



Are we there yet?



MARKETS SUMMIT

Tuesday 16 February 2010

Theme 1

The big picture



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The big picture

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The big picture

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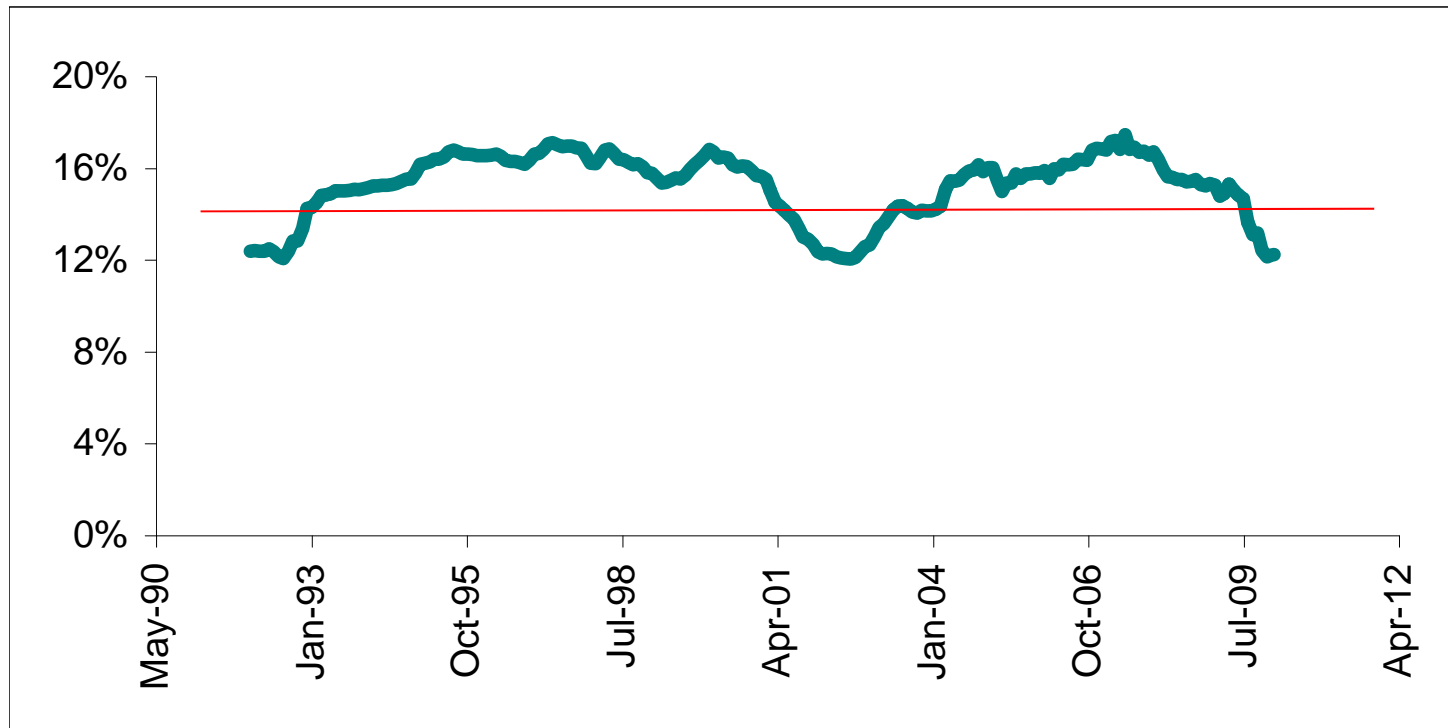
PortfolioConstruction Markets Summit 2010

Robert Swift – Head of Multi Strategies
16 February 2010

1. What happened 2009? – surprises

- Companies reduced costs faster then revenue declined.
- Dividend and free cash flow yields above Treasury and Corporate bond yields were attractive entry points.

USA Return on Equity (S&P 500)



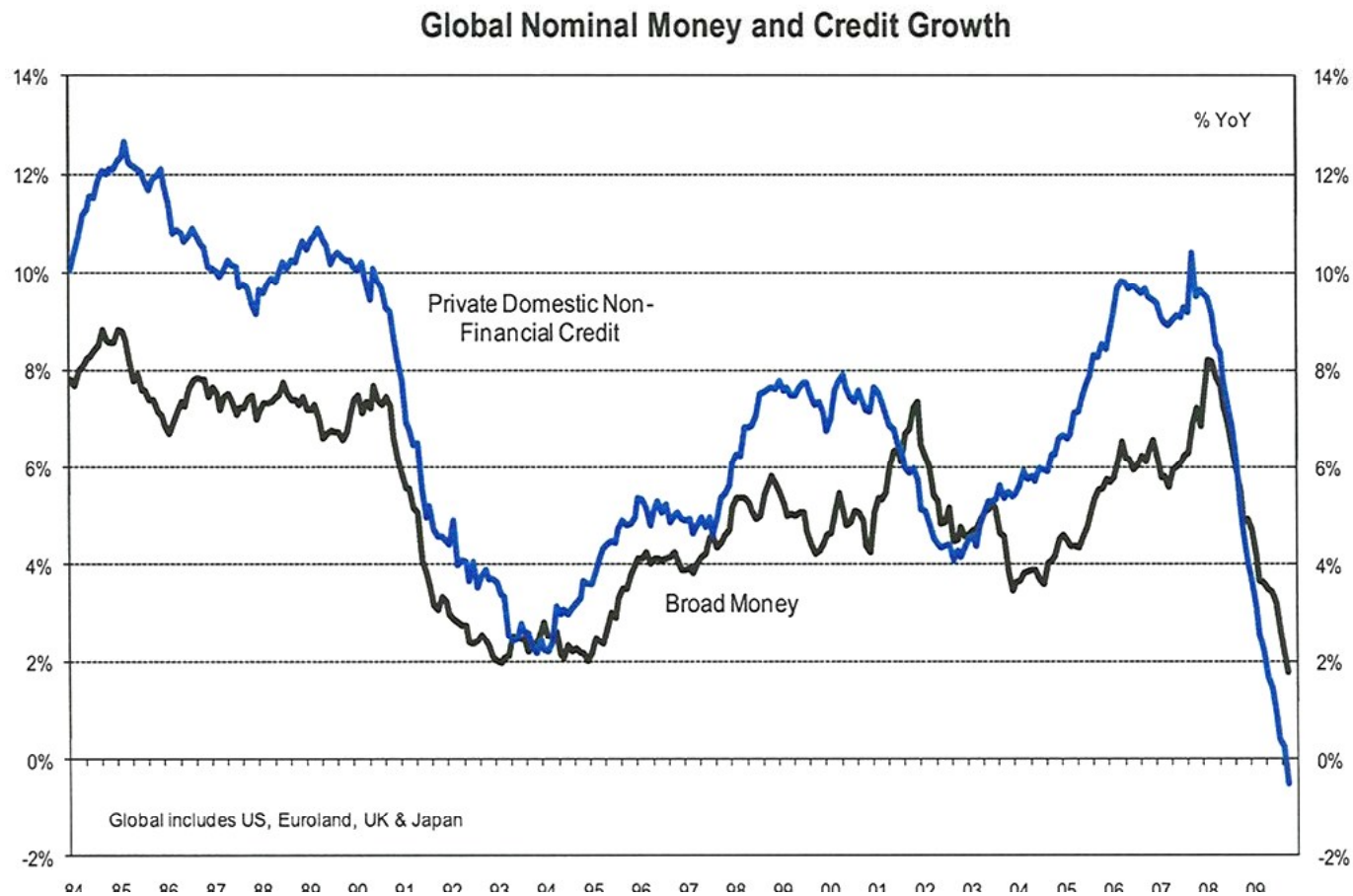
1b. 2009 What Happened? what we got right

- Hedged into AUD\$ for global equities – reduced impact of strong AUD\$.
- Bias to Asia /Emerging Markets equities.
- Overweight Credit vs Sovereign bonds but not enough High Yield.

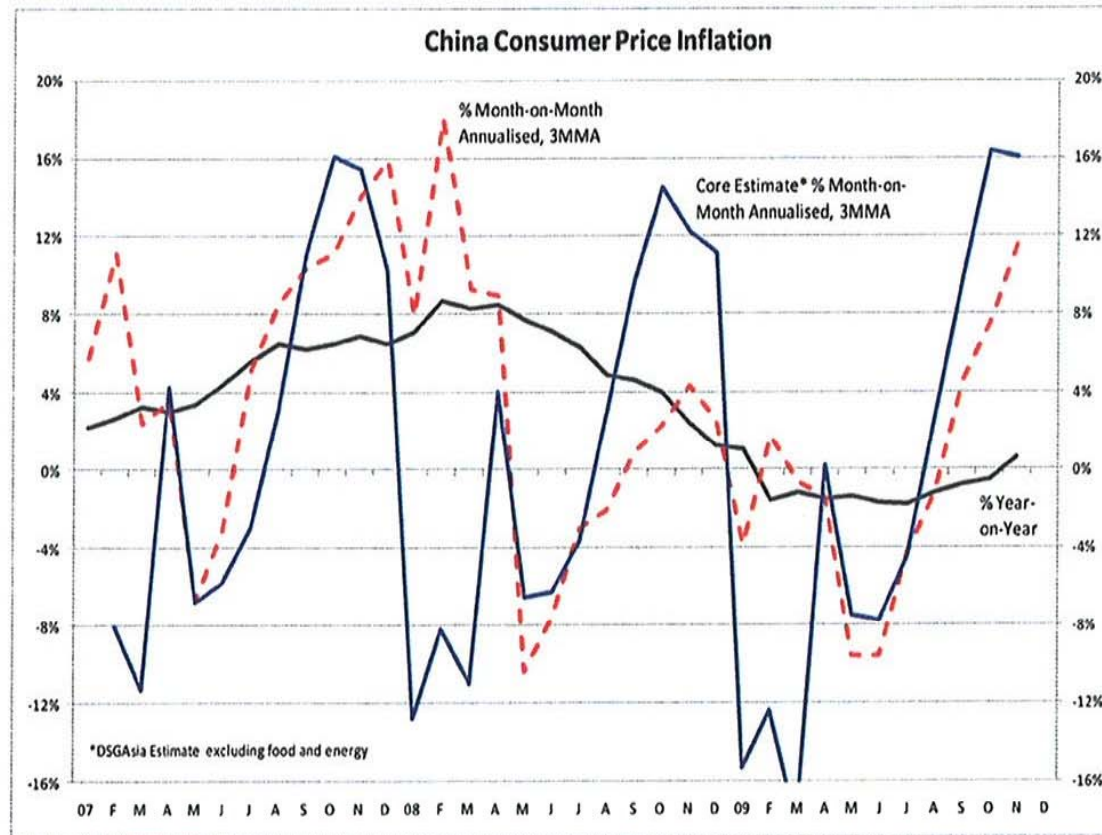
1c. 2009 What Happened? what we got wrong

- Yet another successful re-inflation believed to be possible
- Chinese response - speedy and effective. Fed Balance sheet doubled in weeks!
- → Moral Hazard reinforced but equities love the expectation of growth.
- Second derivatives at work and believed to be sustainable trend.
- Our Asset class Valuation models too long term and 'mean reverting'? – use momentum?
- “Don't fight the Fed”

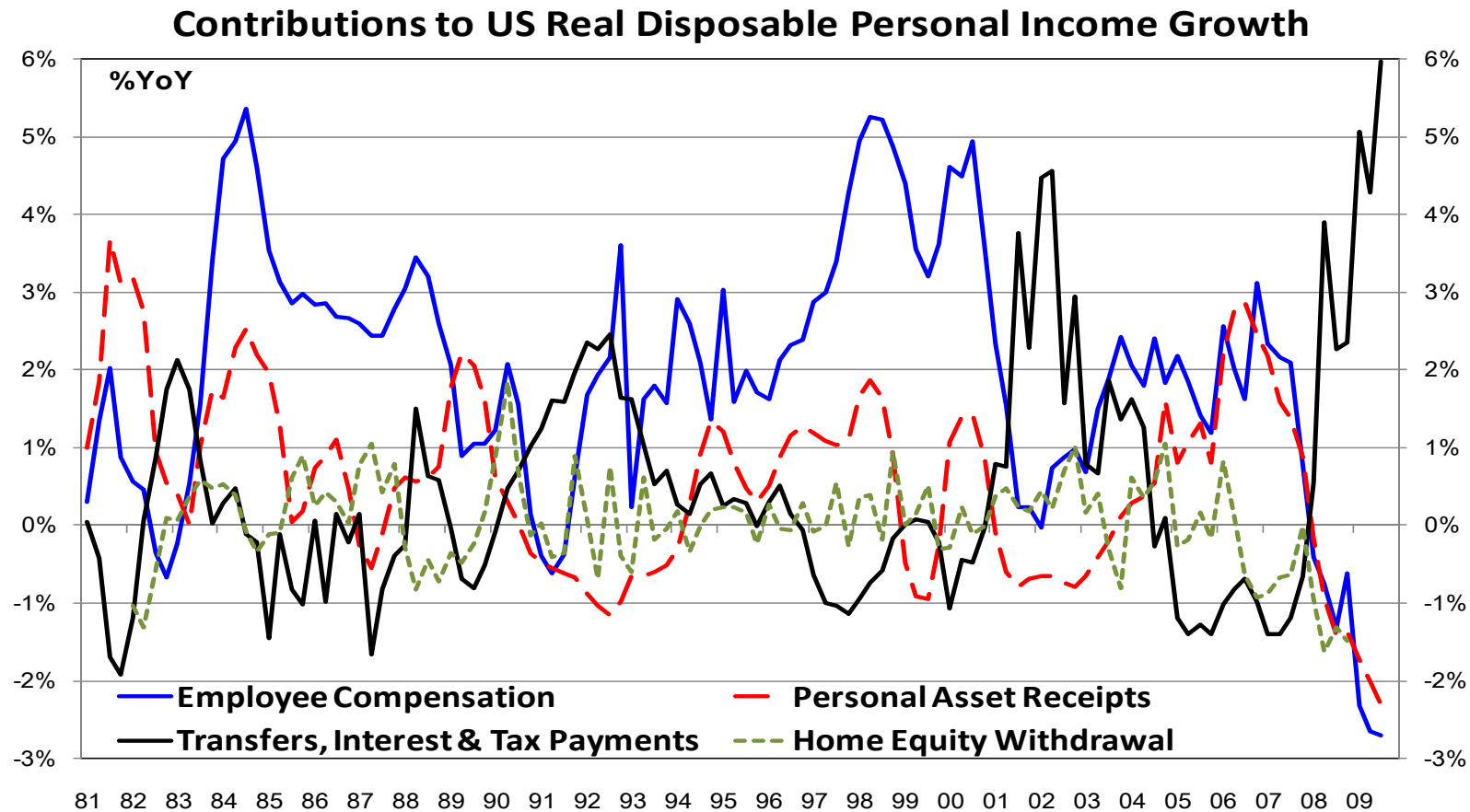
2. The outlook for Global economy 2010 – 2012



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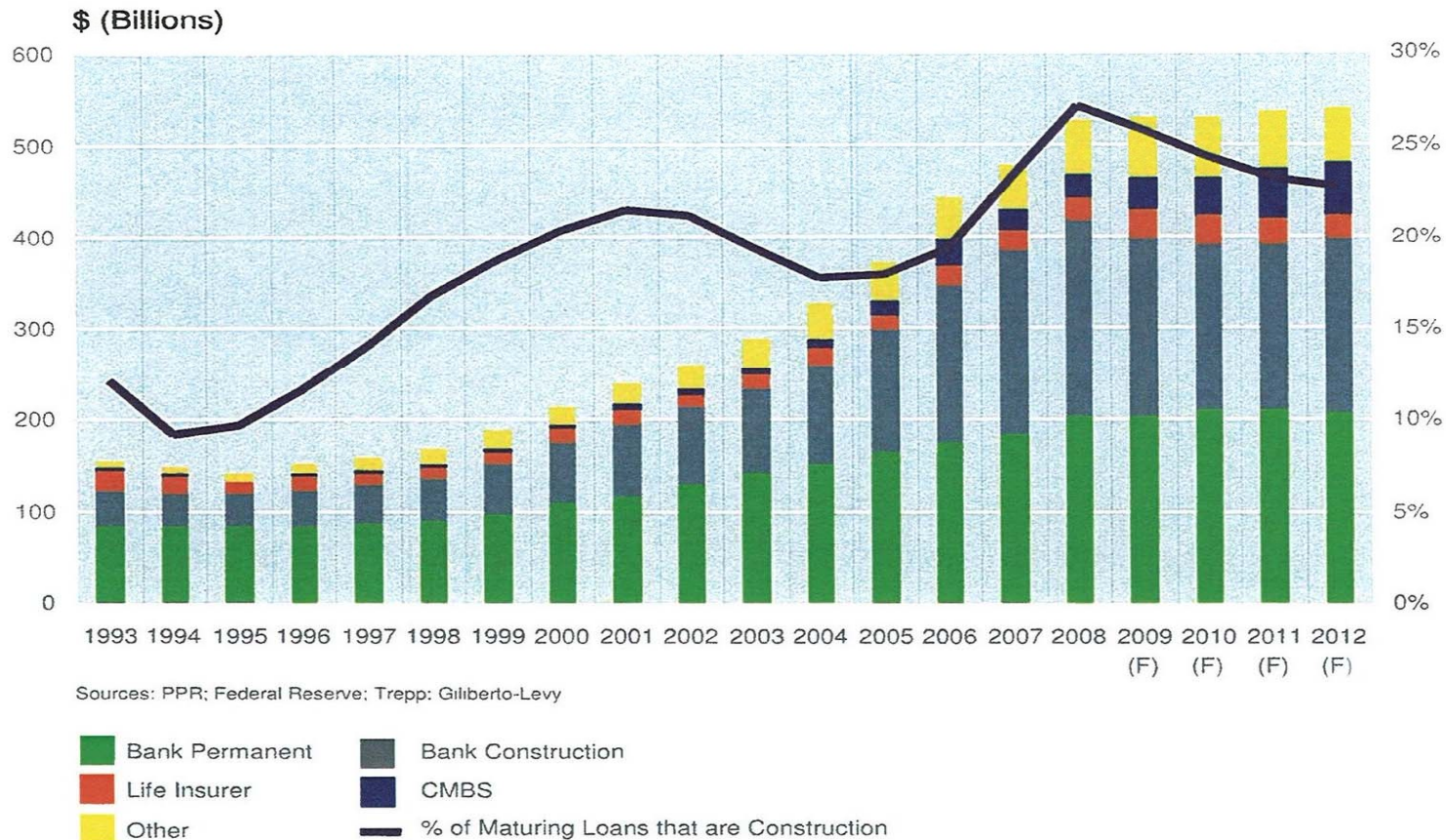
2. The outlook for Global economy 2010 – 2012



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WE HAVE A MATURITY PROBLEM

ESTIMATED LOAN MATURITIES BY LENDER TYPE BY YEAR



2. The outlook for Global economy 2010 – 2012

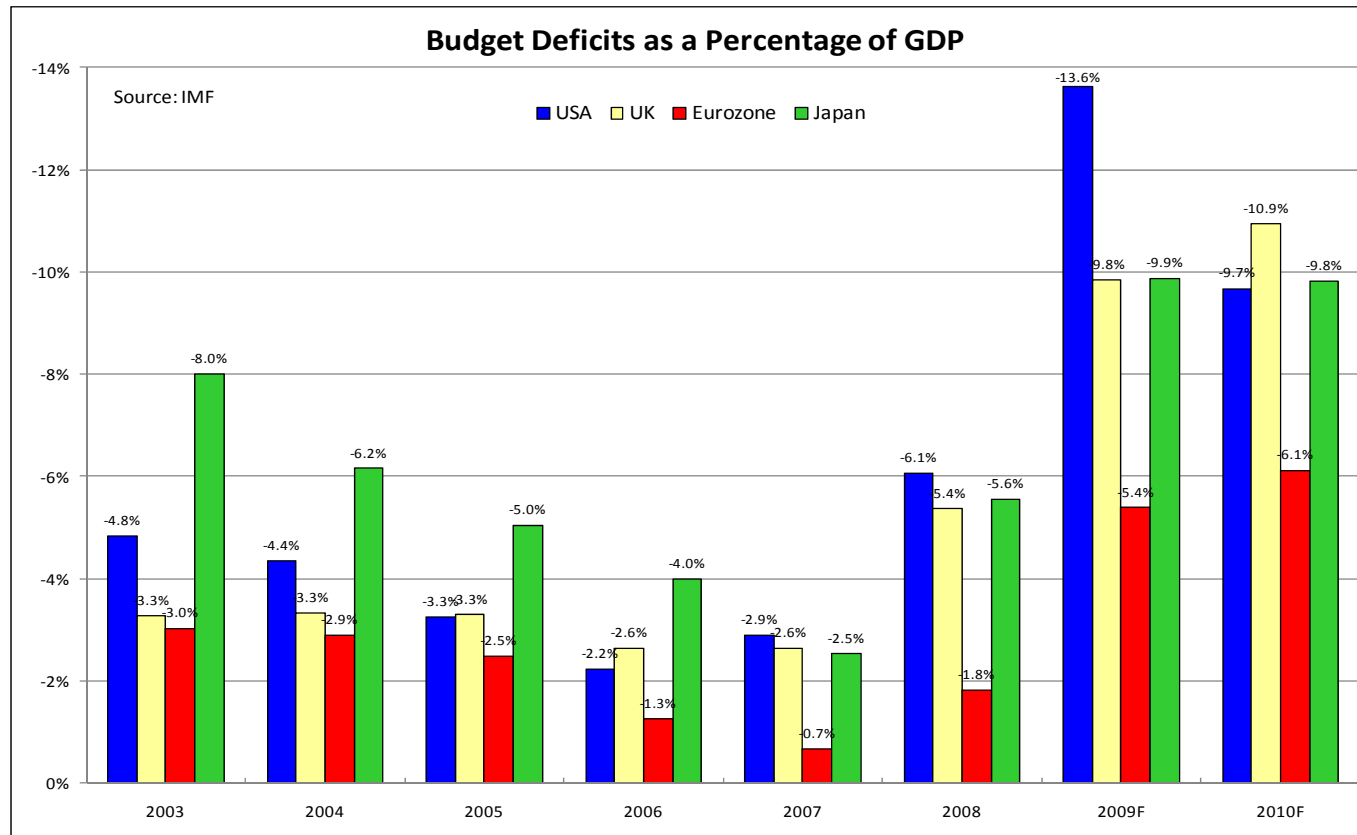
Expected losses as a percentage of Tier 1 capital suggests CRE *alone* could trigger many bank failures

Expected CRE Losses As % Of Tier 1 Capital	# of Institutions	Total Assets (\$ Billions)
0-10	1,759	10,005
10-20	1,107	3,082
20-30	907	762
30-40	815	719
40-50	616	608
50-75	953	910
75-100	356	276
> 100	283	345
Total	6,796	16,706

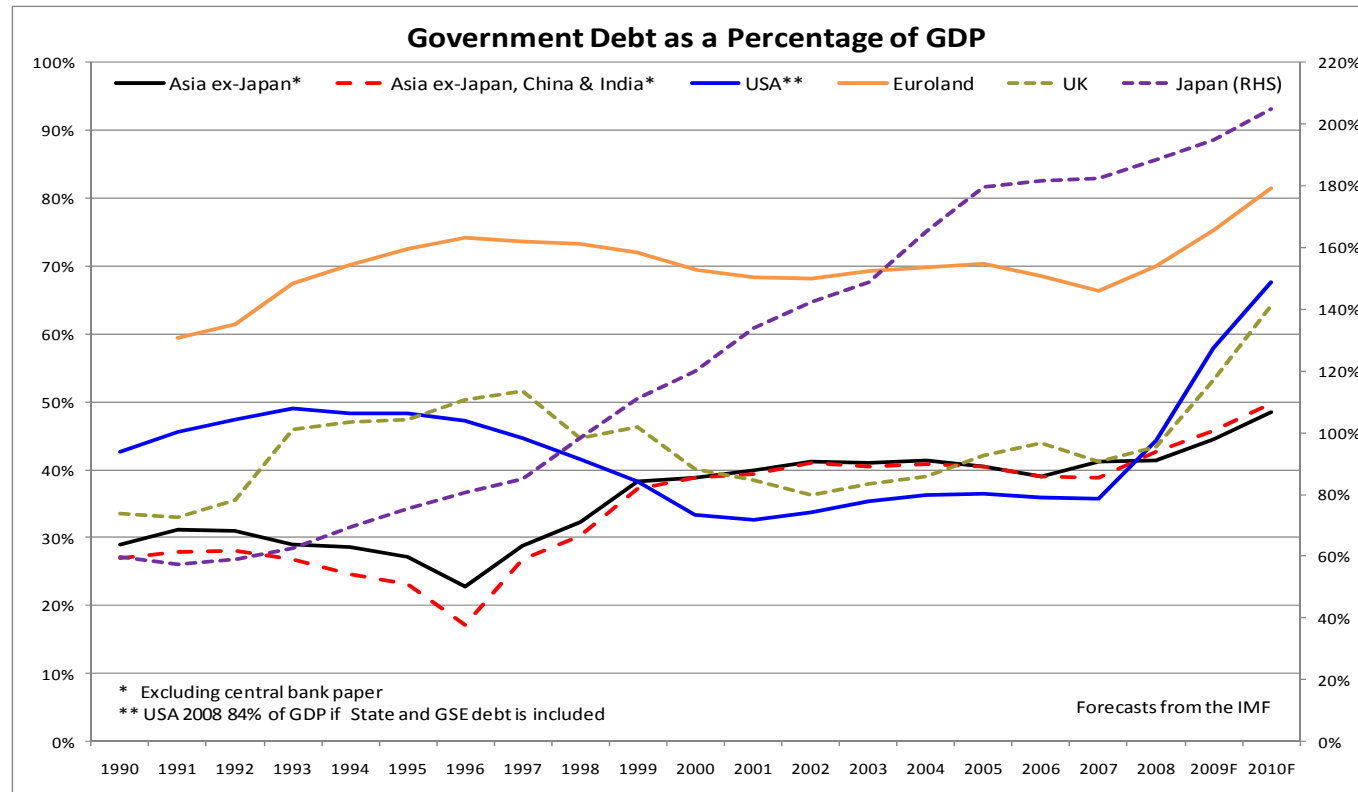
Source: Deutsche Bank, Intex, SNL Financial

- CRE related loan losses could potentially be quite high for a large number of banks, particularly regional and community banks

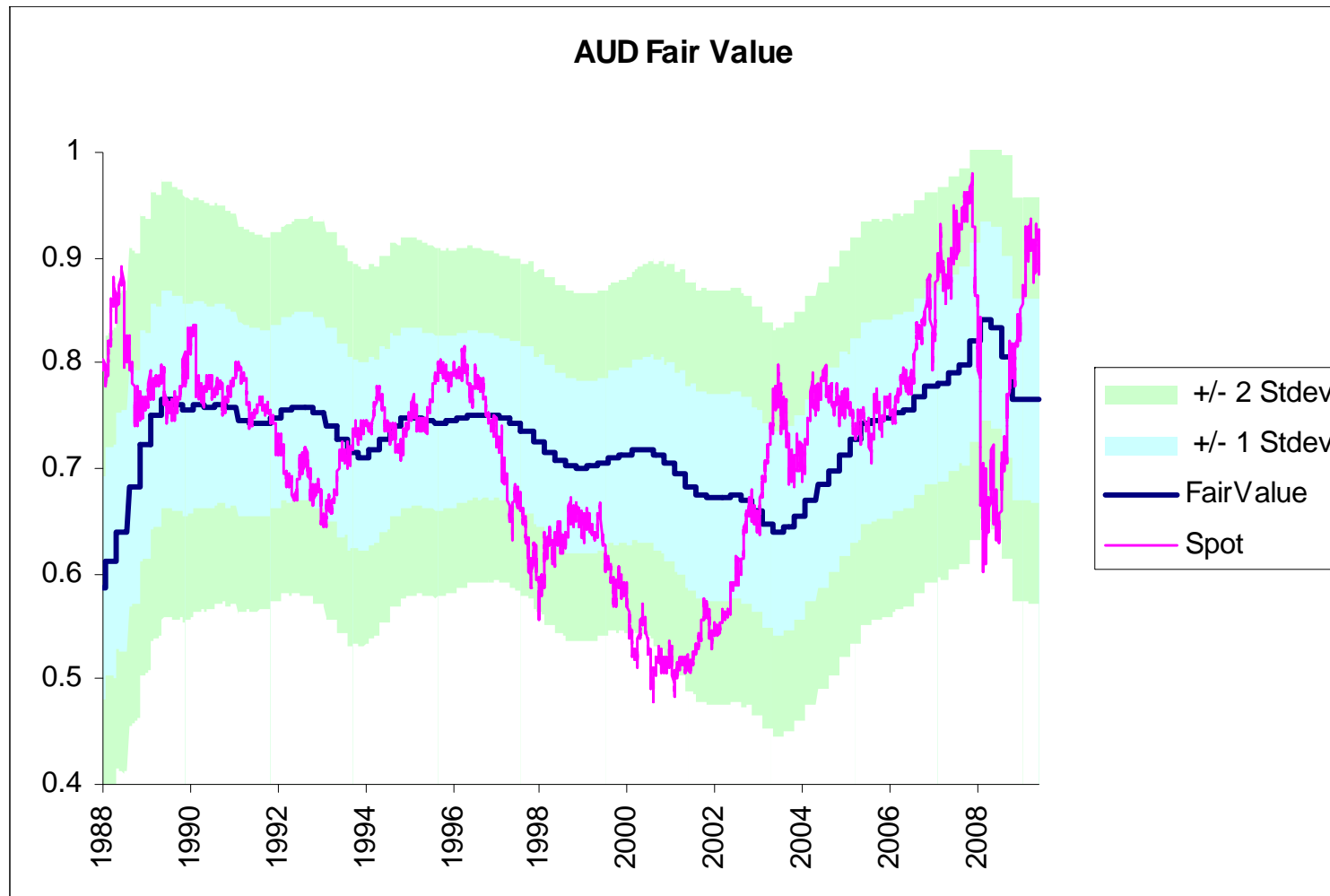
2. The outlook for Global economy 2010 – 2012



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2. The outlook for Global economy 2010 – 2012



3a. Portfolio positioning

	% Allocation	Note
Australian Equities	25%	AUD\$ decline – impacts?
International Equities	20 %	Bias to Asia small caps and quality names. Prepare to remove currency hedges
Australian Property	0 %	
International Property	0 %	
Australian Fixed Interest	20 %	Favour Corporate bonds
International Fixed Interest	10 %	Emerging Debt to price through G7?
Alternatives	20 %	Minimal Beta portfolio Maximum Liquidity
Cash	5 %	Expensive asset class – equitise?
Total Return expected	7.5 %	
Risk expected	6 %	

3b. Portfolio positioning – key risks, opportunities

- Deflation kills profitability and equity prices. (10% prob).
- Inflation expectations rise and kill bond prices / realign currencies (20% prob).
- Capital Controls introduced to counter capital flight and currency “volatility”. Governments effectively default. (10% prob).
- China revalues Rmb significantly (>10%) and ASEAN follows by removing pegs to USD\$ (10% prob).
- ‘Muddle through’ with sub trend growth in West and East but no removal of ‘free market’ policies although greater regulation. (50% prob).

3c. Global Economic Outlook – signposts to watch

- Credit growth, or lack of, in 'The West'.
- House prices in USA. Mortgage rates
- Credible European resolution to budget deficits would be positive ('sort of').
- Rhetoric on Rmb peg in the next few months.
- CMBS + RMBS paper rollover in 2010 -2011.
- Commodity Prices (Copper, Oil).
- Rhetoric on Fed exit from easy money

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