

**Diversified**

## **Diversified's View**

March 2010

*"The biggest risk may be in not taking risk. Also, there are a number of things that could go right ..."*

**Chen Zhao, Managing Editor,  
Global Investment strategy, Feb  
26, 2010.**



*Diversified* Wealth Management Limited offers our model 'Balanced' and 'Dynamic' strategies, which have been operating successfully for 16 years, as Portfolio Investment Entity (PIE) Funds. The DWM Balanced PIE Fund commenced in April 2008, and has an independently determined Unit Price of \$1.0740 at 28<sup>th</sup> February 2010. The DWM Dynamic fund commenced in Nov. 2009 and has a Unit Price of \$0.9782 at February 28<sup>th</sup>, 2010.

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, which offers 'Balanced' and 'Dynamic' member's choice to members.

### **Summary**

- The global economic recovery continues and is accelerating. Particularly the 'Emerging Markets' half of the world, and USA, are exceeding forecasts.
- Persisting media focus that deflation may be faltering, hesitant investors delaying re-engagement, and still nervous governments, serve to keep deflationary forces operating.
- Monetary stimuli will be withdrawn gradually, trending toward neutral over our one-year to 18 month horizon.
- Political indulgences masquerading as fiscal stimuli will linger.
- We regard the growth-triggered, cyclical upswing in corporate profitability is in its early stages most everywhere.
- The global growth setting favours Equities & Commodities as asset classes. Both can be tactically emphasized in portfolios to benefit.
- While the global sharemarket Boom of 2009 (largely camouflaged for Kiwi's by our soaring NZ\$), has passed, history augurs that gentler growth will continue into a second year.
- Government spending is out of control in many western countries. Taxpayer revolt is fomenting.
- NZ may be at a crossroads, as to how to manage its considerable resource riches
- While our outlook is very prospective for long-term investment strategies, we remain cognizant the future is never knowable. The whole portfolio is the investment; including holdings perceived to carry great promise of out-performance, diversified with those necessary to preserve capital in most any conceivable circumstance.
- *Diversified* has just completed its formal, Quarterly Strategy Review process. Changes will be communicated to investors in the course of regular portfolio reviews.

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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**

**Diversified Investment Strategies Limited**

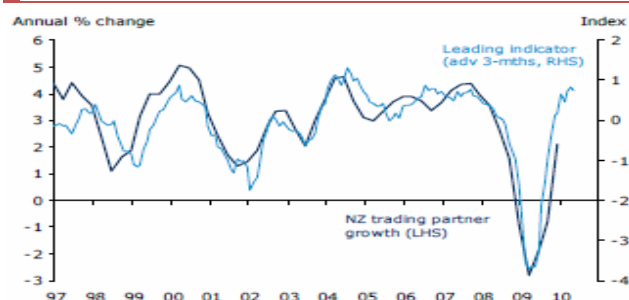
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## New Zealand – sub-par Growth ahead.

At this point, Kiwis and our government, have settled for mediocre growth, if that avoids possibly discomfiting change. Fortunately the external environment is rebounding strongly, and Leading Economic Indicators augur robust growth entrenched. The NZ economy, and notably our export sector, should be dragged along up.

### NZ Trading Partner Growth



Source: ANZ Market Focus, 8 March 2010

The near-term pace for NZ's economic growth has been revised slightly downward, lifting around the time of the Rugby World Cup and, coincidentally, next scheduled election.

### Key Economic Projections

	March 2010	Dec2010	June 2011
GDP % yoy	1.6	2.1	3.7
Inflation (CPI) yoy	2.3	3.1	3.2
Unemployment	7.5	6.8	6.1
Curr. Acct (%GDP)	-1.3	-2.4	-2.6
90-Bill Rate % p.a.	2.70	3.70	4.60

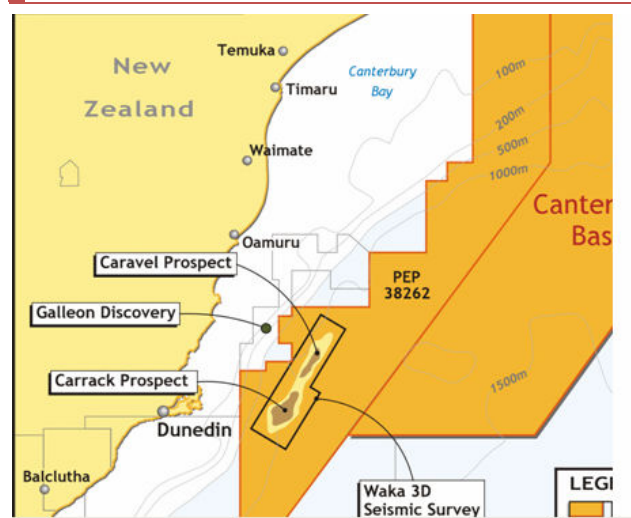
Source: ANZ Market Focus, 8 March, 2010

NZ is extremely well endowed with resources, particularly on a per capita basis. The 10-year hiatus in issuing of mariculture (mussel-farming) licences characterized a reticence to develop same. But a looming issue which could be beneficially debated in an orderly fashion now, is what ought be done with wind-fall royalties, should a major Oil & Gas field be suddenly discovered. The considered Norwegian response was to establish and fund a sustaining sovereign fund with their North Sea windfall, thereby protecting the balance of their economy. Neighbouring jurisdictions (e.g. Holland & the UK), instead spent proceeds on social programmes. Under the latter scenarios, dependency, currencies and costs-bases rose to the detriment of the rest of their economies (aka Dutch disease).

NZ's Geological & Nuclear Sciences SOE describe the Reinga basin as "one of the most prospective frontier basins in the New Zealand region".

More immediately, giant oil company, Anadarko Petroleum Corporation (NYSE symbol APC), this month agreed a 'farm-in' to Origin Energy's Petroleum Licences over the offshore Canterbury Basin, in return for spending the first US\$30 million in costs. Long-time readers will recall the 1985 Galleon-1 Discovery well, flowed 2240 bbl/day of condensate and 30 million m<sup>3</sup> of gas.

### NZ Resources – Highly Prospective if Risky



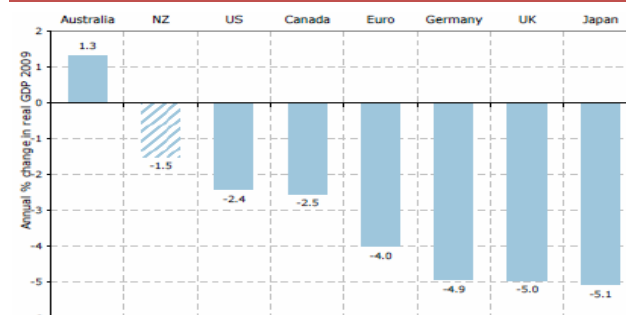
Source: Origin News Release Feb 25<sup>th</sup> 2010.

Diversified's strategy review, somewhat reluctantly, confirmed the current low weightings to NZ assets.

### Australia – Gold Medal Performance during GFC

We may quibble about the mechanisms, but there is no doubting Australia's avoidance of recession amidst the 'Great Financial Crisis', was both a feat and the envy of the Western World.

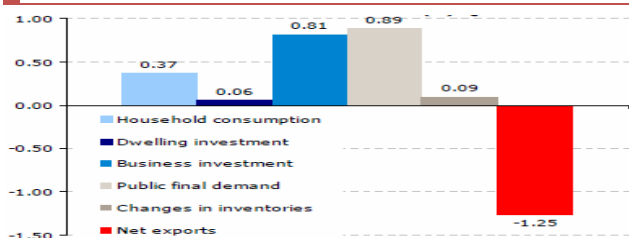
### Australian alone, avoided Recession



Contrary to Kiwis' popular belief, Resources were not the cause of Australia's economic resilience in the downturn.

[Actually NZ has arguably superior resources per capita]. The biggest recent contributors to sustaining positive growth in Australia, have been the traditional sectors of Manufacturing and Farming. Resources actually detracted from GDP growth last quarter.

### Contributions to GDP Q4 '09 - it was not 'Resources'



Source: ANZ Australian Economic Weekly. March 5, 2010

Looking ahead, forecasts for the Australian economy continue to strengthen. 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	+3.2	+3.4
CPI % p.a. (headline)	+2.3	+2.4	+2.8
Unemployment %	5.8	5.2	4.9
Curr. Account (% GDP)	-4.40	-4.5	-4.0

Source: ANZ Market Weekly, \* = 23 December, 2009; 'now' = 5<sup>th</sup> Feb.

While the numerical allocation to Australia has been only maintained in *Diversified's* just completed strategy review, more growth-oriented investment styles or blends are now advocated, especially in our more aggressive profiles.

### International - Reflation blossoming

There is now littler controversy that global economic growth is accelerating and spreading.

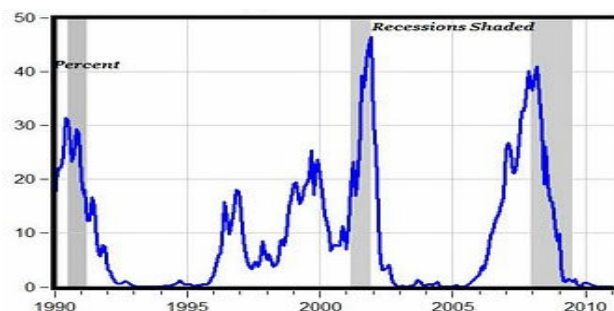
### Progressive Upward Revisions - GDP Growth (% y-o-y)

Region/Country	IMF WEO Jan 2009	IMF WEO Oct 2009	IMF WEO January 2010	
	2010	2010	2010	2011
<b>Developed World</b>	<b>+1.1</b>	<b>+1.3</b>	<b>+2.1</b>	<b>+2.4</b>
- 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
<b>Emerging Markets</b>	<b>+5.0</b>	<b>+5.1</b>	<b>+6.0</b>	<b>+6.3</b>
- 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
<b>World total</b>	<b>+3.0%</b>	<b>+3.1</b>	<b>+3.9</b>	<b>+4.3</b>

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

The threat of a 'Double-Dip' recession (if ever present), has unequivocally receded. The USA – not alone but with the most timely statistics – typifies indications elsewhere. The spread between long-term (10-yr) and short-term (90-day) interest rates, has proven a reliable harbinger of economic recession in 12 month's time. That signal is currently at a record low (0.043%).

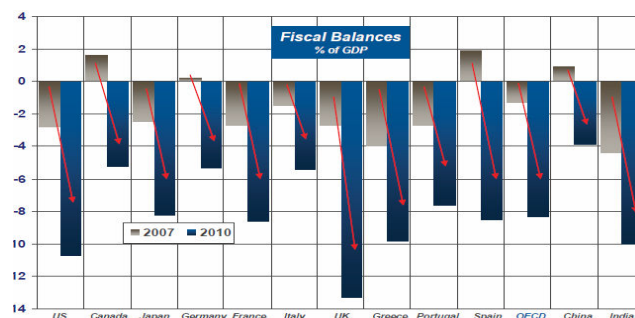
### Probability of Recession - is almost Zero



Source: NY Fed.

Supporting confidence that reflation will prevail, is that fiscal stimulus is entrenched and immutable. While Monetary Policy is controlled by technocrats – and is expected to be withdrawn in a disciplined fashion as circumstances permit - Fiscal policy is captive of political whimsy. Governments and their bureaucrats historically, have contracted only when forced to. Globally, fiscal stimulus is currently Immense, having 'blown-out' in just the last three years.

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



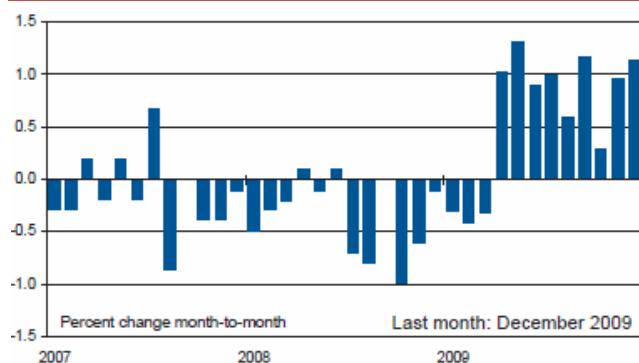
Source: Via *Economic Monitor*, Jan 21, 2010. Dundee Wealth

The Maastricht Treaty creating the euro, supposedly limited member's budget deficits to -3%. It has been utterly abrogated. (Greece's subterfuge revealed its deficit at close to 13.5%). Even UK – once considered prudent - is running an unsustainable deficit at -13% of GDP, and that to beget growth of a paltry +1.3% this year. By contrast, China's much reviled deficit - at 4% to foster GDP growth near 9%, may be sustainable.

As with New Zealand, western governments many places are growing at the expense of the non-State sector. In trend-setting USA, the Great Recession destroyed 6.6 million of private sector jobs, while government employment rose by 355,000 jobs – most all with defined benefit pensions schemes and enduring health cover, adding to intractable and mounting ‘legacy costs’. Taxpayer revolts – such as the USA’s ‘Tea Party’ rebellion – are likely to spread.

Leading Economic Indicators in the USA (statistics projecting growth in 6 to 9 months), remain very strong.

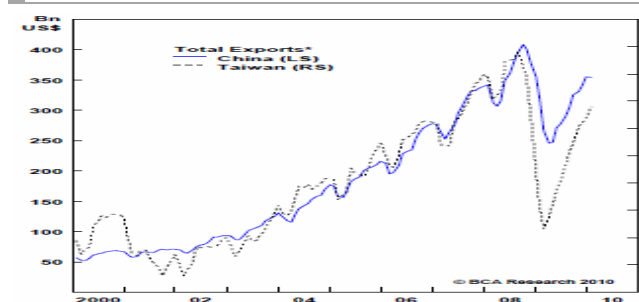
### American Economy – Leading Economic Indicators



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

Globally, economic repercussions from the Great Financial Crisis are drifting unequivocally astern. Global trade has recovered almost to pre-GFC levels in Asia.

### Global Trade Rebound

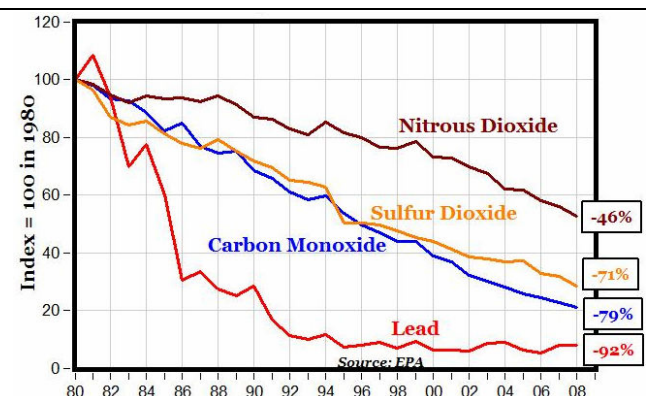


Source: BCA Research, GIS Weekly, March 5, 2010.

*Diversified's* just completed, Quarterly Strategy Review recognizes growth is the greater probability, and confirmed weightings to the high-growth areas of the world. Persistence with some defensive facets has been offset with additional allocation to selected commodities standing to benefit from reflation.

## The Good News Report

### - US Air Pollution is Being Dealt To - A Vast Improvement; The Planet is Getting Better



Source: Carpe Diem, March 2010

During the ‘Environmental Crisis’ of 1970, earnest academics foretold that US life expectancy was on-track to plummet to 42 (by 1980!); that air pollution would cut in half the amount of sunlight reaching the earth (by 1985), and; that the world would be 11 degrees colder by 2000.

40 years later, it evolves the US population is 50% greater, 160% more miles are driven, real GDP has increased by 204%, **and air quality is vastly better**

Good news tends to not get reported. 2010 is likely to bring some too.

## Fixed Interest – Low yields

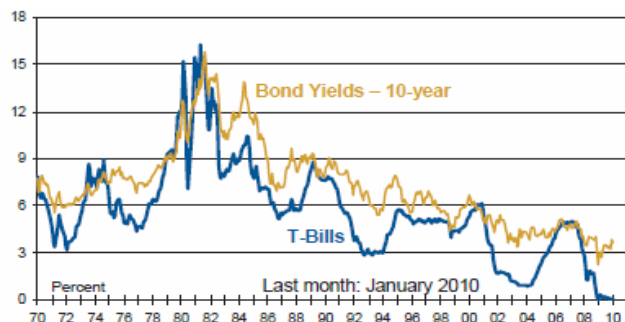
*Diversified* finds prevailing yields on supposedly ‘risk-free’ assets (i.e. high-quality sovereign bonds and Cash), to be quite inadequate – and may in fact be quite risky. We believe yields are destined to lift over our tactical horizon, potentially reducing Bond’s capital values. Cash too is a drag on expected portfolio returns. Beyond diversification & operating needs, is not considered a worthy holding.

The improving global economic setting supports credit risk among corporates diminishing. Corporate Bonds may be the best of a generally unattractive asset class.

Studies show the point of entry determines up to 20% of long-term returns. Fixed Interest as an Asset Class is now very pricey, and with correspondingly derisory yields, expensive by historical comparison. Longer rates in our

opinion allow inadequate compensation for the risk of rising inflation.

**US Bond Yields – at record lows**



Source: *Economic Monitor*, Feb 11, 2010. Dundee Wealth.

*Diversified* has long encouraged sophisticated investors to meet their living costs by drawing from their portfolio's total returns. To subordinate personal income needs to prevailing market yields, is nonsensical.

The strategy review maintained allocations to the Fixed Interest asset class, at minimum levels required for diversification of progressive risk profiles. In NZ, we favour two to three-year maturities, including selected corporate issues. Internationally, debt issued by Utilities, Corporate issuers and sound Emerging Markets, are favoured.

**Equities – “We got past Pearl Harbour . We will win the war. It's going slightly our way”. Warren Buffett, Mar 1<sup>st</sup> 2010 on CNBC**

The global economic setting distinctly favours the growth asset classes, including Equities.

2009 was a great year for sharemarket investors; sufficiently so to overcome a powerful rebound in our New Zealand Dollar reporting currency. (NZ\$ depreciation had earlier sheltered Kiwi investors from the world ravages of the GFC, leaving local values substantially intact).

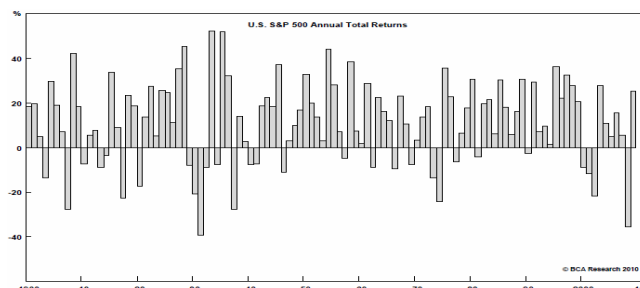
**Effect of Appreciating NZ\$ on 'local currency' Returns**

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 Wld	+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

*Diversified's* research finds a range of factors indicate the global bull market will continue into 2010. Using the bellwether USA market as indicative, the historic record shows most sharemarket crashes are followed by gentler gains in the second year after the initial rebound.

**Plunges Followed by 2<sup>nd</sup>, Gentler Up-Year - US S & P Index**



Source: *BCA Research, GIS Weekly*, March 5, 2010.

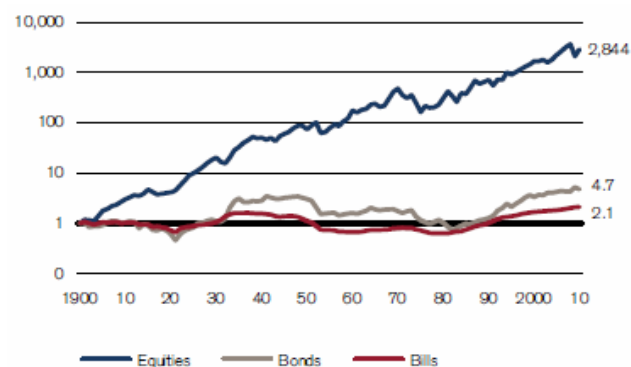
The fundamental economic outlook is for buoyant growth more likely on the upside. Rising prosperity will translate directly into rising company profits.

USA analysts are predicting a +32% gain in Standard & Poor's 500 Index this year, as well as rising capital expenditure to maintain market share. 2010 may also see return to increased merger-and-acquisition activity in markets.

The onset of Official monetary tightening may trigger bouts of volatility, but we expect these may only punctuate the broader upward trend.

Kiwis are privileged to have as the dominant part of the home, 'Australasian' market, the world's strongest and most reliably performing Equity market. Aussie Equities have the remarkable record of having averaged a real return of 7.5% (versus 5.9% for NZX) - aggregating 2844.15% growth (assuming dividends re-invested), over 110 years.

**Australian Sharemarket: 1900 – 2009**



Source: *Credit Suisse Research Inst. Global Returns Yearbook 2010*

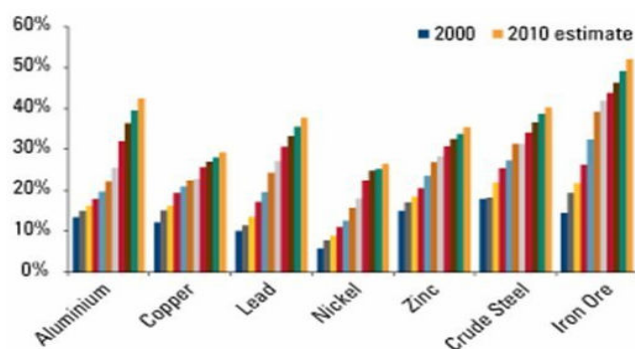
Our review confirmed a dominant allocation to the Australian sharemarket (including local PIE 'Australasian' mandates), in model strategies. Overall allocation to Equities is regarded as relatively full, but retaining some long/short capability for diversity.

### Commodities – “Buy what China needs; avoid what competes with China”. Anon

Consistent with *Diversified's* economic outlook, is that Global commodity prices should continue to advance. Aside from likely out-pacing the global recovery, commodities target the higher-growth areas.

China is illustrative of Emerging Markets more broadly, in having an economy of high, and rising, resource intensity.

#### China's Consumption as % of World Demand

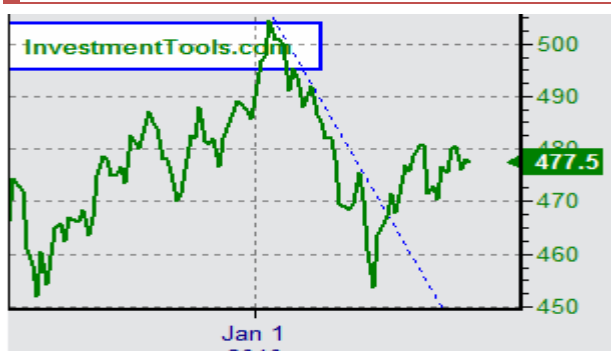


Source: BMG Group March 9, 2010

Whilst we anticipate commodity prices to be in a medium-term up-trend, the asset class is prone to considerable volatility. Commodity markets amplify each nuance, as to global growth exceeding or falling short of, general expectations. *Diversified* gauges a quickening pace and broad spread of global growth will prevail over our one-year to 18-month tactical horizon, in aggregate.

Commodity prices are yet well below peaks achieved during the last period of comparable prosperity.

#### Commodity Prices – CRB Index



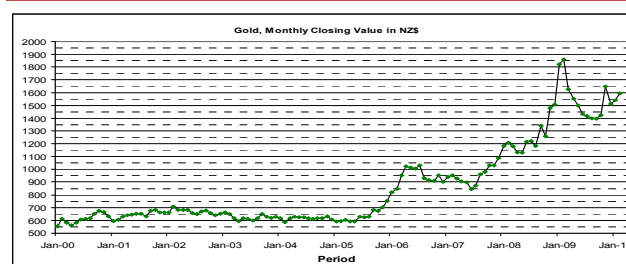
Source: InvestmentTools.com

#### Gold:

The initial attraction of Gold – as a counter to a possible systemic financial failure – has undoubtedly receded. However, this has been superseded by a new rationale. Official measures to combat the GFC were successful, but at the cost of vastly expansionary monetary policies, exploding national debts and competitive global currency devaluations. Fiat currencies, and the taxing authorities underpinning them, have been weakened. Gold is the sole form of money which is not the liability of another party.

Recent bullion price has been volatile, especially in NZ\$-terms.

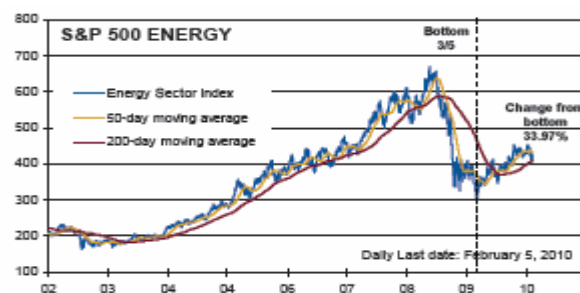
#### Gold Bullion in NZ\$ - to 28<sup>th</sup> Feb, 2009



Source: *Diversified's* Research - data to Feb 28<sup>th</sup>, 2010

Global energy demand will also rise as a consequence of the robust global economic recovery anticipated.

#### Energy Sector – still early days



Source: Murenbeeld Market Monitor, Feb 10, 2010

*Diversified's* just completed strategy review further trimmed our model allocation to gold Bullion. Proceeds should be applied to Commodities more broadly, including those offering superior leverage to continuing global deflation. Advisors will correspond in the course of regular reviews of client portfolios.

#### Currency –

The author is on a personal journey to establish and empirically determine the purchasing power of the Thai Baht. In NZ\$-term.

## Salient Rates, Indices, & Exchange Rates

Following are the Feb 28<sup>th</sup> 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	28/02/10	3 Months	6 Months	One year ago
Prevailing Monetary Conditions Index.	+148	92	124	-807
Prevailing NZ Cash Rate (90-day)	2.71% pa	2.80% pa	2.74% pa	3.19% pa
Prevailing 2011 NZ Gov't Stock Yield	3.66% pa	4.03% pa	4.05% pa	3.49% pa
Prevailing 2015 NZ Gov't Stock Yield	5.02% pa	5.28% pa	5.32% pa	4.18% pa
CHANGE	Value	Gain or loss since...		
NZX NZ Gov't Stock [Bond] Index	1109.95	+2.0%	+3.7%	+2.4%
NZSE 50 (Gross)	3156.10	+1.0%	+1.9%	+25.1%
NZSCI (Gross)	20701.55	0.3%	+2.8%	+40.0%
S&P/ASX200 (Australia) *	4637.70	-1.4%	+3.5%	+38.7%
MSCI World Index (Capital)*	1133.35	-1.4%	+3.6%	+50.9%
Dow Jones (USA) *	10325.36	-0.2%	+8.7%	+46.2%
NASDAQ*	2238.26	+4.4%	+11.4%	+62.4%
FTSE 100 (UK)	5405.94	+1.8%	+12.2%	+41.1%
Nikkei DJ (Japan) *	10138.15	+9.1%	-3.4%	+34.5%
Hang Seng (Hong Kong) *	20659.46	-5.4%	+4.7%	+59.9%
NZD/USD	0.69	-3.1%	+1.1%	+36.8%
NZD/AUD	0.78	-0.4%	-4.1%	-0.7%
NZD/JPY	61.63	-0.3%	-3.6%	+24.7%
TWI	64.36	+1.2%	+1.8%	+23.8%
Gold (US\$ / oz., troy)	1,101.30	+5.7%	+15.0%	+17.2%
Crude Oil (WTI, US\$/bbl)	79.70	+3.0%	+9.6%	+80.5%

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

### NORMAN W. STACEY, INVESTMENT ANALYST

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