

*'Research is to see what everybody else has seen...
... and to think what nobody else has thought'*
A Gyorgyi



RESEARCH REVIEW | MARCH – MAY 2008

Global Economy: The In-House Think Tank

- Equity and Debt Markets: **Threats and Opportunities**
 - Key Views: As the sub-prime credit crisis continues to spread its roots through the global financial system, one of the key sectors being impacted is capital **debt markets**. As investor confidence is subdued and risk is repriced, the cost of debt is rising. While this does provide an imposing threat to earnings for companies with highly leveraged short term debt structures, it also presents opportunities to investors seeking **high yielding** corporate paper. A recently quiet market is starting to re-emerge: the Hybrid Debt market. Profile is **actively researching opportunities** in this space with recent analysis further discussed below.

Sector Specialist: Profile's Interpretation of Who's saying What?

- HFA Asset Management
 - Topic: **Global Economy**
 - Key Takeout: Jonathan Pain on 'what a wonderful world'; Following the sub-prime crisis and globalisation no nation can be viewed in isolation; However going forward, the Asian locomotive replaces America; China slows but 8% is still impressive growth; India still remarkable; Rise of the Asian consumer; Global commodity super-cycle; Slowdowns in Spain and UK but Germany stands tall; **Australia – underwritten by Asia and exports to India however not immune; Further interest rate rises will be taking it too far.**
- Alliance-Bernstein Investment Management
 - Topic: **Global Economy**
 - Key Takeout: Volatility has returned to markets driving risk premiums higher – opportunities; Global economic growth to remain sound, despite recent capital market volatility supported by actions such as the Fed cutting rates; Corporate fundamentals remain sound and valuations have become compelling; **Key is that diversification remains a critical financial discipline.**
- van Eyk Research
 - Topic: **Global Economy**
 - Key Takeout: **The complexity of the current problem was not near its end;** UK economist Andrew Hunt identified inherent issues in the American and UK banking system that would take some time to come out of the woodworks; View that Australia would be turbulent in light of support from China, high corporate debt and severe issues in credit markets; **Equity market turmoil would continue and equity markets would not turn until there was renewed investor confidence.**
- Platinum Asset Management
 - Topic: **Global Economy**
 - Key Takeout: Kerr Nielsen discussed the recent funds performance in light of falling markets; Identified that there was still further turmoil to be felt but that opportunities were emerging; **Maintains an optimistic outlook for Asia but cannot confirm where the fallout will end.**

- Bloomberg Asia
 - Topic: **Asian Economies**
 - Key Takeout: Panel of Asian business leaders discussing their views on the impact of U.S. market turmoil; Identified that while US slowdown would impact growth, it was not as significant a concern for Asian economies given rising internal demand and China; **Key threat identified was the emergence of rising inflation and the capacity of the various economies to deal with it.**

- Becton Property Group
 - Topic: **Property**
 - Key Takeout: Current issues in debt markets were affecting highly leveraged short term-debt property investments; Becton highlighted that while cap rates may be softening this is not as significant if rents are also rising – dependent strongly on the sector of the market; Identified tighter CBD markets as being such a case; **Long term view that Direct Property is more stable than Listed Property and less correlated with Equities.**

- Real Estate Capital Partners
 - Topic: **Property**
 - Key Takeout: Opportunities were presenting themselves but there were still lag effects to be felt in the direct property sector in line with softening cap rates and property revaluations; **Direct Property may be following the lead of Listed Property so tread carefully.**

Investment Analysis: What's on the Radar..?

Review: Profile's Approved Product List

- Credit Suisse Asset Management: Global Hybrid Income Fund
 - Basis: **Sector + Investment Review [Fixed Interest]** – International Debt Markets
 - Analysis and Outcome: Portfolio has been well managed on relative scale in light of current credit crisis; Manager believes that current market **commentary suggesting credit conditions will revert to norm by 2H2008 is unfounded**; Portfolio well positioned to take advantage of emerging opportunities linked to rising credit spreads on well rated debt instruments - maintain **buy**.

- LM Investment Management: First Mortgage Income Fund
 - Basis: **Sector + Investment Review [Fixed Interest]** – Capital Management and Valuations
 - Analysis & Outcome: Efficient liquidity and cash-flow management; Continue to maintain capital preservation supported by a sustained competitive yield; Able to take **advantage of higher interest rates through lending** component of business and passed on to investors [evidenced by recent increase in distribution yield]; Wholesale first-mortgage lender only so not exposed to residential property market; Maintain strict lending policy - maintain **buy**.

- Schroders Investment Management: Fixed Income Fund
 - Topic: **Sector + Investment Review [Fixed Interest]** – Opportunities and Outlook in Debt Market
 - Key Takeout: Described a shifting economic environment in light of slowing economic growth and the rising cost of debt; Identifying opportunities emerge in the listed hybrid market in line with rising credit spreads; Still remain cautious about entering long duration bonds and remain neutrally positioned; However, are prepared to enter this market when opportunity presents itself; **Entering an environment where Fixed Interest funds will benefit strongly** - maintain **buy**.

- Cromwell: Direct Property Fund
 - Basis: **Sector + Investment Review [Property]** – Cap Rates, Debt and Valuations
 - Analysis & Outcome: Demand-supply dynamics remain **supportive for valuations**; Low gearing with medium-term fixed rates; Efficient liquidity and capital management; Property valuations – no new purchases in last two years with valuations kept at reasonable levels – **have already devalued units to reflect current environment**; Sound fundamental and investment approach - maintain **hold**.

- RREEF: Global Property Securities Fund
 - Basis: **Sector + Investment Review [Property]** – Cap Rates, Debt and International Valuations
 - Analysis & Outcome: **Sector has been oversold** relative to underlying assets bringing yields back to more historical levels; **Short term concerns** still remain at large pertaining to valuations and earnings; Quick recovery unlikely and panic selling remains a risk; **Current valuations attractive** and do not support redeeming current investments; **Long-term global property growth prospects remain strong** - maintain **hold**.


- Macquarie: Wrap Cash Account
 - Basis: **Investment Review** – Underlying Investment Changes
 - Analysis & Outcome: Change in underlying base cash account from investment in Treasury Fund [Cash + Fixed Interest Securities] to being held on deposit with Macquarie Bank. Return has been increased by 20bps; Treasury Fund was rated AAA by S&P however **new account is unrated** – however Macquarie Bank has a S&P rating of A-1/A/Stable; **Do not believe extra return is commensurate with change in risk rating**; View is supported by van Eyk; Continue to monitor credit worthiness of Macquarie Bank and have **voiced our dissatisfaction** - maintain **hold**.


- MMC: Australian Share Fund
 - Basis: **Investment Review** – Ongoing Under-Performance
 - Analysis & Outcome: Initial underperformance accepted in line with role in the portfolio - however expected to rise from sideline in current volatile market; Ongoing underperformance - taking into consideration higher cash holding - would indicate poor stock selection; Furthermore recent management issues have arisen leading to **recommended redemption**; Profile is actively researching a replacement for the portfolio.

- van Eyk: Blueprint Diversified Funds
 - Basis: **Investment Review** – Underlying Investment Changes
 - Key Points: **Australian fixed interest exposures were neutralised to strategic weights** in the Capital Stable and Balanced Funds, funded from international fixed interest and Australian LPTs; **Increased allocation to diversified alternatives** within the High Growth Fund, funded from Australian LPTs; In the Alternatives portfolio, the exposure to gold shares (which is correlated to equity markets) has been reduced, while **exposure to bullion has been increased** via investment in CSL's Active Commodities Fund; Fixed income macro manager, **Augustus, has been implemented** within the Alternatives portfolio at the expense of credit manager, AMP;

Exposure to **Australian and international equities is reduced** given evidence that central banks have not yet stabilised the global financial system and company earnings may turn out to be worse than currently expected as the US recession impacts globally; **International Fixed Interest allocations are increased to 'neutral'** as central banks are likely to ease policy beyond consensus expectations and selective opportunities in global credit markets are apparent at current wide corporate bond spreads.

Thumbs Up

- Jigsaw Investment Trust 
 - Description: Private Business in the Childcare Sector
 - Analysis & Outcome: **Business taking advantage of niche market in a growing sector**; Majority of income is contracted to corporate clientele; Current centres located in Sydney CBD with expansion plans in to Eastern Suburbs and Melbourne; Executive Director has a proven track record and will maintain a fifty per cent holding in company to align interests in ongoing profitability.

- Wesfarmers: Entitlement Offer 
 - Description: Capital Raising through a 1 for 8 Entitlement Offer at \$29.00 per WES unit.
 - Analysis & Outcome: Funds would be used to repay debt incurred from acquisition of Coles Group; Strengthens balance sheet and cheaper alternative than raising debt in current environment. **Recommended given significant discount to market and long-term outlook.**


Under Consideration


- ABN Amro: Altera Securities
 - Description: Structured product with exposure to commodities; and BRIC.
 - Analysis & Outcome: Capital protected with monthly averaging and lock-in of returns. Coupon payments dependent on certain target returns being met (does not detract from final capital return). Simple structure using a zero coupon bond and a combination of short and long term options. **Pending final review and peer comparison.**


- Goldman Sachs JB Were: Keystones III
 - Description: Structured product with exposure to commodities; global equities; sustainable investments funds; and food, feed and fuel.
 - Analysis & Outcome: Capital protected over six-year period. No coupon payments for total duration. Returns averaged over final three years with no lock-ins for first three years. Simple structure using a zero coupon bond and long term options. **Pending final review and peer comparison.**


- Westpac-St George: Merger
 - Description: Westpac Bank's merger offer with St George Bank.
 - Analysis & Outcome: Westpac has seized an opportune time to make its move given share price weakness and turmoil in the international banking sector. The St George Bank board has recommended the all script offer be accepted by shareholders. Given recent comments surrounding the maintenance of the 'four pillar' policy it would appear that Westpac has made a smart move. **No recommendation at this stage given pending finalisation of offer.**


Thumbs Down

- Floating Hybrid: SKIES 
 - Description: Interest earning security with yield at 90day Bank Bill (BB) + 180bps.
 - Analysis and Outcome: Rating BBB- with maturity in December 2016; Interest is accumulative and paid quarterly. Offer is **unattractive relative to other comparative offers** given current credit market environment.

- Floating Hybrid: POWERS 
 - Description: Preference shares earning 7.45%; reset every quarter to 90day BB +265bps
 - Analysis and Outcome: Rating BBB- with maturity in December 2016; Interest is accumulative and paid quarterly. Offer is **unattractive relative to other comparative offers** given current credit market environment.

- ANZ: Discovery Asia Fund 
 - Description: This capital protected structured product provides exposure to a number of Asian focused absolute return funds with the specific aim of providing positive long term performance whilst preserving capital.
 - Analysis and Outcome: Profile support the Asian emerging market story; Geared tax advantage exposure with capital protection is appealing; However rejected simply based on higher costs resulting from **multiple layers of fees and hence un-competitive.**

- Antares Lodestar: Absolute Return Trust 
 - Description: Lodestar is a high conviction boutique manager who adopts a 'style agnostic', active investment approach, incorporating both quantitative and qualitative research techniques. Stock analysis focuses on the quality, potential growth and sustainability of company's future earnings stream. The portfolio is concentrated + benchmark unaware and therefore adopts an absolute return approach
 - Analysis and Outcome: Rejected on the basis that it was **not a strategic fit into the existing portfolio** construction process; However will be **kept on the watch-list** for performance and portfolio dynamic purposes

- Cromwell: Phoenix Property Securities Fund 
- Description: As a result in the severe downturn in the Listed Property Trust market, Cromwell are being opportunistic in launching a new fund; hence the name "Phoenix" - rising from the ashes.
 - Analysis and Outcome: Concern remains whether the current LPT market does contain some 'bargains' or whether the market has **simply efficiently repriced the sector**; Yields have risen but concern remains around their sustainability in light of the **rising cost of capital**; Further risk also remains around **property valuations**; Consider Cromwell a good active manager of Direct Property however they **remain untried as a Property Securities Fund Manager**.

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