



Pitcher Investment News

Financial Markets Stumble

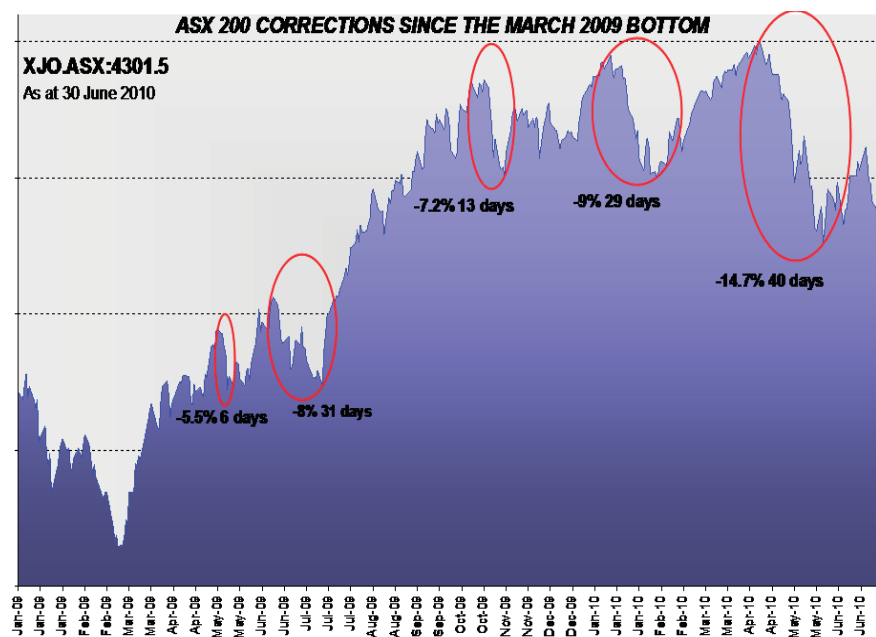
Up to 15 April 2010, which coincidentally is the anniversary of the sinking of the Titanic, investment markets were calm and growing in confidence. The ASX 200 index had hit the 5,000 mark up some 65% since the lows of March 2009. Since mid April 2010 however, the mood has changed markedly for the worse.

X Factors in May/June 2010

We usually expect 3-4 X factors each year that have the potential to unsettle markets but the May/June period produced a bumper crop of new reasons to worry:

- Debt default and currency concerns in Europe
- Two massive rescue packages for Greece and the Euro-zone
- Policy changes to slowdown activity in China
- 1000 point crash error on Wall Street
- Goldman Sachs charged with fraud
- Political uncertainty arising from UK and German elections
- Israeli supply boat attack as well as hostilities in Korea
- Riots in Greece, Thailand and Toronto
- Icelandic volcano re-erupts and massive oil spill in USA
- Failed terrorist attack in New York
- Australia's proposed 40% Resources Super Profits Tax
- Massive fall in \$A
- Chinese Yuan unpegged from \$US
- New Prime Minister in Australia
- US passes financial re-regulation laws
- Toronto G20 meeting agrees to budget austerity measures

These factors have affected all world markets, including Australia. This has widened out the trading range in the expected square root shaped recovery to between 4300 and 5000.



Financial Markets - 30 June 2010

Equities	Current Level	2 Month Return	12 Month Return
AUS ASX 200	4258.2	-11.4%	7.7%
AUS ASX 200 (Acc)	30609.97	-9.9%	13.1%
US Dow Jones	9774.02	-11.2%	15.7%
US S&P 500	1030.71	-13.1%	12.1%
US Nasdaq	2109.24	-14.3%	14.9%
JPN Nikkei	9264.04	-16.2%	-7.0%
UK FTSE 100	4916.87	-11.5%	15.7%
German DAX	5965.52	-2.8%	24.1%
French CAC	3442.89	-9.8%	9.6%
HK Hang Seng	20128.99	-4.6%	9.5%
Shanghai Comp	2398.37	-16.5%	-19.0%
India Sensex	17700.9	0.8%	22.1%
Sth Korean Kospi	1693.22	-2.8%	21.8%
NZ All Index	694.197	-9.8%	-0.6%
MSCI AC World ex-AUS (LC)	293.48	-11.2%	10.4%
Property			
ASX 200 Prop (Acc)	848.1	-5.8%	13.2%
S&P Global Prop Index	122.84	-10.0%	18.6%
Commodities			
Gold (OZ)	1,242.50	5.4%	34.2%
Oil (Barrel)	75.25	-12.7%	7.8%
Aluminium	1,924.00	-11.9%	19.1%
Copper	6,515.00	-11.5%	27.5%
Lead	1,690.00	-22.3%	-2.3%
Nickel	19,430.00	-24.7%	21.4%
Tin	17,475.00	-3.4%	16.9%
Zinc	1,730.00	-23.3%	11.3%
Reuters/Jefferies CRB Index	258.52	-6.9%	3.4%
Currencies			
AUD/USD	0.841	-9.0%	4.2%
AUD/EUR	0.687	-1.1%	19.6%
AUD/GBP	0.563	-7.1%	14.8%
AUD/JPY	74.365	-14.3%	-4.3%
Other			
VIX Index	34.54	56.6%	31.1%
Baltic Dry Index	2406	-28.3%	-36.0%
TED spread	0.36%		
Official Cash Rates			
New Zealand	2.75%		
Australia	4.50%		
China	5.31%		
United States	0.25%		
United Kingdom	0.50%		
Euro-Zone	1.00%		
Japan	0.10%		
Aust Interest Rates			
PPIS ANZ	4.00%	*Official rate less 50bp	
SGB AT CALL	4.48%		
ANZ 30 DAY TD	5.13%		
ANZ 90 DAY TD	5.46%		
ANZ 12 Month TD	6.00%		
10 Yr Govt Bond	5.09%		



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Economic Outlook

The pullback in markets during May/June was inevitable in the face of the magnitude of economic headwinds and market/world uncertainty. However, contagion was effectively contained and the G20 countries meeting in Toronto in late June agreed to work towards a halving of deficits by 2013 and to downward trending debt by 2016. Also inevitable is the fact that most of the developed world cannot grow rapidly while simultaneously seeking to reduce their debt and their budget deficits. Having said that, the OECD released their updated economic outlook in late May, increasing expected world growth to 4.6% in 2010 and 4.5% in 2011. We expect world growth will continue to recover albeit moderately and unevenly as we work through the aftermath of the global financial crisis.

Avoiding a Double-Dip Recession

Numerous commentators have warned that the risk of a double-dip recession is still with us. Nouriel Roubini offers the following seven steps to avoid such a scenario:

1. In Europe budget cuts must remain offset by low interest rates
2. Low European rates also required to stimulate export demand
3. Countries with unsustainable debt levels should commence restructuring the debt
4. EU, IMF and others to provide lender of last resort support
5. In US, UK and Japan stimulus to take precedence over medium term constraints
6. Surplus countries (China) must let currency appreciate and stimulate consumption
7. Regulatory reform to increase capital ratios for banks to be phased in gradually

As at late June it appears that world policy makers are following these steps.

The Ways Out of a Debt Crisis

Harvard University's Niall Ferguson recently offered his thoughts on the six ways out of the current world debt crisis, the magnitude of which we have only ever seen as a result of world wars. The six ways are: 1. Raise economic growth; 2. Lower interest rates; 3. Get bailed out; 4. Cut the Budget; 5. Print money and 6. Default. For most of the world's highly indebted economies 1. and 2. are not possible. In fact, only Britain in 1815 has ever managed to grow itself out of debt and that was with the tailwind of an empire and the industrial revolution. Getting bailed out may work for Greece and Argentina but won't for the USA just on the sheer size of the debt. Cutting budgets and printing money can make matters worse by bringing on depressions and inflation. Default can take many forms – real (inflation adjusted) returns to creditors are reduced, currency adjusted returns to creditors are reduced, there are standstills, rescheduling or full repudiation. Ultimately there is also the default of power and influence in world affairs which is the endgame Ferguson sees for the US. Just as with the Spanish in the

17th century, the Dutch in the 18th century, the Turks in the 19th century and the English in the 20th century, Ferguson now predicts the end of the US as a great power.

Will Greece default ?

Specifically the options for Greece are as follows:

1. Accept austerity measures in return for continued support from EU and IMF – Debt is likely to increase and government locks in a depression - no growth and high unemployment.
2. Leave the EU and/or Euro – Return to the drachma, partial default on debt as it would devalue the currency and make labour and exports cheaper encouraging some growth but also inflation. This scenario makes it very difficult to borrow and hard for fixed income earners.
3. Default over the course of the next few years – debt would be restructured, maturities lengthened, coupons reduced, cuts taken on the principal amounts owing. Most likely and best option for Greece as well as the countries who have lent to it.

Shorter Sharper Cycles

Numerous commentators have offered the view that the need to deleverage, the application of extremes of both monetary and fiscal policy, the greater role of governments in economic activity, current demographic trends and the greater dependency on the growth of emerging economies (which tend in themselves to be more volatile), will lead to shorter and sharper economic cycles over the next decade/s. That means more frequent but shorter recessions as well as boom times. For those of us that remember, it could be back to the seventies.

Implications for Investing

What this would mean for portfolios is more active asset allocation, sector exposure and security exposure aimed at securing access to growth as well as protection opportunities throughout these cycles. It means continued emphasis on rebalancing portfolios - more frequently taking profits in the upper end of cycles and adding to exposures at the lower end of cycles. It also may mean continued departures from strategic asset allocation, sometimes for extended periods. The influence of macro-economic factors on investment portfolios is now at a very high level, while the influence of sector and security specific matters continues.

*Nothing is more difficult, and therefore more precious,
than to be able to decide.*

Napoleon Bonaparte (1769 - 1821)

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