

Investment Overview**Sector Outlook**

Investment Overview

How is the Australian Economy performing?

The continuing drought conditions being experienced throughout most of the country and the unlikely prospects of early relief, have together, caused a scaling back of 2003 growth projections by all economic forecasters.

The extent of these downward revisions though, must be seen in the context of similar and recent analyses of other major equity markets favoured by Australian investors and by local and international Fund Managers.

van Eyk Research figures are revealing in this regard. While Australian growth has been reduced slightly to a still very positive 3.0% for 2003, this level is matched only by the United States while Europe and Japan weigh in at more modest levels of 2.5% and 1.3% respectively

The convergence of corporate, economic and well-publicised accounting problems combined with terrorism and concerns about middle-east war possibilities has understandably impacted on local and world confidence in equity markets. There have been few periods in the past 50 years when such a galaxy of unpropitious stars have converged. However despite all of this, the Australian equity market is proving extremely resilient.

And an Australian Corporate Health Check?

Following on from the above commentary, Australian corporate performance, while seemingly not as exciting as some U.S. results announced recently, remains satisfactory rather than stimulating, under the most unusual conditions prevailing.

The U.S. appears still some way from any general resurgence of economic activity, and confidence, while showing repeated but short-lived signs of returning, is not yet evident in investment patterns seen in recent times.

Again, in perspective, Australian corporates are performing creditably by comparison with their counterparts in other major markets.

The U.S. Economy?

Shortfalls in corporate performance expectations over the last two years have been exacerbated by the various layers of additional concern impacting on the U.S. economy.

That major issues of corporate governance and accounting ethics should surface at a time when the economy was in a weakened condition and the population already moving on to a "psychological" if not "actual" war footing with Iraq, was an accident of timing of rather large proportions whose significance should not be underestimated.

The fact that recent forecasts for 2003 (while slightly reduced) remain as positive as they are, is a sign of the underlying strength of the U.S. economy which will still struggle a while yet, to break through the various layers of problems - some related to the economy, some not - before emerging into less turbulent conditions.

Until that occurs, Europe and Japan are unlikely to emerge from their hiatus.

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Cash

Really, a restatement of past assessments. Cash is no more than a default investment reflecting the attractiveness or otherwise of the available alternatives. If immediate alternatives appear few in number then cash Funds assume a larger portfolio component.

Fixed Interest

Domestic Bond yields remain unattractive following the early flight from equities driving prices up. Entry prices are expensive and will remain so while this period of distorted values continues.

Property

Listed Trusts continue to offer reasonable yields compared to the two sectors above, however the weaknesses beginning to appear – vacancies and the increasing leverage being used by tenants in containing or reducing rent levels, may impact on their comparative attractiveness in the medium term.

Australian Equities

As backgrounded in our Investment Overview, Australian Shares remain reasonably attractive, compared to most available alternatives. In more recent times the differentials previously existing between “large cap” and “small cap” stocks seem to have all but disappeared. This reduction still requires validation in terms of ongoing performance and returns to justify foregoing the risk/return premium previously applied to “smaller cap” stocks.

Perhaps in these times of uncertainty “large caps” remain the more attractive investment, although some “littlies” have drawn the attention of investors prepared to go out on a limb to build an aggressive long term growth portfolio.

International Bonds

Our comments are identical to those regarding “Fixed Interest”.

International Shares

The dual components of risk require careful evaluation. Combined, they show, on the face of it, an extremely attractive investment alternative where, since markets peaked in early 2000, values are down by 35-40%.

This, of course, ignores the very important element of currency risk. Any appreciation in the value of the Australian Dollar has an immediate and negative impact on the relative value of, and yields attaching to, international shares.

Through using “hedge” mechanisms this risk can be partly or fully obviated but the associated costs of so doing, often wipes out a large part of the differential of attraction, leaving investors sometimes wondering why they bothered in the first place.

This need not be true of all investments in international shares but investors should be quite clear in their minds, the possible effect of this second risk component and be satisfied with the level of exposure or alternately “cover” offered in various Fund Manager’s products.

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