

Diversified



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*Wishes you a Merry
Christmas*

Diversified's View

December 2011

"The best way to keep money in perspective is to have some."
Louis Rukeyser

Diversified proprietary investment strategies are utilized in:

- The Law Retirement Plan KiwiSaver Scheme;
- The Law Retirement Plan Superannuation Scheme;
- Diversified Wealth Management's 'Balanced' or 'Dynamic' PIE Funds;
- As Individually Managed Accounts for Private Clients.

DWM 'Balanced' Fund at 30th November was \$1.0641/ unit.

DWM 'Dynamic' Fund at 30th November was \$0.9350/ unit.

An Investment Statement is available at www.diversified.co.nz

Law Retirement KiwiSaver Scheme's Balanced Fund at 30th November was \$1.03862/unit.

Law Retirement KiwiSaver Scheme's Dynamic Fund at 30th November was \$1.00075/unit.

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

2011 in Review

- A good year to bid 'adieu' to. The synchronous global economic growth we expected, faltered.
- While the USA's much feared (and in our view unlikely), 'double dip' recession was averted, European nation's decade of huge spending on tick, became suddenly recognized as unsustainable. Meanwhile China applied monetary brakes to combat rising inflation.
- Beyond China, the broad expectation that withdrawing of monetary stimulus would begin, was met by the inverse. In at least Australia, Brazil, Indonesia, New Zealand and the European Central Bank, official rates were cut further - and the USA endeavoured to force Bond yields down.
- As expected, the corporate sector remained robust & earnings blossomed. Sadly, surging profitability was not reflected in share market prices.
- As 2011 transpired, Asset Class returns were almost the inverse of those we anticipated. Gov't Bonds were gainers, followed by Corporate and Junk Bonds. Commodity prices generally plunged, as did shares in Emerging Markets Shares, while other share markets wallowed.

The Year Ahead, 2012

- *Diversified* finds global economic growth remaining intact in aggregate.
- The USA may surprise to the upside, and China will grow strongly - albeit at less than the recent 'breakneck' pace - while the Emerging Markets' prosperity parade expands.
- Recession(s) in Europe are all but inevitable. Their crisis is unlikely to be cured by new sources of credit, nor by new taxes on the Poms. Credit excesses were a decade in the making, and resolution will take time. Ultimately, deleveraging will involve more spending cuts than new sources of taxation.
- Across Europe and in many USA municipalities, generous but unfunded pension schemes may have to be renegotiated or dishonoured.
- Asset Class returns will change. Poor strategy in 2012 may bet from too much in the 'safety' of Cash and Bonds, and not enough in growth assets.
- Even in comparatively poor years, systematic diversification ensures the portfolio survives substantially intact to participate when the market rebounds. The medium and longer-term trend for share markets is upward.

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Norman Stacey is an Investment Analyst and Portfolio Manager of the Diversified Wealth Management PIE Funds.

Disclaimer

Diversified's View is an economic commentary of a general nature. It is not intended to be personal investment advice and does not consider any individual's circumstances. Retail Investors contemplating an investment should consult a government Authorized Financial Adviser.

Expertise You Can Trust

Diversified Investment Strategies Limited

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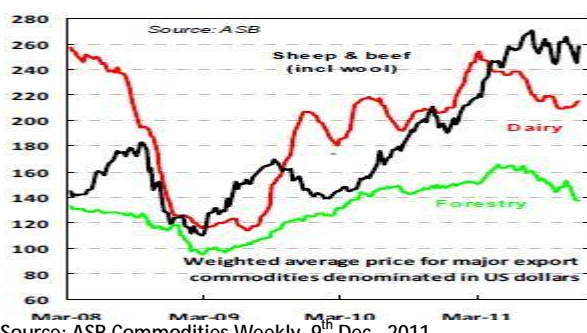
New Zealand – Growth Outlook Trimmed

Whether through good luck or good politics, NZ's General Election on November 26th coincided with economic growth expectations cresting. An NZIER survey in December reports economists' growth projections for 2012 and 2013 revised down – to nearer 2.2% next year (from 2.6%), and to 3% in 2013 (from 3.7%) - on average.

Slower economic growth will require spending to be trimmed if the government's promise to balance its budget by 2014/15 is to be met. Back-sliding may jeopardize NZ's credit rating. Fortunately the task is not difficult. A little austerity could even benefit several of NZ's 39 government departments, 150 Crown entities and more than 200 other agencies. Certainly, the \$6,049,841 annual budget for NZ's, nine-person, 'Commission for Financial Literacy and Retirement Income', seems low quality expenditure for dubious accuracy.

NZ's tradable economy is reasonably robust. Terms-of-Trade dipped very slightly in the September quarter (down by -0.7%, to be still up +3.3% for the year), remaining near a 37-year high. Both export commodity prices and volumes remain strong. Fonterra is forecasting NZ\$6.90 to \$7 per kilogram of milk solids in the 2011/12 season. Milk production lifted 5.2% last season to 1.51 billion Kg, with 2011/12 forecast to be another La Nina summer. And NZ dairy farmers are a productive lot. Since 1980, the average dairy herd size has tripled in size to an average of 386 cows.

NZ Commodity Price Index – Based at \$100 in 1997



Overall, a Very Merry Christmas is warranted in the land of the Rugby World Cup holders. Further – and accepting that the ANZ forecasts below are at the more optimistic end of the range – 2012 is shaping up for sound growth near NZ's sustainable limit.

Key Economic Forecasts –annualized % change

	June 2012	Dec 2012	June 2013
Growth (GDP)	+2.6%	+2.4%	+3.3%
Inflation (CPI)	+2.1%	+2.6%	+2.6%
Unemployment	+6.2	+6.0%	+6.0%
Curr. Acct (% GDP)	-3.7%	-4.3%	-4.6%

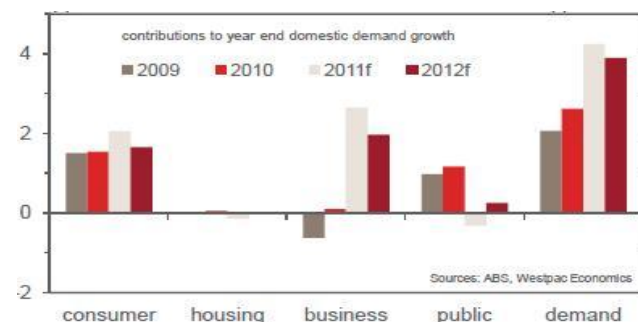
Source: ANZ Economic Forecasts, 12 December, 2011

In the context of a world with growth rendered more fragile by Europe, and off its low base, New Zealand's growth outlook for our tactical horizon is comparatively attractive on a global basis. Longer-term, the size, propensity and deficits of our government are on a trend more akin to Europe than to the high-growth areas of the world. *Diversified's* model investment strategies now slightly favour New Zealand assets in their allocations.

Australia – Uneven Growth

Australia's economy opening 2011 was set-back almost a full percentage point, by fires and floods (in different parts), related to La Nina weather pattern. Of some concern is that the current season is also a La Nina year, albeit a considerably less intense event than last year's. Exports (notably of coal) remain 16% below pre-flood peak, while broad employment, construction, housing and the public sector remained subdued.

Growth - Sector Contributions



Source: Westpac Market Outlook, Dec 2011.

Responding to economic slowing, the Reserve Bank of Australia abandoned its tightening bias. Two cuts in their Official Cash Rate during 2011 are likely to be matched in first-half 2012, arriving at a 3.75% Official Cash Rate around mid-year.

Overall, the period ahead is expected to provide a more even economic expansion, especially if Australia's strong currency moderates. From the upset of 2011, the growth pace is expected to accelerate through 2012 and into 2013.

Key Economic Forecasts - calendar year

	2011	2012	2013
GDP	2.0%	3.0%	3.5%
CPI	3.5%	3.3%	1.9%
Unemployment	5.1%	5.6%	5.4%
Current Account (% GDP)	-2.2%	-4.5%	-3.3%

Source: Westpac Market Outlook, Dec 2011.

Australia's 21-year-old, economic expansion continues. For investors, its more diverse economy, deeper markets and leverage of its key resources sector to the high-growth areas of the world, are important portfolio attributes.

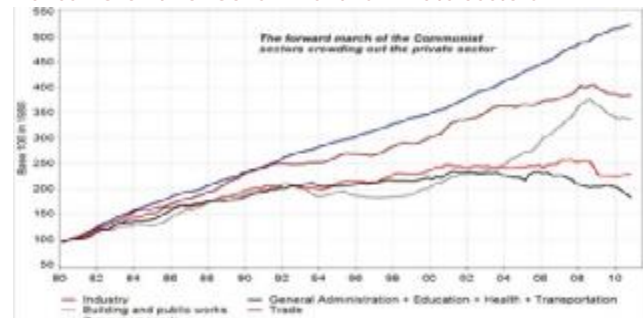
International – Regionally divergent growth

An interesting year 2011 was. Among the mysteries is precisely what triggered Europe's 'crisis' now. Enormous public debts, habitual and chunky deficits and fiscal over-reach were matters of public record characterizing 'the European way' for well over a decade. That credit became a predicament is the logical outcome of disregard for prudent spending –including Sovereign debt and budget deficit limits espoused in their own Maastricht Treaty. But the political inclination still is to add more debt; an apparent official preference is to default on debt rather than 'entitlement' promises. Youthful and unfunded pensions are clearly unaffordable – even before demographics deteriorate. Wages, security and certainty across the Public Sector are

manifestly superior to those similar workers in the Private sector are able to achieve

Europe's crisis is not so much of 'credit', nor purely a Banking one. - it is Economic. Bureaucracies have grown too big and interventions are too many, leaving the productive sectors crowded by the State. This 'crisis' has been decades in the making.

France - Growth of Government vs Private Sectors



Source: Anatole Kaletsky, Sorting Out the Euro Mess, 13 Dec, 2011

And France is only indicative. Italy and most others are similar – a steady growth of government sectors over recent years, even while overall growth did plateau.

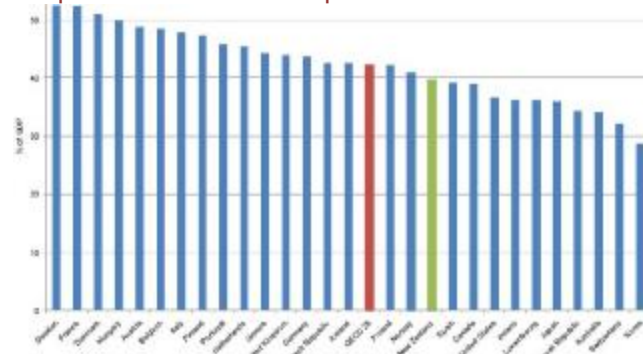
Growth of Gov't in Italy vs GDP (constant prices rebased at 100 in 2000)



Source: Anatole Kaletsky, Sorting Out the Euro Mess, 13 Dec, 2011

The dilemma is that European governments have now grown to dominate their economies. Austerity will induce recession. Credit downgrades are expected. With Canada as a guide, the ultimate solution is likely to involve about seven parts cut-backs for each part of new taxes.

Europeans Dominate Gov't expenditure – as % of GDP

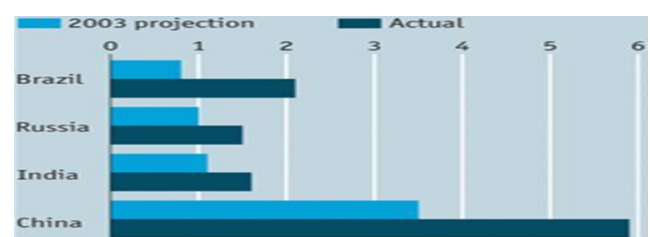


Source: NZ Treasury, April, 2011

Contrasting Europe, and fortunately offsetting it in global growth stakes, is the rosier outlook across Emerging Markets. While market returns disappointed investors in 2011, underlying economic fundamentals remained impressive, and continued to

surprise consensus to the upside. The size of Brazil's economy surpassed that of Italy, and China's that of Japan in 2010. Emergent Africa is now catching the bug too.

GDP Size in 2010 – As predicted in 2003 and actual

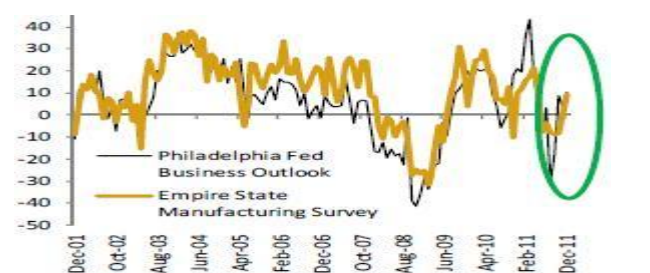


Source: The Economist, Print edition of December 10th.2011.

In addition to superior growth prospects, Emerging Markets carry lesser risks on their national balance sheets than much of the Developed World.

Consensus expectation for the USA over the coming year to 18 months is for about 2.5% real pace – but with possible surprise to the upside. Government in the USA is smaller, the private sector more dynamic, and with early signs manufacturing may be resurgent.

USA – forward Manufacturing Indicators



Source: Macquarie Private Wealth, Canada, Dec., 2011.

Contrasting with pervasive grim sentiment and dire media stories, Diversified finds the global economic outlook underpinning our tactical horizon to be sound, if unexciting. Growth in key Emerging Markets is projected to moderate only slightly (with success emulated by newly Emergent Markets), and accelerating growth from a modest base by USA, should serve to offset the severe slowing in the Euro area.

GDP Forecasts % change on yr earlier



Source: The Economist, Print edition, 3rd Dec., 2011

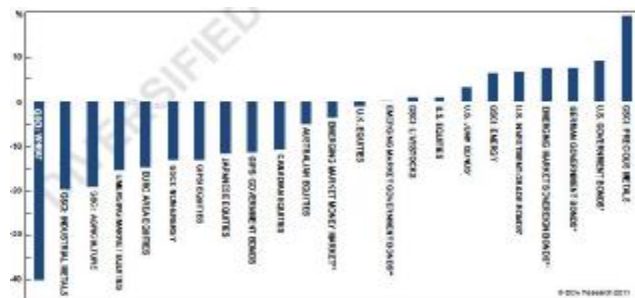
A by-product of de-synchronized and slower overall expected pace of aggregate global growth will be inflation pressures remaining lower for longer. Especially for the developed world, tightening fiscal policies and loose monetary policies are now the expectation.

As 2012 looms, the economic setting remains supportive of a spread of international investments, favouring the traditionally less recognized destinations.

Fixed Interest – Caution Warranted Ahead

As 2011 recedes, it is painfully evident the range of asset class returns was almost the inverse of those anticipated. Already expensive government bonds rose further in 2011. Beyond Precious Metals, Fixed Interest sectors – gov't, corporate and junk - surprised by leading returns.

Year-to-Date Returns (US\$)



Source: BCA GIS, Weekly Bulletin, Dec., 9th, 2011.

Politicians intervened in markets: "It's a battle of the politicians against the markets. But I'm determined to win the battle", opined German Chancellor Angela Merkel back in May 6, 2010. Then in September 2011, the US Federal Reserve Board launched 'Operation Twist'; a deliberate intervention to suppress US bond yields. In Europe, only British PM David Cameron courageously opposed new taxes on financial transactions.

Looking ahead to 2012, the paltry yields now available on either Cash or Sovereign Bonds are insufficient to provide decent portfolio returns, a decent income for retirees, or adequate progress for savers or endowments. Further, with interest on Cash now down to zero on the (USA, and 2.5% gross in NZ); both German and US 10-year bond yields now negative in real terms, the capital gains of 2011 and earlier are not possible ahead.

Neither is Fixed Interest always risk-free. The traditional and historic escapes from excessive debt situations – similar to those in which Europe, USA and Japan now find themselves - is i) to grow, ii) to default, or iii) to inflate.

Diversified finds the probability that growth assets will out-perform 'safety' assets in 2012 to be high.

Equities – Earnings did not Disappoint

Throughout USA, Australia, China, Europe, Japan and even NZ markets, company earnings generally met or exceeded consensus expectations.

Corporate Earnings - USA



Excerpted From: BCA GIS Strategy Outlook, Dec 16th, 2011

We expect corporate earnings to be sustained in 2012 at a pace near 9%, sustained by moderate global economic growth and in a context of restrained wage, energy and broad commodity price increases.

We are optimistic the low point for global growth markets may have passed in early October. Share markets most places ceased falling and even commenced recovery in latter 2011. The Rate-of-Change (ROC) for the most recent quarter (to Dec., 1st 2011) is positive, and contrasts sharply with pervasive losses over the six months and one year prior.

Equity Total Return Trends – local currencies

COUNTRY	3-MONTH R.O.C.	6-MONTH R.O.C.	12-MONTH R.O.C.
NORTH AMERICA			
U.S.	10.8	-5.4	0.2
CANADA	4.7	-7.9	-7.9
ASIA/PACIFIC			
JAPAN	-1.8	-10.7	-14.1
AUSTRALIA	0.2	-4.6	-6.1
EUROPE			
EURO AREA	5.1	-16.8	-13.8
GERMANY	10.4	-15.5	-11.4
FRANCE	4.5	-17.9	-12.7
ITALY	5.5	-18.9	-17.3
U.K.	0.1	-7.2	-5.9
SWITZERLAND	4.3	-6.7	-8.1
SWEDEN	6.6	-12.2	-14.7

Source: BCA GIS Chartbook to 2nd Dec, 2011.

Equity valuations are at levels which have sustained prior rallies, and Equities are inexpensive compared to competing asset classes.

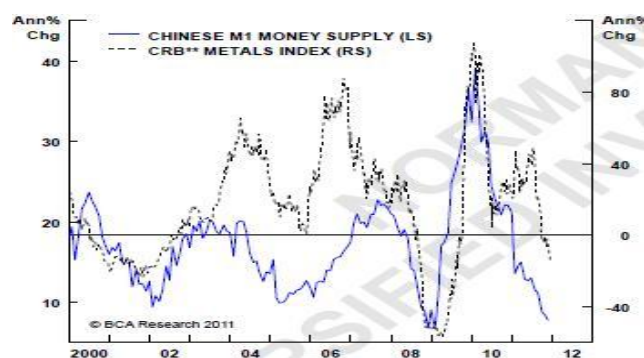
Diversified remains persuaded the Equities Asset class is likely to out-perform Bonds or Cash, over the course of our one-year to 18-month tactical horizon. Model strategies are arranged accordingly.

Commodities – Soft Patch for 'softs'

Most commodities underwent a soft patch in 2011, and few more so than grains (see 'Wheat' in Year-to-Date graphic above). However most commodities remained well in excess of production costs and producer's earnings persist at a good rate.

Hindsight reveals a persuasive correlation between Chinese monetary policy (now reflating), and that harbinger of commodity prices generally, metal prices (measured by the Commodity Research Bureau Index).

Chinese Money Supply vs Metal Prices



Source: BCA GIS Strategy Outlook, Dec 16th, 2011

Consistent with *Diversified's* position that global growth will prevail, model strategies remain engaged in commodities through an allocation to producer's share – in most risk profiles.

Currency – NZ\$ volatile

The NZ dollar's exchange rate exhibited heightened volatility in 2011, but remains a very difficult asset class to capitalize on. Portfolio currency management extends mostly to managing risks over attempting trading gains.

The main effect 2011's volatility in our NZ\$, was to cause reported returns to be lower during periods of strong currency appreciation by our NZ dollar. As the NZ\$ topped US80c in mid-2011, the relative performance of our models lagged that of competitors. The situation is reversed when the NZ\$ returns to a lower exchange rate.

Salient Rates, Indices, & Exchange Rates

Following are the October 31st, 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.

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

ACTUAL

Salient Rates, Indices & Exch Rates	Current	1 Mth Ago	3 Mths Ago	6 Mths Ago	12 Mths Ago	2 Yrs Ago	3 Yrs Ago	5 Yrs Ago
Prevailing Monetary Conditions Index	416	580	793	516	506	92	-243	842
Prevailing NZ Cash Rate (90-day) - p.a	2.73%	2.72%	2.97%	2.69%	3.20%	2.80%	5.86%	7.65%
Prevailing 2015 NZ Govt Stock Yield - p.a	2.86%	8.33%	3.61%	4.11%	4.79%	5.28%	4.99%	0.00%
Prevailing 2016 NZ Govt Inf. Ind. Yield - p.a	1.05%	1.15%	1.12%	2.23%	0.00%	0.00%	0.00%	0.00%
Prevailing 2021 NZ Govt Stock Yield - p.a	4.05%	4.49%	4.55%	5.10%	0.00%	0.00%	0.00%	0.00%

CHANGE

Salient Rates, Indices & Exch Rates	Current	1 Mth	3 Mths	6 Mths	12 Mths	2 Yrs	3 Yrs	5 Yrs
NZX NZ Govt Stock (Gross Returns Index)	1293.86	2.44%	3.28%	6.57%	11.82%	18.96%	24.34%	45.71%
NZX50 (Gross)	3270.2	-1.87%	-1.50%	-7.82%	0.16%	4.63%	20.63%	-15.36%
NZSCI (Gross)	21100.2	-1.03%	3.21%	-3.08%	0.90%	2.26%	17.88%	-15.14%
S&P/ASX200 (Australian)	4119.8	-5.36%	-3.22%	-12.50%	-11.89%	-12.37%	10.08%	-24.85%
MSCI World Index (Capital)	1184.6	-2.69%	-2.20%	-12.55%	-0.75%	3.10%	32.66%	-18.47%
Dow Jones (USA)	11556	-4.10%	-0.49%	-8.07%	5.00%	11.71%	30.89%	-5.45%
NASDAQ COMP	2516	-6.92%	-2.71%	-11.26%	0.71%	17.32%	63.85%	3.45%
FTSE 100 (UK)	5481	-1.14%	1.59%	-8.50%	-0.86%	3.18%	27.82%	-9.39%
Nikkei DJ (Japan)	8435	-14.79%	-5.81%	-12.44%	-15.12%	-9.20%	-0.69%	-48.17%
Hang Seng (Hong Kong)	17989	-9.44%	-12.40%	-24.05%	-21.81%	-17.60%	29.87%	-5.12%
NZD/USD	0.774	-4.54%	-9.44%	-5.97%	3.77%	8.45%	40.45%	13.79%
NZD/AUD	0.7576	-1.10%	-5.15%	-1.88%	-2.35%	-3.06%	-9.78%	-12.55%
NZD/JPY	60.09	-4.95%	-8.13%	-10.27%	-3.67%	-2.83%	14.37%	-23.94%
TRADE WEIGHTED INDEX (TWI)	67.68	-3.85%	-7.19%	-4.81%	-0.35%	6.45%	21.44%	1.18%
Gold (US\$/f.oz., troy)	1717	-0.20%	-5.92%	11.79%	24.00%	46.09%	111.00%	165.38%
Crude Oil (WTI, US\$/bbl)	99.74	7.34%	12.33%	-2.45%	16.89%	32.58%	84.12%	58.39%

NORMAN W. STACEY, INVESTMENT ANALYST

Looking ahead, *Diversified's* model strategies remain free of foreign currency hedging going into 2012. Portfolio returns are expected to reflect underlying asset class performances.

In the short-term, our NZ\$ tends to be more volatile than is justified by fundamentals; apparently captured by the sentiment of global forces, either towards us or away from another currency. Over longer periods we expect fundamentals to re-assert. Currently we find no fundamental reason to expect a significantly stronger NZ\$ exchange rate, especially relative to Asian currencies.

We are indebted to the heroic folks at Westpac for the short-term currency forecasts below:

Key Currency Forecasts

Currency	Mar '12	Dec '12	Mar '13
NZ\$/US\$	0.73	0.78	0.80
NZ\$/A\$	0.76	0.77	0.78
NZ\$/¥	55.5	63.2	67.2
NZ\$/GB£	0.49	0.49	0.49
TWI	66.6	70.6	72.4

Sources: Westpac Economics, Weekly Commentary, 12th Dec., 2011.

Economic research suggests weakening Developed World currencies, and strengthening Emerging Markets (notably Asian) currencies is probable over the long-term. *Diversified's* model strategies include a significant allocation to the Asian region, and does not hedge those back to NZ\$.

News Release, 20th December, 2011

Tradition MC & HNY Replaced

(The standard 'Merry Christmas & Happy New Year' has been redesigned in the spirit of the new Financial Advisers Act (2008), the Regulations to the Act, its Code, the Explanations-to-the-Code, Guidance Notes issued by the FMA, and the nods, winks and nuances of its AFA Inspectorate. The traditional message is adjusted for our Socially Responsible Investment (SRI) screen, has been passed by Cultural Advisers and carries the benefit of input from Legal Counsel - – without confirming or denying that we may carry P.I. insurance):

Diversified's Adjusted Seasonal Missive 2011/2012

“Best wishes for a carbon neutral, environmentally conscious, socially responsible, low stress, non-addictive and gender-equal, summer solstice holiday, practiced within the most joyous traditions of the religious persuasion of your choice - but with respect for the religious persuasion of others as well as those who choose not to practice any religion at all - and a fiscally successful, fair-taxed, personally fulfilling, and medically uncomplicated recognition of the generally accepted calendar year 2012 (but not without respect for the calendars of choice of the other cultures whose valuable contributions enrich our multi-cultural NZ society), and without regard to the age, disabilities-if-any, race, creed, colour, religious, or sexual preference of the wishees.”

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