PHILO CAPITAL ADVISERS

PHILO CAPITAL MARKET MONITOR

End April 2013

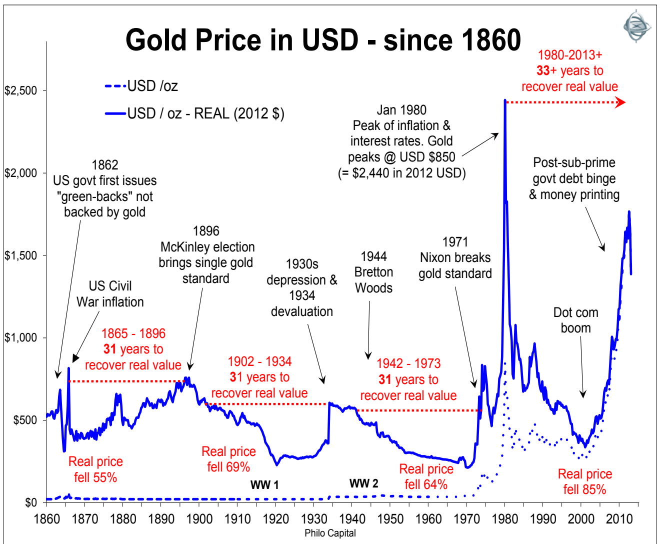
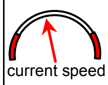
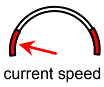
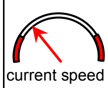
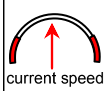
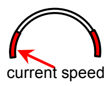


CHART OF THE MONTH: GOLD

Most of the time one ounce of gold has been able to buy items worth the equivalent of around $500 in today's dollars adjusted for inflation. It has done so for much of the past 2,500 years through many societies. Occasionally the gold price (when measured in paper currencies) surges when paper currencies devalue, but it then falls back again in real terms. If bought below its long run level, gold can provide a hedge against the devaluation of paper, but if bought above the level it is speculation, not "investing". Since early 2012 we have written extensively warning investors against buying gold at inflated levels.

The gold price reached $1900 USD per ounce on 5 September 2011 in the midst of the US debt ceiling & credit downgrade crises. Since then it has fallen by more than 20%, including a 10% fall on 15 April this year, triggered by fears that Cyprus and the PIIGS may have to sell their gold reserves to repay debts.

Gold may shoot up to $4,000 or $5,000 in one of two scenarios: (a) an extreme left wing outcome resulting in run-away US inflation leading to a breakdown of society; or (b) an extreme right wing scenario with a Tea Party-led Republican government bringing back the gold standard. These scenarios are looking remote. People who bought gold in the last bubble in 1979-80 are still waiting to get their money back in real terms after inflation 33 years later.

MAJOR MARKETS		Current position	Direction / Trend	Pace of growth
Australia	The federal government is always talking about Australia's "miracle" economy that survived the GFC. We have low unemployment, low inflation, rising wages and the highest growth rates in the developed world. But they are also claiming this very same economy is so sick that it needs even more doses of massive deficit spending. Five years after the GFC and 22 years since the last official recession, they're still deficit spending despite good economic numbers. The biggest mining boom since the 1850s gold rush has come and gone and we are left with record government deficits and increasing government debt. Despite the mining export boom, we haven't had a single current account surplus since 1973. Tax revenues are up by a healthy 9% over the past year but the government spending continues to escalate. Plus it's an election year so the hand-outs and subsidies to protected industries continue. Meanwhile our less well known major export industry - educating foreigners - is picking up, with foreign student numbers rising for the first time since the GFC. An astounding half a million new foreign students start courses in Australia each year.	Below average growth rate	Growth flattening	
Europe	Despite the set-back with the Cyprus bank deposit debacle in March, Germany continues to gradually soften its hard-line austerity medicine for the PIIGS. Harsh austerity programs have resulted in higher unemployment rates and political instability, leaving countries vulnerable to radical splinter groups and sudden threats to repudiate debts and exit the Euro - as was seen in Greece and Italy. These threats are leaving Germany with little choice but to extend deadlines and soften bail-out conditions. In April, Ireland and Portugal were given seven more years to repay their bailout loans, and the worsening situation in Spain is forcing a re-think of the austerity conditions there. Angela Merkel even softened her line against France last week. Italy has found a new leader in Enrico Letta and this has buoyed markets, but Berlusconi is lurking. He's still out on bail and he has magnanimously offered to sacrifice his body for his country one more time!	Contracting	Remaining very weak	
US	The US economy continues to improve. Growth in domestic demand has been steady, primarily driven by relatively strong private consumption, while government spending levels have clearly slowed as a result of the automatic "sequester" cuts. The encouraging house price growth over the past year has recently slowed a little, but new housing starts are now back above 1 million new dwellings per year for the first time since before the sub-prime crisis. No "double-dip" just yet.	Below average growth rate	Recovery remaining slow	
Asia	On 14 March 2011 China's National People's Congress approved its 12th Five-Year Plan that set a target for growth at 7% pa for 2011 to 2015. So it is a mystery why markets were so surprised by the "unexpected" slowing of growth from an annualised 7.9% to 7.7% for the March quarter this year. (Perhaps they all were watching the Japanese tsunami on TV, which dominated the news that day in March 2011). The only surprise should have been why growth was any higher than the targeted 7%, two years into the current 5 year 7% growth plan. An even bigger surprise is why anybody puts any store in the numbers at all, since even the new Premier Li Keqiang admits that China's official economic statistics are "man-made". Despite the slower reported growth numbers and their questionable heritage, they do show some encouraging trends (although not for miners), consumption growth is exceeding investment growth, and services are exceeding manufacturing. But the biggest news for markets so far this year came from across the disputed waters in Japan. On 4th April the Bank of Japan's new chief Haruhiko Kuroda announced an "entirely new dimension of monetary easing" - to double the central bank monetary base within 2 years, from 135 to 270 trillion yen. This is twice the rate of "QE" than in the US relative to the size of their respective economies. With the BoJ planning to buy around 7 trillion yen worth of bonds each month, bond yields fell immediately, enticing Japanese investors to search elsewhere for returns - in Japanese shares and property and in foreign assets. This has a double whammy effect by depressing the yen as investors sell yen to buy foreign assets. In addition, Kuroda and PM Shinzo Abe are trying to talk up wages and rents, and encourage everybody to spend instead of save. The results thus far have been dramatic - share prices are surging, the yen is collapsing and manufacturing, exports and company profits are rising. The effect on the real economy will be lagged and consumer prices are still deflating, as evidenced by Japan's March CPI figures.	China: Cyclical slowdown Japan: Very slow	China: Lower structural growth trend Japan: Stimulus improving exports, production & growth	 

ASSET CLASSES			Current position	Long term returns (1)
Shares	Australian shares	Australian shares gained another 3% in April, and have now returned 12% for 2013 so far, following the 20% returns in 2012. Four of our core holdings starred - Telstra (up 10%), Woolworths (up 7%), ANZ (up 11%). Also Woodside jumped 10% on the 23rd when it announced a special dividend and flagged higher dividend payout ratios in the future, following the shelving of the Browse and Pluto expansion projects earlier in the month. BHP and RIO have also recently cut projects and dumped their big spending CEOs to refocus on cost control and shareholder returns. We had increased our weightings to Woodside and ANZ in portfolios a week before their surges. On the other hand the gold miners were down another 20% in April, and are now down 30% for the year, after falling 20% last year. We hold no gold miners or explorers in our portfolios and we have been bearish on gold for the past year. We remain over-weight Australian shares.	Below fair value	Above average long run returns
	Developed markets shares	Global stock markets also had another good month - up a couple of per cent plus 1% in currency gains for un-hedged Aussie investors with the lower AUD. In Japan the Nikkei was up another 12% for the month, making it 33% for the year and an incredible 60% gain since mid-November. The US market hit new records and is up 10% for the year. Apple announced a record-breaking $100 billion buy-back but fell back toward $400 - near where it was when Steve Jobs died in October 2011 - having shot up to $700 in 2012. Believe it or not, the likes of Apple, Microsoft and Intel are now "high yield" stocks - churning out mountains of cash profits, paying unprecedented levels of dividends, but trading on relatively modest price/earnings ratios - unlike the cash-less "profits" and astronomic ratios of the dot com era. We remain over-weight global equities.	Mixed – US moderately is over-priced on long term measures, but most other markets are under- priced to fairly priced	Around average long run returns, but currency gains expected (2)
	Emerging markets shares	The big emerging markets continued their long slide. China (down 3%) has had to tighten credit policy again to stem housing inflation. Concern is mounting over a looming bad debt problem, causing credit rating agency Fitch to downgrade Chinese debt during the month. In India (up 2%) growth rates and reform are slowing. Brazil (down 2%) has had to start raising interest rates for the first time since the cuts in 2011-12, due to rising inflation, and Russia was down 5%.	Extremely hard to value. Many appear inexpensive to fair value	Above average long run returns, but high volatility (2)
Fixed Income	Australian Gov't bonds	Following small losses in January and March of this year, Australian bonds had a positive month in April. Yields fell back across all maturities, starting on the day the Bank of Japan announced its QE plan. We are expecting poor returns and we have only been holding minimal exposures in portfolios for liquidity purposes. With all bonds trading at large premiums above par, even if the government pays at maturity (and we have little doubt that it will), new bond holders face guaranteed capital losses from current levels. We would only increase allocations if we were bearish on Australian shares and were expecting a significant economic contraction in Australia.	Yields below (prices above) long run average level	Below average long run returns
	Bank Term Deposits	Interest rates on TDs remain high relative to underlying treasury yields (since the GFC), but low relative to yields on many other assets. Rates are in the high 3's on short term TDs (under 1 year), around 4% for 1 year, and in the low 4's for 3 years and longer. With banks now starting to raise fixed loan rates and with more money now leaving TDs for the higher yields of shares, we expect banks may start to raise TD rates as well. We are staying at the short end rather than lock in now at low rates, and we are also using "breakable" longer term TDs.	Rates around long run average	Around average long run returns
	Global Bonds	Global government bond returns continued their steady upward march (up 1% for the month, and up 3% year to date) as yields fell everywhere (except Japan which ended flat). Despite the Cyprus setback in March, yields on PIIGS debt continues to decline. Italian yields are now down to around 4% and Spanish yields are now in the low 4's - down from 6% and 7% respectively only nine months ago. Somehow in the global bond-buying frenzy France has gone from being the next big PIIG to becoming a "safe haven", as French yields are now as low as those in Germany and the US. With so much free money being thrown around, strange things are bound to happen! The Bank of Japan is going to have a tough time talking up inflation while buying enough bonds to prevent the much hoped-for inflation from showing up in bond yields. Let's not forget that in late 1989 at the very peak of Japan's almighty asset price bubble, Japanese government bonds were trading at 6% while inflation was around 2%, the Bank of Japan's current target. Today bond yields are just 0.6%. Makes the 1989 bubble look like great value!	Yields below long run average level	Below average long run returns (2)
Cash	Australian target cash rate	Australian inflation remains relatively benign - although central banks in Europe, Japan and the US can only dream about the 2-3% inflation we "enjoy". With house prices starting to rise, wages growing relatively strongly, unemployment rates still low and the government still running large budget deficits, there is little scope for the RBA to cut rates much further, short of a major crisis.	Cash rates below long run average level	Variable, rising over medium term
Real Estate	Australian commercial property	The local commercial property market is weak, with rents falling and vacancies rising, but the listed property market is on fire. After falling 3% in March, the listed market shot up 8% in April, making it the best month since the tremendous post-GFC rebound ended in September 2009. April's surge started on the day the Bank of Japan's bond buying plan was announced. Local institutions were the main buyers, hoping for a wall of money from Japan, but it is yet to arrive in force. We hold neutral weights, but were over-weight during much of last year's strong rise.	Over-valued on long run measures	Around average to below average long run returns
	Australian residential property	Despite rising unemployment and the slowing of the mining boom, relatively low interest rates are finally starting to lift buyer interest and prices. Most of the activity has been in existing houses, as building approval rates for new houses and flats remain weak. Top end prices are showing signs of life, but prices are still up to 50% below pre-GFC boom-time levels for many properties. We don't see a boom for a while, as household savings ratios are still high and credit is still tight.	Varies by market, but over-valued overall	Below average to average long run returns
Australian dollar		In April the Australian dollar fell a little against the USD and especially against the stronger Euro, Swiss franc and Pound Sterling. But it rose against the much weaker yen which has fallen 20% since mid-November of last year. Overall the AUD has been virtually flat for the past 9 months, but it remains over-valued on fundamental measures.	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 AUD terms – ie including any profits/losses from hedging or currency movements