Welcome to the September 2012 edition of the Martin Bros. Monitior.

Thank you, RBA.

Welcome to the September edition of the MBM. Seasonally, this is the weakest period for global (and local) equity markets. September has the worst track record, followed by October. So far this year, the opposite has been true. October is not over yet, so we won’t count our chickens before they hatch, but there is reason to be optimistic with a 3-6 month view.

As we write the ASX200 is trading just below the 4,500 point level. This index has now broken through the top end of its trading range that it has been stuck in for the past 16 months (see chart below). This is good news, even if it were to drop back below the upper band over the next few weeks, which is entirely possible after bouncing 4% in the past month. The other bullish sign on this chart is the “higher highs” that have occurred since the July 2011 sell off.

Before we move off technical analysis and back to the real business of economic and corporate fundamentals, below is the chart of the ASX200 index that most of you will be familiar with as it has appeared from time to time in the MBM over the past ten plus years.

As you can see above, despite the recent run up over the past 16 months to the top end of its trading range, on a long term basis (20 years) the market is still trading below its trading band. This is supported by fundamentals such as Price to Earnings (P/E's) multiples and dividend yields at multi decade lows and highs respectively. Is it a sign of imminent gains? Of course not. But the longer we track sideways the closer we get towards the next sustainable equity market rally. IT WILL HAPPEN, despite what the drama enthused media commentators would have you believe.

It is worth re-visiting part of what was written in this years June edition of MBM. Back then we wrote:

"*Put simply, there is not another Global Financial Crisis pending because of the mess in Europe. The few peripheral (put bluntly – completely irrelevant in terms of global output) countries causing the crisis in confidence is not a global financial market crisis but a buyer of "risk" assets crisis. Simply, it has created a buyers strike in "risk" assets (equities) at a time when valuations are at extremely low levels and comparative "safe" assets are now "dangerous". With current prices in these asset classes, we feel there is a greater chance of a "melt up" in equity prices rather than a "melt down".*

We are not predicting that we are currently seeing the precise bottom in equity markets. However, a growing range of indicators such as fundamentals, technical's and psychological reasons are converging to create the start of an equity market rally at some point. Europe might steal the headlines in the short term, but with their bank recapitalisations almost over, money will soon start to flow back into "risk" assets. It will be a trickle to begin with, but once the herd catches on, it will gain steam and the "buyers strike" will turn into a

"sellers strike" and cause a "melt up"."

The Europe "crisis" as it has often been called is over. Europe is still a mess and sustainable growth seems a long way off for now, but all signs point to the fact we are not on the verge of another financial crisis. The bank recapitalisations referred to above have now been in place for over two months. The difference between the Euribor (the rate at which banks lend to other banks) and AAA rated European bank deposits (the rate at which banks lend to the European central bank) is at 22 basis points (0.22%). This rate was at 150 basis points (1.50%) in December last year and 35 basis points last month. The historical long term average is 11 basis points. This is not the behaviour (inter bank lending) of an economy on the brink of financial Armageddon.

Added to these bank recapitalisations, approximately two months ago, Mario Draghi, the head of the European Central Bank (ECB), muttered the words "Whatever it takes". Since this time equity markets have rallied and the bond yields of "risky" countries such as Spain and Italy have continued to fall. European nations now have an unlimited and open ended guarantee from the ECB to support their sovereign debt obligations.

In conjunction with the ECB embarking on a large scale unlimited bond purchasing program to support all European nations, if required, the Federal Reserve of the US has commenced Quantitative Easing package number three (QE3). All of this serves to provide the banking / finance "system" with liquidity and cheap cheap money. This all but forces investors and savers (pension funds, government, banks etc) to take on "risk" as the returns available from cash deposits evaporate. As returns come down on cash deposits, eventually human greed (or necessity) takes over. When interest rates on short term and long term deposits / bonds are sub 2%, you can see why people are prepared to move into those equities that have high sustainable dividend yields.

Now we have the RBA to thank too. With interest rate cuts of 1.5% over the past twelve months and the promise (based on market pricing) of more to come, safe haven investors in Australia are now seeing new term deposits rates at under 5% for the first time in many years. These rates look like they are going under 4% at some stage too. Most retirees cannot afford to live on 3-4% interest income with no prospect for growth in income or capital. Eventually the cash flow doesn't add up and Australians will be forced to take on more risk, as others have around the globe. Throw in a possible change of government in 2013 and a falling $A on the back of falling interest rate differentials with the rest of the world and you can see why we feel the next twelve months might just be much better than many expect.

In the last MBM we talked about a "buyers strike". Many buyers are still on strike, short positions are still at all times highs and yet the market is at the top of its 16 month trading range. This is not the combination of a market about to capitulate again. Santa Claus may just come to Christmas again this year.

Stock Review - Brickworks Limited (BKW)

We have covered Brickworks in this section before but not for quite some time. Brickworks was first listed in 1962, after being an unlisted company for many decades prior. Brickworks chairman, Robert Millner, is also Chairman of Soul Pattinson (SOL) and Milton Corporation (MLT), amongst others.

Brickworks is 48% owned by Soul Pattinson and in turn has a cross shareholding in SOL of 43%. As the name suggests, Brickworks is a building products producer and supplier. It's main brands include Austral Bricks and Masonry and Bristile Roofing.

It will come as no surprise to most that the building sector has been particularly hard hit since the GFC and not helped by the introduction of the carbon tax. Brickworks have been no exception and they have had to cut costs to remain profitable. There are signs that the interest rate cuts over the past twelve months may have just started to spur new home activity. Brickworks will be a major recipient of any housing recovery. Since the most recent interest rate cut announcement last week, interest in building supply companies has escalated.

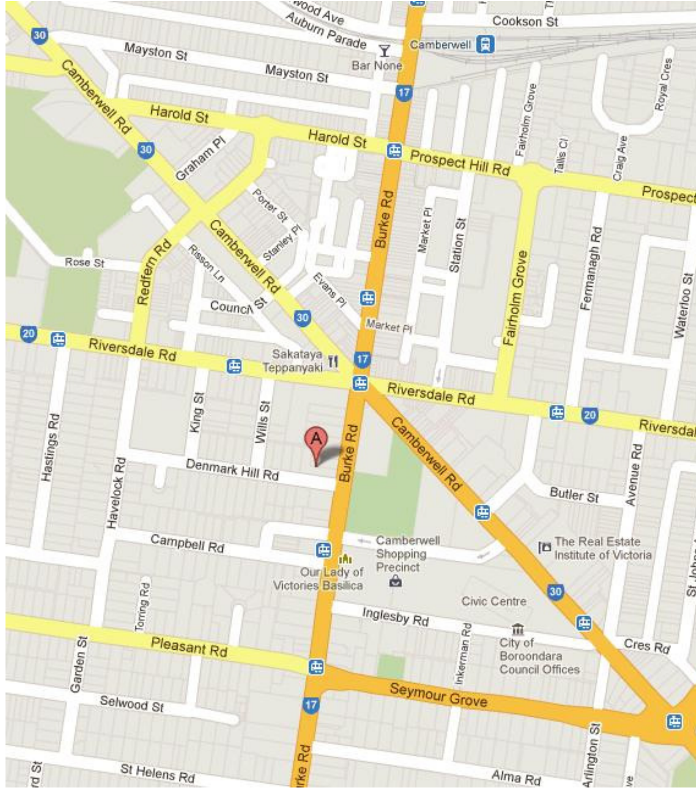
Brickworks shareholding in SOL, based upon current market prices, is some $1.38b. Brickworks own market capitalisation is only $1.63b, or some $250m less than its interest in SOL alone. This means the market is only ascribing a value of $250m to all of the operating businesses and other investments within Brickworks. The company always trades at a discount to its Net Tangible Asset (NTA) backing because of its cross shareholding with SOL. This trading discount might close further if the housing recovery gathers some steam.

Besides Brickworks operating business it also has a land and development business that they are selectively selling off with joint venture partners and booking profits on. These land realisations should continue for many years to come. Interestingly, this land was former quarry sites that were used for sourcing raw material for their brick making operations many decades ago, which is now in key growth corridors, predominantly around Sydney.

Our new office

On the 1st of October, the Martin Bros. Team moved to our new Camberwell office at Level 5, 689 Burke Road.

The office is located on the corner of Burke & Denmark Hill Roads (red marker on the below map), with entry from Denmark Hill Road.



All our contact details (phones, faxes & emails) remain unchnaged. Our new mailing address is now PO Box 361, Camberwell VIC 3124.

Should you be visiting our office, 2 hour street parking is available in the surrounding streets whilst the Camberwell Railway Station is 800m away. Tram routes 70, 72 and 75 also run by our office.

We look forward to seeing you at the office for our next meeting!

RBS Morgans Limited | ABN 49 010 669 726 | AFSL 235410 A participant of the ASX Group

RBS Morgans Limited and its associates hold or may hold securities in the companies/trusts mentioned herein. Any general advice included in this email has been prepared without taking into account your objectives, financial situation or needs. Before acting on the advice, you should consider its appropriateness or discuss with one of our investment advisors. Personal information held by RBS Morgans Ltd may have been used to enable you to receive this publication. If you do not wish your personal information to be used for this purpose in the future please advise us, including your account details to your local RBS Morgans Ltd office or to Reply Paid 202, GPO Box 202 Brisbane Qld 4001

Paul & Jarrod Martin are Authorised Representatives (259367 & 259249) of RBS Morgans Ltd.