BAIOCCHI GRIFFIN
PRIVATE WEALTH

Issue 2

Autumn 2013

Investment Update

Contents

Welcome to the Autumn edition of the Baiocchi Griffin Private Wealth Investment Update

In this edition we take a look at the never ending task of ‘the search for yield’ and balancing risk and return for our clients. We also have news of a new bond market opening soon in Australia and then we look more closely at the economic growth of Europe and the United States.

The Australian Dollar has been a thorn in the side of Australian exporters for several years now but with the May fall in official cash rates are we about to see the $A drift lower, below parity with the US Dollar?

BAIOCCHI GRIFFIN
PRIVATE WEALTH

The search for yield - balancing risk and return!

At any time, constructing and managing investment portfolios to deliver the required level of income (portfolio yield) is a delicate process of balancing the various levels of yield on offer, from a wide range of investments, with the underlying risk that accompanies them. In a climate of falling interest rates this task increases in difficulty.

To this end our focus on long-term capital preservation compels us to filter out large sections of the investment universe due to the very high capital risks that are inherent in some types of investment. From our perspective, there are certain types of investments that we just will not – even for a moment – consider recommending to our clients.

We aim to further reduce risk of permanent capital loss through researching investments that we believe have a tolerable risk level. We then look to identify assets that provide a competitive rate of income return. By competitive we mean when compared to normal deposit rates on offer from Australian banks.

> *"We aim to further reduce risk of permanent capital loss through researching investments that we believe have a tolerable risk level."*

Australian government bonds soon on the ASX.

On 21 May it will be possible to buy and sell Australian government bonds via the Australian Securities Exchange (ASX). This is an interesting development as it will provide access to AAA- rated fixed interest securities that for many years were only accessible by large financial institutions.

Up until now, government bonds were denominated in very large amounts – typically many hundreds of thousands of dollars. However, the new market for government bonds will see trades starting from $50,000 and will provide access to individual investors.

In due course the new bond market will broaden our palette of investments to aid in building portfolios and assist us in our search for yield.

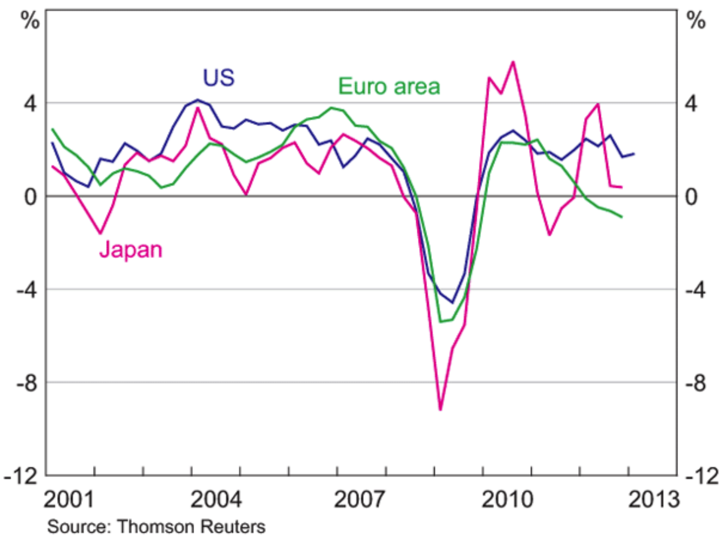
Working through the global recovery

Europe remains a problem

It will soon be five years since the first rumblings of what we now know as the Global Financial Crisis (GFC). While the collapse of Lehman Brothers, the then very large United States investment bank, occurred in September 2008, a month or two earlier there were great concerns about the US government-backed home loan groups known as Fannie May and Freddie Mac.

As the initial epicentre of the crisis, the US is still hamstrung by high unemployment and on-again/off-again growth. However, that economy is beginning to show some signs of moving forward with a measure of stability. The same cannot yet be said for Europe where many economies are saddled with high sovereign (government) debt and corporate debt problems.

As you can see from the chart, economic growth in the Euro-denominated economies



continues to slide lower. The downward GDP trend is accompanied by rising unemployment and very low consumer sentiment.

With substantial austerity measures enacted by several European governments, the question remains whether or not such measures are appropriate. When governments retreat from economies (reduce spending and investment) it can snowball into increased difficulty for such governments

Cont'd

in meeting debt repayments due to falling tax receipts.

While central banks across the world have intervened over recent years in order to stabilise economies, the ongoing task remains for those economies to grow at such a rate that sufficient tax revenue is derived by governments to, in part, meet their loan interest and repayment commitments.

While the European sovereign debt issues have retreated from news headlines for the present time, the possibility of loan defaults by some governments remains real.

… the ongoing task remains for those economies to grow at such a rate that sufficient tax revenue is derived by governments…

The Australian Dollar – still holding its own with the big currencies but for how long?

A$ - where to from here?

At its May meeting, the Reserve Bank of Australia lowered the official cash rate by 0.25% p.a. to 2.75% p.a. and there was a very quick response in currency markets as the $A drifted lower. The fall was, in part, due to the lower return (less interest) on offer in Australia. However, it is also partly due to further positive data emerging in the US economy.

While the high dollar of recent years has been helpful in keeping 'imported inflation' under control, it has been very detrimental to Australian manufacturing.

Even with a lower cash rate from the RBA, surprising as it may seem, Australian interest rates remain very attractive (a higher *reward*) with very low risk when compared to interest rates in the USA, UK, Europe and Japan, for example. This suggests that for the dollar to move sufficiently lower to improve the outlook for Australian exporters, an extended period of interest rate declines would need to unfold.

How low might the A$ go? We can't answer that other than to say that, for the foreseeable future, US$0.48 cents of a decade ago, seems a long way off.

BAIOCCHI GRIFFIN PRIVATE WEALTH

The Outlook

Interest Rates

The weight of evidence points to the likelihood of further reductions in interest rates if the RBA remains comfortable with inflation trends.

There is nothing on the horizon to suggest an interest rate rise in the near term.

Australian Shares

The sharemarket has hovered just under/over the 5,000 points level on the All Ordinaries Index for several months now. There may be further market rises if interest rates move lower again and the relative income return from share dividends versus interest rates becomes more pronounced. However, as the mining boom moves from the construction to operational phase, coupled with a weakening in commodity prices, we tend to believe that the next growth phase in the market will require further sustained economic growth.

International Shares

With the New York Dow Jones Index posting record highs in recent weeks, we tend to think that the US market now requires a consolidation based on fundamental improvement and not just optimism.

With regards to China, the world's second largest economy is continuing to transition from an export orientation to a more domestically driven focus. As such, China is seeing its economic 'tectonic plates' shift and the rest of the world remains eager to understand how it will interact with a changing Chinese economy.

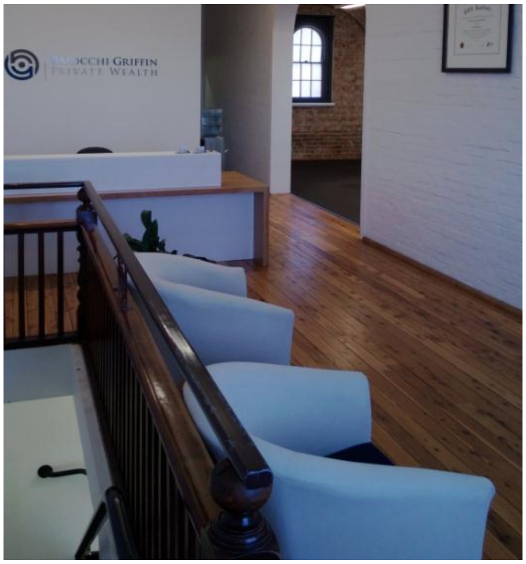
There may be further market rises if the interest rates move lower again and the relative income return from share dividends versus interest rates becomes more pronounced

Japan's newly-elected prime minister is committed to spending the government's way to higher growth and inflation. The initiative has initially pleased markets however the very large level of Japanese government debt remains a major problem. To some extent, Japan continues to delay an inevitable need to tackle its government debt problems. As discussed earlier, Europe has substantial difficulties that will take quite some years to resolve.

Summary

The world's economic conditions are of no surprise to us – nothing has changed that would substantially alter our approach to portfolio construction. Our search for yield without excessive risk remains our primary portfolio role for our clients.

Baiocchi Griffin Private Wealth



We thank you for your support and look forward to working closely with you in the years to come.

Business Update

We have now completed the full transfer of all portfolio data from Capricorn and have settled into our new software administration system.

It was a mammoth task and we thank you for your forbearance during recent months. Thank you also to Annette Darlington who managed the project in her role as Portfolio Administration Manager. Annette will soon complete her twelfth year of working with Justin and Ray and we are very grateful for her loyal and dedicated service to our clients and the firm.

On other business news we will shortly begin to further develop our website and keep an eye out for your invitation to the next *Client Investment Briefing.*

Facts & Figures at a Glance

	This quarter	Last quarter
Australian inflation rate	0.4% ↑	0.2% ↑
Australian unemployment rate	0.1% ↑	-0.1% ↓
RBA Cash rate	3.00%	3.00%
ASX 200 Index	6.83% ↑	5.95% ↑
MSCI World Index (ex-Australia)	7.23% ↑	2.06% ↑
Australian $ vs. US $	$1.0415	$1.0384
Australian $ vs. UK £	$0.6849	$0.6428
Australian $ vs. Euro €	$0.8122	$0.7868

facebook.com/BaiocchiGriffinPrivateWealth

@BaiocchiGriffin

Baiocchi Griffin Private Wealth Pty Ltd
ABN 58 159 154 944
AFSL 424658

Level 1, 462/464 Peel Street
PO Box 590, Tamworth NSW 2340
enquiries@bgprivatewealth.com.au
www.bgprivatewealth.com.au