MARKET COMMENTARY: July 2013

EXECUTIVE SUMMARY

- Courtesy of Bernanke commentary, financial markets have brought forward the prospects for a reduction in central bank support, at least in the US.
- This has triggered a major asset allocation shift out of assets such as bonds, gold and emerging markets towards $US, and potentially equities and property.
- China's new leadership appears committed to a broader and accelerated period of structural reform that may reduce near term growth prospects in China and be unhelpful for commodities.
- We think there is a good chance that global growth prospects will positively surprise towards year end, supporting equity markets through the second half.
- Investment strategy remains biased towards overseas earners, higher yielding stocks with reasonable earnings growth, companies with internet based business models and energy stocks with exposure to east coast gas prices; we suggest an underweight position to resources.

Transition Phase Initiated

The two major features of the June quarter set to shape financial market outcomes through the balance of 2013 and beyond were:

1. The Federal Reserve Board announcing the prospect of **reducing the level of 'stimulation'** it has been applying to the US economy since 2009. Note, the Fed is talking about applying less stimulation-not a tightening of policy!
   a. The major consequence of this apparent change of stance has been a **full 1% increase in US 10 year bond yields** from a low of 1.6% in May to a high of 2.74% in early July.
   b. A move of this magnitude in the value of the world's "risk free" benchmark has introduced a **period of increased volatility** in financial markets, one that could well continue in the short to medium terms.

2. China. The new regime has sent clear signals that the policy settings for the next decade will be fundamentally different from those of the last. The structural reforms that the previous regime 'side-stepped' (partly because of the impact of the developed world GFC) will be tackled by the new leaders Xi and Li.
   a. However the implications of an accelerated program of structural reform are a **lower level of economic growth**, **greater emphasis on consumption rather than investment** (negative impact on growth in commodities demand) and a pause in the appreciation of the RMB.

Shift in Asset Allocation

The confluence of these two events has put financial markets into 'a **period of transition'**. Those days of virtually free money are now clearly numbered. **Major shifts in the allocation to various asset classes are underway, delivering increased market volatility and unexpected consequences.**
In summary, the flow of global funds is from:

1. Bonds into Equities
2. Emerging markets to Developed markets
3. Safe havens ($A) to growth / recovery areas ($US)
4. Gold to growth / recovery assets
5. Commodities / commodities based currencies to $US assets
6. High yield to growth assets

Implications for Investment Strategy

Key turning points in financial markets and the broader macro framework are challenging times for investing. Established trends get broken while new trends take time to establish. Liquidity and flow of funds tends to drive markets while valuations become irrelevant in the short term. High volatility makes markets look an unattractive place to be. At times such as these, it is **very important to have a clear "base case" macro framework** that drives medium term investment strategy.

The Peak "base case" framework currently is:

1. The US economy is now in a sustainable recovery phase. Fiscal tightening is in place, monetary policy will become less accommodative, Banks have been recapitalized. $US assets are likely to outperform most others over the next year.
2. Interest rates are at multi decade lows in most of the developed world, and regardless of recent moves, should now trend up.

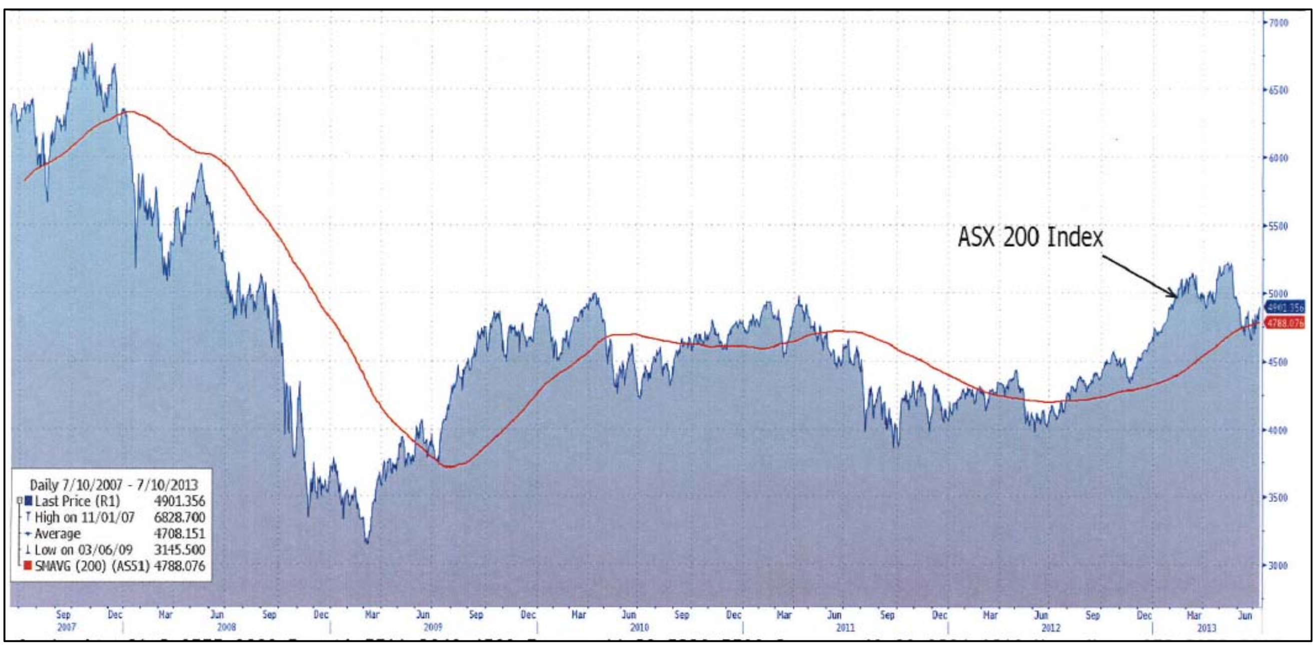
3. Commodities have passed their peak in a long term cyclical sense, primarily driven by China. While we don't expect a collapse, we don't see a lot of upside in the medium term.
4. The new regime in China has introduced a sense of longer term structural reform that we see as positive medium term, but does introduce shorter term challenges for markets, including commodities and equities.
5. Australia is globally an expensive place to do business and to live. Lower rates and a lower A$ will ultimately offer strong support. However the transition from a mining / energy investment boom to a more conventional economic cycle is not being supported by a dysfunctional political set up.

The Current Peak Approach to Investing Your money

Given the current period of market volatility and Australia's own set of unique near term uncertainties, Peak's current strategy is based on the following investment themes:

1. A bias towards companies with a majority of earnings coming from overseas, especially the US, and preferably in $US. Our key holdings have been Brambles, Fox (ex News Corp), CSL, Cochlear.
2. A blend of dividends and growth, rather than just straight yield. The Banks, Telstra, IINet where appropriate, Wesfarmers, Woolworths, Coca Cola are key holdings
3. A bias away from China exposed commodities such as iron ore and base metals towards energy, particularly related to the Australian East Coast, where prices are set to rise. We have reduced exposure to RIO, PanAust, Newcrest. Our core resources will remain BHP, with its diversified commodities exposure. Energy exposure has been increased via Santos and Beach, where appropriate.
4. Increased exposure to online business stocks. We have added REA to many portfolios over the last few months, and will opportunistically add others such as Seek and Carsales.
5. Long term secular growth stocks and sectors. Ramsay Healthcare is an example of a stock where the macro and micro attributes are aligned. Others include Wesfarmers, CSL, Fox, Santos, Treasury Wines,

ASX 200: It's still a long way to the top: Lower $A will assist



Source: Bloomberg

We look forward to catching up with you soon to discuss your portfolio and address any change of circumstances or issues that we might be able to help you with.

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