



Outlook for Investment Markets in 2010

“Headwinds & Tailwinds”

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February 2010



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Agenda



- A look back at 2009
- Equity market outlook 2010

Headwinds

- Stimulus packages unwind in 2010
- Debt and the household
- Chinese moves to stem inflation
- Sovereign debt concerns

Tailwinds

- Greater business and consumer confidence
- Low unemployment supports the consumer
- China & Commodities
- Australia's ability to manoeuvre (Interest Rates and Debt)



A look back at 2009



A look back at 2009



Australian share market up 37% (Accumulation index) for 2009

- 60% rebound from the March low
- Driven mostly by P/E rerating
- Index is still 21% below October 2007 peak

S&P/ASX 200 Accumulation Index



A look back at 2009

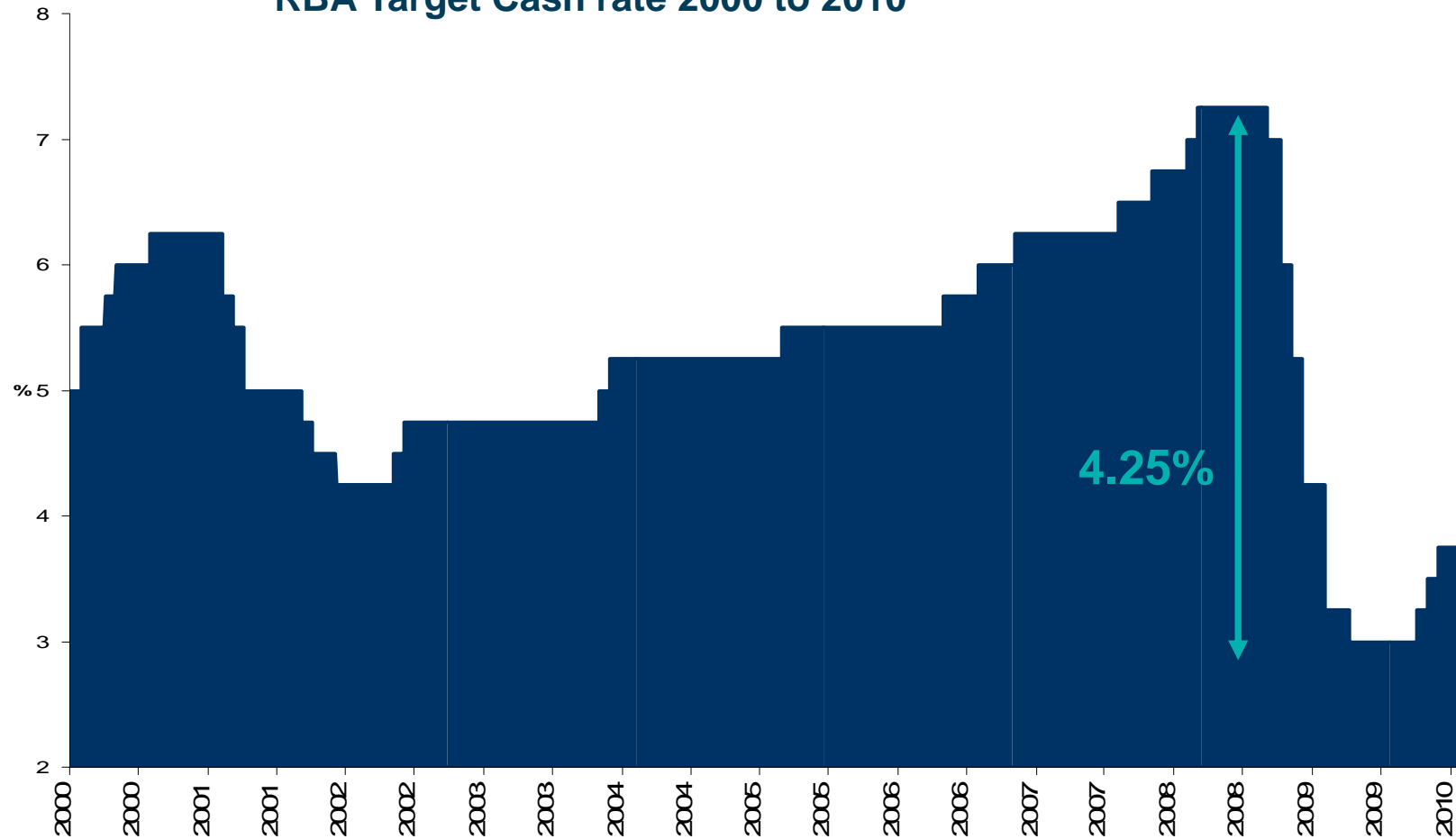


- Initial Outlook for Australia was negative following a weak 2008
- What helped offset the weakness
 - **Australian Federal government stimulus packages (Cash handouts, schools building spend, business tax incentives to buy capital items)**
 - **Overseas governments and Central banks also stimulated their economies which supported global demand and confidence**
 - **China launched a massive stimulus package resulting in demand and prices for Australian iron ore and coking coal (both key steel making commodities) recovering**
 - **Strong AUD (from above) lowered the price of fuel and imported consumer goods**

RBA moved quickly to drop rates through the crisis



RBA Target Cash rate 2000 to 2010



Source: Reserve Bank of Australia as at 31 January 2010



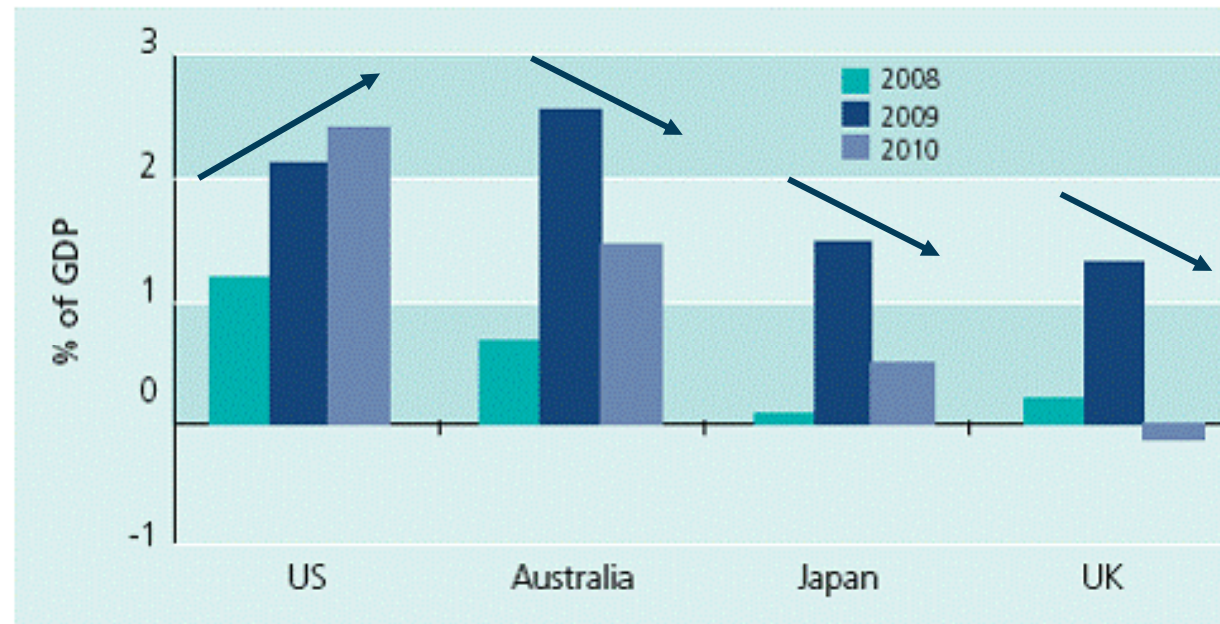
2010 Headwinds



Stimulus Packages set to unwind in 2010



Distribution of Fiscal Stimulus, 2008-2010



2010 will see the gradual unwind of fiscal stimulus in most developed countries and it will be interesting to watch how economic growth holds up as this unfolds.

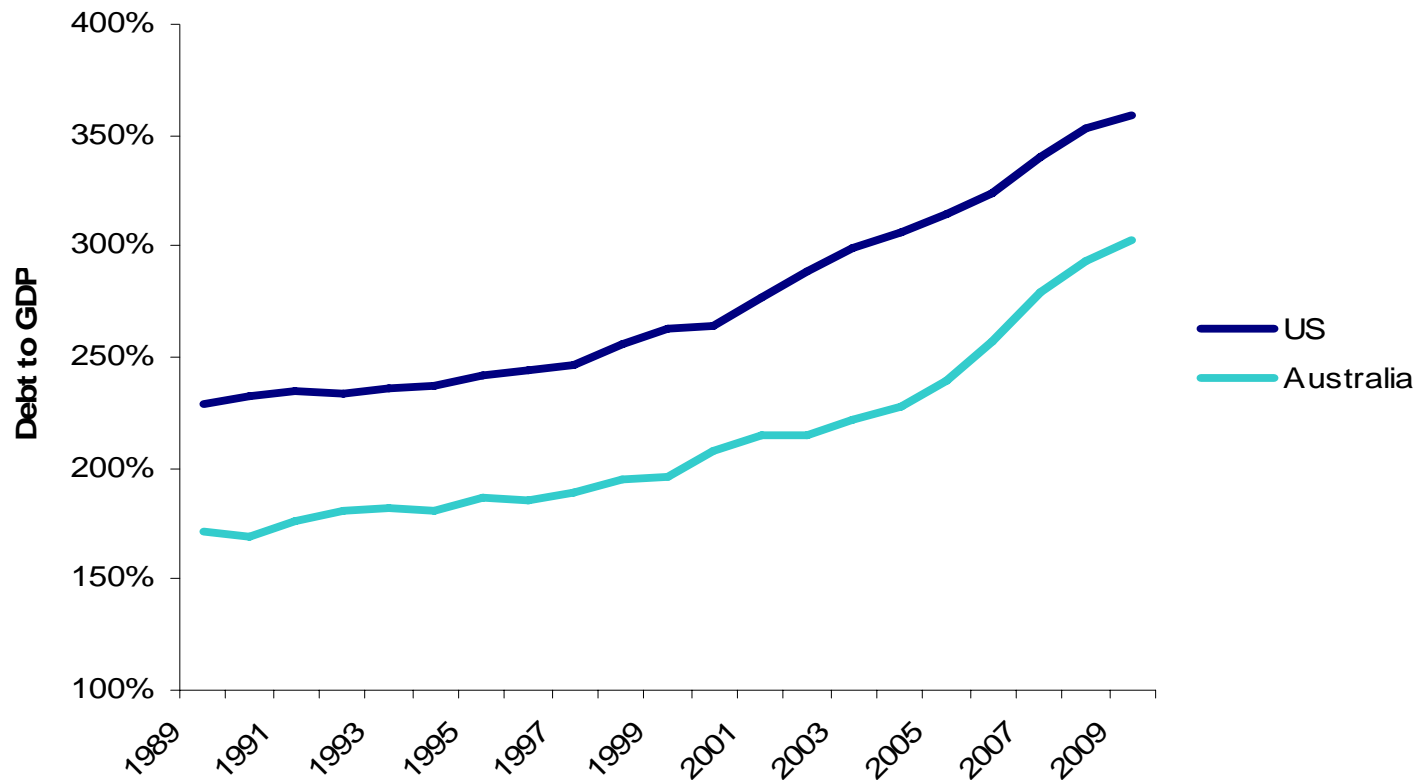
Early anecdotal evidence of weak pre-Christmas sales by some retailers indicates that the unwinding effect of the Australian government's cash handouts is already playing out.

The rise of debt has occurred both in Aus and USA



Australia's debt to GDP has increased significantly over the last 20 years

Total Debt to GDP - US vs Australia

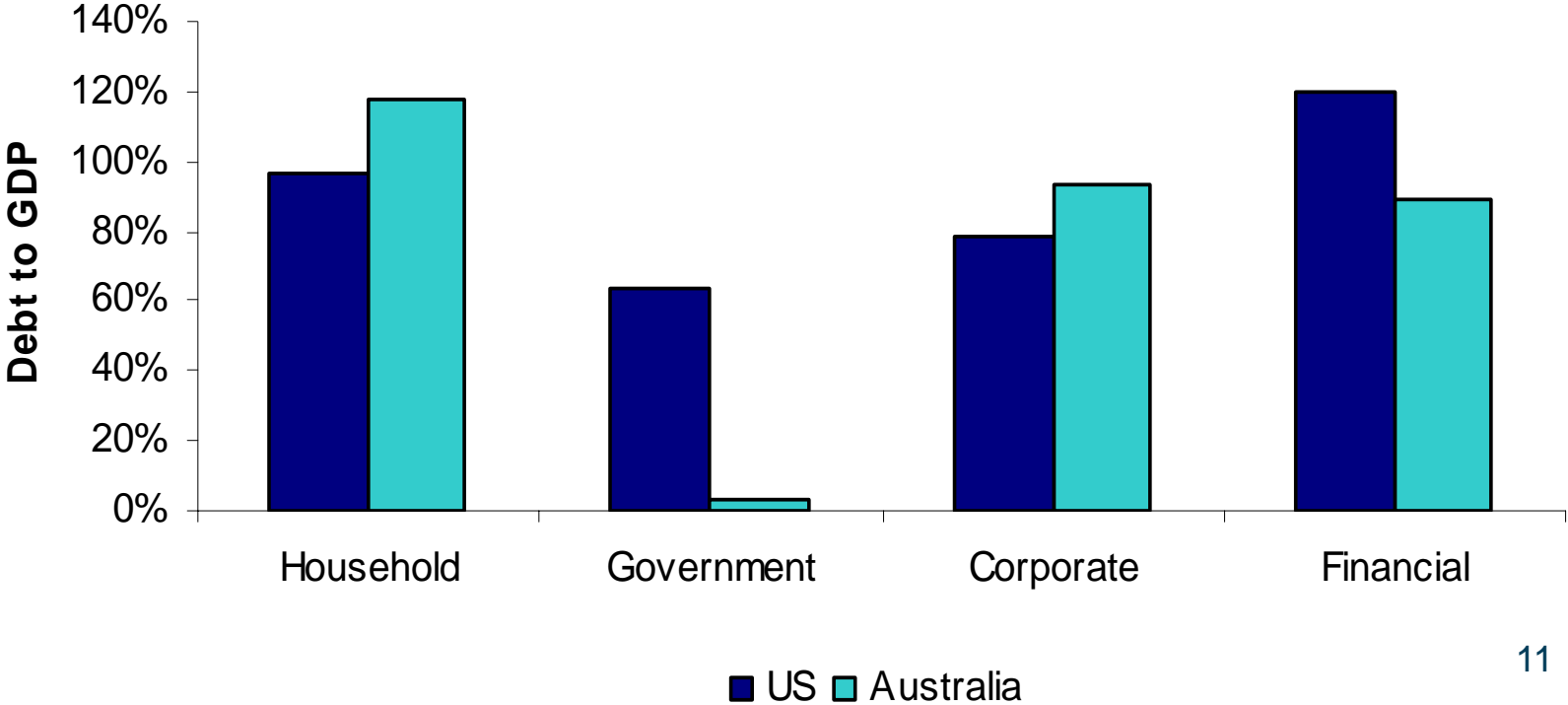


Difference lies in the sectors exposed



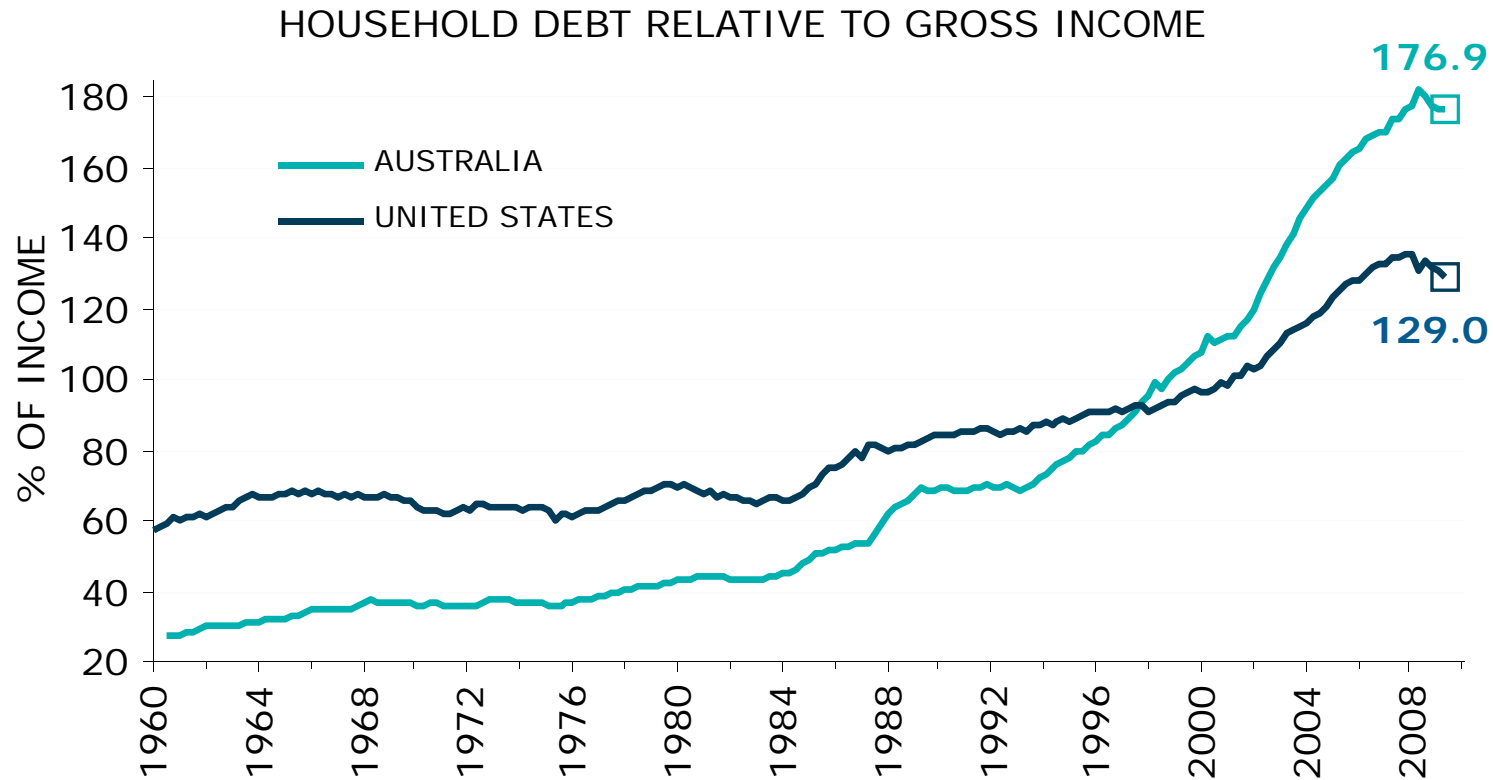
Australia's debt relative to GDP has increased significantly over the last 20 years driven by the household and financial sectors

Current Debt to GDP by Sector - US vs Australia

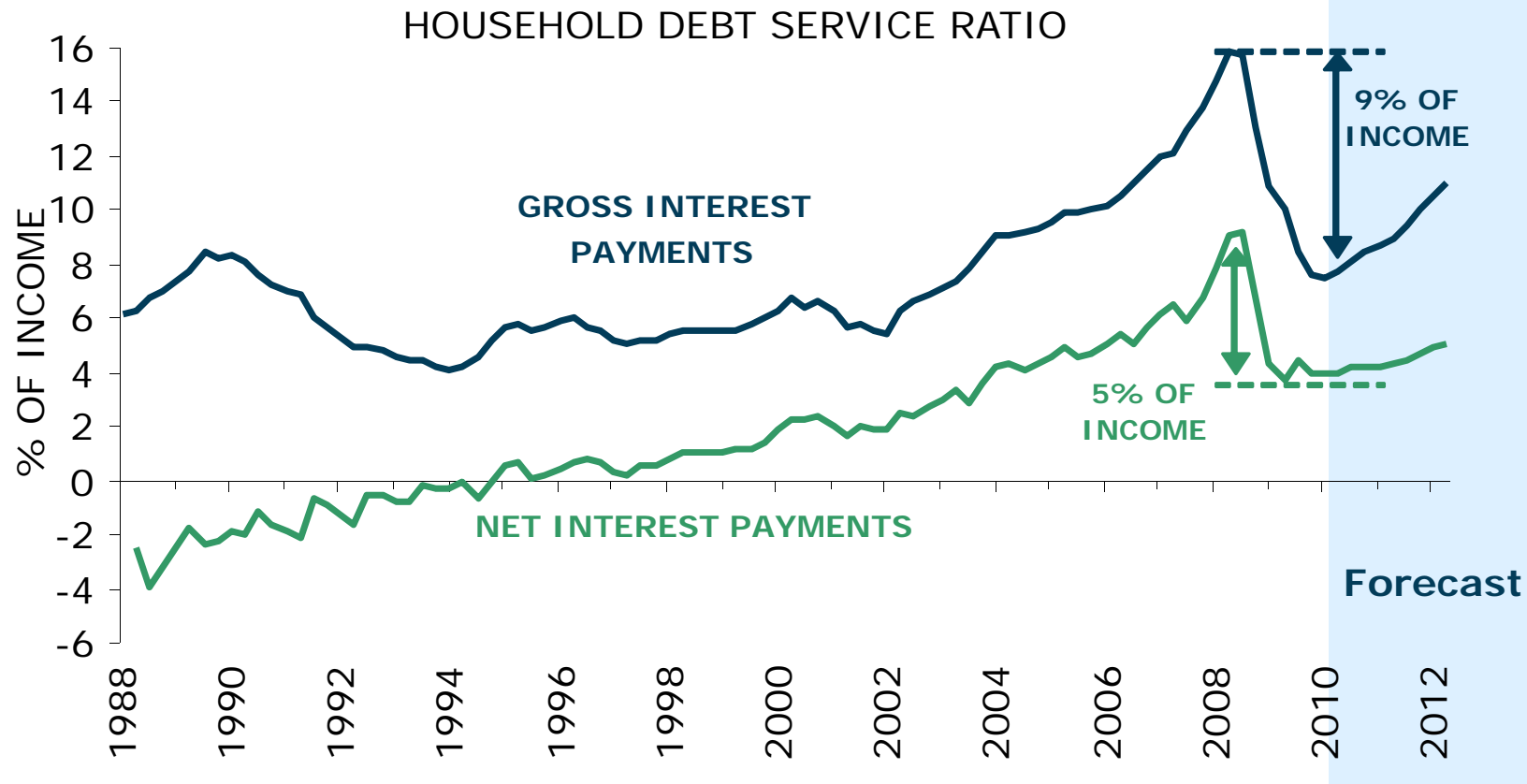


Source: OCED, Morgan Stanley

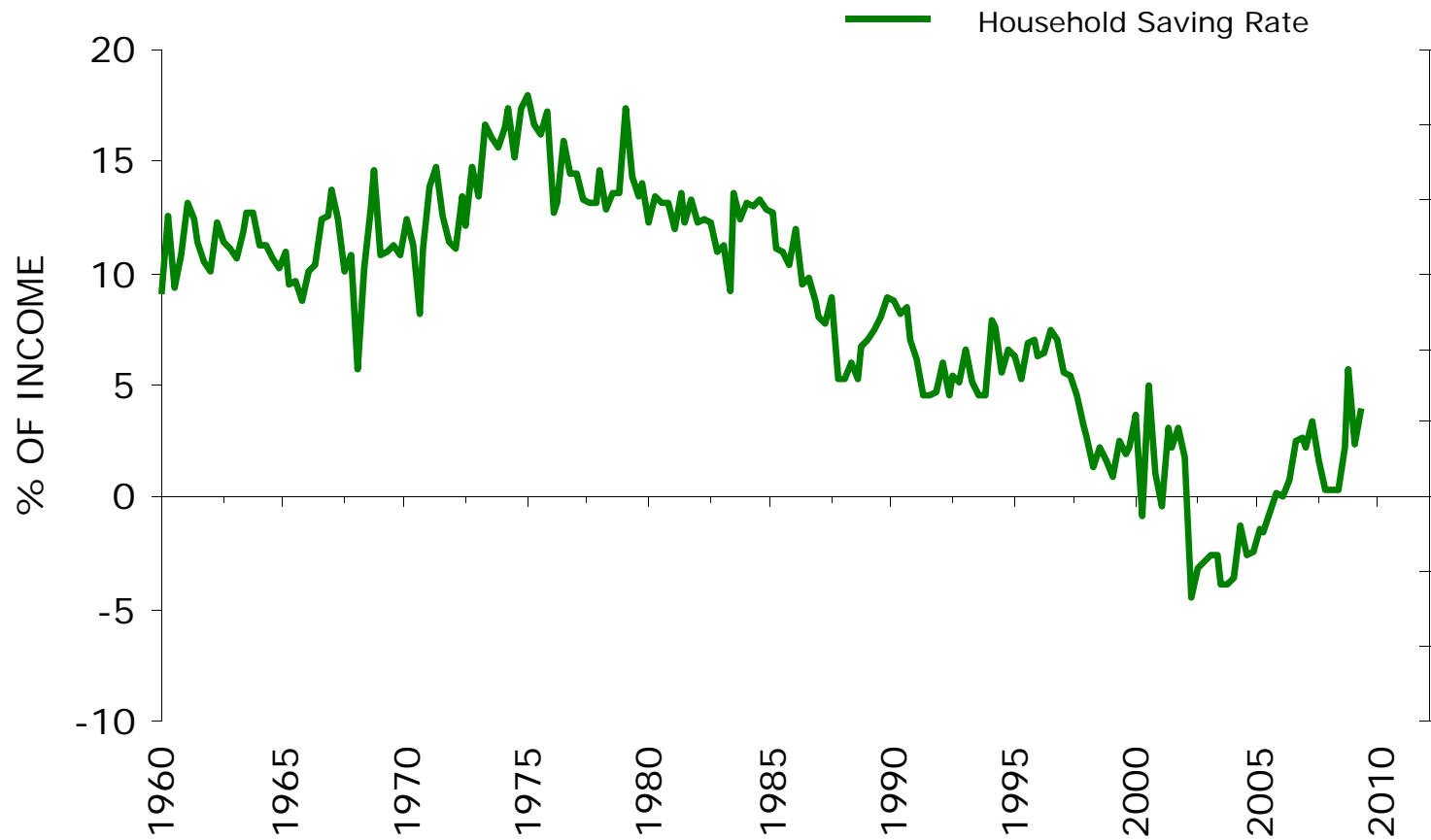
Australia's household debt to income higher than US



Drop in rates supported the households ability to service debt



Rising cash rates and savings rates may affect spending in highly leveraged households

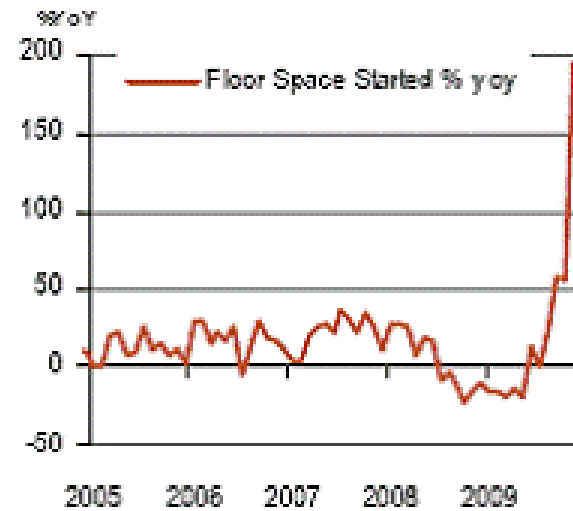
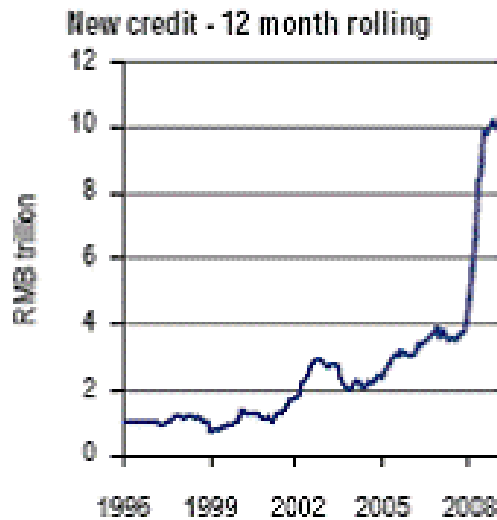


A look at China



Chinese stimulus packages caused a spike in credit growth which in turn led to a spike in property construction

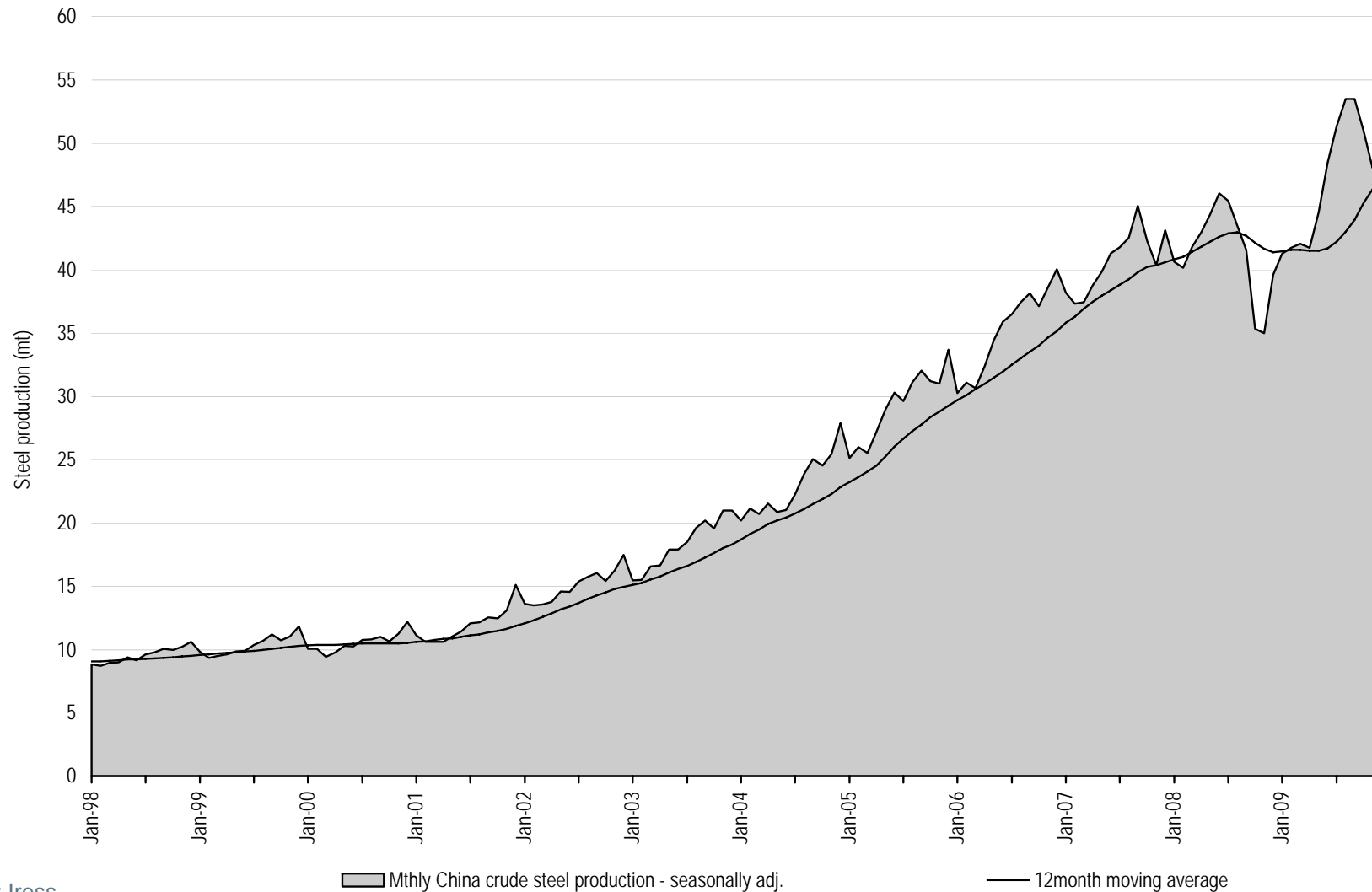
Chinese new credit - 12 month rolling total



A look at China



With credit growth and infrastructure/property construction demand for commodities has risen



Source: Iress

A look at China



- Money Supply in 2009 was 34%
- Past spikes of ~20% have caused inflation to increase.

China may be forced to curb lending to property and infrastructure developments to keep a lid on inflation, which would result in lower demand for iron ore and coking coal. If destocking occurs at the same time this would result in Chinese demand for iron ore and coking coal to drop significantly.

Chinese inflation and money supply



Sovereign Debt



- At best means the potential for highly indebted countries to stimulate their economies going forward is more limited
- At worst, a debt default could cause long term interest rates around the world to increase



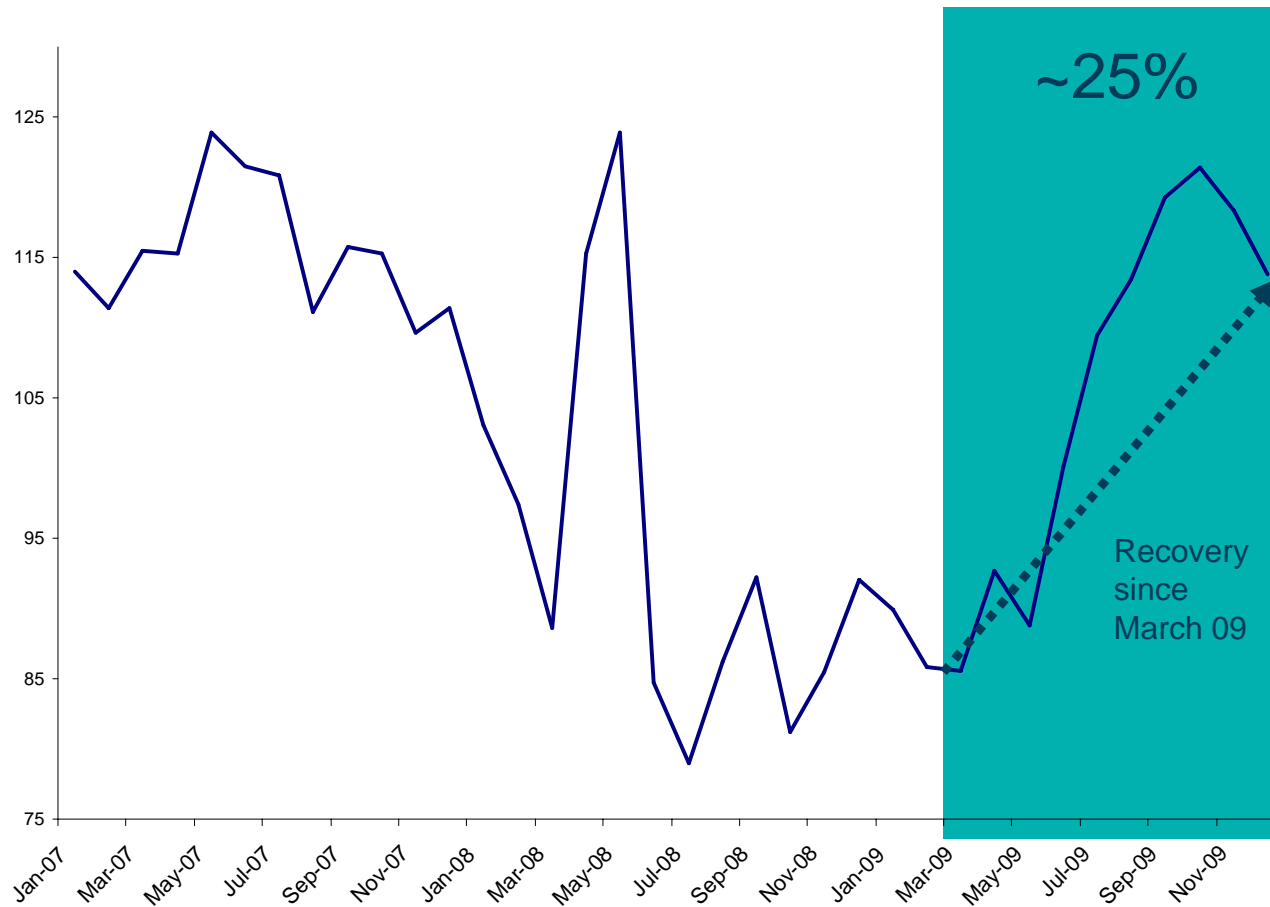
2010 Tailwinds



Greater business and consumer confidence



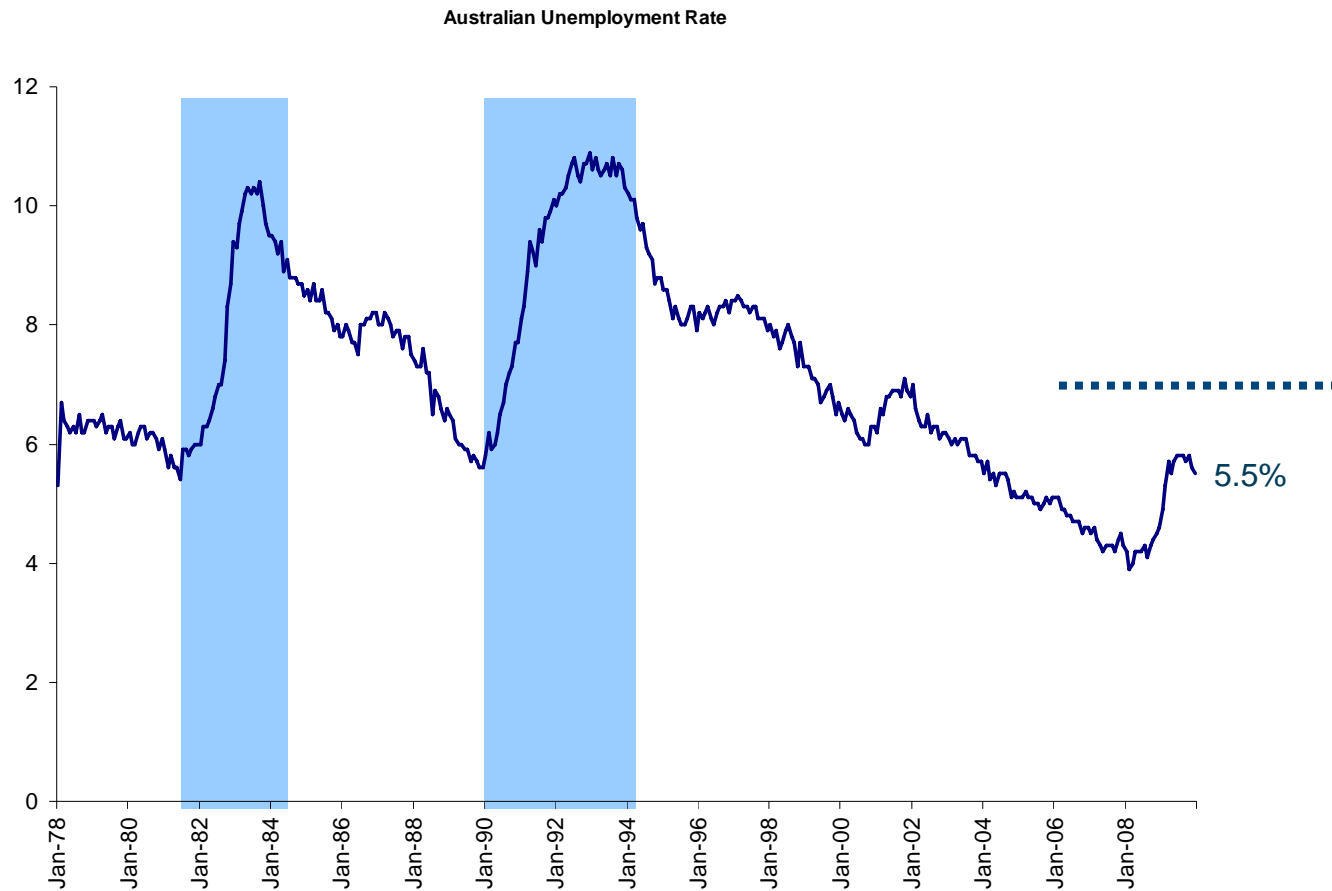
Consumer Confidence



Unemployment



Higher levels of employment support consumers ability to carry household debt and continue spending.

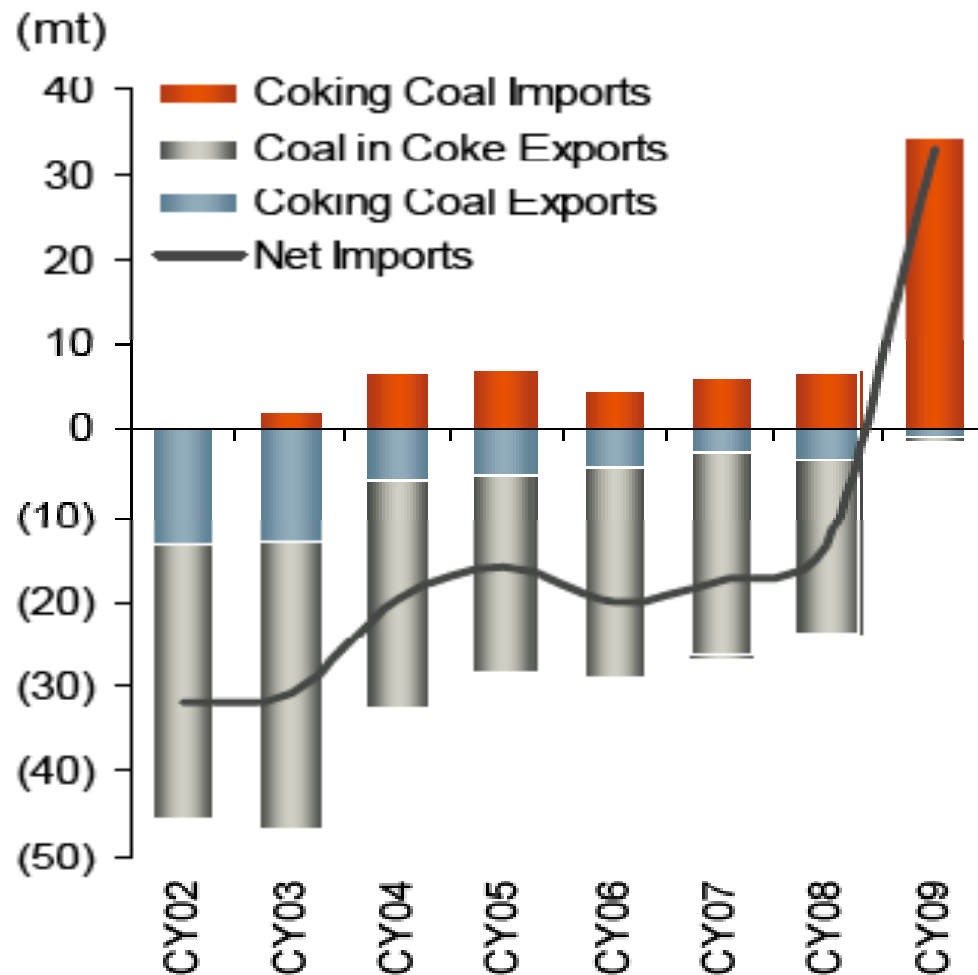


China



Chinese Imports increased significantly in 2009 and are continuing into 2010

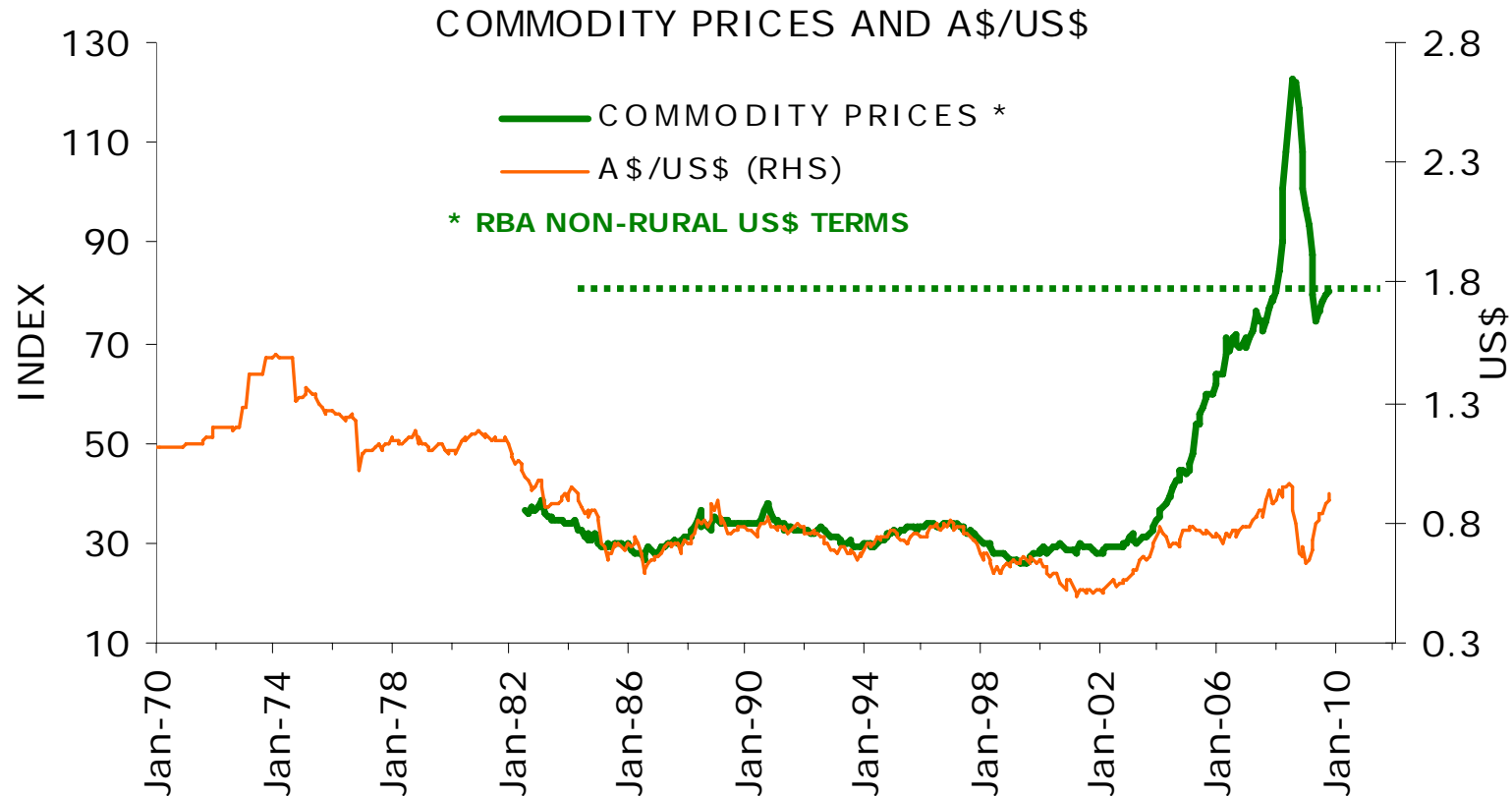
Chinese Net Coking Coal Imports (mt)



China



With Chinese growth commodity prices should remain supported

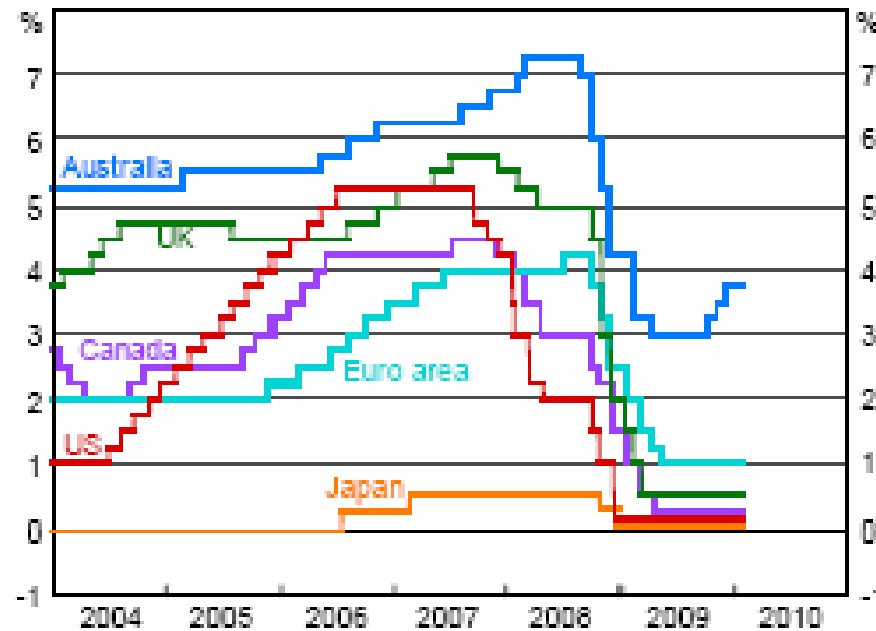


Australia's ability to manoeuvre



RBA well positioned to inject further stimulus if needed

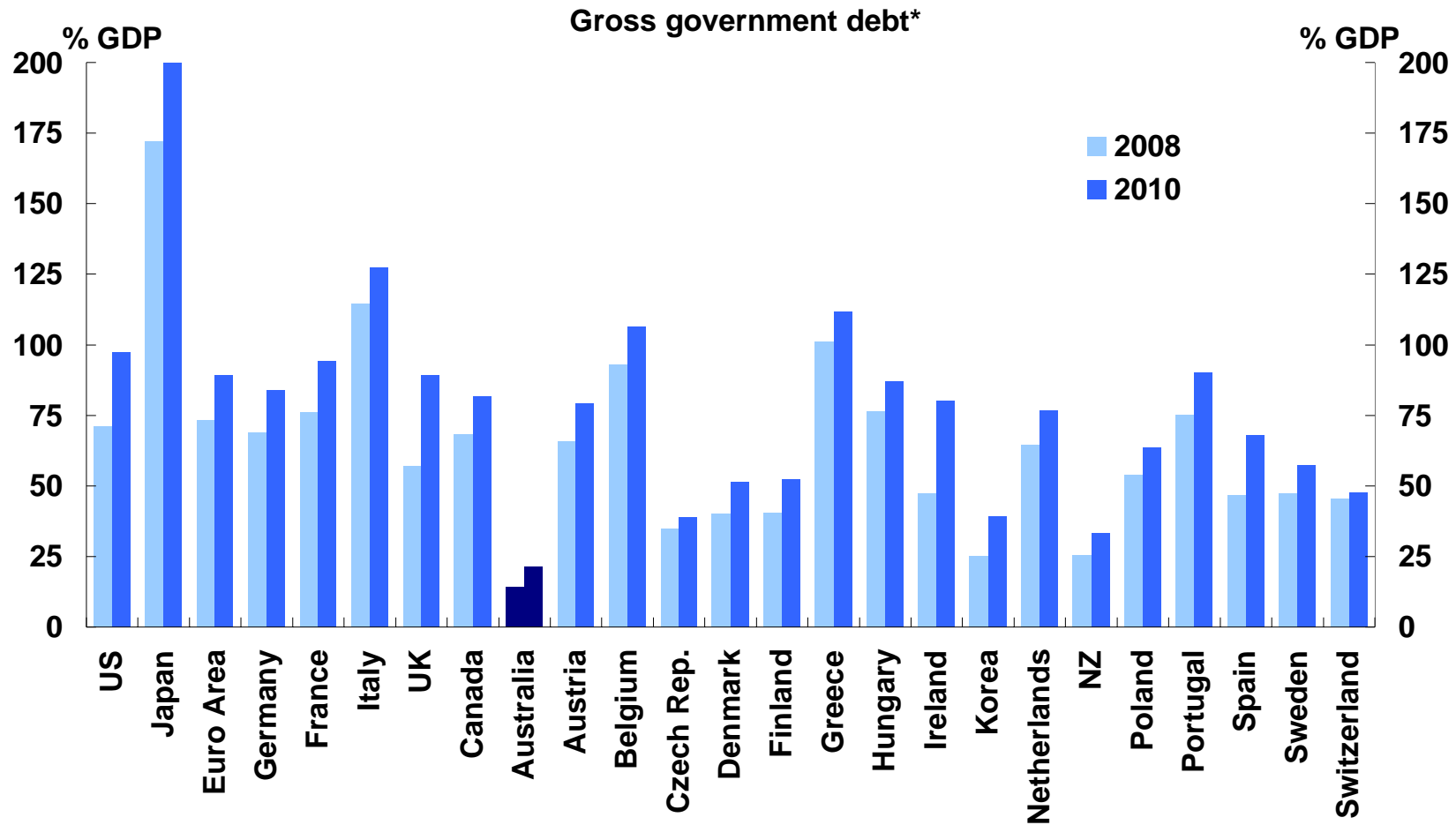
Major Countries' Policy Interest Rates



Australia's ability to manoeuvre



Strong debt position relative to other countries



*OECD 'System of National Accounts' methodology, where government bonds are valued at market value or at issue price plus accrued interest, compared to nominal values according to the Maastricht definition. Source: Morgan Stanley



Conclusion



Our view on Australian equities



- **Bounce since March 09 requires earnings delivery to justify**
- **Beta trade done; stock picking from here**
- **Cost down programs fully exhausted (double edged sword)**
- **GFC has resulted in material structural changes**
- **Market trading in narrow PE band – filter qualitatively (SS* & BE**)**
- **Stock picking starts with bottom up fundamental analysis**
- **Fundamental research rewarded again = Active management**

** Shareholder stewardship*

***Business evaluation*

Stocks and Process – RESMED (RMD)



RMD is #2 global player in CPAP flow generator and Masks used for treating sleep apnea.

- **Shareholder Stewardship = 4 out of 5.**
 - Very focussed on organic growth
 - Demonstrated an excellent ability to manage costs.
 - Shifted manufacturing from Sydney to Singapore 12 months ago thus reducing costs and reducing exposure to the volatile AUD.
 - 35% EPS growth.
 - Aligned with shareholders as management has “skin in the game at many levels”.
 - Reason its not a 5 is the company has an extremely lazy balance sheet with >US\$300M in net cash and growing at circa \$200M pa !! They own all their property (valued at \$200M). We prefer to see capital management.
- **Business Evaluation = 4 out of 5.**
 - This is a high growth business (17% top line growth) gaining share and has superior Intellectual property and product innovation.
 - High ROE and Cash flow generative.
 - Demand tailwinds driving the rising incidence of sleep apnea is due to obesity and aging trends.
 - Technology change is making diagnosis easier. 40% of people don't turn up to sleep labs when referred
- **Market Milestone = 5**
 - Following the recent excellent 2Qtr result, we believe the market profit forecasts are still too low. In our view the market has not captured the upside from the new product launches (and its positive impact on margins).
 - Also, we think the market underestimates the impact of home diagnostic testing.
 - Greencape's forecasts are 20% above the market's in FY12, so we expect further upward profit revisions from analysts.
- **Valuation = 5 , ie \$7.50. (~\$6.25 – 11 Feb)**
 - Hidden value is in the balance sheet, given the cash and property on the balance sheet.
 - Expected impact from accelerating volume growth (driven by new products and home diagnostics) has a positive impact on margins and cash flow generation – this is not being captured in today's share price.