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QUARTER ENDED 31ST MARCH 2010 INVESTMENT REVIEW — TREADING WATER

by Ian Murdoch and Jamies Nemtsas

Market recovers lost ground

The quarter started well with a new post bear market high on the 11th of January, however a fall of nearly 10% by early February was the result of further concerns on sovereign debt issues, this time in Europe. The market recovered the lost ground to finish up just 0.1% for the quarter ended 31st March 2010.

In the US, returns were better with a 4.1% return on the NYSE and a 5.7% return for the NASDAQ. The market made two new highs, one in January and then again in late March after a similar correction to what we saw in Australia. With appreciation of the Australian dollar, the MSCI World index in Australian dollar terms was up just 0.7%.

We have seen a further steepening of the US yield curve while the Australian yield curve has continued to flatten with a rise in yields out to nine years, as the Reserve Bank increased the cash rate in March and then again in April. The ten year bond yield changed marginally in the US and Australia. Australian Government bonds have underperformed global bonds, with a 1.1% total return against global bond returns of 1.5% (hedged), however on an unhedged basis global bonds saw a -0.3% return for the quarter. Corporate bonds continue to outperform government bonds returning 3.7% for the quarter globally (hedged), Australian corporate bonds returning 2.0% for the quarter, while cash generated just under 1% for the quarter.

Markets were impacted by concerns over sovereign debt issues which gave way through the quarter to broader acceptance of a sustainable recovery. Forward looking indicators around the globe are all indicating a good to strong recovery, however the Greek economy is unsettling along with some uncertainty about China.

Outlook

Confidence in the global recovery continues to grow as key leading indicators are generally pointing in the same direction. Government policy remains supportive of economic recovery and interest rates remain at emergency lows in Europe, the UK., the US and elsewhere.

With unemployment improving overseas and in Australia, combined with improvements in economic growth, industrial production and other lagging indicators, we are getting confirmation that recovery has begun and is now becoming widespread.

Global growth for 2010 is now anticipated to be around 4.1%, up from the 3.9% projected by the International Monetary Fund (IMF) in January. The IMF also raised its expected growth for the US to 3.0% while the Euro zone forecast has been significantly reduced.

We continue to expect Australian Gross National Product growth somewhere around 3.0% – 4.0% for the calendar year. Unemployment is expected to fall gradually and inflation to remain below 3% over the next year.

Asset Classes

Growth assets remain significantly below trend and thus remain favourable investments.

Australian Equities – have recovered well but not to the extent of the global market and so we continue to recommend an overweight position. Key areas remain resources and energy, despite recent underperformance, due to China's lack of these resources. Companies with good growth prospects remain desirable.

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KEY BENCHMARK INDICES - ONGOING REVIEW

Benchmarks are an essential part of managing your portfolio to compare between the various forms of investments and with peer groups to see if your assets are keeping pace with expectations. We summarise key benchmark indices for your information and review of your portfolio to 30th April 2010. We have highlighted returns for 1, 3, and 5 years ended 30th April 2010 for the medium to long term to benchmark your asset class returns.

Source : FactSet	ACTUAL TOTAL RETURNS		
As at 30th April 2010	1 yr % pa	3 yrs % pa	5 yrs % pa
S&P/ASX All Ords Accumulation - Australian Sharemarket	34.17	-3.75	8.61
S&P/ASX 200 Property Trusts Accumulation	37.44	-22.78	-6.31
UBS Composite Bond Index 0+YR - Australian Fixed Interest	3.29	6.46	5.78
MSCI World ex Aust (Net Div) (AUD) - International Equities - unhedged	7.94	-9.89	0.05
Barclays Capital Global Aggregate - International Bond Market - unhedged	21.17	2.43	1.87
Australian CPI (Actual) - Inflation	2.89	3.20	3.00

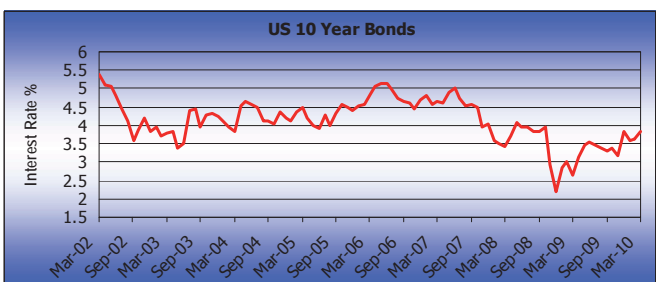
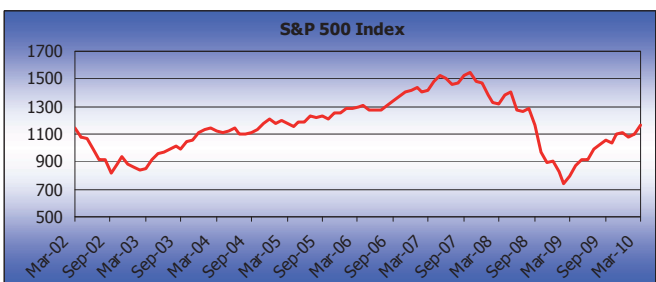
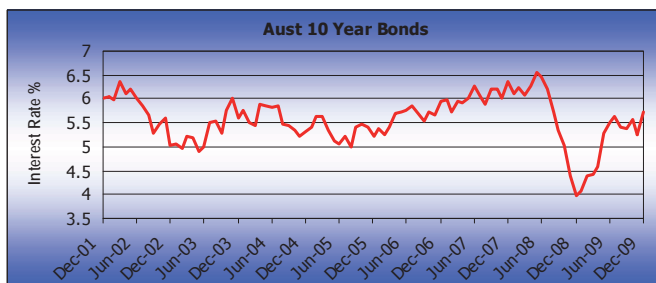
QUARTERLY INVESTMENT REVIEW — TREADING WATER

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Global Equities – we believe portfolios should remain overweight to emerging markets where we see the potential for improved risk return profiles for portfolios. Clearly the growth and urbanisation of China, and to a much lesser degree India, are important themes to which emerging market investments will get exposure. As companies in Asian markets become over valued managers of broader emerging market funds can increase investment in other developing countries outside of Asia.

Property – listed property struggled over the quarter with capital return of -3.3%. Including income the return was still a negative 1.5%. While on a twelve month basis property has performed in line with the S&P/ASX 200 accumulation index, going forward property trust growth is likely to be constrained as banks look to reduce their exposure to commercial property. Direct commercial property prices appear to have bottomed with some unlisted property funds reporting upgrades to revaluations. While these increases have been somewhat limited we would expect broader based positive revaluations going forward.

Fixed Interest – corporate credit spreads remain elevated and as such corporate bonds and hybrid securities remain preferential to government bonds. Tactically we remain underweight fixed interest with a tilt to corporate debt within the sector. For those with lower risk appetite fixed interest term deposits will secure capital while giving reasonable returns as well as surety of income.



Source: Iress

Interest Rates

The Reserve Bank of Australia (RBA) again tightened interest rates but not before surprising the market in February when it left rates on hold. The official cash rate was increased from 3.75% to 4.0% in March and subsequently has been raised to 4.50% by May. The latest RBA statement said, “the Board judges that with growth likely to be around trend and inflation close to target over the coming year, it is appropriate for interest rates to be closer to average.” This increase leaves interest rates still below average however given the level of private debt some are suggesting we are now at a point where interest rates are only mildly stimulatory. We are now at the low point of the previous cycle which was in 2002.

In Europe, Japan, the UK and the US with much weaker economies and higher unemployment, policy rates remain at emergency lows which is supportive of recovery in global economic growth.

Inflation concerns in India could lead to an increase in interest rates in the very near future, while Japan further eased monetary policy by doubling the size of its fund-supply tool adopted in December, at which it offers loans to commercial banks at the policy rate of 0.1 percent.

The European Central Bank recently left rates on hold and continues to look to unwinding non standard measures which is expected to occur gradually through the second half of the year.

Strategy

With our proximity to Asia and our relative economic position in the developed world we see Australian shares as favourable. A general and self sustaining global economic recovery would be supportive of commodity prices and thus the Australian share market. However with the strength of Asia and other emerging markets we remain overweight emerging markets.

Global equities remain a core component of our portfolios with a significant tilt towards the emerging markets of Asia as well as Central and South America. While a portion of the portfolio has remained hedged, global share funds are usually unhedged, because the A\$ normally moves in line with share markets and so tends to smooth out their volatility. In 2008, the fall in the value of the A\$ helped cushion the fall in international share markets for Australian based investors in unhedged international shares. While in the short term the Australian dollar relative to most currencies is climbing again we don't believe these levels will be sustained in the long term. For portfolios that may be underweight now is an opportunity to build exposure to global equities on an unhedged basis.

Corporate interest rate spreads continue to be at elevated levels indicating a pricing opportunity. We maintain that having fixed interest investment is beneficial from a diversification perspective for portfolios and that a mix of government and corporate bonds is appropriate. A more conservative albeit lower return approach is to have fixed term deposits across a variety of maturities to get exposure across the interest rate curve.

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