

**Diversified**

## **Diversified's View**

April 2010

*"... if you spent \$1 million per day since the founding of Rome (≈ 2700 years ago), as of today you would have accumulated "only" \$1 trillion in debt." Jeff Saut, Investments strategist, Raymond James.*



*Diversified Wealth Management Limited's, two Portfolio Investment Entity (PIE) Funds, and all model strategies, hit new, all-time high values at March 31<sup>st</sup> 2010. We are proud of the strategies resilience through 2008.*

The monthly Unit Price at March 31<sup>st</sup> 2010 for the *Diversified* Balanced Fund (commenced April 2008), is independently determined to be \$1.1070; that of the *Diversified* Dynamic Fund (commenced Nov. 2009), is independently determined to be \$1.0205.

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

*Diversified* also manages The Law Retirement KiwiSaver Scheme, which offers 'Balanced' and 'Dynamic' choices to members. An Investment Statement for the Law Retirement KiwiSaver scheme is available by contacting our office or from associated Advisors.

### **Summary**

- *Diversified* cheerfully finds the greatest probability to be that vigorous global economic growth will mature into a global economic boom. Cheap money with Gov't bailouts and blow-outs, are supportive.
- We believe Sharemarkets broadly are most likely to be higher in one-year to 18-months hence. While the 're-rating' stage of Price-to-Earning multiples may be largely complete, resurgent earnings should fuel a second year of sharemarkets gains ahead.
- Many lay, or poorly advised, investors are favouring what *Diversified* considers the least attractive asset classes. We find yields on conventional Fixed Interest inadequate, and many valuations precarious.
- Rising global demand atop relatively fixed supply is boosting Commodity prices -at least selectively. *Diversified's* model strategies advocate exposure to Energy, Base-metal and to Hard Commodity producers – mostly via ETF's.
- The 'safe-haven' attraction of gold bullion ebbed with the GFC. Jewellery demand is off. Our model weightings have been progressively reduced to less than half peak levels.
- US economic growth rates may surprise pundits on the upside.
- NZ prosperity is destined to under-perform peers – largely as a consequence of economic and social decisions taken earlier. Eventually, growth rates here should lift to more competitive levels, aided by a low base.
- While *Diversified* is uncharacteristically upbeat in our economic view, markets are no longer cheap. As ever, the future is uncertain, and systematic diversification is maintained across all risk models. However the current tactical bias is to growth assets and styles.

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

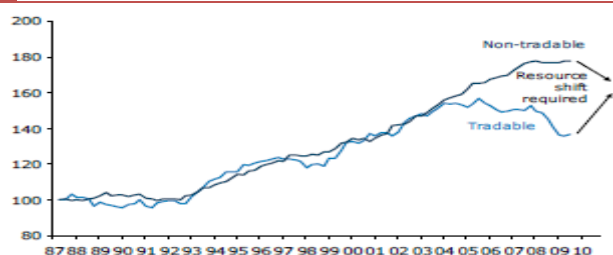
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## New Zealand – strong external environment helps

Our economy is being dragged along by the powerful global recovery unfolding externally. Economic linkage with growth-oriented Australia, and rising Asian demand for ‘soft’ commodities, are a blessing.

Although muted, this economic upturn signals the tentative but welcome participation of NZ Business, following six years of recession. NZ’s Tradables Sector has been in relative decline since 2004.

### NZ Growth - Tradable Sector vs Non-Tradable



Source: National Bank Quarterly Economic Forecast, February 2010.

Beyond expected rhetoric, Budget 2010 on May 20<sup>th</sup> will signal government’s content with the status quo, or an appetite for change. The International Monetary Fund’s, ‘Mission to NZ’ (March 29<sup>th</sup> report) recommended greater fiscal constraint and lesser government. Still, NZ’s already huge gov’t sector is expanding faster than the economy. The State also leads inflation.

NZ Consumer Price Index - % change same ¼ previous yr

	Dec '08	Mar '09	Jun '09	Sep '09	Dec '09
All NZ	+3.4%	+3.0%	+1.9%	+1.7%	+2.0%
Gov't Charges	+6.5%	+6.3%	+5.4%	+5.4%	+4.4%

Source: Selected from Statistics NZ, Jan 2010

Despite economic expansion coming from a low base, and building only gradually, inflation in NZ is projected to burst through the 3% supposed ‘ceiling’. GST hikes, Rugby World Cup exuberance, or Emissions Trading Scheme cost could boost inflation further. The Reserve Bank should commence lifting Official Cash Rates shortly, and likely with a string of increments within the coming year.

Key Economic Projections

	June 2010	Dec2010	June 2011
GDP % yoy	1.8	2.1	3.7
Inflation (CPI) yoy	2.4	3.0	3.3
Unemployment	7.4	6.8	6.2
Curr. Acct (%GDP)	-4.2	-4.7	-4.2
90-Bill Rate % p.a.	2.50	3.25	4.00

Source: ANZ Market Focus, 19 April, 2010

## Securities Commission advocates ‘Painting over the Rot’.

The long awaited, “Draft Code of Professional Conduct for Authorised Financial Advisers was released 31st March. An objectionable feature of compulsory registration is “Code Standard 2”:

***“An AFA [authorized financial adviser] must not do anything that would bring the AFA, or financial advisors generally, into disrepute”.***

If over-reaching bureaucrats are successful, the law from December 2010 will precluded us from identifying, warning of, or shepherding Kiwi’s from the shills, spivs, rip-off merchants, mountebanks and sleaze-balls of well-earned and deserved disrepute, who characterize segments of this industry.

Censorship has not worked elsewhere, but the folks who presided over the regulation of BridgeCorp, Capital & Merchant, DYF, MFS, Vestar and about NZ\$7 billion in lost or impaired assets, evidently find silencing reputable industry participants is desirable.

Partly by virtue of its lagging performance (establishing a low denominator), but also from sustained higher commodity prices in a year or so, NZ’s rate of economic growth will eventually lift closer to that of trading partners. Meanwhile, *Diversified* maintains a neutral allocation to NZ, favouring growth assets.

## Australia – No let up in growth

Alone in the western world in having escaped a recession, Australia is now projected robust economic expansion and manageable inflation ahead.

Key Economic Forecasts - Australia

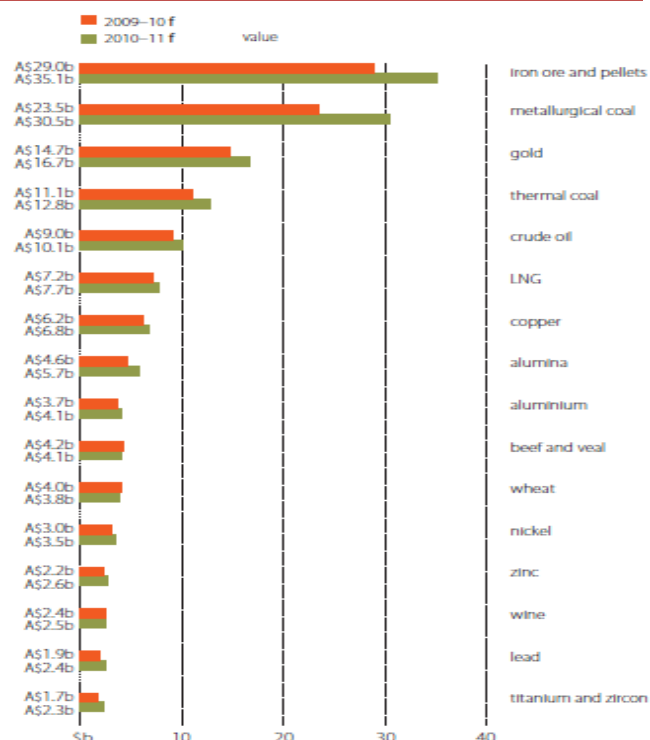
	2010	2011	2012
GDP % yoy	3.1	3.1	3.4
Inflation (CPI) yoy	2.4	2.8	2.9
Unemployment	5.0	4.8	4.9
Curr. Acct (%GDP)	-4.6	-4.1	-4.8
90-Bill Rate % p.a.	5.2 (Dec)	5.5 (June)	

Source: ANZ Australian Economics Toolbox, 9 April, 2010

Australia’s happy status is attributable to it being a first derivative of resource-hungry China, combined with its foresight and preparedness to develop its vast array of bulk commodities, metals and energy. The historic ‘tyranny-of-distance’ has been reversed too. Australia’s geographic location now extends relative advantage over most all competitors. Australia’s deposits are also mostly handy to cheap, sea-borne freight.

2010 should be another banner year for Resource exporters. Production of every one of Australia's major export earners is projected to expand over 2009.

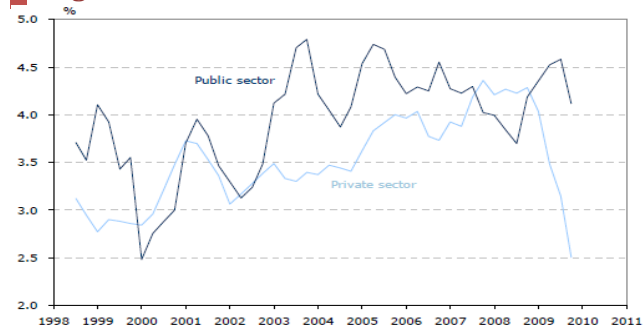
### Mineral Exports - advancing across the board



Source: ABARE, Vol 17 No 1, March Quarter, 2010

A Federal election, due in October or November this year, is widely expected to return the incumbent Labor government. Their handling of the 2008 economic downturn is justifiably drawing plaudits. But early signs are that the left-of-centre government there too, may be disposed to favouring their Public sector constituents over other Australians.

### Wage Price Index - Public sector vs Private



Source: ANZ Australian Economics Toolbox, 9 April, 2010

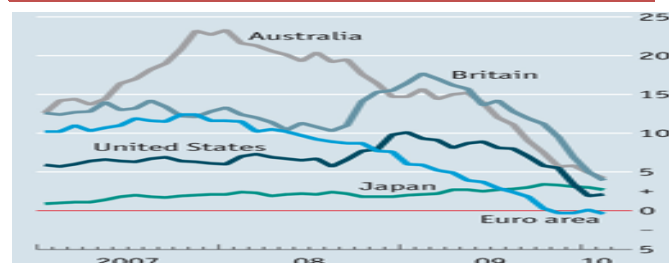
Diversified's tactical positions currently favour Australia for its development heritage, higher growth and linkage to promising global expansion. Equities and Currency are particular attractions.

### International - Boom Times Beckon

Aggregate global economic growth is broadening and accelerating impressively. Yet much of the powerful array of 'emergency measures' invoked to ensure reflation remain in place. Retail sales are lifting, corporate profits are rising and capital expenditure is on the increase. We could be in the early stages of a great, global expansionary cycle.

Despite recessions having ended almost everywhere, historically low Cash Rates along with Fiscal largesse, remain very accommodative to growth. Government fiscal deficits this year in the OECD alone, tally over US\$4 trillion. And governments and bureaucracies seldom ever cut back until forced to. Liquidity remains abundant with money supply only ceasing to expand as quickly.

### Broad Money Supply - % change y-o-y.



Source: The Economist, April 10<sup>th</sup>.

Global economic growth is synchronous in all major - New World or Old World; Developed or Emerging Markets, North or South.

### Synchronous Global Growth Ahead - GDP, % change p.a.



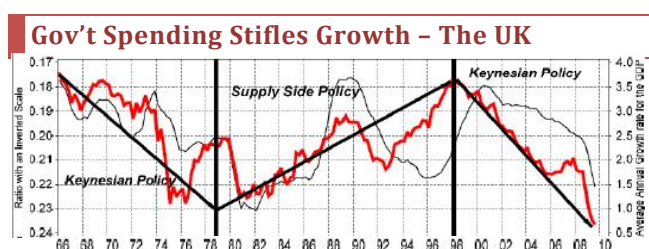
Source: The Economist, April 17<sup>th</sup>, 2010.

Eventually de-leveraging (of national accounts and by households), demographic challenges and the need to combat inflation, will again reassert. But for now, the coming year to 18-months looks unequivocally positive.

Scepticism is useful. Lingering official fears of a 'double-dip' recession, investor reluctance to re-engage in growth

assets, and governments need for Bond issuance, all serve to prevent the early expansionary cycle from overheating.

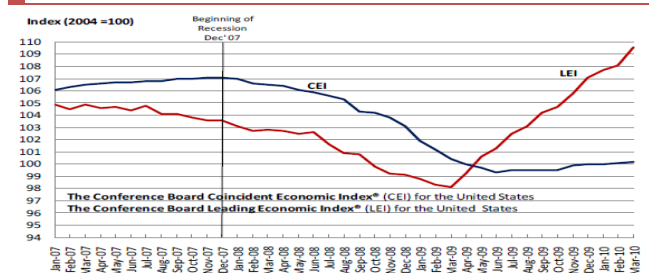
In Britain, the general election on May 6<sup>th</sup> may resolve current uncertainty, relieving their exchange rate and markets. History suggests a Tory victory would be better for growth. The heavy (red) line below (inverted scale) tracks rising Gov't expenditure as a percentage of GDP; the lighter (grey) line plots average GDP growth. Labour governments prior to 1979 increased spending at the expense of growth. Thatcher and successor Tories cut government's size from 1978 to 1997, to the benefit of GDP growth. Britain's experience since May 1997 has been back to bigger government, and to declining pace of economic growth.



Source: Modified from Jeffrey Saut presenting GaveKal data

America's economic flexibility is legendary. From contracting at a rate of -6.4% p.a. in the first Quarter of 2009, it rebounded to a +6.4% growth pace in the final Quarter. Among large countries, only China, India and Brazil have shown faster growth. Further, current Leading Economic Indicators (suggesting activity in 6 to 9 months) for the USA, are at the highest in six months.

### American Economy – Leading Economic Indicators



Source: The Conference Board, April, 2010

“Its tough to put out a Greece Fire”. Anon

It is probable Greece will eventually default. It's situation has parallels in other like countries. Clearly the Maastricht Treaty (limiting member's deficits to -3% of GDP) was widely disregarded. Greece's deficit this year has now been exposed at -12.5% of GDP. Worse, unfunded liabilities for legacy pension 'entitlements' risk rising to 750% of GDP, unless changes are made. Clearly spending

is unsustainable, but the necessity for cuts are not conceded, let alone embraced. The chunky €45 billion 'rescue' package (€30 billion from euro members and €15 from IMF), buys only one-year of time - swallowed by this year's deficit and maturing debt. The debt trajectory is still growing. Bond default appears inevitable.

Greece is not alone. Sequels may include other peripheral European members. Japan too carries debt equal to 200% of GDP, with costs of an aging population increasing by ¥1-trillion per year, and a population set to fall 50% by 2050. California has an unfunded liability of US\$500 billion if generous State Pensions are to be honoured.

China has avoided legacy debts. With seaborne imports rising 10-fold – from 75 million tonnes in 2000, to 615 million tonnes in 2009 - this nascent super-power is as important for its imports as exports, in its global impact. Economic success (+11.9% p.a. growth in Q1 2010), is of concern to the extent it may trigger authorities to dampen earlier. Property, selected Equity and Commodity prices are vulnerable.

A quick visit to Thailand finds Property Developments that were suspended during the slow-down, now universally back on track and selling. Myanmar has scheduled elections this year. Even once sleepy, communist, Laos has averaged +7.2% growth between 2002 and 2007.

Beyond India, inflation is not yet a problem globally. For China, India and other objects of US pressure, tolerance of comparatively higher inflation may be a method to effect the currency depreciation demanded.

## Healthcare

Perceptions that the USA has been an under-spender on healthcare would be inaccurate. There exists a poor correlation between higher expenditure and efficacy – as measured in longevity.

### Health Care Performance

	OECD	USA	Japan	Ger.	UK
Spend - % GDP	8.9	16.0	8.1	10.4	8.4
Per capita US\$	3,000	7,300	2,600	3,600	3,000
Life Expectancy.	79.1	78.1	82.6	80.0	79.5
Dr's /1,000 pop	3.1	2.4	2.1	3.5	2.5
Acute beds/ 1,000 pop	3.8	2.7	8.2	5.7	2.6

Source: OECD via Bank Credit analyst, April 2010 (Rounded)

Global healthcare spend is as disparate as outcomes. Sadly, no country seems to exhibit clear leadership as to best practice in this vital but fraught sector.

### Fixed Interest – Risks ahead. The Herd can be Wrong

Retail investors and poorer Advisers, have a disturbing propensity to allocate their savings the inverse of prospectively. The herd favours yester-year's favourites, while tending to shun bargains and tomorrow's winners. Bank Deposits now offer derisory interest, but command the largest portion of retail savings. Beyond Cash, the next largest portion is flooding into traditional Fixed Interest assets (Bonds etc), where yields are at historic lows and issuance is at record highs. Inflation may be rekindling too. Retail Funds Flows in flagship USA (US\$125 billion in Q1, 2010, excluding Cash), amply this counter-prospective tendency that is also present elsewhere.

#### Retail Funds Flow - USA

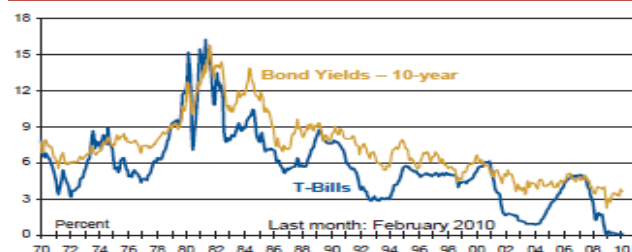
Asset Sector	Q1 2010	March 2010
Fixed Interest	70.7%	75.0%
Int'l Equities	15.8%	13.9%
US Equities	1.3%	2.8%
Hedge Funds	4.9%	3.1%
Commodities	2.4%	2.3%
Balanced Funds	4.9%	2.9%
Total (excluding Cash)	100	100

Source: Calculated from MorningStar Funds Flow Update, April 2010

However disturbing, the Funds Flow trends provide contrarian investors with comfort that a mountain of money is yet available to re-engage in growth assets.

The fact is running yields on conventional bonds are at 40-year lows. Incoming investors are purchasing at record high capital prices.

#### US Bond Yields – set to move higher



Source: Economic Monitor, March 23rd, 2010. Dundee Wealth.

Modern Portfolio Theory requires us to target Total Returns, irrespective of whether they derive from orthodox income or gains. *Diversified* finds the current stage of the business cycle favours capital gains.

Sophisticated investors can readily meet their living costs by drawing from their portfolio's Total Returns. [Talk to your Advisor].

Model allocations to the Fixed Interest asset class, are currently at minimum levels required for diversification. Within NZ, we currently favour relatively short (2 to 3-yr) maturities. Corporate issuers, including Utilities and selected Emerging Markets, are utilized for the unhedged, International Fixed Interest allocation.

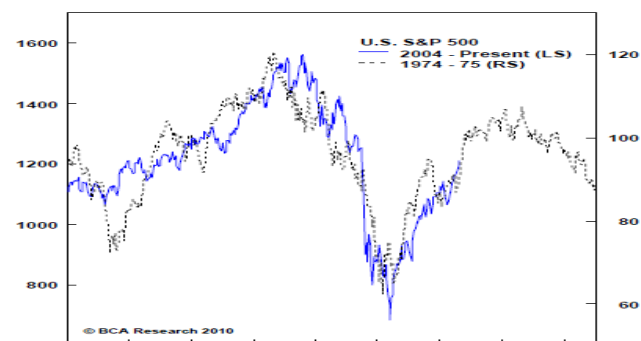
### Equities – “Stock markets may have traversed two-thirds of the rally in magnitude, but maybe only half in duration”. BCA Research, Apr 9, 2010

Of course a consolidation is always possible after the spectacular rebounds such as the world sharemarkets delivered over the past year (somewhat offset for Kiwis, by powerful appreciation in our NZ\$ reporting currency).

*Diversified's* process operates on a one-year to 18-month, tactical horizon. We find the primary trend remains upward. i.e. sharemarkets will most likely be higher over that period. Fundamentals include growth supported by still strong monetary and fiscal stimuli operating in most places. Market crashes are more likely when real interest rates exceed economic growth, and when yield curves are inverted – neither of which are imminent developments.

The rebound phase from the oversold depth of panic may be substantially complete. Rising revenues for leaned-down corporations, is set to boost earnings, thereby sustain a second year of good markets.

#### This Bull Market is yet Young

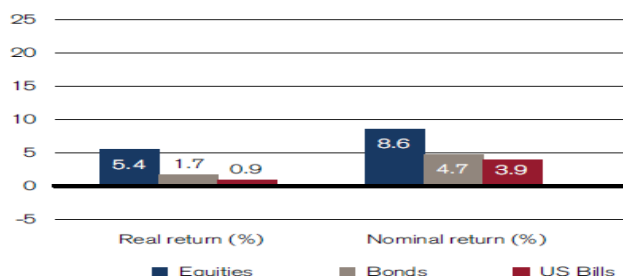


Source: BCA Research GIS Weekly, 16 April 2010

Market recoveries for China, and Emerging Markets, generally, extend from October 2008. China is now withdrawing stimulus. The out-performance of Emerging over Developed Equity markets may wane ahead – particularly that over USA.

2010 has been a good year for well-positioned investors. The average long-run global return (for 19 primarily western nations for which data is available), is salutary. 110 years of Sharemarkets data finds the long-run, nominal return was +8.6% p.a., and long-run real return was +5.4% p.a.

#### Average Global Returns: 1900 – 2009



Source: Credit Suisse Research Inst. Global Returns Yearbook 2010

We expect 2011 will continue the good times in Equity markets. We are more concerned that when this reflation is complete, when leading Emerging Markets have attained appropriate recognition befitting their global economic leadership, then structural issues will re-assert. Aging demographics (led by Japan and including China), debt deleveraging, rising inflation and possibly Carbon constraints, are each potential headwinds for Equity Markets. Subdued returns may lie ahead.

The objective of all *Diversified's* research is to ensure our strategies capture a portion, or excel, during periods of high returns. Participating in Equity bull markets is vital if a superior, long-run rate of portfolio growth is to be achieved.

#### 'Commodities & Commodity Producers' Shares

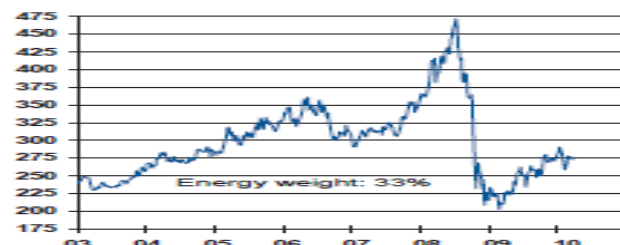
The above category is gaining in usage as a 'new' asset class – though it is simply a re-grouping of familiar investment factors.

*Diversified's* model strategies progressively embraced commodity producers shares as recovery from the Great Financial Crisis unfolded. Oil Producer's shares were an early addition to models, followed by metal producers shares, depending on risk profiles. More recently, an allocation to Hard Commodity Producer's was added to most portfolios. Exchange Traded Funds are the preferred mechanism. Subject to rigorous stock exchange rules including continuous disclosure, ETF's remain available and liquid through in the depths of market down-turns, as well as offering superior transparency, lower costs and dilution of issuer risk.

Consistent with our economic outlook – that of vigorous global economic expansion and robust Emerging Markets

growth - commodities continue to present. Despite strong gains since this reflationary cycle began, prices are generally still well short of levels when synchronous global growth last reigned

#### Commodity Index - Reuters/Jefferies CRB Index



Source: Dundee Wealth Economics. March 2010

#### Gold:

As threats to the global financial system ebbed, model [mid-point] allocation to gold bullion were progressively reduced – from 13% at the height of the GFC to around 5% currently. Proceeds were applied to broader Commodities Producers, notably Oil.

While investment in bullion remains fashionable, even lovely gold is not immune to normal economics. High prices have reduced demand for Gold used in jewellery to the lowest in 21 years. Jewellery demand last year was barely half the 2,200 tonnes so utilized 1997.

#### Currency – Diversification is the least-risk course

The major global currency blocs continue to be very volatile. Any decisive outcome from Britain's imminent election might relieve pressure on the Pound Sterling. Developing economic travails are undermining the euro, while economic prevarication is behind the Japanese yen. Comparisons present the US green-back in a flattering light.

NZ's economic parameters do not augur for any sudden relative strength here. Hedging to NZ\$ remains risky.

#### NZ\$ Exchange Rate Forecasts

	Dec '10	June '11	Dec '11
US\$	0.70	0.68	0.65
A\$	0.75	0.76	0.76
Euro	0.53	0.53	0.52
GBP (£)	0.46	0.45	0.43
Japan ¥	65.8	66.6	65.0
NZ\$ TWI	65.1	64.9	63.4

Source: Rounded from ANZ Market Focus, 19th April, 2010.

## Salient Rates, Indices, & Exchange Rates

Following are the March 31<sup>st</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	31/03/'10	3 Months	6 Months	One year ago
<b>Prevailing Monetary Conditions Index.</b>	+293	+264	+275	-416
<b>Prevailing NZ Cash Rate (90-day)</b>	2.67% pa	2.80% pa	2.82% pa	3.37% pa
<b>Prevailing 2011 NZ Gov't Stock Yield</b>	3.76% pa	4.29% pa	4.17% pa	3.90% pa
<b>Prevailing 2015 NZ Gov't Stock Yield</b>	5.19% pa	5.49% pa	5.33% pa	4.85% pa
CHANGE	Value	Gain or loss since...		
<b>NZX NZ Gov't Stock [Bond] Index</b>	1106.91	+2.3%	+2.9%	+4.1%
<b>NZSE 50 (Gross)</b>	3267.99	+1.2%	+3.4%	+26.2%
<b>NZSCI (Gross)</b>	2020.93	-3.6%	-2.6%	+27.1%
<b>S&amp;P/ASX200 (Australia) *</b>	4875.50	+0.1%	+2.8%	+36.1%
<b>MSCI World Index (Capital)*</b>	1200.53	+0.1%	+6.5%	+49.1%
<b>Dow Jones (USA) *</b>	10856.63	+4.1%	+11.3%	+42.7%
<b>NASDAQ*</b>	2397.96	+5.0%	+12.7%	+56.9%
<b>FTSE 100 (UK)</b>	5554.90	+2.6%	+7.7%	+41.5%
<b>Nikkei DJ (Japan) *</b>	11097.19	+5.2%	+9.5%	+34.3%
<b>Hang Seng (Hong Kong) *</b>	21339.94	-2.4%	+1.8%	+58.1%
<b>NZD/USD</b>	0.71	-1.7%	-1.9%	+26.0%
<b>NZD/AUD</b>	0.77	-4.3%	-5.7%	-6.5%
<b>NZD/JPY</b>	65.87	-1.3%	+1.6%	+20.3%
<b>TWI</b>	66.15	-0.2%	+0.8%	+15.9%
<b>Gold (US\$ / oz., troy)</b>	1,103.15	+1.2%	+9.5%	+20.4%
<b>Crude Oil (WTI, US\$/bbl)</b>	81.87	+3.8%	+18.2%	+68.80%

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

### NORMAN W. STACEY, INVESTMENT ANALYST

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