

MONITOR



Always Back Fundamentals

Overleaf is an interesting graph showing the relationship between Australia's GDP and the sharemarket. As you can see, if you ignore the short term "noise" of markets, ultimately the market will move in the direction of our (Australia's) economic growth (GDP).

Why the relationship?

Economic growth, or Gross Domestic Product (GDP), is the total economic output of a country. It is measured in terms of the total market value of all final goods and services made within the borders of a country within a year.

Hence, if GDP is positive, it means the total output in the past year was up on that of the previous year. In contrast, a recession is where there are two consecutive quarters of negative GDP growth.

So, if GDP is positive, it also follows that company profits, on average, would also have grown over the same period as private enterprise (versus government) represents the vast majority of Australia's economic output.

If company profits on average are increasing, then fundamentally their share prices should also be increasing. More profits equal larger dividends or greater retained profits for re-investment.

This is why on the overleaf graph, the

Australian sharemarket has over time roughly traded with the same bias as the long term direction of Australia's GDP. Clearly on a short term basis the sharemarket has undershot or overshot the equivalent GDP growth at any point in time. This is where short term sentiment and influences play a role.

What does it all mean?

This graph has been incorporated to show that long term, fundamentals win out and the short term "noise" of the market provides opportunities.

In our first (and only to date) special edition of MBM in October 2008, we stated that the ultimate fear of a financial system collapse had passed and the market would again focus on economic fundamentals as this is what drives the markets in the long term.

In the past few months the market has traded in a 10-15% band as we swing from the glass being half full to half empty. This volatility is likely to continue for some time, but we suspect with an upward bias.

There will be plenty of more "noise" along the way, but if the overleaf graph is any indication, we need not fear as we re-trace closer to our GDP.

We still stand by our prediction of the markets again breaching the 5,000 point level by Christmas.

Stock Review BKW

Brickworks Ltd (BKW) is the sister company to Soul Pattinson (SOL), another listed company that we have covered in this section before. We say sister company because they each have a very large cross ownership in each other. This has historically been the case for decades, primarily as takeover protection so that either company cannot fall prey to a third party. Given the respective performance of both companies over the past 40-50 years versus the market average, it is fair to say that shareholders have not been disadvantaged by this structure.

BKW is a diversified industrial company. Operationally it is one of Australia's largest brick and tile manufacturers. It operates under the brand Austral, plus several other product specific brand lines. BKW also has a large land bank from current and old quarry sites. In addition to these operations and assets, Brickworks has a 42.85% ownership of Soul Pattinson.

BKW's interest in SOL, at current market prices is approximately \$1.37b. BKW has a current market valuation of \$1.74b. BKW's net debt is \$195m. Therefore, the market is currently only subscribing an enterprise value of \$565m to one of Australia's largest brick and tile manufacturers. And that does not take into account their land bank.

BKW is currently trading at \$11.84. We have a price target of \$15.84.



Our New Look

As mentioned in our last Martin Bros Monitor we have upgraded our design. This is the first face lift we have done since launching the first edition in 2002. We hope you like it.

As always, we welcome any feedback you may have on the MBM layout or our new Martin Bros logo.

Efficient Market Theory

Efficient Market Theory (EMT) suggests that share markets should work efficiently—that is, all known information about each company should be built into all share prices on a rational basis. EMT assumes two things:

1. that there is rational behaviour from all market participants; and

2. that all known information about a company has already been factored into the share price.

Efficient Market Theory was developed into its current form in the 1960's. With the advent of Hedge Funds and recent events such as the GFC, it makes it hard to believe in EMT. If the markets were open one day every year, perhaps EMT would hold true. But not on a daily basis.

 RBS Morgans

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