

2009 - A Year of Extremes

It is difficult now to look back to March 2009 when we were all contemplating the possible failure of the banks, both in Australia and overseas. At the lowest point the Australian share market was down 55% and the doomsayers were in full flight. Many of us were questioning everything we thought we understood about investment markets and struggling to make any sort of reasonable predictions about the future.

In retrospect, the end of the world was never going to occur and we were always going to recover but there was certainly some days when it was hard to understand how. Governments around the world have provided major economic stimulus and economies have shown early signs of recovery. Investment markets around the world have surged in anticipation of a return to a more normal economic environment and as a result of the stimulus provided.

Reading through our predictions the 2009, made in December 2008, we were not too far from the mark although more pessimistic than the outcome. We did, however, recognise at that point that if we were wrong, markets were likely to recover more quickly and more strongly than we had expected. It was great to be wrong! Our predictions in relation to hedge funds the commercial property market and the resilience of China proved to be on the money.

2010 - A Normal Year?

Defining a normal year is difficult at the best of times but it is our view that 2010 will be significantly more normal than what we've seen over the last three years. In that context we expect sharemarkets to outperform alternatives in cash and property but with more modest performance than we experienced in 2009. Cash rates will, in our view, continue to climb after hitting their 50 year low point in Australia in 2009. Whilst this is not great news for borrowers, for investors, this will provide reasonable returns in the cash markets. We expect rates to rise over the 2010 calendar year by between 1% and 2%. This will bring cash returns back, closer to historic averages.

Our view on commercial and retail property for 2010 continues to be very negative. There is significant refinancing that needs to happen over the next 12 months and there are a number of challenges associated with that. Firstly, banks are experiencing a relative shortage of capital so they are being much more selective about whom they're prepared to lend to, so some borrowers are finding that their bank simply doesn't want to refinance at the end of the loan period. Even those banks prepared to refinance are typically doing so at a much lower loan to valuation ratio, therefore, requiring significant equity contributions from property owners - many of whom are in no position to make those contributions. It is our view this will lead to significant sales from distressed owners or mortgagees.

At the same time, property owners are faced with increasing vacancy rates and lowering rents. These



factors make owning commercial property challenging for any investor. We expect this will push prices in the sector lower, potentially offering grapevine opportunities towards the end of 2010 or into 2011.

We believe that interest rates across the world will at best remain flat, but most likely to rise over the course of the next year. That outlook is negative for Bonds and we continue to avoid them in client portfolios. It remains our view that cash and term deposits offer both better returns and security of capital.

Our view that currency is too hard to predict remains consistent and 2009 has shown what extremes currency can move through. Investors in international sharemarkets have experienced fantastic performance but those Australian investors without currency protection would have lost all of that and in fact ended up with a negative return. Our view to hedged out currency risk is unchanged.

Other predictions 2010:

- Australia's small banks and building societies will be under renewed pressure as we move towards the end of the government guarantee and a number of them will be taken over.
- Unemployment around the world will remain high by historic standards and the level of social unrest will increase accordingly.
- The Australian government budget will perform better than expected in the last update, as a result of increased revenues. Notwithstanding that the Henry tax review will look to increase tax collections.
- There will be made to reforms in the provision of financial advice across Australia, with a push towards elimination of commissions and conflicts of interest. (Having already done this we don't expect any impact from this at Tupicoffs.)

Thank you for your support and the trust you put in is over last year, and we look forward to working with you again in 2010.

Neil, Ross, James and Kearsten

Tupicoffs Pty Ltd

The information supplied above is general advice for the exclusive use of Tupicoffs clients. No actions should be taken without first seeking advice relevant to your personal circumstances.

