



Research Review | September – October 2007

Profile wishes to communicate to clients a regular review of our research activity, including strategic asset allocation, investment and economic research and analysis. This is another service provided by Profile to educate, empower and partner with clients.

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Investment Research & Analysis

- **Challenger Property Hybrid Fund: review – “redeem” recommendation**

Issue: The direct property component of this fund has held some attractive property investment opportunities dating back to the funds legacy when managed under the HSBC brand. To this point Profile has been keen to maintain existing exposures to allow investors the opportunity to realise those potential returns that the assets were anticipated to deliver. Since the changeover from HSBC to Challenger the highly respected direct property specialist group who were managing the direct property exposure (Fortius Funds Management), have exited their involvement and Challenger had undertaken this role upon themselves.

Considerations: It does appear that Challenger has been transitioning the fund into a more traditional vanilla property fund, without the high-level specialist opportunities that Fortius formerly brought to the fund. In addition, the fund has now reported the positive revaluations on several of the property assets, which we had been waiting to come to fruition. Therefore, there seems little incentive to remain in the fund with more attractive direct property opportunities consistently being reviewed.

Outcome: While this recommendation is not a “sell”, per se, advisers will be directing clients to redeem according to their circumstances at their discretion.

- **Acumen Office Trust (being renamed Australian Unity Investments Office Fund) : update**

Update: Australian Unity has been voted in as the new Responsible Entity of the fund, replacing Acumen (Multiplex).

Considerations: This fund is a single asset structure and leasing management requires relatively low maintenance with existing core tenants already under long-term leases. Therefore, the management role is very insignificant at this stage of the fund (approx 4 years into 5-6 year life). Australian Unity has a good track record with managing property syndications anyway, and their most important role will be managing the exit strategy.

Outcome: Profile has every confidence that Australian Unity will perform an adequate role at least to the equal of what Acumen/Multiplex would have done.



- **Generator Notes (GNAHA) - update.**

Update: Given the recent credit market events this investment was reviewed to access any heightened risk that would cause Profile to change the recommendation.

Considerations: No portfolio events have occurred to date since the security's inception and the fund is over 3 years into its 5-year term. This effectively means that the chance of exceeding the number of default (events which would trigger a material effect to investor holdings) is extremely remote. Even though several research houses are putting blanket sell recommendations on all credit, Profile believes this is simply a knee jerk reaction with no specific consideration applied to individual investment schemes, which is exactly where they are paid to perform.

Outcome: The accessed risk of the underlying book of corporate debt remains sound and the current repricing of listed debt in credit markets should not affect this particular investment structure. Profile is therefore comfortable maintaining our current exposure.

- **Credit Suisse Global Hybrid Fund - update.**

Update: As per the issues raised above for Generator Notes regarding credit markets, this fund was monitored closely in regards to how Credit Suisse have their investments positioned across the spectrum of fixed interest/credit markets. Upon examination the manager has been about as well positioned as it could be within its mandates and has barely been affected relative to the wider credit markets it invests in.

Considerations: Profile then considered if they believe zero exposure to these markets is justified or are we satisfied the manager (Credit Suisse) to guide the portfolio through these turbulent times and take advantage of the opportunities created through volatility.

Outcome: We are comfortable with the investment process and philosophy Credit Suisse apply in this area and their ability to manage the investments allocations to the asset class' sub sectors to extract relative value.

- **RatePlus - Cap Guaranteed 1yr Note targeting cash +2.00% - offer declined.**

Offer: NAB are offering this note which aims to return 2% in excess of the RBA Cash Rate after fees. The capital guarantee structure is achieved by using the majority of the investment funds being parked in an interest bearing secure facility. A small portion of the funds are traded in a highly geared active quantitative trading system, to try and achieve the positive returns to the scheme.

Considerations: Profile does not favour these types of structured product where the bulk of funds are parked in a capital guarantee structure because they are ultimately inefficient from a portfolio construction and fee basis. This fund is also only accessible for minimum \$500k investment.

Outcome: We are exploring more efficient capital guaranteed structured products, which give upside exposure to more growth oriented assets.

- **Becton Development Fund No.1 – under consideration.**

Offer: The Development Fund No.1 is the first from Becton in a planned series of development funds that will enable sophisticated and wholesale investors to invest in a diversified portfolio of Australian property developments in which the Becton Property Group will both manage and co-invest. The four development sites (2 Melbourne, 1 Canberra and 1 Byron Bay) are at various stages of the development process and offer some diversification from both geographic and development risk aspects.

Considerations: This fund is also only accessible for sophisticated and wholesale investors, therefore limited in the first place. The Byron Bay site is significantly the largest project and offers the greatest potential returns, and accordingly is carrying the greatest risk.



Outcome: While this seems an exciting offer we have several reasons to be patient before recommending any investment into the fund. Currently there are several existing property related funds winding up or looking to wind up, which Profile clients are invested in, and funds will become available for these types of opportunities on a wider scale. In addition, Becton are planning to offer more of these development funds, therefore we have the opportunity to monitor the progress of this fund and Becton's performance as a manager.

Economic and Market

van Eyk September Investment Outlook Report – reviewed

Summary: Two major items discussed

1. The “carry trade and market volatility”
2. What can go wrong?

Considerations: As pointed out by Citi economists, there are three key questions that policymakers need to address:

- i. Does the market deterioration reveal information about economic prospects that were not apparent?
- ii. Are there signs of emerging systemic risk?
- iii. Have financial conditions deteriorated sufficiently to alter and achieve economic prospects?

Central banks have been forced to add liquidity directly to their respective banking systems. This intervention was relatively limited but helped to stabilise markets. In order to restore market confidence, it is essential that there is an orderly handling of the large leveraged buyout deals that have been held-up. Investors are now in a better position to require better terms and conditions, which could result in some marginal deals being undertaken. It is less certain now how soon it will be before derivative markets return to ‘rational’ pricing and whether there will be more hedge fund casualties as assets are marked to market. Central banks are uncertain about who has the highest risk exposures in the trillion-dollar credit derivatives market.

Outcome: In view of this uncertainty we have a preference to continue being overweight to Australian cash over other credit related assets.

van Eyk October Investment Outlook Report – reviewed

Summary Points:

- The larger than expected cut in the Fed Funds rate from 5.25% to 4.75% on the 18th September boosted equities, which had slumped due to the credit ‘crunch’ that resulted from the US sub-prime mortgage market slump.
- The Australian dollar appreciated by 8.56% during the month, the majority of which occurred after the aforementioned cut in the Fed Funds rate. This was primarily due to weakness in the US\$, greater confidence in the commodities outlook and a resumption of the carry trade.
- Australian equities were the top performer over the month, driven by a 15% increase in the resources sector and continued strong demand from China. Note that BHP alone accounted for approx. 1/3 of the index move in September, highlighting large cap stock specific risk.
- Global developed equity markets performed well in local currency but performed poorly on an unhedged basis due to the appreciation of the A\$.
- Emerging equity markets continued their strong performance, generating 8.4% over the month and 48% over the year. Emerging markets did not experience the same levels of volatility during July and August compared to developed markets due to the fact that financials are a much smaller component of emerging markets relative to developed markets.



Considerations: Profile expects continued volatility from markets, firstly from the sub-prime collapse and secondly the US economy is looking very shaky.

Outcome: We are comfortable with our current portfolio positions being a more defensive bias.

Presentations

- **T Rowe Price – International Equities seminar**

Attendees: Evan Davies

Summary: Stephen van Eyk and Rob Gensler (portfolio manager) discussed global economics and markets. Of interest it was noted that US proportion of global trade has dropped significantly from 2000, from around 26% to 19% hence less reliance on their consumers. It is also highly likely that China's growth in actual dollars will be greater than the US this year. T Rowe Price is a manager in the van Eyk Blueprint International Fund, and they are continuing to demonstrate their high conviction and growth management style continues to achieve out performance.

- **Portfolio Construction Conference**

Attendees: Phillip Win, Jai Parrab, Kurt Ohlsen and Evan Davies

The Portfolio Construction Forum allowed us to hear from some of the leading economic and investment academics from around the globe as well as a range of Fund Managers. The forum is widely regarded within the industry as one of the most intensive portfolio construction conferences encompassing a variety of topics in including modern portfolio theory, asset allocation, unique investment approaches and their respective real world applications. While a variety of presentations were heard across these topics, some of the key takeouts Profile came away from the conference with included:

- Re-assessing current life expectancy tables used in financial modeling
- The incorporation into modeling of both investment risk and longevity risk (the risk of outliving your capital) when evaluating individual risk profiles.
- Calculating the impact of asset allocation on portfolio risk as well as returns
- Critically analysing existing portfolio construction theory and its role in evaluating and forecasting returns.
- The role of active management within portfolios in reference to outperformance versus costs.
- The increased implementation of Alternatives as an asset class within portfolios.