



Economic & Market Update

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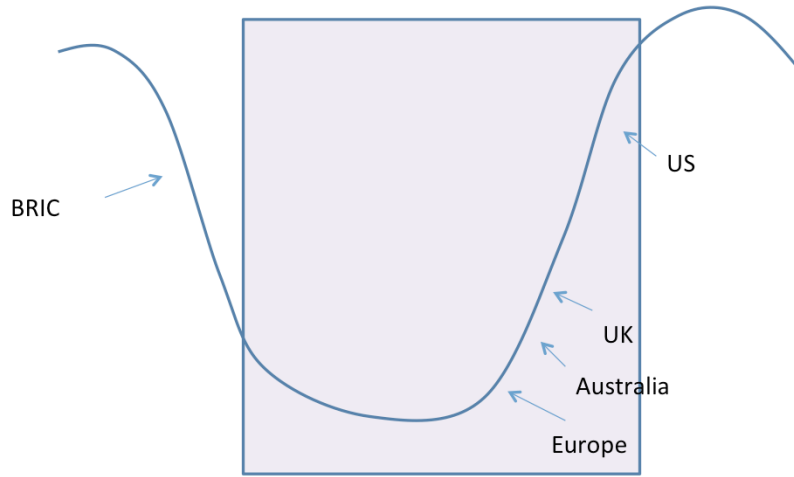
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Where are we?

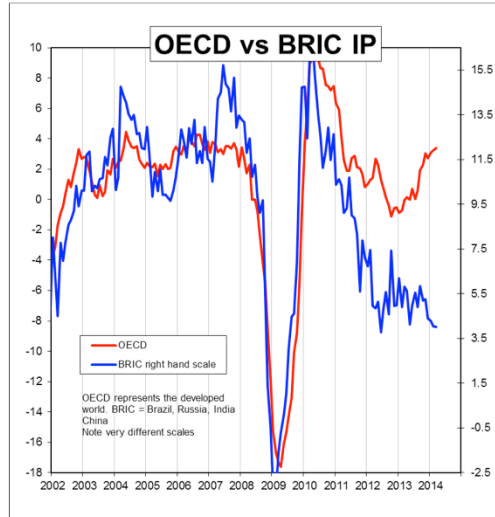


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Share markets turn up and down before economies do.

OECD & BRIC

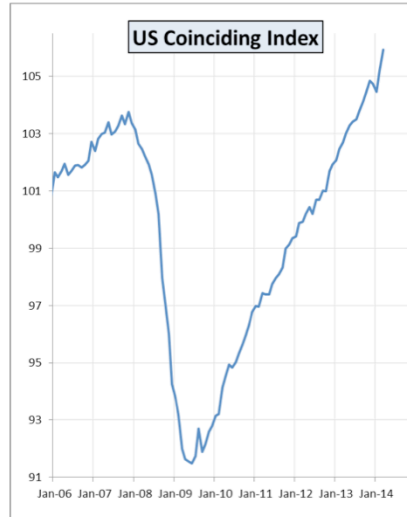


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Historically good correlation but note different scales – e.g. in 2007 OECD around 4%, BRIC 15 to 16%. Now lines diverging; OECD recovery, BRIC slowdown

US coinciding index

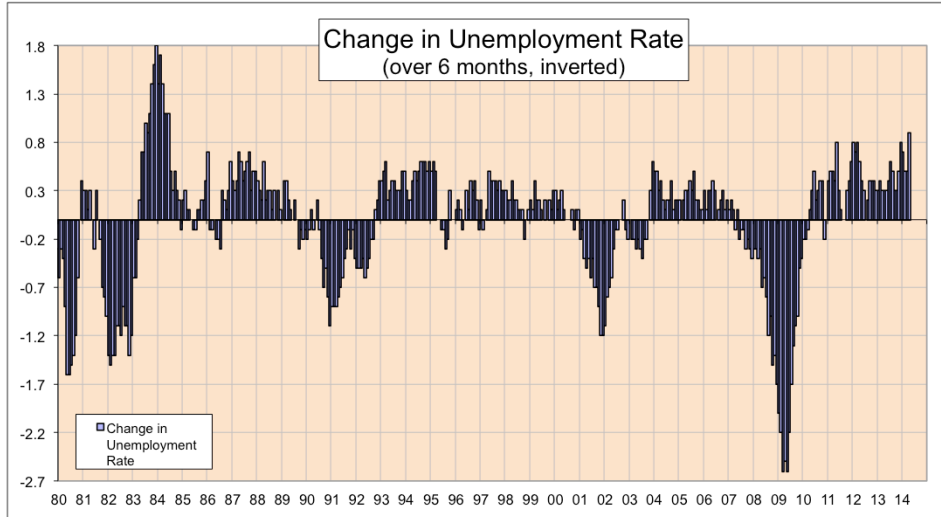


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Our coinciding index rising steadily from GFC low. Blip in January from big freeze. Compare with European chart later on in this presentation.

US Unemployment plummeting

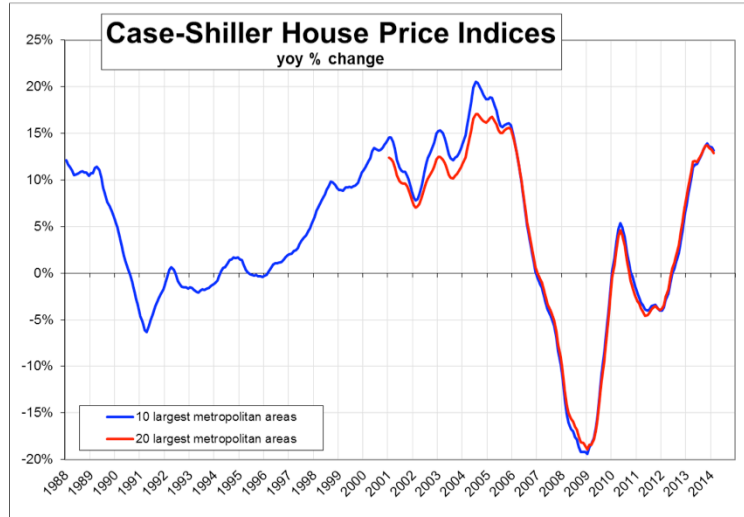


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This shows CHANGE in unemployment rate, INVERTED. Because unemployment FALLS in eco recovery, RISES in slowdown. Last time we had such a big fall in unemployment rate was 30 years ago. Suggests strengthening recovery.

Housing recovery



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Housing markets and dodgy mortgages led to GFC collapse. House prices finally recovering properly, but note unlike Oz, still below previous highs. Good for confidence and consumer spending.

US Boom

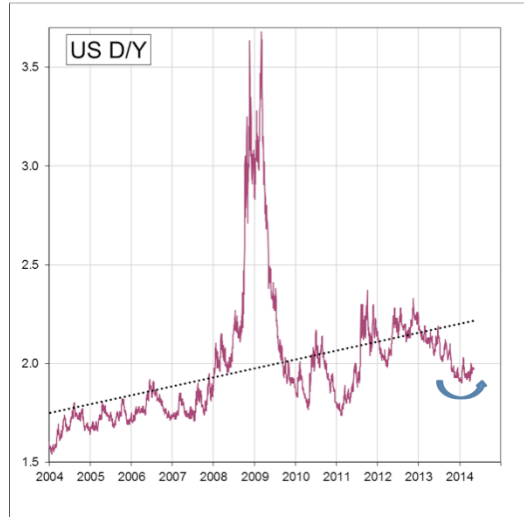


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Our coinciding index, note dip because of weather in Q1 2014. Leading index leads eco cycle, note sharp recovery over last year.

US Share market toppy?



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But eco strength means extraordinary easing must end. So logical D/Y may be rising.

A pause?



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Market up 3 times roughly since low. Will it start to fall as policy is tightened, or will it just level off?

Europe recovering

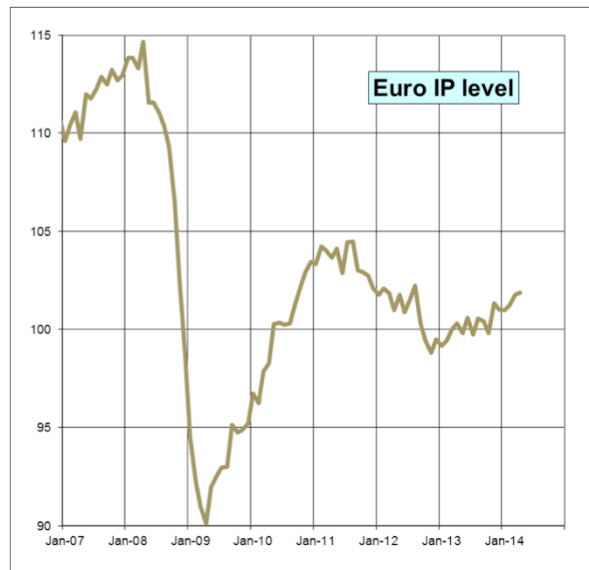


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Europe is recovering. PMI = Purchasing Managers Index, a useful early guide to economy

But still v. sluggish

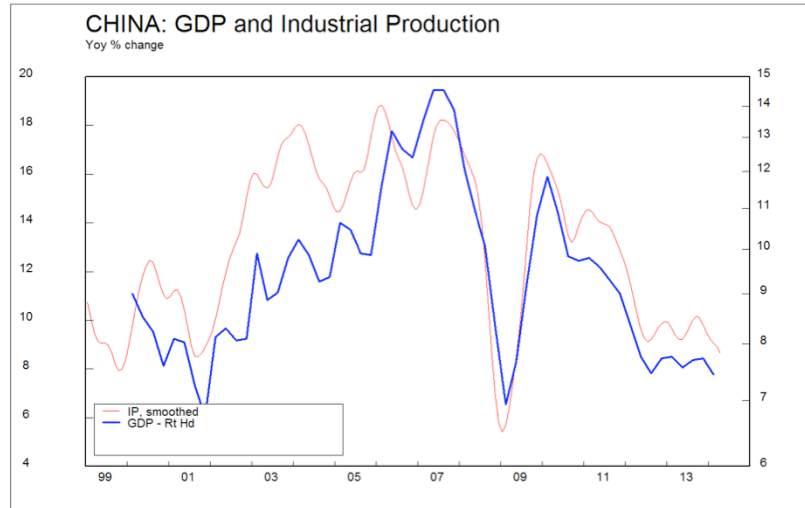


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Remember US chart earlier? Their recovery just kept going. Europe started a normal recovery from GFC in 2009, but then ill-advised austerity stopped it. Even GDP is not yet above 2007 high. So interest rates not going up soon.

CHINA

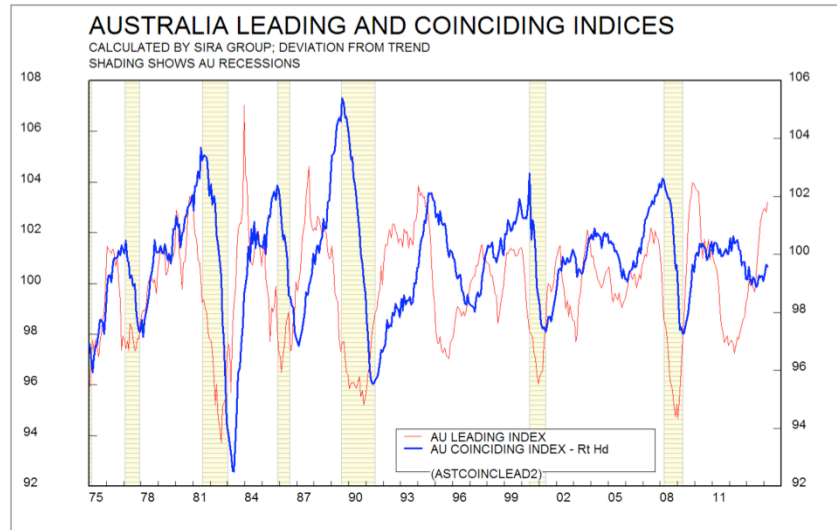


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Note very high China growth in '02-'07. Then GFC plunge. Now growth target is same as low point of '09 post GFC recession. Because of problems caused by stimulus; corruption; banking; house price boom; pollution. **THIS IS THE NEW CHINESE GROWTH RATE.** 10% GDP growth is over. Important implications for Oz as China world's largest consumer of commodities.

Australia

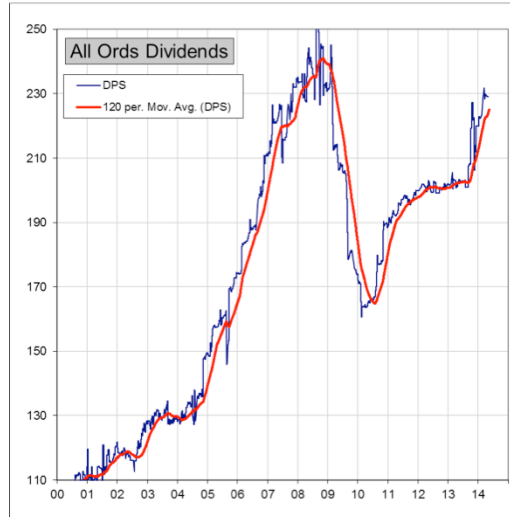


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Our own leading and coinciding indices for Australia. Note how leading index points towards eco recovery which has just begun.

ALL ORDS DPS

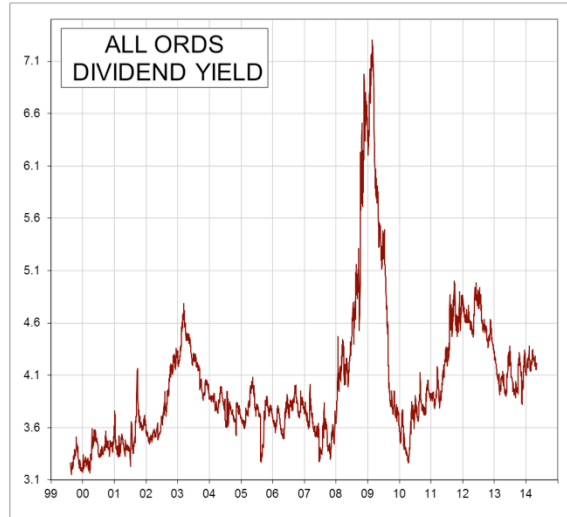


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Economy important for profits. (You'd get a similar chart using EPS). The DPS is calculated as if the All Ords was a share. Note that we are within 13% of previous peak. Note that 2004-2007 bull market fuelled by DPS growth. Divs forecast to rise 8-ish % this year and next.

D/Y high

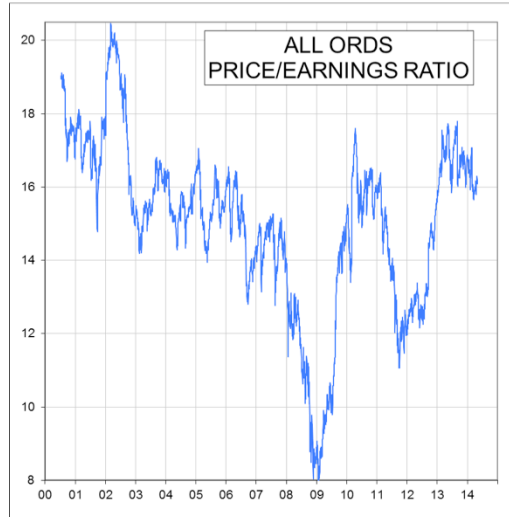


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Meanwhile D/Y has room to fall (=positive for share market)

PE's not excessive

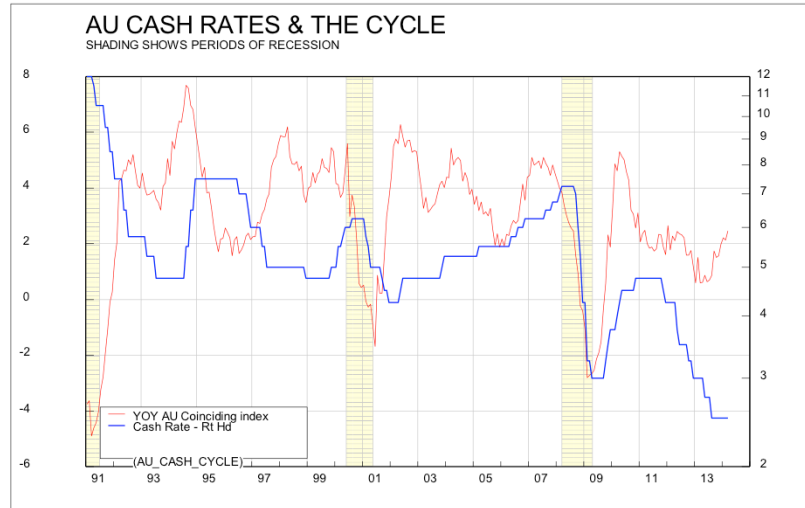


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And PE's (NB, trailing not forecast) not excessive.

.. but interest rates troughing

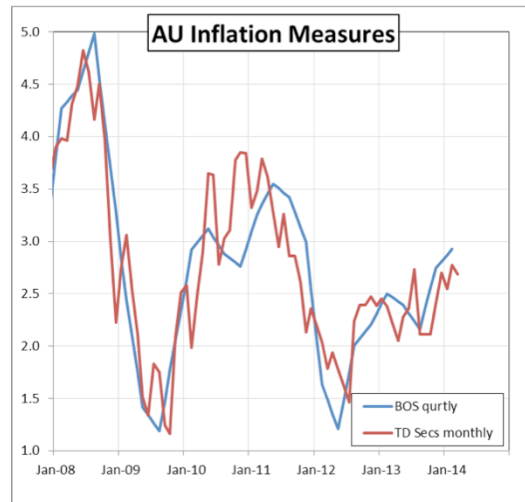


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Eco recovery says interest rates likely to start rising soon. Glenn Stevens Gove of RBA says economy strong. And cash rate at 60 year low. Expect a rise, soon, unless budget very tight.

Inflation



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Another reason why cash rate to rise.

Austerity budget?



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Remember chart for Europe? Ill-advised austerity led to eco downturn. HIGH RISK.
But if govt. does tighten too much, cash rates won't go up

From this ...



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Don't often talk about longer-term trends. But who would have predicted in the 1920s that aircraft would evolve from this ...

... to this

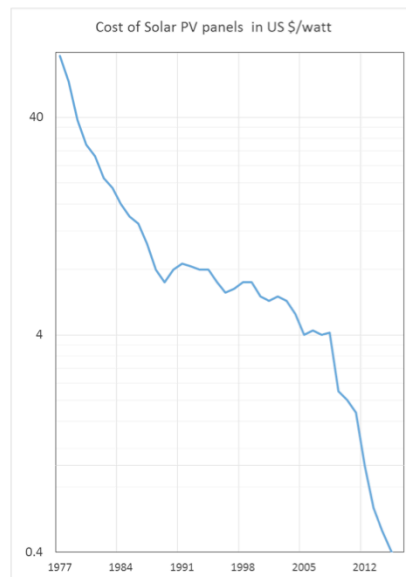


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... to this?

PV Cost



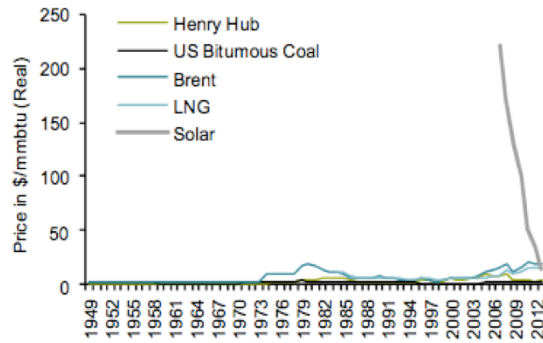
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PV (photovoltaic = solar) cells have fallen from nearly US\$80,000 for 1 KW to \$600 beginning of this year, \$500 end of this year and (forecast) \$400 end of next year. In Australia you can install a 5kw system (includes other costs) for A\$5000, which will pay for itself here in Melbourne (at 28 cents per KW) in 3 years or at 8 cents per KW (feed in tariff) in 10. Panels last for 25 years.

PV vs other coal

Exhibit 2
Welcome to the Terrordome... \$/MMBTU by Energy Type



Source: EIA, CIA, World Bank, Bernstein analysis

Source: <http://reneweconomy.com.au/2014/solars-dramatic-cost-fall-heralds-energy-price-deflation-76250>

Note ridiculous decline. Chart out of date. Henry Hub = gas exchange with 13 pipelines in southern US.

Battery costs plummet

Figure 23: DB Auto team lithium-ion battery price forecast (\$ per kWh)



Source: DB Auto team, industry discussions and private interviews, Deutsche Bank

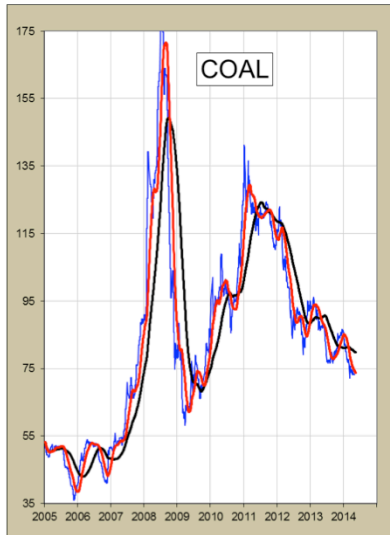
Source: <http://cleantechnica.com/2013/06/14/the-electric-car-price-slide-chart/>

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But sun doesn't shine at night and is low in the sky in winter. So storage very important. Lithium-ion battery costs falling at 13% per annum.

Coal



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Coal price chart looks like China IP chart (earlier) But if China has moved to a permanently lower growth rate and is also targeting pollution via renewables, isn't coal prices set for extended decline? Coal export price index for Oz covers 40% of exports and IS STILL FALLING

A\$ slither to continue?

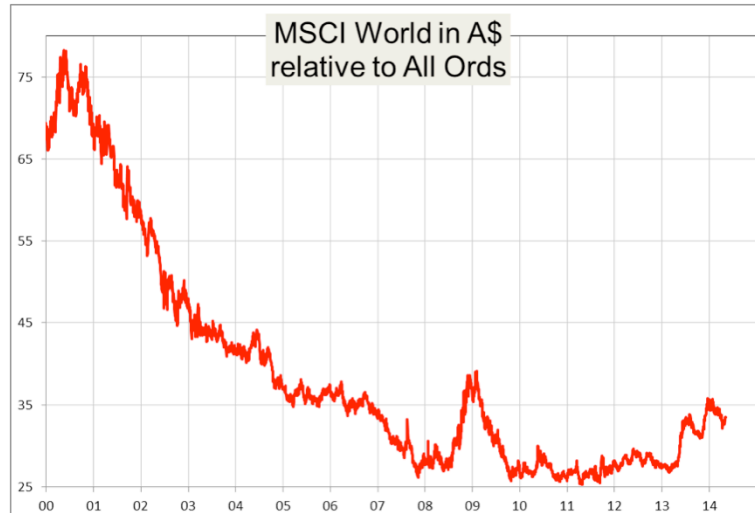


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Which means A\$ probably will slide too, especially if excessive austerity in Oz plus rising rates in US. Agricultural might help but global warming will increase both floods and droughts.

All Ords lagging world



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From 2000 to, say, 2010 Australian markets mostly significantly outperformed the world—in A \$. But commodities boom waning, Oz growth slower than US, A\$ likely to slither. World markets now outperforming.

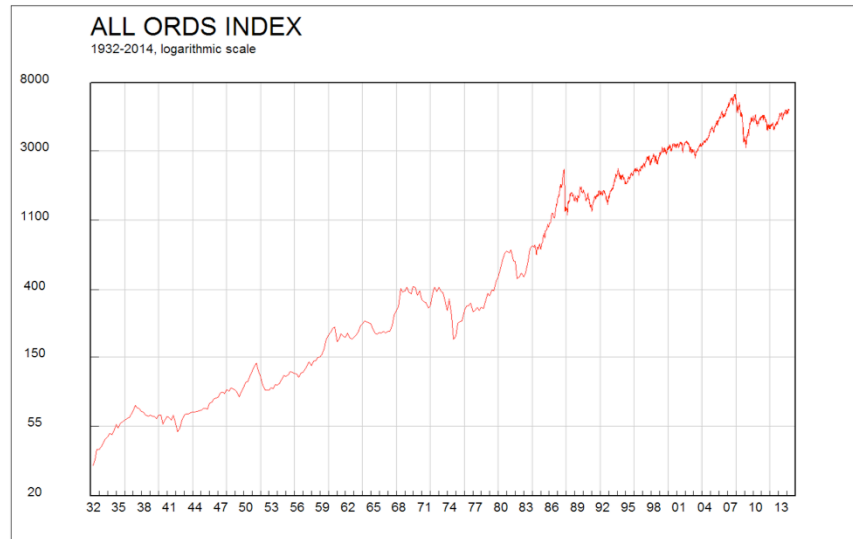
Economic Summary

- US boom
- Europe tepid but rising
- BRIC still slowing
- Australia recovering
 - key risk short term: budget
 - long term: coal

Markets

- US share market toppy?
- Europe bull market still further to go
- BRIC slide hasn't finished yet
- All Ords EPS & DPS to go on rising
- Market cheapish
 - but interest rates have troughed
- International (in A\$) will outperform
- Key short term risk : Ukraine

Buy shares



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Shares excellent long term performers. Chart does not include dividends. V. long term return about 6.5% per annum since 1932.

No pointers allowed!

