



View from the top

Hello and welcome to the spring edition of "Towards Financial Success".

You will recall in our last newsletter I made the following observation with respect to our market.

"Markets are a leading indicator (generally by 6 to 8 months) of what the economy is doing and tend to overshoot both on the positive as well as the negative. At the moment, Blue chip Australian companies represent very good value if we take a longer term outlook. Many companies reported above expectations in the March reporting season, and from a yield perspective (even after a drop in dividends for many) significantly outperformed the official cash rate. Now is the time to be positioning for the future and adjusting portfolios to capture the yield currently available. Growth will take a little longer but on a five year outlook current prices represent good value".

In the September reporting period just concluded 80% of Australian companies reported better than expected earnings results. As I write this column, National Australia Bank has announced its results and whilst it was a significant fall in full year profit (down 42%) the stock is trading at around \$30 per share. It also announced a dividend of 73c which brought its full year dividend to \$1.46. Even on today's prices this represents a yield of 4.86% plus the

In the September reporting period just concluded 80% of Australian companies reported better than expected earnings results.

attached franking credits. If someone had purchased NAB shares in March at the depths of the market they would have paid around \$17 per share. The yield on this purchase then rises to 8.5% again with franking credits attached.

The same test can be applied to many other leading companies with a

similar result. My point is not to recommend National Australia Bank or indeed any other specific company but to illustrate what I had previously said about repositioning portfolios to capture yield and being patient about growth.

A recent article by Investors Mutual, a leading Australian funds management group points to this in discussing the performance of its flagship Australian Share fund. In the period 30th June 1998 to 30th June 2009, an investment of \$100,000 at inception would have grown to almost \$300,000 by June 2007 however had fallen back to \$179,000 by the end of June 2009. Astonishingly though, distributions over the same period totalled \$106,568. This does not take into account the value of imputation credits.

Investor's mutual founder and investment director, Anton Tagliaferro said that "when investing in shares it is often easy to focus only on their capital value and its short term fluctuations while overlooking the income stream that good companies deliver to investors over the years".

There remains a lot of debate as to whether the current rally is sustainable and a mountain of "information and research" can be found to justify a positive or a negative view.

One of the most balanced views I have read recently is that of Mark Dutton, Chief Investment officer at AXA. His view on whether the market has come too far is reproduced on pages two & three of this newsletter.

Elsewhere in this edition we profile key staff members, Simon Benson and Matthew Brooker.

We would also like to take this opportunity to welcome Kristi Langtree to the TFS team. Kristi joins our client service team and has worked in financial services for the past three years.

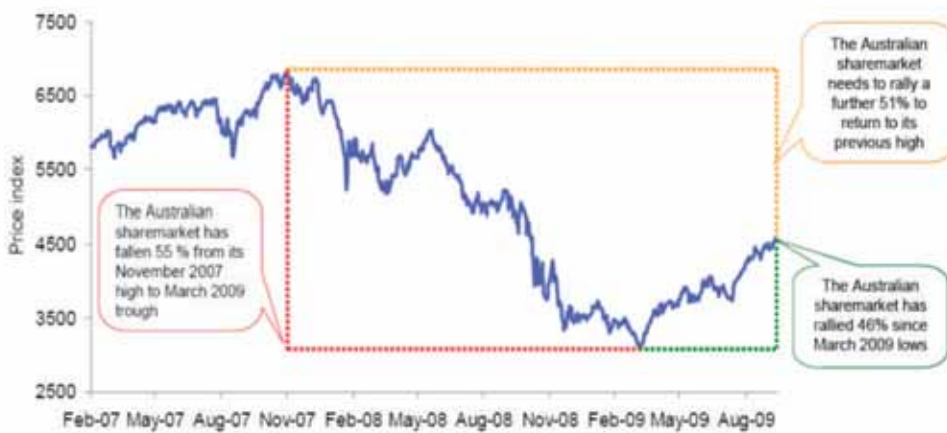
Danny Maher, General Manager



Market rally - has it come too far?

The Australian sharemarket has rallied strongly since its lowest point in March this year. In this Point of View, AXA's Chief Investment officer Mark Dutton looks at what's behind the rally to help assess it's sustainability over the longer-term.

The Australian Market Rally



Source: Bloomberg, All Ordinaries Index, data from 1 February 2007 to 15 September 2009

A rally from the bottom always looks bigger than a fall from the top

A rally from the bottom of the market can create a false signal that markets have rallied too far and too fast, so it's worth being clear on the numbers. We are not even half way back yet.

After reaching an historic high of 6854 on 1 November 2007, the Australian All Ordinaries Index fell by 55 per cent to its lowest point of 3112 on 6 March 2009.

From this low point to the present level of 4541, the index has risen by 46 per cent. But the current level is still 34 per cent lower than its November 2007 high.

In other words, the rally has only recovered a little more than one third of the decline. The Australian sharemarket still needs to rally another 51 percent from current levels to return to its previous high.¹

In brief

- **The current market rally is coming off a low base - the Australian sharemarket still needs to rally 51 per cent to return to its previous November 2007 high.**
- **So far the market recovery has passed through two stages: a change in risk assessment, followed by a second phase which began to price in recovery potential.**
- **Valuations for the Australian sharemarket are currently still cheap using forward earnings if companies continue to experience stronger earnings.**

¹ Current Level is taken as of 15 September 2009

Phase 1

Disaster to just plain difficult

We are progressing through a series of phases in what can amount to an extended recovery. The first phase of market recovery, from March to July, came as it became increasingly apparent that policy measures were proving to be effective at stabilising the global financial and economic system. During this period, the risk outlook changed from 'disaster' to just plain 'difficult'.

While the outlook at this stage was not highly positive, the relative change and cheap valuations were enough to justify the relative increase in the sharemarket valuations.

Phase 2

Pricing in recovery potential

The second phase of the rally, from July to now, reflects an increased willingness to price in a recovery in company earnings. During this period, confidence was boosted by the positive mid year reporting season as well as the emergence of stronger than expected economic data.

Profit results which deviate from consensus expectations are often referred to as earnings surprises. The August reporting season revealed 44 per cent positive surprises, 38 per cent on target and 18 per cent negative surprises. In other words, more than 80 per cent of companies met or exceeded expectations.

These positive trends were needed to support the view that an earnings recovery has commenced, and have subsequently led to an upward revision of analysts' forecasts for 2010.

Better than expected economic growth and business investment data also helped validate sharemarket performance.



How sustainable is the market rally?

Looking at Australian equity valuations, the market rally has pushed the forward price to earnings ratio (p/e ratio) just past its longer-term historical average, suggesting that the Australian sharemarket is trading at around fair value. For example, figure 2 shows the Australian sharemarket p/e ratio on a 12 month forward consensus earnings is at almost 16 times expected earnings, which is not too far from its longer-term historical average.

On this view, while the market no longer looks 'cheap', it is important to note that we are currently working with below average profit levels and depressed asset values.

Providing earnings fundamentals continue to improve, the market still represents good value at today's levels.

Figure 2: Australian sharemarket 12 month forward p/e ratio



Source: AllianceBernstein, IBES, MSCI, Datastream, Deutsche Bank. MSCI Australia price to earnings ratio on consensus 12 month ahead expected earnings. Data from January 1990 to August 2009

The Australian sharemarket indicates fair value on other measures, such as price to book ratio (p/b ratio) and historical dividend yield.

Figure 3 below show p/b ratio is reverting back towards its longer-term average.

Figure 3: Australian sharemarket p/b ratio



Source: AllianceBernstein, MSCI, Datastream, Deutsche Bank. MSCI Australia price to book ratio. Data from January 1990 to August 2009

Figure 4 below reveals that while the dividend yield has fallen a long way, its current level is consistent with longer-term historical trends.

Figure 4: Australian sharemarket historical dividend yield



Source: AllianceBernstein, IBES, MSCI, Datastream, Deutsche Bank. MSCI Australia trailing dividend yield. Data from January 1990 to August 2009

At current levels, dividend yields including franking credits represent an attractive source of return, especially when compared with current low levels of interest rates.

What this means for investors

The Australian sharemarket has plenty of ground to make up to get back to previous highs.

However, in the next phase of the recovery, there is likely to be more divergence of individual stock returns, as those companies which fail to meet expectations are punished, and those with strong profit growth are favoured by the market.

In this phase, we can expect to see a continuation of recent trends. Consumer, business and investor confidence is likely to continue to increase as the global economy moves nearer to exiting recession.

However, investors will need to be cautious of becoming overly optimistic in the short term.

The underlying fundamental issues of too much global debt (leverage) still remain and need to be unwound.

Having said this, the Australian sharemarket still offers high return potential even if recovery significantly slows down.

For example, if it takes another three years for the Australian sharemarket to return to its previous high, this equates to an annual average return of 14.7 per cent (plus dividends).

Over an even longer time frame of seven years, this equates to a healthy average annual return of 6 per cent (plus dividends).

18 September 2009 Mark Dutton, Chief Investment Officer – Australia & NZ, AXA 9.

In preparing this document, National Mutual Funds Management Limited (AFSL 234652) (NMF) has taken care to ensure that the content is both accurate and correct. However, NMF provides no warranty as to the accuracy or completeness of this document. Any opinions or forecasts mentioned in this document do not necessarily represent the opinions or forecasts of NMF. Past performance is not necessarily indicative of future performance. This document is intended to provide general information and does not take into account the investment objectives of any particular investor. Before making an investment decision, investors should seek professional financial advice and should read and understand the product disclosure statement.

National Mutual Funds Management Ltd. ABN 32 006 787 720 AFS Licence No. 234652 Member of the Global AXA Group www.axa.com.au



Staff Profiles



In September we held our client briefing 'The Future of Property' with guest presenter, **Mark Quinn** - Director of Herron Todd White Cairns. If you would like a copy of the DVD, please contact TFS

Simon

Simon joined TFS Financial Planning in 2008 and has in excess of 20 years experience in the financial services industry with 10 years in Financial Planning and the balance in the rural and commercial lending and banking operations.

He enjoys using his diversity of experience to provide comprehensive and practical advice to a wide range of clients in a variety of situations. As well as

looking after his client's in Cairns, he travels to his clients in Townsville as well as the Mossman / Port Douglas area and on the Atherton Tablelands – usually in time for morning tea!

At home, Simon is married with two children whom he spends much of his spare time with. When not with the family, he is a keen gardener, a trait derived from his childhood on a property in central Queensland.



Matt

Matt has worked in the Financial Planning industry since 2006 and is currently employed as Para-planner with TFS.

Matt has completed a Bachelor of Business with JCU and is completing a postgraduate Diploma of Financial Planning with Kaplan. In his role as Para-planner Matt is responsible for assisting the advisory team in modelling portfolios and analysing strategies.

Matt enjoys working with our

Financial Planning staff to ensure that our clients are in the best position to achieve their lifestyle and financial goals and is himself working towards becoming a Financial Adviser.

When away from the office Matt likes to play touch football when he is not breaking his ankle, he also enjoys reading and watching DVD's. Matt is currently reading "Bulls Eye Investing" by John Maulden.

