

PortfolioWatch

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Quarterly newsletter for PortfolioWatch clients

Spring 2011

Investor sentiment held captive by global events

Investor sentiment in share markets remains mute, particularly in the US and Europe. Australians are saving at rates not seen for decades and this is reflected in the low levels of retail spending, which has resulted in deteriorating profitability for some sectors.

Reflecting the mood of the consumer, and to a certain extent business, broader credit growth in Australia also remains subdued. Structural reforms such as the carbon tax and the resource rent tax have been additional sources of uncertainty for business.

Sovereign debt

The number one issue for global markets is the heavy burden of debt in various countries and in some countries, such as Greece, the issue needs to be dealt with urgently. Measures taken by the European Central Bank to assist Greece on a more permanent basis are likely to set precedent for future bailouts. While Greece and some other countries cannot pay their debts without assistance, other countries still have time in which to improve their balance sheets. From an Australian perspective, the Government does not have high levels of debt. From a consumer perspective, consumer debt is high, but it appears manageable as long as interest rates and unemployment levels do not rise sharply.

Why is Greece a concern to the rest of the world?

If a country is unable to repay its debts, it can have an adverse impact on balance sheets and on the profitability of banks outside the affected country. Recent European debt issues, therefore, could put a strain on major banks, particularly those in France. Australian banks have little direct exposure to the European peripherals, however there could be some increases in their offshore borrowing costs.

Resolving the debt issue

Some European peripheral countries must be provided with lower cost funding on a long-term basis and bond holders will need to accept some form of loss. We believe a move such as this would provide some certainty in markets and most importantly, improve sentiment.

The US economy

The US is also a heavily indebted country, but has a much larger economy and over the longer term we believe it can improve its balance sheet, if it gets its budget deficit under control. To achieve this outcome, difficult decisions will need to be made and expenditure cut.

The weaker US dollar has been beneficial for the US export industry, though the underlying economy has been moving through a period of unexpected weakness recently. Unemployment has remained stubbornly high and the housing sector continues to fall, although recent numbers have improved optimism and we believe it is close to bottoming.

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There is good news

One headline that continues to make the front page this quarter is the Government's carbon tax proposal. While the tax will be levied on the top 500 polluters for their carbon emissions, the Government has assured Australians that most households will be compensated in some way for any additional costs that may flow through to consumer expenditure.

Another issue concerning investors is the heavy debt burden in some European countries and the US. The European Central Bank has stepped in and introduced further measures to help those countries in the most urgent situations, in particular Greece, and it is hoped that over the long term the US will be able to get its own deficit under control. The good news is the Australian economy continues to be driven by exports of metals and energy to China.

Australians, however, are becoming more cautious; saving more and borrowing less. In fact, Australians are estimated to be saving 10 per cent of their income. With more in savings, there are more investment opportunities. If you would like to teach your children, or grandchildren, good habits that will set them up for life, why not refer them to a Bridges financial planner.

Financial advice does make a difference. Recent research by the Financial Services Council illustrates that those with a financial planner are better off by the time they reach retirement.

There is a world of investment opportunities for investors, but in this edition of Portfolio Watch we look at infrastructure, one of the sectors that is faring particularly well at present.

If you have any questions about any of the topics covered in this edition of Portfolio Watch, please speak to your Bridges financial planner.

Michael Carter
Chief Executive Officer

Investor sentiment held captive by global events... *continued*

The recent Japanese earthquake and recent spikes in energy prices shocked the US economy, which have since pulled back. While the outlook looks negative some of the issues affecting recent economic growth seem to be reversing. The majority of the US corporates remain in a sound position, partially as a result of very low interest rates, and they continue to deliver on growth expectations, as many are able to benefit from emerging market growth.

China

The Chinese economy continues to power on despite some having misgivings about the growth in residential property prices, rising inflation and the loan obligations of the local governments in China. The Chinese economy has indeed slowed, as a result of government policy, however this takes some of the heat off economic growth and lowers inflationary pressures, setting the economy up for future growth. On the local government debt issue, the Chinese government has allayed some concerns. The local government debts add up to only 30 per cent of the economy's total outstanding debt and, as long as interest rates do not move much higher, we do not expect these debts to hamper the Chinese financial system to a large degree. We expect that the government may start allowing the currency more latitude to increase which could also lower inflationary pressures and, by implication, place less pressure on interest rates to rise.

While growth rates have slowed there are signs of continuing strength. Without slowing growth, the Government would be under increased pressure to slow the economy, risking a hard landing. The Chinese economy grew by 9.5 per cent in the June quarter, ahead of expectations, with consumer spending rising double digit over the past twelve months.

Australia

Chinese economic growth continues to remain the driving force for the Australian economy as it benefits from record prices and export volumes of metal and energy resources. We have seen weakness in other sectors of the economy, most evidently in the retail and housing sectors. These sectors have borne the brunt of higher domestic interest rates, which have been increased to stave off inflationary pressures. These headwinds have been at least partially responsible for the change in attitude in the domestic consumer. This has resulted in savings rates increasing dramatically and a distinct lack of credit demand as the consumer repairs their balance sheet and corporates see little need to borrow as sales growth remains muted. Overall, this scenario continues to follow our long-held belief that we remain in a lower growth environment, which will see companies focusing more on cost reduction strategies to maintain earnings growth.

The pressures discussed here, however, should be seen in the broader context of the earnings of many companies being already at cyclical lows. In this regard, share price valuations are not yet cheap but certainly not above the long-term average. The dividends of most companies are also supported by conservative payout ratios (dividend as a proportion of cash income). Earnings growth will inevitably return when domestic consumption growth picks up and cost pressures reduce, the timing of which is uncertain. Despite the headwinds to earnings we believe that markets are pricing in these concerns and as such do not look expensive.

There are opportunities for investors, especially for those looking to invest over the long term. Talk to your Bridges financial planner to find out more.

Why invest in infrastructure?

Over the last six months, to 30 June 2011, the domestically listed infrastructure stocks have fared reasonably well relative to the broader market indices. We take a look at why this sector is performing so well.

First of all what is infrastructure? When we talk about infrastructure we are generally referring to listed vehicles on the Australian Securities Exchange (ASX) that own mostly domestic assets such as gas transmission and distribution pipelines, electricity transmission grids, airports, marine ports and toll roads.

The recent outperformance of the security prices of companies that own these assets, relative to the broader market index, can be attributed to the following three main reasons.

Firstly, a number of companies with government-regulated infrastructure assets have recently undergone a 'regulatory re-set' period for another five years. This means these companies now have greater certainty on the tariff charges their customers will need to pay and the funding requirements for growing their business in line with expected demand. A number of these companies have raised additional equity capital, bolstering their balance sheets and thereby increasing their appeal to investors.

Secondly, forecast sales for most infrastructure companies seem sustainable with growth expected over the medium term. Moreover, certain infrastructure companies for example Spark Infrastructure (SKI) and Macquarie Airports (MAP) have brought their management teams in-house which will reduce annual operating costs and better align management decisions with investor interests.

Thirdly, domestic infrastructure assets are operating reasonably well with both pricing and volumes holding up.

A closer look at transport infrastructure assets

Transport infrastructure assets such as airports, toll roads and ports continue to be buoyed by strong demand, inflation and pricing power (driven by both competitive advantages and monopolistic characteristics).

The higher oil price does not appear to have had a material negative impact on volumes with positive volumes seen across most infrastructure assets, albeit with some signs of slowing growth.

Airports: Sydney airport's passenger numbers increased +4.2 per cent in May 2011 compared to +5.2 per cent for the last 12 months – a strong performance.

Tollroads: Transurban's largest asset, CityLink, experienced growth of +7.2 per cent in the March 2011 quarter compared to +10.1 per cent in the September 2010 quarter.

Ports: The average container volume grew +6.1 per cent at Port Botany in May 2011 compared to +8.1 per cent for the last 12 months.

Regulated gas and electricity: Revenue growth has been achieved through increased customer numbers and strong volumes. Cash earnings have also shown improvement from better cost management and greater operating leverage.

The outlook for infrastructure

Supported by positive volume growth, inflation-linked price increases and good cost control, the financial performance of Australian infrastructure assets looks to remain strong. Growth in operating profit and stable or higher operating profit margins are expected to be reported in the August 2011 company results.

If you're interested in investing in infrastructure, or any other sector, call your Bridges financial planner for advice, tailored to your own particular circumstances. And remember, we have our own in-house research, so you have access to extensive research, and offer full service stockbroking, so you can receive professional stockbroking advice and trade shares or securities easily.

The financial performance of Australian infrastructure assets looks to remain strong.

Saving becomes fashionable

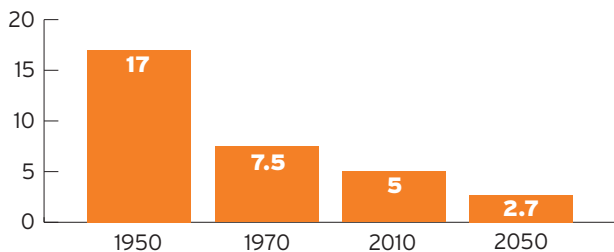
Australians are tightening their purse strings, spending less and saving more. In fact, average households are saving 10 per cent of their disposable income¹. And in June 2011, household savings increased to 11.5 per cent of the Gross Domestic Product, the highest level since 2009.

Why start saving now?

After the global financial crisis, people have become more cautious, realising the importance of saving for a rainy day or funding their retirement. One in two Australian retirees regret not saving more for their retirement² and research suggests that the nine per cent superannuation guarantee contribution is not enough to fund a comfortable retirement³.

Another challenge facing future retirement income is the aging population. In 1950 there were 17 tax paying workers for every retiree compared to only 5 tax paying workers for each Government supported retiree in 2010. To address this, the Government is increasing the age pension age which means less people will be eligible to receive it. Many may have to continue working later in life or rely on their own retirement savings.

Workers per retiree



The earlier that good saving habits start, the easier it is, particularly for the younger generations. The tougher limits on super contributions mean they won't be able to boost their super as they head into retirement, but starting to contribute more to super, earlier and frequently, will help. That's why good saving and investment habits are especially important for the younger people in your life (children, grandchildren, friends etc).

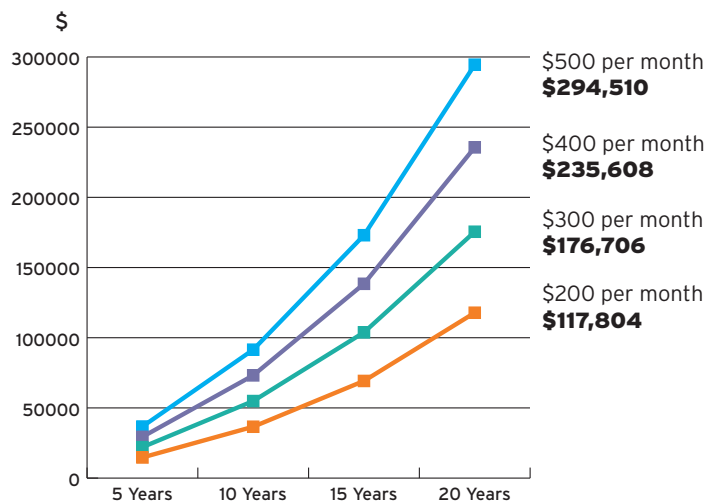
Easier ways to save

While saving is good, investing is better, and these simple strategies can make a world of difference.

Compound interest

Compound interest is basically interest on your interest. Reinvesting the income earned on investments, instead of withdrawing it and spending it, means the next interest calculation will be based on a higher amount, which means the next interest payment will also be higher, and so it continues.

What could your savings grow to over time?*



* Assumes an initial investment of \$25,000 and regular monthly deposits based on a compound investment return of 8 per cent pa net of fees and expenses.

Regular investing

Saving, and investing, doesn't have to be painful; all it takes is a little discipline...and a regular habit!

By making regular investments in shares or managed funds, you also benefit from a dollar cost averaging strategy. When the market is down, prices are lower and you receive a higher number of shares or units. Conversely, when the market is up, prices are higher and you receive a lower number of shares or units. Over time, however, the average price per unit can smooth the market's fluctuations.

Start a good, regular habit today

It's never too early to start. Why not look at your spending and borrowing habits and consider investing? Or start teaching the younger generations the secret to financial success! To find out more why not speak to your Bridges financial planner today.

1 Source: The Age 19 Feb 2011

2 Source: Investment Trends 2010

3 Source: ASFA 2011

How would you like to be remembered?

Australians have always been known for their generous nature and, just last year, Charities Aid Foundation put Australasia first in the World Giving Index.

The ultimate example of the Australian spirit was seen earlier this year following the devastation caused by flooding and bushfires across the country. Many Australians pledged both emotional and financial support to the communities affected as well as helping out with the clean-up operations.

Perhaps 2011 is the year for giving. In January, banker and philanthropist, Simon McKeon was named Australian of the Year, an enviable title. So it seems the rich and famous are no longer being judged on the amount of money they earn but also on the amount of money they give away.

The Bloomberg Business Week's list of top American Philanthropists names Warren Buffet and the Bill and Melinda Gates foundation in first and second place. And in April, ten more tycoons signed the Buffet and Gates giving pledge, which asks the world's richest people to pledge half their wealth to charity.

Charities also benefit from the showbusiness industry and, as you would expect, Oprah Winfrey is one of the most generous. Brad and Angelina have their own foundation, the Jolie-Pitt Foundation, and they've given millions of dollars that they've received for photographs of their children to this and other charities.

Philanthropy is not just for the rich and famous, you too can bequeath money or belongings to a charity or favourite cause.

If you would like to support a charitable organisation, there are a number of ways you can do it. Apart from making one-off donations, you can set up a charitable trust in your Will to perpetuate donations after your death, or you can establish a private ancillary fund to make donations during your lifetime.

A charitable trust allows you to develop your own special giving program that will carry on in your name and support the causes that are dearest to you, after you have gone.

A private ancillary fund has significant tax advantages. You can also use it to create a family foundation to share the tradition of philanthropy with existing and future members of your family.

If giving is one of the ways you'd like to be remembered, an experienced trustee company such as Australian Executor Trustees can help you:

- ▶ set up and administer a charitable trust or private ancillary fund
- ▶ adhere to the ATO's guidelines that govern the way charitable trusts are used
- ▶ manage the assets in your fund or trust, and
- ▶ ensure distributions are made to your chosen charity in the way that you'd like.

If you'd like more information, speak to your Bridges financial planner.

If you would like to support a charity there are a number of ways you can do it.

Ladies! It's time to make your money work for you!

Is the fairer sex getting a fair deal? Did you know that the average super account balance for a woman is half that of a man¹?

There are a number of reasons for this. On average women get paid less than men, which means their super contributions are also smaller. Women are more likely than men to take time out of work to care for children or family members. And generally women live longer so their retirement savings need to stretch further.

The good news is, whatever your stage in life, there are some simple things you can start doing today that will make a big difference later. Here are our top ten tips for women, so why not take a look for yourself or share them with your family and friends?

1. Splitting contributions

Do you have a spouse who is working? Did you know they may be eligible to split up to 85 per cent of their concessional contributions to your super account each year? This not only allows both of you to maximise your annual contribution limits, but it also allows you to accumulate a greater amount of tax-free benefits in retirement.

2. 'Sacrifice' some of your salary and minimise your tax

By simply 'sacrificing' an amount of your pre-tax salary to your super fund you pay 15 per cent tax on that amount instead of your marginal tax rate (which can be up to 45 per cent) and your taxable income is reduced by the amount you sacrifice. So, not only will you have more in super, but you're paying less in tax.

3. Get your super together

If you have more than one super account you could be paying more in fees than you need to.

4. Receive a co-contribution from the Government

Do you earn less than \$61,920? Did you know that every dollar you contribute to super (up to certain limits) could be matched by a co-contribution from the Government?

5. Not working? Reap the benefits of super – it's win-win

- Are you not working? Or only working part time? Did you know that your partner may be eligible for an 18 per cent tax offset simply by making a contribution, of up to \$3,000 to your super?
- Are you under age 65 and no longer working? Did you know that you can continue making contributions to your super?

6. Ease into retirement gracefully

If you want to reduce your working hours or even pay less tax without sacrificing your income, a transition to retirement pension could be the answer... but you must have reached your preservation age (currently 55).

7. Make the most of your Centrelink entitlements

Working out which benefits you're entitled to can be confusing, and the rules often change. Did you know you may be able to get help from the Government if you're caring for a family member?

8. Plan for the unexpected

Get the appropriate insurance such as: income protection, trauma, total and permanent disablement and/or life insurance – to protect you and your family members in the event of injury or death.

9. Pass on your good work to your daughters or grand-daughters

Remember, it's important to have a valid and up-to-date Will in place to protect your loved ones after you've gone.

10. Get some good advice

Whatever your life stage, there are some great ways to increase your financial security. If your circumstances have changed, have you reviewed your financial plan? Or maybe it's time you passed your good habits onto your family. Why not recommend Bridges financial planning to your loved ones?

¹ Source: FINSIA 8 May 2011

Investment market review

quarter ended 31 July 2011

Asset	Index	1 yr return	5 yr return pa	Comments
Australian shares	S&P/ASX 300 index	3.00%	2.01%	The Australian share market retreated over the quarter due to ongoing investor nervousness on the sovereign debt crisis in Europe and the US. Domestic earnings expectations also declined as the domestic economy came under increased pressure. Relatively high interest rates and a frugal consumer has seen weak consumption spending, pressuring the discretionary consumer sectors. Bank's shares have also de-rated, taking into account the lower credit growth environment as consumers move their priorities towards the repayment of debt instead of increasing consumption.
Listed property trusts	S&P/ASX 300 A-REIT index (property)	-2.04%	-9.42%	The past quarter saw the listed property sector post negative returns. The largest detractor was Westfield as investors pared back growth expectations for the entity. Other large property groups such as Stockland and Mirvac also saw declines due to weakness in the residential property sector.
International shares	MSCI World index (AUD)	18.54%	1.99%	The past quarter saw increased volatility in international shares, a result of sovereign debt woes in both Europe and the US, weaker US economic growth and emerging market inflationary concerns. Over a longer twelve month period, international shares have fared relatively well as stocks on major exchanges like the US and UK benefit from a robust earnings outlook. Companies have been cutting their cost base and also improving profitability through productivity gains.
Fixed interest	UBS Warburg Comp. Bond All Maturities index	6.99%	7.81%	Strong performance was seen over the quarter as bond yields declined. This was based on a weaker domestic growth outlook and recent international events. With yields presently at depressed levels, we would expect yields are likely to increase over the medium term. While yields are currently low, should Greek or US issues see further contagion, it would not be unreasonable to see domestic rates fall even further.
Cash	TPS cash management fund	5.16% (as at 30 June 2011)	n/a	The TPS cash return over the three month period to 30 June 2011 performed slightly above the benchmark UBS Bank Bill index. Overall we don't believe that rates are going down in the near term and nor do we anticipate that rates are increasing anytime soon, despite underlying inflation issues. We believe that the bias for the next move in official rates continues to be on the upside, though we believe the next movement is still some time off.

Stock Watch – Tatts Group (TTS)

Tatts Group Limited (TTS) is a provider of leisure and entertainment products and services in the gaming, wagering and lotteries segments of the Australian gambling industry and has an investment in UK gaming venues.

We recently upgraded Tatts to a 'Buy' recommendation. Our upgrade is supported by our view that the company is now finding a sustainable footing for future growth after navigating through the tumultuous past couple of years. We also believe the defensive nature of TTS earnings is attractive given the market volatility and macro uncertainties.

The catalysts which could potentially deliver upside to TTS's valuation, include: (1) acquisition of Tabcorp or South Australian Lotteries licence, both present significant synergy opportunities, (2) being awarded the Victorian wagering licence (decision expected soon, however, Tabcorp is the likely frontrunner for this) and (3) upside from TTS receiving compensation from the Victorian Government for the loss of Victorian Gaming licences. The downside risks to our view include regulatory changes, a value destructive acquisition funded by too much debt and downturn in discretionary spending.

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Bowral	02 4862 1230
Brisbane	07 3217 6044
Brisbane – Bayside	07 3821 1161
Brisbane – North Quay	07 3236 3711
Broadwater	07 5500 6994
Canberra	02 6247 4111
Canberra – Kingston	02 6239 5188
Castle Hill	02 8850 1466
Charlestown	02 4942 2922
Chatswood	02 8448 2006
Coffs Harbour	02 6651 2000
Darwin	08 8981 7722
Doncaster	03 9848 8311
Dubbo	02 6881 8177
Essendon	03 9379 1166
Geelong	03 5221 7557
Gippsland	03 5144 1622
Gold Coast	07 5562 2177
Gosford	02 4323 7468
Griffith	02 6964 2122
Homebush	02 9735 9156
Honeysuckle	02 4927 5833
Hurstville	02 9570 3222
Launceston	03 6334 4900
Laurieton	02 6559 9950
Lismore	02 6622 0353
Liverpool	02 9821 2274
Maitland	02 4934 6133
Melbourne	03 9629 8188
Melbourne CUC	03 8779 5254
Mildura	03 5022 7062
Miranda	02 9525 5900
Morwell	03 5133 7744
Newcastle	02 4926 5255
Newcastle East	02 4032 4400
Nowra	02 4422 1877
Parramatta – George St	02 9635 5305
Parramatta – McNamara	02 9633 9044
Parramatta – North	02 8843 0677
Parramatta – PCU	02 9841 8207
Penrith	02 4721 5800
Perth	08 9221 7566
Perth – King St	08 9481 0501
Port Macquarie	02 6584 5050
Shepparton	03 5821 4711
St Leonards	02 9906 8005
Sunshine Coast	07 5476 0811
Sydney – Maritime Centre	02 8243 6500
Sydney – St Martins Tower	02 8262 4000
Tamworth	02 6701 9100
Toowoomba	07 4638 3611
Townsville	07 4725 2910
Wagga Wagga	02 6931 9744
Whyalla	08 8645 8055
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Carbon tax – a quick summary

The Australian Government has recently unveiled the details of its proposed carbon pricing scheme, commonly called the carbon tax.

The carbon tax is designed to change energy use and encourage investment in clean energy sources such as solar, gas and wind. A flat charge of \$23 per tonne of carbon dioxide (CO₂) emissions will be levied on the top polluters.

The scheme is expected to be legislated through both the lower and upper houses of the Federal Parliament in the second half of 2011 and will commence from 1 July 2012. In 2015, the tax will be replaced with a market based carbon pricing system, referred to as an emissions trading scheme (ETS).

Who will pay the tax?

Only the nation's top 500 polluters will pay for their carbon emissions and fuel will be excluded from the scheme. In total, 0.02 per cent of Australia's three million businesses will be taxed, a total of sixty thousand businesses.

Some industries, however, will be exempt from paying the tax including

- ▶ fuel suppliers and distributors
- ▶ companies emitting synthetic greenhouse gases, including the refrigeration and air conditioning industries.

Some high-polluting industries – such as coal miners and steelmakers – will also be given funding to help them transition to cleaner energy practices.

How will this affect households?

Ninety per cent of households will be compensated in some way, with seventy per cent fully compensated either through tax cuts or increases to family payments. Age pensioners will receive a higher pension, in line with the cost of living increases.

Impact on the Australian stock market

The carbon pricing scheme is not expected to have a material impact on the earnings of listed companies in the short to medium term. However, over the longer term the tax will encourage companies to adjust their assets to be more carbon efficient.

Analysts estimate the impact of the carbon price on aggregate earnings of ASX200, Australia's top 200 listed companies, will be less than 0.5 per cent. The most affected stocks will be steelmakers, building products companies and utilities, however the companies from these industries will receive Government assistance over the next few years so that the impact on their profit will be insignificant.

Our analysis suggests that the average earnings impact is negative 1.1 per cent pa over the first three years of the proposed carbon pricing. However, it will be important for these companies to adjust their business models for the longer term when the Government's funding for those high-polluting industries will no longer be available.

Some companies will be able to pass on higher costs to customers, but it will vary from sector to sector. Companies in generally highly competitive consumer sectors will be limited to how much they can pass on and will have to bear the costs themselves, or reduce their carbon emissions.



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