Research Bulletin

Australian Equities: Portfolio Strategy Review 31 Dec 2005

- The Australian equity market (S&P/ASX200) finished the year strongly, rising 2.8% in December and establishing new record highs. The market returned 17.6% for the 2005 calendar year. The resources sector was once again the standout performer for the month, with broad based gains driven by record high prices across several of the base metals and continued strength in both gold and oil prices.

- On the economics front, the RBA left interest rates unchanged at 5.50% in December. The unemployment rate dropped to 5.1% and the Federal Government announced that its underlying cash balance for 2005-06 is now estimated at $11.5bn, up $2.6bn from the $8.9bn estimated in the May Budget, paving the way for further tax cuts. The Australian dollar attempted a rally during the month, but finished lower at US$0.7344.

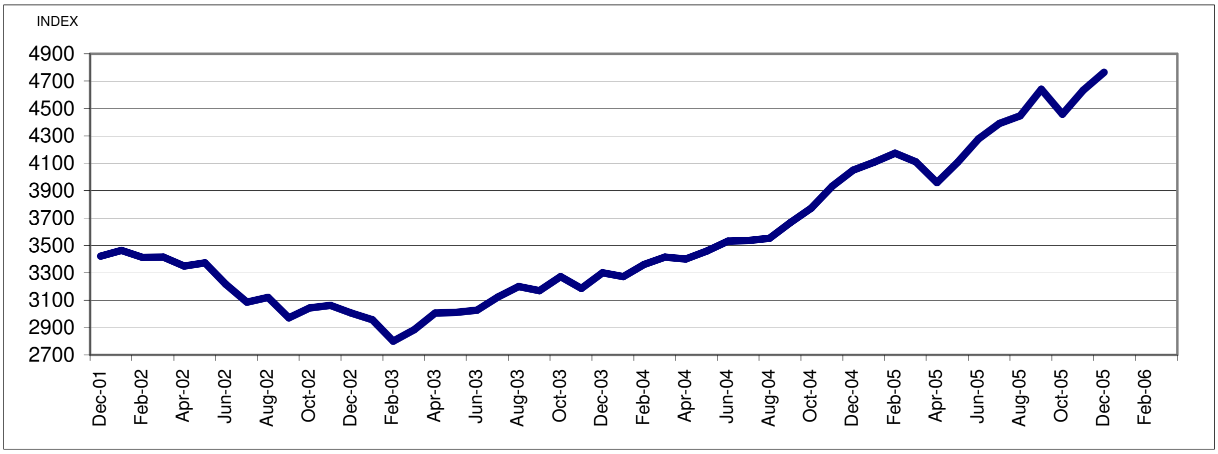
- Investor activity for the month reflected a focus on adding market leverage to portfolios with the Materials (Resources), Energy and REIT sectors outperforming, whilst stocks exposed to Consumer Spending, Healthcare and domestic General Insurance lagged. Small Caps also disappointed following a number of profit warnings.

	Accumulation Index Performance		
	1 Month	**6 Month**	**12 Month**
S&P/ASX 200	3.1%	13.9%	22.8%
S&P/ASX 200 Industrials	2.2%	10.7%	17.0%
S&P/ASX 200 Resources	6.4%	27.9%	51.8%
S&P/ASX Small Ordinaries	1.4%	13.6%	19.6%
	Relative Index Performance to S&P/ASX 200		
Consumer Discretionary	-2.5%	-11.3%	-27.5%
Consumer Staples	-2.9%	-6.3%	-13.8%
Energy	3.4%	4.4%	39.8%
Financials	-0.9%	-0.3%	-0.7%
Health Care	-2.1%	7.5%	18.3%
Industrials	1.3%	-6.6%	-6.2%
Information Technology	-5.7%	1.2%	-5.8%
Materials	2.9%	13.9%	20.0%
REITs	2.2%	-2.9%	-10.3%
Telecommunications	-1.1%	-28.7%	-32.3%
Utilities	0.3%	3.5%	11.2%

Source: GSJBW Research, IRESS

Australian Equity Market Performance: S&P/ASX 200 Index

(December 2001–December 2005)



Source: IRESS

Company Performance: Best and worst performing stocks

In December, the best and worst performing stocks (absolute share price returns) in the ASX 100 were as follows:

Best	% Change	Worst	% Change
Zinifex	28.6	Ten Network	-8.7
Oxiana	25.2	Caltex Australia	-8.6
Alumina	16.7	Pacific Brands	-7.3
Cochlear	14.9	Lihir Gold	-7.2
Newcrest	14.1	OneSteel Limited	-6.9
Billabong	14.0	Resmed	-6.3
Paperlinx	12.3	Mayne Pharma	-5.2
Woodside Petroleum	12.1	Multiplex Group	-4.6
Rio Tinto	11.7	Symbion Health	-4.1
Macquarie Goodman	10.4	Tattersall's	-3.3

Source: IRESS

Significant Company/Economic News

Banking Sector **Analyst: James Freeman**

- **St George Bank (SGB): Short Term Marketperform; Long Term Hold**
  Share Price as at 31/12/05: $29.66 Valuation: $28.58
- **Westpac Banking Corporation (WBC): Short Term Underperform; Long Term Hold**
  Share Price as at 31/12/05: $22.75 Valuation: $20.87

During the month, Westpac completed a $1bn buyback, $300m higher than the $700m it announced at the time of its full year result, at a buyback price of $19.13. The increase in the buyback amount reflected the strong demand for the offer, with over $2bn of shares tendered at the maximum discount of 14 percent or at Final Price Tender. As such, a scale back of 53.8% was required. Capital management was a feature elsewhere in the sector, with St George announcing a $300m off-market buyback tender at its AGM (to be completed in February 2006). A number of the banks commented at their recent AGMs that the operating environment in the sector remained encouraging and this, in turn, drove positive sentiment towards the sector, with the banks up 2.2% for the month.

Cochlear (COH) **Analyst: Jack Mordes**

- **Investment View: Short Term Outperform; Long Term Buy**
- **Share Price as at 31/12/05: $45.73 Valuation: $45.21**

Cochlear upgraded its guidance for fiscal 2006 to core net profit of approximately $80m versus previous guidance of $70m. The revised guidance represents 36% growth on the previous corresponding period. Chief Executive, Dr Chris Roberts, commented that sales momentum had been stronger than anticipated, particularly from the recently launched Nucleus Freedom hearing device. The profit upgrade was very well received by the market, with the stock climbing sharply on the announcement. Cochlear ended the month as one of the top performers in the S&P/ASX100, returning 14.9% during December.

Qantas Airways (QAN) **Analyst: Paul Ryan**

- **Investment View: Short Term Marketperform; Long Term Hold**
- **Share Price as at 31/12/05: $4.04 Valuation: $3.74**

Qantas' board approved Jetstar's international expansion and services are expected to commence in January 2007 with a launch fleet of 10 aircraft. This announcement provided an insight into the future strategic shape and direction of Qantas's international business, a focus of which is on employing Jetstar's low cost model on those short haul international routes which generate comparatively low yields. Around mid-month, Qantas also announced a firm order for 65 Boeing 787 aircraft (scheduled for delivery from August 2008 to 2013), with purchase rights on an additional 50 aircrafts. The market viewed the announced initiatives positively and sent the share price 7.5% higher for the month.

Consumer Discretionary **Analyst: George Batsakis & Phillip Kimber**

- **JB Hi-Fi (JBH): Short Term Outperform; Long Term Buy**
  Share Price as at 31/12/05: $4.03 **Valuation: $4.10**
- **Colorado Group (CDO): Short Term Marketperform; Long Term Hold**
  Share Price as at 31/12/05: $4.14 **Valuation: $5.65**
- **Pacific Brands (PBG): Short Term Marketperform; Long Term Hold**
  Share Price as at 31/12/05: $2.66 **Valuation: $3.00**

Sentiment towards retail stocks at the smaller end of the market was mixed in December. A number of profit warnings within the sector highlighted that operating conditions remain difficult and that profit growth will likely prove challenging in the near term, given that most businesses are cycling a high earnings base from the previous year's strong conditions. The apparel sector was particularly weak, with sales in this segment of the market reportedly very soft over recent months. Colorado finished the month down 14.5%, whilst Pacific Brands also lost ground falling 7.6%. Conversely, JB Hi-Fi's share price was well supported as the market focused on the company's major new store roll-out and robust business model (i.e. low overhead operating costs, discount prices and wide range of merchandise).

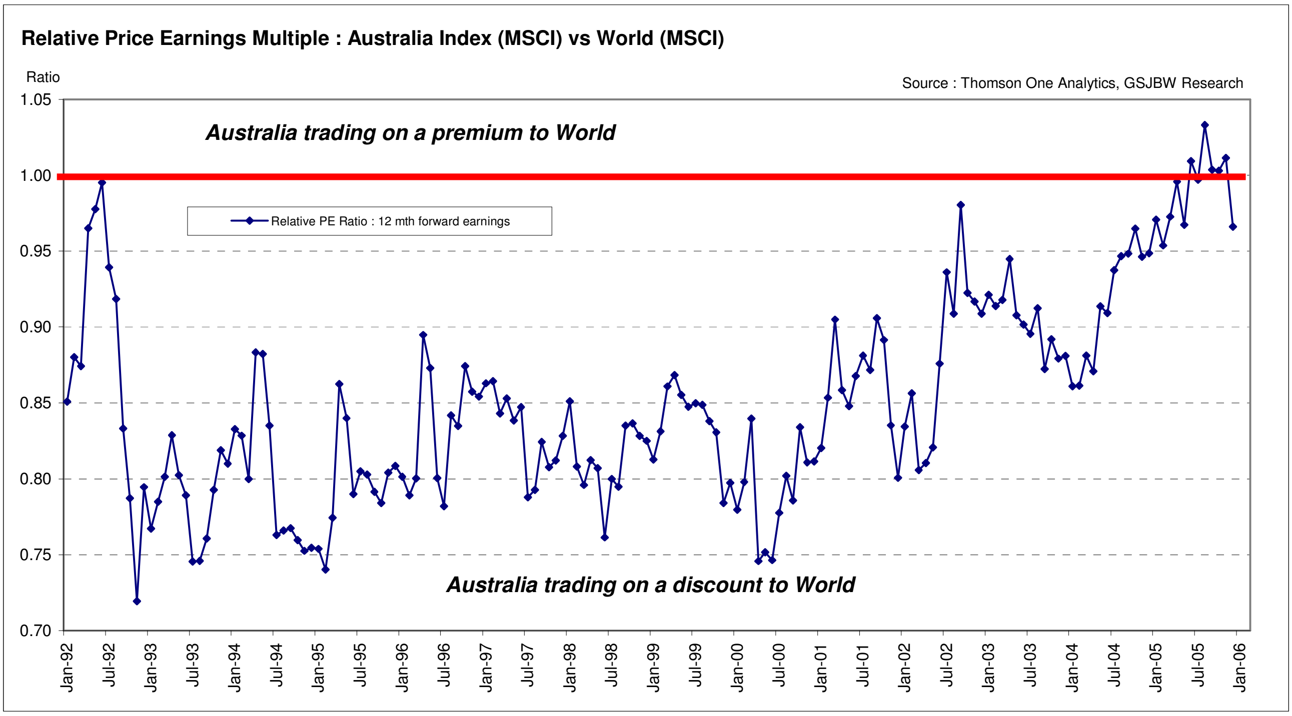
Multiplex Group (MXG) **Analyst: Nick Vrondas**

- **Investment View: Short Term Underperform; Long Term Sell**
- **Share Price as at 31/12/05: $3.15** **Valuation: $2.96**

The implications for Multiplex of the cost overruns and delays around the Wembley Stadium project continue to worsen. The company released findings of a report into the project which concluded that "the likely loss position is now expected to be substantially adverse from the position that was indicated at the full year result and the updated commentary provided at the most recent AGM." The Board advised that any additional losses on Wembley were likely to lead to a direct reduction in 2006 earnings guidance provided at the full year. Management revised its most likely estimate of 2006 earnings revision down by $61m (8 cents per share). Within the top 100 stocks, Multiplex was one of the worst performers for the month, down 4.6%.

Relative Value: Australian Equity Market versus Global Equities (as at 19/12/2005)

A solid outperformance by world equities against the Australian market over the past month has improved the relative valuation picture for the local equity market – the recent trend which has seen Australia trade at a premium to global markets reversed somewhat over December, with the local indices now trading at a slight discount to the global market.



Australian Equities: Key Issues for Portfolio Strategy

- After showing some long-awaited strength through the second half of 2005, the outlook for global markets into early 2006 still looks relatively bright. The consensus has now shifted firmly in favour of the view that the global economy will do well in 2006. We have little reason to challenge the consensus on this point – if anything, we feel that the risks are tilted in favour of activity exceeding expectations over the coming quarters. The more critical medium term issue for global markets will be whether this economic strength can be delivered without any material negative implications for global interest rates – the current consensus view. On this issue we are somewhat more circumspect. We continue to believe that global policy normalisation has further to run and that the general level of global interest rates is still low relative to the current strong nominal economic environment. We therefore believe that the uptrend in global rates will continue through 2006, possibly in a more stop/start fashion than was the case in 2005.
- The US Federal Reserve will ultimately determine the duration of the current global business cycle. Goldman Sachs Research believes that the Federal Funds Rate will continue to rise into 2006, peaking around the 5.00% level (currently 4.25%). Until recently, the Fed’s ability to contain rising inflation risks (and an increasingly speculative US property market) had been curtailed by the resilience of long term bond prices. While this resilience was again in evidence through November and December, we still believe US bond yields will trend higher over the next 3-6 months (prices lower). The Fed will become a far more potent risk for the global economy in 2006 if its “measured” increases in short term rates are accompanied by higher long term rates.
- Looking at the Australian economy, discretionary consumer spending has been soft since late last year, residential construction activity remains in a contractionary phase and the export sector is struggling to generate meaningful volume growth. Business spending remains the one bright spot. While the softer macro environment of the past year is not a surprise – given the boom conditions of 2002/04 – we believe that with the help of a still-supportive policy stance – and the financial strength of the corporate sector – household sector activity will strengthen through 2006. If this occurs, it will imply that little has been gained in terms of resolving the structural imbalances/inflationary risks that now overhang the economy. Thus, interest rate pressures would quickly re-emerge. After growth of 3.1% in fiscal 2005, GSJBW Research expects production (GDP) to expand by 3.2% in fiscal 2006 and 3.6% in fiscal 2007.
- The policy stance in Australia remains on the generous side of neutral. Interest rates are relatively low, the terms of trade are at a 50-year high, the Australian dollar has retreated, further income tax cuts (possibly significant) are likely at the next Budget and asset prices are healthy. This assessment is acknowledged by the Reserve Bank, which has recently shifted back to the view that rates are more likely to rise than fall. We still expect that interest rates will move higher over the next year (5.50% currently), although much will depend on whether household spending rebounds over the next 3-6 months.
- After a strong November/December, valuations across the Australian equity market are back in the full-to-expensive range. On the basis of the prevailing outlook for profits, interest rates and liquidity, we continue to believe that the risk of a prolonged correction at this point is low. Material price weakness requires material profit disappointment and, while Industrial fiscal 2006 and fiscal 2007 earnings estimates have been tempered over recent months, we still believe that the risks of major market-wide downgrades remains relatively contained – particularly while the RBA sticks to its more cautious approach. While all this is a source of comfort, valuation risk will become a far more material issue if the market makes further solid gains over the next 3-6 months. For this to occur, the February reporting season will need to deliver significant good news. Appropriate portfolio construction therefore remains critical. The market is likely to remain wary about stocks directly exposed to interest-sensitive spending – particularly in the US. Likewise, the more aggressive financial engineering models that have emerged over recent years in the infrastructure, property and utilities sectors will, we believe, eventually be challenged by the impact of higher global interest rates on asset valuations and the pricing of credit risk.
- Consistent with our view that the market is fully valued, we are finding it difficult to identify stocks that offer compelling absolute value at current prices. Within the large-cap defensive universe, we view **Macquarie Communications Group**, **Coca-Cola Amatil**, **Promina** and **Publishing & Broadcasting** as representing the best relative value. The major banks have performed strongly over recent months and the sector is now looking fully-valued. Into any meaningful share price weakness we prefer **Commonwealth Bank** and **St. George**. We continue to believe that the medium term outlook for the resources sector is favourable, although higher interest rates have the potential to, at some point in 2006, trigger a cyclical downturn in the global economy and, in all likelihood, dampen sentiment towards the sector. We continue to view periods of share price weakness as an opportunity to add to positions in **BHP Billiton**, **Rio Tinto** and **Oil Search**.

GSJBW Market Forecasts:

As at 31/12/2005	Price Earnings Ratio (PER)			Earnings Per Share Growth (%)			Dividend Yield (%)		
	FY05	FY06E	FY07E	FY05	FY06E	FY07E	FY05	FY06E	FY07E
S&P/ASX 300	16.7x	14.5x	14.4x	28.7	15.9	0.4	3.7	4.0	4.2
S&P/ASX 300 Industrials	17.1x	15.9x	14.5x	11.9	8.1	9.2	4.5	4.7	5.0
S&P/ASX 300 Resources	16.0x	12.2x	14.3x	81.3	31.9	-14.8	1.9	2.4	2.6

Source: GSJBW Research estimates

Portfolio Management: Build Positions

Computershare (CPU) **Analyst: Ashwini Chandra**

- **Investment View: Short Term Marketperform; Long Term Buy**
- **Share Price as at 31/12/05: $6.79** **Valuation: $6.20**

Year End June	2006 Estimate	2007 Estimate	2008 Estimate
Net Profit ($m)	197.0	241.2	273.3
EPS Growth (%)	32.4	22.4	13.3
PER (x)	20.5	16.8	14.8
Yield (%)	2.2	2.7	3.4

Source: GSJBW Research estimates

The premium to valuation at which CPU is currently trading and the difficulty in forecasting earnings performance at its upcoming first-half result leaves us somewhat guarded in our near term view on the stock. Nevertheless, we highlight that, on a 12-month view, CPU will likely benefit from a very strong operating environment leaving earnings risk firmly weighted to the upside. Accordingly, we remain very comfortable with our long term Buy recommendation on the stock.

EquiServe is Computershare's largest acquisition to date and the success of its integration into the group is clearly critical to share price performance. In this regard, the company recently reiterated its guidance around the level of synergies it expects to extract from the acquisition, a strong indication that the integration is proceeding according to plan.

We expect that corporate-activity revenues will likely grow strongly over the next twelve months. Globally, there has been a very large number of M&A transactions over calendar 2005 and we believe the momentum behind the M&A cycle will continue into 2006; corporate balance sheets are cashed up and exploring M&A opportunities has been noted as one of the top priorities for many companies in the US. Although the earnings impact is difficult to forecast in any period, Computershare is significantly leveraged to the M&A cycle.

Computershare is a net beneficiary of higher interest rates in the short-to-medium term. The company holds funds in trust, on behalf of large corporates, before they are distributed to shareholders as dividends payments or in relation to corporate actions. Whilst in their control, Computershare earns interest on these funds and, hence, the level of 'margin income' generated by the business is determined by the prevailing level of interest rates. We believe the uptrend in rates will persist through fiscal 2006 and into 2007, driving further growth in Computershare's recurring earnings base.

Billabong International (BBG) **Analyst: Phillip Kimber**

- **Investment View: Short Term Outperform; Long Term Buy**
- **Share Price as at 31/12/05: $14.52** **Valuation: $13.60**

Year End December	2006 Estimate	2007 Estimate	2008 Estimate
Net Profit ($m)	149.5	175.7	206.5
EPS Growth (%)	14.7	18.4	17.6
PER (x)	20.2	17.1	14.5
Yield (%)	2.9	3.4	4.1

Source: GSJBW Research estimates

Globally, Billabong remains a dominant brand in the boardsports lifestyle/apparel markets, with many opportunities to drive growth. Whilst the company is a top three global boardsports brand in each of its key markets, it remains under-represented in Europe and the Americas – we note that its main competitor Quiksilver has more than twice Billabong's sales in the US and more than three times Billabong's sales in Europe. We believe there is significant scope for the company to continue to generate high growth in international markets as it further develops its product offering.

Billabong's Australasian business grew earnings by 52% in fiscal 2005. Given this high base – and comments from both Quiksilver and Billabong that momentum has slowed significantly in this region – we expect the key drivers of Billabong's fiscal 2006 earnings will be the US (44% of our estimates) and Europe (17% of our estimates). Following the comments made by Billabong at its recent AGM and, given trends highlighted by Quiksilver in recent announcements to the market (i.e. momentum in the US market has strengthened), we remain very confident that Billabong will at least achieve (if not exceed) our 15% EPS growth estimate in fiscal 2006.

With significant excess capacity on its balance sheet, we believe there is potential for BBG to consider further acquisitions. Billabong's most recent purchase, Nixon Inc., a premium boardsports watch and accessories brand, continues its strategy of bolt-on acquisitions. We highlight that this focus on growth through acquisition has historically proven highly successful, partly reflective of the company's ability to leverage its strong distribution and marketing capabilities. Overall, the solid medium term outlook for earnings, driven by growth of the boardsports market and Billabong's increasing share within this market, underpins our long term Buy recommendation.

Portfolio Management: Reduce/Switch Exposures

Macquarie Bank (MBL) **Analyst: James Freeman**

- **Investment View: Short Term Marketperform; Long Term Hold**
- **Share Price as at 31/12/05: $68.15** **Valuation: $67.40**

Year End June	2006 Estimate	2007 Estimate	2008 Estimate
Net Profit ($m)	978.0	1014.0	1104.0
EPS Growth (%)	13.9	0.7	5.6
PER (x)	16.6	16.5	15.7
Yield (%)	3.4	3.5	3.7

Source: GSJBW Research estimates

Although Macquarie Bank operates a unique and clearly highly profitable franchise, we believe that its risk profile is increasing, in particular if the rate of asset value appreciation or the Bank's ability to recycle its capital continue to slow over the next 18 months. Strong share price performance over the last 3 years and, in particular, the last 6 months has been driven by material earnings momentum, which came on the back of solid core operational growth, as well as significant fee income from its specialist funds (which peaked at around 15% of Net Profit After Tax in fiscal 2004).

We have detailed our macro views on the normalisation of global interest rates (i.e. higher) in some detail elsewhere (refer GSJBW Research Bulletin, "*Australian Equities: Subdued Outlook but Plenty of Cyclical Variety*", 8 December 2005) and our more circumspect view of Macquarie Bank's investment case in recent months is a direct reflection of this (e.g. specialist fund underperformance, slower core business growth). However, we believe that the recent postponement of the Macquarie International Real Estate Fund initial public offering (IPO) highlights the potentially significant short-to-medium term risks for the group's business model.

With the stock trading around our DCF valuation, we believe that potential share price upside remains somewhat limited from here. While we remain supportive of Macquarie's long term investment case, we would look to revisit the stock at a discount to our valuation.

Macquarie Infrastructure Group (MIG)/Connect East (CEU)/ Macquarie Communications Infrastructure Group (MCG) **Analyst: Alison Booth**

- **MIG: Investment View - Short Term Marketperform; Long Term Hold**
- **MCG: Investment View – Short Term Marketperform; Long Term Buy**
- **CEU: Investment View – Short Term Marketperform; Long Term Buy**

FY2006 Estimates	MIG	MCG	CEU
Net Profit ($m)	109.3	53.1	N/A
DPS Growth (%)	N/A	34.5	N/A
Yield (%)	5.9	6.9	5.7

Source: GSJBW Research estimates

We believe that Macquarie Infrastructure Group's (MIG's) involvement in the recent acquisition of the French Government's ~70% stake in French toll road company Autoroutes Paris-Rhin-Rhone (APRR) will not provide any significant catalyst for share price performance. The transaction itself was relatively uncompelling, given the roads' short concessions/high regulation and had an immaterial effect on our valuation – MIG's $600m contribution for ~28% of the total stake will be funded from existing cash reserves and through underwriting its next two dividend reinvestment plans.

Given the largely neutral impact of the long-awaited French toll road bid, we believe that the market's focus will return to the underlying performance of MIG's key assets, the M6 Toll in the UK and H407 in Canada. On this front, traffic growth continues to be weak, but we believe that this is largely reflected in the current share price. While these clearly remain high quality long term investments, we continue to prefer cleaner toll road and infrastructure exposures within the Australian equity market.

We retain a general degree of caution in relation to the infrastructure sector in a rising long bond yield environment. However, on a long term view, our preferred exposure to the toll road sector is ConnectEast Group, which is constructing an attractive toll road in a high growth region and which continues to trade at a material discount to our valuation. We are also comfortable to build positions in Macquarie Communications Infrastructure Group, which provides investors with a solid, defensive distribution yield, which is largely funded from actual operating cashflows, as well as exposure to high quality growth options.

Emerging Companies: Monthly Update

With our institutional research team continuing to expand coverage within the Small Cap sector, we will now include a regular commentary in our monthly *Australian Equities: Portfolio Strategy Review* focusing upon recent additions to the research list, as well as our preferred investment ideas in this segment of the market.

Timbercorp (TIM) **Analyst: Nga Luu**

- **Investment View: Short Term Outperform; Long Term Buy**
- **Share Price as at 31/12/05: $3.00** **Valuation: $3.30**

Year End December	2006 Estimate	2007 Estimate	2008 Estimate
Net Profit ($m)	73.5	79.0	96.0
EPS Growth (%)	21.8	3.5	16.2
PER (x)	11.7	11.3	9.7
Yield (%)	3.0	3.3	3.7

Source: GSJBW Research estimates

Timbercorp is a marketer and manager of agribusiness investment projects on behalf of investor-growers. The primary objective of investors in these projects is to defer the payment of income tax liability and, in the process, look to earn an adequate return on investment. We believe the scope for growth within this industry is strong, given increasing acceptance of managed investment schemes and low penetration levels within key distribution channels (financial planners and accountants).

A growing annuity style income stream is also central to our favourable investment view. As projects mature and harvesting begins, recurring income from management, rental and licence fees should continue to expand. This is a defensive revenue stream, locking in 2-3 years of forward revenue growth when the project is initiated, followed by a minimum level of earnings for the remaining life of the horticultural project (up to 23 years).

Investors should be aware that this industry is not without risk. Land and water availability for new projects is tight. In addition, while we believe that returns on existing projects are currently tracking at an acceptable level, failure to deliver relatively favourable returns from future projects would damage the marketability of Timbercorp’s managed investment schemes. Finally, we highlight that the chance that the government introduces sweeping taxation changes which withdraw the ability to claim expenses as a tax deduction is a difficult event to predict and therefore price.

On valuation grounds, the investment case stacks up relatively well. We estimate that the stock is currently trading on 11.7x our fiscal 2006 earnings forecast, which represent a 27% discount to the Small Industrials index. In addition, on our forecasts, the business will generate earnings per share growth of approximately 20% over the next five years. We believe Timbercorp’s share price should rerate over time on the back of this strong growth profile and thus reiterate our Buy recommendation on the stock.

Transpacific Industries (TPI) **Analyst: Craig Temby**

- **Investment View: Short Term Marketperform; Long Term Hold**
- **Share Price as at 31/12/05: $5.65** **Valuation: $4.06**

Year End December	2006 Estimate	2007 Estimate	2008 Estimate
Net Profit ($m)	49.2	59.7	68.7
EPS Growth (%)	73.2	21.5	15.1
PER (x)	22.9	18.9	16.4
Yield (%)	1.8	2.1	2.5

Source: GSJBW Research estimates

Transpacific Industries (TPI) is the largest liquid waste collection and recycling group in Australia. TPI is also a major importer and distributor of heavy duty trucks and provider of industrial services. We highlight the following points which are supportive of the long term outlook for the business:

- The waste management industry in Australia has been growing at around 7.5% over that last 10 years and the market for heavy duty trucks has been expanding at around 6% over the same period. We expect this positive growth momentum to continue, albeit at moderately lower levels.
- Increasingly stringent regulations in the waste management industry have resulted in higher barriers to entry in the industry. We expect that there will be further consolidation within this market and that TPI is in a good position to add value via acquisitions. On this note, TPI has announced that it will work with CHAMP Private Equity to consider the acquisition of Cleanaway and Brambles Industrial Services in Australia. Any significant acquisition would most likely require an equity raising.

With TPI now trading at a wide premium to our valuation and on 23x forecast 2006 earnings, we believe the market is now largely factoring in this positive outlook for the business. Accordingly, we would look to build new positions in the stock closer to our valuation, hence our Hold recommendation on the stock.

Stock Selection Using Quantitative Techniques

The main GSJBW multi-factor Quant stock selection model aims to provide diversification across market themes and thus to deliver stable 'through-the-cycle' returns. This is achieved by combining several individual stock selection screens which attempt to capture returns, momentum and value factors. The current top rankings in GSJBW's large industrial stock screening model, as well as changes in rankings over the last month, are shown in Table One below.

Table One: Large Industrial Stock Selection Model

Rank	Company	EVA Spread: Level	EVA Spread: Trend	Earnings Revision: Actual 3 Month	Earnings Revision: Predicted	Positive RSI	ROFE/ PEG	TOTAL	Previous Rank (30-Nov-05)	Move in Rank
		(out of 15)	*(out of 15)*	*(out of 15)*	*(out of 15)*	*(out of 10)*	*(out of 30)*	*(out of 100)*		
1	RIN	13	15	13	15	5	28	**89**	1	0
2	ASX	15	14	13	8	9	30	**89**	4	2
3	COH	10	13	15	15	8	25	**86**	10	7
4	JHX	14	14	5	15	7	29	**83**	3	-1
5	PPT	15	15	12	8	5	27	**81**	2	-3
6	ALL	14	5	14	8	7	29	**77**	6	0
7	TOL	12	14	3	8	10	26	**72**	7	0
8	BBG	12	12	9	8	8	22	**70**	14	6
9	RIO	11	2	10	15	4	28	**70**	5	-4
10	CPU	9	12	12	8	2	26	**69**	8	-2
11	UTB	14	14	4	8	5	23	**67**	13	2
12	WOW	12	0	8	15	1	27	**63**	12	0

Source: GSJBW Research

We have published these rankings in our monthly *Australian Equities: Portfolio Strategy Review* since February 2005 and thought it timely to review the performance of this model over the period, also demonstrating how it can be practically implemented.

To this end, the following 'backtest' simulates the management and performance of our published model results over the last 11 months, from the perspective of a private investor.

We begin by notionally purchasing $1,000 worth of each of the 12 top-ranked stocks in the model, as at the close of trade on the 28th of February 2005 (refer Table Two), for a total portfolio size at initiation of $12,000. Of course, we deduct brokerage for these transactions at a rate of 1% of the market value of each purchase – so the actual initial portfolio size is $11,880.

For the purposes of the exercise, we assume that fractions of shares can be purchased, so we have not rounded any of the holdings – investors may prefer to round some holdings up and others down.

At the end of each month, we update the value of the portfolio, given the changes in share prices over that period. At this time, we also assess the new rankings provided by our model, sell any shares that are not included in that next month's top 12 and buy whichever have been selected in their place.

For example, one month after initiation, at the 31st of March 2005, three stocks changed within the top 12: Ansell, Toll Holdings and Coles Myer were removed and replaced by UNiTAB, BHP Billiton and Woolworths.

Where this happens, we assume that the proceeds from the sale of the first three holdings (in this case, net $2,974.45 after brokerage) are split evenly between the three new holdings (in this case, net $981.57 in each after brokerage).

We have also incorporated the receipt of dividends in eligible holdings, that is, in those stocks which were held in the portfolio over the ex-date for those relevant dividends. We have assumed that the proceeds of dividend payments (made on the actual payment dates) are invested into a cash management account that pays a competitive interest rate (we assume 5% per annum).

We then repeat this process over the 11-month period. Given we are using the GSJBW Large Industrial Stock Selection model, we can compare the performance of our portfolio to that of the S&P/ASX200 (ex-Property Trusts) as a benchmark.

As at the close of trade on the 31st of December 2005, the total value of the portfolio was $14,142.85, plus $309.17 from dividends earning interest in our cash management account, for a total of $14,452.02 and, hence, a raw pre-tax total return of 20.44% versus our initial $12,000 investment over 11 months. The same $12,000 notionally invested in the benchmark would have returned $14,038.50 – 2005 was a good year for the Australian market – a pre-tax total return of 16.99% and hence raw portfolio outperformance was 3.45% over the period[1].

It is interesting to note that in most months, three stocks in the portfolio were sold and bought (termed 'turning over' – refer Table Two), except in the last three months, in which only one or two stocks turned over. Ordinarily, 25% portfolio turnover per month would be considered a fairly high level. This is normally a concern because of the transaction costs that are involved, but this appears not to have been a significant issue for portfolio performance in this case, even having taken reasonable fees into account.

While the outperformance of the Quant portfolio relative to the market over this period is a favourable result, **the more important message to take away from this exercise is that market-like performance can be achieved with just a 12-stock portfolio based on key quantitative factors, even after accounting for all of the turnover issues that this strategy implies.**

An alternative to applying this strategy outright (as we have demonstrated in the backtest above) is to use the recommendations of the Quant model as an adjunct to portfolio construction. That is, rankings in the model – and movements thereof – can be good indicators of entry points into recommended equity exposures.

Table Two: Large Industrial Stock Selection Model – Historical Monthly Outputs

Rank	28-Feb-05	31-Mar-05	30-Apr-05	31-May-05	30-Jun-05	31-Jul-05	31-Aug-05	30-Sep-05	31-Oct-05	30-Nov-05	31-Dec-05
1	ASX	RIO	RIO	RIN	JHX	ALL	JHX	JHX	JHX	RIN	**RIN**
2	ALL	BHP	BHP	JHX	ALL	JHX	ALL	RIN	RIN	PPT	**ASX**
3	WES	BBG	RIN	ALL	RIN	ASX	RIN	CPU	PPT	JHX	**COH**
4	RIN	ALL	ALL	RIO	RIO	RIO	RIO	PPT	SHL	ASX	**JHX**
5	BBG	WES	BBG	WES	LEI	RIN	PPT	RIO	CPU	RIO	**PPT**
6	CBA	RIN	WOW	BHP	WES	LEI	CPU	SHL	RIO	ALL	**ALL**
7	ANN	UTB	WES	LEI	BBG	WES	SHL	UTB	ASX	TOL	**TOL**
8	LEI	CBA	WAN	ASX	WOW	BHP	LEI	COH	WOW	CPU	**BBG**
9	COH	COH	LEI	BBG	BHP	BBG	ASX	ASX	RMD	SHL	**RIO**
10	TOL	WOW	CML	WOW	SGB	COH	COH	TOL	TOL	COH	**CPU**
11	RIO	LEI	UTB	UTB	ANN	WOW	BHP	WOW	COH	MTS	**UTB**
12	CML	ASX	TOL	TEN	CBA	UTB	WOW	CML	ALL	WOW	**WOW**
Inclusions (as at each date shown above)		ANN TOL CML	CBA ASX COH	WAN TOL CML	TEN UTB ASX	CBA ANN SGB	UTB BBG WES	BHP LEI ALL	CML UTB	RMD	**BBG** **UTB**
Exclusions (as at each date shown above)		UTB BHP WOW	CML WAN TOL	JHX TEN ASX	SGB ANN CBA	ASX COH UTB	PPT CPU SHL	CML TOL UTB	ALL RMD	MTS	**SHL** **MTS**

[1] Note that performance figures are calculated as at 31 December 2005, but before incorporating the new model recommendations listed in both Tables One and Two as at that date.

GSJBW Model Portfolios

Income Portfolio

Commonwealth Bank of Australia	Rio Tinto
Westpac Banking Corporation	West Australian Newspapers
Australian Gas Light Company	Rural Press
St. George Bank	Alesco
Alinta	Foster's Group
Tabcorp Holdings	Hills Industries
Promina	Ten Network
Wesfarmers	Publishing & Broadcasting
Coca-Cola Amatil	Australand Holdings
Woolworths	
Macquarie Communications Infrastructure Group	

Source: GSJBW Research

Our changes to the Income Portfolio during December 2005:
Removed: Macquarie DDR Trust
Increased: Publishing & Broadcasting, Alinta, Hills Industries, Foster's Group, Australian Gas Light, Macquarie Communications Infrastructure Group

Income Portfolio Summary: Fiscal 2006 (*Please note, MCG and ALN excluded from the calculation of the EPS growth rate and PER)

Earnings per Share Growth	8.7%
Price to Earnings Ratio	15.2x
Average Yield	5.1%
Franking	86%

Source: GSJBW Research estimates

Defensive Portfolio

Commonwealth Bank of Australia	Publishing & Broadcasting
BHP Billiton	Tabcorp Holdings
Woolworths	Wesfarmers
St. George Bank	Australian Gas Light Company
Promina	Ramsay Health Care
Westpac Banking Corporation	Rinker Group
Origin Energy	Brambles Industries
Coca-Cola Amatil	Mirrabooka Investments
Macquarie Communications Infrastructure Group	Sonic Healthcare
Rio Tinto	
Australian Foundation Investment Company	
Foster's Group	

Source: GSJBW Research

Our changes to the Defensive Portfolio during December 2005:
Removed: Transurban, Macquarie DDR Trust
Increased: Tabcorp, Rinker, Wesfarmers, Mirrabooka Investments, Publishing & Broadcasting, Brambles, Australian Foundation Investment Company, Australian Gas Light Company

Defensive Portfolio Summary: Fiscal 2006 (*Please note, MCG excluded from the calculation of the EPS growth rate and PER)

Earnings per Share Growth	14.5%
Price to Earnings Ratio	15.2x
Average Yield	4.0%
Franking	90%

Source: GSJBW Research estimates

All figures or amounts stated in the table above are an estimate only and provided by way of illustration.

Actual figures or amounts may vary from those figures or amounts

Balanced Portfolio

BHP Billiton	News Corporation, Inc.
Commonwealth Bank of Australia	Alesco
Woolworths	Sonic Healthcare
St. George Bank	Computershare
Promina	Australian Gas Light Company
Westpac Banking Corporation	Healthscope
Origin Energy	Brambles Industries
Australian Foundation Investment Company	Billabong International
Coca-Cola Amatil	Wesfarmers
Rio Tinto	Rinker Group
Macquarie Communications Infrastructure Group	Publishing & Broadcasting
Axa Asia Pacific	

Source: GSJBW Research

Our changes to the Balanced Portfolio during December 2005:
No changes.

Balanced Portfolio Summary: Fiscal 2006 (Please note, MCG excluded from the calculation of the EPS growth rate and PER)

Earnings per Share Growth	17.5%
Price to Earnings Ratio	15.5x
Average Yield	3.7%
Franking	85%

Source: GSJBW Research estimates

Growth Portfolio

BHP Billiton	Computershare
Commonwealth Bank of Australia	Alinta
Woolworths	Salmat
St. George Bank	Billabong International
Origin Energy	Sonic Healthcare
Promina Group	Rinker Group
Australian Foundation Investment Company	Macquarie Airports
Rio Tinto	Symbion Health
News Corporation, Inc.	Brambles Industries
Healthscope	Toll Holdings
Alesco	Cochlear
Aristocrat Leisure	

Source: GSJBW Research

Our changes to the Growth Portfolio during December 2005:
Reduced: Healthscope
Increased: Symbion Health

Growth Portfolio Summary: Fiscal 2006 (*Please note, ALN and TCL excluded from the calculation of the EPS growth rate and PER)

Earnings per Share Growth	18.5%
Price to Earnings Ratio	16.0x
Average Yield	3.3%
Franking	94%

Source: GSJBW Research estimates

All figures or amounts stated in the table above are an estimate only and provided by way of illustration.
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GSJBW Recommendation Changes in December

STOCK	ASX CODE	SHORT-TERM Recommendation		LONG-TERM Recommendation	
		NEW	OLD	NEW	OLD
Seven Network	SEV	Marketperform	Underperform	No Change	Hold
Australian Agricultural Co.	AAC	Underperform	Marketperform	No Change	Hold
Macquarie Goodman Group	MGQ	Marketperform	Underperform	No Change	Hold
Iluka Resources	ILU	Underperform	Marketperform	No Change	Hold
Transpacific Industries	TPI	Marketperform	Outperform	No Change	Hold
Qantas Airways	QAN	Marketperform	Underperform	Hold	Sell

Source: GSJBW Research

Referred to in Document:

Company Name	Stock Code	Share Price (as at 31 Dec 2005)	Valuation	Short Term Recommendation	Long Term Recommendation
Australian Agricultural Co.	AAC	1.56	1.51	Underperform	HOLD
Australian Foundation Invest. Co.	AFI	1.60	1.60	N/A	HOLD
Australian Gas Light	AGL	17.19	12.70	Not Rated	Not Rated
Aristocrat Leisure	ALL	12.32	13.00	Outperform	BUY
Alinta	ALN	11.15	11.18	Outperform	BUY
Alesco	ALS	9.95	8.25	Marketperform	BUY
Australand	ALZ	2.07	1.83	Marketperform	BUY
Alumina	AWC	7.42	5.28	Marketperform	HOLD
AXA Asia Pacific	AXA	5.08	4.90	Marketperform	BUY
Billabong International	BBG	14.52	13.60	Outperform	BUY
BHP Billiton	BHP	22.75	17.31	Outperform	BUY
Brambles Industries	BIL	10.12	10.40	Outperform	BUY
Commonwealth Bank	CBA	42.75	39.70	Marketperform	HOLD
Coca-Cola Amatil	CCL	7.71	8.80	Marketperform	BUY
Colorado Group	CDO	4.14	5.65	Marketperform	HOLD
Connecteast Group	CEU	1.15	1.37	Marketperform	BUY
Cochlear	COH	45.73	45.21	Outperform	BUY
Computershare	CPU	6.79	6.20	Marketperform	BUY
Caltex	CTX	3.48	2.57	Underperform	HOLD
Foster's Group	FGL	5.58	6.10	Outperform	BUY
Hills Industries	HIL	4.88	4.30	Outperform	HOLD
Healthscope	HSP	5.61	5.37	Outperform	BUY
Iluka Resources	ILU	7.84	5.20	Underperform	HOLD
Lihir Gold	LHG	2.18	1.21	Outperform	BUY
JB Hi-Fi	JBH	4.03	4.10	Outperform	BUY
Macquarie Airports	MAP	3.17	3.53	Outperform	BUY
Macquarie Bank	MBL	68.15	67.40	Marketperform	HOLD
Macquarie Communications	MCG	5.68	6.71	Marketperform	BUY
Macquarie Goodman Group	MGQ	4.78	4.14	Marketperform	HOLD
Macquarie Infrastructure	MIG	3.56	4.05	Marketperform	HOLD
Mirrabooka Investments	MIR	3.56	4.05	N/A	HOLD
Mayne Pharma	MYP	2.54	2.39	Marketperform	HOLD
Multiplex	MXG	3.15	2.96	Underperform	SELL
Newcrest	NCM	24.30	9.60	Marketperform	BUY
News Corporation, Inc	NWS	22.80	26.50	Outperform	BUY
Origin Energy	ORG	7.51	7.15	Outperform	BUY
Oxiana	OXR	1.74	1.22	Outperform	HOLD
Oil Search	OSH	3.69	3.03	Outperform	BUY
One Steel	OST	3.35	3.36	Outperform	HOLD
Pacific Brands	PBG	2.66	3.00	Marketperform	HOLD
Publishing & Broadcasting	PBL	16.48	15.95	Marketperform	BUY
Promina	PMN	4.84	5.25	Marketperform	BUY
Paperlinx	PPX	3.84	3.80	Marketperform	SELL
Qantas Airways	QAN	4.04	3.74	Marketperform	HOLD
Ramsay Healthcare	RHC	9.50	9.22	Marketperform	HOLD
Rinker	RIN	16.45	15.91	Outperform	BUY
Rio Tinto	RIO	69.00	53.10	Outperform	BUY
Resmed	RMD	5.25	4.16	Marketperform	HOLD
Rural Press	RUP	11.35	9.20	Marketperform	HOLD
Seven Network	SEV	8.32	8.75	Marketperform	HOLD
St George Bank	SGB	29.66	28.58	Marketperform	HOLD
Sonic Healthcare	SHL	14.80	14.12	Outperform	BUY
Salmat	SLM	3.40	4.59	Marketperform	BUY
Symbion Health	SYB	3.53	3.15	Outperform	BUY
Tabcorp Holdings	TAH	15.57	17.30	Underperform	HOLD
Ten Network	TEN	3.16	3.30	Marketperform	HOLD
Timbercorp	TIM	3.00	3.30	Outperform	BUY
Toll Holdings	TOL	14.90	13.00	Marketperform	HOLD
Transpacific Industries	TPI	5.65	4.06	Marketperform	HOLD
Tattersall's	TTS	3.19	2.70	Marketperform	HOLD
West Australian Newspapers	WAN	8.26	8.10	Marketperform	HOLD
Westpac Banking	WBC	22.75	20.87	Underperform	HOLD
Wesfarmers	WES	36.97	36.13	Marketperform	HOLD
Woolworths	WOW	16.85	17.85	Outperform	BUY

Source: IRESS, GSJBW Research

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Recommendation Definitions

Short Term

Underperform (UP)	Stock is expected to underperform the S&P/ASX 200 on a 0-6 month timeframe
Marketperform (MP)	Stock is expected to perform in line with the S&P/ASX 200 on a 0-6 month timeframe
Outperform (OP)	Stock is expected to outperform the S&P/ASX 200 on a 0-6 month timeframe

Long Term

Sell (S)	Stock is expected to underperform the S&P/ASX 200 for beyond 6 months
Hold (H)	Stock is expected to perform in line with the S&P/ASX 200 for beyond 6 months
Buy (B)	Stock is expected to outperform the S&P/ASX 200 for beyond 6 months

Other Definitions

NR — Not rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or Goldman Sachs JBWere policies in circumstances when Goldman Sachs JBWere is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations

Research Criteria Definitions

The above recommendations are primarily determined with reference to the recommendation criteria outlined below. Analysts can introduce other factors when determining their recommendation, with any material factors stated in the written research where appropriate. Each criterion is clearly defined for the research team to ensure consistent consideration of the relevant criteria in an appropriate manner.

SHORT TERM (0-6 MONTHS)

Relative Earnings Outlook: Forward looking assessment of risk to consensus EPS estimates relative to estimated EPS risk across the market.

Earnings Revision: The percentage change in the current consensus EPS estimate for the stock (year 1) over the consensus EPS estimate for the stock 3 months ago. Stocks are rated according to their relative rank, effectively making it a market relative measure.

News Flow: The consideration of stock specific news flow, market and/or cyclical thematics and other issues such as index changes. Addresses two issues: (1) What is the potential news flow; and (2) What is the share price reflecting?

Relative Performance: Historic rolling 3 month performance versus the broader market. Stocks are rated according to their relative ranking.

Valuation Support: Considers a range of valuation methodologies, including discounted cash flow (DCF) valuation, PER, dividend yield and any other relevant measure.

LONG TERM (> 6 MONTHS)

Industry Structure: Based on Goldman Sachs JBWere industry structure ranking. All industries relevant to the Australian equity market are ranked, based on a combination of Porter's Five Forces of industry structure as well as an industry's growth potential, relevant regulatory risk and probable technological risk. A company's specific ranking is based on the proportion of funds employed in particular industry segments, aggregated to determine an overall company rating, adjusted to reflect a view of the quality of a company's management team.

EVA™ Trend: [1] EVA™ trend forecast for coming two years. Designed to reflect "turnaround stories" or to highlight companies Goldman Sachs JBWere analysts believe will allocate capital poorly in the estimated timeframe. (An ROE measure is used for insurance stocks in conjunction with an assessment of the strength of an insurer's balance sheet).

Growth Option: A qualitative and quantitative assessment of a company's long term growth options that the analyst believes should be considered and possibly recognised by the market.

Price:Base Case DCF: The premium or discount to base case DCF valuation at which the stock is trading relative to the average premium or discount across the market.

[1] *EVA™ is a registered trademark of the U.S. consultancy firm Stern Stewart*

For Insurers

Return On Equity: Rating taking into account the expected level and trend of ROE over the next two to three years.

Balance Sheet: Analyst's assessment of the quality and strength of the insurer's balance sheet, including conservatism of provisioning, sufficiency of capital, and quality of capital.

For REITs

EPU Growth: Ranking of Earnings Per Unit growth relative to other listed Real Estate Investment Trusts. Used instead of EVA™ Trend.

Strategy: Used instead of industry structure as many REIT investors are intra rather than inter sector focussed.

Yield: Yield relative to the REIT sector average. Used instead of Valuation Support.

For NZ Companies

Relevant Index: If a research report is published by the New Zealand affiliate of Goldman Sachs JBWere, the recommendation of a company or trust is based on their performance relative to the NZSX 40 Index (Gross) and not the S&P/ASX 200 index.

Distribution of Recommendations - As at 30 September 2005

Short Term	Overall	Corporate relationship* in last 12 months	Long Term	Overall	Corporate relationship* in last 12 months
Underperform	16%	13%	Sell	8%	6%
Marketperform	59%	59%	Hold	61%	58%
Outperform	25%	28%	Buy	31%	37%

* No direct linkage with overall distribution as the latter relates to the full GSJBW stock coverage (>200 companies). The above table combines the corporate relationships and recommendations of both Goldman Sachs JBWere Pty Ltd and its affiliate in New Zealand, Goldman Sachs JBWere (NZ) Limited.

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