

“It happened when it went from 90 to 40 back in 1974 and 75. It happened in 1987. It went down 50 per cent in 1998 to 2000 ... I hope I live long enough so it happens a couple more times to me.”

Warren Buffett on the share price of Berkshire Hathaway falling 50% for the fourth time.
November 2008

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FROM THE MD'S DESK



BRAD MARTYN

Last year will go down as the worst calendar year for the Australian share market ever. In the USA it was the second worst performance on record. Like every other boom or bust, no one knows when the market will change direction, although many are quick to express their guess. Unfortunately that is all it is, a guess. However, gauging the direction over the longer term is a little easier to get right.

Over the longer term the share market has always trended upwards and should always do so, because it reflects the progress of economic development and human endeavour. In simple terms, as the global population increases and collective human intelligence and experience grows, so does global productivity. Increased production means increased wealth. World share markets are a barometer of the world's wealth and as long as populations continue to grow and humans retain a drive to better themselves, share markets will continue their long-term trend upwards. However, in the short-term we continue to face one of the bleakest economic periods since the Great Depression. The massive government stimuli around the globe has not stopped a global recession, but it is hoped they will cushion the impact and hasten the recovery.

Share markets act as a leading indicator. Share markets turned down well before the economy showed any signs of slowing and so too will the market turn up before the economy begins to improve. Typically, share markets change directions between six and 12 months before the economy does. Therefore it is considered risky to sit on the sidelines waiting for economic indicators as a guide to return to investing. Typically, the market bounces back reasonably dramatically in the first year after recession level lows (about 32% on average over the past nine bear markets).

Last year was very trying for our clients and for us. We sincerely thank our clients who have again proved very loyal and caring. We have been amazed at the level of concern from our clients regarding our mental and emotional health. This has been particularly helpful to our morale, as there have been many quite depressing days and no escaping the relentless bad news. However, our team remains in good spirits and has worked hard at maintaining our sanity and an optimistic outlook.

As always, we encourage our clients to contact us if they are feeling anxious or stressed. Despite the circumstances, we enjoy client visits and gain a great deal of inspiration from them.

Looking forward to a better year ahead. ■

STOP PRESS

When news headlines say things like “Superannuation Funds down 30%!” you may question what benefit you receive by making salary sacrifice contributions to your superannuation ... after all, superannuation account balances have been on the decline for over a year now!

Remember, superannuation is NOT an investment; it is a tax structure that holds the investments. The benign tax environment that super provides is available whatever the performance of investment markets, so changing your tax planning strategy due to investment prices going down can be very counter-productive. Salary sacrifice contributions are taxed at 15% on the way into superannuation as opposed to up to 46.5% if taken as salary ... a possible saving of up to 31.5%!

What you do with the contribution when it is in your super fund is the investment strategy, which is secondary to the tax planning strategy. By owning a self-managed super fund (SMSF) you can have greater input into your investment strategy, so while investment markets are volatile, you may elect to hold your contributions in cash for future investment or to meet pension payments. This control rarely exists with retail and industry superannuation funds. ■

PRICE V's EARNINGS



PAUL BEGLEY

In an ideal world, investors could buy shares in a business already knowing the return they would receive on their investment. Provided they knew what rate the business earnings would grow at they could then assume that the share price would also grow at this rate over the long-term. This would eliminate the need to track the share price over the investment period. However, economic (top-down) and company specific (bottom-up) factors influence company share prices and undermine this simplistic investment theory.

Over the past 12 months macroeconomic factors have played a considerable role in affecting share prices. It is because of these events that even the best businesses will have earnings that fluctuate to some extent over the short-term. While mindful of the top-down and bottom-up investment approaches, long-term investors require stocks that will stand the test of time. As no company can control the macroeconomic conditions in which it operates, it's vital that it be able to survive the various economic cycles.

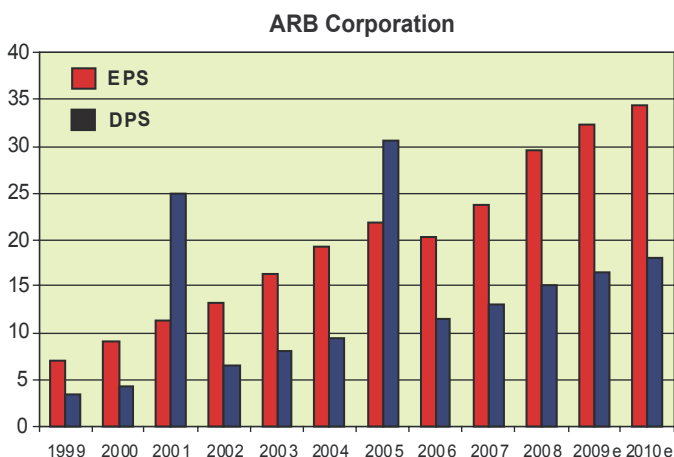
Over the long-term, 10 years or more, share prices should reflect the company's ability to grow its earnings which, over time, are paid as dividends to shareholders. Take for example ARB Corporation (ARB).

ARB is a manufacturer of four wheel drive accessories and exhibits strong long-term quality-focused investment characteristics. ARB holds a dominant position in its key markets with a history of making successful new additions to its product range.

At Alliance a number of investment principles must be satisfied in order for a stock to continue being held in portfolios. Using ARB as an example, we'll work through four of these principles:

1) History of stable profit growth:

ARB has grown its earnings over 5 years at 12.6% pa and 10 years at 17.1% pa. Its average return on capital



over 5 and 10 years has been impressive at 25.3% pa and 23.3% pa respectively. Referring to the previous graph, while maintaining a stable growing earnings base, the company has also sought to return excess earnings to shareholders in the form of special dividends as was the case in 2001 and 2005. Note that 2009e and 2010e are forecast earnings per share (EPS) and dividends per share (DPS).

2) Transparent & sustainable business model:

ARB's business is relatively simple to analyse. Sales are primarily generated in Australia and the US while products are manufactured in Australia and the recently completed plant in Thailand. The Thai plant has assisted in reducing costs (lower labour costs) and alleviating production pressures at the company's original Kilsyth plant in Australia.

Given the recent pressures of rising fuel costs and general higher costs of living, large 4WD sales are expected to slow considerably. Having earlier identified this, ARB has been actively targeting new products towards the 4WD utility market where sales continue to grow significantly despite the broader automotive slowdown.

3) Proven management:

ARB has a long-standing chairman and managing director in Roger Brown. Together with his brother Andrew, they hold a combined stake in the company of 16%.

Management has a strong and successful expansion and acquisition history as evidenced by the company's new Thai plant and recent Thule (car rack manufacturer) acquisition.

4) Sound financial base:

ARB has a history of paying out excess franking credits to shareholders in the form of special dividends. However, ARB has also maintained a conservative payout ratio of 50% over the past 10 years (excluding special dividends). These retained earnings are used for business expansion and new product developments.

Further, the company maintains a significantly under geared balance sheet that would be the envy of many companies given the current credit environment. As at October 2008, net debt (total debt minus cash) was under \$9 million putting ARB on a net debt/equity ratio of only 11%.

It's important to understand that although a company may be in a sound financial position with a solid earnings growth profile, short-term issues can often override these thematics and affect its share price. Looking at ARB since June 2007, one could easily conclude that the business must be performing poorly. After all, the share price has fallen some 33% over this period.

Continued on page 3

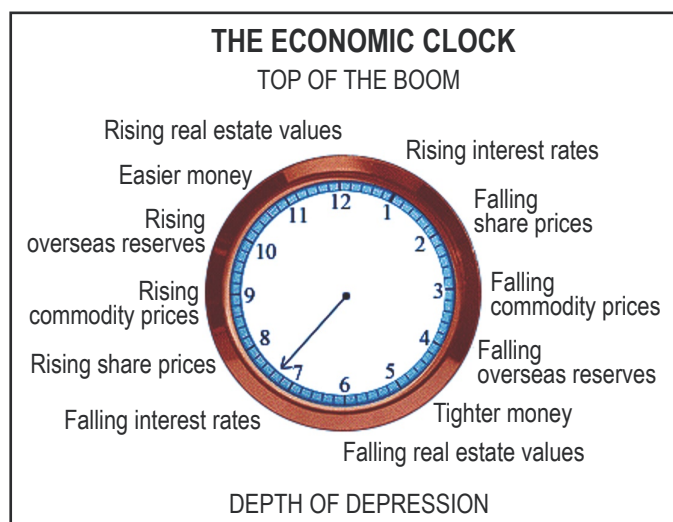
THE ECONOMIC CLOCK



SCOTT STANLEY

The “Economic Clock”, also known as the “Investment Clock”, was first compiled by *The Evening Standard* of London from a study of economic cycles over a period of 150 years. Today, while there are many variations, its principles are based on a 10-year economic cycle of booms and busts. Therefore, the clock assumes long-term investment horizons.

Over the years since its introduction in 1937, the clock has proved to be a reasonably accurate method of reflecting the cyclical relationship between different asset classes such as shares, property and fixed interest, as well as the order in which they all occur. This means that different sectors will do well in different market conditions. However, it is not a good indicator for predicting the timing of various trends in the market with great accuracy. In other words, the rate at which the clock rotates can be unpredictable.



The clock depicts the most appropriate investment medium, taking into account prevailing economic indicators such as interest rates, commodity prices and inflation. It shows that the share market cycle is followed by the real estate and then the fixed interest cycles.

Experienced investors have a good understanding of how the economic clock functions and often refer to it when making investments decisions.

In Australia, evidence suggests that the time (according to the economic clock) is between 5 o'clock and 7 o'clock. The Reserve Bank of Australia (RBA) has been cutting the cash rate since September 2008. Consequently, the cash rate has more than halved since its high in March 2008 of 7.25%. Furthermore, we have witnessed falling share prices, falling commodity prices, falling real estate values and of course, tighter credit markets. This indicates we are approaching the recovery region of the economic clock.

Market analysts believe the beginning of the recovery phase is an excellent time to invest in the share market, by increasing exposure to equities and reducing exposure to cash and fixed interest to reap greater long-term returns.

As mentioned above, the rate at which the clock rotates can be unpredictable. Therefore, it is extremely difficult to pick the “bottom of the market”. It is important to bear in mind that share markets are forward-looking. When the outlook for economic growth is improving, markets will tend to do well, and when the outlook is worsening markets will struggle. Although the global economic outlook and the value of markets have plummeted considerably, at some point in time the forecasts will slowly begin to improve. In turn, the economic clock will then be telling us the time is eight o'clock and ticking! ■

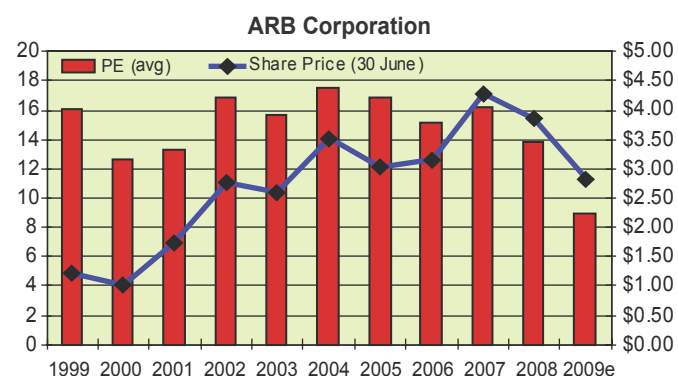
“Price V’s Earnings” continued from page 2

What’s really occurring however, is that investors are no longer willing to pay as much for today’s earnings (and dividends) because they are concerned future earnings and dividends may be at risk.

However, looking over a longer period, ARB is trading on a 10 year price to earnings ratio (PE ratio) low of about 9x based on 2009 forecast earnings.

Based on the premise that the share price will ultimately reflect the underlying financial performance of a business over the very long-term, those investors who are comfortable with ARB’s past, present and future should be confident in holding shares in the company. In the meantime, short-term concerns that other investors may have should be seen as a

better opportunity for those with patience to invest over the long-term. ■



Dr CHRIS CATON SEMINAR

Thank you to the 100 or so Personal Funds Management clients and guests who attended the Chris Caton Seminar at the Kings Park Function Centre. Chris made the topic of economics understandable and relevant at all levels.

Chris is a leading analyst of both Australian and International Economics, and their potential impact on individual industries.

His major role is to provide advice on the implications for financial markets of economic developments, including major economic statistics, policy pronouncements and political developments. ■



Le and Christine Potts, who attended the seminar with Alliance's Steven Hendry

PROFILE FIVE MINUTES WITH JAMES GOULDSON

- 1. Marital Status:** I'm 22 and enjoying the single life... while I still can.
- 2. Place of Birth:** Born and bred in WA although both my parents originated from Adelaide. Thankfully they both saw the light.
- 3. School, University (including degrees held):** Graduated from Christ Church Grammar in 2003 and completed a Bachelor of Commerce from UWA in 2006. I majored in Corporate and Investment Finance but also took a minor in Business Law just for a bit of added interest.



4. Professional specialty: While I admit I'm still an infant in the professional world, I'm eagerly working my way into a research and investment analysis role within the Alliance team.

5. Previous professional history: Although I wouldn't call it a professional history, I held a part-time position at the local Coles during my time as a student.

6. Memberships (professional): I'm currently studying the first of 3 levels under the Chartered Financial Analyst (CFA) accreditation. With some hard work and discipline I look forward to becoming a CFA within the next 3 to 4 years.

7. Favourite holiday destination: I was lucky enough to take a whirlwind backpacking trip through Europe last year. I thoroughly enjoyed every minute so I can't say I have any particular favourite destination. Memories included partaking in Oktoberfest celebrations in Munich (in moderation of course), watching the International AFL Championships in Prague (for the record England won) and driving the Route du Champagne in France, enjoying some quality bubbly along the way.

8. Dream holiday destination: Another holiday may be off the cards for a little while although I'd love to explore more of Eastern Europe and the US.

9. Hobbies/interests: For a few years now I've been restoring a 1988 BMW 635csi with some modern additions made along the way. After some delays and costly mistakes the finish line is finally in sight and I can't wait to enjoy the end result. ■

WHO TO CONTACT AT ALLIANCE

Christina MacGregor

Administration Queries/Cash Withdrawals

Jan Williams

Queries relating to Portfolio Administration

Peter Eastman, Steven Hendry or Your Adviser

Investments or Financial Planning



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