

Diversified

Diversified's View

February 2010

"We are fast approaching the stage of the ultimate inversion: the stage where the government is free to do anything it pleases, while the citizens may act only by permission" **Ayn Rand [may have had NZ in mind].**



Diversified Wealth Management Limited now manages two Portfolio Investment Entity (PIE) Funds, which follow our model 'Balanced' and 'Dynamic' strategies respectively. The DWM Balanced Fund commenced in April 2008, and has a Unit Price of \$1.0487 at 31st January 2010. The Unit Price of new DWM Dynamic fund (commenced Nov. 2009), was \$0.9648/Unit at Jan 31st.

A joint Investment Statement for both Funds is available on our website, by contacting our office or from any Advisor.

Diversified is also Investment Manager for The Law Retirement KiwiSaver Scheme.

Summary

- The global economic recovery is well established & is accelerating. The outlook for 2010 is for robust aggregate global economic growth expanding into 2011.
- Rising global prosperity will support corporate profitability.
- Synchronous global growth increases demand for most Commodities.
- Economic recovery in the USA may exceed broad expectations.
- Despite the power of 2009 sharemarket rebounds, history shows such bull-markets usually extend into a second year. (For Kiwi's, 2009's boom in local currencies was substantially offset by the rise in our NZ\$ reporting currency).
- Sharemarket gains are likely to be gentler in 2010, but this outlook also carries less risk. January's market swoon may be typical of 'corrections' punctuating an overall respectable level of market gains in the coming year to 18 months.
- Values and the economic backdrop, both greatly favour Equities as an Asset Class over Bonds. There is no scarcity of new Bond issues.
- Government spending is out of control (therein may lie the seeds of the next Bubble). Resentment of government activism, expansion and intrusion is already manifesting some places.
- Copenhagen marked the peak of Global Warmongering. NZ's cap-and-trade legislation will be a quaint outlier.
- As ever, the future is not knowable. Even the best strategy deals with probabilities only. Systematic diversification, in accordance with Modern Portfolio Theory, remains the best approach to managing ever-present risks & uncertainties.
- Tactical asset allocation – favouring those aspects expected to perform best, while shunning those perceived to be over-priced – adds value.

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An Adviser Disclosure Statement is available on request and without charge, or may be accessed via our website.

Expertise You Can Trust for Private Client Portfolios and Trustees

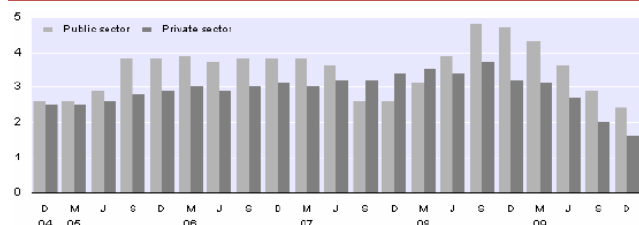
New Zealand – KPI's Pretty Ordinary

Kiwi's can be grateful to our well-paid civil servants, as most of them are captured in the top tax bracket of 38%: some by \$400,000. This well-placed and effective Wellington lobby group virtually ensures a 21% tax reduction (from 38% to 30%). An initial cut to match the 33% Trust rate may be in the May 20th Budget, with the balance an inducement to vote correctly next election.

The Budget is also likely to deliver the easy bits from independent task forces studying how to lift NZ's economic performance, how to facilitate better capital markets or how to reform taxes.

A gap exists between government spin and action. Finance Minister Bill English, in a speech to Auckland Chamber of Commerce 18 Feb, seems to identify and recognize drags. *"Government Spending has ballooned, growing 50% in the five years to 2009..."*, and, *"most Government operations will receive no budget increases over the next five years"*. But rhetoric is unmatched in action. Statistics for the year to December 2009, show public sector average total hourly earnings soaring by +5.6%, heedless of others' 'recession'. The year set new levels for already higher government pay rates to outstrip those of the private sector.

Gov't Wage Growth vs Private - 2004 to Dec 2009



Source: Statistics NZ, QES, 2 February, 2010.

As 2010 unfolds, bloated government agencies – some with very poor records of efficacy – will continue their activism and expansion, facilitated by Budget deficits extending out six years.

The fact is NZ's economic performance in recent years has been poor. Exports have not increased appreciably in a decade. NZ's Central Government at 37.3% of GDP, (plus Regional and Local Governments – about 43% in total), is bigger than that of any high-growth economy.

NZ's, controversial, *'Climate Change Response (Emissions Trading) Amendment Act 2008'*, may already be an anachronism. Chastened by misinformation & exaggeration, Australia and USA are retreating from such

measures [Suddenly, no statistical evidence exists that the world has warmed at all since 1995.].

But NZ carries economic potential longer-term. Geographic proximity to high-growth Asia, and our rich resource endowment (including high metallogenic propectivity and hydrocarbon prone geology) are national blessings, if a development path is chosen.

Key Economic Projections

	March 2010	Sept2010	March 2011
GDP % yoy	1.8	2.6	2.4
Inflation (CPI) yoy	1.9	1.6	3.0
Unemployment	7.5	7.3	6.9
Curr. Acct (%GDP)	-1.3	-2.4	-2.4
90-Bill Rate % p.a.	2.8	3.70	4.10

Source: ANZ Market Focus, 15 Feb. 2010

Even amidst lack-lustre growth, NZ investment assets offer selective scope for recovery from depressed prices. Medium-term however, policy mix, currency outlook, cash-rate and growth characteristics are not compelling. A slightly underweight model allocation is expected to be confirmed by the review of our strategy.

Australia – Upbeat ; Election Year

Leading Economic Indicators suggest growth in 2010 will match the resources boom of 2007. Job creation in January was the highest since Dec 2006; Small Business Expectations are at their highest level ever (series started in 1996), and; Business Confidence generally, the highest since 1994.

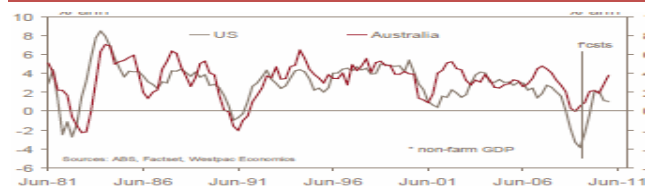
The Reserve Bank of Australia will be relieved by wage increase expectations at a modest at +2.2%, but will nonetheless soon resume its Official Cash Rate beyond the 3.75%. Fiscal stimulus is being withdrawn too with their Federal Budget – traditionally delivered in the first half of May – projecting balance restored in the 2013/14 fiscal year.

The Lucky Country's Emissions Trading Scheme has stalled in the Senate, risks being side-lined as a Federal Election required before April 2011 takes priority. A quick and very diluted scheme will pass shortly, or some simpler form of carbon tax may result post-election.

Australia's heritage of exploring, delineating and developing its mineral estate, combined with progressively enhanced roads, rails & ports infrastructure), find it in pole position as preferred supplier to booming Asia. Alone among Developed

nations Australia avoided the recession. In recent years, growth by The Lil' Sheriff has exceeded that of the USA.

Aussie Growth beats USA



Source: Westpac Regional Economic Outlook, Vol 4, 2009

Economic fundamentals continue to be revised upward. The table below contrasts ANZ forecasts made in December, 2009, with their revised estimates this month, and new outlook for 2011.

Key Economic Forecasts – Australia

	2010 in Dec*	2010 now	2011 now
GDP % p.a.	+2.9	+3.1	+3.3
CPI % p.a. (headline)	+2.3	+3.0	+2.7
Unemployment %	5.8	5.2	4.8
Curr. Account (% GDP)	-4.40	-5.7	-5.3

Source: ANZ Market Weekly, * = 23 December, 2009; 'now' = 11 Feb.

Australia's leverage over the robust global growth commands investor's attention. Growth fostering policies, combined with its stronger and more diverse economy cause it to be the preferred Australasian partner.

International – Synchronous & Accelerating Growth re-established

Our once lonely prediction for a V-shaped rebound has become mainstream. Official estimates, initially for a weak recovery, have been progressively revised upward to a now robust pace expected almost everywhere. This good pace of aggregate global growth in 2010 is projected to accelerate in 2011. All regions and countries are expected to participate.

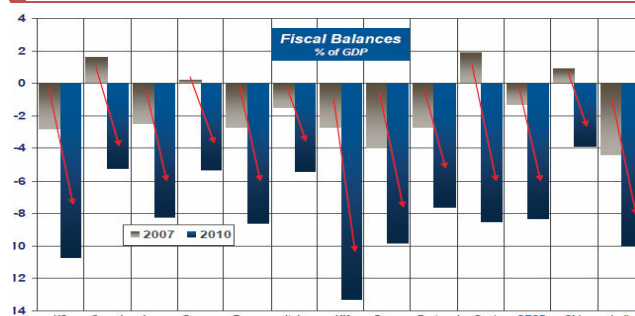
Progressive Upward Revisions - GDP Growth (% y-o-y)

	IMF WEO Jan 2009	IMF WEO Oct 2009	IMF WEO January 2010	
Region/Country	2010	2010	2010	2011
Developed World	+1.1	+1.3	+2.1	+2.4
- USA	+1.6	+1.5	+2.7	+2.4
- Euro-land	+0.2	+0.3	+1.0	+1.6
- UK	+0.2	+0.9	+1.3	+2.7
- Japan	+0.6	+1.7	+1.7	+2.2
Emerging Markets	+5.0	+5.1	+6.0	+6.3
- Brazil	+3.5	+3.5	+4.7	+3.7
- Russia	+1.3	+1.5	+3.6	+3.4
- India	+6.5	+6.4	+7.7	+7.8
- China	+8.0	+9.0	+10.0	+9.7
World total	+3.0%	+3.1	+3.9	+4.3

Source: IMF WEO Jan., 2009, Oct 2009 & Jan 26, 2010

Our confidence in the robust economic outlook is relatively high, in part attributable because powerful official stimuli continue to operate and have significant lead-times. Easy monetary policy (mainly low interest rates) - is very widely recognized, monitored and reported. Central Bankers' discipline in withdrawing it appropriately is largely assumed. Just as influential, albeit more obscure and subject to political whimsy, is the scale and role of fiscal stimuli.

Selected Budget Deficits - % of GDP (2007 vs 2010)



Source: Via Economic Monitor, Jan 21, 2010. Dundee Wealth

Budget deficits are massive – the UK deficit is at -13% of GDP to produce +1.3% growth. Meanwhile crises such as that of Greece serve to keep stimulus operating.

The rapid succession of firstly, the 'War on terror' (military & personal invasions), then Bank Bail-outs, and followed by unfettered spending in pursuit of 'recession fighting', have enticed ambitious governments nearly everywhere into unchecked activism. But resentment is now rising some places. The Great Recession destroyed 6.6 million of American's private sector jobs, while government employment rose by 355,000 jobs. On current trends, the Public Sector of the USA will be 25% of GDP by 2018. 'Tea Partyists' are riled.

What Recession? – Not in US Gov't Employment (Employees X1,000)

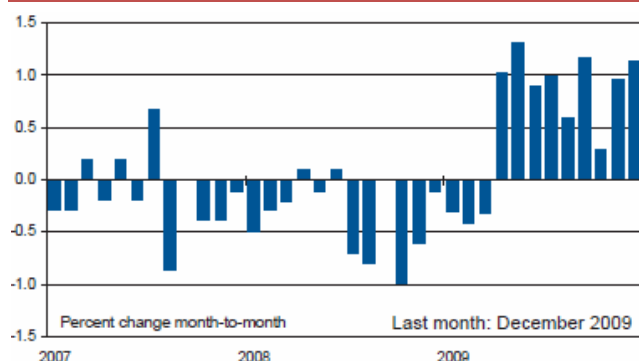


Source: Casey's Daily Dispatch, Feb 17th 2010

Nevertheless, *Diversified* finds economic growth for the USA in 2010/11 may be under-estimated. Leading

Economic Indicators in the USA (statistics projecting growth in 6 to 9 months), are persistently strong.

American Economy – Leading Economic Indicators



Source: *Economic Monitor*, Jan 21, 2010. Dundee Wealth

A hallmark of *Diversified's* strategy process since inception, has been a benchmarked international spread according to relative economic size (regional or national GDP's adjusted for Purchasing Power Parity). Having an economic basis provides better diversification and stability. The rate of economic change is small and incremental compared with sharemarket volatility. Yet many - MSCI Indices and New Zealand Herald columnists among them, cling to the inferior sharemarket capitalizations for their benchmarks and spreads. The difference is depicted below:

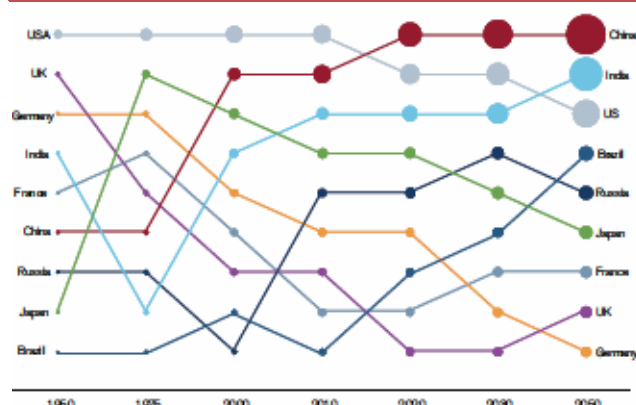
Global Economies vs Sharemarket Capitalizations

Rank	Country	GDP PPP (billion)*	% of World Economy*	Stock Mkt Capitalization **
	World	\$70,210,	100%	100%
1	Euro. Union	\$14,520	20.7%	6.1%
2	USA	\$14,250	20.3%	32.2%
3	China	\$ 8,767	12.5%	7.6%
4	Japan	\$ 4,141	5.9%	7.1%
5	India	\$ 3,548	5.1%	5.4%
7	U K	\$ 2,165	3.1%	6.0%
9	Russia	\$ 2,103	3.0%	n.a.
10	Brazil	\$ 2,024	2.9%	2.8%
19	Australia	\$ 819	1.17%	2.7%
58	N.Z.	\$ 116	0.17%	0.08%

Source: *Data from CIA - The World Factbook, 2009; ** Mkt Cap Data from Wld Fed Of Exchanges, Yr-end 2009.

Further we find the market-capitalization approach to be distinctly inversely prospective. The object of tactical asset allocation is to favour those regions or countries in economic ascendance; those with above average growth rates. Current indications are that USA may do best among Developed world in maintaining market share, but Emerging Markets are the next leaders. Europe is destined to fade markedly.

Ascending and Descending Economies - 1950 to 2050



Source: Credit Suisse Research Inst. Global Returns Yearbook 2010

Diversified believes vigorous and synchronized global growth is most likely to prevail over our whole one-year to 18 months tactical horizon. Further, we suspect the pace of economic expansion is likely to be higher than is popularly assumed. Relative growth rates should be similar and continue, with USA likely to exceed consensus on the upside.

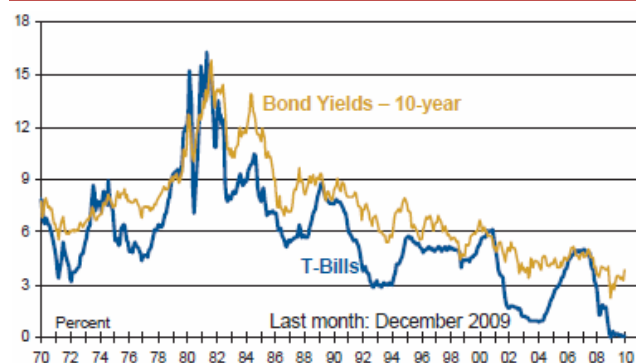
Fixed Interest – Low yields

Currently available 'risk-free' yields are destined to lift over our tactical horizon, but beyond diversification & operating needs, Cash is still not a viable Investment.

The improving global economic outlook augurs credit risk diminishing. Corporate Bonds may be the best of a generally unattractive asset class.

The whole Fixed Interest Asset Class is very expensive by historical comparison. Yields are at period lows, allowing no margin for rising inflation.

US Bond Yields – at record lows



Source: *Economic Monitor*, Jan 21, 2010. Dundee Wealth.

Investors living costs can readily be met by drawing on yield, dividend and gains, as well as capital. *Diversified* believes investors do themselves a disservice when

endeavouring to match their requirements with market yields.

Our model strategies have reduced allocations to the Fixed Interest asset class, to the minimum levels required for diversification of progressive risk profiles. For NZ, we favour two to three-year, generally corporate, maturities. Internationally debt issued by Utilities and Corporate issuers is utilized.

Equities – Bull Market on Average

The global economic setting we anticipate for our tactical horizon – high growth, and continuing low interest with tame inflation – unequivocally favours the Equities asset class.

2009 was a vintage year for sharemarkets; a boom most felt in local currency terms. Investors who did not swap foreign currency diversification for NZ\$ risk (Diversified's usual stance), had local gains reduced to the extent our reporting currency rose. Conversely, the year just past was one during which hedging to the NZ\$ was handsomely rewarded

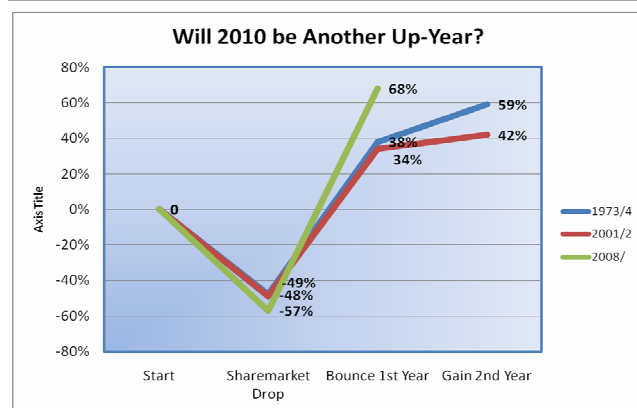
Effect of Appreciating NZ\$ on 'local currency' Returns

Market	1-Yr gain in local currency	NZ\$ movement	1-yr gain in NZ\$-terms
Hong Kong	+54.3%	-38.2%	+16.1%
NASDAQ	+45.4%	-38.0%	+7.4%
MSCI Wid	+33.5%	-20.4% (TWI)	+13.1%
Australia	+29.1%	-0.8%	+29.9%
Japan	+29.1%	-39.1%	-10.0%
UK	+25.0%	-22.1%	+2.9%

Source: *Diversified's* research, to 31 Jan, 2010

We do not believe the global bull market is over. The record following severe sharemarket disruptions is of recovery generally extending into a second year; at a considerably gentler pace, but also with less risk (than trying to pick the bottom of a crash).

Severe Mkt Crashes Followed by Extended Recoveries



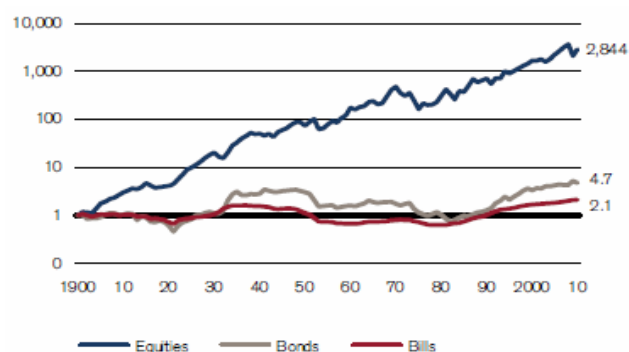
Source: *Diversified* Research, from Industry Data

Fundamentally, we expect buoyant economic growth will translate directly into rising company profits. Analysts in reflating USA are predicting a +32% gain in Standard & Poor's 500 Index this year. Contrasting with the distressed equity-raising and deleveraging of a year ago, 2010 is also likely to see increased merger-and-acquisition activity in markets, as well as new capital expenditure. The inevitability of interest rate hikes eventually, may trigger periodic volatility. The journey back to neutral monetary policy is likely to take several quarters.

Sharemarket volatility is more likely than during 2009's unchecked rebound. However, while mixed economic statistics, or even spreading sovereign difficulties, may periodically check the market, uncertainty also serves to extend stimuli and prolong the secular Bull Market.

Kiwis are lucky to have as their second, most readily accessible market, the world's strongest and most reliably performing Equity market, according to a new study. Over 110 years, Aussie Equities have averaged a real return of 7.5% (versus 5.9% for NZX) - aggregating 2844.15% growth (assuming dividends re-invested).

Australian Sharemarket: 1900 – 2009



Source: Credit Suisse Research Inst. Global Returns Yearbook 2010

Australian Equities feature prominently, and currently carry a full weighting in *Diversified's* model strategies.

Commodities – Blessed by Synchronous Growth

The quickening pace and broad spread of global growth will also lift demand for most all commodities.

The last period of high and synchronous economic growth – had global demand for base metals surging at +4.6% p.a., and energy and agricultural commodities experienced similar trajectories. The new cycle of rising demand is one year old this month. Our sources predict world demand will rise at about a 2.3% p.a. pace ahead, perhaps for several years. The price of many commodities (e.g. Copper, Oil) has already risen very sharply from one year ago. However, this rise was from

the abyssal depth of deeply oversold markets during depths of the Great Financial Crisis of 2008. Absolute prices remain well below the high levels set last cycle.

Commodity Prices - upward momentum

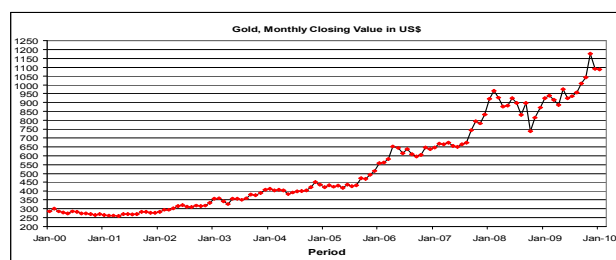


Source: *Economic Monitor*, Jan 21, 2010. Dundee Wealth.

One tool allowing tactical leverage to global reflation - without excessive allocation to Equities, or incurring style-switching drags (e.g. defensive-capable selections for more aggressive, or 'small-cap' styles), - is inclusion of the Commodities Asset Class.

Nuclear Energy is resurgent. In underwriting the USA's first new US reactor-building programme in 30 years, (in Georgia), President Obama recognized nuclear energy as the only carbon-free sources of significance. Other parts of the world moved earlier. The World Nuclear Association reports 56 nuclear plants are under construction globally; 100 more are planned, with 270 additional proposed.

Gold Bullion in US\$ - to 31st Jan., 2009



Source: *Diversified's Research*

Currency - continuing volatility, NZ\$ exchange rate

Key emerging currencies, notably China's Renminbi, remain tightly controlled against the US dollar, resulting in intense volatility befallen fully-floating peripheral currencies. That situation is expected to persist. Very material exchange rate swings are unrelated to NZ's needs, and sometimes to our best interests.

NZ\$ Exchange Rate Forecasts

	Mar '10	Mar '11	Sept '11
US\$	0.70	0.64	0.64
A\$	0.79	0.78	0.83
Euro	0.51	0.50	0.52
GBP (£)	0.44	0.41	0.42
Japan ¥	62.3	61.4	64.0
NZ\$ TWI	64.4	62.0	63.8

Source: *Rounded from ANZ Market Focus*, 15th February, 2010.

Salient Rates, Indices, & Exchange Rates

Following are the January 31st, 2010 rates and selected equity market indices, relevant currencies, with their percentage gain or loss from that of three months, six months, and one year earlier. Figures are before taxation, fees or any impact from NZ currency.

ACTUAL	31/01/'10	3 Months	6 Months	One year ago
Prevailing Monetary Conditions Index.	+217	220	-71	-813
Prevailing NZ Cash Rate (90-day)	2.77% pa	2.79% pa	2.79% pa	3.71% pa
Prevailing 2011 NZ Gov't Stock Yield	3.99% pa	4.32% pa	3.80% pa	3.35% pa
Prevailing 2015 NZ Gov't Stock Yield	5.18% pa	5.49% pa	5.28% pa	4.03% pa
CHANGE	Value	Gain or loss since...		
NZX NZ Gov't Stock [Bond] Index	1097.95	+2.2%	+3.0%	+1.0%
NZSE 50 (Gross)	3164.65	-1.6%	+4.9%	+14.1%
NZSCI (Gross)	21185.81	0.0%	+11.1%	+29.3%
S&P/ASX200 (Australia) *	4569.60	-1.6%	+7.7%	+29.1%
MSCI World Index (Capital)*	1199.54	+1.2%	+7.2%	+33.5%
Dow Jones (USA) *	10067.33	+3.7%	+9.8%	+25.8%
NASDAQ*	2147.35	+5.0%	+8.5%	+45.4%
FTSE 100 (UK)	5188.52	+2.9%	+12.6%	+25.0%
Nikkei DJ (Japan) *	10239.69	+2.2%	-0.9%	+29.1%
Hang Seng (Hong Kong) *	20198.19	-7.8%	-1.9%	+54.3%
NZD/USD	0.70	-3.8%	+6.7%	+38.6%
NZD/AUD	0.79	-1.5%	-0.5%	-1.6%
NZD/JPY	63.33	-5.4%	+1.2%	+38.5%
TWI	64.65	-1.6%	+5.4%	+25.3%
Gold (US\$ / oz., troy)	1,086.20	+4.2%	+16.1%	+17.3%
Crude Oil (WTI, US\$/bbl)	73.63	-4.8%	+16.2%	+77.1%

*Indices, figures and performances in respective local currencies unless otherwise stated.

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