



Asset Allocation  
Investing in the new reality...



CONFERENCE

# Why use ten year forecasts?

EPS	PE	Price	Contribution	
\$1.00	10	\$10.00	5%pa	Income
				+
			+7%pa	Income Growth
\$2.00	10	\$20.00		+
	▼		+7%pa	PE effect
\$2.00	20	\$40.00		
			<hr/> 19%pa	<hr/> Total

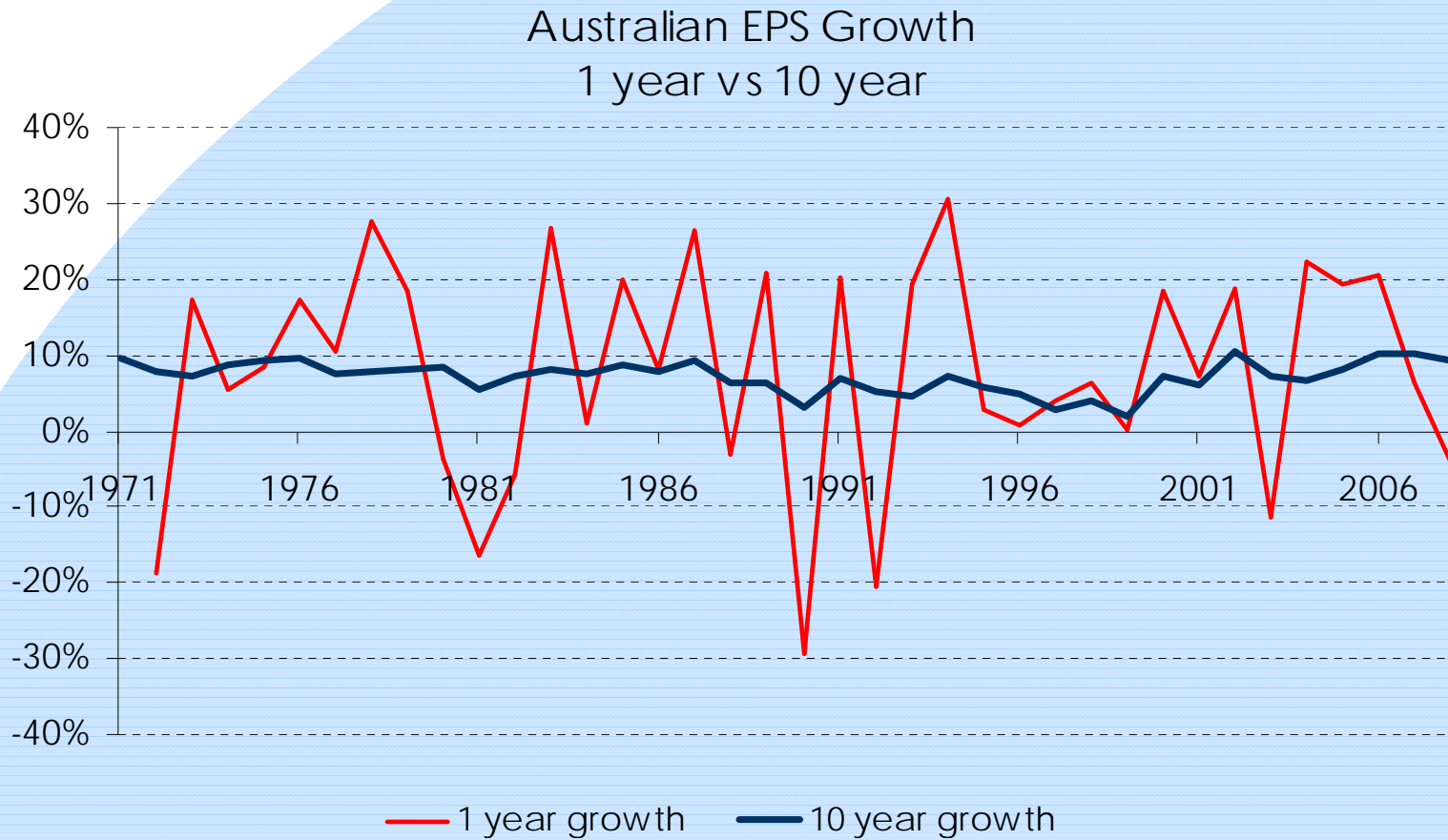
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# One year forecasts?

EPS	PE	Price	Contribution	
\$1.00	10	\$10.00	5%pa	Income
				+ Income Growth
\$1.07	10	\$10.70	+7%pa	
				+ PE effect
\$1.07	20	\$21.40	100%	
			<hr/>	<hr/>
			112%	Total

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# Why 10 year forecasts?

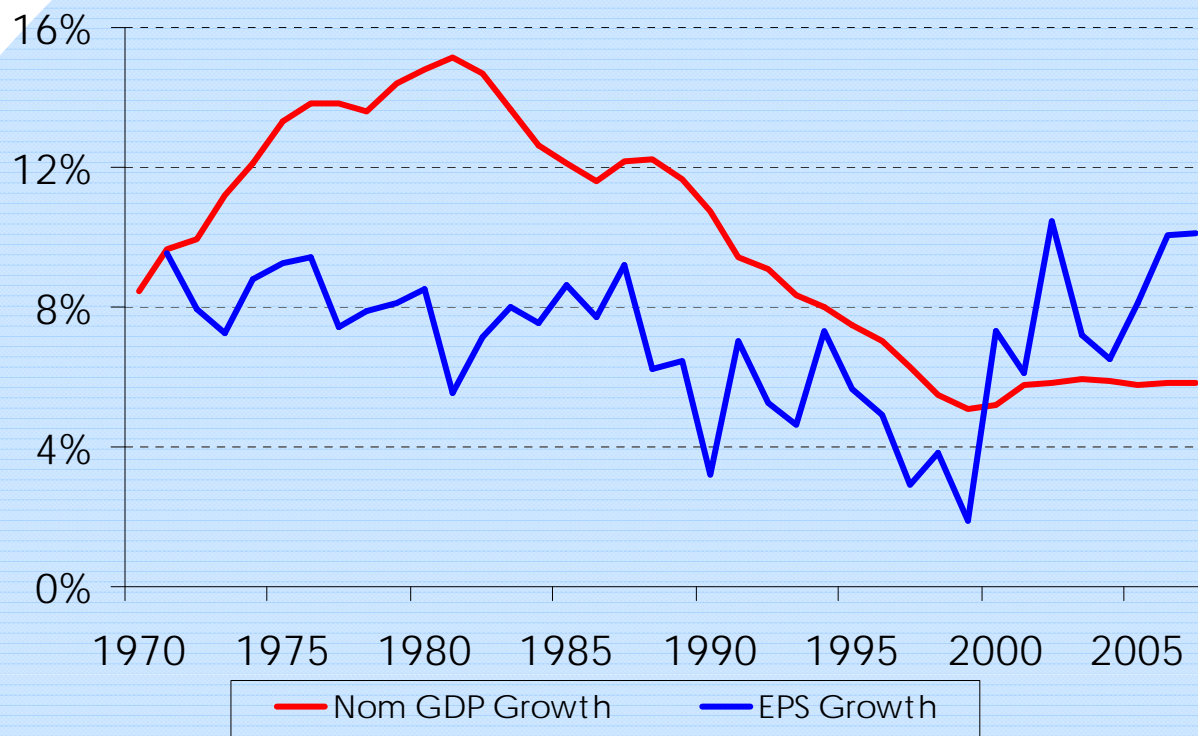


# Forecasting EPS growth....

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# How fast can companies grow their earnings?

Aus GDP v EPS Growth  
10 year rolling returns



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# Earnings growth lags GDP

GDP Growth v Dividends Growth 1900 - 2000			
Country	Real Div Growth %pa	Real GDP Growth %pa	Dilution %pa
Australia	0.9	3.3	-2.4
Canada	0.3	4.0	-3.7
Ireland	-0.8	2.3	-3.1
South Africa	1.5	3.4	-1.9
Sweden	2.3	2.5	-0.2
Switzerland	0.1	2.5	-2.4
UK	0.4	1.9	-1.5
US	0.6	3.3	-2.7
<b>Average</b>	<b>0.7</b>	<b>3.0</b>	<b>-2.3</b>

# Could this go on?

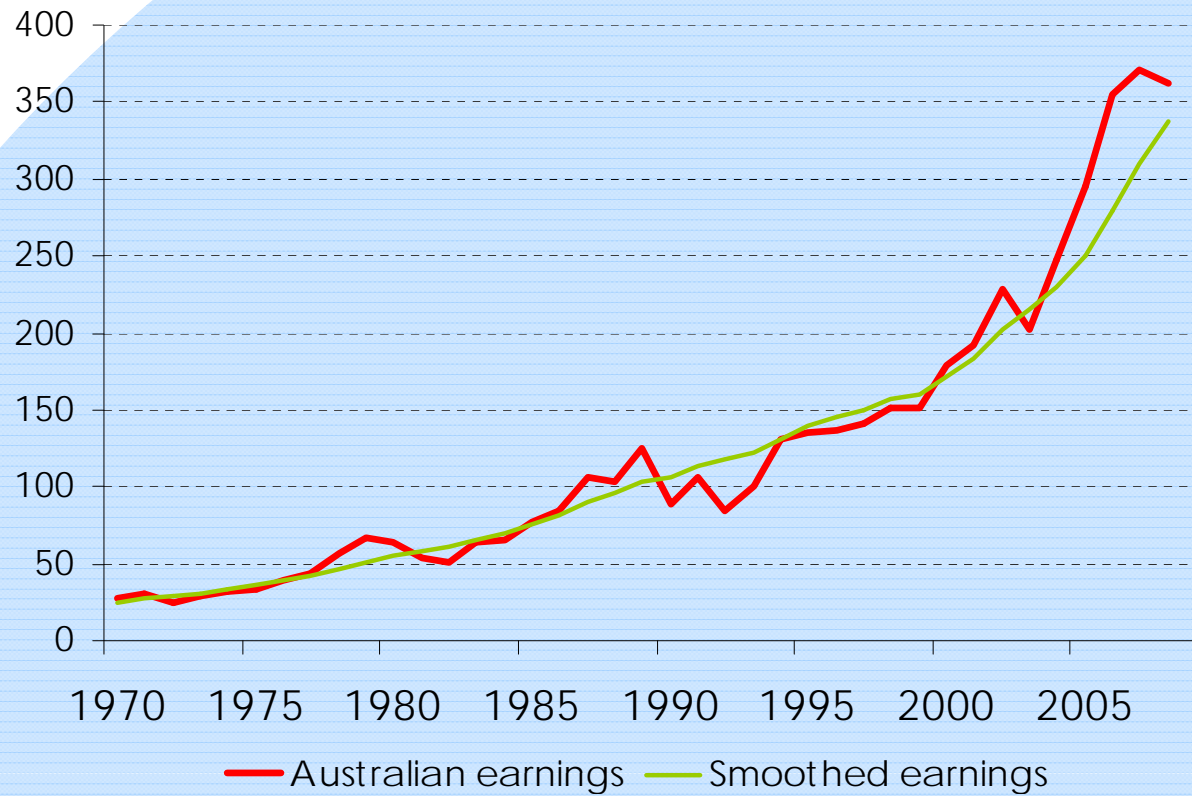
Australia : Profits as a share of GDP



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# Capitalism at work...

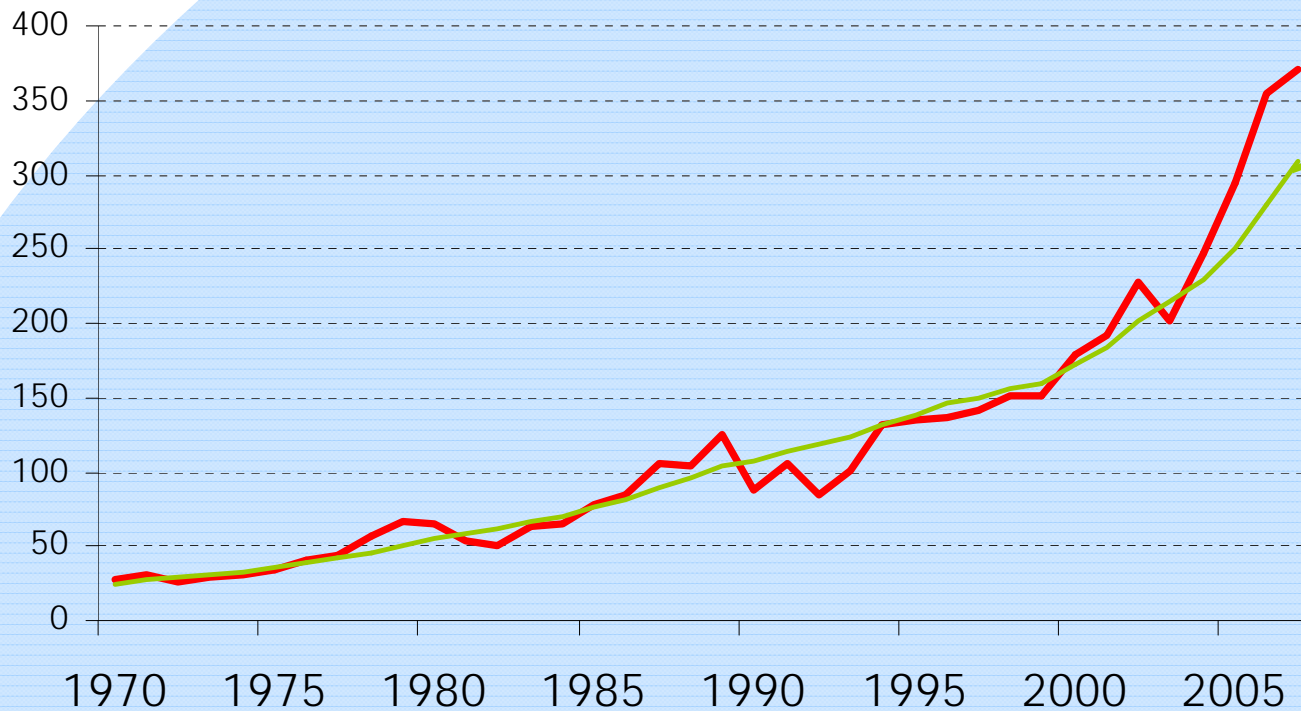
## Aus EPS Smoothed v Actual



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# What happens to forecasts when earnings collapse?

## Aus EPS Smoothed v Actual



— Australian earnings — Smoothed earnings

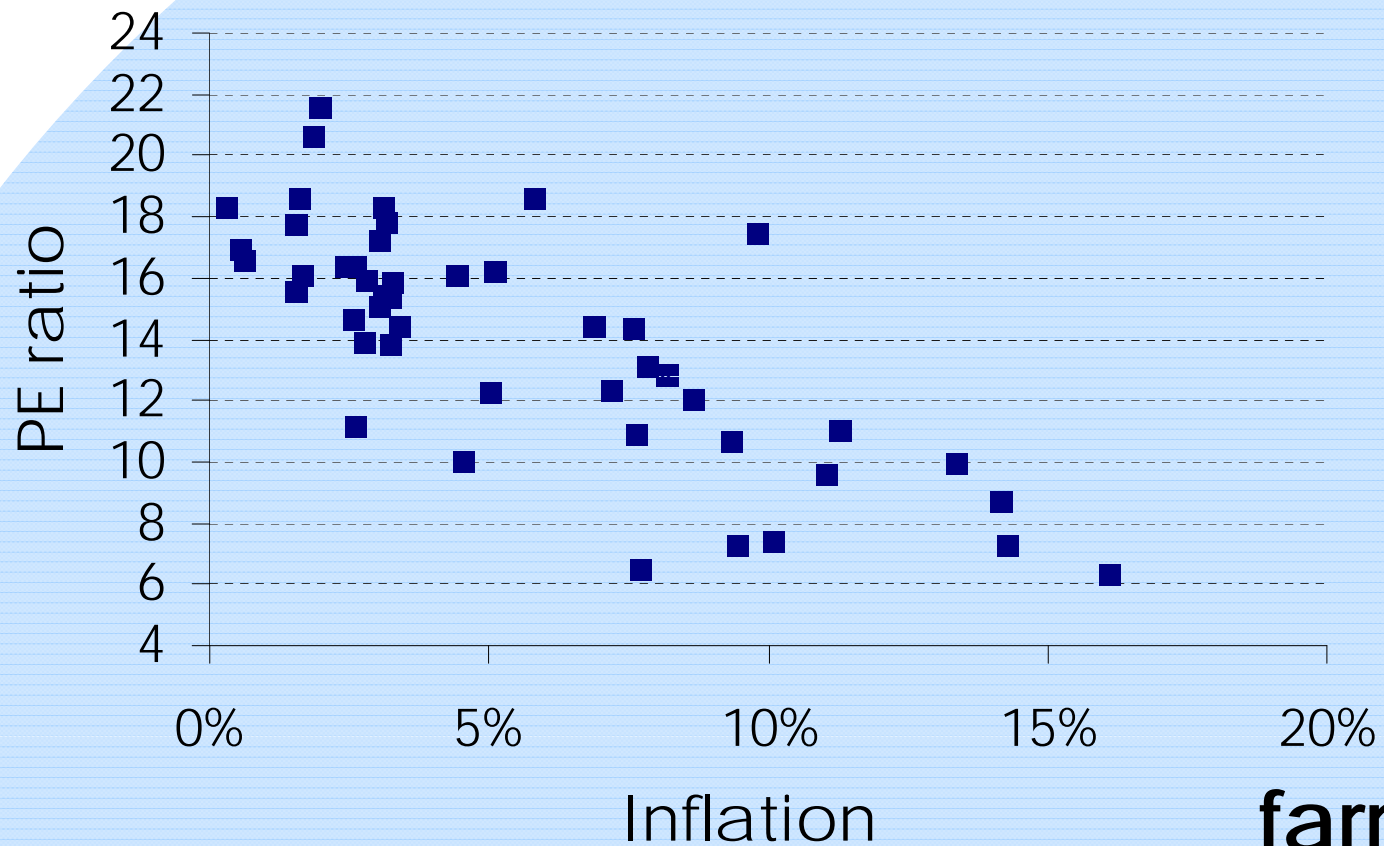
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# Forecasting PEs....

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# Where will PE's be in 2019?

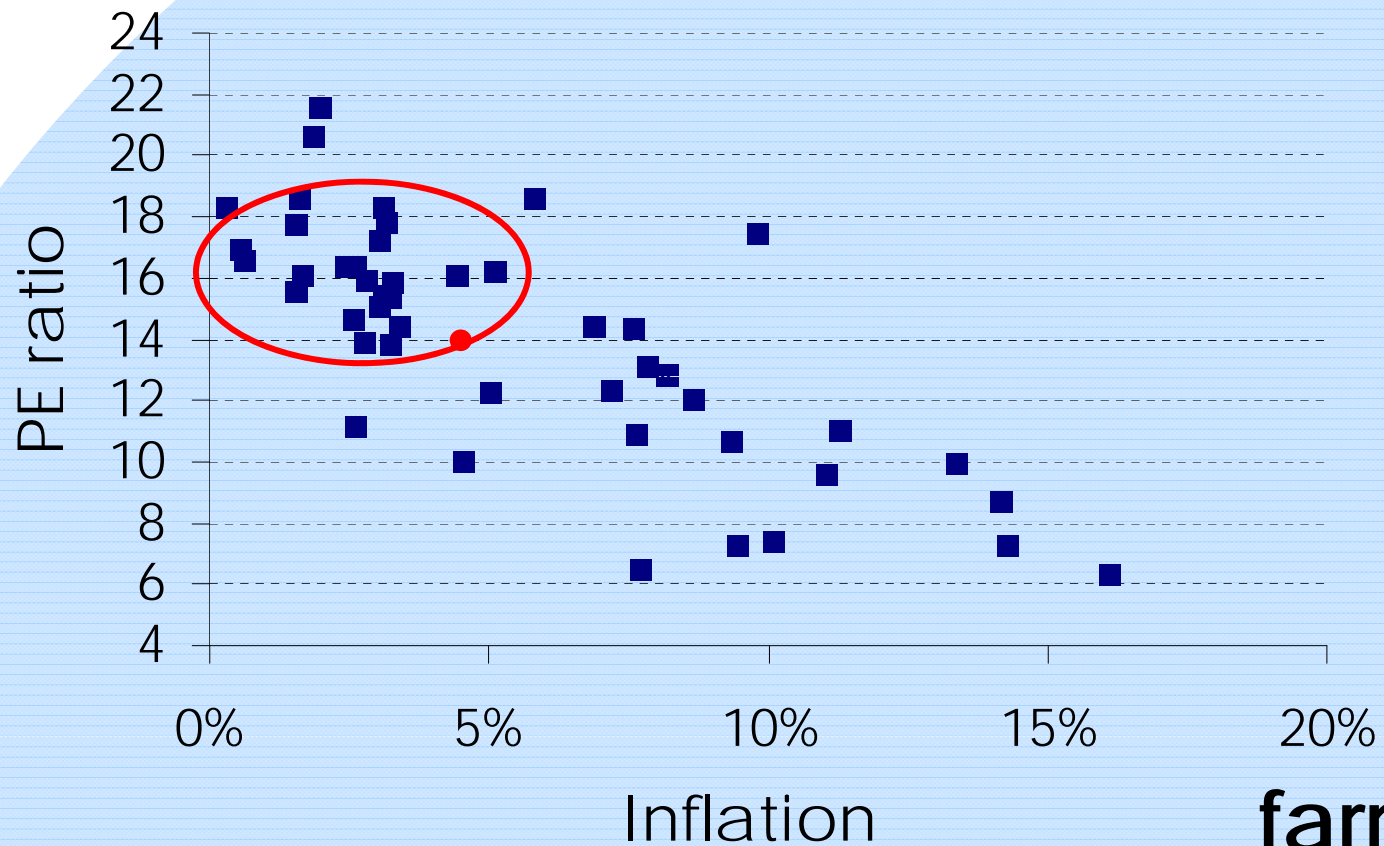
Australian PE's vs. Inflation  
1961-2008



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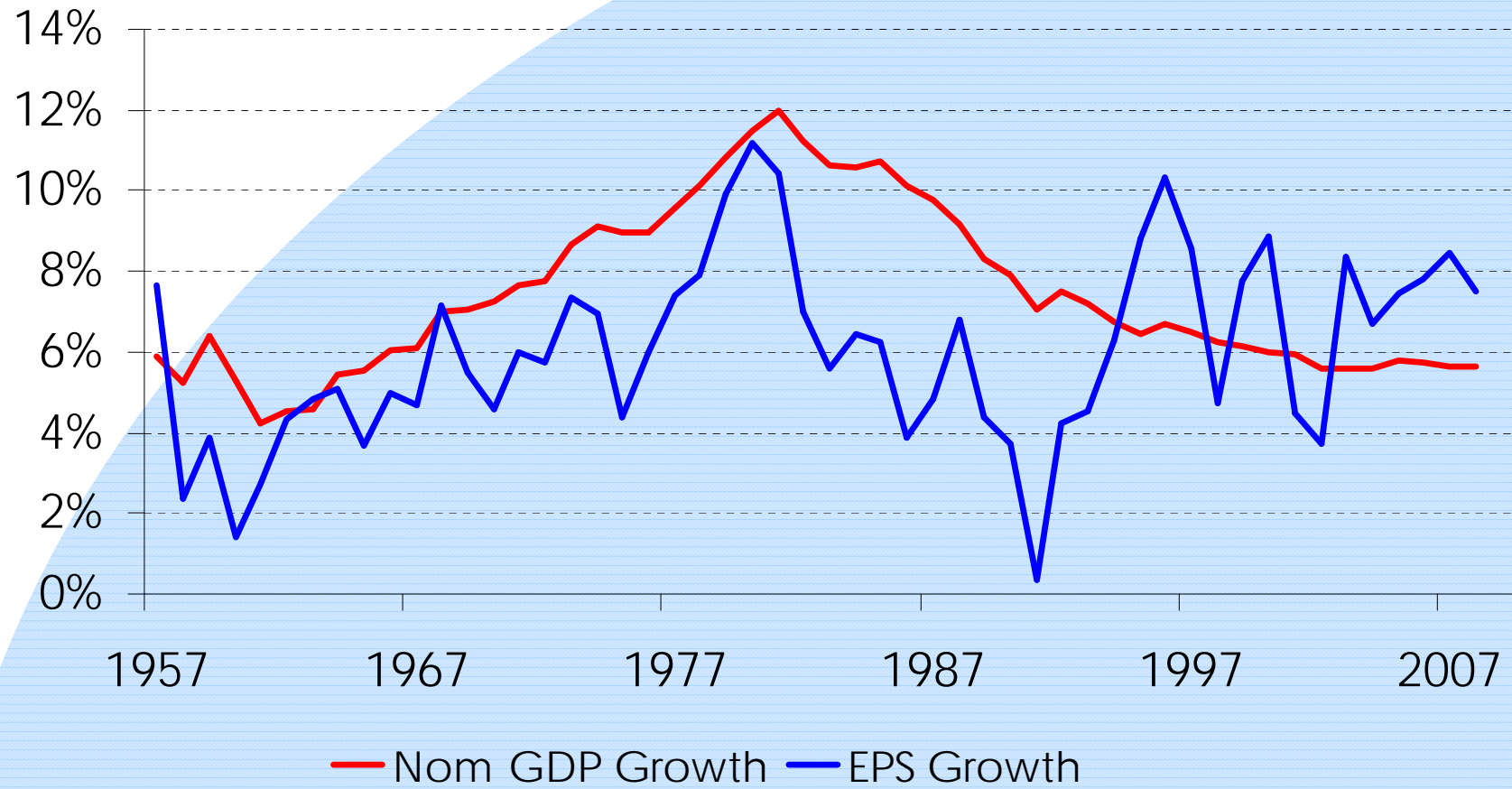
# Where will PE's be in 2019?

Australian PE's vs. Inflation  
1961-2008



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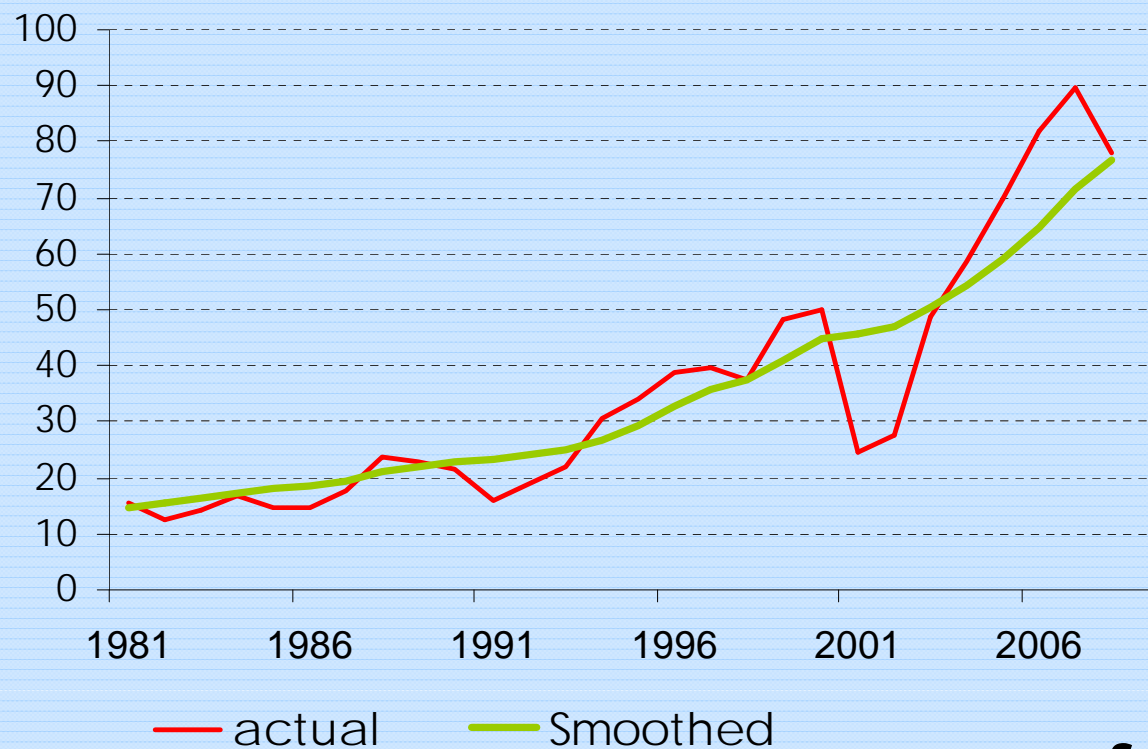
# US GDP v EPS Growth



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# Earnings growth is mean reverting

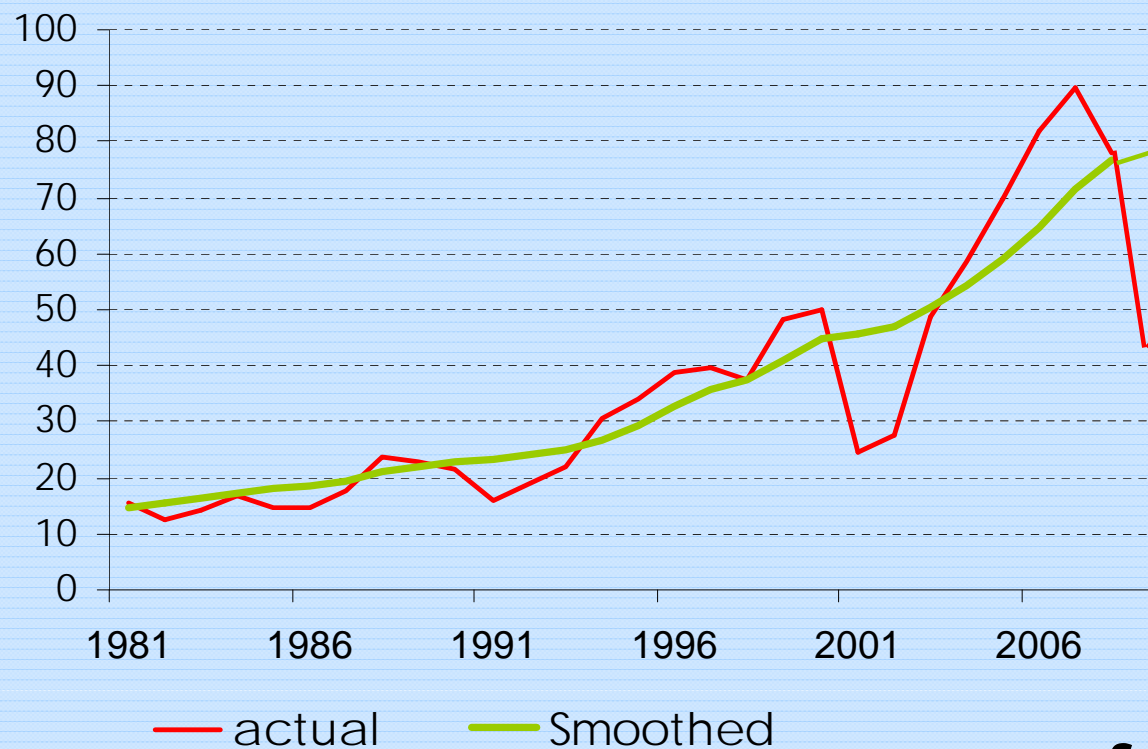
US Equities  
EPS smoothed v Actual



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# 12 year no growth forecast

US Equities  
EPS smoothed v Actual



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# US pre-tax profitability was close to post war highs...

US : Profits as a share of GDP



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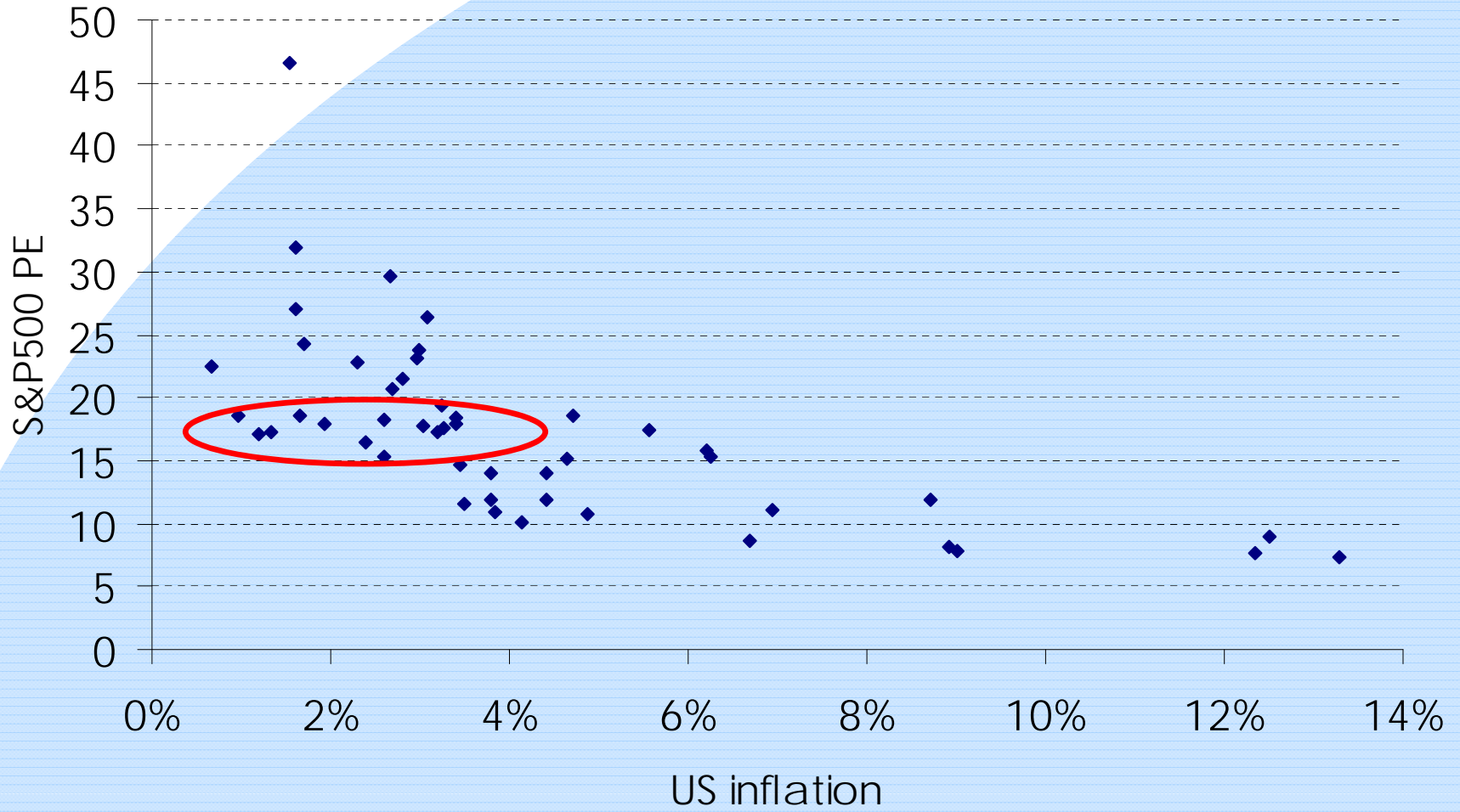
**but has fallen rapidly to low levels...**

US : Pre tax Profits as a share of GDP



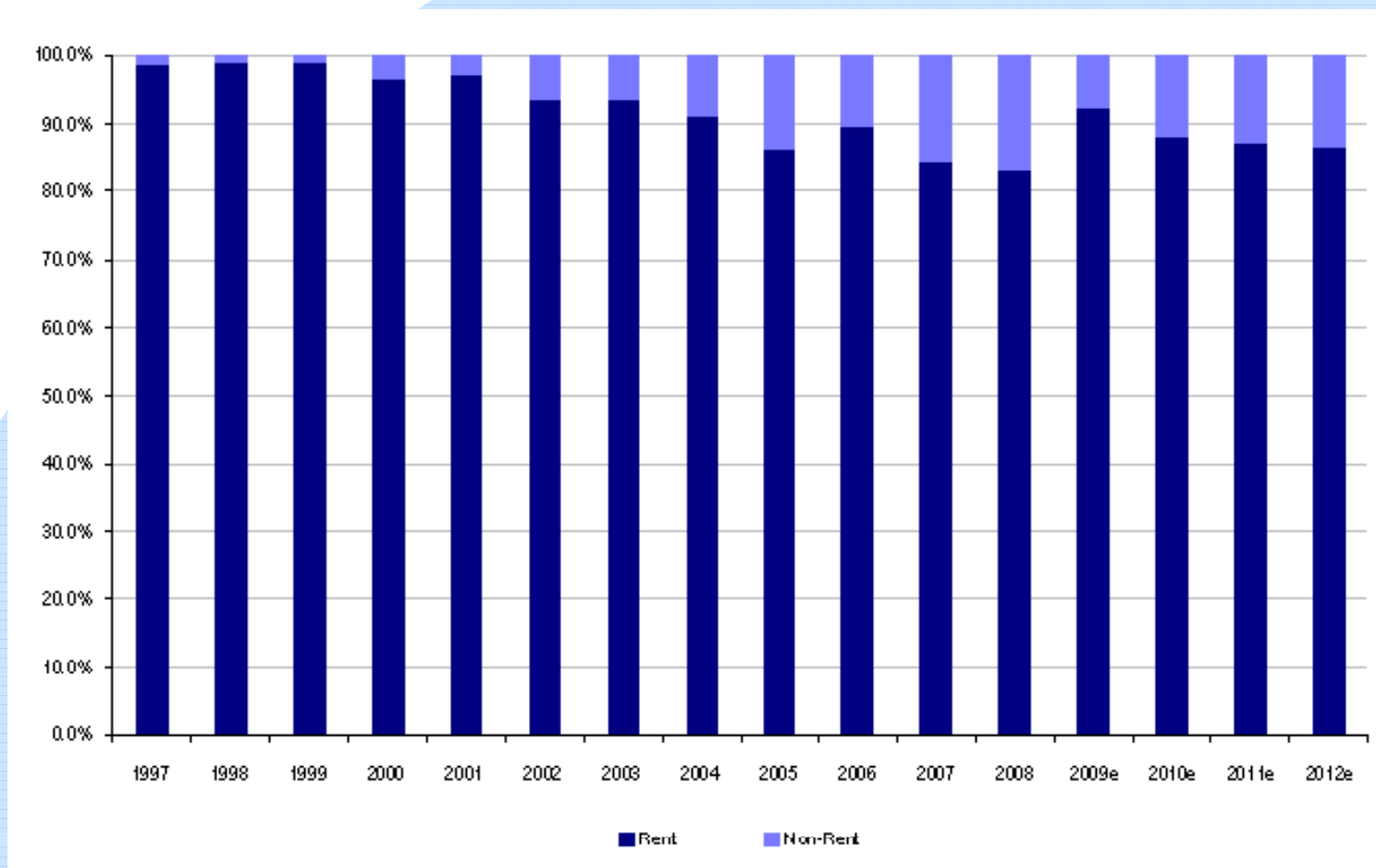
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US PE vs Inflation 1961-2008



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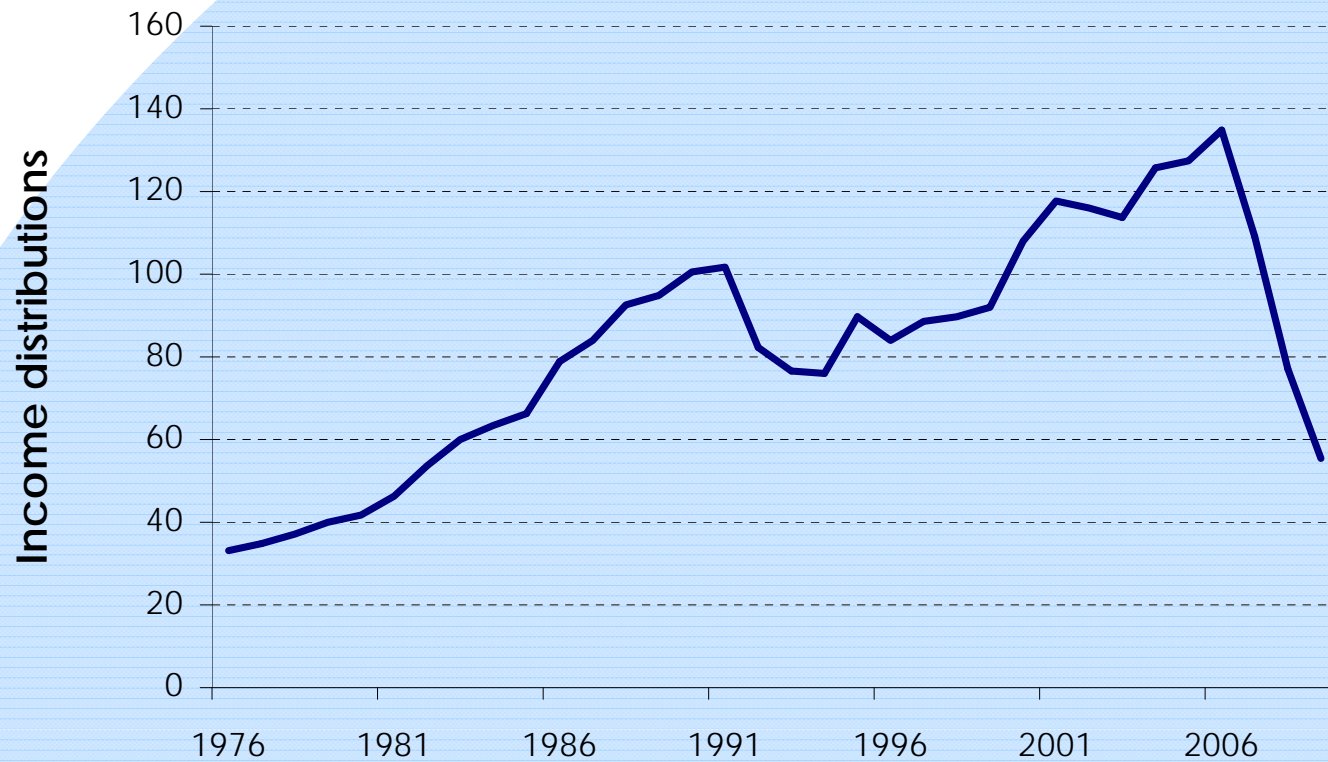
# Rent as a share of total income



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# Distributions have collapsed

A REIT Income Distributions



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# The sad story of GPT...

	NAV	New issue price	Shares on issue	Gearing	Div/ share	Share price
Mar 08	3.68		2.2	47%	29.1	3.00
Sep 08	3.68		2.2	47%	16.4	1.90

# The sad story of GPT...

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<b>Oct 08</b>	<b>2.09</b>	<b>0.60</b>	<b>4.4</b>	<b>42%</b>	<b>8.4</b>	<b>1.53</b>

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<b>Dec 08</b>	<b>1.43</b>		<b>4.4</b>	<b>47%</b>	<b>8.4</b>	<b>0.92</b>

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<b>May 09</b>	<b>0.86</b>	<b>0.35</b>	<b>9.3</b>	<b>37%</b>	<b>4.0</b>	<b>0.46</b>

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May 09	0.86 <sup>1</sup>	0.35	9.3	37%	4.0	0.46
<b>Dec 09</b>	<b>0.60<sup>2</sup></b>		<b>???</b>	<b>51%</b>	<b>???</b>	

1. Average cap rate 6.5%

2. Average cap rate 7.5%, exit offshore ventures for nil consideration

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# The top ten A-REITs...

	Change in distribution since 2007	
	2009	2010 <sup>1</sup>
Westfield Group	-13%	-9%
Stockland	-21%	-52%
GPT Group	-75%	-78%
CFS Retail Property Trust	8%	-2%
Dexus Property Group	-32%	-48%
Mirvac Group	-76%	-74%
Commonwealth Property Office	-13%	-37%
ING Office Fund	-14%	-64%
Macquarie Office Trust	-73%	-73%
Goodman Group	-50%	-78%

1. Aegis/PIR estimates

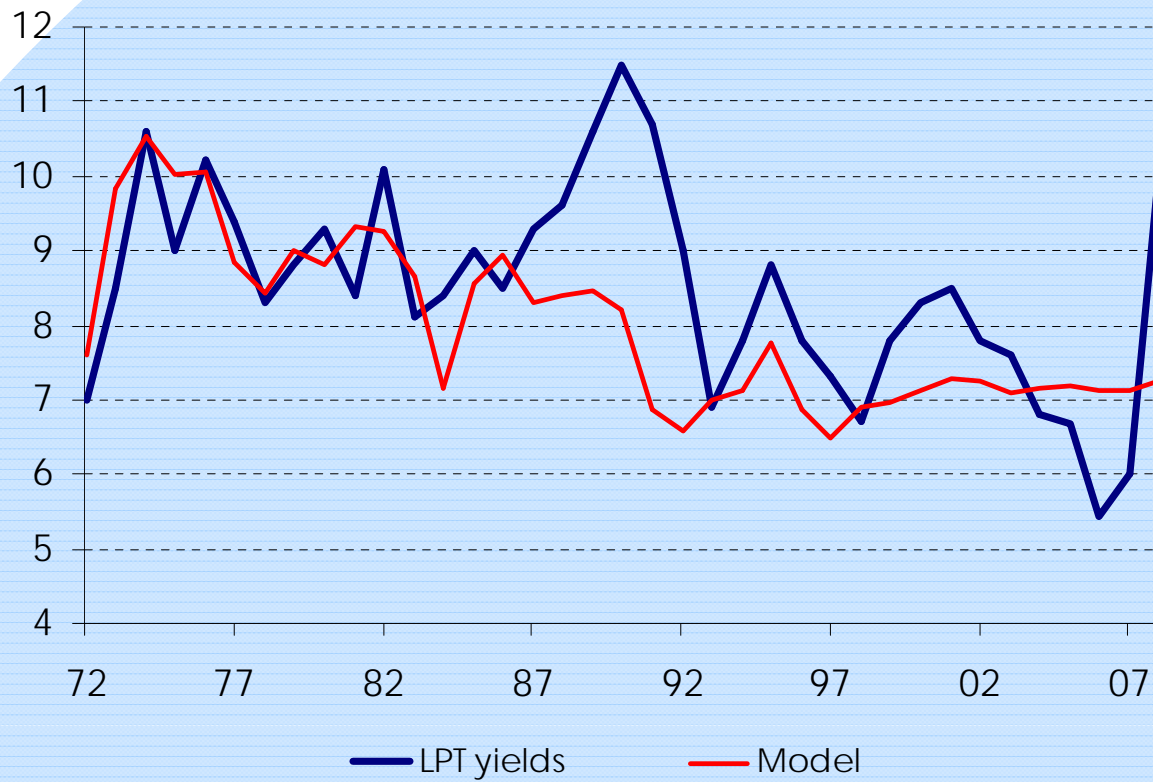
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# Is it over yet?

- Credit markets re-opening
- Covenants ok
- What is a sustainable level of gearing?
  - What does the market think?
  - What do management think?

# Forecast LPT yields are aligned to inflation...

Yields on LPTs vs model

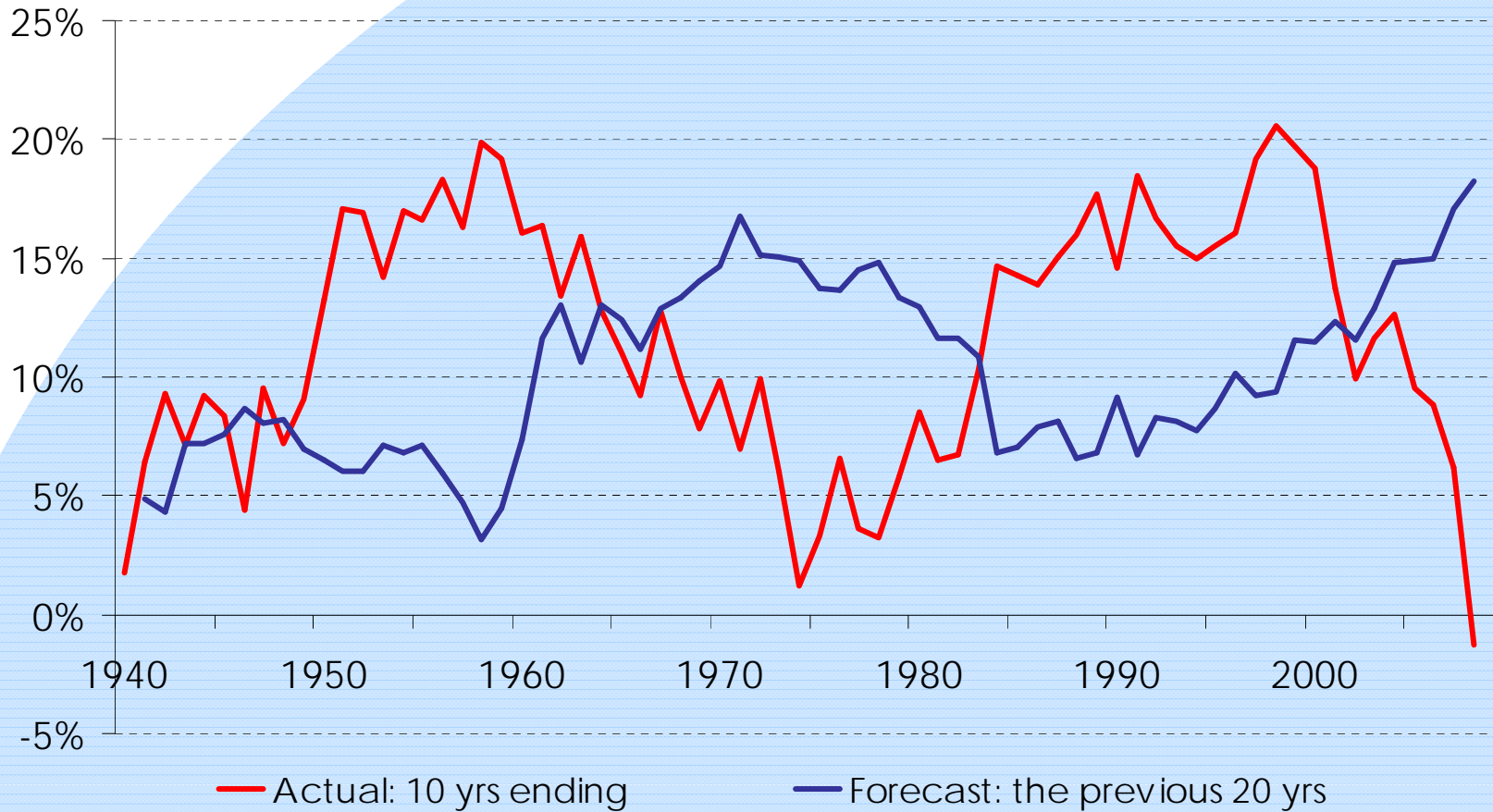


# Can we rely on the forecasts?

- Track record?
- How long do we need to wait?
- How accurate do we have to be?

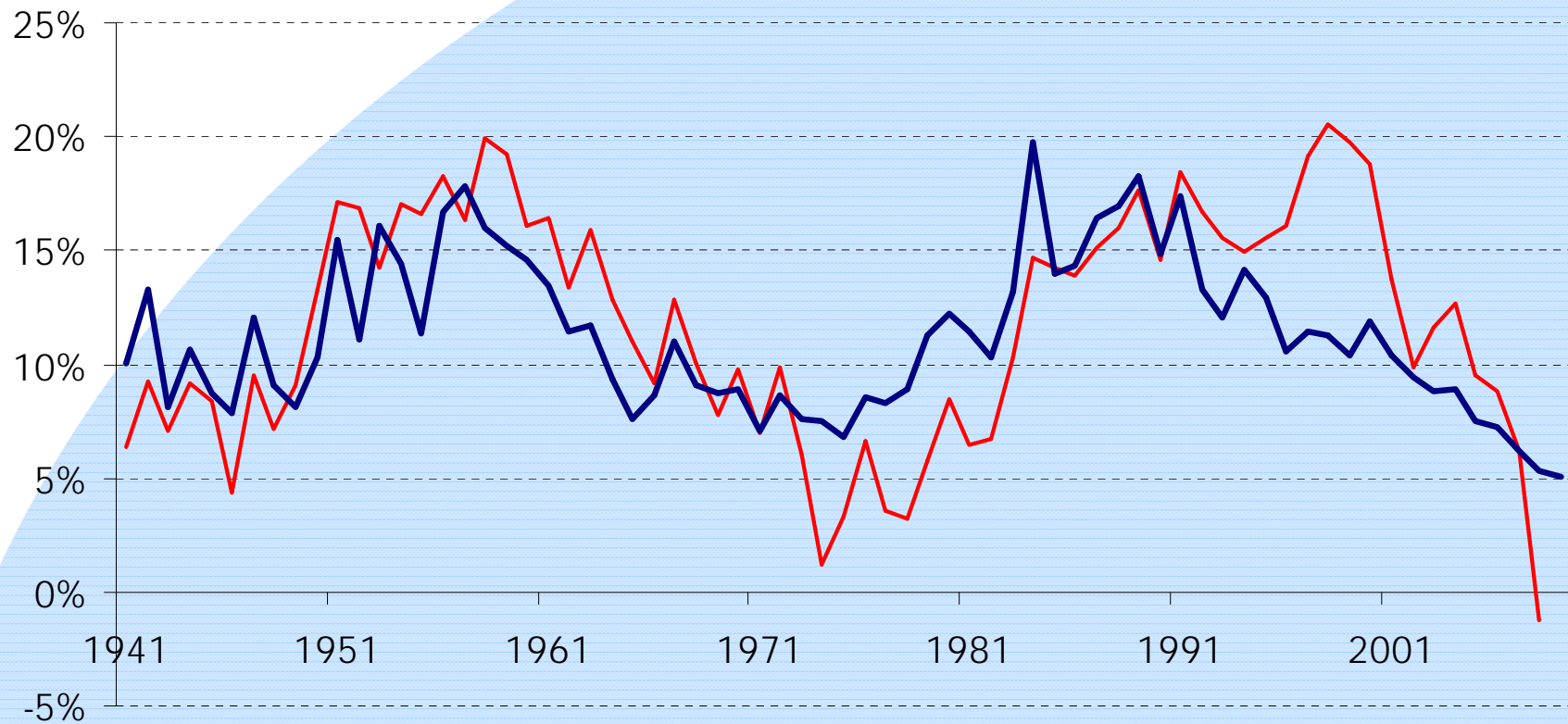
# Using the rear view mirror!

US Equities:  
Using the past to forecast the future



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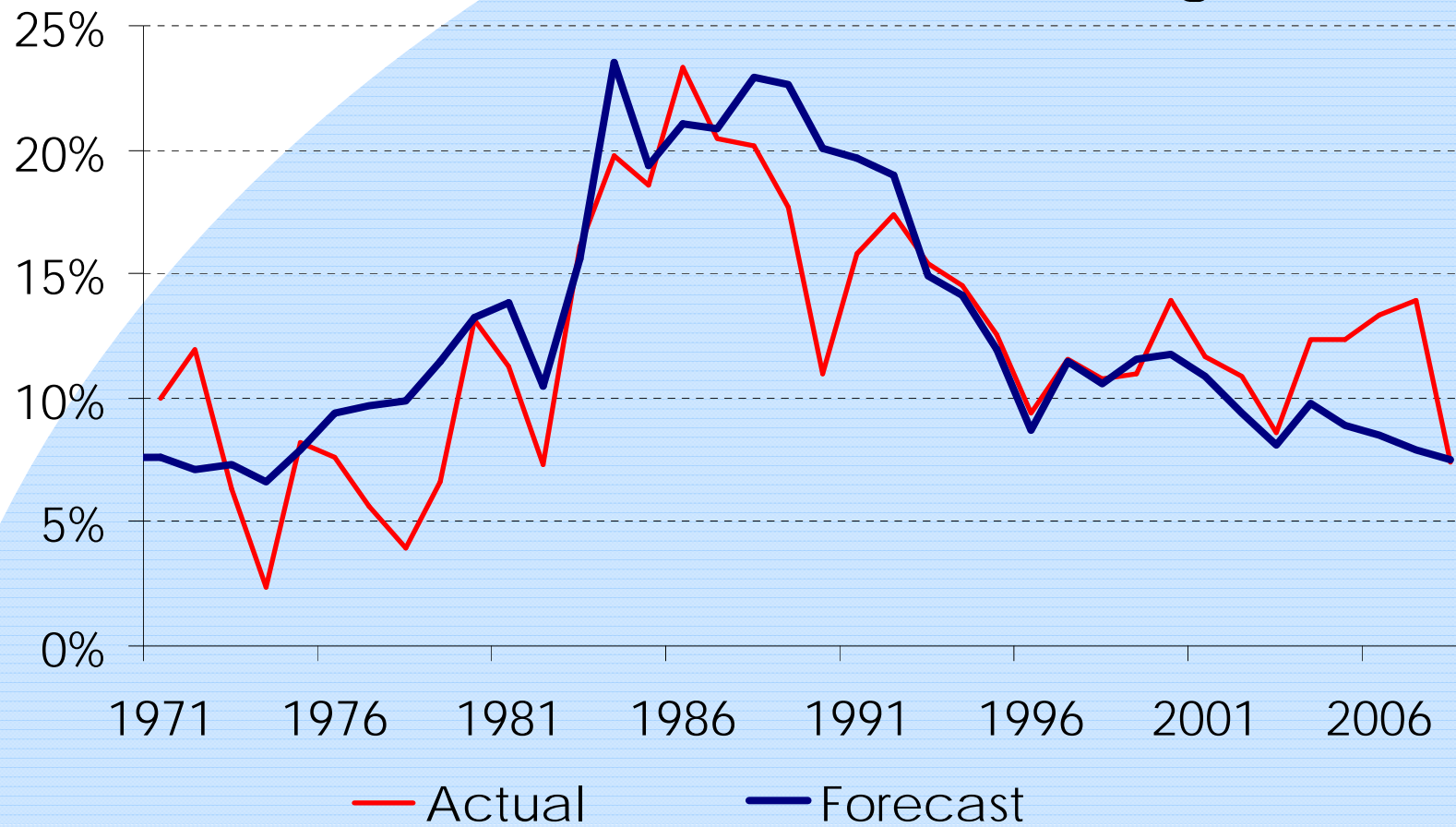
# US equity returns Actual v Forecast, 10 yrs ending



— Actual — Forecast

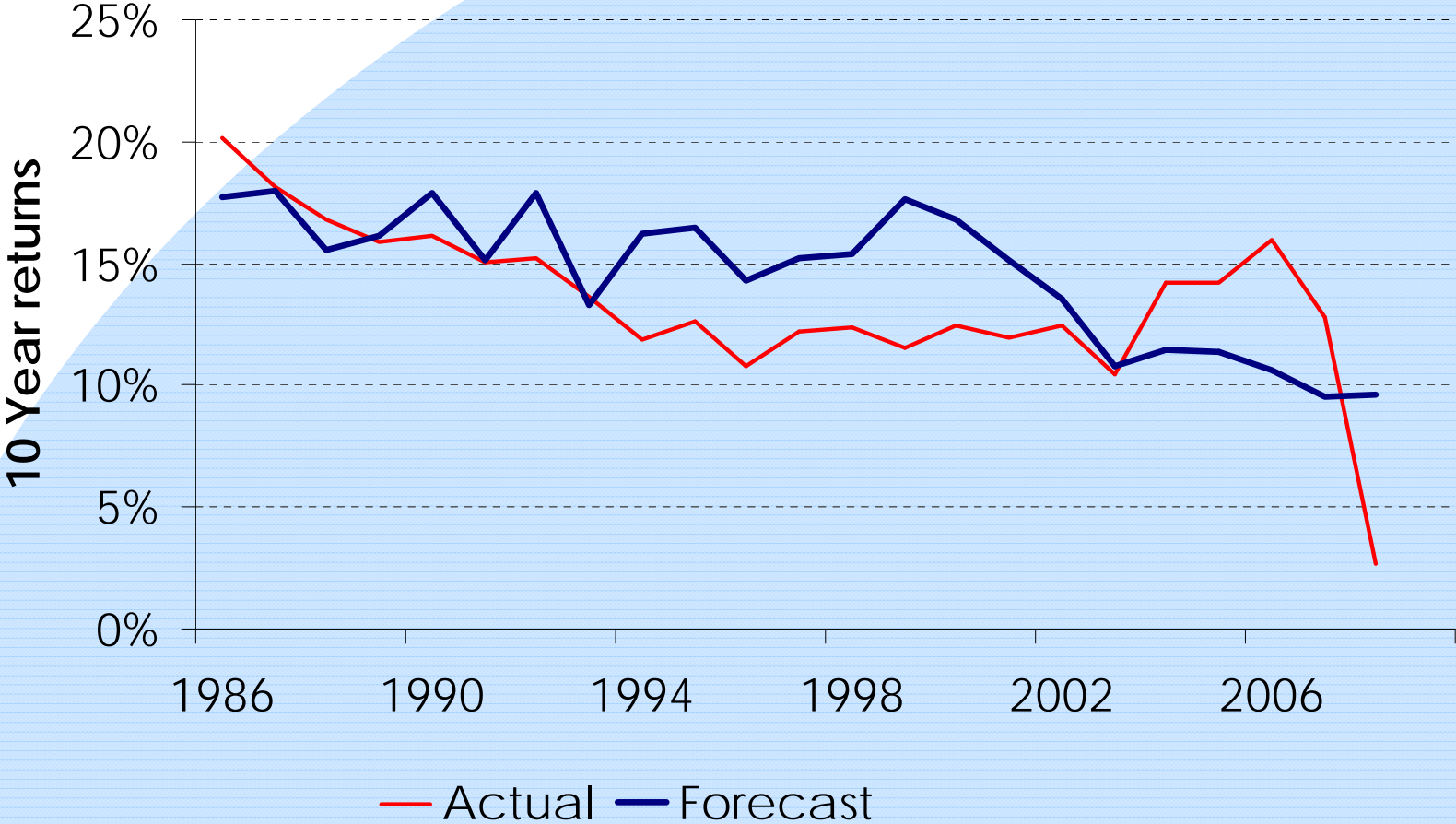
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# Australian Equities Actual v forecast, 10 Yrs ending



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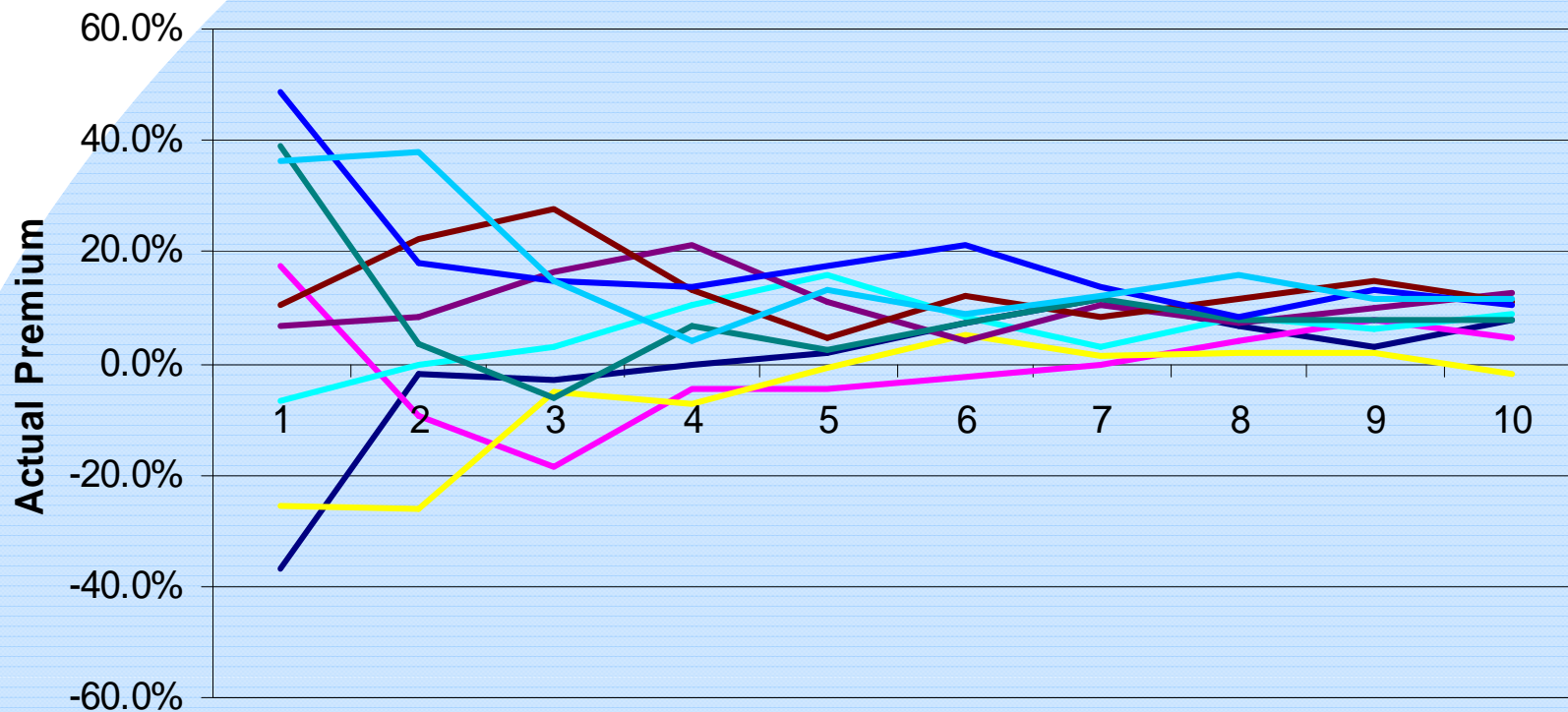
# Listed Property: Forecast v actual



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# It may take a while...

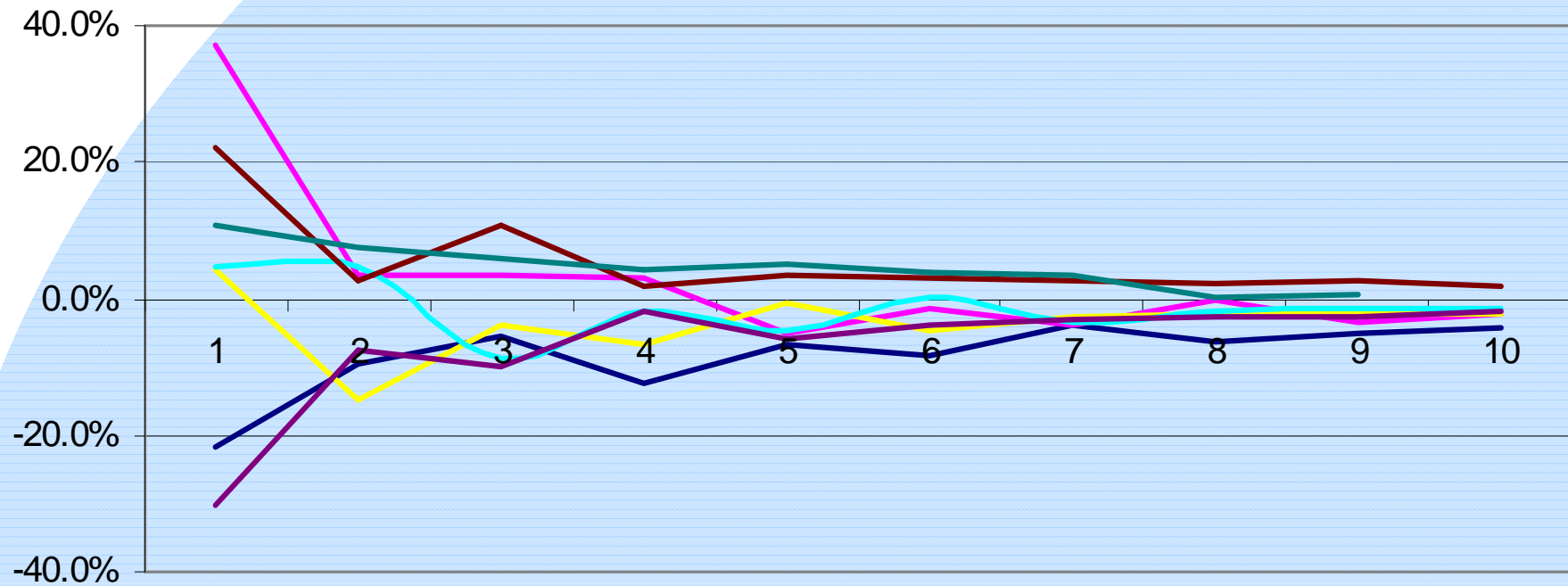
Australian Equities  
Forecast premium 6+%



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# It may take a while...

Australian Equities  
Forecast premium <0%



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"Watch a pro football game, and it's obvious the guys on the field are far faster, stronger and more willing to bear and inflict pain than you are. Surely you would say, 'I don't want to play against those guys!'

Well, 90% of stock market volume is done by institutions, and half of that is done by the world's 50 largest investment firms, deeply committed, vastly well prepared -- the smartest sons of bitches in the world working their tails off all day long. You know what? I don't want to play against those guys either."

**Charles Ellis – Chairman Yale Endowment**

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# Asset allocation process

1. Forecast returns of asset classes
- 2. Forecast risks of asset classes**
3. Trade off risk and return to create model asset allocations
4. Match model allocations to client's profile
5. Implementation

# Risk of not meeting cash flow needs

- Main problem is insufficient, real, long term returns
- Anxiety along the way also an issue
  - Volatility
  - Volatility of income
  - Familiarity with the assets
- Liquidity easily managed

# 10 Year Forecasts as at October 2000

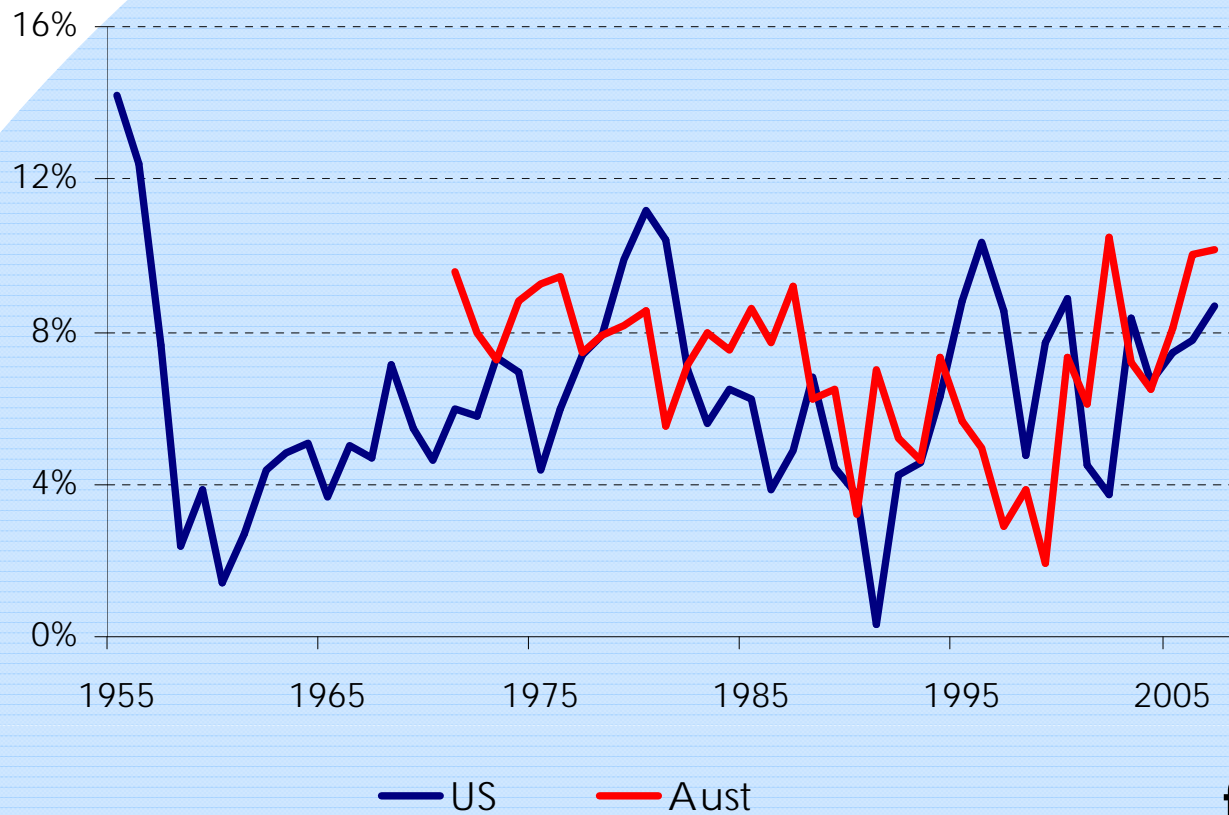
Asset	Dividend Yield	EPS Growth	PE Effect	Central Forecast
Australian Equities	4.5%	5.0%	-1%	8.5%
US Equities	1.0%	6.0%	-1%	6.0%
LPTs	8.5%	1.0%	0%	9.5%
Bonds	6.0%	0%	0%	6.0%

# Pessimistic 10 year forecasts as at October 2000

Asset	Dividend Yield	EPS Growth	PE Effect	Pessimistic case
Australian Equities	4.5%	2.0%	-4.0%	2.5%
US Equities	1.0%	2.0%	-7.0%	-4.0%
LPTs	8.5%	-2.0%	-1.5%	5.0%
Bonds	6.0%	0%	0%	6.0%

# Pessimistic forecasts...

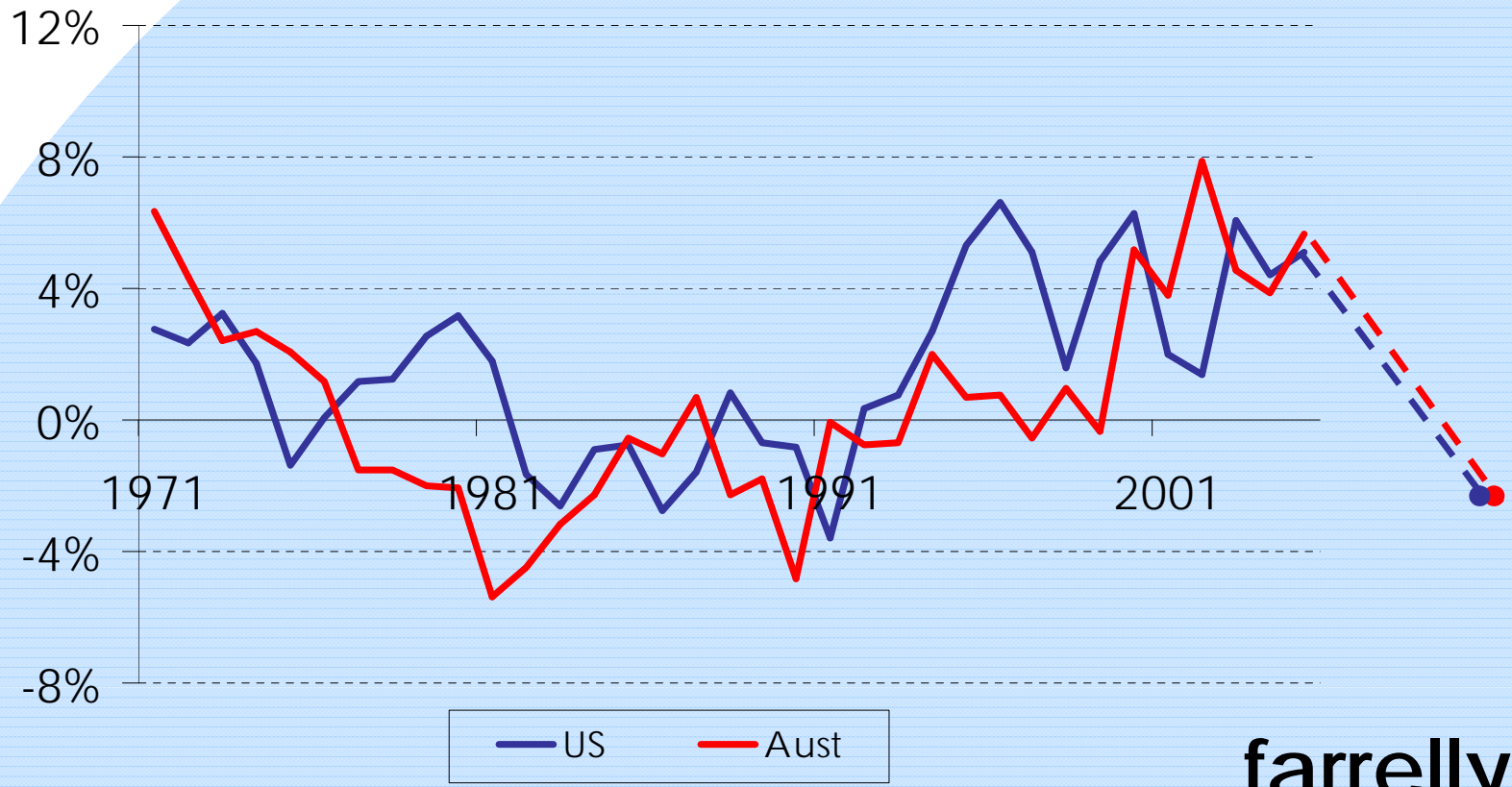
EPS Growth %pa  
(10 years ending)



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# Pessimistic...

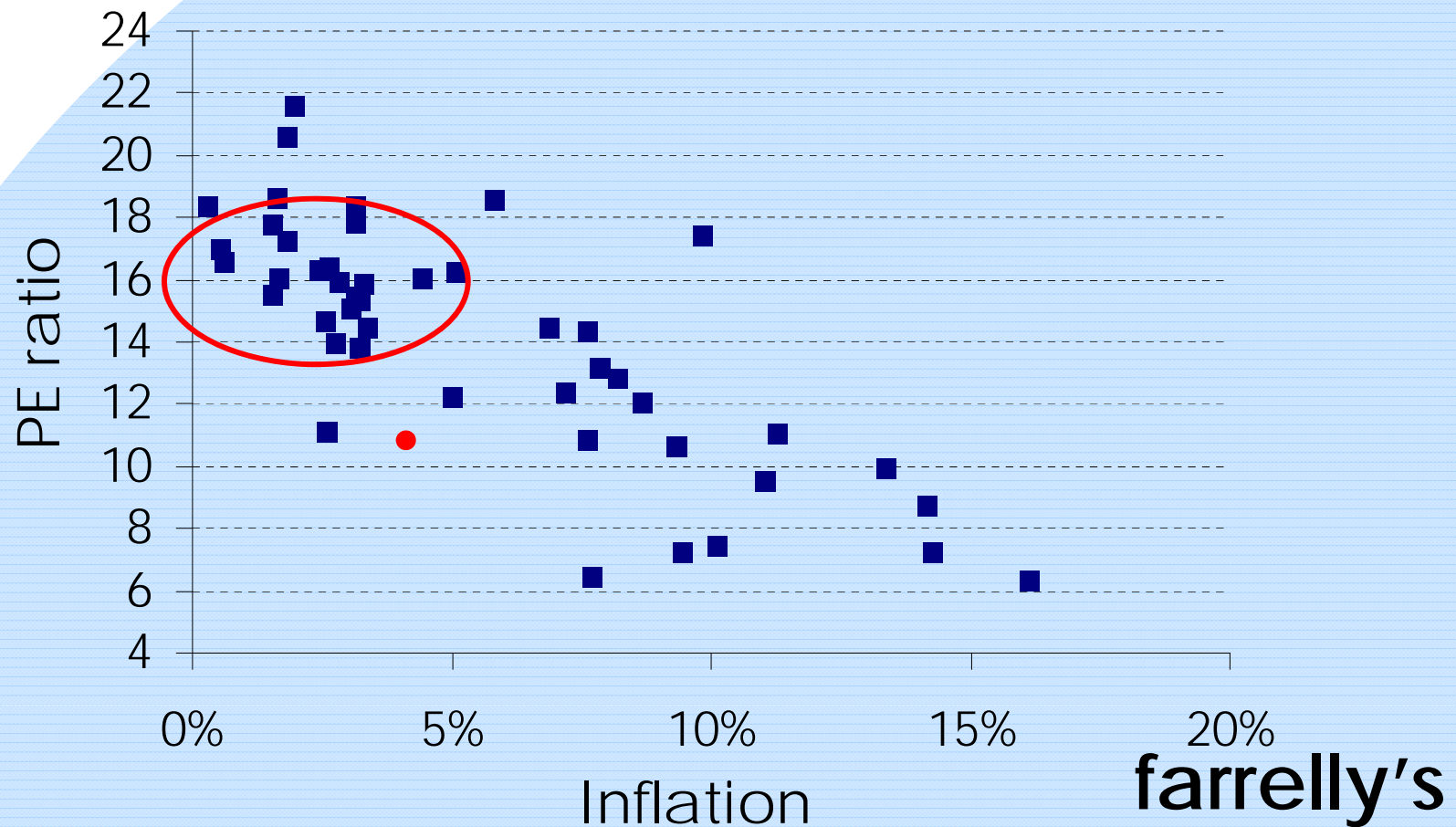
Real EPS Growth %pa  
(10 years ending)



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# Pessimistic forecast....

Australian PE's vs. Inflation  
1961-2007



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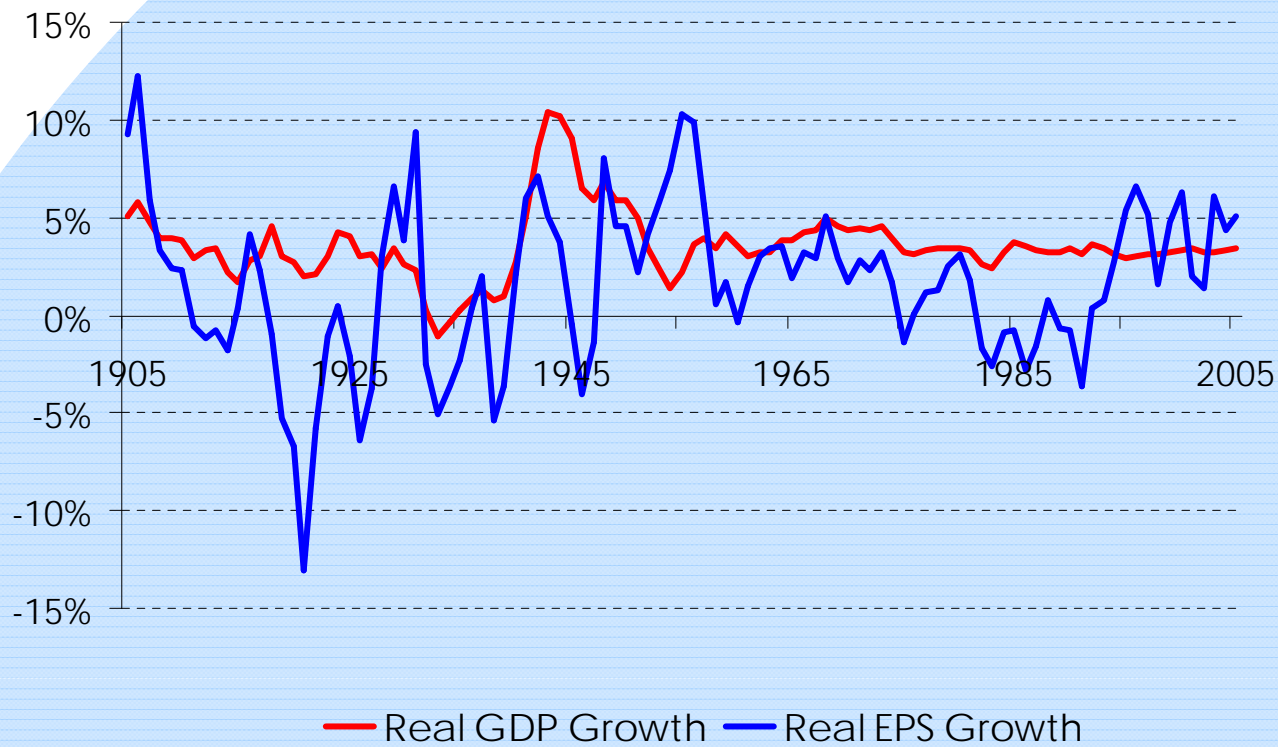
# Pessimistic 10 year forecasts as at February 2009

Asset	Dividend Yield	EPS Growth	PE Effect	Pessimistic case
Australian Equities	7.6%	0.0%	0.0% <sup>1</sup>	7.6%
World Equities - Currency	3.6% 0.9%	0.0%	0.0% <sup>2</sup>	4.5%
LPTs	9.3%	-2.0%	0.0%	7.3%
Bonds	4.5%	0%	0.0%	4.5%

1. PE stays at 10.9
2. PE stays at 10.4

# Really pessimistic forecasts...

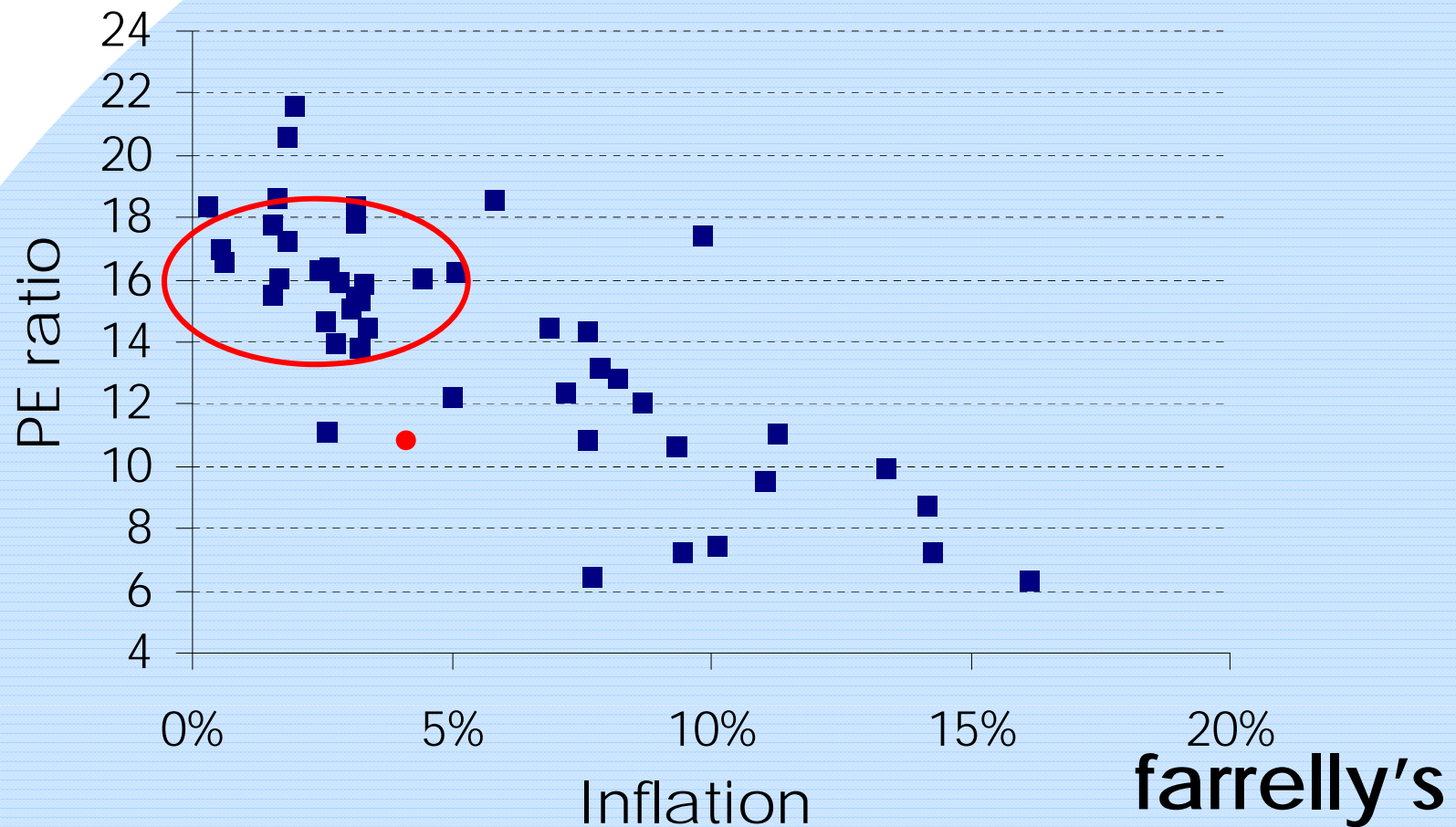
## US GDP v EPS Growth (Real)



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# Pessimistic forecast....

Australian PE's vs. Inflation  
1961-2007



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# Really pessimistic 10 year forecasts as at February 2009

Asset	Dividend Yield	EPS Growth	PE Effect	Pessimistic case
Australian Equities	5.0%	-4.0%	0.0% <sup>1</sup>	1.0%
World Equities - Currency	2.7% 0.0%	-4.0%	1.8% <sup>2</sup>	0.5%
LPTs	4.6%	-6.0%	-4.0%	-5.4%
Bonds	4.5%	0.0%	0.0%	4.5%
Cash	1.0%	0.0%	0.0%	1.0%

1. PE stays at 9.5
2. PE moves to 10.0

# Risk is chance of not meeting cash flow needs

- Multi faceted
- Concentrate on long term uncertainty
- Forecasting process helps develop range of possible outcomes

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