

Period: 1<sup>st</sup> to 30<sup>th</sup> November 2006

### **Fund Performance**

The volatility in the Australian equity market presented us with buying opportunities. The NavTraDE system buys shares as share prices depreciate. Our cash holding at the end of November was 29.0% as we have taken the opportunity to buy stocks at favourable prices. The actual returns in November for the Retail and Wholesale funds were both +2.60% compared to the +1.81% return of the S&P/ASX200.

The NavTraDE system takes advantage of irrational investor behaviour to buy quality companies as their share prices are falling and to sell them as they are rising. Consequently, the system can realize capital gains from dealing in shares with volatile price movements, irrespective of the net price movement from the beginning to the end of the period. It takes time for shares to move through price cycles and therefore for the potential of the NavTraDE system to be fully realized.

The stocks that performed well this month and generated realized capital gains through trading include The ANZ Bank (ANZ), BHP Billiton (BHP), Fairfax (FXJ), Great Southern Plantations (GTP), Macquarie Bank (MBL), National Australia Bank (NAB), Origin Energy (ORG), Orica (ORI), OneSteel (OST), Publishing & Broadcasting (PBL), Tabcorp (TAH), Toll Holdings (TOL), Westpac Bank (WBC), Westfield (WDC), Wesfarmers (WES), and Woolworths (WOW).

The stocks that performed well this month and generated unrealized capital gains include Boral (BLD), Bluescope Steel (BSL), Futuris (FCL), Fairfax (FXJ), Great Southern Plantations (GTP), Origin Energy (ORG), OneSteel (OST), Publishing & Broadcasting (PBL), Toll Holdings (TOL), Westfield (WDC), and Woolworths (WOW).

During the month, the shares that detracted from performance either due to low volatility or because they were displaying unrealized losses were BHP Billiton (BHP), Lion Nathan (LNN), Macquarie Bank (MBL), Orica (ORI), Santos (STO), and Woodside (WPL).

The NavTraDE system resulted in increased weightings in: The ANZ Bank (ANZ), BHP Billiton (BHP), and Macquarie Bank (MBL).

The NavTraDE system also resulted in decreased weightings in: Bluescope Steel (BSL) and Westpac Bank (WBC).

There were no inclusions or exclusions to the portfolio.

To view our current portfolio, please [click here](#).

### **The Australian Share Market**

**The Australian stock market grew 1.8% in November after surging 4.5% in October.**

**The jobs market remained strong while the housing market continues to cool due to recent interest rate hikes.**

**Retail sales recovered due to the falling petrol prices.**

The Australian equity market grew 1.81% in November after surging 4.46% in October (S&P/ASX200 Index).

The economy is showing some signs of slowing growth, with the GDP expanding by 0.3% in the September quarter following a similar rise in the previous quarter, which was the slowest in three years. Annual GDP growth was only 2.2%, reflecting the impact of the drought, a softening real estate sector, and capacity-constraints. Encouragingly net exports contributed 0.4% to GDP, albeit largely from the resources sector. The headline CPI was 3.9% over the year to September after leaping to an 11-year high in the June quarter, while core CPI rose 0.7% in the quarter or 2.9% over the year.

Consumer spending has rebounded with retail sales rising 0.8% in October (+0.1% in September), or 6.6% over the year, driven by lower petrol prices. The continued strength in the housing market, easing petrol prices and a strong jobs market seem to have counterbalanced recent official interest rate rises. Credit growth is still growing strong at 14.7% p.a.

The employment market remained active, with the unemployment rate staying at 4.6%. The participation rate is trending upwards, while wage costs also grew at a growth rate of 0.8% in the third quarter or 3.8% over the year.

***Australia's trade performance shows increased mining volumes and capital imports.***

The housing market again continued its slow downward trend with both owner-occupier and investor approvals falling since June. The total value of housing finance commitments edged up 0.1% in October after falling 1% the previous month. Residential housing approvals fell 7.4% to be 1.8% lower over the year. Housing credit fell 1.8% or down 6.4% over the year.

The trade figures were positive in October. The trade deficit widened in the month from \$0.7billion in September to \$1.3billion, driven by a 5% surge in imports. Encouragingly capital investments accounted for much of the imports, while exports grew 2% mainly due to mining volumes.

Overall, Australian economy is still strong although the growth rate has moderated. There are signs that inflation is cooling, putting less pressure on the RBA to raise interest rates. The housing market is cooling, while the employment market remains strong as is consumer confidence.

***The best performing sectors were Software & Services; Technology Hardware & Equipment; Transportation; and Media.***

Most sectors were in positive territory in November. The best performing sectors were Software & Services (+13.3%); Technology Hardware & Equipment (+9.2%); Transportation (+8.3%); and Media (+6.1%).

The worst performing sectors were Telecommunication Services (-3.7%); Automobiles & Components (-0.8%); and Materials (-0.5%).

***World markets held gains in November. The crude oil price recovered while the gold price rose on the back of a weakening US dollar.***

Global stock markets rose for the fifth consecutive month. The MSCI rose 2.3% in November and 18.2% over the past year. The S&P500 rose 1.7%; the Nasdaq rose 2.8%, the FTSE fell 1.3%, the Nikkei 225 slipped 0.8%, while the Hang Seng rose 3.5%.

After retreating for two months, the crude oil price recovered by 7.2% in November. The gold price has continued its recent strength by rising 6.6% in the month or 30.8% over the past year. Aluminium and copper retreated in price while the prices of the other major base metals rose. Over the past year the most impression price gains have been by nickel (+175%) and zinc (+156%).

***The US economy rebounded in the previous quarter, with strong corporate profits and lower inflation.***

The US economy was stronger than expected, with the third quarter GDP revised from 1.6% p.a. to 2.2% p.a., due to higher inventory buildup and lower imports. Corporate profits increased 4.2% in the quarter to be up 30.9% in the year. The unemployment rate edged up 0.1% to 4.5% in November. The total number of jobs and the participation rate remained steady from October. Average hourly earnings rose 4.1% in the year, the largest gain since the 4.2% p.a. gain in February 2001.

***Retail sales recovered strongly due to heavy discounting and a strong jobs market. The housing market continued to cool.***

US CPI was weaker than expected, rising 0.5% in October after falling 0.5% the previous month. The yearly headline CPI rate fell from 2.1% to 1.3%, while the core CPI fell 0.2% to 2.7% p.a. Retail sales surged 1% in November, following three lacklustre months, driven by heavy discounting. Most categories gained, particularly electronics, appliances and automobiles. Core retail figures, excluding automobiles and gasoline, increased 1.1% , the sharpest gain since a 2.5% increase in January. Given good CPI data and a cooling housing market the Federal Reserve held rates steady for the fourth consecutive month. The housing market continued to soften. New sales dipped by 3.2% in October. In the third quarter, home prices rose 7.73% p.a., compared to a peak of almost 14% in mid-2004. On a quarterly basis, home prices rose 0.86%, the smallest gain since the second quarter of 1998.

***The US trade position improved, although the trade gap with China continued to break records.***

The trade deficit improved to fall by 8.4% to US\$58.9 billion in October. The monthly decline was the biggest since December 2001. US imports fell 2.7% during October, also the largest decline since December 2001, aided by an 11.3% fall in the price of imported oil. Oil import volumes also fell for a second consecutive month.

***China's economic growth rate is now the fastest in more than a decade with yet another record trade surplus.***

The Chinese economy continued to boom. China's trade surplus reached a record US\$123.5 billion in the year to October. The US deficit with China increased US\$2.1 billion to a record US\$24.4 billion. Chinese exports to the US surged to a record US\$29.3 billion and the trade gap increased to yet another record of US\$229 billion p.a. Despite strong capital growth, China's CPI is relatively low, rising 1.3% in the first eleven months year-on-year, 0.5% lower than the same period last year.

## **Share Market Outlook**

***Australian economic fundamentals remain sound. Economic growth expectations may have slipped to below 3% but a sharp decline is unlikely due to healthy domestic fundamentals and the continuing strength of the Chinese economy.***

***The risk of a US recession may be receding as the economy slows, and may have dampening effects on global growth in the next 2-3 years.***

***Europe and Japan may be benefitting from the recent investment boom.***

***The key drivers of global growth remain the US and China. While the US economy cools, the Chinese economy continues to drive the world economy.***

***Resources companies may benefit from rising production and prices. Banks are supported by continued economic growth.***

***Ongoing problems are expected in the telco and rural sectors.***

The slowing of the US economy has become more evident despite the recent upward revision of the GDP data. Economic growth during the third quarter slowed to a pace of only 1.6%, the slowest in more than three years, reflecting the housing slump. Investment in home building was cut by the largest amount in 15 years. However, the corporate sector and business investment remain strong and should help support GDP growth of around 2.5% in 2007. The Federal Reserve's actions to curb inflation seem to have borne fruit with core CPI now below 3%. The strong jobs market and good wages growth are stimulating consumer confidence. The strong equity market, low inflation expectations, and falling fuel prices should also support the retail sector.

A recession in the US economy is unlikely in the short-term, a soft landing being more likely as most economic fundamentals are sound despite the weakening housing sector. Recent commodity price increases may be starting to flow through to global inflation as the China-driven inflation downturn may have reached its trough.

The effects of a US slowdown may not be as significant as previously anticipated due to strong capital investments in Europe and Japan leading to a more self-sustaining domestic demand. Euro zone growth is expected to slow from 2.7% p.a. in 2006 to 2.2% p.a. in 2007. UK GDP growth should remain steady at around 2.6% p.a. through 2007. Real GDP growth should be around 2.8% in 2006, falling to 2.6% the next year. Nevertheless, inflationary pressures are growing in Europe and Japan.

The outlook for the Australian equity market remains positive in the short term. The Australian economy is expected to continue growing, largely driven by the strong resources sector. Unemployment is at record lows, the housing market appears quite resilient, and consumer confidence is strong. Business investment remains strong particularly in mining, transport and construction. However, the outlook for the rural sector is not positive due to anticipated drought conditions.

Most analysts expect China's growth rate to slow marginally in the coming year with stricter government controls over monetary supply to curb excessive investment. China is already the world's biggest consumer of steel, copper, aluminium, cement, iron ore and zinc, and the second largest consumer of crude oil. Demand for world commodities should continue with anticipated capital investments, especially in the lead up to the Beijing Olympics.

The risks to the world economy in the short to medium term have increased slightly with a slowing US economy. The likelihood of a global downturn is still relatively low due to strong capital investment and domestic demand in most major economies. The outlook for the world economy is positive in the short term, albeit with signs of rising inflation and slowing growth.

The Resources sector should continue to drive the stock market. Energy stocks could see high volatility due to geopolitical and supply issues. Sectors able to harness general economic activity such as Banks and Infrastructure should also benefit. However, if interest rates rise sometime through the next year, Banks may face consumer and housing credit issues. The wealth effects of buoyant housing and equity markets should support Materials companies, and the resurgent consumer confidence is likely to boost retail companies.

Manufacturing and telecommunication should remain relatively weak. Tourism and other related industries may benefit from resurgent consumer confidence in the summer months. The rural sector remains unappealing.