

# Bookmakers Super Fund

## Investment Managers Review

March Quarter 2009

### Investment & Economic Review

The March 2009 quarter had two distinct periods – a calamitous and hopefully final market capitulation occurred during January and February, followed by a strong recovery in March that has continued into April.

Economically, most industrialized countries are experiencing a synchronized economic slowdown, with the United States, Britain and much of continental Europe now in recession and Australia having reported one quarter of negative growth (GDP). This is expected to be followed by a further small contraction in the March quarter with a small improvement likely in the June quarter assisted temporarily by the positive effect of the first-homeowners grant on the housing market, and the broader government fiscal and monetary economic stimulatory adjustments.

Global GDP for 2009 is now forecast to fall by 1%, reflecting the weakest period of GDP since the Second World War. However the economic performance of many of Australia's key trading partners will continue to be positive in 2009, notably China, which is now our largest trading partner. Like most countries China appears to have been surprised by the speed and severity of the financial crisis and consequent economic downturn. However they have reacted decisively by implementing both monetary and fiscal measures to stimulate their economy.

Economic cycles tend to last 8-10 years, and the last economic slow-down was in 2001, followed by a robust period of growth. Recessionary periods tend to last between two and five quarters, and it is our expectation that this particular slow-down will be more severe than normal, caused by the sheer magnitude of the financial meltdown in the United States and Europe. The chart below depicts the economic cycles in Australia, represented by the quarterly percentage changes in GDP. It is an interesting pictorial view of the economic cycle and shows the volatility of our economy.

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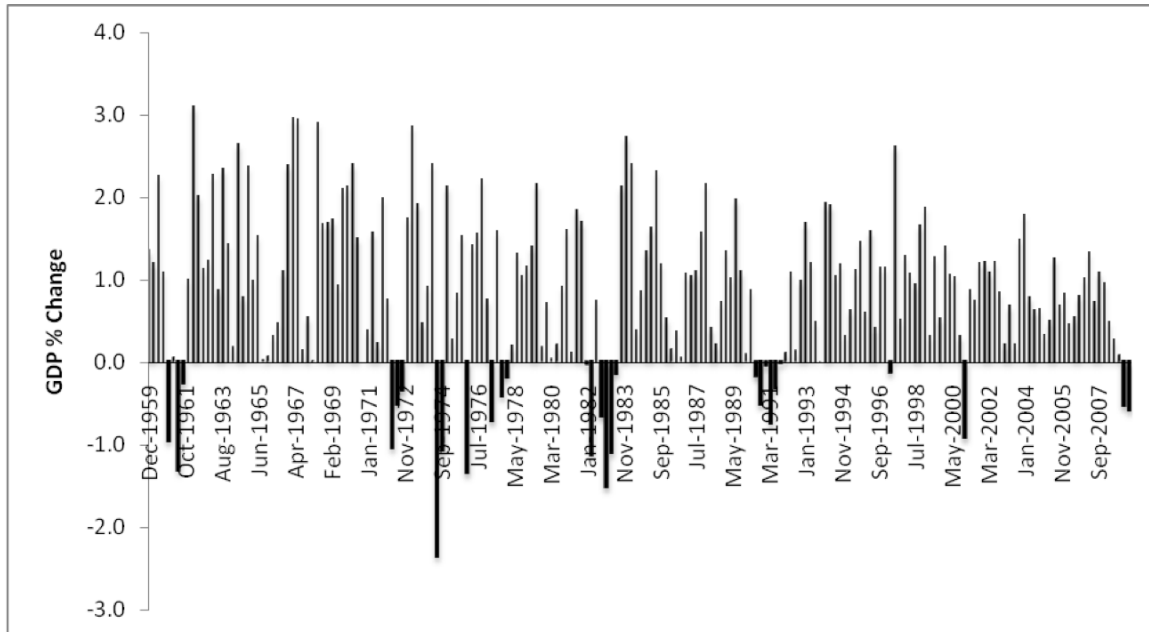
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Australian GDP % change per quarter

Looking forward, we expect the economic downturn to linger for a while and, statistically it will take until 2010 before more promising data is more widespread. Investment prices look forward and markets tend to turn upwards well before the underlying economy recovers.

## Shares

Recent share transactions undertaken for the Bookmakers Super Fund have been directed towards ensuring that the share portfolio consists predominantly of large secure companies. At 31 March 2009 the two largest share investments of the Balanced Fund were BHP Billiton and Westpac. The Conservative Fund is unable to own shares. Performance for the quarter was assisted by rises in most bank shares, BHP, Rio Tinto and Wesfarmers, and negatively affected by price falls in Bluescope Steel, QBE Insurance, Suncorp-Metway and property shares such as Westfield and Stockland.

The Australian stock market, as measured by the benchmark ASX 200 Index, fell by 140 points or 3.8% during the quarter from 3722 to 3582 points. However the market declined savagely to a low point of 3120 by early March before the strong recovery. Indeed the market at time of writing is now in positive territory for the year.

The last leg of the sharp fall in share prices was probably overdone. At the low point Australian shares were trading at about 10 times forecast earnings (P/E ratio) and the average dividend yield of the leading companies was about 7%.

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The profit reporting season in February had the usual mixture of both positive and negative surprises. Most good companies reported satisfactory results in the deteriorating economic conditions. Many companies will lower dividend payments in 2009, such that we expect an average dividend reduction of about 20%.

We remain focused on the constituents of the ASX100 for the Bookmakers share portfolio, and, in particular, we prefer shares of the largest and industry leading companies. Our expectation is that the current market rally will soon run out of steam, affected probably by further financial bad news in the United States. However by mid 2010 our analysis suggests that the market index should have risen beyond 4000 points.

## Property

Property prices in Australia have suffered severely of late, most particularly commercial and industrial properties. Residential prices have to some degree been protected by solid demographic dynamics and the artificial boost afforded by the expanded first home owners grants.

Capitalisation yields on commercial property are rising as the economic crisis and the tightness of credit create forced sales, revaluations and panic. This unusual phenomenon of rising rental yield at a time that market interest rates are falling will inevitably lead to an overreaction, and consequently some excellent investment opportunities will arise for investors as the cycle bottoms.

The Bookmakers Super Fund owns two commercial properties, both of which are fully let and are performing to expectation. The Fund also took mortgagee possession of an almost complete development consisting of three new houses in Rose Bay in Sydney during the quarter.

## Interest Rates

The extraordinary decline in global interest rates remains one of the major themes of 2009. Australian cash interest rates were reduced by a full percentage point to 3.25% in February, then again to 3% in early April. However longer term interest rates are now rising. For example the three year bond yield, which bottomed at 2.6% in February, is now 3.3% and the ten year bond yield, having bottomed at 3.8% is now 4.5%. Consequently the yield curve has now progressed from neutral to positive. A positive yield curve, in which longer term interest rates are higher than short term rates, is normally a leading indicator of a re-flating and improving economy.

Global cash interest rates remain remarkably low. The current cash rate is 0.1% in Japan, 0.25% in Switzerland and the United States, 0.5% in Canada and England and 1.25% set by the European Central Bank.

Adapting and understanding the economic and investing consequence of low interest rates is very important. Clearly, there has been some recent positive asset market effect, as investors begin to switch funds from low interest rate deposits back to shares, hybrids and property. This strategy is sound, but

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should be executed with some care as economic bad news and market volatility will remain for some time.

Eventually corporate balance sheets will be assisted by lower interest rates, however the reluctance of banks to lend and the tightening of credit have so far stymied this positive effect.

The fixed interest component of the Bookmakers Fund has weighed on the overall Fund performance. The distressed credit markets and the consequent difficulties to refinance loans have led to some mortgage defaults and redemption delays. The Fund's Trustee has made provisions where they deem appropriate and as investments and loans mature these monies are being either held in cash, mostly within the Conservative Fund, or redeployed to other asset classes.

## Outlook

We are now two quarters into the domestic economic recession and more than a year has passed since the global financial crisis commenced. The first glimmer of positive economic news is now apparent, and this coupled with the decreased likelihood of further global bank financial failures should underpin an economic and market recovery in 2010.

Share prices have begun to rise, but are expected to suffer further short term down trend periods on the back of economic and corporate bad news. However we are likely to have passed the low point in the share price cycle and we expect prices to be modestly higher over the remainder of 2009 and into 2010.

Australian cash interest rates are also close to the cyclical bottom; however a further small adjustment downwards is still possible in 2009 as the Reserve Bank acts in concert with the Federal Government fiscal stimulus packages.

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