Welcome to the June 2013 edition of the Martin Bros Monitior.

In this edition of the Martin Bros Monitor:

The End of the Australian Dollar Party?

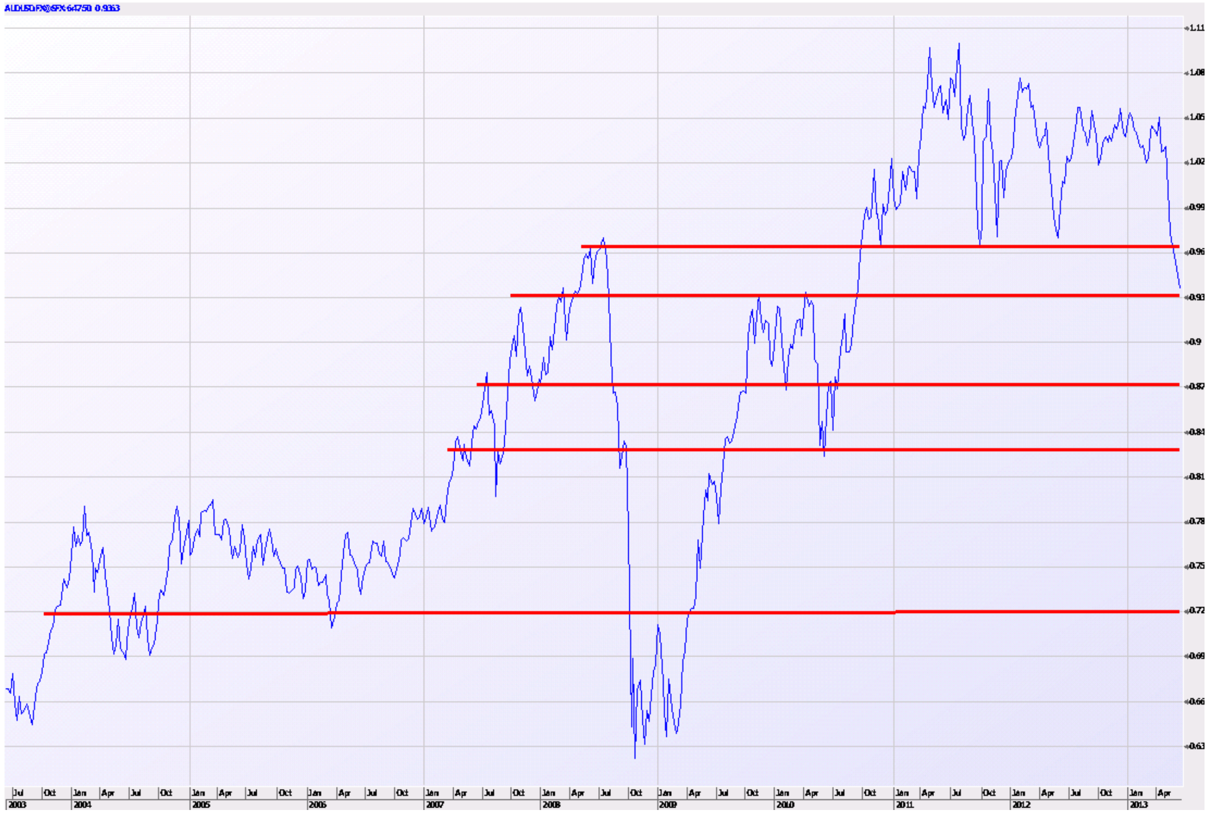
Since our last Martin Bros Monitor (MBM) in March, the Australian equity market rose another 5% to reach a short term peak of 5,250 points. Since this level was reached in mid May the market has pulled back to the 4,680 point level, representing a 10.5% retreat. In our March edition we suggested the recent run up was unlikely to continue as it has gone too far, too quickly. We did not expect however, for the market to fall more than 5-6%. Two factors have contributed to the recent pull back. One, the market ran up a further 5% from where we were at the start of March before turning down. The second and more influential factor has been the “collapse” in the Australian dollar cross rates (with the US dollar, Euro, Pound and virtually every other currency).

Like the bond market bubble we have talked about for a couple of years, the Australian dollar was destined to go lower over time and trend back closer to its long term averages (circa 75 US cents, 45 British pence and 60 Euro cents). In this day and age of instant information, markets react at break neck speed to any related news and the Australian dollar is no exception. It all started with a famous US investor, George Soros, who claimed that he was shorting (selling) the Australian dollar as it was the most overvalued currency in the world and the end of the mining boom meant that it had peaked. This saw some initial selling come in, of course after George had set himself, and the AUD/USD cross rate quickly fell through the magical parity mark.

For a week or two after this the currency (AUD/USD) bounced around in the 98-99 cent mark, with 97 cents seen as the first critical technical support level. Then, in testimony to Congress, Ben Bernanke (the head of the US Federal Reserve and the man responsible for zero interest rates and unprecedented quantitative easing in the US), stated that there will come a time, possibly later this year, that the Fed "could" scale back their quantitative easing (bond buying). This saw an immediate jump in long bond yields (rates) and the US dollar strengthen against all major currencies.

The Australian dollar then quickly broke through the 97 cent technical support level and has free fallen since then to be at 94.85 cents currently. In contrast to the US talking about reducing their monetary stimulus, we are still experiencing interest rate cuts in Australia as a result of peaking mining investment and an East Coast economy struggling to pick up the slack. Interest rate differentials are an important part of currency movements, as they dictate large amounts of global money moving to higher yielding markets (known as the “carry trade”).

Below is a long term (10 year) chart of the Australian dollar versus the US dollar. You can see the recent sharp fall and break of the initial support line at 97 cents. The next support comes in at 93 cents, which is close to where it currently is now. Below this level it’s a slippery slope to 87 and 83 cents. Under this, it’s a free fall to 72 cents which is around the mark of the ultra long term average. You can see on the below chart the recent two year period where we generally traded at or above parity. This coincided with our record terms of trade, substantially higher interest rates on a global scale and the peak period of US monetary stimulus. These factors have now all converged to work against the Australian dollar and we envisage continued relief for our exporters (and unhappy overseas travelers) in the foreseeable future. Of course there will be some short term bounces or bargain hunters on the way down, but I think they are playing a dangerous game of “catch the falling knife”.



We wrote in our last MBM about investors being conditioned to their most recent experiences. The Australian dollar around parity seems normal to many. History tells us this is an anomaly.

Unless you're a frenetic internet shopper, overseas traveller, importer or global travel company, the falling Australian dollar will be most welcome. The falling dollar will certainly help the economy more than a rising one (as a whole). In fact, a fall in the AUD/USD of 10%, which is what we have now seen, has been likened to a cut in interest rates of 0.75% by many economists. This will help the RBA on their drive to re-instate activity on the East Coast to help offset the mining slow down. It may mean there are fewer rate cuts ahead. Although we still believe there will be at least one more, as unemployment rises over the next six months.

The falling Australian dollar is good for our economy and in turn good for our sharemarket. A falling dollar will boost company profits as a whole, encourage investment and help with general confidence. Mix this in with historically low interest rates and all we need is a clear election result (rather than being governed by minorities) in September and the pieces are in place for a substantially improving economy in the second half of this year and into 2014. The equity market always looks twelve months out, so any indication sentiment is improving towards the end of this year, or is likely to in 2014, will see a strong end of year rally. In the mean time, our fast depreciating dollar has seen a lot of global "hot" money exiting Australia as their losses build up, accentuated by the declining currency. This exit will seek a natural end shortly, and despite global markets having the potential to pull back further (as they are only down circa 4%), our market should be very close to bottoming in this sell off.

With term deposit rates still falling and many dividends still rising, the hunt for a decent yield (income) will begin again in earnest. It's a matter of when, not if.

Stock Review - National Australia Bank (NAB)

Everyone loves to hate the banks. But the greatest revenge is to join the dark side. And by joining we mean being a part owner (shareholder). The banks have been the backbone of the recent sell off, driven by global hedge funds dumping them after their run up over the past six months on the early stages of the yield trade in Australia. As we highlighted above, the falling Australian dollar has accentuated this fall.

Global momentum traders have probably joined the party and started to short sell the banks too. We know this is likely the case because the global financial media start publishing articles on a residential property price crash looming in Australia. These are the same articles run out by the media 12-18 months ago, the last time the shorters tried to destroy our banks. Now they are starting from a higher point and are trying to gain traction once again. Like last time, we think this will fail miserably. Even on market down days now we are seeing bank share price resilience. That is because they have fallen too far in this trading correction and are offering compelling value on a yield basis alone (circa 8-9% gross dividends).

NAB is one of the big four banks in Australia and currently offers the highest forecast grossed up dividend yield of the majors – at 9.72% for FY2014. NAB is trading on a 10% discount to its peers, largely due to its ongoing issues faced with its UK division. However, our analyst sees the drag of the UK division stabilising with margin bottoming. The UK could in fact turn into a positive if earnings can recover and the Australian dollar falls against the pound, as any UK earnings will be translated into Australian dollars at more favourable exchange rates. There still remains the possibility that the UK division is sold. If this were to occur, you would likely see an instant re-rating in the share price as more capital is freed up.

Our analyst has a $30.99 price target on NAB versus a current price of $28.26.

Make your Concessional Contributions to Super before June 30

A reminder of the concessional contribution limits for the 2012/13 financial year are listed below. Concessional contributions include any Superannuation Guarantee (SG) paid by an employer on your behalf as well as salary sacrificed amounts and eligible self-employed contributions.

Concessional Contributions (deductible) for the 2012/13 Financial Year

- Up to age 75 - $25,000 p.a. per person
- If over 65, must meet work test
- Excess tax rate on contributions over Concessional Cap (in addition to standard 15% contributions) - 31.5%

The Concessional Contribution Cap increases from $25,000 to $35,000 for individuals who are turning 60 in the 2013/14 financial year. Over 50s will be able to access this higher limit from 1 July 2014.

Last chance for Government Co-Contribution this year

How the scheme works

The co-contribution works in the following way:

1. If you earn $31,920 or less in a financial year as assessable income, the Government will contribute 50 cents for every dollar you personally contribute into your super, up to a maximum of $500 in that year.
2. Where your income is more than $31,920 but less than $46,920 in a financial year, your co-contribution payment will be adjusted based on your income and how much you personally contribute. For example, if you are eligible and your income is $36,000 and you make a personal super contribution of $1,000 during the year, you will be entitled to a co-contribution payment of $364.

Eligibility for payment

You will be eligible for the co-contribution payment in a year of income if:

- you make personal superannuation contributions to a complying superannuation fund or a Retirement Savings Account; and
- you do not claim a tax deduction for the personal contribution; and
- the contribution is not a spouse contribution where the contributing spouse is claiming a tax

offset; and

- your total income (assessable income plus reportable fringe benefits) is less than $46,920; and
- 10% or more of your total income is derived from eligible employment (from 1/7/2007 this includes self-employed people where at least 10% of total income is earned from carrying on a business, eligible employment or combination of both); and
- you do not hold an eligible temporary resident visa at any time during the year; and
- you lodge an income tax return for the year of income; and
- you are less than 71 years old at the end of the year of income.

The Australian Tax Office will automatically determine who is eligible to receive the co-contribution. Payments will be made to the same superannuation fund to which the non-concessional contribution was made originally. If that particular superannuation fund is no longer active, or has been converted to a pension, the individual can request the ATO pay the co-contribution to another active superannuation fund, or as a cash payment directly to the individual.
