



The challenge of investing in desperate times

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Summary

- The bad news
- The better news
- What does all this mean for investors

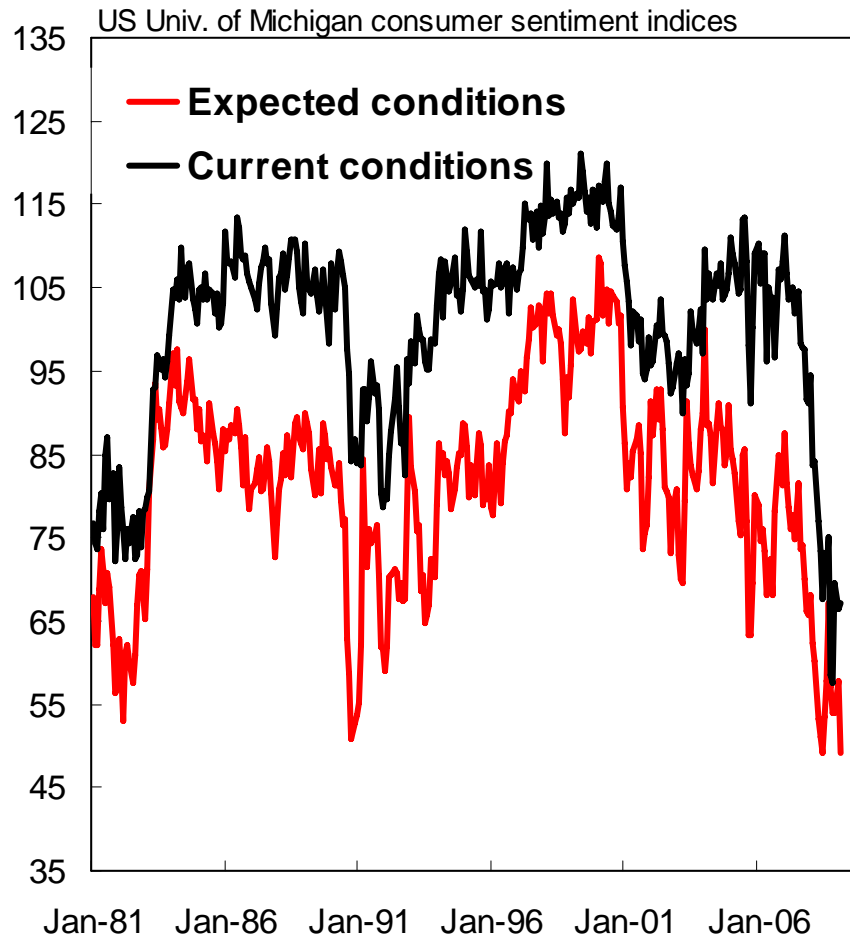




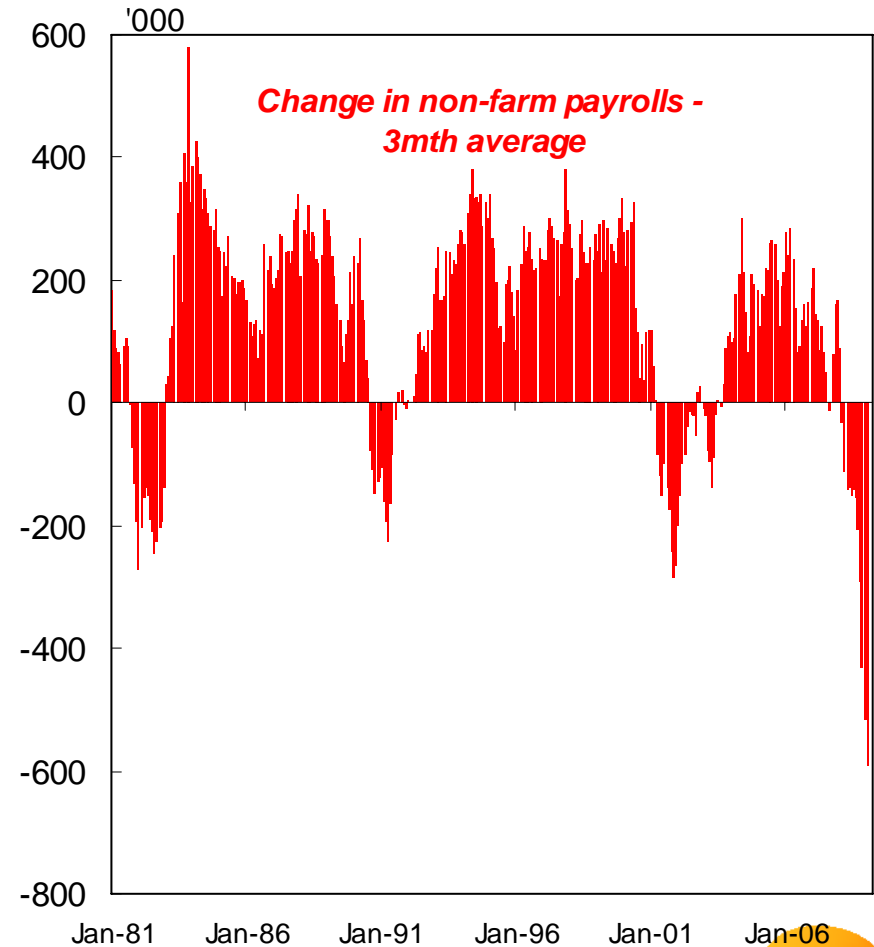
1. The bad news

US economy has been in recession for over a year..

Consumer confidence has been falling since mid '07..



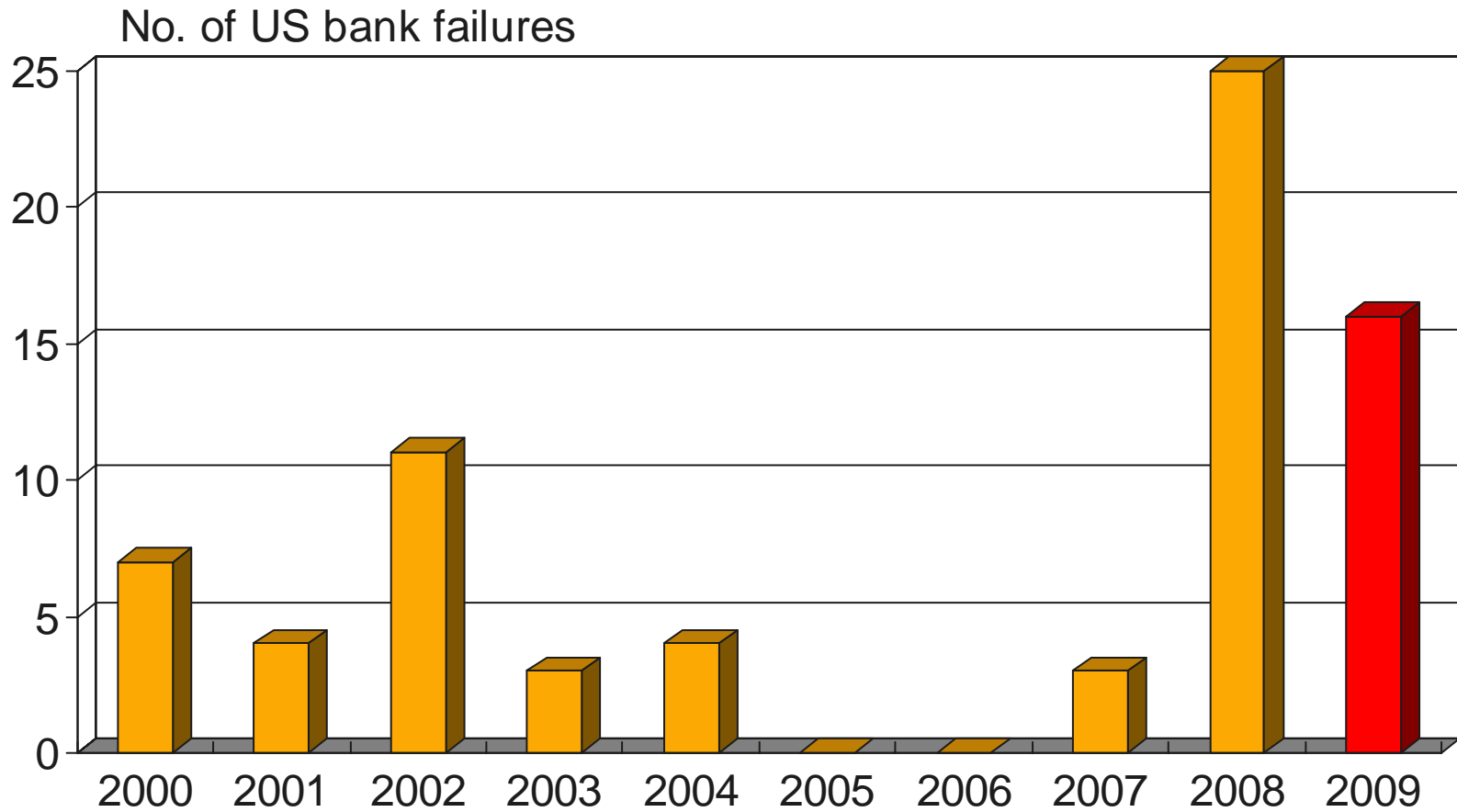
..and employment has been falling since the start of '08



Source: Thomson Financial



Bank failures soared even before the recession had really hit!



Source: FDIC. 2009 data as at 2 March



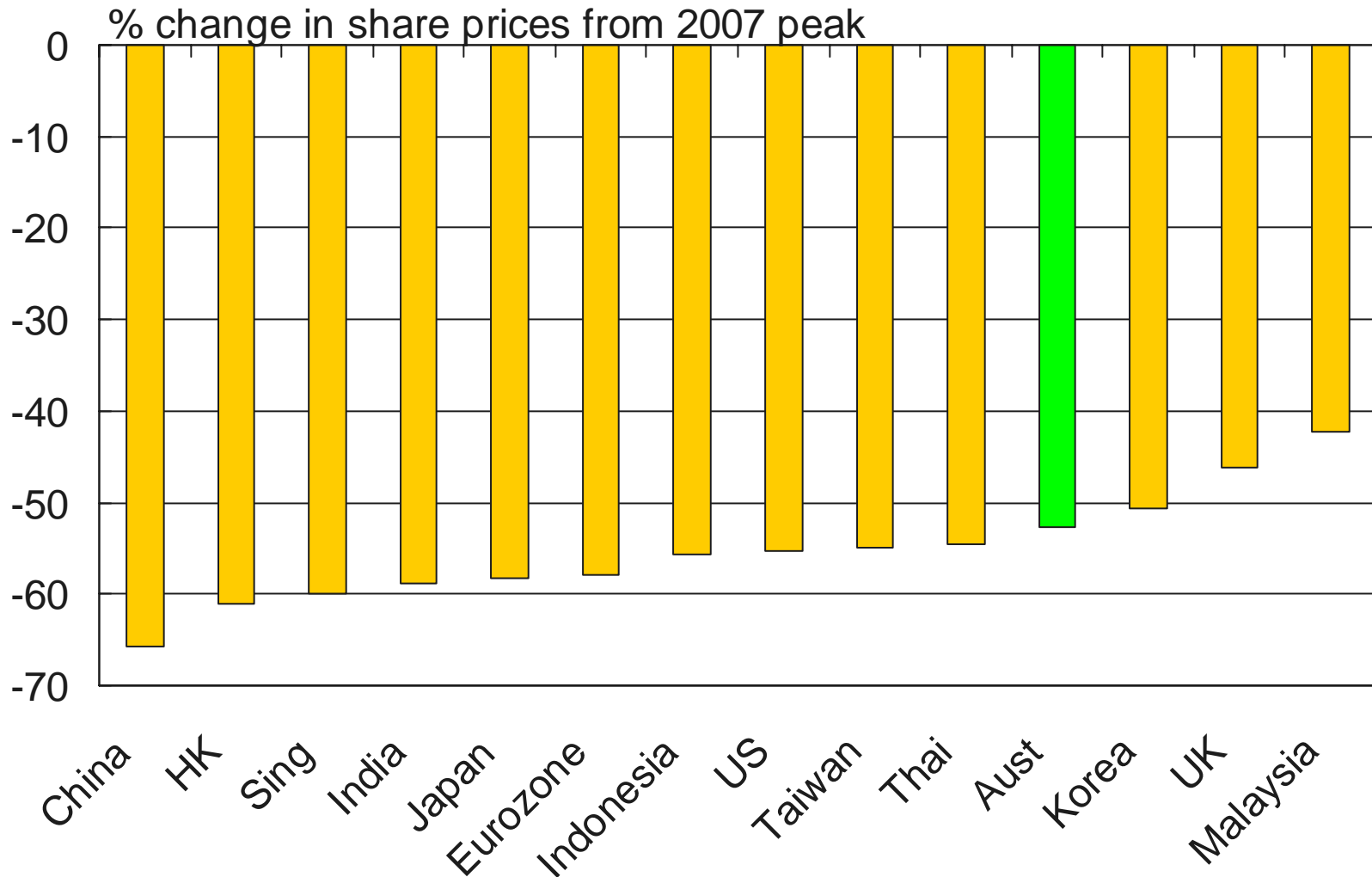
Just how big are the losses and how much money do the US banks need?

	US\$ billion
What the US banks and investment banks were worth at the end of Q3 2008	1417
Their likely losses# (known + expected)	1744
Shortfall	-327
How much they've raised/been given so far	430
Their implied worth	103
Estimated capital required to get back to pre-crisis levels#	1400

Source for data and estimates: Nouriel Roubini and Elisa Parisi-Capone, RGE Monitor, January 2009
losses include loan losses and mark-to-market losses on securities held. Estimates of losses assume a further 20% fall in US house prices, a fall in US GDP of 5% over 2 years, and an unemployment rate that rises to 9%



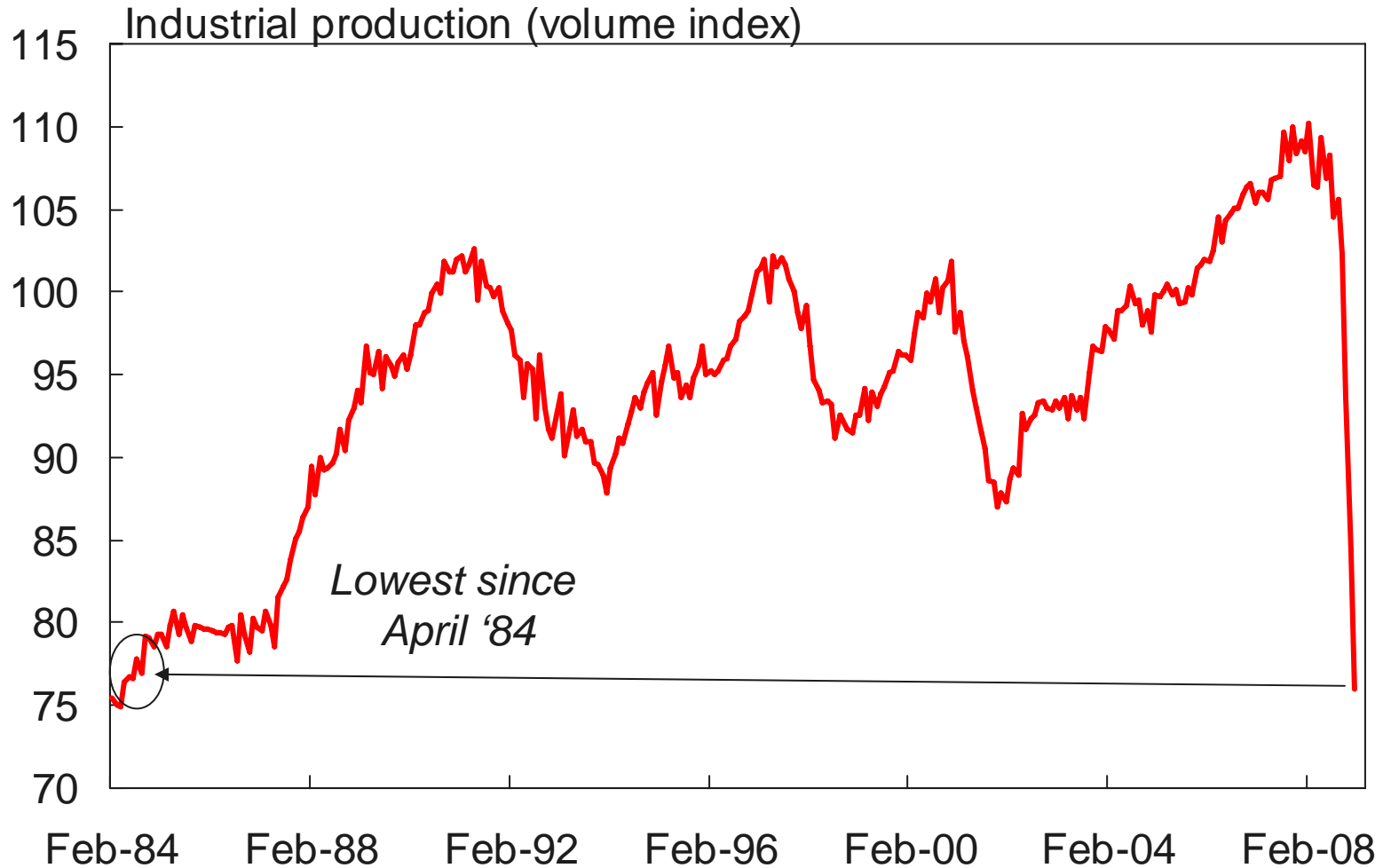
De-coupling in Europe and Asia? Sharemarkets never really bought it



Source: Thomson Financial. As at 24 February 2009.

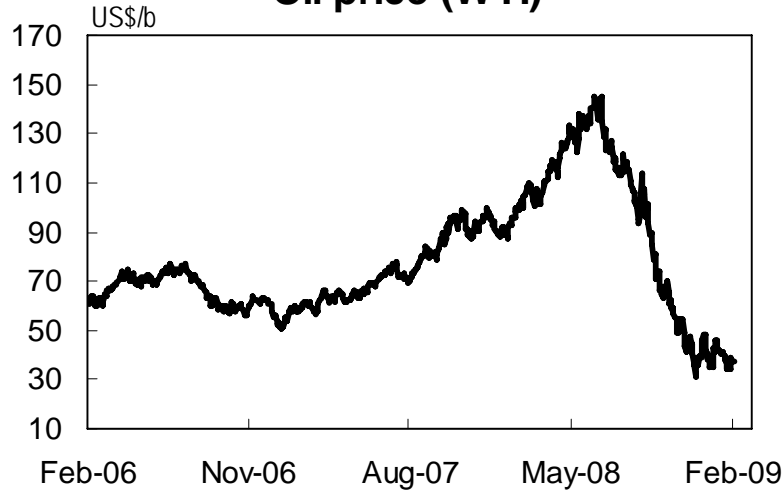


Japan's shrinking manufacturing sector

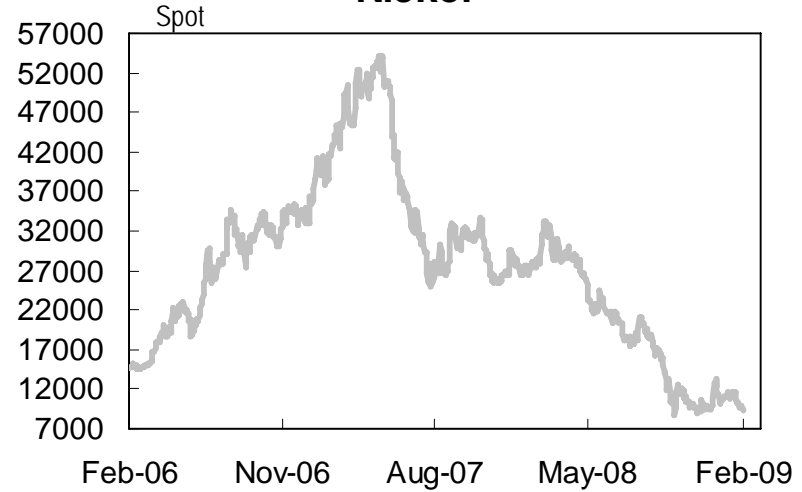


Every commodity boom comes to an end, and this one was no different

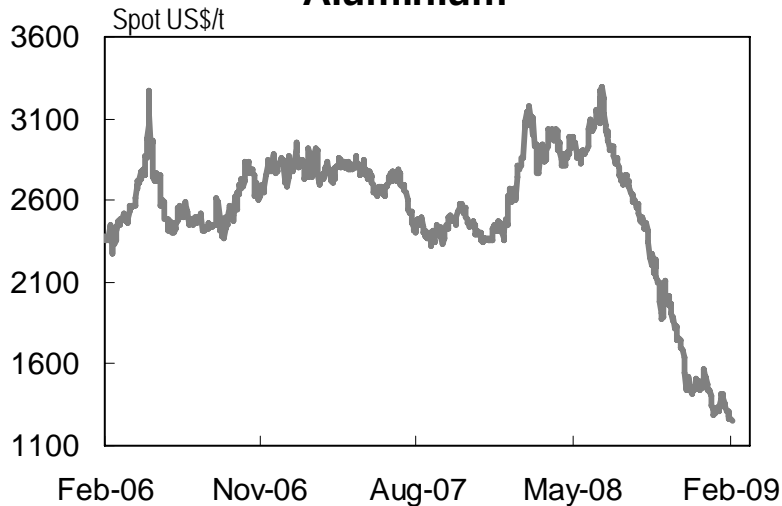
Oil price (WTI)



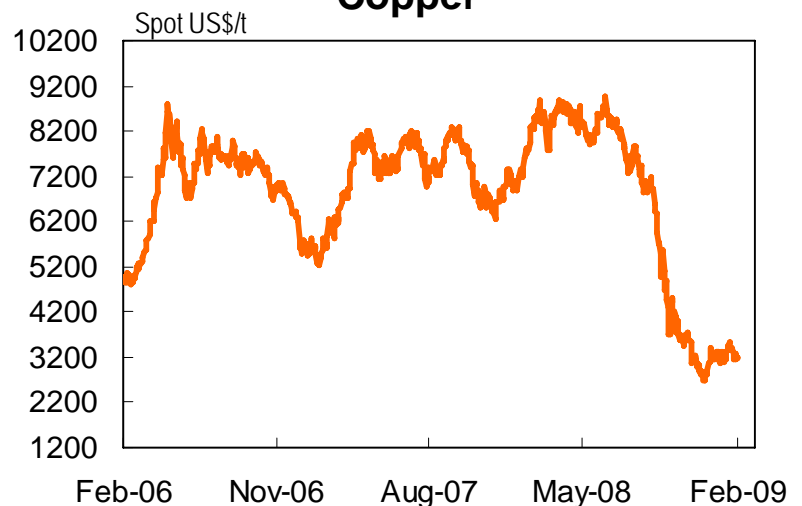
Nickel



Aluminium



Copper



Australian prospects

- Our households are in more debt, and we live in vastly more overvalued houses than our American friends
- The commodity boom is over – terms of trade effect moves into reverse
- Mild recession in 2009

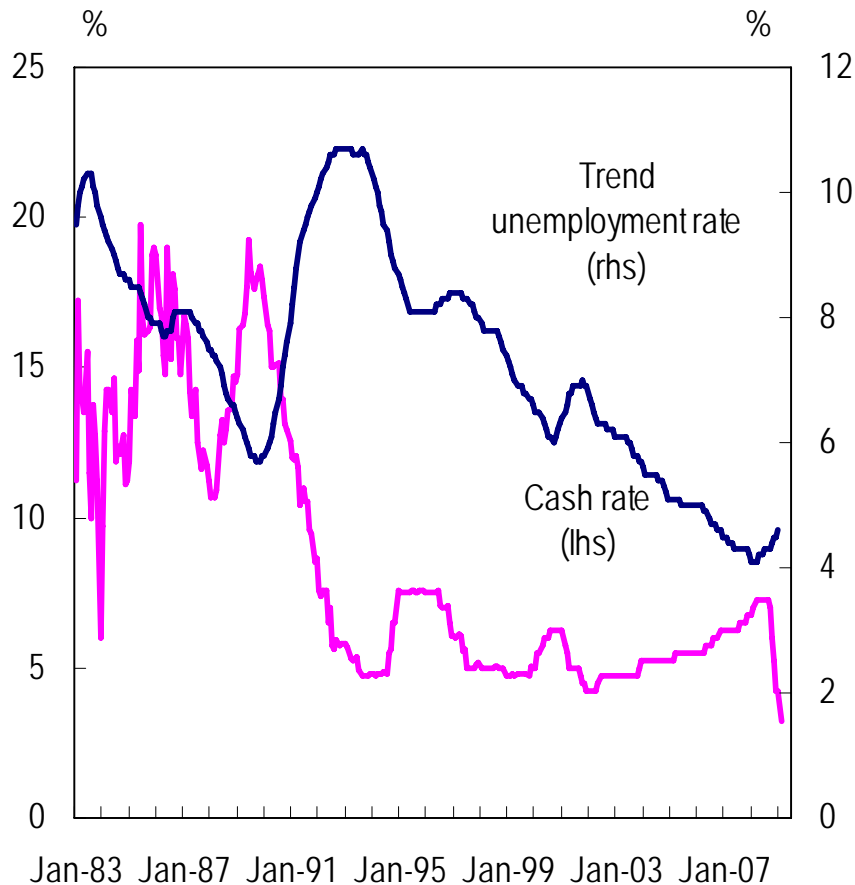
BUT...

- Our banks are better regulated, and have been better managed
- Our policymakers have enormous flexibility, and have acted aggressively
- \$A is doing exactly what we should want it to do!

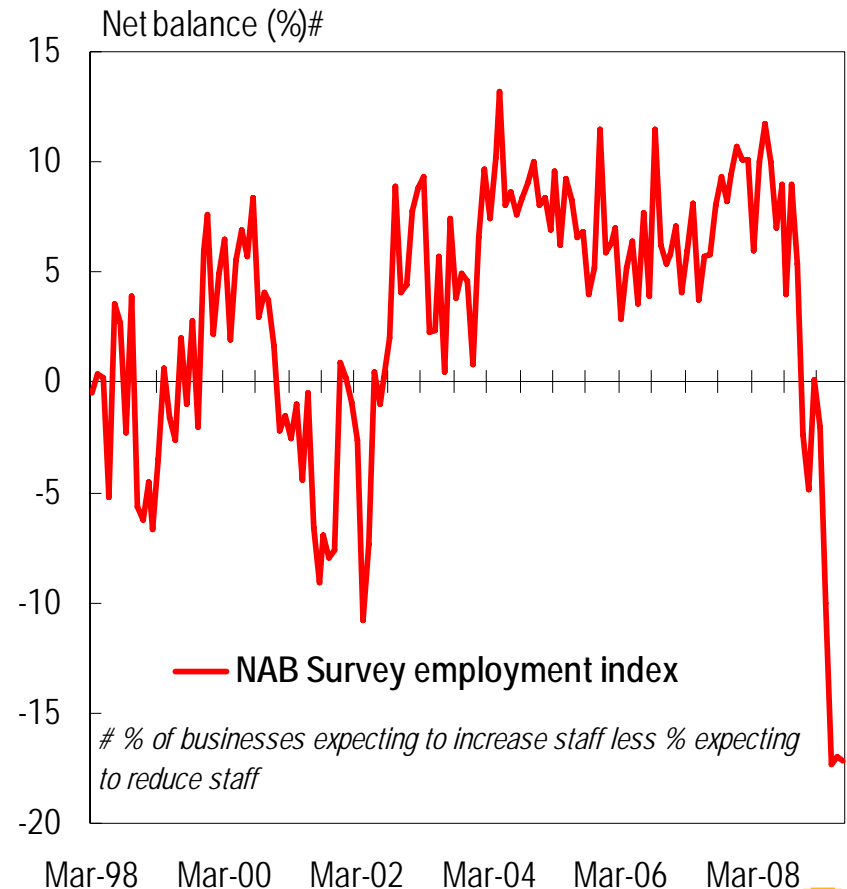


Labour market is traditionally the best guide to RBA policy

Uptrend in unemployment met with aggressive RBA rate cuts..

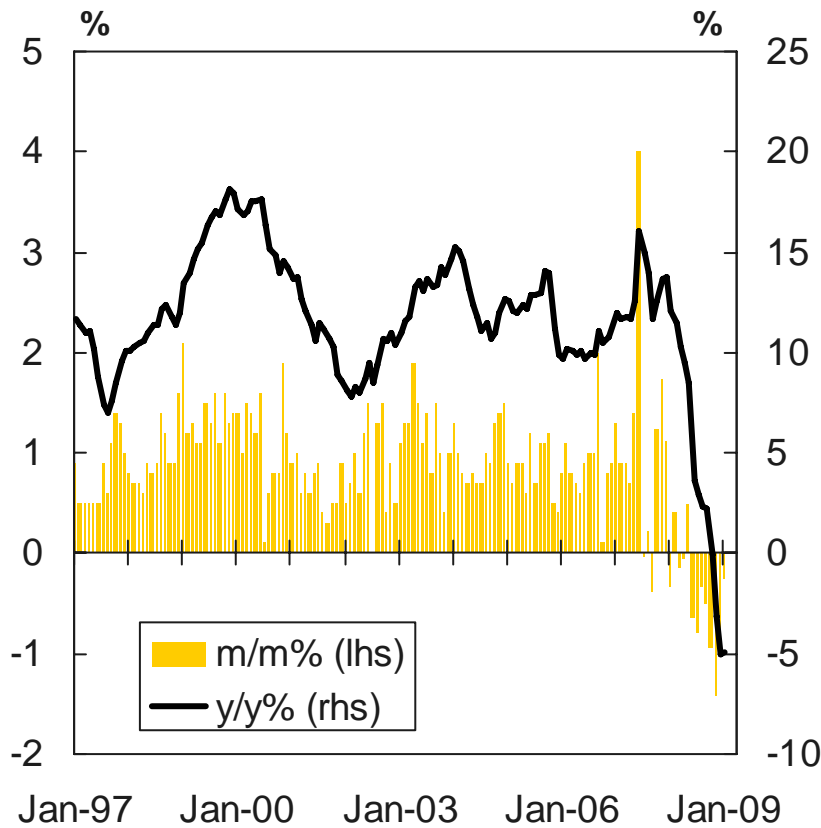


..and the NAB survey suggests trend unemployment will rise further

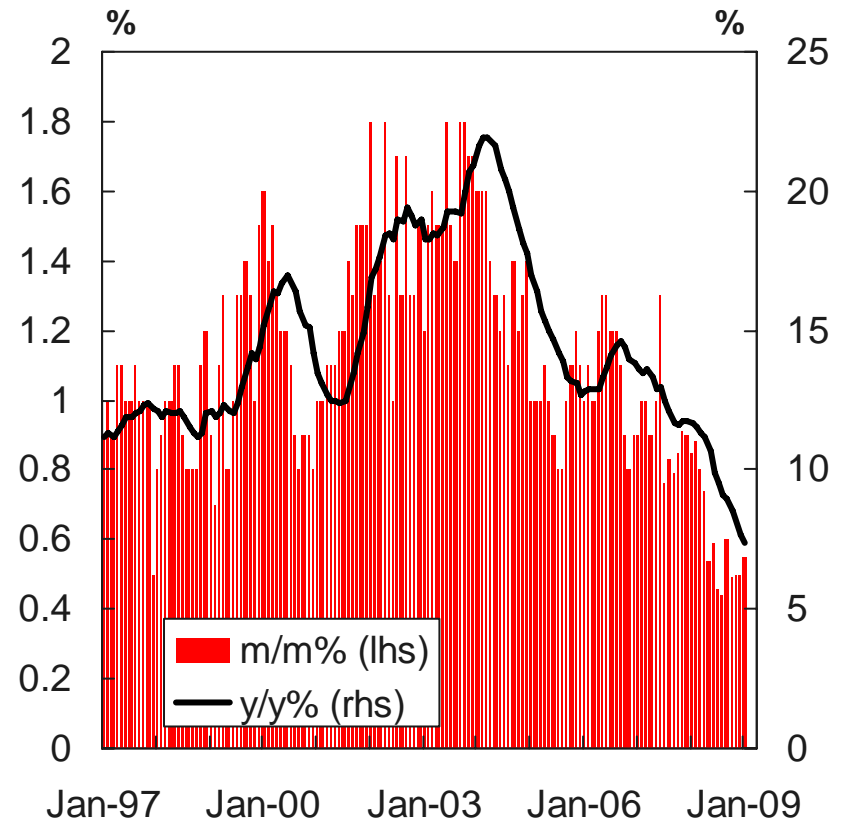


Our love affair with credit looks to be over

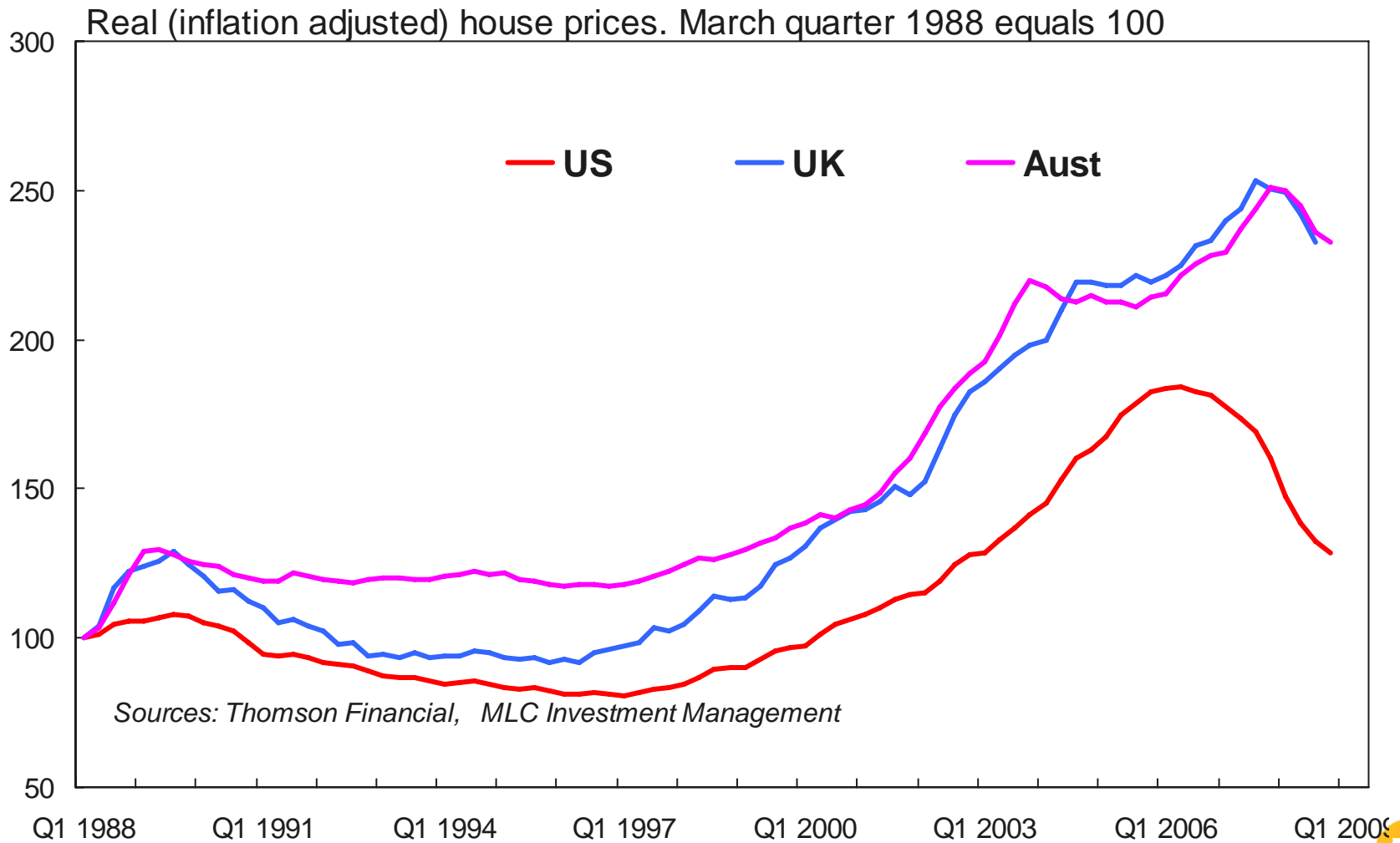
Personal credit outstanding is falling sharply



While housing credit growth has slowed dramatically



Bad news waiting (starting?) to happen?





2. The better news

- what can't get much worse**
- what's improving**
- where are the opportunities**

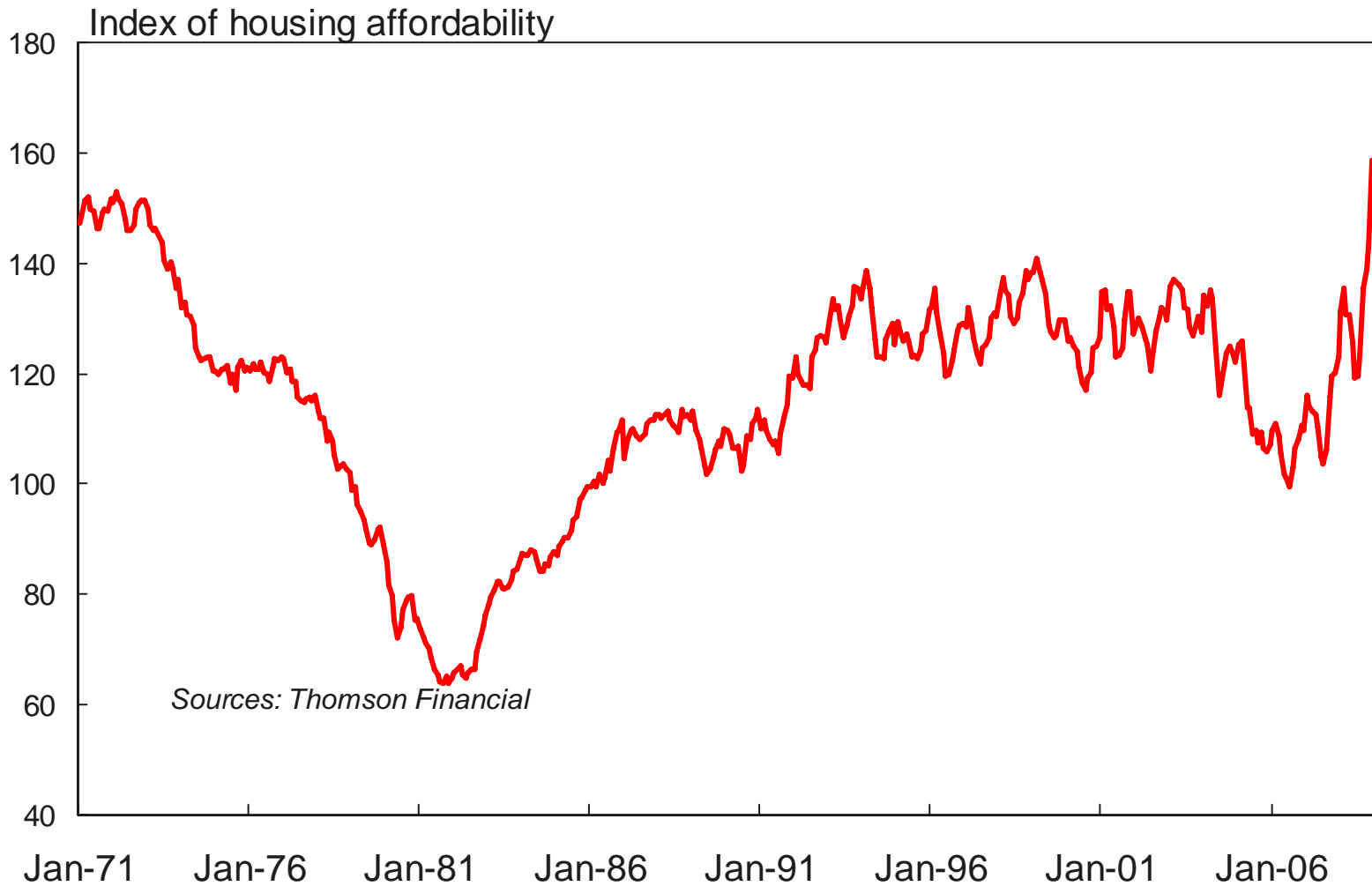
US housing: adjustments are well underway *(how much further can starts fall?!?)*



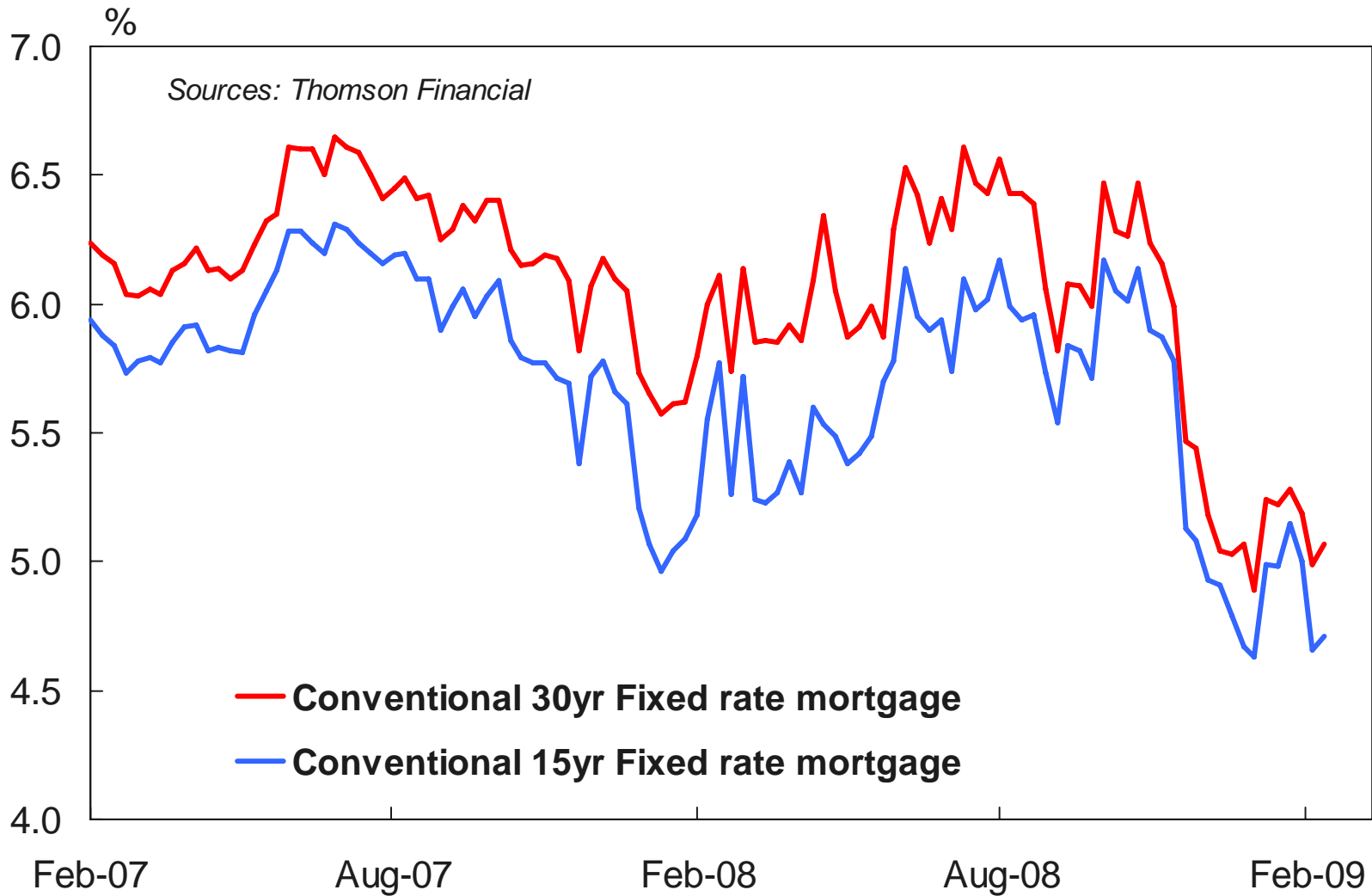
Source: Thomson Financial



US housing is now *much* more affordable (cheapest in decades!)..

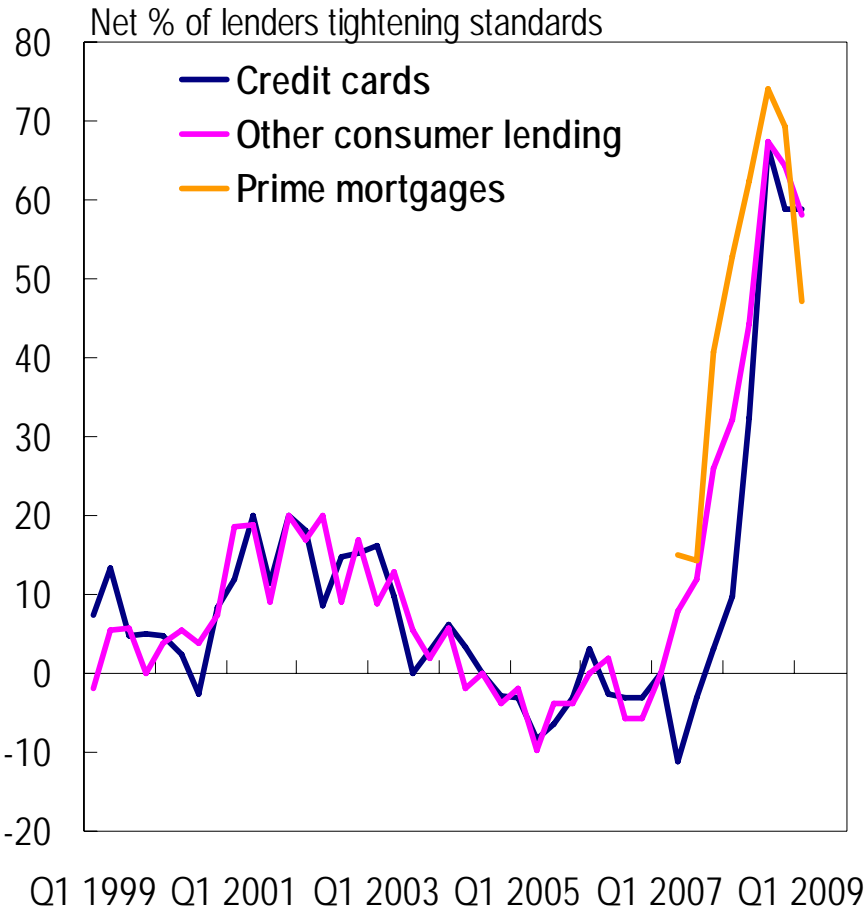


..and now mortgage rates have come down..

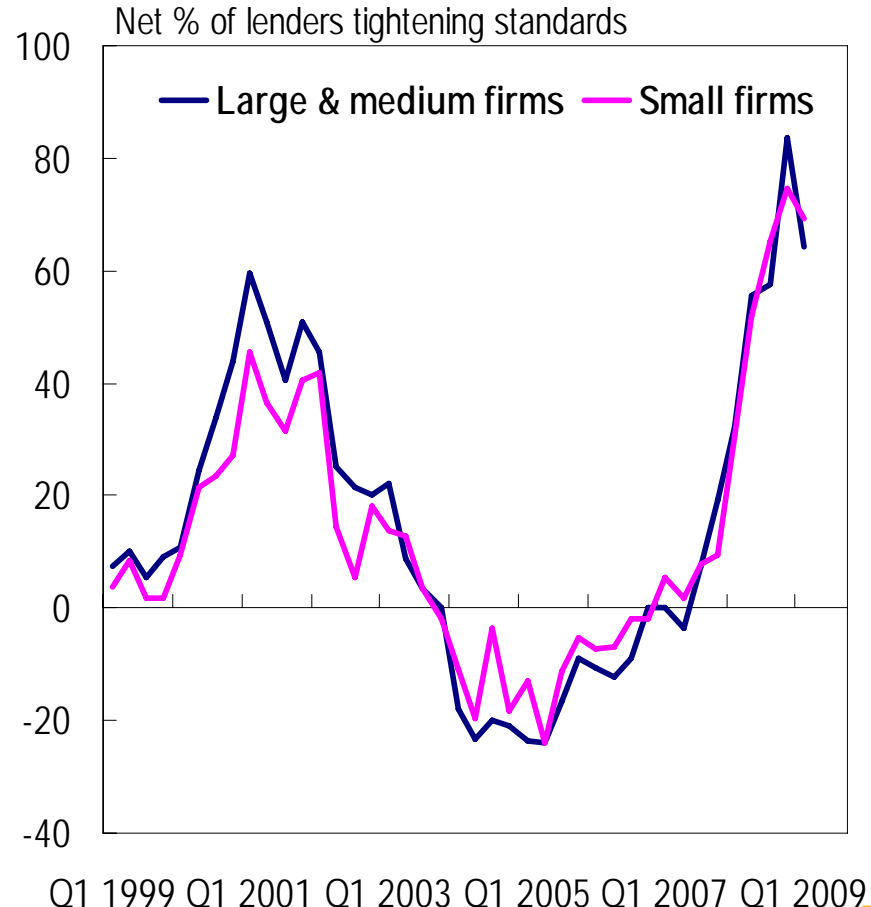


..however, US banks are not keen to lend *yet*, *but things are improving.*

US Consumer lending standards are tight, but seem to be easing..



..as are standards for both large and small businesses..

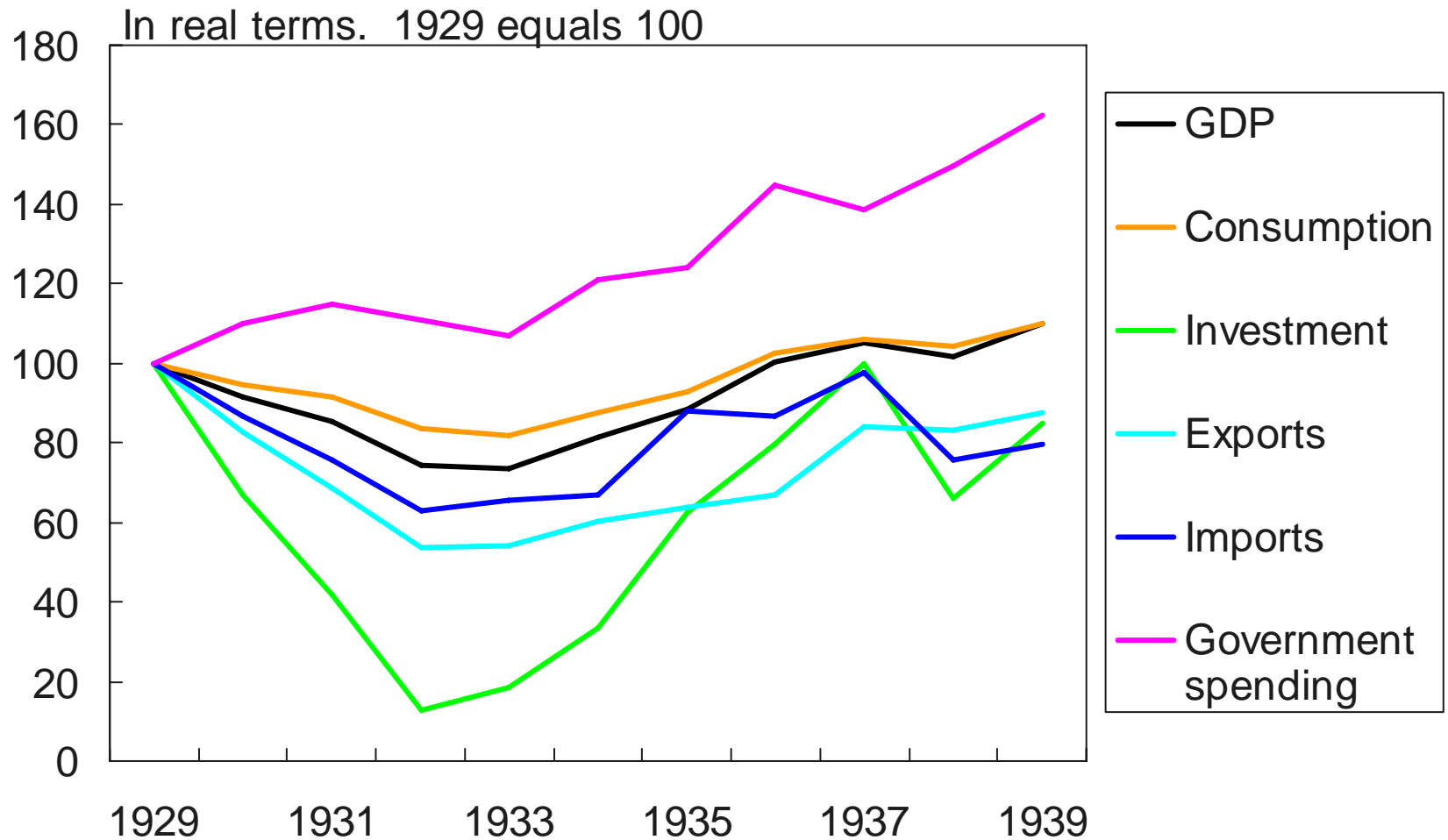


Why this is not Great Depression Mk II?

- Key policy mistakes of the early 1930s are not being made (e.g. fiscal tightening, tariff hikes)
- Banks *can* fail, but the process is *managed* and depositors are protected
- Economic structures and demographics are vastly different
 - More stable economy (e.g. services vs agriculture)
 - Welfare system
 - Active monetary policy
 - Female participation in the workforce



The US economy in the Great Depression



Source: US Bureau of Economic Analysis



Equity markets typically bottom before a recession ends

S&P 500, 1969/71

■ Recession *



S&P 500, 1972/75



S&P 500, 1980/83



S&P 500, 2000/03



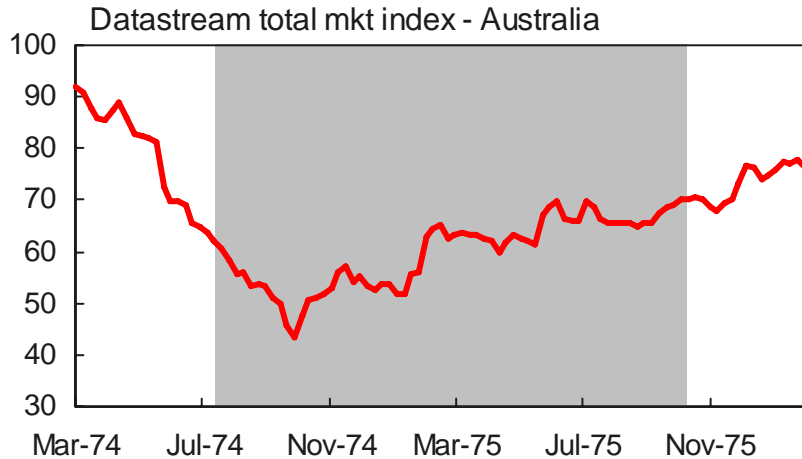
Sources: Bloomberg, NBER, JPMorgan

*Note: Recession periods, as defined by the National Bureau of Economic Research, are denoted by bars in each chart

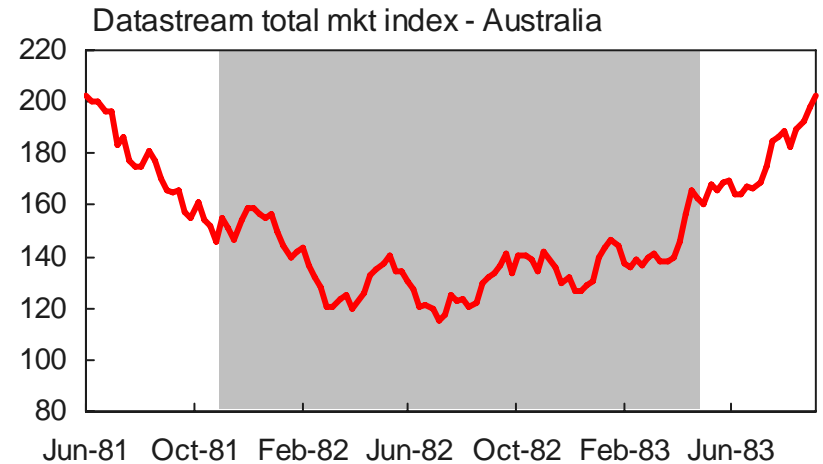


Equity markets typically bottom before a recession ends - the Australian experience

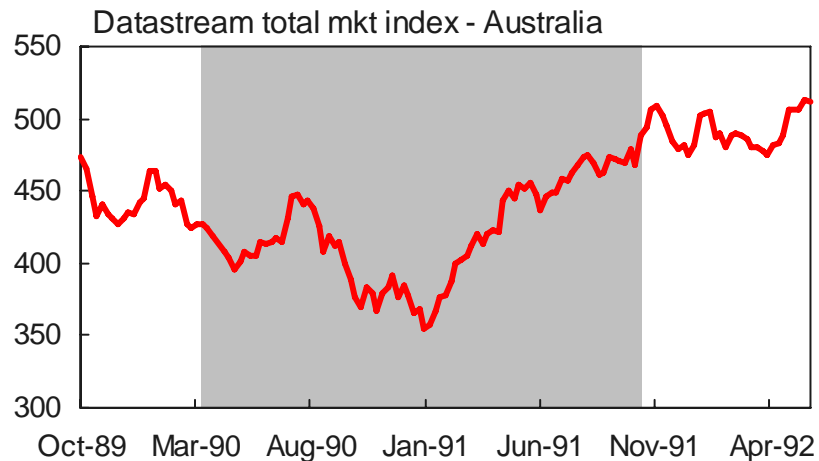
1974-75



1981-1983



1990-91



There is a lot of cash coming to consumers in 2009 (vs 2008)..

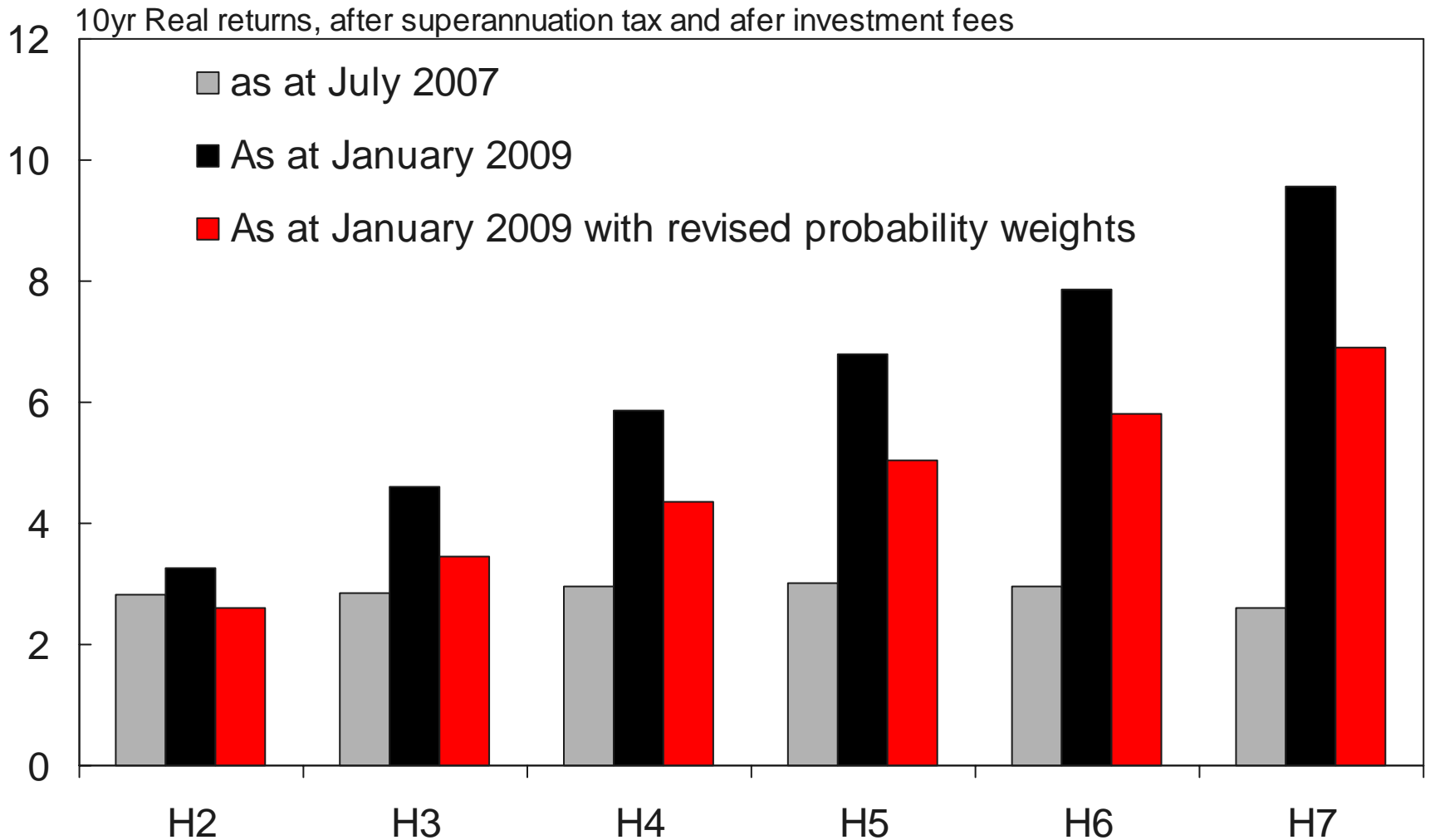
	\$A billion
Interest rate cuts	37.8
Lower petrol prices	1.2
Federal Govt cash handouts	12.0
TOTAL	51.0

- This is BEFORE the mid-year tax cuts, and assumes cash rates are cut to 2.5% by the end of 2009

Source: UBS, MLC Investment Management



Return expectations have greatly improved

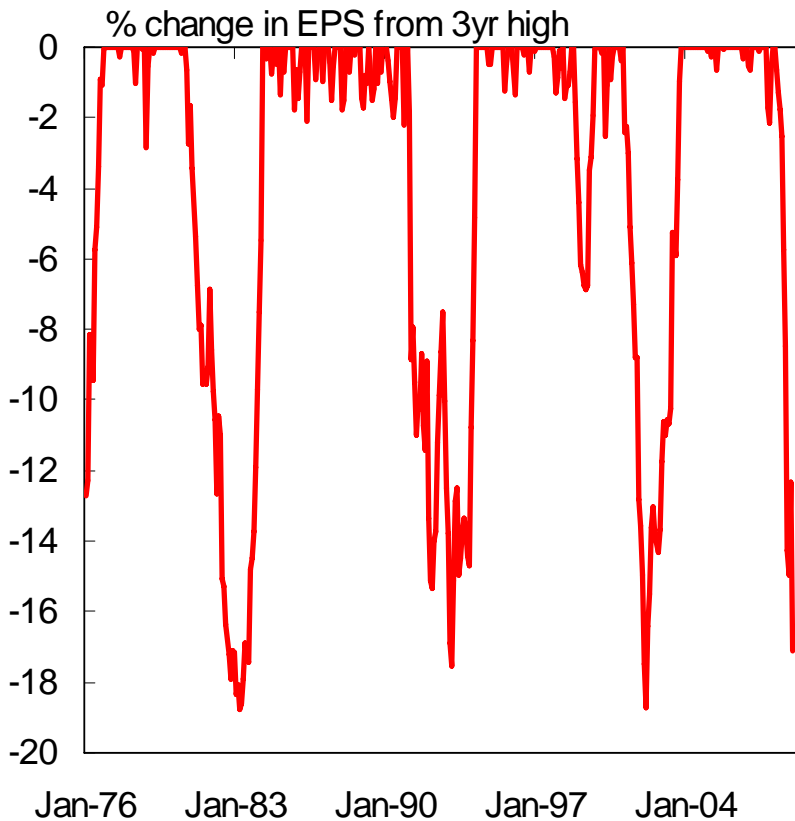


Source: MLC Investment Management. Probability weighted return assumptions.
Projections are subject to change without notice.

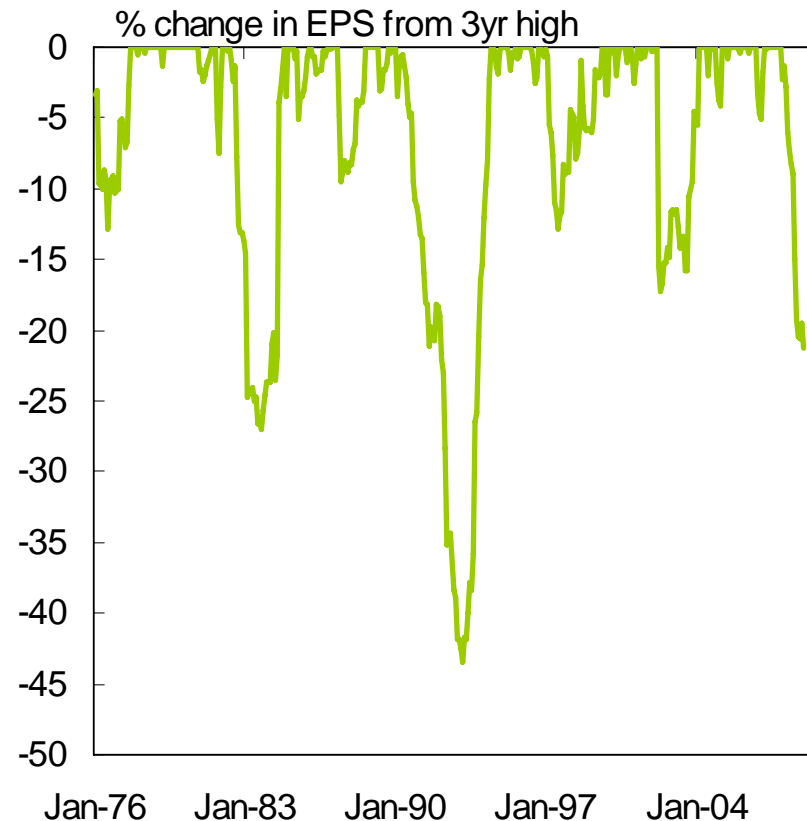


How far do earnings typically fall in a recession?

Global equities - profit declines vs cyclical peaks



Australian equities - profit declines vs cyclical peaks



Is enough bad news on earnings priced in?

	Trailing PE	How far have EPS already fallen (%) ?	PE assuming EPS fall 40% from peak
Australia	10.6	-20.1	14.0
US	11.7	-22.8	15.8
Japan	14.6	-19.6	19.6
EU	7.4	-23.9	9.4
UK	7.1	-4.8	11.3
Developed mkts	9.5	-19.3	13.2
Emerging Mkts	8.2	-25.4	10.7

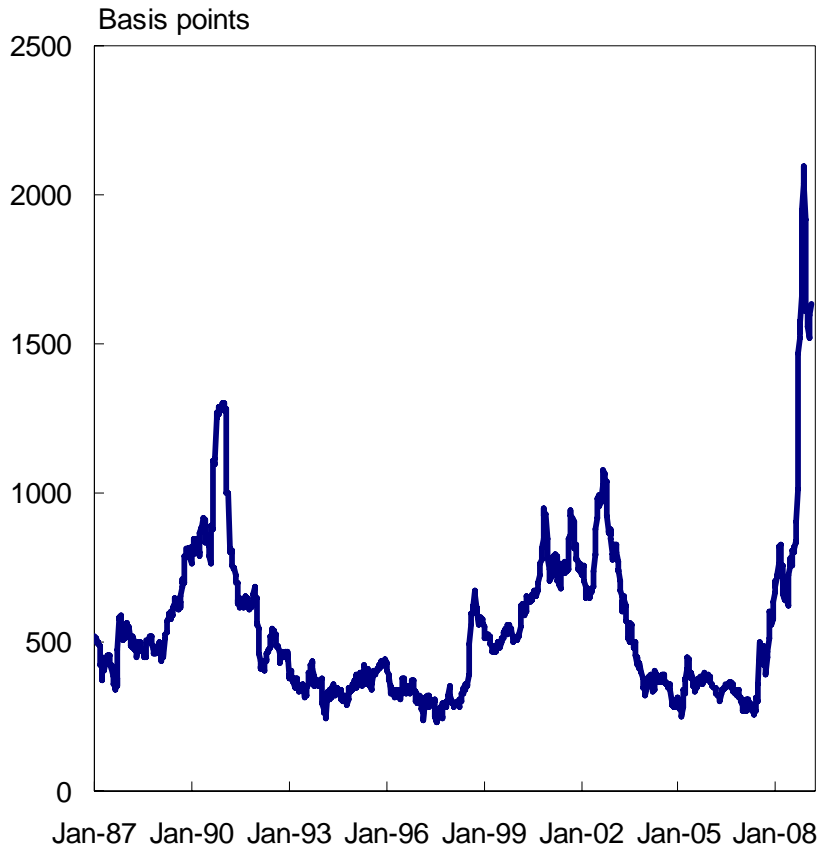
Source: Thomson Financial Datastream

Data as at 13 February 2009

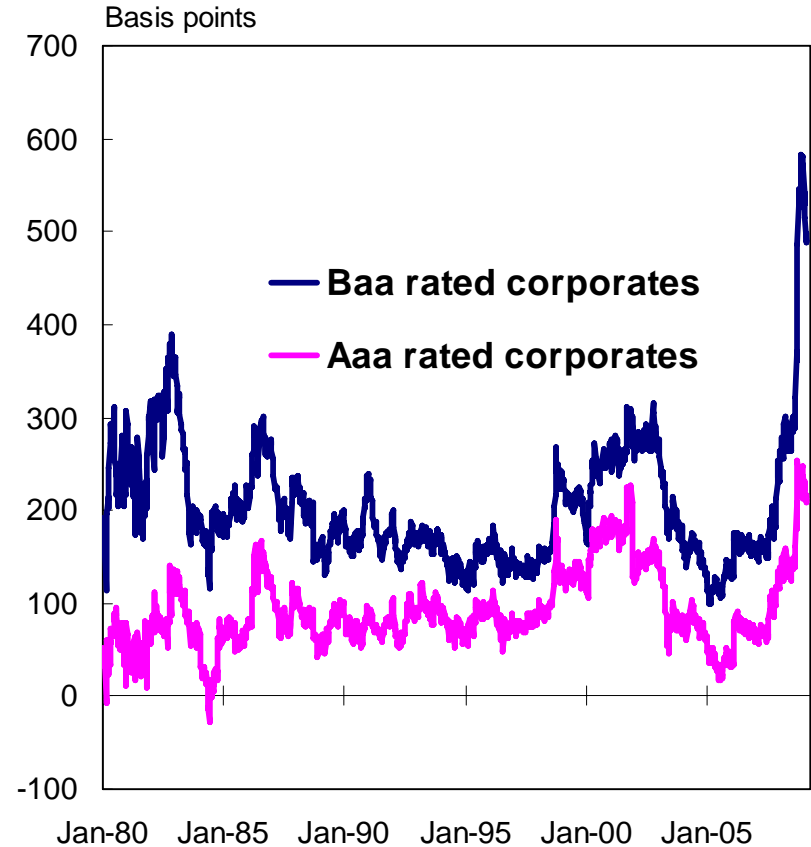


Credit markets look very cheap. *(US corporate yields seem to be pricing in a massive rise in defaults.)*

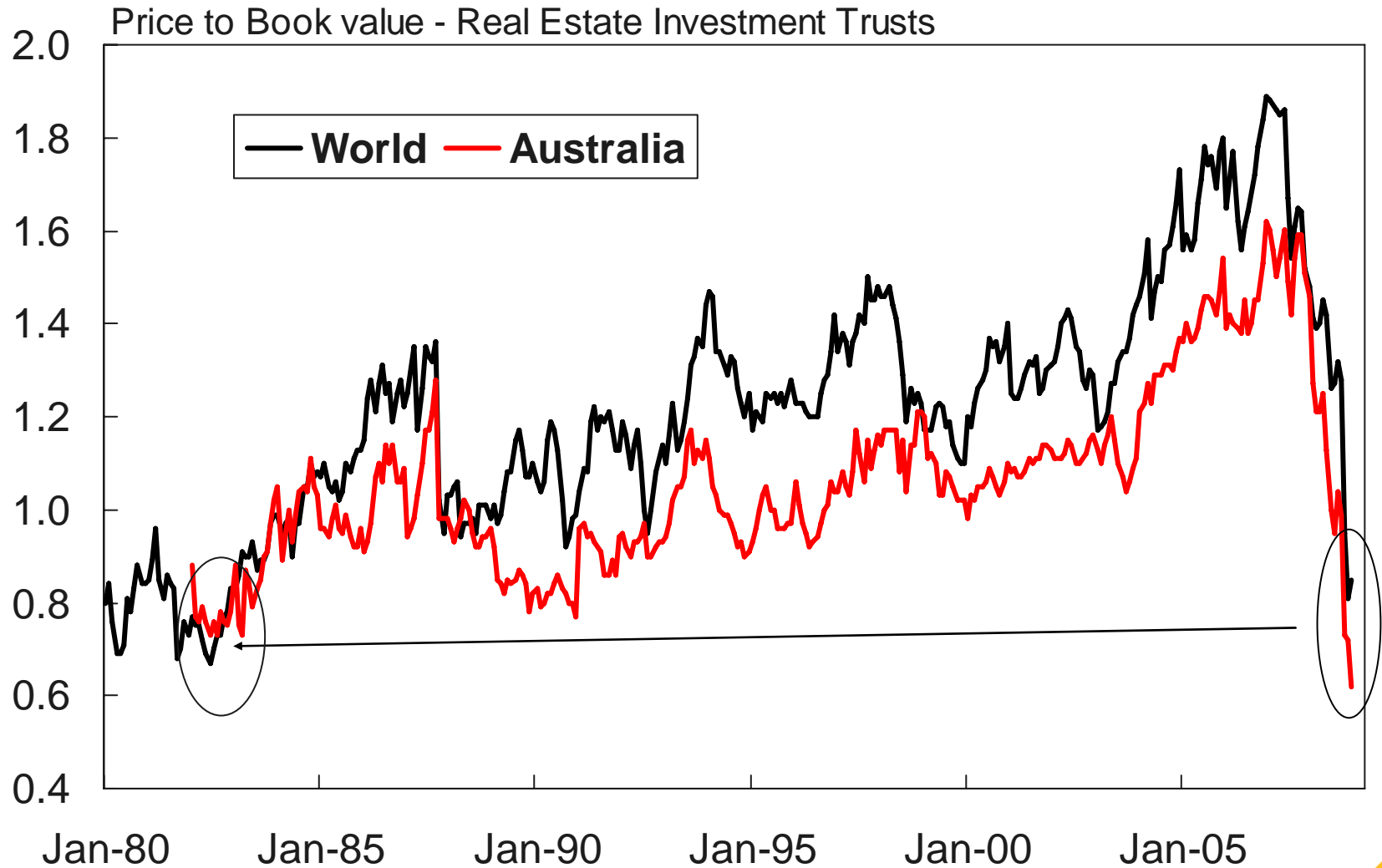
Barclays high yield spread over Treasuries



Spreads on investment grade debt are close to their widest in decades



Listed real estate has been a disaster, but are opportunities emerging?



Source: Thomson Financial



Summary: economic conditions vs market prospects

- A lot of necessary adjustments are well underway (US housing, household saving)
- This is a global financial crisis, which has triggered a global recession
- Global economic conditions are awful, and will get worse before they get better, *BUT..*
- ..financial markets move *in advance of* the economy, and signs are starting to improve
- Policymakers increasingly 'get it'
- Every crisis creates opportunities, and this one is no different
 - Equity valuations are much more attractive (the best investors in the world are buying, NOT selling)
 - Credit spreads look extremely cheap





3. What does all this mean for investors?

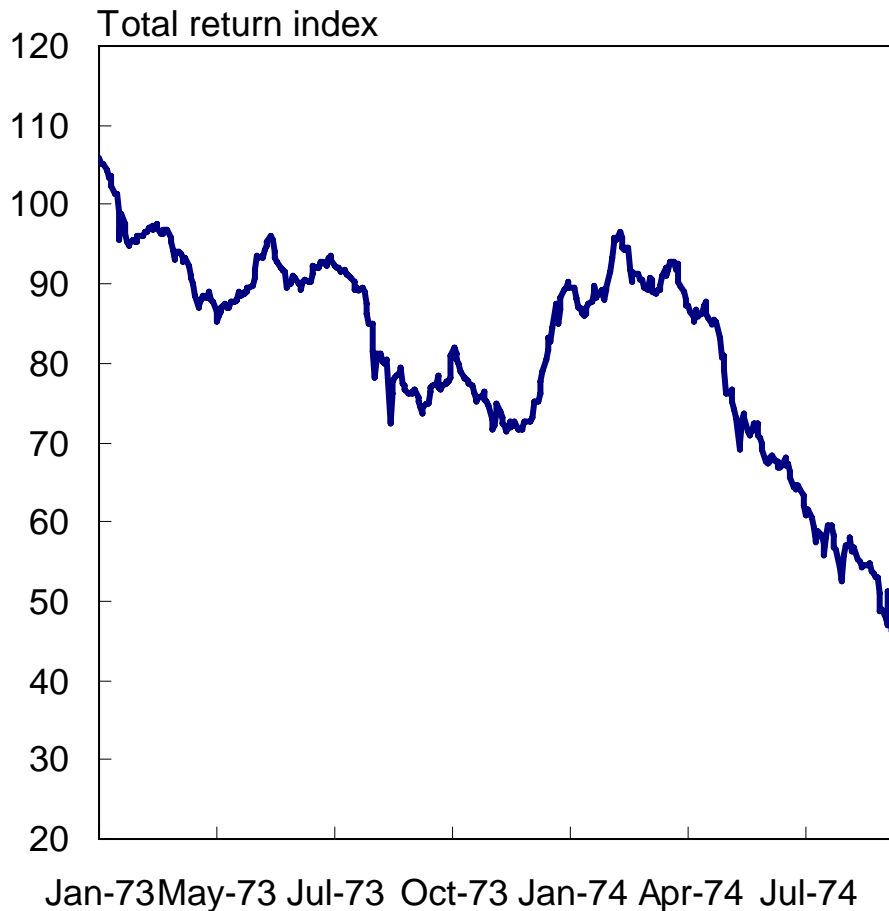
There's always a crisis around the corner

- The 1929 crash
- Great depression
- WW II
- Korean War
- Cuban missile crisis
- Vietnam War
- OPEC oil crisis I
- OPEC oil crisis II
- Latin American debt crisis
- Australia's 'banana republic' moment
- 1987 stockmarket crash
- The fall of the Berlin Wall
- Iraq War I
- US savings and loan crisis
- The recession we had to have
- Bond market crash 1994
- Mexican debt crisis 1995
- Asian crisis 1997
- Russian debt/LTCM crisis
- Tech wreck
- September 11
- Afghanistan
- Iraq War II



Australian market downturns and their aftermath

1973 - 1974...



...5 years' later



Australian market downturns and their aftermath

1980 - 1982



...five years' later

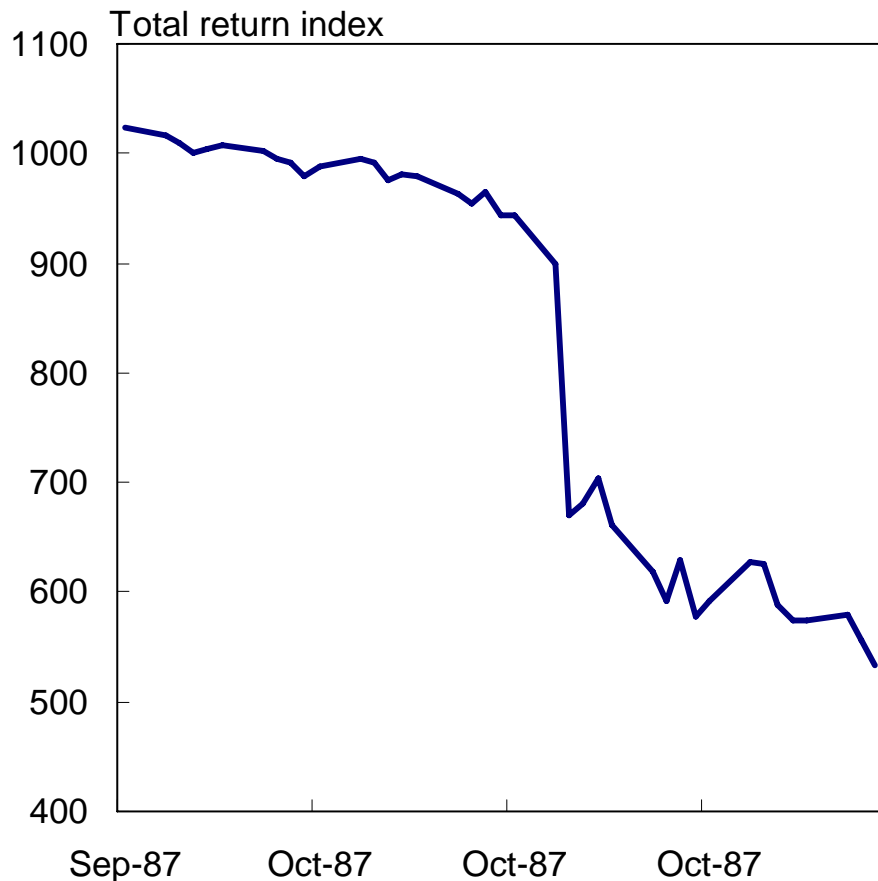


Source: Thomson Financial

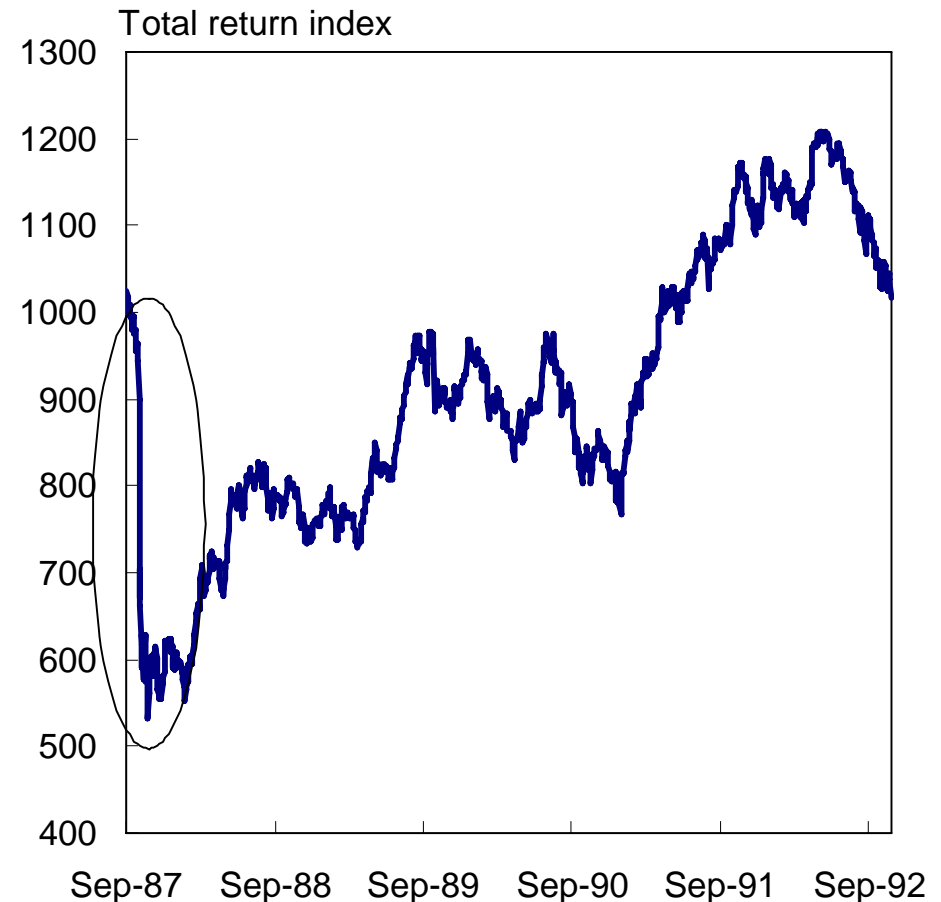


Australian market downturns and their aftermath

The biggest crash in sharemarket history..



..five years' later



Australian market downturns and their aftermath

1994

...five years' later



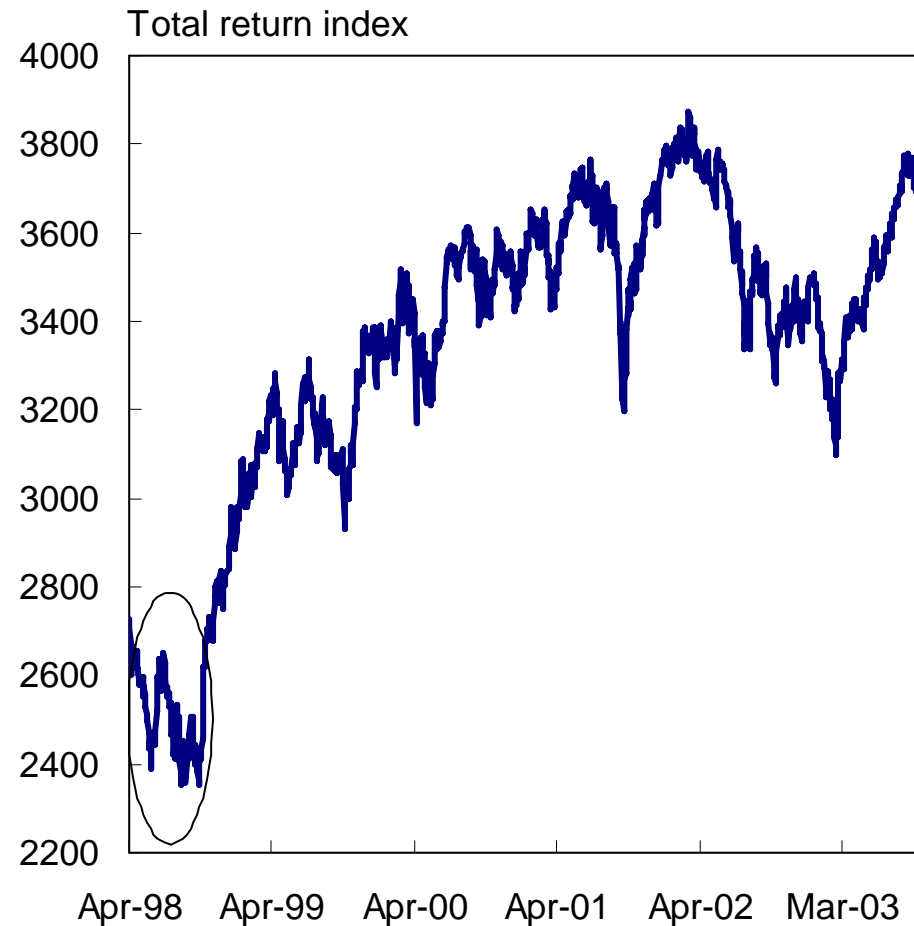
Source: Thomson Financial



Australian market downturns and their aftermath

Emerging mkts/LTCM crises

...five years' later



Australian market downturns and their aftermath

Post tech/Sep 11, et. al...



..five (and a bit) years' later



Source: Thomson Financial



What else everyone needs to know

- This is the biggest global financial crisis since the 1930s but..
- ..every crisis, every bear market, every recession, come to an end, and this will be no different.
- Good financial plans are built on the basis that recessions, crises, bear markets, will happen.
- Exposure to businesses will still deliver over time (the world has not changed THAT much)
- *Everyone's different: need to take enough risk to achieve decent long-term returns, but not so much risk that you can't sleep.*

