

Investment Overview**Sector Outlook**

Investment Overview

The Big Picture

Further complications, injected since our last Bulletin, have included the interest rate differential now existing between the U.S. and Australia (see our web page – www.platinumhouse.com.au). This is at levels not seen for some considerable time and introduces opportunities as well as cautions.

Should I restructure my portfolio?

This is not the time for wholesale restructuring of an investment portfolio. While some minor adjustments may be desirable to take advantage of a few opportunities which may exist for portfolios of a certain profile, riding out the continuing storm is still the prime consideration.

In most circumstances investors need to re-visit their specific asset allocation and the exposure to equity investments in their portfolios.

The booming 90's was the golden era for equities and it wasn't too difficult for fund managers to produce double digit returns. Looking forward, we believe that investment returns, and in particular equities, will revert back to their historical mean. This means that investors should expect single digit returns as the norm for the majority of asset classes in the years ahead.

So what is going on?

The markets, both local and international, continue to seek new equilibriums appropriate to the times, as between various classes of assets – beginning with equities versus debt instruments and then reclassifying and rating the various elements of risk in each sector (e.g. industrial versus high-tech equities).

This exercise remains incomplete as is seen by the “one pace forward, two back” process occurring in most of the markets in recent times. And it will continue for some time to come as the bold and brave test the markets (almost sector by sector) trying to find new floors and ceilings for various investment types.

What is happening is neither new nor should it be frightening – but to those who have not seen (and lived) through this experience before – it is sometimes both.

The way through is to take advice you trust and get on with life – resisting the urge to revalue your portfolio on a daily basis. To use Shakespeare's words – “that way madness lies”.

There may be a new “shape” beginning to emerge. It is too early to give it an identifiable form but some of the pre-requisites to the beginning of a recovery are starting to be seen in off-shore equity markets. At this stage these could as easily retreat as develop further, so analysts await more than these preliminary signs before making recommendations.

What are the risks?

Recent developments have not so much changed, but dampened some of the moderate enthusiasm beginning to grow in favour selected equities. Current risks include:-

1. Concern expressed through world equity markets towards the seemingly inexorable path towards armed conflict in the near future between a U.S. sponsored western coalition - and Iraq.
2. The sluggishness of the global economy and the apparent inability of the U.S. to stimulate its, and others demand-levels for goods and services despite the lowest interest rate regime for decades.

3. The continuing unattractiveness in yields on “sovereign risk” i.e. Government Bonds and the high entry price for would-be investors looking to balance their portfolios.

So where to from here?

The expected improvement and easier reading of markets is now deferred for some time. Recent developments in off-shore equity markets show some promise which may or may not develop further. Some differentials beginning to be seen between peak equity prices and values of 18 to 24 months ago and now - are making some equity investments look reasonably attractive, however there is a cautiousness in the market towards taking advantage of these situations at this time. Repeated countless times around the world, this mind-set becomes almost universal and results in the pervading atmosphere of oppressiveness seen in most markets.

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Cash

More than ever, cash is the investment of default and the few attractive investment options for more conservative investors in equities or debt instruments, mean that cash-based investments, despite their modest yields are still favoured.

Fixed Interest

Again, we find ourselves repeating the position taken in our previous Bulletin. Government bonds, the world over, are still significantly overvalued. As investors have been positioning towards defensive asset classes, yields in government bond portfolios make them significantly overvalued. In terms of building a portfolio, our recommendation remains that investors retain an underweighted position.

There are still some quite attractive alternatives in corporate debt and these are preferred to entering, or building on a Government Bond portfolio at this time.

Property

The position with property trusts also remains as before. We continue to believe that property trusts offer a good alternative to bonds for those investors seeking a higher income stream. At around 7.5%p.a. this can be attractive. However weaknesses in the rental market and reduced “escalators” in new leases being signed suggests that property trusts may now be beginning to feel the cold winds from other sectors of the economy. This of course will depress “new starts” until the sector again comes into equilibrium with revised demand / supply factors. This assessment applies as much to “residential” as “commercial / industrial” markets.

Australian Equities

Shares continue to be the preferred asset class, especially when compared to domestic bonds and most international assets. Within the broader market, from time to time apparent imbalances appear and are quickly corrected by the more swiftly moving fund managers. The continuing absence of “premium” which used to attach to the smaller capitalized listed companies has moved many analysts to recommend current investment in Australian equities revert to “large caps” more in perceived growth sectors, rather than investing in “value” stocks.

While this is a sensible defensive move the opportunities to pick up some long-studied “tiddlers” at an attractive price will presumably not be overlooked.

International Equities

Perhaps, as much for reasons of paucity of opportunity elsewhere, several analysts including the top-rated van Eyk organization are beginning to look favourably at international equities. Some of these are now up to 40% cheaper than they were at peak prices a year or two ago. The fundamentals which made them attractive then are still in place and some funds are taking in several of these stocks on a partially or fully hedged basis. Fully hedged, the risk/return factor is fairly modest, but on a partially hedged basis, fortune could again favour the brave.

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