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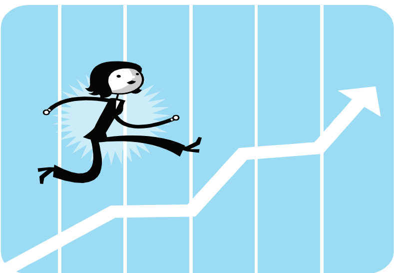
SIRAGROUP

SIRA VIEWS

Market Update

The US market is unlikely to advance much over the next few months. The Fed will probably continue to increase interest rates, slowly but inexorably, as long as growth continues, because the risks are that inflation will increase. This is driven by global rather than purely US demand -- in particular, China, now the world's second largest economy, is expanding at 9.5% p.a., and is driving up commodity demand and commodity prices. The oil price is obviously not being pushed up by oil companies, but by a whole new class of car owners in China as well as by the fashion for petrol-guzzling 4-wheel drives in the US.



In the past, fuel costs have been excluded from "underlying" or "core" inflation because they have often been driven by political factors (e.g., the Gulf War). However, now that oil prices are rising because of global demand, there is an argument that it is the overall inflation level that is significant, and in economies where there is nearly full employment (the US and Australia), the risk is that high "headline" inflation will feed through into wage inflation and general inflation expectations.

Even after China's removal of the Yuan's fixed peg to the US dollar, Chinese monetary policy is still largely determined by US policy. Thus, US policy may have to tighten more than is required by purely domestic circumstances to choke off inflation – a mirror image of the need to loosen policy dramatically when there was global deflation 4 years ago.

Even though there is significant (company) earnings growth in the US, it is hard to see how the market can rise strongly in the face of upwardly trending interest rates.

In Australia, the recent run in the share market has been driven by resources. This resource boom is comparable to the "Poseidon" boom of 30 years ago. The resources index is up more than 2 and a half times from the low in July 2003. We don't know whether the falls of the last few days presage the beginnings of a resources bear market, but what is apparent from past bull markets, is that when the correction comes after such a rise, it tends to be substantial and prolonged. (Our position is to have some exposure to the resources sector, but to have less than the weighting of resources in the index, to reflect these risks at the tail end of the bull market)

However, other sectors are not as overblown as the resources (and resource-like stocks, such as Caltex), and the overall market price-earnings ratio is not expensive. Housing, which had concerned the Reserve bank, is in a slump (new housing approvals have fallen to the lowest level since 2001), and our interest rates are already higher than the US's. If the markets do believe resources have peaked, the A$ will fall, and in the past this has always cushioned the Australian share market from the worst of any Wall St weakness.

We are recommending a switch out of resources and resource-like stock into more conservative shares such as Transurban (TCL), Macquarie Infrastructure Group (MIG), Macquarie Airports (MAP), Westfield group (WDC), and our two preferred banks (NAB and St George's Bank) These all have reasonable forecast earnings growth and good yields (after adding back franking credits in the case of the banks).

We are not recommending a switch out of equities in general. Though the All Ords index is unlikely to rise from current levels, it is also not expected to fall substantially either, as it is not expensive, and the interest rate environment is likely to remain neutral.

In This Issue

Special points of interest:

- *Fuel costs rising*
- *Resources overvalued*
- *Market likely to consolidate*

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End of Defined Benefit Pensions in Self managed Super Funds

In the 2004/05 budget the Government announced that self managed superannuation funds ('SMSF') would no longer be able to pay defined benefit pensions. These new measures were to take effect from 12 May 2004.

Due to overwhelming response from participants in the SMSF industry, the Government announced a transition period to allow those people, who on 11 May 2004 were members of a SMSF and who retire on or after age 55, or reach age 65, the ability to commence a defined benefit pensions ('DBP') until at least 30 June 2005. A review process was established and was to report to the Government in April 2005.

The report was not submitted in April and in June 2005 the Government extended the transitional period to 31 December 2005 i.e. the member must become entitled to the pension prior to 1 January 2006 with payments commencing within 12 months of the entitlement date.

On 27 September 2005, the government announced its response to the review of the provisions of pensions by SMSF.

Broadly, the government proposes the following changes:

1. extending the term of market linked pensions ('MLP') so that payments can continue until the member (or their spouse) reaches age 100;
2. allowing annual MLP payments to vary between plus or minus 10%; and
3. update the Allocated Pension ('AP') factors in line with current life expectancies.

These changes will apply to new pensions commencing from 1 January 2006.

The government has also confirmed that the deadline for the commencement of DBPs by members who satisfy the transitional relief will remain at 31 December 2005.

The report into the provision of DBPs by SMSFs expected in April this year will not be issued, but the above changes will be made to the superannuation regulations prior to 1 January 2006.

Whilst this announcement reduces the scope of RBL planning within SMSFs, the new guidelines for MLPs and APs offer greater flexibility for these products.

Accordingly, it is imperative that if you plan to retire or to commence a DBP, act soon and call us to ensure that the required pension documentation, actuarial sign-off and documents are finalised prior to 1 January 2006.

"YOUR REFERRAL IS OUR GREATEST COMPLIMENT"

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Market Update:
Nigel Purchase
End of Defined Benefit Pension:
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