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AUSTRALASIAN INVESTMENT REVIEW

**285**



**HOW HIGH  
FOR THE  
AUSSIE?**

**> Growth, interest rates heading up, together**



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**AUSTRALASIAN INVESTMENT REVIEW**

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#TWO HUNDRED AND EIGHTY FIVE

5th March 2010

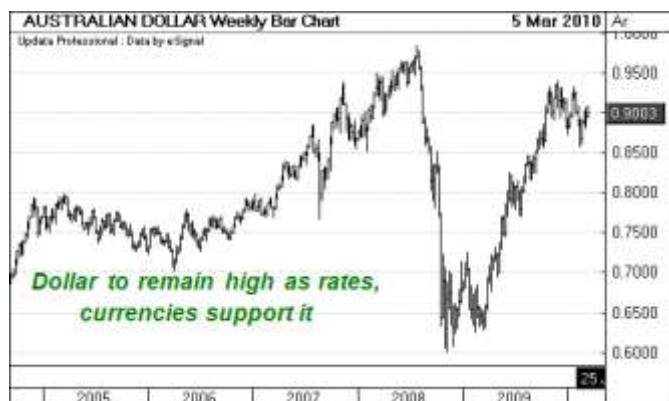
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**Editor's Message**

Iron ore prices to rise, gold prices up, and coal prices up, no wonder the Aussie dollar will remain high for some time to come. Of course businesses should be aware that the dollar's strength will continue to clip export income and make imports cheaper. With interest rates on the rise, the dollar's strength is further underwritten for 2010. And the Indian budget is good news for Australia because the country is our fastest growing export market, or was until the GFC. Now growth is forecast to rise strongly in the coming year.

## Dollar To Stay Strong, Then Sag



As risk worries have eased this week, the Australian dollar regained the 90 US cent mark, trading in a 2 cent range over the past few days.

It was another week and another series of ups and downs in the value of the dollar; it's all really ho hum these days.

Of course, if the dollar was to slump then there would be an outbreak of

commentary about drop, most of which would be meaningless.

The current interest is whether the dollar reaches parity with the US currency.

The AMP's Dr Shane Oliver believes that it will in the next few months; a forecast he had on the table now for some months.

This week's interest rate rise and the 4th quarter of 2009 growth figures confirm there's nothing in the economy to undermine the currency, but plenty there to force it higher, especially as resource income rises from April 1 when coal and iron ore contracts are re-written.

Some sort of resolution of Greek's financial problems would take pressure off the euro, refocus the market on the US dollar, and possibly help the Aussie higher.

The dollar traded around 90 US cents overnight Thursday.

A Commonwealth Bank executive yesterday forecast a cash rate of 5% by the end of the year (the same as the AMP and others) and 5.5% by the end of 2011.

CBA vice-president Madeleine Bertelli told a Committee for Economic Development of Australia briefing yesterday the bank saw the Aussie dollar around 88 US cents by June and 85 cents by the end of this year.

The currency has emerged as THE single most important factor in absorbing the shock from both the surge in 2007-09 in our terms of trade, and then the sharp fall in late 2008 and early last year as the credit crunch hit and recession dragged world growth lower.

Perhaps the biggest impact of the floating dollar has been in the way it has helped ease inflation, as Reserve Bank Deputy Governor, Ric Battellino explained in a speech last month

"In the current episode, with a floating rate, the behaviour of the nominal exchange rate has been very different from the past. It has risen early in the boom and by a large amount. This has been an important factor helping to dissipate inflationary pressures.

"In the 30 years since the previous boom, the Australian economy has developed in ways that should make it better able to accommodate the surge in mining activity that is currently under way.

"The floating exchange rate is a key difference, but goods and labour markets are also more flexible, and the monetary and fiscal policy frameworks are now more soundly based.

"This gives grounds for confidence that we can do better this time, but the task will not be without challenges."

Challenges are always there, this time it's how to manage the returning mining boom without being caught up in an inflationary surge as we were in 2007.

The national accounts also suggest, quite strongly, that growth will accelerate, and rates will rise when the RBA sees the need and fears about the budget deficit and federal debt are overblown.

The AMP's Dr Shane Oliver sees the 2010 budget deficit coming in around \$38 billion and not the \$57.7 billion estimate from Treasury last November.

That will drop the percentage of GDP to around 3.3%, from the 4.5% a lot of forecasters have been using.

If the economy grows at 5% (nominal) or more (that's around 3% real and inflation of around 2%-2.5%) and the government holds spending to 2% real, then the deficit will be cut again in 2010-11, especially with a surge in taxes expected.

Commodity export revenue is projected to rise by \$27 billion next financial year: the terms of trade have already bounced back sharply, rising 4% in two quarters after falling around 16% in the space of nine months.

All this is positive for the dollar, and means a host of companies that have had revenue and earnings clipped, face continuing pressure over the next year or so.

In its March commodity outlook, the Australian Bureau of Agricultural and Resource Economics (ABARE) projected the Aussie dollar to trade around 88 US cents for the near future.

"The Australian dollar appreciated significantly both against the US dollar and on a trade weighted basis during the second half of 2009, before a partial reversal in early 2010," ABARE said.

"For the first eight months of 2009-10, the Australian dollar is estimated to average around US88c and TWI 68. This compares with US75c and TWI 60 in 2008-09.

"The recent appreciation of the Australian dollar appears to reflect a number of factors, including the improved outlook for global economic recovery, robust economic performance of Australia's major trading partners in emerging Asia, particularly China, and stronger growth in the Australian economy relative to other major OECD economies.

"Changes in financial market sentiment toward the US dollar appear to have also affected the recent movements in the Australian exchange rate.

"As the world economic outlook improved, financial market sentiment toward the US dollar as a safe haven appears to have retreated and weighed on the value of the US dollar, which has been declining against many other major international floating currencies.

"In the short term, the value of the Australian dollar is assumed to remain relatively high.

"There are a number of reasons underpinning this assessment.

"First, the assumed global economic recovery in 2010 and 2011 is expected to provide strong support for the demand for mineral resources and, hence, Australia's minerals and energy exports.

"Second, Australian interest rates may rise more rapidly in the short term than in other major OECD economies given Australia's advanced stage of the economic recovery.

"Australia's prime lending rates are assumed to average 6.5 per cent in 2010-11 and 6.8 per cent in 2011-12, compared with an estimated 6 per cent in 2009-10.

"Looking beyond the short term, there is a strong possibility that the value of the Australian dollar could ease gradually from the current highs.

"This would especially be the case if economic recovery in other major OECD economies, particularly the United States, gathers pace, leading to an improvement in their fiscal position and higher domestic interest rates.

"By that time, financial market sentiment toward the US dollar could also strengthen, which would place some downward pressure on the value of the Australian dollar.

"Taking the above into account, the Australian dollar is assumed to average around US88c and TWI 69 in 2009-10 and US88c and TWI 69 in 2010-11, before moderating gradually to an average of US80c and TWI 62 by 2014-15."

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## Iron Ore Talks See 50% Price Rise On The Table

The 2010 iron ore contract talks are settling down to the tough stuff, with Chinese media leaks and reports claiming that Rio Tinto and Vale of Brazil, want steelmakers in Asia to pay 50% more, and BHP Billiton asking the mills to lift their spot purchases.

The claims were detailed on the China Daily website yesterday. The companies have made the offers to Japanese steel mills.



The China Daily said the lead Chinese negotiator, Baosteel Group Corp, will wait to see how Japanese and South Korean steelmakers react to the price offers before deciding on a stance (which it will reach after talking to the government).

Bloomberg reported this week that the Japanese investment house Nomura says Vale, Rio and BHP, the three biggest iron ore producers, may win price rises of up to 70% in the talks for the 2010 contract year starting April 1.

Other brokers in Australia last night were talking about 80% price rises.

That would take contract prices, presently \$US61 a tonne, close to the current spot prices of over \$US130 a tonne (no freight in either price). The freight component of the spot price is around \$US10 a tonne ex Port Headland and Dampier for China).

China Daily said that Rio wants a 50% increase on the benchmark price, which was a cut of 33% on average for lump ore and fines with the Japanese mills.

BHP wants the mills to take more at spot prices and Vale was a 50% increase based on the difference between the spot price and the benchmark price.

Current financial year shipments into China are priced at either the benchmark price established with the Japanese mills (China wanted a 45% price cut, but the big three refused) or spot prices.

Chinese iron ore purchases jumped sharply in the last half of 2009 as steel production and demand rose. Over all of 2009, China lifted iron ore imports 42% to 628 million tonnes.

Chinese steel mills are forecasting an 8.6% increase in output this year to 621.5 million tonnes.

Chinese iron ore exports fell to around 46 million tonnes in January after a jump in November and December ahead of the winter and Chinese New Year in February.

That forced the Chinese mills to pay a lot more for ore because the extra tonnage was priced at spot levels which rose to over \$US100 a tonne.

This week the spot price hit around \$US130 a tonne (or \$US140 a tonne including freight).

That's more than double the current spot price.

In its first estimate for 2010 for commodity prices and exports this week, ABARE said that "export earnings from iron ore are forecast to decline by 15 per cent to \$29 billion.

"Like metallurgical coal, this is primarily a reflection of a sharp decline in contract prices in JFY 2009, partially offset by a 21 per cent increase in export volumes.

"Export earnings in 2010-11 are forecast to increase by 21 per cent to \$35 billion, which reflects assumed higher contract prices for JFY 2010."

Hard coking coal (the best quality) could jump from around \$US125 a tonne to close to \$US200 a tonne in the new contracts because of a continuing shortage of coal in Asian markets at the moment.

"Over the medium term, the value of iron ore exports is projected to increase by 4 per cent a year, to reach \$43 billion (2009-10 dollars) in 2014-15.

"The main driver underpinning this increase is higher export volumes, while real contract prices are assumed to ease toward the end of the outlook period."

ABARE said Australian exports of iron ore are projected to increase at an average annual rate of 7% over the outlook period to 2015.

By then "Australia's iron ore exports are projected to account for 42 per cent of world trade, as several large projects scheduled for completion during the period are expected to meet the projected demand growth.

"In addition to BHP Billiton's Rapid Growth Project 4 (additional 26 million tonne annual capacity) completed in late 2009, several large projects are scheduled for completion in 2010.



"Rio Tinto is scheduled to complete the Mesa A (25 million tonne capacity) and Hamersley Iron Brockman 4 (22 million tonnes) projects, CITIC Pacific Mining is scheduled to complete the Sino Iron project (28 million tonnes), and Fortescue Metals Group is scheduled to complete the Christmas Creek project (16 million tonnes).

"Furthermore, completion of BHP Billiton's Rapid Growth Project 5 (45 million tonnes) is scheduled for 2011.

"Although the full capacity of these projects is not expected to be utilised until the second half of the outlook period, the combined effect of these projects will support export growth in the short and medium term."

BHP and Rio shares had a solid day yesterday. BHP finished up 61 cents at \$42.28, and Rio shares rose 53c to \$74.40.

## Gold Prices To Rise This Year and in 2011?

A week ago we gave you the thinking of the World Gold Council on the outlook for gold in the coming year.

This week, it's the turn of ABARE, the federal government's resource forecaster.

It sees production and prices rising this year into 2011, before a price tumble to under \$US900 an ounce in 2012.



Export income will fall this financial year, before rising in 2011.

The extent of the rise and fall will depend on the amount of non-monetary gold imported for processing and then re-exported.

Looking at global production, ABARE said it saw 2009 up 6% to 2553 tonnes, the highest level for six years.

Australian annual gold mine production is projected to be between 266 tonnes and 276 tonnes until the end of the outlook period in 2015.

Newmont's Boddington mine is a major reason for the higher production, but it will be supported by a host of smaller companies and their projects.

The biggest influence on gold prices will be the huge deficits and debts in major economies like the US and Europe, and the growth path of the global economy in the next couple of years.

ABARE says Australian production may rise 11% in the June 30 financial year, 10% in the 2011 financial year and a further 2% in 2012.

"The start up of the Newmont's \$3 billion Boddington redevelopment is expected to be the largest contributor to this growth," the bureau said this week in its March commodity outlook.

"Australian gold mine production is forecast to increase by 11 per cent to 242 tonnes in 2009-10. Supporting this growth is the start-up of Newmont's \$3 billion Boddington development in Western Australia, which is expected to produce around 31 tonnes a year over the first five years of its operation.

"Also contributing to this rise is the increase to full capacity of several medium-sized projects including Apex Minerals' Wiluna redevelopment, Avoca's Higginsville project (each 6 tonnes a year) and OzMinerals' Prominent Hill mine (2 to 3 tonnes a year).

"In 2010-11, Australian gold production is forecast to increase by 10 per cent to 267 tonnes.

"The ramp-up of the Boddington redevelopment is expected to be the largest contributor to this growth; however, a number of new projects are also expected to begin production.

"These include the recommencement, under new owners, of Crocodile Gold's Northern Territory tenements (6 tonnes a year) and Swan Gold Mining's Mt Ida and Carnegie projects (3 tonnes a year). Also contributing to growth are Citigold's Charters Tower's operation (increasing to 9 tonnes a year by 2013), St Barbara's Gwalia Deeps (increasing to 6 tonnes a year by 2012), Saracen Minerals' South Laverton operations (3 to 4 tonnes a year) and Newcrest's Ridgeway Deeps project (6 tonnes a year).

"In 2010-11, higher Australian gold mine production is projected to lead to export volumes rising by 19 per cent to 449 tonnes.

"Relatively stable Australian gold mine production and the expectation of continued refining of overseas sourced gold is projected to result in the quantity of Australian gold exports remaining at between 460 and 475 tonnes a year for the remainder of the outlook period." (2014-2015).

ABARE said it saw the value of Australian gold exports falling 9% to \$14.7 billion in 2009-10. In 2010-11, stronger export volumes are projected to result in the value of Australian gold exports rising to \$16.7 billion.

"In 2011-12 and 2012-13, the value of Australia's gold exports (in 2009-10 dollars) is projected to fall to between \$14 billion and \$15 billion as the gold price falls.

"However, by 2014-15, the real value of Australia's exports is projected to return to around \$16 billion, which reflects a strengthening of export volumes and prices."

ABARE said it could see a further rise in Australian output in the period from 2013 onwards.

"There are a number of mines scheduled to be in operation in the second half of the outlook period. These include Newcrest's Cadia East underground project (producing 22 tonnes a year by 2013) and AngloGold Ashanti/ Independence Group's Tropicana Joint Venture project (10 to 13 tonnes from 2013).

"Offsetting the increased production from these new mines is lower production from existing mines which are close to exhausting gold reserves," ABARE said.

In 2010 the gold price is forecast to rise by 11% to average \$US1080 an ounce, ABARE forecast.

"Uncertainty surrounding the pace of global economic recovery is expected to sustain the investment appeal of gold and continued weakness in the US dollar in the short term is expected to increase gold demand.

"Also influencing gold demand in 2010 is the continuation of expansionary monetary and fiscal policy in the United States, which is likely to place downward pressure on the global demand for US Treasury bonds in favour of other low-risk assets such as gold.

"In 2011, the gold price is forecast to fall by 11 per cent to US\$960 an ounce.

"The assumption of an ongoing recovery in world economic growth is forecast to lead to a reduction in speculative investment demand for gold.

"Similarly, as the appetite for higher risk assets such as shares and property increases, investment demand for retail gold, such as gold bars and coins, is forecast to moderate.

"As world economic growth returns to levels which are more consistent with its longer term potential, further falls in investment demand in 2012 are projected to lead to an 11 per cent fall in the price, in real terms, to around US\$840 an ounce.

"Between 2013 and 2015, the real gold price is projected to increase moderately, rising from US\$834 an ounce in 2013 to US\$880 an ounce in 2015."

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## Indian Budget Accepted By Markets

A week on from the release of the 2010-11 Indian budget, the country seems to have survived any test of confidence in the country's prospects with the usual collection of bears, worriers, etc more focused on the tribulations of Greece than India.

Central to this acceptance was the government commitment to cutting its budget deficit over the next two years, while maintaining a fairly tight hold on spending.

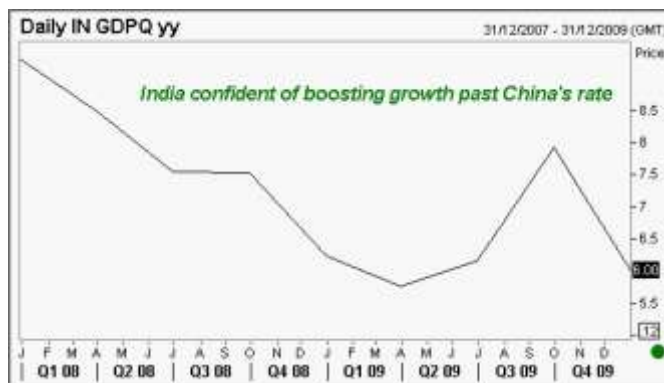
At the same time it's committed to quickening the pace of economic growth to more than 9% in the coming year, a bull point for Australian companies investing in India, such as Woolworths and the ANZ Bank.

The government is aiming to wind back some of its stimulus spending (and the Reserve Bank of India will add its own bit soon with an interest rate rise, according to commentators in Mumbai).

But some spending plans will remain in place.

The government aims to cut its budget deficit to 5.5% of gross domestic product for the year that starts April 1 - against the 6.9% estimate for the 2010 year.

A further cut to 4.8% of GDP the following year, was also revealed in the budget.



Growth is projected to rise to around 8.5% next financial year from an estimated 6.9% for the year ending March 31.

Growth fell to 6% (annualised) in the third quarter thanks to weaker agricultural output.

But the government is planning to boost spending 8% in the new financial year to a total of 11.08 trillion rupees (around \$US280 billion) and there's some scepticism the budget cuts can be achieved.

Government borrowing has been set at 4.57 trillion rupees (\$US100 billion) against this year's record 4.51 trillion rupees.

While the borrowing and spending remains flexible and controllable with a bit of political will and guts, inflation remains something that India still has trouble controlling.

It has been a major concern for the government and the central bank, thanks in part to the failure of last year's monsoon.

A return of the rains later this year will go a long way to cutting a lot of momentum from price pressures in the closing months of 2010.

India's headline inflation rate rose to 8.56% in January from a year earlier, while wholesale food prices rose 17.58% (in the week ended February 13) with food prices leading the way.

An immediate worry for inflation is the impact of the budget measure to increase fuel taxes.

The move to levy an excise duty of one rupee per litre on petrol and diesel has already led to a hike in fuel prices, which will add to price pressures.

The bottom line of the change was that the government raised the price of petrol 6%, and diesel by about 8%.

"Inflation is likely to increase at the faster pace from here on, due to higher fuel prices and higher disposable income (due to the tax reliefs) as indicated in the budget FY11," according to Mumbai-based broker, Khandwala Securities.

"We expect inflation to touch around 10% by next month and remain in double digits for few months."

An imponderable is the reform of taxes for individuals and corporates, with the aim to lower tax for both.

The government has yet to explain how it will do this, while managing to keep a lid on spending and cut the deficit.

The tax cuts will have to be balanced by spending cuts (obviously not happening in a budget where outlays are projected to rise 8%) or by higher revenues from tax increases.

Brokers say the rise in fuel taxes could finance a cut in individual and corporate tax.

In his budget speech, Finance Minister Pranab Mukherjee, said the "symptoms of economic recovery are more widespread now.

"The improvement of the economy encourages a course of fiscal correction."

He set a target for India of becoming the world's fastest-growing economy within four years, surpassing China.

He told the [Financial Times overnight](#) that India can reach its goal of 10% annual economic growth even if the Congress party-led government fails to implement pressing structural reform.

He told the paper that the lack of a parliamentary majority for the Congress party was an obstacle to moves such as raising the cap on foreign investment in the pension and insurance sectors and steps to improve governance.

"We will be going [to 10 per cent] because of the steps which we have taken," Mr Mukherjee told the FT.

India's annual Economic Survey (prepared by officials advising Mukherjee) was released a day before the budget was delivered and said "it is entirely possible for India to move into the rarefied domain of double-digit growth and even attempt to don the mantle of the fastest-growing economy in the world within the next four years".

India has averaged GDP growth of 7% over the decade ending last December, against China's 9.1%.

The report said India's \$US1.2 trillion economy may "breach" a 9% growth pace by March 2012.

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## Linc's Bullish Coal Comments



Shares in Linc Energy jumped 10% and more yesterday at one stage after a bullish update on its Queensland coal interests.

The shares closed up 5.4% at \$1.56, a rise of 8c.

The sharp rise handed a 20c a share profit to some US people who were paid Linc shares at \$1.44 each for their stakes

in coal leases in the US state of Wyoming.

Linc wrapped up that purchase, announced on Christmas Eve last year, yesterday.

In its [main announcement](#) Linc said its planned sale of coal tenements at Emerald, Pentland and Galilee in Queensland was "progressing albeit more slowly than hoped".

It also revealed details of possible mining plans (and one "third party" valuation of one prospect) that it commissioned, perhaps to impress on the market the value of the prospects.

One of the mining plans came from an outside consultant, and two other 'plans' were the company's internal estimates.

It claimed the three prospects could support annual output of more than 36 million tonnes a year of soft coking or thermal coal.

Linc claimed that one prospect, the Galilee area, could see production of 30 million tonnes of thermal coal a year.

"The Company continues to pursue sale outcomes that reflect full and fair value for these high quality assets on behalf of its shareholders. Discussions and negotiations are continuing with a number of overseas interests and Australian based mining houses.

"The interested parties are in some cases negotiating to buy all three assets and in other cases individual assets.

"Some of these negotiations are at a very advanced stage. A written offer for the purchase of all three coal assets has been received from one party and whilst negotiations with that party are now at a very advanced stage, the Company is continuing to progress all potential avenues until a sale(s) is realised.

"The Linc Energy board has insisted that a sizable deposit accompany any signed sale agreement. Accordingly, a considerable amount of time has been spent working through these financial details from the buyers' side to ensure that ultimately the Company achieves a smooth and successful transaction that serves all parties."

Linc said it commissioned Brisbane-based MineCraft Consulting to complete a Conceptual Mine Development Study for the Theresa (Emerald) resource.

"The study identified a high value underground longwall mine development option yielding 3.8 Mtpa of product coal over a 30 year life of the mine study with approximately 2.5 million tonnes/annum of semi-soft coking coal being produced and 1.3 million tonnes of good quality thermal coal production per annum.

"MineCraft was asked to provide a third party determination of the value of the Theresa resource based on the proposed mine development and their assessment of long-term coal pricing. The conservative central case valuation of the project/asset was estimated by MineCraft to be A\$529M (Australian dollar net present value).

"A similar conceptual mine plan is currently being completed on the Galilee tenement by Xenith Consulting however Linc Energy's own modeling currently suggests a very cost effective long life open cut strip mine, producing 30 million tonnes per annum of low sulphur very good quality thermal coal with strip ratios commencing at approximately 2.5:1.

"The indicative NPV from Linc Energy's own modeling has the valuation at over A\$1 billion (including an allowance for infrastructure, investment into railways etc). Linc Energy will complete a third party valuation at the same time as it completes its conceptual mine plan study.

"The Company has also had a conceptual mine plan study (inclusive from mine face to port) completed by Xenith Consulting for the Pentland tenement.

"The plan shows approximately 3 million tonnes per annum of thermal coal suitable for open cut extraction.

"Pentland is the smallest of the three coal assets both in size, tonnage and opportunity but the Company believes that it remains a good hedge against rising thermal coal prices and has good prospects of a relatively fast commencement of operations.

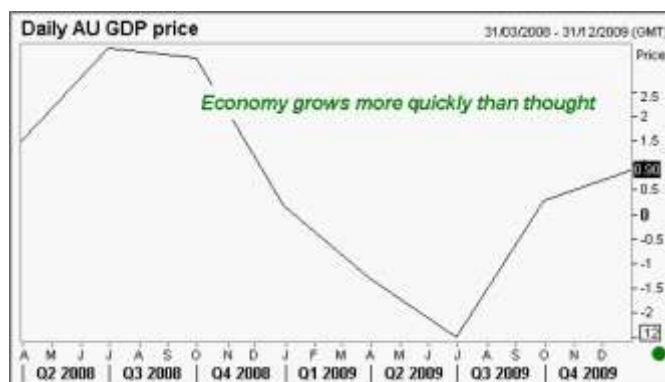
"Whilst it is not possible to state when the coal sales will be completed, Linc Energy remains locked in negotiations to complete a sale that the Company believes will realise very good value based on continuing levels of interest and the continued strong market demand for thermal and metallurgical coals."

## Growth 1: More To Come

2000 turned out to be quite a good year for Australia, much, much better than we all thought a year ago.

2010 looks like turning out to be better.

The solid 4th quarter economic [growth figures](#) from the Australian Bureau of Statistics revealed the extent of the improvement over the year.



The ABS reported yesterday that the economy grew 0.9% in the December quarter, just above where many market forecasts sat, and 2.7% for 2009. Non-farm GDP grew 2.5% over the year.

Both were higher than the Reserve Bank estimate of 2% and 2.25% respectively in the first set of forecasts for 2010, issued last month.

A year ago though, the central bank forecast growth of just 0.5% for the year, a forecast which many analysts rejected as the Australian economy was buffeted by the global crisis and credit crunch.

For the year GDP reached \$1.2 trillion, or \$55,103 for every Australian man, woman and child.

That's the highest ever, unlike many other countries whose GDP is still under 2008 or 2007 levels.

In another positive, growth in the September quarter was revised up to 0.3%, up from the first estimate of 0.2%.

That made Australia the best performing major western economy in 2009, while growth in the final quarter was better than Europe (Germany and the UK especially).

US growth in the 4th quarter was around 1.4% (5.9% annualised) but that was driven by heavy stock rebuilding and government spending.

Growth in China was faster, around 2.7% quarter on quarter (10.7% annualised). Japan's was also faster quarter on quarter, but that was from September quarter growth when growth almost collapsed back into the red.

In fact rather than forcing the Reserve Bank to lift rates again, as suggested by many commentators, the growth figures supported the central bank's decision this week to lift rates several more times over the coming year.

This was outlined by RBA Governor, Glenn Stevens in Tuesday's post board meeting statement:

"The Board judges that with growth likely to be close to trend and inflation close to target over the coming year, it is appropriate for interest rates to be closer to average."

The Reserve Bank in fact sees the economy as able to grow on its own, without any need for additional stimulus from an expansionary monetary policy, so rates will rise back to a neutral setting, to allow the expansion to continue at a safe pace.

And if you look at what drove growth in the final quarter, you find further confirmation of the RBA's stance.

There was a 10.2% jump in government investment, a solid 3.5% rise in private investment and a 0.7% rise in consumption by households.

Machinery and equipment spending surged 10.9% in the quarter, adding 0.8 percentage points to GDP. Household spending rose 0.7% and government spending jumped 1.8%.

The rise in machinery and equipment spending and private investment reflect the re-emergence of the mining boom, especially in the December quarter.

Government investment will gradually fall away this year but business investment is projected to increase as the year goes on (the first estimate of business capital spending for 2010-11 is already above \$100 billion, the highest ever).

The central bank sees inflation and wages as being under control, but wants to push rates to a level to try and head off any resource bottlenecks or cost pressures emerging under pressure from the growing mining boom.

Growth in the expenditure measure of GDP was driven by a 3.5% increase in private investment, a 10.2% increase in public investment and a 0.7% increase in household expenditure.

Offsetting these increases was a fall in net exports. That was due to imports (up 7.7%) growing faster than exports (up 1.7%).

The ABS said that "In seasonally adjusted terms, during the December quarter, real gross domestic income increased by 1.5%, while the volume measure of GDP increased by 0.9%, reflecting an increase of 2.9% in the Terms of trade, 1.1% in the September quarter. (Terms of trade fell 11.2% over 2009).

"That improvement in the terms of trade will grow in coming months as higher prices (and volumes) for iron ore and coal are reported by exporters from contract talks with Asian buyers.

"The industries that provided the main contribution to growth in the production measure of GDP in the December quarter were manufacturing with a 5.1% increase in seasonally adjusted volume terms and wholesale trade with a 3.6% increase in seasonally adjusted volume terms," the ABS said.

NSW grew 2.4% for the year, WA 2.6%, Victoria 3%, Qld 1.3%, South Australia 0.6% and Tasmania 1.6%.

## MODEL PORTFOLIOS

1

**The Fat Prophets Mining and Resources Model Portfolio**, a diversified portfolio of large and small companies listed on the Australian Stock Exchange with operations in an array of sectors such as mining, metals and commodities.

2


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## Growth 2: Earnings Solid, Dollar To Remain High



The AMP's chief economist, Dr Shane Oliver, says that as we approach the one year anniversary of the bear market low in shares (Australian shares bottomed on March 6, 2009 and US shares bottomed on March 9) things are vastly different; the economy is much stronger than expected and corporate profits are recovering solidly.

He said the reporting season wrapped up this week with some encouraging signs:

In terms of net positive surprises the reporting season just ended in Australia is the strongest since August 2007.

Profits have now bottomed and with the economy picking up pace and costs well and truly under control profits are likely to rise by around 20% over the next year.

The upswing in the global profit cycle is pretty much a global phenomenon, albeit most evident in Asia and the US.

As a result of the recent correction in shares and upwards revisions to earnings expectations shares are now slightly cheap.

Stronger earnings are likely to be a key antidote to worries about sovereign debt and monetary tightening in some countries this year.

Australia's December quarter GDP came in slightly stronger than expected, with growth of 0.9% in the quarter which, combined with upwards revisions to growth in the previous two quarters, resulted in growth over the year to the December quarter of 2.7%.

This is the strongest pace since March 2008. While the impact of fiscal stimulus was clearly evident in strong public investment, private sector spending is also strong, particularly in terms of business investment.

Net exports detracted from growth

There are several points to note.

First, Australia's growth performance remains stellar compared to other advanced countries - Australia's growth of 2.7% through 2009 compares to just 0.1% growth in the US, a 0.4% contraction in Japan, and a 2.1% contraction in the euro-zone and a 3.3% contraction in the UK .

Second, the Australian economy has turned the corner on the GFC-inspired slowdown.

Our leading growth indicator is pointing to growth accelerating to at least 4% by the end of this year with business investment, housing construction, public investment, consumer spending and the boost to national income from higher export prices all likely to be key drivers.

Thirdly, the upswing in Australian economic growth is coming in much faster than anticipated by both the RBA and the government.

For example, the most recent forecasts from the RBA were for growth of 1.75% through 2009 and the federal government's mid year economic forecasts from last November also implied growth of around 1.7% though last year, whereas the outcome has been 2.7%.

The strength in growth is consistent with more interest rate hikes ahead, a much lower than projected federal budget deficit for 2009-10 (probably more like \$38bn than the government's recent projection of \$57.7bn) and increasing pressure on the federal government to tighten fiscal policy.

Finally, the strength in growth is positive for profits and hence Australian shares and will help underpin further gains in the Australian dollar.

Our year end forecast for the Australian share market remains 5600 and we still see the \$A breaching parity against the \$US some time in the next six to 12 months.

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## **Global Car Sales Weakened Last month**

Car sales in the US, Germany and Italy stalled last month, a situation that could put further pressure on embattled manufacturers if it continues, and on beleaguered economies as well.

Government stimulus moves have helped car sales and production recover in the US, Germany, Italy and the rest of Europe, plus Japan over 2009.

That helped pull the respective economies from the crunch.

But in Germany, the car scrappage scheme ended and German production and growth stalled in the final quarter.

The fear is that now, with the impact of cold snowy weather across much of Europe and the US since January, there will be further downward pressure on sales and production and on economic growth.

US car sales stalled in February, thanks to the snow, the safety problems at Toyota and continuing weak personal demand. Strong sales to car rental fleets helped boost output, especially at Ford, which went into the industry's top spot for the first time since 1998.

To battle a drop in sales, Toyota said that it would attempt to win back consumers with unprecedented discounts including zero-percent financing for five years on top-selling models like the Camry.

General Motors also announced new buyer incentives on leftover 2009 and some new 2010 models as its sales growth dawdled.

Industry-wide sales for February were flat from the depressed sales rate of 2009.

Industry-wide US sales were 10.38 million vehicles, according to industry watcher Autodata.

That's down from the 10.8 million rate in January.

Sales dropped to 10.4 million units in 2009, the worst performance in 27 years.

The weak auto figures add to emerging concerns that the US economic recovery could stumble in the second half of the year if spending remains lackluster. Consumer spending is considered the key to recovery because it accounts for roughly two-thirds of economic activity.

But analysts blame a combination of the snow storms in the East, parts of the Midwest and South, plus the problems and recalls at Toyota for the slide.

They say they expect sales to rebound in March.

Toyota's US sales dropped almost 9% in February from an already-low level a year earlier in the depths of the economic crisis.

The decline was led by a drop of nearly 20% for Toyota's top-selling Camry sedan.

Ford's US sales rose 43%, with sales to rental companies up 175%.

GM saw sales rise nearly 12%, Chrysler lifted sales 1% (it had been forecast to experience a fall).

GM was forced to recall 1.3 million vehicles yesterday to fix a fault it claimed originated in parts made by a supplier to it and Toyota.

Nissan saw sales rise 29%; Honda 12% and Hyundai Motor 11%. These rises however were less than forecast by industry analysts.

Late yesterday Nissan said it will recall nearly 540,000 vehicles worldwide, most of them in the United States, due to brake pedal defects and faulty fuel gauges.

Nissan said in a statement it plans "to inspect and, if necessary, repair brake pedal pins and fuel-gauge components on certain trucks and minivans."

In Europe, France, Italy and Spain for February car sales reported reasonably solid sales.

German sales fell 30% from a year ago, when sales hit a decade high as the car scrappage scheme kicked in.

France, Italy and Spain have maintained their car scrappage schemes in to 2010, while Germany's finished late last year and sales have been falling every since.

France will retain its scheme this year, Italy's ends soon and the Italian industry group forecasts a "Black Spring" with sales down 20% to 30%.

Italian sales fell last month, but even bigger falls are seen once the government support is finished in a few months.

Spain is keeping its program in place; it has no other option, the economy is still in recession and the government doesn't want more unemployed car workers pushing the jobless rate past 20%.

## But Local Car Sales Up

It was a far more positive story in Australia where industry figures showed the number of cars shipped to dealers rose in both February 2009 and January of this year.

The rise for on February last year was expected: a year ago sales were falling when buyers pulled their horns in as the economy was hit by the GFC, the credit crunch and falling confidence.



Thanks to slowly recovering confidence and helped by tax breaks for small and medium business from the federal government, car sales recovered well last year.

Hyundai saw a rise in sales and it reached third place in the list of top sellers, a sign of solid demand from private buyers who rose from a year ago.

Sales to rental fleets rose sharply, as did sales to business.

Both had been mostly excluded from the tax breaks of last year which were aimed at small and medium business.

The 2.7% rise in growth in 2009 and 0.9% in the final quarter, confirmed that not only had demand recovered in Australia, but the economy was now more responsive to it than stimulus spending.

The car sales figures for February proved that by being higher than January, showing little evidence of a fall off caused by the pull forward of demand by those tax breaks which boosted sales in 2009.

Figures yesterday from the [Federal Chamber of Automotive Industries](#) (FAI) show a 17.1% rise in February, compared with a year ago, as both business and private buyers returned to the market.

There were 82,219 passenger cars, sport utility vehicles (SUVs) and commercial vehicles sold in February, according to the Chamber's figures.

Compared to January, there was a rise of nearly 10%, or more than 7,300 units in February, a good sign that demand had not been soaked up by the tax break induced jump in sales from June onwards.

"This is a very strong result and provides further evidence of renewed growth in vehicle sales," FCAI chief executive Andrew McKellar said in a statement.

"The number of private buyers rose 9.3% in February, compared with a year ago, while business sales increased 22.7% and the number of vehicles sold to rental companies was up 175% (similar to the US).

"It is encouraging to see private buyers edging back into the market following the financial concerns of the past year," Mr McKellar said.

"Looking ahead, sustaining the confidence of private buyers is the key challenge for the economy.

"For that reason we continue to be cautious about the impact of interest rate increases."

Troubled Toyota had the largest market share in February at 20.5%, followed by Holden at 13.6%. Hyundai, which came in third for the first time, had 8.8%.

## New Oil and Gas Services Float



Macquarie Group is looking to float oil and gas services firm Miclyn Express Offshore in an initial public offering that could raise up to \$365 million.

The proposed float is a play on the growth prospects of Asian oil and gas prospects, especially in and around Australia.

The company said yesterday it plans to offer about 160 million shares ranging from \$1.85 to \$2.30 apiece.

Macquarie Group plans to keep at least 30% of the shares following the completion of the offer.

The float is another step into the resources servicing business by Macquarie and one of its investments.

For some investors the float recalls the Boart Longyear float a few years ago from Macquarie.

Boart Longyear was a drilling and mining services contractor; Miclyn is different in that it services the offshore oil and gas sector, and is being floated at a far different time in the business cycle.

The company says it aims to meet rising demand from the oil and gas industry as more projects proceed off the coasts of countries such as Australia.

Miclyn said it plans to expand its fleet, pursue "growth opportunities" and pay down debt.

"The Offer comprises a retail offer and an institutional offer and Miclyn Express Offshore will issue up to approximately 159.6 million Shares.

"The Offer represents 59% of the total Shares in Miclyn Express Offshore, with the remaining 41% to be held by the existing shareholders and management on completion of the Offer.

"Post listing, Miclyn Express Offshore will have a market capitalisation of approximately A\$502.0 million – A\$623.7 million (based on the midpoint of the Indicative Price Range)," the company said in a statement on its website.

"The Offer will enable Miclyn Express Offshore to purchase MEO Finance Company Limited (the company that currently owns the Miclyn Express Offshore business) and 50% of Samson Maritime.

"Funds raised under the Offer will be used to pay a portion of Miclyn Express Offshore's debt balance, pay break fees on related interest rate hedging arrangements, pay its portion of Offer costs and establish a capital structure to pursue growth opportunities."

Miclyn said it will seek to list on the Australian stock exchange by April 6.

The company provides offshore ship and barge services to the energy industry across Southeast Asia, Australia and Middle East.

Its big competitor is [Mermaid Marine Australia](#).

"The Group charters a diverse range of OSVs, Crew/Utility Vessels, Barges and Coastal Survey Vessels to a wide range of customers operating across all phases of the offshore oil and gas cycle, namely: exploration, development and production," the company says on its website.

"Vessel Chartering is Miclyn Express Offshore's primary business and accounted for 98.5% of the Group's FY2009 revenues.

"Miclyn Express Offshore has a strong local presence in many of its markets with access to support centres in Indonesia, Saudi Arabia, Thailand and the UAE and joint ventures and agency agreements in Thailand, Indonesia and Saudi Arabia.

"Miclyn Express Offshore also provides chartering services to the marine civil construction industry, in particular providing Barges to support major projects for customers including Marine & Civil and John Holland in Australia.

"The Group operates a vertically integrated business model through its Vessel Chartering and Shipyard businesses.

"The Shipyard provides in-house vessel Newbuilding, conversion, repair and maintenance services, as well as third party vessel conversion, repair and maintenance services when spare capacity exists.

"The Shipyard is strategically located in Batam, Indonesia, approximately 20km off the coast of Singapore, providing the Group with a competitive cost and time advantage and enabling it to utilise the Shipyard as a berthing base for its fleet deployed in South-East Asia."

Macquarie plans to cut its stake in Miclyn to 30% from 59% while Ray Rider, an entity connected to Miclyn's founder, will cut its stake to 10% from 40%.

The company's top two managers will retain the 1% they already own.

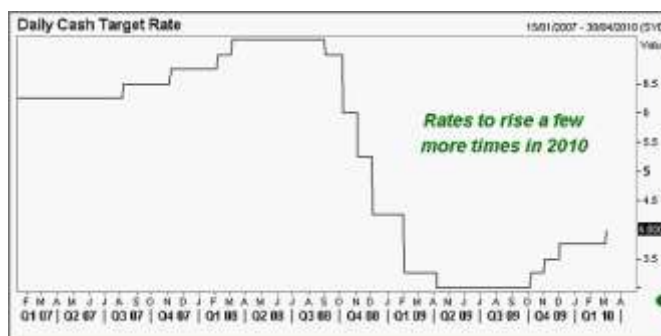
Macquarie Capital, JP Morgan and Morgan Stanley are joint lead managers on the offer.

## Rates Up, More Will Follow

Interest rates will continue heading higher in 2010.

The Reserve Bank yesterday lifted Interest rates 0.25% to 4%, still below what economists called 'trend', or neutral.

The Reserve Bank made that clear, in its usual fashion, in yesterday's post-meeting statement.



It described yesterday's decision as "a further step in that process".

If Reserve Bank Governor Glenn Stevens is to be believed, we could have three more increases to go (he told a parliamentary committee last month that it could take another four rate rises to get to where monetary policy was neutral).

Perhaps it might take another four, to 5% (a nice round number).

With nine more meetings of the RBA board and three or four rate rises to be made.

If things go the way the RBA hopes, they could then take a breather for a while in 2011 to see if the economy can handle a cash rate of around 5%, with inflation in the target zone, wages growing moderately, unemployment falling, wages rising nicely and costs not blowing out in resources.

In reading yesterday's statement, the wording of the last two paragraphs seems to have changed somewhat from the February 2 post meeting statement.

### This is what Governor Stevens said yesterday:

"The risk of serious economic contraction in Australia having passed, the Board moved late last year to lessen the degree of monetary stimulus that had been put in place when the outlook appeared to be much weaker. Lenders generally raised rates a little more than the cash rate and most loan rates rose by close to a percentage point.

"Interest rates to most borrowers nonetheless remain lower than average.

"The Board judges that with growth likely to be close to trend and inflation close to target over the coming year, it is appropriate for interest rates to be closer to average.

"Today's decision is a further step in that process."

### Here's what he said on February 2:

"With the risk of [serious economic contraction](#) in Australia having passed, the Board had moved at recent meetings to lessen the degree of monetary stimulus that was put in place when the outlook appeared to be much weaker.

"Lenders have generally raised rates a little more than the cash rate over recent months and most loan rates have risen by close to a percentage point.

"Since information about the early impact of those changes is still limited, the Board judged it appropriate to hold a steady setting of monetary policy for the time being.

**"Interest rates to most borrowers nonetheless remain lower than average. If economic conditions evolve broadly as expected, the Board considers it likely that monetary policy will, over time, need to be adjusted further in order to ensure that inflation remains consistent with the target over the medium term."**

The significant change is in the final paragraph of yesterday's statement (in bold); it's shorter and more direct, indicating the RBA's likely course of action

We will have to wait for the minutes of yesterday's meeting to see if the phrase "finely balanced" is used in connection with this decision.

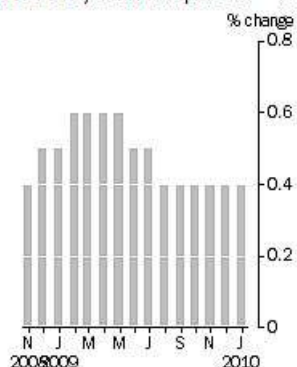
But if anything, the changed wording in the final paragraph suggests the bank now knows its course of action for this year after last month's pause.

All that remains to happen are the rate increases, which won't necessarily happen when we think they will.

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## Retail Sales Up, Building Approvals Mixed

Monthly Turnover, Current prices - Trend estimate



Retail sales were solid; the 1.2% rise in January was again driven by a rise in spending in cafes, takeaway joints and eateries.

Australians obviously have enough money to spend on luxuries like eating out, even if it is coffee.

This group has now being leading the retail recovery for the best part of a year or more.

Food, department stores, clothes and household goods were also sold, while sales were up in WA, NSW, Victoria and South Australia, down in Tasmania, steady in Queensland.

The market had been expecting a rise of half a per cent.

Building approvals was a bit of a surprise on the surface.

The 7% fall followed four months of rises.

Approvals for private sector houses rose 0.3%, and the usual lumpy nature of non private dwellings showed up with a 21.9% drop in approvals for apartments, units and townhouses.

It and private sector houses had had two months of rises.

Obviously the councils were slow in January, or the banks were unusually tough in extending credit to developers.

The market had been expecting a 1% fall, a bit of an under-estimate.

Going on the score so far of 2010 financial information, the January employment data was strong, with the rate down to 5.3%, retail sales are OK, private housing also OK, new home sales were up 9.5% in January, according to the Housing Industry Association, and business conditions seem to be on the up with the manufacturing sector seeing growth.

Confidence is still solid. Job ads were weak in January, but its early days. Ad revenues in TV and radio are improving and newspapers report stronger demand from advertisers.

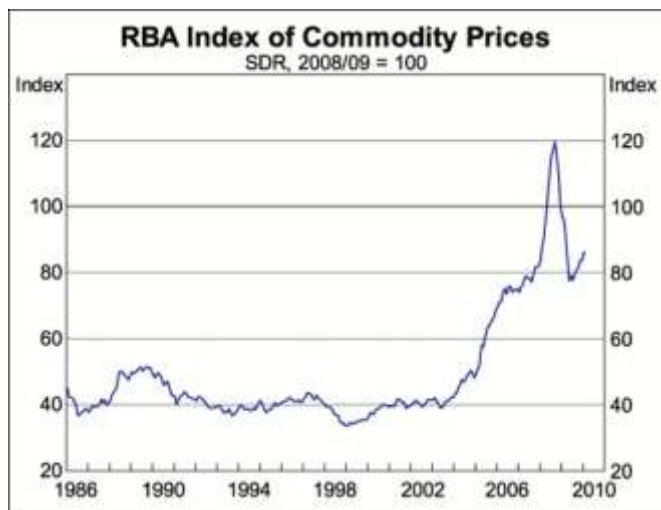
In short the economy is now growing under its own steam.

## ABARE Sees 2011 Resources Surge

Australia's commodity boom keeps growing in strength.

After being halted by the credit crunch and recession in 2008-09, it is returning, as the latest monthly commodity price index from the Reserve Bank shows us, with a solid rise now underway for the past three to four months.

And [figures yesterday](#) from ABARE (Australian Bureau of Agricultural and Resource Economics) confirm the rebound, with a 15% rise in commodity export income forecast for the 2011 financial year.



ABARE commodity export income in the 2010-11 year hitting \$186.8 billion, up from the \$162.5 billion in the year to June 2010.

The 2011 figure will be within sight of the record \$197.45 billion achieved in 2008-09.

Next year's forecast total will be the second highest on record and will see an estimated \$24 billion in extra income flowing into the economy.

A new record \$201.2 billion in commodity export revenues is forecast for the 2011-12 financial year.

ABARE said the value of Australia's farm exports is forecast to be around \$29 billion in both 2009-10 and 2010-11, before increasing to \$32.2 billion (in 2009-10 dollars) by 2014-15.

"The projected increase in farm export earnings will be supported by recovering world economic growth and is under the assumption of favourable seasonal conditions in Australia", according to Phillip Glyde, executive director, ABARE.

The rise in total earnings from commodity exports next financial year will mainly come from mineral resources, with a 19% rise, to \$154 billion forecast.

ABARE said that compared with 2009-10, the value of Australian commodity exports is projected to increase by 30% to \$211 billion (in 2009-10 dollars) by 2014-15, with earnings from mineral resources exports reaching \$175 billion in real terms.

"Agricultural commodities for which export earnings are forecast to rise in 2010-11 include barley, rice, raw cotton, sugar, wine, live cattle and dairy products.

"However, an expected increase in world grain supplies is likely to continue placing downward pressure on prices in the short term.

"Also, herd and flock rebuilding, if seasonal conditions permit, and stronger competition in some of Australia's major overseas markets are likely to put some constraints on exports," Mr Glyde said

For energy commodities, export earnings are forecast to rise by around 20% to \$66 billion in 2010-11, driven largely by higher forecast prices for oil and coal.

For metals and other minerals, export earnings are forecast to increase by around 18% to \$88 billion in 2010-11.

A forecast increase in export volumes and higher expected prices for Australian iron ore are the main reasons for this projected rise in earnings from metals and other minerals.

The bureau warned that the global recovery remains subject to risks, including a premature withdrawal of government policy support and any tightening of financial conditions.

It expects gold prices to average \$US1,080 an ounce in calendar 2010, compared with \$US973 an ounce in 2009, while the price of West Texas Intermediate crude oil is forecast to increase to \$US77.38 a barrel from \$US61.68 in 2009.

The Australian dollar is forecast to average about 88 US cents this fiscal year and next, ABARE said.

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## Nufarm's New Warning (A Loss)



Little wonder that shareholders in Nufarm okayed a tie up with Sumitomo of Japan yesterday.

They had just heard the company issue its 3rd earnings downgrade in the past nine months.

In fact there are no earnings for the first half: losses now seem to be the order of the day.

The shares reacted adversely to that news, losing 8% at one stage after the meeting in Melbourne and [the statement](#).

They closed at \$9.47, down more than 2.8%.

The greenlight given to Sumitomo taking a 20% stake in Nufarm at \$14 a share was a no brainer.

That's quite a vote of confidence in the company's future.

The third profit warning vindicated the move by Sinochem, to cut and then walk away from its offer for Nufarm in December after more than six months of talks after it took a close look at the books and how the company was travelling.

Nufarm rebuffed Sinochem's lowered offer and turned instead to Sumitomo's plan.

Nufarm again blamed global demand for its key weed killer, glyphosate.

It's still much weaker than expected, with prices dropping to less than half last year's level as demand continues to be hit by farmers cutting back on usage to save money, and weak farm credit from banks in many markets.

Brazil, a key market, was again weak in the first half to the end of January.

Brazilian farmers have cut consumption, in many cases because local banks have cut credit.

Nufarm said that as a result of this slump it will incur a loss of about \$40 million for the first half, even after the big write-down on its glyphosate inventory in the second half of last year.

The company expects a stronger second half to push the full year headline profit to \$80 million to \$100 million.

"The outlook for the second half of the financial year provides grounds for confidence that acceptable profits can be generated in this period," managing director Doug Rathbone, who owns 11% of the group, told shareholders.

"Our detailed results for the six months to the end of January will be released on March 30.

"Those results (which are still to be finalised and are subject to audit review) will reflect the fact that some of the negative impacts that contributed to such a disappointing full year result last year have extended into the first half of the current year," Mr Rathbone said at the meeting.

He said the operating profit would be between \$110 million and \$130 million, well below analysts' forecasts for around \$165 million.

"Shareholders will recall that the company wrote down the value of glyphosate inventory at the end of last financial year.

"We did so with an expectation that pricing had reached its low point in most markets and that the company could clear remaining inventory without incurring further losses on those sales.

"The continued pressure on pricing has largely been driven by intense competition from suppliers who held much higher than average product inventory levels at the end of last season.

"As we have previously disclosed, at the end of July last year Nufarm held glyphosate inventories in the US that equated to some six months of sales.

"Faced with the option of either standing out of the market in the hope that prices would begin to recover – and potentially losing long term market access – or clearing those inventories so that we could reduce our cost position on subsequent sales and maintain

market share, we have opted to suffer a further short-term loss by electing to maintain our market positions by selling at the lower market prices," Mr Rathbone said.

## Telstra's New Low On NBN Fears

Telstra shares touched a new low yesterday after the company released a letter to shareholders in which it raised more questions about its talks with the government over the National Broadband Network.

The shares hit \$2.88 during trading, before recovering to close at \$2.93, down 1c on the day.

That was a new closing low for the stock.



The company's shares have been under renewed pressure since the interim profit announcement last month and the lack of any movement on finalising the NBN discussions with the government.

In the letter [Telstra claimed](#) that draft laws for the government's national broadband network company NBN Co could create a retailer rather than a wholesale network provider.

The legislation states NBN Co is to be a wholesale-only company but it gives the communications minister significant powers of discretion to allow it to conduct retail services.

"Such an outcome would run counter to the core purpose of the NBN and the government's primary policy objective of restructuring the industry to have separate providers for retail and wholesale fixed network services," Telstra chairman Catherine Livingstone and chief executive David Thodey said in the letter.

"We are very concerned about this potential change in the government's position."

On February 24 the Federal government released draft legislation that would govern how NBN Co is operated and regulated.

The draft laws allow NBN Co to offer services directly to certain end-users and to purchase other communications companies even if they have retail businesses.

This could allow NBN Co to compete directly with retail providers such as Telstra and Optus that would be buying its wholesale services.

"If enacted, we would need to factor this into the financial consideration required to achieve an agreement that is in the company's and your best interests," Telstra said of the legislation in its letter to shareholders.

Telstra also said that its position on the Telecommunications Legislation Amendment Bill 2009 had not changed.

"We have always said this legislation is likely to destroy shareholder value and makes an agreement with NBN Co and the government harder to achieve."

Telstra is negotiating with the government and its NBN Co on the implementation of the \$42 billion high-speed broadband project, which could see some of Telstra's infrastructure integrated into the network.

"As you know, the NBN negotiations are extremely important for Telstra," Telstra told shareholders.

"We remain engaged with the Government and NBN Co; we also remain committed to trying to find a mutually acceptable outcome.

"There are several complex issues about which we await clarification from the Government and NBN Co.

"However, these commercial discussions cannot be divorced from the current legislative risks your company faces."

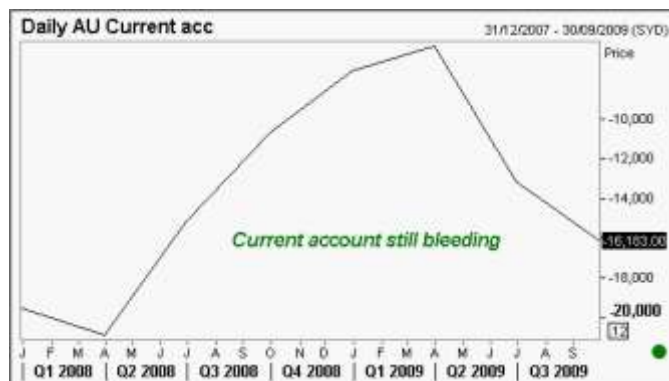
The government is committed to breaking up Telstra's retail and wholesale arms in an effort to introduce greater competition into the telecommunications sector.

It has said that it will force the Telco to sell its half of Foxtel.

"Telstra's position on this Bill has not changed: while we support the Government's National Broadband Network (NBN) vision and sensible reforms for our industry, we have always said this legislation is likely to destroy shareholder value and makes an agreement with NBN Co and the Government harder to achieve."

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## Economy: Rates Decision Today



**Company gross operating profits**, in current prices, rose 2.2% in the December quarter, seasonally adjusted, and were down 11.2% in 2009, according to the Australian Bureau of Statistics. But that was after a surprise fall in September.

**The current account** was a deficit of \$17.459 billion, higher than the median market expectation for a deficit of \$17.2 billion in the quarter.

The ABS data showed that the deficit is expected to subtract from the GDP estimates.

It said that the increase of \$7.750 billion in the deficit on goods and services in chain volume terms (adjusted for price changes) "would subtract 1.3 percentage points from growth in the December quarter measure of gross domestic product (GDP), according to the ABS.

That is better than the estimate for the September quarter for a negative impact of 1.8 percentage points

**The business indicators** data would make an 0.1 percentage point contribution to GDP. Inventories, a major part of this series of figures, will add an estimated 0.2 percentage points.

Inventories rose 0.2%, a bigger gain than the 0.1% recorded in the September quarter, but smaller than many (optimistic) estimates.

The estimate of income from sales by manufacturers in the December quarter, in seasonally adjusted chain volume measures, was up 3.5% and the estimated income from sales by wholesalers in the December quarter in adjusted chain volumes measures was up 4.1%.

They are both solid reports.

**In other economic news**, sales of new homes rose 9.5% in January, the best for five months, driven by a sharp rise in the booming Victorian market.

The 9.5% rise came after a 4.6% fall in December.

The rise was the most since August when they leapt 11%.

In Victoria, new home sales jumped 17.1%, in NSW, 3.1%, 6.3% in Queensland and 6.6% in South Australia.

**And Australian manufacturing** activity expanded at a two year high in February due to a lift in new orders which flowed through to stronger production and input deliveries.

The Australian Industry Group/PricewaterhouseCoopers performance of manufacturing index (PMI) rose by a seasonally adjusted 2.8 points in January to 53.8.

(Readings above 50.0 indicate a rise in activity.)

The result comes after an expansion in January and a fall in December.

Manufacturing growth was supported by a lift in new orders which flowed on to stronger production and input deliveries for the month.

The survey said selling prices rose for the first time in five months while input costs also increased.

And the TD Securities/Melbourne Institute's latest inflation gauge shows price pressures moderate and under control.

The gauge rose 0.1% last month after the 0.8% rise in January.

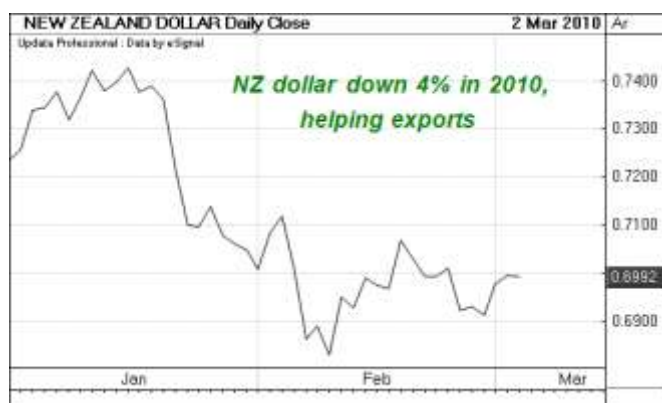
In the 12 months to February the inflation gauge rose 1.9%, still below the Reserve Bank's target range of 2% to 3% over the course of the economic cycle.

## NZ Economy Slowing In Places?

Signs of a slowdown in the New Zealand economy, just when everyone thought it was on the road to recovery?

The NZ Treasury said yesterday the economy lost some momentum as retail spending and the property market slowed in the first months of 2010.

It said leading indicators suggest January retail sales may decline and the housing market has slipped.



But offsetting this, the department said in its monthly update that forward-looking indicators such as immigration and [business confidence were strong](#). The monthly update didn't contain new forecasts.

Export prices are also up, according to a survey from the ANZ Bank and prices of major exports such as milk products remain high.

"The New Zealand economy is continuing to recover, though some momentum, particularly in the household sector, may have been lost over the initial months of 2010," Treasury said.

"Forward-looking indicators are generally positive, especially for the manufacturing and construction sectors and the lower exchange rate in recent months is providing more confidence for exporters.

"Retail sales rose further in the December quarter, reflecting the significant lift in consumer confidence over the second half of 2009 as the economy emerged from recession.

"Discounting played a key role in increasing volumes, as the higher exchange rate helped to lower the price of imported goods.

"However, sales in the December month were weak and initial indicators for January suggest momentum may continue to ease in the short term, with both consumer and retailer confidence slipping."

The Department said that following the strong recovery through the middle of 2009, "housing activity has also lost momentum in recent months, with January data showing a sharp fall in sales.

## Idiots Guide to Building An Australian Equity Portfolio—introduction

From the series of 10 articles by Marcus Padley of Marcus Today - We hope this extract will give you a feel for the philosophy behind Marcus Today. To find out what else we have to offer, start a [free trial](#).

Building a portfolio in Australia is not rocket science.

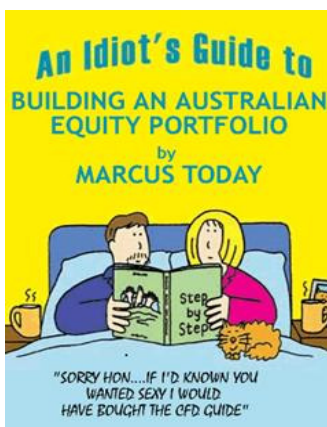
When I first came over here in 1994 two things struck me about the stockmarket. The “Gift of Franking” (it is not normal) and the predominance of monopoly stocks and, amazingly enough, because monopoly stocks have limited room for expansion, they are often the ones paying the big fully franked yields as well.

I couldn't believe your luck.

I have written an idiots guide (Ten Steps) to building a plain vanilla Australian equity portfolio. It involves a heavy dose of Monopoly stocks, but rather than list them all straight off, there are a few steps you need to go through first.

It is not a “Buy this at this price and look at my fantastic track

record” type series but a guide to navigating the stockmarket, not



killing yourself and growing your money without having to punt and without (hopefully) losing any money.

For a sneak preview, see *Step 1—Should you be in the market*, on the following page.

## How to get the full series

To get the full series of articles, you need to be a subscriber to Marcus Today. Before you make that leap, you can try out everything else we offer through our free trial.



Take a free trial to see what else is on offer from Marcus Today. If you decide to subscribe, your subscription will include access to the full series of articles on building your equity portfolio.

### What is Marcus Today

- ⇒ An online newsletter covering the Australian Stockmarket - choose from a daily or monthly newsletter.
- ⇒ A Daily Email from Marcus, with his take on the market, what's happened, & what it means.
- ⇒ The Idiots Guide to building your own Portfolio - 10 steps & 20 stocks to a 'safe' investment portfolio.
- ⇒ Articles by Marcus on investing, the psychology of the herd, & the importance of peace of mind.

### The 10 Steps in Summary

- Step 1 - Should you be in the market?
- Step 2 - Equities or Property?
- Step 3 - Do you do it yourself or not?
- Step 4 - If not you, then who?
- Step 5 - Portfolio Construction - what to think about
- Step 6 - Portfolio Construction Cont. - Monopoly Stocks & Franking
- Step 7 - The Method
- Step 8 - The 1<sup>st</sup> 8 Stocks
- Step 9 - The next 5 Stocks
- Step 10 - A reasonably magnificent 7

# Idiots Guide to Building An Australian Equity Portfolio

## STEP 1 -Should you be in the market?

The stockmarket is for investors. People with money to invest. People who are looking after their (excess) money.

Of course most people don't have enough money, they are behind the eight ball in life and the stockmarket is a tool for them to make more money than they would in their jobs or by paying off the mortgage.

But to get any leverage to the market you will have to borrow money. Sometimes it doesn't feel like borrowing because borrowing is second nature to us all now. That redraw facility isn't borrowing after all. Is it? But if you have a mortgage and a stock portfolio at the same time I hope you are netting off your extra interest costs against your portfolio returns and relating that to the risk you are taking.

Gambling with other people's money (its not yours) is high risk because you have heightened leverage to the downside as well as the upside. It only works when the stockmarket goes up.

***The best long term investment of all is in your own business, your own career, your own development, your own intellect.*** Far better you invest in that than any equity investment. Don't let your core asset development go by the wayside just because the stockmarket is easy money.

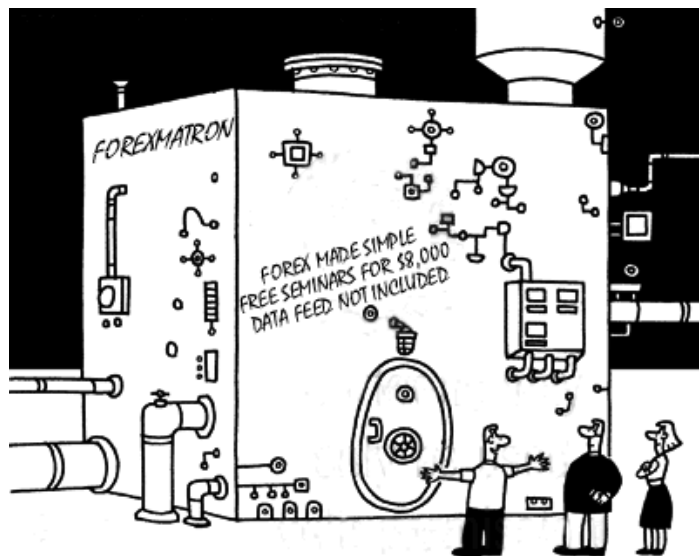
Might just drop in here [the distinction between investment and punting](#).

You all know it but you may not know this. Over many years of stockbroking I can tell you that the attrition rate on clients punting (rather than hedging) in Futures, Forex and CFDs is very high. Vastly higher than equities and vastly higher than equity portfolio investors. Clients constantly have to put up more money. Dealers constantly have to replenish their client base. They are great products for the tiny tiny minority that consistently gets it right and for the brokers taking commissions on high turnover hopefuls, but there is little science and a lot of luck for Joe Blow.

The plethora of simple trading systems belies a truth that this is not for amateurs. The currency markets exist for a commercial purpose, if you really think you can take on the

professional Forex market and come out a winner you are simply kidding yourself. That stake money will disappear as surely as your TAB credit balance. It's the truth.

**There is a saying** - "What's the difference between a professional trader and a beginner" - Answer - "Two weeks" or less if you pay more.



"THE FOREXMATRON IS PERFECT FOR MUMS AND DADS"

There are some financial website trading system Ads at the moment saying things like "Make the next few minutes count".....yeah right. Just how weak do you have to be to fall for that short term crap.

**Its easy to kid yourself**, and its easy to spend large sums of money on what looks like an instant solution, a trading system, a course. But in my experience....if these courses pass the quality test (and many many don't - otherwise why are they selling them and not trading) then they require a lot (A LOT) of after course attention and experience before they pay off. Meanwhile you have a job to do, a family to attend to and a life to lead. If a lack of attention to the work that needs to be done doesn't kill you off, the cost of the data feed you have to subscribe to and the cost of the software updates you need almost certainly will.....**you** are the bunny - not the other forex traders.

There is investment and there is punting. We are talking about investing. That means getting the best return on your money, not the pursuit an exceptional life changing miracle event. We are talking plain vanilla. Lets get that right first before we go play at the edges (which we will).

[Subscribers to Marcus Today stockmarket newsletter have access to the full 10 articles in this series. For a free trial of the newsletter, go to \[www.marcustoday.com.au\]\(http://www.marcustoday.com.au\)](#)

**marcustoday**

"While some of the weakness may reflect some uncertainty about future changes to property taxes, it is more likely the initial euphoria resulting from historically low interest rates earlier in 2009 has somewhat faded.

"However, residential construction is expected to contribute strongly over coming quarters, as building consents continue to rise and activity expectations remain at historically high levels.

"Employment was fractionally more positive than we had expected in the December quarter, while unemployment lifted above market expectations.

"With employment intentions continuing to rise, we expect employment to begin to expand again in coming quarters.

"Wage growth slowed in December, reflecting the lag between labour market conditions and wage setting.

"With more people seeking work and more firms in a position to increase work hours rather than employee numbers, wage growth is likely to remain subdued in the near term.

"While uncertainty continues to dominate the global economic environment, Australia and Asia are recovering strongly, which along with a lower dollar and more positive outlook for manufacturing and construction bodes well for exporters.

"While we are yet to see the full pass-through of higher expectations to activity, growth is likely to continue gradually recovering, in line with a strengthening labour market and other economic indicators."

Despite the suggestions of slowing consumption, no economist is expecting the Reserve Bank of New Zealand to change rates at its next meeting on March 11 (Thursday week).

Buoying the economy, immigration is rising and New Zealand's currency has fallen nearly 4% against the US dollar in the past three months.

"The lower exchange rate in recent months is providing more confidence for exporters," the Treasury said.

Annual immigration growth was the strongest in more than five years, according to a government report yesterday.

The number of permanent migrant arrivals exceeded departures by 22,588 in the 12 months ended January 31, up from 21,253 in the 12 months through December.

That's the highest since May 2004.

## Does Sigma Have Profit Problems?



Still no definite news about what's going on at Sigma Pharmaceuticals.

The company failed yesterday to meet its own self imposed deadline for an update on trading by the start of trading yesterday.

It actually asked that its shares be suspended from trading for an indefinite period.

"The suspension is necessary as Sigma expects to make an announcement to the market in relation to revised earnings guidance for the year ended 31 January 2010," Sigma said in a statement to the ASX on Monday.

"Sigma expects to make an announcement to the market concerning the revised earnings guidance before the expected date for the release of its preliminary final results."

Sigma shares closed at 90 cents on Friday.

Media and market reports suggest the company is having difficulties with "accounting issues" to quote several people and reports.

These will require end of year adjustments to its January 31 accounts.

The first suspension request last Thursday wasn't clear, but media reports have suggested that the accounting issues will impact 2009-10 earnings.

If this was the case, the company would have felt it had to update the market as soon as these were confirmed.

Just why it couldn't make its own deadline on yesterday morning is worrying.

If the problems with the accounts are so bad that it will take days to straighten them out, what's it say about the quality of the management and the board supervision?

Fairfax Media ruled out "at this stage any concerns the financial problems are linked to misappropriation of funds or its recent acquisition of a pharmaceutical brand portfolio and manufacturing facility from global pharmaceutical firm Bristol-Myers Squibb".

Sigma reported a 4.9% rise in net profit to \$32.2 million for the six months to July 31.

Revenue rose 3.5% to \$1.54 billion.

The company had forecast a modest increase in 2009-10 profit.

## Rio Lifts Stake in Ivanhoe

Rio Tinto, the world's third- largest mining company, will spend \$C245 million to increase its holding in Ivanhoe Mines Ltd., its partner in the Oyu Tolgoi project in Mongolia.

Rio will buy 15 million shares at \$C16.31 each.

That will lift its holding 2.7% to 22.4%.

Rio shares rose 1.3% to \$71.40 yesterday, on a day when world copper prices had their biggest rise in 11 months in the wake of the Chile earthquake at the weekend.

Comex copper prices jumped 20.3 cents, or 6.2%, at one stage in trading in Asia yesterday to reach \$US3.4870 a pound.

They later eased to be up 3.27% at \$US3.3915 a pound and finally ended up 2% at \$US3.3485.

Major mines in Chile seem to have escaped damage and some were coming on back line last night as power was restored.

Rio Tinto said its Chilean copper interests (Escondida) were unaffected.

The miner had earlier announced its increased stake in Ivanhoe.

The shares are being issued to Rio Tinto as part of an accord with Ivanhoe Mines in 2008 to finance equipment for the Oyu Tolgoi copper-gold complex in Mongolia's South Gobi region.

The mine, described by Rio as the world's largest untapped copper and gold resource, is expected to start output in 2013.

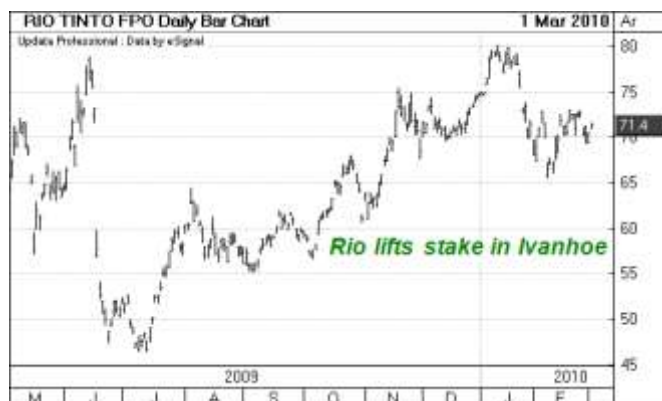
"Our further investment in Ivanhoe Mines underlines our confidence in the quality of the world class Oyu Tolgoi deposit and its priority in our project portfolio," Rio's said in the statement.

Rio Tinto and Ivanhoe Mines are development partners for the Oyu Tolgoi project.

Production is expected to commence in 2013, with a five year ramp up to full expected production of 450,000 tonnes of copper a year and 330,000 ounces of gold.

After the completion of the acquisition, Rio Tinto will own 98.6 million shares of Ivanhoe Mines.

By financing the equipment at that time, Rio Tinto provided Ivanhoe Mines with the funds necessary for the ongoing development of the Oyu Tolgoi project and maintained the critical long lead manufacturing time for the equipment.



If Rio Tinto were to exercise all of its share purchase warrants and convert its US\$350 million loan into shares it would own approximately 267.6 million shares of Ivanhoe Mines representing 44% of Ivanhoe Mines.

Rio also announced last night that its asset sales program has passed the US\$10 billion mark with the completion of the sale of its Alcan Packaging Food Americas division to Bemis Company for a total all cash consideration of US\$1.2 billion.

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## **AGL's New Windfarms**

A day after revealing a solid inter profit, AFL Energy has revealed plans to go deeper into wind energy.

On Friday the company revealed a 22% rise in underlying earnings and a small rise in interim dividend, both pointers to improved trading.

Yesterday it said it would, with a New Zealand group, build a 170 turbine strong wind farm in southern Victoria.

It was the company's second wind farm deal in two days.

Friday saw it approve the construction of Hallett 5 which, at 52 MW, is the smallest of the Hallett wind farms.

"The investment in Hallett 5 is required for AGL to meet its obligations under long term contracts with the South Australian and Victorian desalination plants as well as the recently announced Melbourne Water transaction.

"The total installed capital cost of Hallett 5 is approximately \$120 million and completion is expected in December 2011," the company said.

Yesterday it revealed that it had entered into conditional arrangements for the construction of Macarthur Wind Farm in south-west Victoria.

This follows the federal government's announcement last week of proposed changes to the operation of the Renewable Energy Target (RET) scheme.

But on Friday AGL said it had put this wind farm and others (but not Hallett 5) on hold because of uncertainty about the certificates.

Now the Macarthur Wind Farm is a goer, sort of.

AGL said it will be constructed under a joint venture between it and Meridian Energy Limited, one of New Zealand's largest energy companies.

AGL will take all of the wind farm's energy output and renewable energy certificates.

The contractual arrangements are subject to a number of conditions precedent, including approval by the boards of the joint venture partners.

A key consideration of AGL's board in approving the transaction will be certainty around the final form of the legislation to give effect to the federal government's announced changes to the RET scheme.

When constructed, the Macarthur Wind Farm will comprise 174 turbines for a total capacity of 365 megawatts which is expected to deliver approximately 945 gigawatt hours of electricity each year.

Construction is expected to take approximately 3 years from the time the conditions precedent have been satisfied.

AGL said full details of expected capital cost of construction will be announced separately after AGL has finally committed to construction.

So ignore the headlines which said that AGL Energy reported an 89% fall in first-half net profit.

That was true, as was its reaffirmation of its full year profit guidance, which doesn't seem to go together.

Nor did a small rise in interim dividend.

AGL [said on Friday](#) first half net profit was \$183.7 million, down from \$1.655 billion in the prior corresponding half year.

Instead, for once, focus on the underlying net profit performance is a better guide.

It was up 22% to \$234.8 million for the December 2009 half year from \$192.5 million in the prior first half year.

AGL declared an interim dividend of 29 cents fully franked, up from 26 cents fully franked in the first half of 2008-09.

The company reaffirmed earlier guidance for full year underlying net profit.

Both are solid indications that the board sees further improvement this half year.

"We are on track to meet our full-year (underlying NPAT) guidance of \$390 million to \$420 million and are well placed to continue to grow through a combination of organic growth and acquisitions," AGL said in a statement.

While the privatisation of NSW electricity assets has been delayed until later this year, AGL said it remains interested in evaluating the assets for sale if the process proceeds.

AGL shares closed up 1.9% yesterday, or 28c, at \$14.65.

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