-9 June summit. Greece's repeat election on 17th June left the same parties in power (New Democracy and Pasok), despite big voter shifts to the extreme left (Syriza) and extreme right (Golden Dawn). Greece is now re-negotiating the austerity terms of the bail-out, including delaying reforms, halting lay-offs and even cutting taxes. In the Spanish bank rescue, €100b was pledged (to the same banks that recently passed numerous "stress tests"), but it is just more debt, when what banks need is more capital. Italy looks like joining the bail-out queue behind Greece, Portugal, Ireland and Cyprus. Italy is too big to fail but also too big to bail out, and this finally convinced Germany to relent and allow the first steps down the path to a banking union. It will also allow the ESM (European Stability Mechanism) to lend directly to national governments and to re-capitalise banks directly. This is a major breakthrough, but this still leaves a lot of work to be done and a lot of German conditions to be met.	Contracting	Weak growth	
	US	The US economy remains weak, but at least it is still growing, and housing is starting to turn the corner. Everybody seems to be focused on the jobs numbers, but that is always one of the last numbers to move. Improvements in unemployment numbers generally ***lag*** the economic growth numbers by several years, but stock market returns generally ***lead*** the economy by several quarters, so share prices recover years before unemployment rates come down. The Presidential election campaign is finally underway, with both sides promising even more tax cuts as the only "solution" to the debt problem. Tax cuts haven't worked so far, and do nothing to address the debt problem. Tax cuts over the past 30 years, accompanied by massive build-ups in government spending (especially healthcare and the military) created the current debt crisis. The housing market has been posting modest gains for several months now, and petrol prices continue to fall. Pump prices have now fallen from $4 per gallon last year to below $3.50 now, boosting confidence and spending.	Below average growth rate	Recovery remaining slow	
	China	Over the past several months our outlook for China has been for the slowdown to start to turn the corner mid-year, and this now looks to be happening. Inflation is down to 3% (less than half the rate of a year ago) and this is providing more leeway for broader stimulus measures. The interest rate cut on 8th June was the first cut since 2008, and banks have also been given more flexibility to set rates within the target bands. Bank lending is now showing early signs of rising again. Prices of industrial commodities continued to decline in June, giving up their gains experienced in the tremendous new year rally, and so prices are back to their levels of late last year. More stimulus measures are on the way, but the government is being more careful this time, fearful of re-igniting inflation and fuelling further civil unrest.	Cyclical slowdown	Growth recovering in coming months	

		Asset Classes	Current position	Long term returns (1)
Shares	Australian shares	The overall stock market was up a little in June, leaving total returns across the broad market index up 3% for the year to date. Telstra, banks and healthcare stocks were stronger, but energy and resources sectors, especially gold miners, were down for the month. On the energy front, a major milestone was reached in the great LNG revolution:– the first gas from the new batch of LNG projects was shipped to Japan from Woodside's Pluto field in WA. It was 25% over-budget (it cost $15b) and a year late, but at least it is now generating some cash. Much larger projects are under darkening clouds, with rapidly rising costs and collapsing gas prices. The overall market remains relatively cheap, and dividend yields (including franking credits) on most of the major stocks are now around double the interest rates paid on bank deposits and TDs.	Below fair value	Above average long run returns
	Developed markets shares	Almost all stock markets were up in June, especially in Europe, despite the Greek election dramas and the on-going banking/debt crisis. So far in 2012, the main markets have been relatively strong – the US market is up 8%, Germany up 9%, and Japan up 7% for the half year. Many of the major markets are relatively cheap and should do well if confidence in Europe holds.	Mixed – many markets under-fair to priced	Around average long run returns, but currency gains expected (2)
	Emerging markets shares	June was also a good month for most emerging stock markets. For the half year to June, almost all Asian markets are up, with India, Pakistan, Philippines and Thailand up by double digits. Chinese and other east Asian markets are up more modestly. Latin American markets are all up except Brazil, while Eastern European markets are mixed, affected by slower exports to Europe. The Russian market has given back its big gains from earlier this year due to the collapsing oil price, and ended the year flat, as around 60% of the Russian stock market is oil/gas related.	Around fair value	Above average long run returns, but high volatility (2)
Fixed Income	Australian Gov't bonds	As expected, yields on Australian government bonds rose from their ultra-low levels reached in May, with yields across all maturities rising by 20-30 basis points in June. Yields may fall further from current levels (if the Europe situation deteriorates dramatically) but they are more likely to rise over the rest of this year, leaving limited scope for upside returns.	Yields below (prices above) long run average level	Below average long run returns
	Bank Term Deposits	Bank TD rates have continued to fall, and many investors have been tempted by the increasingly attractive yields from listed property trusts and even into shares, where grossed-up yields (including franking credits) on dozens of so-called "blue chip" shares are up near, or above, 10%.	Rates around long run average	Around average long run returns
	Global Bonds	June saw an improvement in sentiment over global growth prospects and the European debt crisis. Yields on PIIGS bonds fell, as politicians edged slowly toward a solution, while yields on "safe haven" bonds (US, Germany and Japan) rose slightly, as growth and inflationary expectations rose. Yields on Spanish and Italian bonds did reach critically high levels in mid-June – Spanish yields crept above 7% and Italian yields above 6% - before easing slightly with more ECB-funded bond-buying. The global government bond index in hedged AUD terms is up 4% for 2012 to date.	Yields below long run average level	Below average long run returns (2)
Cash	Australian target cash rate	Four rate cuts in this cycle have brought the policy cash rate target down from 4.75% to 3.5%, which is not far from the 3% rates at the bottom of the GFC in 2008-9. Business leaders and retailers always want lower interest rates, but inflation "hawks" warn of inflationary risks in future if cash rates are kept too low. The official inflation numbers are low, but the macro economic growth numbers are relatively strong, official unemployment rates are low and wages are rising strongly, so there is limited scope to reduce rates much further, unless European crisis suddenly deteriorates.	Cash rates below long run average level	Variable, rising over medium term
Real Estate	Australian commercial property	The Australian listed property trust sector remains the best asset class so far this year, and prices were up again in June. Distribution yields are still relatively good, and becoming increasingly attractive as interest rates fall. Unit prices are also being supported by buy-backs in many of the major trusts. Even Westfield Retail is doing well, finally getting back above its original float price.	Around long run fair value	Around average long run returns
	Australian residential property	House prices continue to fall, and this is prompting more tax-payer funded hand-outs. For example, the NSW government has announced new hand-outs and subsidies – up to $35k for first home buyers of new flats and houses, which has in the past done little more than line developers' pockets and prop up house prices temporarily, luring even more buyers into over-priced properties who in turn accumulate massive debts and make housing even less affordable for the rest.	Varies by market, but over-valued overall	Average long run returns
Australian Dollar		The Aussie dollar was higher against most currencies in June, but is flat for the half year. The AUD is still at elevated levels, despite declining commodity prices and declining interest rates here. It is being held up by foreign buying of government debt, as Australia is one of the few remaining AAA countries with lots of debt to be bought. Despite claims of aiming for a budget "surplus" next year, the Federal government is still borrowing an average of around $1billion each week, and foreigners are still falling for the relatively high yields on offer, despite facing losses when the AUD falls.	AUD Above fair value	Currency gains for Australian investors as the AUD falls

(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