Are things improving?

It's been an unsettling quarter for share markets anywhere in the world – no country has been spared. The debt default crisis in the Euro zone is holding global investment markets (including Australia) to ransom. So what does this mean for investors; more volatility – for example, in the US on 5th October 2011 the Dow Jones Industrial Average (DJIA) was trading at 10,434 points then in the last hour it jumped more than 370 points or around 3.7 per cent. What happened tells us a lot about the capital markets we now live with. Jumps and falls in the DJIA typify how traders are thinking at the moment – buy on the rumour sell on the fact. Please see the graph below which displays volatility in the US share market. In the last few months it is showing similar levels as was the case in the GFC.

Source: Yahoo Finance

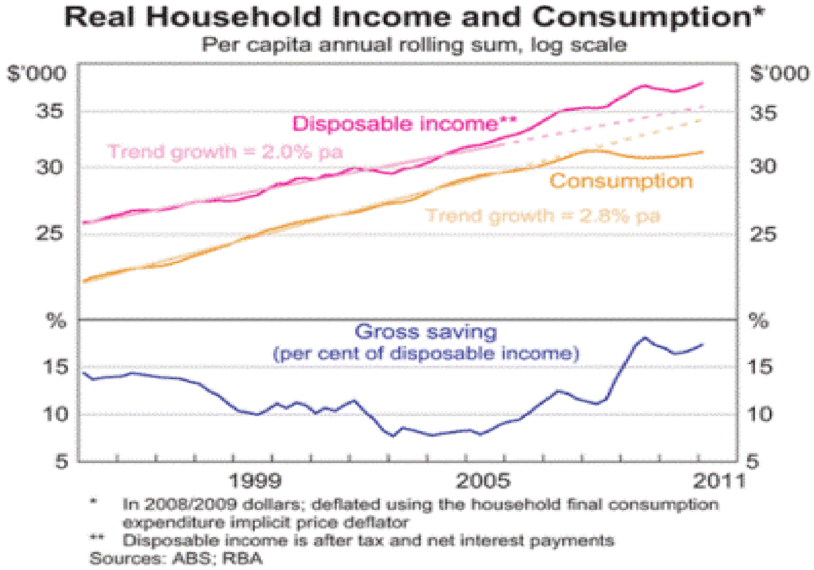
As Europe protests austerity measures and as US unemployment keeps climbing, the outlook for Australia is brighter. We are still of the opinion that as a nation we face one of the greatest opportunities in the world today as the shift in economic growth from the developed to the developing world continues to progress at speed. And it does not relate solely to the export of minerals and energy – but the continued creation of a massive middle class number of consumers throughout China, India and South East Asia – countries on our doorstep.

In addition, the Australian government has the lowest government debt to revenue and our companies have healthy balance sheets. Australia is, of course, not immune to the global crisis. Although the current fall in the Australian dollar has eased pressure on companies that export.

Where to from here?

Turn the volume down and review cash return strategies (as noted in our last quarterly update). With the amount of information being put forward regarding short term forecasts, longer term rational cashflow behaviours are being ignored. The short term approaches will not last forever as national, corporate and consumer debt levels are normalised and consumption behaviour in Asia increases.

To evidence this, retail sales for the month of August according to the Australian Bureau of Statistics (ABS) rose again for the <u>second</u> consecutive month. As per the graph below we can see that consumers since the GFC have decreased consumption and paid down debt, this will eventually change.



Where does this leave investors?

For long-term investors willing to look beyond short-term uncertainties, shares offer great value. Currently the dividend yield on Australian shares is 5.1%, but grossing up for franking credits means the cash flow being paid from Australian shares is over 7% of their current value. For financials and blue chip stocks, dividend yields are even higher than this. This is well above bank term deposit rates and means that share values only need to rise by 3% per annum to provide attractive double digit returns for investors.

The Market: The All Ordinaries Top 200 Companies Index started the quarter at 4,608 and after the impact of uncertainty surrounding European Debt coupled with softness in housing starts and high unemployment numbers in the US, ended the September quarter at 4,009. This represents a fall of 13% for the quarter and about the same fall for the last 12 months ending 30 September 2011.

We would like to thank AMP Capital and Perennial Investment Partners for some of the information used to collate this letter. If you have any questions with regard to the report or any of the issues raised above please don't hesitate to contact me. Thank you for your continued support.