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Diversified

Diversified's View

March 2011

"Buy when there's Blood in the Streets" – investment advice attributed to 18th century British nobleman, Baron Rothschild. The good Baron would have been spoiled for choice today, between the carnage in metropolitan Christchurch, Japan's Tohoku Great Quake, and assorted revolutions across North Africa.

Through the many market cycles since *1994, Diversified* Investment Strategies Ltd has continued to provide leading investment strategies. Independent Asset Allocations are formulated with a NZ perspective, and combined with in-house investment analysis and experience. We are very proud of the results investors have achieved.

The Unit Price for ***DWM* Balanced 'PIE'** Fund (Established March 2008), attained another new high at 28th February of $1.1988 - up +3.99% for the month, and a +11.69% gain for the year.
The Unit Price for ***DWM* Dynamic 'PIE'** Fund (established Nov. 2009), also attained a new high of $1.1163 at 28th February, up 4.33% for the month, and a +14.12% gain for the year.
(Performances after fees, but before tax)

The **Law Retirement KiwiSaver Scheme mimics *Diversified's* Balanced** and **Dynamic** strategies. **LRKS welcomes transfers from lesser performing schemes**.

Investment Statements for KiwiSaver are available from the scheme's website: www.lawretirement.co.nz.

Check out our revamped website: www.diversified.co.nz

Summary

- At the risk of appearing callous, and as locally devastating as natural disasters may be, they are humanitarian catastrophes. Such events rarely change an economy's economic trajectory significantly. Especially in wealthy nations, growth recoils for a quarter or two, and is soon pushed up by reconstruction.

- In aggregate, the global economic situation continues to be one of rising strength across Developed Economies, combined with only slight moderation across Emerging Markets.

- Projections for a robust pace of global economic growth are intact. The pace of growth in the USA may surprise consensus forecasts on the upside.

- Higher oil costs are yet manageable, but would be cause for concern if they rose rapidly. Perhaps perversely, elevated oil prices, political uncertainty throughout Arabia and combined with natural disasters, are investors' friends in serving to keep western monetary and fiscal stimuli lingering for longer.

- As seismic awakening of supposedly tectonically stable Christchurch, a Great Quake (magnitude 9) off Japan, or the collapse of the 30-year, Mubarak regime in Egypt amply demonstrate, the future is never entirely 'knowable'. Systematic diversification remains the best course for long-term investors. It is also the basis of *Diversified's* process.

- An updated graph of the performance investors have enjoyed by pursuing a *Diversified* 'Balanced' strategy since the company's inception, is appended (after fees but before taxes)

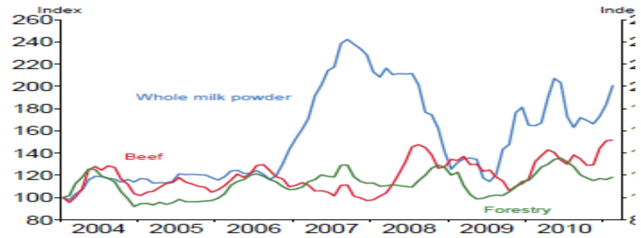
Norman W. Stacey (*nstacey@diversified.co.nz*)
An Adviser Disclosure Statement is available on request and without charge.

New Zealand – Growth ahead…

… coming off a low base. The destructive Christchurch earthquake of 22 February crystallized what was already apparent; New Zealand's economic growth rate in 2010 had been very subdued.

The New Zealand economy has not picked up to the extent some (not *Diversified*) might have expected, especially given the strong economic recoveries most all of our major trading partners have enjoyed, and the participation this time of our key export commodity prices in rising global prosperity.

Selected NZ$ Commodity Prices

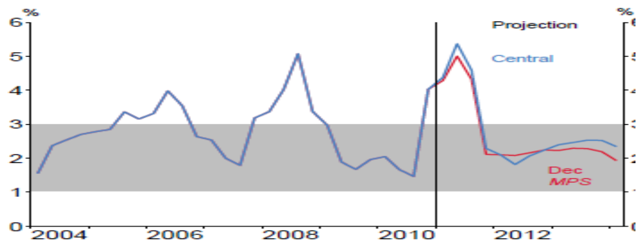


Source: Reserve Bank of NZ, Monetary Policy Statement, Mar 2011

Clearly the very strong external environment has not been sufficient to lift NZ from torpor, despite the success of near neighbours. Local impediments require re-examining – notably the sheer size of combined governments in NZ; a decade of low productivity policies, and the non-sustainability of a debt-fuelled binge. Speculators and primary producers alike are now applying new revenues to debt reduction.

Fortunately - and while government is still over-funded, over-staffed and profligate - it is now contributing less to inflation. Beyond the GST induced spike, inflation is projected to return to within the Reserve Bank's mandated range.

Projected Inflation – NZ Consumer Price Index



Source: Reserve Bank of NZ, Monetary Policy Statement, Mar 2011

Looking ahead, New Zealand's sounder economic policies place growth and inflation trajectories on a potentially more rewarding course for investors, than in recent times

Key Economic Projections – Calendar year

	2011	2012	2013
GDP % yoy	0.9	+2.7	+4.7
Inflation (CPI) yoy	4.4	2.1	2.4
Unemployment	6.7	6.2	4.9
Curr.Acct (%GDP)	+0.2	-3.3	-4.7
90-Day BB % p.a.	3.1	3.0	4.2

Source: Reserve Bank of NZ, Monetary Policy Statement, Mar 2011

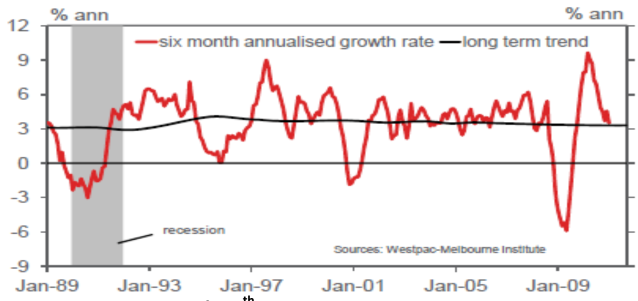
NZ's Budget due on May 19th, and national election November 26th, allows government further scope to veer toward growth policies – from some of the dimwitted regulation and prescriptive cant still characterizing such as the Securities Commission during first term.

A pick-up in growth is easier to achieve from a low denominator. From a risk perspective, NZ is also free of the frothiness now befalling erstwhile more lucrative investment destinations. *Diversified*'s recently completed strategy review has marginally lifted model allocations to NZ investments.

Australia – Possible Frothiness

In its first survey since the December to January, storm-ravaged period, Australia's leading economic indicators (designed to forecast economic activity 3 to 9 months in the future) signalled slowing economic growth. December's LEI pace of 4.6% tumbled to 3.5% in January. The larger drags were New Dwelling Approvals and Overtime Worked components. Confirming the imminence of slowing, the most recent reading of the Coincident Index also dipped from its 3.3% recent trend, to 2.0%.

Westpac / Melbourne Inst. Leading Economic Index

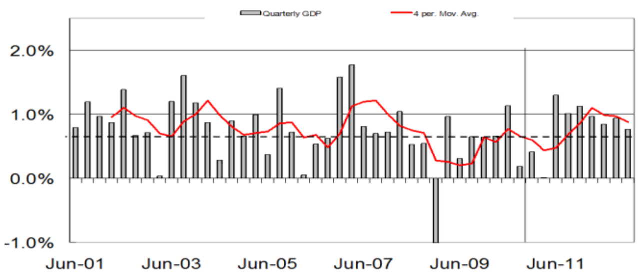


Source: Westpac, March 16th 2011.

Australia's trade relations with Japan run deep - 21% of Australia's Iron Ore exports; 31% of its metallurgical coal; 50% of thermal coal; 16% of copper and 37% of Aluminium. Immediate disarray should be temporary, while additional steel for rebuilding, and thermal coal to replace nuclear generation, will soon be required.

Beyond softer growth in the near-term, Australia's economic growth is projected to recover in the second half, accelerating to maybe 4% in 2012.

Real growth Output - Quarterly



Source: NAB's Chief Economist Alan Oster, *in presentation to* ABARES Conference, March 1-2, 2011.

The silver lining to near-term, domestic & trading partner set-backs is that Australia's Reserve Bank is now expected to keep their Cash Rate on hold through to at least September.

Key Economic Forecasts - Australia

	First Q 2011	Calendar2011	Calendar 2012
GDP %	-0.2%/Q	2.7%y-on-y	4.0%
Inflation (CPI)	1.3%/Q	2.7	2.6
Unemployment	5.1	5.0	4.5
Cash Rate	4.75	5.00 (Sept)	5.25 (June)

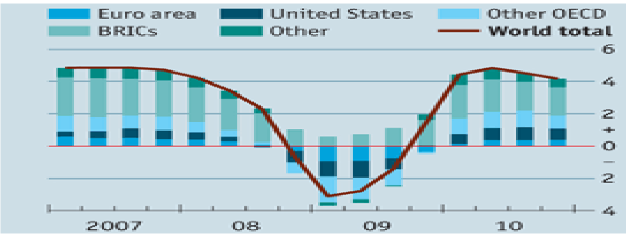
Source: Westpac Weekly, 21st Mar., 2011

Diversified's recent strategy review continues a significant allocation to Australia, though with slightly lesser emphasis on A$ currency. We also accept heightened probability of near-term volatility among resource prices.

International - Strong Outlook Intact

Now very clear is that successful reflation followed the 'Great Financial Crisis of 2008/9. Further, it was a 'V-shaped' recovery, and was disproportionately reliant on BRIC (Brazil, Russia, India & China) along with other Emerging Markets, as predicted. Investors or Fund Managers who shied away from markets '*until the outlook become clearer*', or who systemically underweight Emerging Markets by mimicking the hoary old MSCI World Index, missed a powerful rebound.

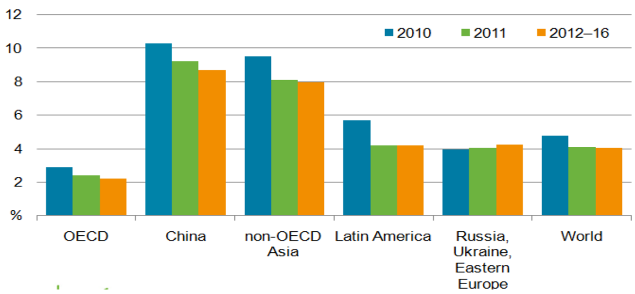
World GDP % Change on Year earlier



Source: The Economist, March 12, 2011

The outlook throughout or tactical horizon is for more-of-the-same – i.e. a robust pace of aggregate economic growth (near 4% p.a.), and that heavily dependent on growth in China, other Asia and Emerging Markets in general. At this stage, we do not find events in peripheral Europe (deteriorating Portugal and Belgium adding to intractable Greece), revolutions in North Africa, instability in the Middle East or Japan's Great "Tohoku" Quake, to seriously impede the global expansion expected to dominate the next year and 18-months.

Regional Global Growth



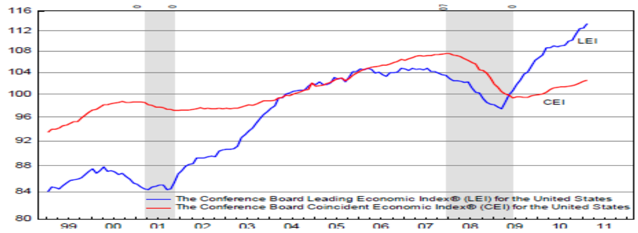
Source: ABARES' Outlook 2011 Conference presentation, Mar, 2011

Similarly, rising oil prices are a headwind for growth, but not yet of great concern. Empirical evidence is that the absolute price of oil (it varies markedly across countries), matters less that the intensity of price increases. The price rise to date is well short of doubling over a short period – which triggered earlier recessions.

Japan is a humanitarian catastrophe, but not an economic one. Preliminary World Bank reports are that it will take Japan five years to rebuild damage from the Great "Tohoku" Quake and resulting Tsunami of March 11th. Japan's real GDP will be negatively impacted though mid-2011, but is then expected to rebound. Further, Japan's slow-down should have only a very modest and short-term impact on the wider Asian region. Preliminary estimates put Tohoku damage at between US$122 and US$235 billion. Japan represents approximately 8% of global GDP, and is a low relative contributor to aggregate global growth.

In the USA, key leading economic indications continue to strengthen. The Conference Board's widely watched Leading Economic Index gained a strong 0.8% in February, following a 0.1% rise in January and a 1% rise in December. Improvements in labour markets, financial components, and consumer expectations, more than offset falling housing permits

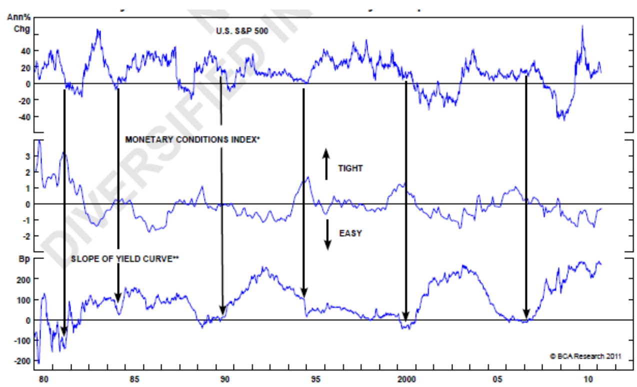
US Economy Re-accelerating



Source: Conference Board, US LEI, Jan 20, 2011 News Release

On the basis of our current information, recent upheaval is insufficient to derail the world's promising economic backdrop. However, uncertainty brought on by those events will be exploited to maintain monetary and fiscal stimuli longer than might otherwise have been the case. Trusty *BCA Research's Global Investment Strategy* are unequivocal, "There has never been a [USA] bear market in stocks during a time when the monetary conditions index has been so stimulative, and the yield curve so steep".

US Monetary Conditions & Yield Curve vs Equities



Source: BCA GIS Weekly Bulletin, March 18, 2011.

Asset allocations and indicative selections from our, formal strategy review conducted in February, remain operative. Positions are reviewed on a rolling Quarterly basis – next in May.

Fixed Interest – Bond values precarious

Ignoring sudden and temporary panic to 'defensive' assets causing blips, *Diversified* perceives a major re-rating has commenced across the Fixed Interest asset class. Reasons for this include:

- Recent bond yields had reached fundamentally inadequate lows, given consensus growth projections and inflation rates;
- Prevailing bonds yields are uncompetitive (about 1.85% p.a. below) with earnings on Equities;
- Funders of the 'carry trade' – notably Japanese and European savers – suddenly have cause to not reinvest, or even to repatriate their proceeds;
- Artificial demand from the US Federal Reserve Board's Quantitative easing program (responsible for to 70% of US Bond purchases), will quit from mid 2011;
- Weight-of-money. Following a long and comparatively lucrative rally, Institutional and retail investors yet remain overweight in Cash & Bonds, Rebalancing has commenced, and may turn to a torrent when initial Bond losses are registered.

A Bond market sell-off has begun. The value of US 20-year Bonds has lost 10% of its capital since September of last year. Return from being short that index on a daily basis has handsomely exceeded the coupon.

US 20-year Bond Capital Value (green line)

Source: CNN Money using iShares 20-year Index ETF's (TLT) as proxy

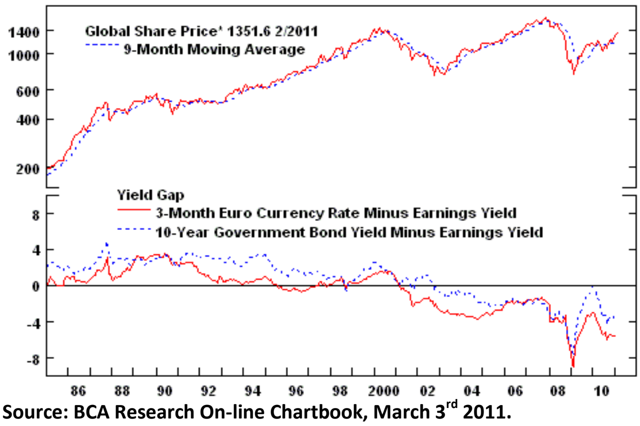
Diversified's indicative strategies now include selected, high-quality perpetual issues, trading at discount and which stand to benefit from Basel III changes.

Equities – Bull Market Intact

As disturbing as the natural disasters (Canterbury NZ or Honshu Japan) may be, they do not threaten the global bull market in Equities - though investors should be braced for a possible bumpy Quarter or two.

We are comforted that a 'correction' is more probable than the onset of something more serious , markets currently being between fair value and marginally cheap by most historic valuation measures. Further, the world is awash with liquidity with Equities offering a significant yield premium over Cash or Bonds - a 'negative yield gap' in the parlance.

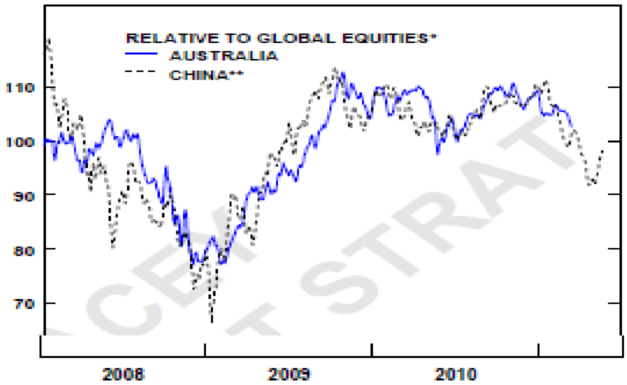
Global Equity 'Yield Gap'



Source: BCA Research On-line Chartbook, March 3rd 2011.

Australian equities have in recent years provided a good proxy for investment in high-growth China. Consistent with our expectation China will moderate its economy adeptly; Australian Equities should continue to be a worthy prospect for diversified investors ahead.

Correlation Australian with Chinese Equities



Source: *Modified after* BCA Research S. R. on Australia. Mar 18, 2011

Diversified's formal strategy review confirmed Equities as the most favoured Asset Class in the current economic environment. The powerful bull market in Equities is expected to prevail over our tactical horizon as a whole. Elevated 'corrections' as a response to global events may add short-term volatility, but an overall advance should be the primary trend.

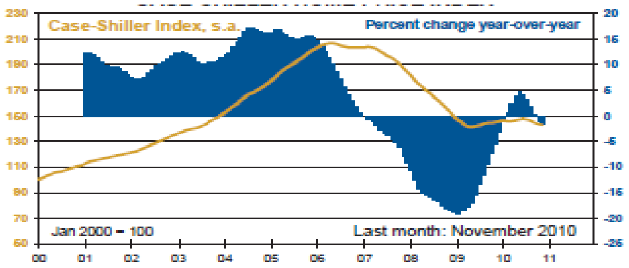
Property – a home for the fabled 'Double-Dip'?

Property is the asset class most at risk from interest rates rising as we expect.

The trend in flagship USA - where house prices are already a fraction of those prevailing in NZ or in Australia – is not encouraging for Property as an asset class more broadly.

Updated statistics confirm further falls - on either a month-on-month or year-on-year basis – coincident with the onset of the back-up for Bond yields in latter 2010.

Case-Schiller Home-Price Index (USA)



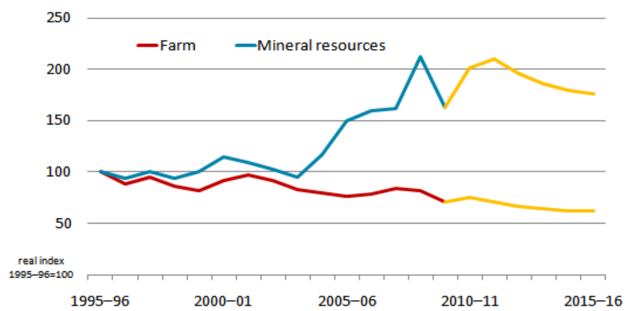
Source: Dundee Wealth Mgmt, Economic Monitor, Feb, 2011.

Beyond lifestyle assets, *Diversified's* model strategies continue to advocate only a very modest weighting to Property, and that favouring the sub-set likely to benefit from the consumer re-awakening from currently very subdued levels globally.

Commodities – Super-cycle intact

Notwithstanding possible near-term softness, *Diversified's* research finds a multi-year 'Super-cycle' in Commodity prices and demand to be underway. Less than perfectly for our NZ economy, our sources continue to predict mineral commodity prices will continue more robustly, than the outlook for Agricultural Commodities.

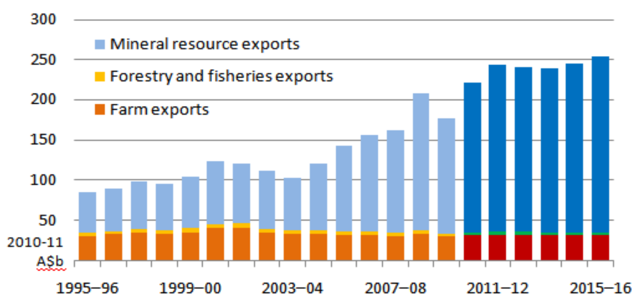
World Commodity Prices



Source: ABARES Conf. *Outlook for Australian Agriculture*, Mar 2011

Prices for most commodities, but especially mineral and energy commodities, is expected to remain strong through our tactical horizon, and likely for several years beyond.

Australian Commodity Exports - Value



Source: ABARES Conf. Outlook for Australian Agriculture, Mar 2011

Diversified's recently completed strategy review broadened models exposure to Commodities, selecting diversified minerals as well as adding a hard-commodities specialist. A tactical position to agriculture-related commodities was also introduced. The allocation to Gold was trimmed at the margin, in order to accommodate these additions.

Nuclear – *"Facts whisper, fear screams during crisis"*

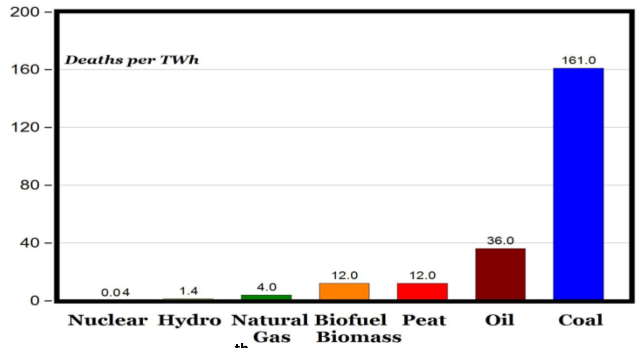
Stan Grant CNN March 20th, 2011.

The exhaustively reported events at Fukushima served to demonstrate shortcomings and vulnerabilities – more in the storage of spent fuel than controlled chain reactions – of nuclear facilities faced with multiple events.

While the standards for nuclear power generation facilities will be reviewed (to benefit), far from abandonment the nuclear option is undergoing a renaissance across Emerging Markets. The World Nuclear Association reports 131 reactors under construction or planned globally. Of this, 54 are in China (26 under construction and 28 planned, adding to 14 operational).

Countering the Fukushima crisis in nuclear advocate's minds is nuclear generation's long-term safety, relative to the riskiness associated with other forms of power generation.

Deaths per Terawatt hour from Energy Sources



Source: Carpe Diem, 19th March, 2011

Diversified's model strategies do not advocate any allocation to, or investment in the nuclear industry, beyond possible by-products associated with diversified miners.

Currency –kiwi grounded

The exchange rate of our kiwi dollar most recently conveyed the 'downside' to its role as a benefactor of global 'reflation'. Our currency was sold off heavily amidst the risk aversion surrounding Japan and Libyan events.

While Kiwi-based exporters are stuck with local currency volatility, there is no reason portfolio investors should subject themselves to similar volatility. *Diversified* models and Funds eschew the silly local practice of hedging offshore portfolio holdings back to NZ$ risk. Our method prefers the diversity which results from systematic asset allocation.

Again, we rely on those courageous folk at ANZ for exchange rate predictions.

NZ$ Exchange Rate Forecasts - Month-end

	June 2011	June 2012	December2012
US$	0.73	0.72	0.70
A$	0.73	0.74	0.76
Euro	0.56	0.54	0.52
GBP (£)	0.46	0.45	0.44
Japan ¥	63.5	66.2	66.5
NZ$ TWI	66.6	65.9	65.0

Source: ANZ Market Focus, 21 March, 2011

Salient Rates, Indices, & Exchange Rates

Following are the Feb 28th, 2011 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 impact of NZ currency.

ACTUAL	28/02/11	3 Months	6 Months	One year ago
Prevailing Monetary Conditions Index.	+337	+506	+390	+148
Prevailing NZ Cash Rate (90-day)	2.86% pa	3.20% pa	3.21% pa	2.71% pa
Prevailing 2011 NZ Gov't Stock Yield	2.86% pa	3.47% pa	3.53% pa	3.67% pa
Prevailing 2015 NZ Gov't Stock Yield	4.35% pa	4.79% pa	4.43% pa	5.02% pa
Prevailing 2021 NZ Gov't stock Yield	5.59% pa	n.a.	n.a.	n.a.
CHANGE	**Value**	**Gain or loss since…**		
NZX NZ Gov't Stock [Bond] Index	1183.56	+2.3%	+1.8%	+6.6%
NZSE 50 (Gross)	3370.52	+3.2%	+11.0%	+6.8%
NZSCI (Gross)	21860.70	+4.5%	+12.6%	+5.6%
S&P/ASX200 (Australia) *	4830.50	+3.3%	+9.7%	+4.2%
MSCI World Index (Capital)*	1351.65	+13.2%	+21.6%	+19.3%
Dow Jones (USA) *	12058.00	+9.6%	+20.7%	+16.8%
NASDAQ*	2643.68	+5.8%	+25.5%	+18.1%
FTSE 100 (UK)	5994.01	+8.4%	+14.7%	+10.9%
Nikkei DJ (Japan) *	10615.36	+6.8%	+20.6%	4.7%
Hang Seng (Hong Kong) *	23193.29	+0.8%	+13.8%	+12.3%
NZD/USD	0.7503	+0.6%	+6.5%	+8.5%
NZD/AUD	0.7391	-4.7%	-6.4%	-5.1%
NZD/JPY	61.28	-1.8%	+2.8%	-0.6%
TWI	66.46	-2.1%	+1.1%	+3.3%
Gold (US$ / oz., troy)	1,413.00	+3.9%	+13.9%	+28.3%
Crude Oil (WTI, US$/bbl)	95.54	+17.3%	+27.1%	+19.9%

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

NORMAN W. STACEY, INVESTMENT ANALYST

Corporate and individual Investment Adviser Disclosure Statements are available free of charge, or may be viewed on our website