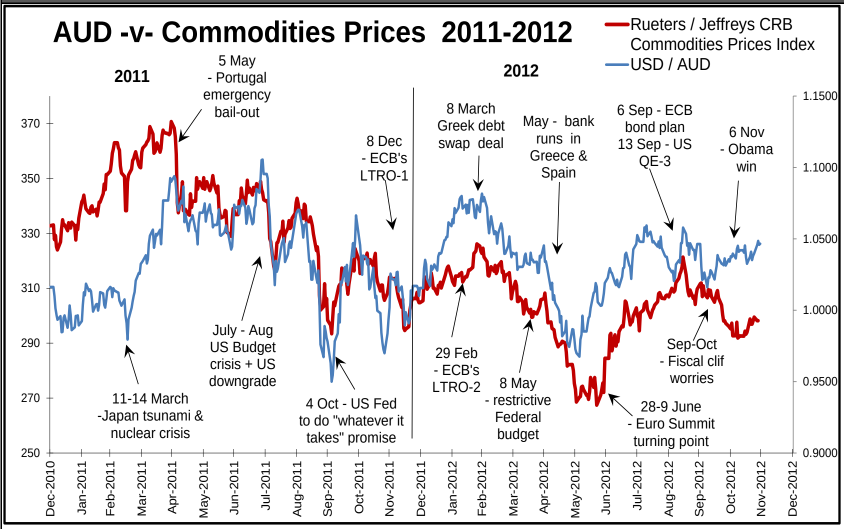
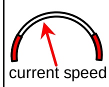
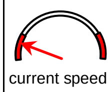
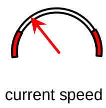
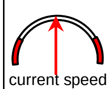
PHILO CAPITAL MARKET MONITOR – END NOVEMBER 2012

Chart of the month: The Australian Dollar - hardly a "safe haven"



There has been talk lately of the Australian dollar being a "safe haven", and that foreign investors are seeking "safety" in our high yield bonds. Our dollar is, and always has been, a high risk "hot money" currency, and remains highly correlated with other high risk assets like shares and commodities. The AUD, commodities prices and share prices, are all barometers of global investor sentiment. Our dollar plummets in every crisis, and soars with every piece of good news – the opposite of what the real safe havens do (US dollar, Swiss Franc, gold).

Most of the foreign investment in our high yield paper is un-hedged, meaning it is a pure naked bet on our interest rates and exchange rate remaining relatively high. Foreign yield chasers will stampede for the exits at the first sign of trouble. The dollar will fall, bond yields will rise, and they will go chasing yield on the next "hot money" bet in some other far flung outpost. It makes sense to buy quality foreign assets with our over-valued dollars.

		Economies	Current position	Direction / Trend	Pace of growth
Economies	Australia	During November, more doubt was cast over several future resources projects, and the mining investment boom is looking like peaking sooner and lower than politicians and the Reserve Bank expected. In searching around for ways to fill the budget hole, the government is looking like heading toward raiding the tax breaks on superannuation. Attention was diverted away from the corruption scandals in Canberra to corruption scandals in NSW, with the ICAC investigations into the Obeid family's mysterious dealings in mining interests. In the midst of all of these diversions, consumer confidence is finally looking up, probably as a delayed reaction to the interest rate cuts in May, June and October. Consumers are looking like they are getting ready to open their purses over Christmas and they are also getting ready to buy houses again.	Below average growth rate	Growth flattening	
	Europe	The theme we have adopted since the middle of this year has been the gradual softening of Germany's hardline stance on government budgets and debts. We saw more progress on this in November, with EU finance ministers, the ECB and IMF finally agreeing on conditions for release of the delayed €34b installment of bailout funds to Greece. This latest deal confirms that Germany has finally come to accept that the austerity path has little chance of working – that savage cuts to government spending are unlikely to generate the growth in employment and tax revenues that are required to repay the interest and principal on existing debts, plus the interest and principal on the bail-out loans. The latest deal extends maturities on debts, suspends interest payments, reduces interest rates on bail-out loans and provides loans for Greece to buy back its bonds from investors at 35c in the euro. All this is on the assumption that Greece reduces its level of government debt from 190% of GDP down to below 110% by 2022. This puts the problem into the next generation, and there are likely to be many more tortuous machinations at each stage along the way. Germany has yet to accept the idea of debt forgiveness and outright write-offs (this would decimate the capital bases of many large European banks, probably triggering a new wave of nationalisations and tax-payer funded capital injections), but for now the illusion of solvency is being kept alive.	Contracting	Remaining very weak	
	US	The main event during November was Barak Obama's decisive win over Mitt Romney in the Presidential elections on the 6th. The Democrat win changed the state of play in negotiations over the so-called "fiscal cliff". Republicans are now accepting the prospect of some tax increases in the form of cuts to deductions and loopholes, as long as there are no increases in margin tax rates, provided the Democrats agree to cuts in spending and entitlements. Both sides agree to retain the Bush tax cuts for almost all tax-payers, but Republicans want nobody to pay more tax, even (and especially) billionaires, whereas Obama wants the top 2% to pay more. A compromise is in sight, but it is too soon just yet to backtrack on too many promises made only weeks ago in the election campaign. Meanwhile, in the real economy, exports are stronger, trade deficits are narrowing, the jobs market is still improving slowly, and consumer confidence and spending are stronger. The housing market continues to improve slowly but steadily. Housing inventories are falling and new home starts are rising.	Below average growth rate	Recovery remaining slow	
	China	The 18th National Congress of the Communist Party handed over power to the new leadership team in a highly orchestrated and stage managed affair. All has not gone smoothly – with political intrigue, corruption scandals, trumped-up criminal charges, media manipulation and the odd murder thrown in. The bumpy transition will probably mean the new leaders are more likely to accelerate stimulus efforts. This may take some time to come into effect, but in the meantime the cyclical rebound appears to be gathering pace. Chinese manufacturing orders are finally growing after a year of contractions, and home sales and lending seem to be improving. Across in Japan, the effects of the territorial disputes with China are continuing to adversely affect manufacturing production and exports. Japan is also going through its very own "fiscal cliff", and Prime Minister Yoshihiko Noda has been forced to call an election for December in the hope that a new Diet can come up with a compromise deal in January. By the time we learn each new Prime Minister's name, they elect a new one. One PM per year is about the average.	China: Cyclical slowdown	China: Growth recovering in coming months	

		Asset Classes	Current position	Long term returns (1)
Shares	Australian shares	The Australian market fell by 4% in the first half of November but recovered to be square for the month. The big diversified miners (BHP and RIO, both in our portfolio) were flat, while specialised miners (of which we hold none) were down. CBA was the best of the banks (up 3%, in portfolio) while NAB was the worst (down 7%, not in portfolio). The overall market index is now up 11% for the year to date, and up 15% including dividends. Year to date, the star of the large cap stocks as been CSL (up 60%), followed by News Corp (up 33%) and Telstra (up 28%) – all are in our portfolio. We have been over-weight Australian shares in portfolios for most of this year, and this has worked well with the market performing strongly, despite the slowing economy, falling commodities prices and the budget and political troubles.	Below fair value	Above average long run returns
	Developed markets shares	Global share markets were up a little in November. European markets were stronger, especially France, despite its credit rating downgrade and the widening dispute with Germany over fiscal policy. The US had a flat month, dragged down by Apple which is back below $600 due to its iPhone 5 problems. Japan was up 5% despite slipping back into recession, and despite the big losses in Sony, Sharp and Panasonic. The London market was flat, with the big development there being Glencore completing its take-over of Xtrata. This creates a new global force in global mining, but the going will be tough in a world of falling commodities prices, rising costs and tax-hungry governments. The big developed markets are heading for a reasonably good 2012 – with Germany up 25%, the US, France, Japan and Switzerland up by double digits, and most other markets in positive territory.	Mixed – US is over-priced on long term measures, but other markets are under-priced to fairly priced	Around average long run returns, but currency gains expected (2)
	Emerging markets shares	Emerging markets had a mixed month in November. Among the BRICs, China was down 5% but India, Russia and Brazil were more or less flat. As a whole, the sector is heading for a pretty good full year for 2012, with the overall emerging markets index up 12% with a month to go. Year to date: Pakistan, Turkey, Thailand, Philippines and India are all up by more than 20%, and several other markets are up by double digits for the year. The worst market has been China (down around 10%), which is by far the largest market in the emerging markets index. (China was also the worst market in 2010 and 2011).	Around fair value	Above average long run returns, but high volatility (2)
Fixed Income	Australian Gov't bonds	Returns from Australian bonds fell a little in November as yields rose across all maturities, especially in the latter half of the month. Despite the slightly negative month, returns are still around 7% for the year to date, which is higher than their long term expected average. The volume of government borrowing is still high (due to the budget blow-out), but demand remains reasonably strong.	Yields below (prices above) long run average level	Below average long run returns
	Bank Term Deposits	Despite interest rates rising in the bond market, bank term deposit rates remain low as a result of the banks' slower demand for loans. With consumer confidence rising, share markets rising and TD rates falling, a tipping point is being reached where more retail investors are heading back into shares. There are still some reasonable returns available from TDs on a reward-for-risk basis. We have been recommending longer term TDs this year as rates have fallen, so those investors are still enjoying relatively higher locked in rates.	Rates around long run average	Around average long run returns
	Global Bonds	Global bond returns have continued to edge up this month. The Australian dollar hedged global government bond index (the benchmark for this asset class in our portfolios) is now ahead 8% for the year, nudging ahead of Australian fixed income. Yields fell in all of the major global markets but for different reasons. Yields fell in the big "safe havens" - US, Germany, Japan - as growth expectations remained subdued. Yields also fell in the big problem countries - Italy, Spain and France (despite the credit rating downgrade) – thanks to positive developments on the Greek debt deal, meaning a domino effect of defaults across Europe is now less likely.	Yields below long run average level	Below average long run returns (2)
Cash	Australian target cash rate	Interest rates in Australia are still the highest in the "developed" world and are still attracting yield chasing foreigners in droves. The Reserve Bank appears open to the idea of cutting interest rates further, to bring down the dollar, to improve demand and compensate for a sharper than originally expected slowdown in mining investment.	Cash rates below long run average level	Variable, rising over medium term
Real Estate	Australian commercial property	The listed property sector took a breather in November, with all the major players down by a per cent or so, after their very strong runs this year. We had favoured the listed sector this year as it was under-valued relative to shares and relative to the unlisted sector. However we reduced weightings a couple of months ago after the rebound brought the listed sector back to around fair value. We see the listed sector generating reasonable returns from current levels but the prospects for further out-performance have diminished. We have also recommenced our search for unlisted opportunities to add to portfolios. In what was the largest local float of the year, Woolworths spun off several of its shopping centre premises into a new listed property trust called Shopping Centres Australia and raised an additional $470m. The new trust should generate relatively stable and defensive rental income together with some inflation protection.	Around long run fair value	Around average long run returns
	Australian residential property	Activity looks like returning to the first home buyer market in the coming months. Rents have been rising, interest rates have been falling, and the home lending market is the only segment banks have any real interest in expanding as it receives preferential treatment under the Basel capital rules and is perceived as relatively low risk. Further up the chain the markets for trade-up homes, holiday flats and top end homes remain very soft.	Varies by market, but over-valued overall	Below average to average long run returns
Australian Dollar		The Australian dollar drifted up a fraction in November, up 1% against USD, Euro and Sterling, and up 4% against the Yen, which weakened over its "fiscal cliff" uncertainty and its renewed quantitative easing campaign. The Reserve Bank is finally voicing concerns over the dollar being over-valued, and has undertaken some very limited money printing of its own. The RBA is also under mounting pressure to cut interest rates further in the coming months, which should assist.	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