

Private Wealth Management

Investment Strategy Bulletin

Australian Equities: Portfolio Strategy Review

31 July 2006

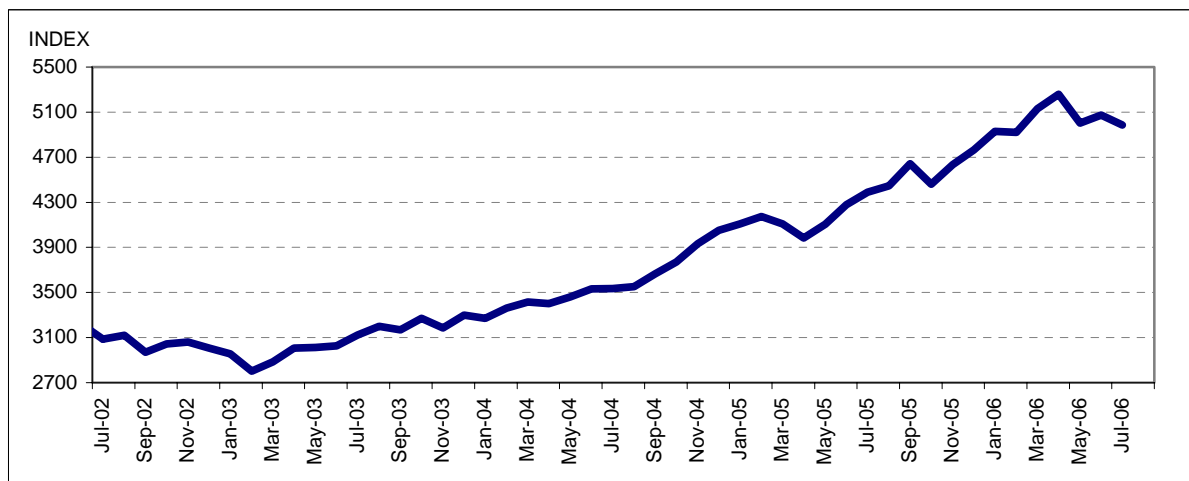
- The Australian equity market (S&P/ASX200) finished the month of July down 1.7% as investors' fears on rising global interest rates continued to trigger the sell-down of stocks with global exposure and those leveraged to US housing activity. Market volatility was further enhanced by the unstable political situation in the Middle East (and potentially higher oil prices).
- On the economic front, rising Producer Price Index (PPI) and Consumer Price Index (CPI) were the main features of the month. The Australian dollar strengthened, up 3.1%, whilst 10-year government bonds were sold off, with yields finishing at 5.85%.
- Materials, Healthcare and Consumer Staples underperformed relative to the market while utilities, Telecommunications and REITs had a solid performance, highlighting the marginal investor's focus on stocks with relatively defensive characteristics.

Accumulation Index Performance			
	1 Month	6 Month	12 Month
S&P/ASX 200	-1.7%	3.3%	18.7%
S&P/ASX 200 Industrials	-1.2%	3.0%	13.6%
S&P/ASX 200 Resources	-3.4%	4.5%	40.6%
S&P/ASX Small Ordinaries	-0.4%	6.0%	20.4%
Relative Index Performance to S&P/ASX 200			
Consumer Discretionary	0.4%	1.9%	-15.3%
Consumer Staples	-1.1%	1.3%	-7.6%
Energy	0.9%	-0.8%	11.9%
Financials	1.1%	1.5%	1.1%
Health Care	-2.0%	-1.7%	-0.6%
Industrials	1.4%	-3.4%	-11.4%
Information Technology	0.1%	5.2%	0.7%
Materials	-3.4%	-1.3%	15.0%
REITs	4.4%	7.2%	-0.1%
Telecommunications	4.9%	-8.3%	-38.5%
Utilities	5.4%	2.0%	6.9%

Source: GSJBW Research, IRESS

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

(July 2002 – July 2006)



Source: IRESS

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Company Performance: Best and Worst Performing Large-Cap Equities

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

Best	% Change	Worst	% Change
Leighton Holdings	11.1%	Rinker Group	-16.7%
PaperlinX	10.3%	DCA Group	-14.0%
Multiplex Group	9.2%	Bluescope Steel	-13.8%
Australian Gas Light	8.6%	Ansell	-13.2%
QBE Insurance Group	7.6%	Harvey Norman	-12.9%
Fairfax (John) Holdings	6.7%	Sonic Healthcare	-11.1%
Iluka Resources	6.4%	AWB	-10.9%
Westfield Group	6.2%	Babcock & Brown	-10.8%
DB RREEF Trust	5.8%	Macquarie Bank	-10.4%
Mayne Pharma	5.8%	Newcrest Mining	-9.1%

Source: IRESS

Significant Company/Economic News

Base Metals & Resources

Analysts: Ian Preston, Neil Goodwill

❑ **BHP Billiton (BHP): Short Term Outperform; Long Term Buy**

Share Price as at 31/07/06: A\$27.77; Valuation: A\$25.61

❑ **Rio Tinto (RIO): Short Term Outperform; Long Term Buy**

Share Price as at 31/07/06: A\$74.36; Valuation: A\$53.35

❑ **Zinifex (ZFX): Short Term Outperform; Long Term Buy**

Share Price as at 31/07/06: \$10.55; Valuation: \$10.34

Several companies released their production reports for the quarter ending June 30 during the month. The most common themes were cost pressures continuing to flow through and production coming either in line or below market expectations. In the current environment, most production reports fail to surprise on the upside as mining companies continue to face significant capital and operating cost increases while operating at or near full capacity. Zinifex reported lower quarterly revenue due to weaker lead production than most in the market expected and increased exploration charges. Similarly, production reports for diversified resources giants, BHP Billiton and Rio Tinto, were somewhat mixed – some key areas were in line with consensus (e.g. iron ore) whilst others disappointed.

Healthcare

Analyst: Hamish Tadgell

❑ **Sonic Healthcare (SHL): Short Term Marketperform; Long Term Hold**

Share Price as at 31/07/06: \$12.63; Valuation: \$14.07

❑ **Healthscope (HSP): Short Term Marketperform; Long Term Hold**

Share Price as at 31/07/06: \$3.90; Valuation: \$4.56

Sonic underperformed the market (in line with most healthcare stocks) in the last four to five months. The de-rating of the overall sector was driven by market concerns on slowing revenue growth, cost pressures, integration risk due to acquisitions and potential changes to government price controls (which may impact margins for pathology businesses such as Sonic). As part of a consortium, Healthscope was appointed sole provider of community pathology services in the Auckland region from 1 July 2007, effectively winning the tender from Sonic, the incumbent provider. For Sonic, the contract loss is equivalent to approximately \$65m in revenue per annum and sparked further selling pressure of the stock as the market evaluates the longer term growth expectations and appropriate rating for the stock and pathology businesses generally. Sonic was down 11% in July whilst Healthscope was flat.

Excel Coal (EXL)

Analyst: Neil Goodwill

❑ **Investment View: Short Term Marketperform; Long Term Hold**

Share Price as at 31/07/06: \$8.75; Valuation: \$6.82

Peabody Energy, a company listed on the New York Stock Exchange, made a cash offer of \$8.50 per share for EXL, valuing the company at ~\$1.83 bn. The Excel Board believes the offer is in the best interests of shareholders and in the absence of a superior proposal, the Directors unanimously recommend the offer. EXL was up 8.4% for the month.

Building Materials

Analyst: Matthew McNee

- **Rinker (RIN): Short Term Outperform; Long Term Buy**
Share Price as at 31/07/06: \$13.17; Valuation: \$19.51
- **James Hardie Industries N.V. (JHX): Short Term Marketperform; Long Term Hold**
Share Price as at 31/07/06: \$7.00; Valuation: \$9.82

Building and construction material companies remained in negative territory during the month as fears about the length and extent of a housing slowdown in the US combined with an upward-biased interest rate environment globally continued to impact sentiment: Rinker (-16.7%) and James Hardie (-9.1%) finished lower. Rinker's strong fourth quarter sales result and management reconfirming fiscal 2007 guidance failed to provide support to the stock, given the market's focus on the company's exposure to US housing activity. In other news, the company announced an on-market share buy-back of 45 million shares, equivalent to ~5% of Rinker's total issued capital (commencing August 18).

Retail

Analyst: Phillip Kimber

- **Woolworths (WOW): Short Term Outperform; Long Term Buy**
Share Price as at 31/07/06: \$19.04; Valuation: \$20.15
- **Coles Myer (CML): Short Term Marketperform; Long Term Hold**
Share Price as at 31/07/06: \$11.37; Valuation: \$11.82

WOW's fourth quarter sales result was solid, driven mainly by continuing momentum in the Food & Liquor businesses in Australia/NZ. Further, management indicated that the integration of the NZ Supermarkets (acquired from Foodland in April 2005) is on track. Nonetheless, the stock ended the month 5.5% lower driven by the market's concerns on the long term growth potential of the company. WOW's nearest competitor, CML, announced new strategic initiatives, involving the integration of Coles, BI-LO, Liquor, Coles Express and Kmart under the banner 'Coles brand', capex spend of ~\$1.2bn in fiscal 2007 for new and refurbished stores as well as the change in name from Coles Myer to Coles Group Limited. CML will also take a provision of \$300m against its fiscal 2006 earnings to "largely cover the cost of strategic initiatives". The stock ended the month flat as the market weighed the significant capital expenditure, provisioning and restructuring associated with the new initiatives.

Media

Analyst: Christian Guerra

- **Fairfax (John) Holdings (FXJ): Short Term Marketperform; Long Term Hold**
Share Price as at 31/07/06: \$4.00; Valuation: \$4.10
- **Southern Cross Broadcasting (SBC): Short Term Marketperform; Long Term Hold**
Share Price as at 31/07/06: \$11.54; Valuation: \$11.45

During the month, the government announced its proposed reforms to the media industry. The proposal includes plans to relax the current restrictions on cross-media ownership as well as the removal of the existing foreign ownership restrictions. In addition, the government aims to promote new digital broadcast services by implementing a Digital Action Plan to drive the take up of digital television and assist the transition from analogue to digital services. The prospect that media reform may actually proceed was positively taken by the market. FXJ (+6.7%) and SBC (+9.9%) finished the month strongly as the market saw the two companies as the most likely targets in the event of any corporate activity within the sector.

Economics

Analyst: Tim Toohey

- **Domestic Inflation**

The Consumer Price Index (CPI) increased by 1.6% in the June quarter, easily exceeding consensus expectations for a rise of 1.0%. At 4.0% year-on-year, the CPI is 1% point above the top of the RBA's 2-3% target band. As a result, the market is now expecting the RBA to increase the cash rate by a further 25bp to 6% at its August meeting. Table One highlights the steep increase in inflation in the June half from the previous half.

Table One

	Consumer Price Index (CPI)	
	Dec Half 05	Jun Half 06
Total	1.3%	3.0%
Ex-volatile items	1.0%	1.4%
Tradeables	1.2%	3.5%
Non-tradeables	1.6%	1.7%
Trimmed Mean	1.1%	1.7%

Source: ABS

Australian Equities: Key Issues for Portfolio Strategy

- From early 2005, a buoyant global economy combined with a still generous interest rate environment (i.e. plenty of liquidity) to encourage investors (and companies via M&A activity) to take on more risk. Accordingly, growth assets significantly outperformed defensive assets. Through early 2006, the hunger for risk spilled over into 'high beta' areas such as commodities and emerging markets. Over recent months, this hunger has obviously tempered. While global economic conditions (and company profitability) have remained healthy, the uptrend in global interest rates has finally reached a point (more-so in the US) where it is impacting economic performance, the valuation of financial assets and how investors feel. At this stage, we remain confident that the global economy will continue to perform relatively well into 2007 and 2008. The marginal global investor, however, is likely to favour a more risk-averse approach over the next 6-12 months.
- While we remain very comfortable that the basic fundamentals for global equity markets are sound, performance is likely to be more subdued and volatility more pronounced as investors confront an environment of slowing economic growth, persistent inflation risks and tighter liquidity conditions. The US economy has stepped down a gear or two as the correction in residential construction gathers momentum and households respond to softer house prices via a more circumspect approach to cashing-in home equity. This outlook should ensure that the US Federal Funds Rate has peaked at 5.25% – although Goldman Sachs Research feel there will be one final rate rise. Looking beyond the US, we believe the 'policy normalization' has further to run and that the general level of global interest rates is still low relative to the current strong nominal economic environment. The uptrend in global rates will continue through 2006 and, potentially, into the medium term. For the past two years, the US has led this process. Leadership is now shifting to Japan, China and Europe.
- So far in 2006, household spending in Australia is showing renewed vigor – a reflection of supportive financial conditions. We are increasingly confident that economic growth will exceed consensus expectations in 2006 and FY07. If this occurs, however, it will imply that little has been gained in terms of resolving the structural imbalances/inflationary risks that overhang the economy. Accordingly, Australia remains locked into a scenario where economic strength will be immediately accompanied by higher interest rates. GSJBW Research expects production (GDP) to expand by 3.6% in FY07.
- Despite the May rate increase, 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 is tracking sideways, income tax cuts are now flowing through, state governments are finally addressing infrastructure shortfalls and asset prices are healthy. Thus, we believe that further monetary tightening will be required (the cash rate is currently 5.75%). Another rate increase is likely in early August with the risks tilted towards at least one further increase after that.
- In our April report, we stated that ASX300 Industrials were "expensive". While the valuation picture has subsequently improved, we believe it remains well-short of being attractive. The strong performance of the industrials over the past year has been driven by P/E expansion rather than earnings upgrades. The justification for the re-rating is not immediately evident, particularly in light of the step-up in global and domestic interest rates. Although we find valuations demanding, material price weakness requires material profit disappointment and while rising interest rates and cost pressures point to potential problems in 2007 and beyond, corporate news flow should remain supportive over the next six months. The August Reporting season will be a critical test of this conclusion.
- Despite the recent correction in some commodities, the earnings revision risk for the major resource stocks remains biased to the upside as current prices continue to track well-above market expectations. This process has now been going for three years, supported of late by further evidence of tangible supply constraints. As noted above, however, the 'global policy normalisation' process is now at a point where it will be a drag on economic activity. The market has begun to digest this fact over recent months. As such, investors with a large resources exposure need to appreciate that a typical cycle is brewing and that periods of fervor – such as we saw through early 2006 – represent an opportunity to take some profit.
- Consistent with our view that the market is still fully valued, we are finding it difficult to identify stocks that offer compelling absolute value. Within the large-cap defensive universe **Macquarie Communications Infrastructure Group, Australian Infrastructure Fund, ConnectEast Group and Promina Group** provide the best relative value. The major banks have performed strongly over recent months and despite the recent pull-back valuations still look very full – particularly versus global peers. Globally exposed stocks we recommend accumulating during periods of market weakness – **Brambles Industries, QBE Insurance, BHP Billiton, Aristocrat Leisure** and **AXA Asia Pacific**. Sentiment toward the US housing cycle is deteriorating sharply – a reassessment that is likely to continue over the next 2-3 months. We are comfortable building a position in **Rinker Group** through this period.

GSJBW Market Forecasts:

As at 31/07/2006	Price Earnings Ratio (PER)			Earnings Per Share Growth (%)			Dividend Yield (%)		
	FY05	FY06E	FY07E	FY05	FY06E	FY07E	FY05	FY06E	FY07E
S&P/ASX 300	17.8x	14.3x	13.5x	28.5	24.7	6.9	3.6	4.0	4.2
S&P/ASX 300 Industrials	17.5x	16.1x	14.9x	12.1	9.0	7.9	4.3	4.7	4.9
S&P/ASX 300 Resources	18.4x	11.8x	11.2x	79.4	57.3	5.3	2.2	2.6	2.9

Source: GSJBW Research estimates

Portfolio Management: Building Positions

Aristocrat Leisure (ALL)

Analyst: Ashwini Chandra

□ Investment View: Short Term Outperform; Long Term Buy

□ Share Price as at 31/07/06: \$12.06; Valuation: \$15.35

Year End December	2006 Estimate	2007 Estimate	2008 Estimate
Net Profit (\$m)	247.7	340.2	420.0
EPS Growth (%)	4.1	39.4	12.5
PER (x)	22.5	16.2	12.9
Yield (%)	2.9	4.0	5.1

Source: GSJBW Research estimates

Within the Australian equity market, we believe Aristocrat remains a high quality exposure for private investors to have. Indeed, the company is a leader (and as such, has strong pricing power) in an industry that competes mainly on product performance. In our view, Aristocrat has significant earnings leverage potential from expanding the recurring revenue model, which management successfully rolled out into the US, into new markets. In addition, it has potential growth options in regions like Russia and Latin America as well as margin expansion in the Australian business driven by increased software sales. From a longer term perspective, we see growth opportunities in the US as more states legislate to allow slot machines.

Aristocrat's cash flow generation continues to be strong and its balance sheet remains robust – the business generates return on capital employed (ROCE) in excess of 50% and return on equity (ROE) above 70%. The company will continue to pay dividends (payout ratio of ~60-70%) to the extent that they can be fully franked. Nonetheless, given the company's strong balance sheet position, we believe that management will maintain regular capital management programs. We note that the company is currently undertaking an on-market buyback of ~\$100m.

There has been a recent spate of earnings downgrades by analysts across the in market light of difficult conditions in Japan. As such, we are comfortable that the recent share price weakness represents a base, and we remain very comfortable with Aristocrat leading into the result. We highlight that Aristocrat's solid cash flow generation, strong earnings profile and diversified earnings stream are key reasons why we believe Aristocrat deserves to trade at a premium to the market. Given the stock is trading at a 21% discount to our DCF valuation, we remain comfortable for long term investors to accumulate the stock at current levels and into market weakness.

Singapore Telecommunications (SGT)

Analyst: Christian Guerra

□ Investment View: Short Term Marketperform; Long Term Buy

□ Share Price as at 31/07/06: A\$2.14; Valuation: A\$2.35

Year End March	2006 Estimate	2007 Estimate	2008 Estimate
Net Profit (\$m)	2695.8	2720.0	2754.6
EPS Growth (%)	13.3	3.4	15.3
PER (x)	14.8	14.3	12.4
Yield (%)	3.8	3.9	4.3

Source: GSJBW Research estimates

We recently initiated coverage on SingTel (SGT) with a long term Buy recommendation. SGT is our preferred long term exposure within the large-cap telecommunications sector. The company comprises of two core businesses (Singapore and Optus) and a portfolio of equity-accounted investments in Asia. The key driver behind our positive investment case is that unlike many of its peers, SGT has genuine growth opportunities via its associates. On our estimates, SGT's Associate businesses will generate over 130% of the company's net profit from fiscal 2006 to fiscal 2009.

SGT's most important Associates are Telkomsel (Indonesia, SGT's equity ownership 35%), Bharti (India, 30.5%), AIS (Thailand, 21.4%) and Globe (Philippines, 44.6%). These four businesses are the #1 or #2 ranked mobile player (by market share) in their respective markets. Mobile penetration in these countries is low. For example, Indonesia's mobile penetration is ~20% while in India it is ~9%. SGT's associate businesses are enjoying significant growth in sales and profits as penetration grows. Further, SGT has an under-gearred balance sheet (we estimate net debt/equity of ~25% and interest cover of ~8x), which should provide scope for SGT to continue pursuing strategic opportunities (e.g. acquisitions or further investment in existing Associates) or capital management initiatives.

We believe the stock is unlikely to outperform in the short term due to the following reasons: (1) concerns over competition, particularly in Australia; and (2) currency risk largely from a weaker Indonesian rupiah. However, given the stock's earnings growth profile, long term growth prospects and relatively cheap valuation; we remain comfortable investing into SGT on a long term view.

For further information on this publication please contact your Goldman Sachs JBWere adviser.

Portfolio Management: Infrastructure Exposure

Macquarie Infrastructure Group (MIG) is now trading ex-entitlement to Sydney Roads Group (SRG) following the recent de-merger of its mature Sydney toll roads. We have taken this opportunity to undertake a detailed review of the remaining MIG business, its cash position, implications of its distribution policy and operating outlook. In the short term, we believe the risk/return equation for the remaining MIG business remains unattractive despite the recent share price weakness. Accordingly, we have downgraded our short term recommendation to Underperform (from Marketperform).

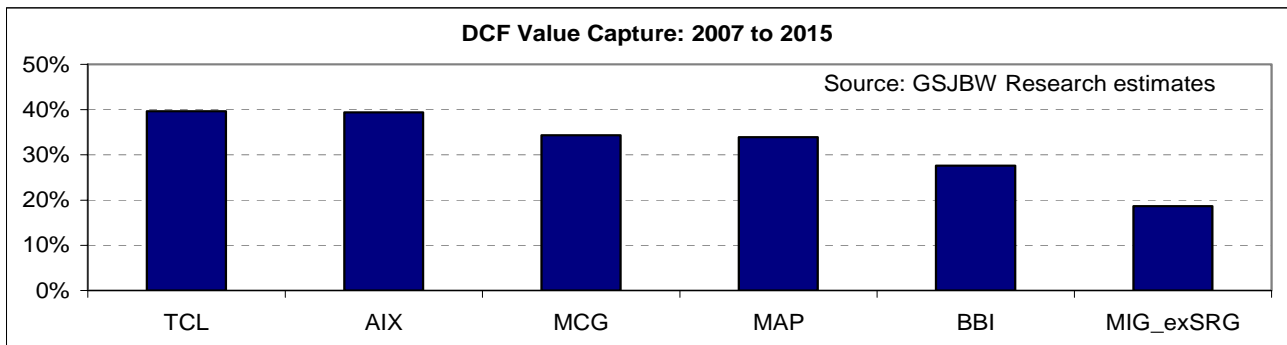
Our negative investment case for MIG is driven by the following factors:

- MIG is trading on a 7.4% fiscal 2007 yield, however, given the lack of free cash flow, short term distributions are effectively capital returns which are reliant on the use of re-financings for funding.
- Based on our estimates, MIG is free cash flow negative until 2010.
- The outlook for traffic on the majority of MIG’s roads remains weak due to various roadworks being undertaken, and there is the possibility of greater demand sensitivity to upcoming toll increases and the potential for a lagged impact of sustained high fuel prices.
- We also retain our view that MIG has considerable acquisition risk if it continues to aggressively bid for acquisitions in an increasingly competitive environment for infrastructure assets, particularly toll roads.

Valuation – Different Perspectives

Figure One highlights that MIG does not compare well with its peers when looking at how much of the value investors receive in the next 9 years, as a percentage of our Discounted Cash Flow (DCF) valuation. The majority of the group’s value is generated beyond this period – reflecting the aggressive gearing in place and its effect on the assets’ ability to generate cash in excess of the debt servicing requirements, particularly in the early years. As a result, investors are paying for the ‘long term’ value of MIG. However, we are of the view that the value beyond this period is at far greater risk given the potential for forecasting error beyond 10 years, as well as the potential for material changes to prevailing economic conditions, petrol prices or driving habits.

Figure One



We have undertaken a standard DCF valuation of MIG Group’s cash flows comprising of 10 years of explicit cash flows and then a perpetuity value, in addition to using a perpetuity growth assumption of inflation (2.5%). The DCF value we calculated was \$1.81/security vs. \$3.10 under our current MIG DCF where we explicitly forecast every year of cash flow. The key difference being that we assume higher growth (~4%) in the cash flows forecast in our current MIG DCF. Whilst we are not suggesting that forecasting explicit cash flows is an incorrect approach or that we believe MIG will only achieve 2.5% growth in FCF beyond 2016, it does demonstrate how much of the value in our DCF (and those of the market) is being attributed to the period beyond the next 10 years. Furthermore, it highlights the sensitivity of MIG’s valuation to a fairly minor reduction in the long term growth outlook for the business.

Our preferred exposures within the infrastructure sector are: **Macquarie Communications Infrastructure Group (MCG)**, **Australian Infrastructure Fund (AIX)** and **Connecteast Group (CEU)**.

REITs Update

The REIT sector in Australia is a mature industry and over time the valuation metrics applied to ranking stocks have adapted and changed to recognise fundamental movements in the composition of the earnings, particularly post the introduction of the Stapled security. Other key changes involve the inclusion of a significant percentage of foreign assets (>35%), the rise in gearing, an increase in financial structuring and the introduction of more company-style earnings streams such as funds management, development and construction margins and facilities management.

We have relaunched our REIT sector coverage by ranking the top 11 stocks (refer Table Two). All valuations are an average of our two methods - Dividend Discount and Sum-of-the-Parts. We have retained the use of Dividend Discount Model (DDM) that we apply to overall group distributions (valuing the price of a stock by using predicted dividends and discounting them back to present value), regardless as to whether the entity is externally managed or a stapled security. Our secondary Sum-of-the-Parts valuation technique combines a mark-to-market of the Trust portfolios (current market value rather than its book value) with an Earnings Multiple valuation approach for the Corporation. There are some nuances in this technique including adjustments for portfolio quality and size, adjusting for the stamp duty benefits of a listed entity, as well as adjustments based on the development pipeline and potential for accretive acquisitions.

Table Two

Rank	Company Name	Stock Code	Recommendation		Valuation	Price
			Short Term	Long Term		
1	Westfield Group	WDC	Outperform	Buy	\$19.12	\$18.40
2	CFX Retail Property Trust	CFX	Marketperform	Buy	\$1.97	\$1.86
3	Multiplex Group	MXG	Outperform	Buy	\$3.45	\$3.57
4	GPT Group	GPT	Marketperform	Buy	\$4.34	\$4.52
5	Stockland	SGP	Marketperform	Hold	\$6.85	\$6.84
6	Investa Property Group	IPG	Marketperform	Hold	\$2.15	\$2.29
7	DB Reef Trust	DRT	Marketperform	Hold	\$1.46	\$1.55
8	Mirvac Group	MGR	Marketperform	Hold	\$4.31	\$4.27
9	Centro Properties Group	CNP	Marketperform	Hold	\$6.38	\$6.94
10	Macquarie Office Trust	MOF	Underperform	Hold	\$1.32	\$1.37
11	Macquarie Goodman Group	MGQ	Marketperform	Sell	\$5.00	\$5.97

Source: GSJBW Research estimates

We have selected Westfield Group (WDC) and CFX Retail (CFX) as the top two picks, given the high quality exposure to retail assets and opportunities for significant accretive redevelopment, along with trading at discounts to valuation. WDC also has the added attraction of an underleveraged Funds Management platform.

Mirvac (MGR) is slowly making the move towards Funds Management. However, in the short term it is more leveraged to a turnaround in NSW residential and Sydney office markets. We anticipate some improvement in both markets over fiscal 2007, though upside is largely reflected in the current share price.

We suggest some stocks that may prove laggards for the rest of the year include Centro (CNP), Macquarie Office (MOF) and Macquarie Goodman (MGQ). CNP has an unparalleled track record of delivering above market growth per share; although we believe funds under management expansion is currently fully priced. MOF should benefit from the improving US office market conditions, particularly in its key market of Southern California. However, the key negative focus continues to be the amount of financial structuring, particularly on the currency, which can revert sharply in future years. MGQ has delivered a stellar total return YTD, though our analysis suggests the price has overshot an acceptable risk-adjusted valuation, despite the strong track record of the company. Its growing development earnings stream is a positive for the bottom line, though this type of income is more volatile than funds management earnings, and the difference is not being reflected in the price.

Review of the Managed Investment Scheme (MIS) Industry

We have downgraded our view on the managed investment scheme (MIS) industry. We are of the view that both the economic model and industry structure of MIS is unsustainable. We expect that both industry and government intervention will reduce the appeal of future projects, leading to lower growth and profitability. Additionally, although the listed companies in the industry have already experienced underperformance in the past month, we believe that the equity and debt markets will continue to de-rate the industry.

Our negative view is a consequence of the numerous reasons detailed below, specifically:

1. Disparity between returns – the rate of return investors in these schemes receive is disproportionately less than the commission rates paid to financial planners and the margins received by the largest MIS companies
2. Reliance on tax saving driving the investment decision – This has become the driving force of the industry. That is, the tax incentives have effectively created “needs based” investing vs. “allocation based investing”
3. Reliance on unsustainable commissions to financial planners to drive sales –we expect the MIS industry to self regulate, with a likely targeted commission cap of 5% vs. current commission rate averaging between 8-15%
4. Rising interest rates and their potential to dampen new sales
5. Reduction in personal tax rates –may reduce the attractiveness of MIS
6. Increased sophistication of investors – risk is that they will make more informed comparisons of returns among various alternative asset classes
7. Ongoing changes to superannuation – increases the attractiveness of this investment structure as a way to minimise tax
8. Legislation on the deductibility cap for forestry projects – will also reduce the attractiveness of MIS (proposed deductibility cap of \$6,500 for forestry projects versus the approximately \$9,000 cost)
9. Argued inequality of tax advantages – most notably the 12-month prepayment rule in forestry
10. Structural advantages MIS companies are afforded in both forestry and horticulture – given the MIS investors achieve close to full tax deductibility due to total costs being expenses with no capital outlay (investors do not buy the land) while the existing farmers are disadvantaged given their current position of owning the land
11. Uncertainty surrounding achievable yields on some projects – We believe the 12-month rule has encouraged MIS companies to “land grab” to satisfy investor demand, and is now resulting in some MIS companies investing in very marginal areas unlikely to generate adequate economic harvest yields
12. Uncertainty surrounding economic viability of a second rotation – As a consequence of this “land grab”, our expectations are that a number of the MIS forestry sites will not be economic for second rotation
13. The sustainability of the investor deductions with the ATO – Currently the ATO accepts MIS investor deductions of \$9,000 (the cost of the MIS Timber project) against the true real world plant-able hectare cost of \$2,500. The difference represents the MIS companies gross margin which allows them to subsequently invest in excess land banks etc for future sales or investor yield top-ups
14. The potential glut of MIS commodities in end markets
15. The risk of the MIS companies moving into commodities not suitable for large scale harvesting
16. The general very poor visibility for all participants involved – particularly for investors returns for existing projects
17. The groundswell of protest amongst the farming and agricultural lobby groups – regarding the speed of the MIS rollout, and the ramifications in rural areas.

Stock Selection Using Quantitative Techniques

Continuing on from last month’s theme, in which we reviewed the quantitative screens run by GSJBW Quantitative Research that provide insight into the reporting season, we thought it timely to review signals that might help indicate earnings surprise during the period. The team found that upon measuring two signals of uncertainty, the results have provided an impressive indicator of both earnings surprise and price reaction. Two complementary measures of uncertainty (fundamental and market) were examined to help highlight opportunities and also manage portfolio risk in the upcoming season.

By examining *fundamental uncertainty*, the team looked at the spread of analyst earnings forecasts and inferred that the higher the spread of forecasts the greater the degree of uncertainty in the future fundamentals of the company. The second signal was *market uncertainty* and how the volatility pattern of stocks in the lead up to the season provides an indication into the level of uncertainty by market participants.

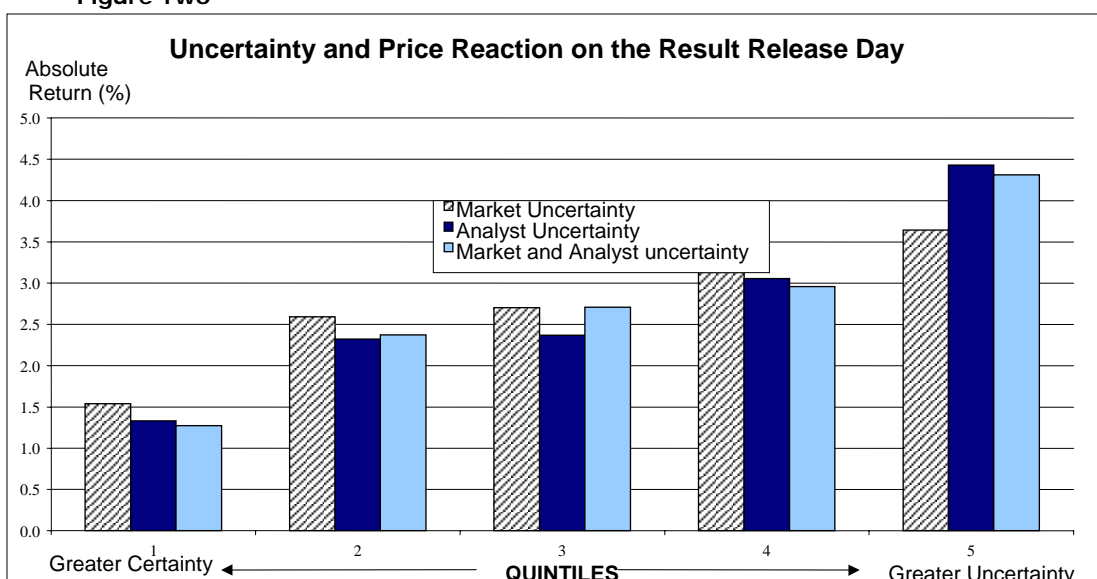
Testing this uncertainty signal over the past ten reporting seasons highlights that it has been a strong indicator. To test the signal, stocks covered by GSJBW Research were ranked into quintiles prior to the start of reporting season under both ‘fundamental’ and ‘market’ uncertainty measures. Stocks classified into the 4th and 5th quintiles offer a high degree of uncertainty whilst those in the other three offer greater confidence in reported results.

Interestingly, in relation to *earnings surprise*, the stocks with greater uncertainty have produced earnings surprise seven times the size of stocks rated with greater certainty. For the *price reaction* measure, while it highlights that ‘greater uncertainty’ stocks report the largest earnings surprise, the more interesting test is the market’s reaction to the stocks that have been classified as containing greater certainty (those in the 1st and 2nd quintiles) and greater uncertainty (4th and 5th quintiles) – refer Figure Two. As shown in Figure Two, the average absolute price reaction differential on the day of the result is 300 bp (4.3% for uncertain stocks and 1.3% for more certain stocks). These are very favourable results and have held the test of time over the last ten seasons. The return differential increases to 600 basis points over the subsequent six days.

We highlight that investors need a high degree of conviction to invest in the following stocks, given the greatest amount of uncertainty (both downside and upside leverage) in their upcoming result:

- Industrials: HWI, RCL, TOL, BKN, MGW, TPI, SEK, IRE, AXA, SEV and RIN.
- Resources (feature heavily given recent earnings revisions and commodity price sensitivity): AWE, BDG, LHG, MRE, NCM, OXR, PMM, ROC and ZFX.

Figure Two



Source: GSJBW Research estimates, IRESS

GSJBW Model Portfolios

Income Portfolio

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

Source: GSJBW Research

Our changes to the Income Portfolio during July 2006:

Reduced: Coca-Cola Amatil

Increased: Alesco Corporation

Removed: Australand Property Group**

Added: David Jones

Income Portfolio Summary: Fiscal 2007 (*Please note, MCG excluded from the calculation of the EPS growth rate and PER)

Earnings per Share Growth	5.0%
Price to Earnings Ratio	14.8
Dividend Yield	5.3
Franking	86%

Source: GSJBW Research estimates

** GSJBW Investment Research has recently suspended coverage of Australand Property Group. For compliance reasons, we have removed the stock from the portfolio.

Defensive Portfolio

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

Source: GSJBW Research

Our changes to the Defensive Portfolio during July 2006:

Reduced: Coca-Cola Amatil, Sonic Healthcare

Increased: Rinker Group, Australian Gas Light Company

Removed: Australian Foundation Investment Company

Added: Australian Infrastructure Fund

Defensive Portfolio Summary: Fiscal 2007 (*Please note, MCG excluded from the calculation of the EPS growth rate and PER)

Earnings per Share Growth	7.0%
Price to Earnings Ratio	14.9x
Average Yield	4.1%
Franking	86%

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	Brambles Industries
Woolworths	Origin Energy
Commonwealth Bank of Australia	Publishing & Broadcasting
Macquarie Communications Infrastructure Group	Rio Tinto
National Australia Bank	Computershare
Promina Group	News Corporation, Inc.
Rinker Group	Sonic Healthcare
St. George Bank	Billabong International
Australian Gas Light Company	Healthscope
Aristocrat Leisure	Wesfarmers
Alesco Corporation	
AXA Asia-Pacific Holdings	

Source: GSJBW Research

Our changes to the Balanced Portfolio during July 2006:

Reduced: Origin Energy, Commonwealth Bank of Australia, Sonic Healthcare

Increased: Promina Group, Rinker Group, Alesco Corporation, Macquarie Communications Infrastructure Group

Removed: Coca-Cola Amatil, Australian Foundation Investment Company

Added: Aristocrat Leisure

Balanced Portfolio Summary: Fiscal 2007 (Please note, MCG excluded from the calculation of the EPS growth rate and PER)

Earnings per Share Growth	23.3%
Price to Earnings Ratio	15.2x
Average Yield	3.9%
Franking	82%

Source: GSJBW Research estimates

Growth Portfolio

BHP Billiton	News Corporation, Inc.
Woolworths	Sonic Healthcare
Rinker Group	Australian Foundation Investment Company
National Australia Bank	ConnectEast
St. George Bank	Publishing & Broadcasting
Aristocrat Leisure	Alinta
Brambles Industries	Billabong International
Origin Energy	Healthscope
Promina Group	Macquarie Capital Alliance Group
Rio Tinto	Symbion Health
Alesco Corporation	Cochlear
Computershare	

Source: GSJBW Research

Our changes to the Growth Portfolio during July 2006:

Reduced: Woolworths, Origin Energy, Billabong International, Sonic Healthcare, News Corporation, Inc

Increased: ConnectEast, Promina Group, Rinker Group, Aristocrat Leisure

Removed: Macquarie Airports

Added: Macquarie Capital Alliance Group

Growth Portfolio Summary: Fiscal 2007 (*Please note, ALN excluded from the calculation of the EPS growth rate and PER)

Earnings per Share Growth	10.0%
Price to Earnings Ratio	15.4x
Average Yield	3.5%
Franking	84%

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

GSJBW Recommendation Changes in July

STOCK	ASX CODE	SHORT-TERM Recommendation		LONG-TERM Recommendation	
		NEW	OLD	NEW	OLD
Kimberley Diamond	KIM	Marketperform	Underperform	-	HOLD
Perseverance Corporation	PSV	Underperform	Marketperform	-	HOLD
Macquarie Infrastructure Group	MIG	Underperform	Marketperform	-	HOLD
Timbercorp	TIM	Underperform	Outperform	HOLD	BUY
Ramsay Healthcare	RHC	Outperform	Marketperform	-	HOLD
Westfield Group	WDC	Outperform	Marketperform	BUY	HOLD
Metcash	MTS	Marketperform	Outperform	-	BUY
Transpacific Industries Group	TPI	Marketperform	Not Rated	HOLD	NR
Multiplex Group	MXG	Outperform	Underperform	BUY	SELL
Investa Property Group	IPG	Marketperform	Underperform	-	HOLD
Centro Properties Group	CNP	Marketperform	Outperform	HOLD	BUY
Smorgon Steel Group	SSX	Not Rated	Outperform	NR	HOLD
Envestra	ENV	Marketperform	Underperform	-	HOLD
Sonic Healthcare	SHL	-	Marketperform	HOLD	BUY
Felix resources	FLX	-	Marketperform	HOLD	SELL
Macquarie Goodman Group	MGQ	-	Marketperform	SELL	HOLD
Macquarie Office Trust	MOF	-	Underperform	HOLD	SELL
Stockland	SGP	-	Marketperform	HOLD	BUY
DB RREEF Trust	DRT	-	Marketperform	HOLD	SELL

Source: GSJBW Research

GSJBW Initiation of Coverage in July

STOCK	ASX CODE	SHORT-TERM Recommendation		LONG-TERM Recommendation	
		NEW	OLD	NEW	OLD
Singapore Telecommunications	SGT	Marketperform	-	Buy	-

Source: GSJBW Research

GSJBW Suspension of Coverage in July

STOCK	ASX CODE	SHORT-TERM Recommendation		LONG-TERM Recommendation	
		NEW	OLD	NEW	OLD
Australand Property Group	ALZ		n/a		n/a

Source: GSJBW Research

Referred to in Document:

Company Name	Stock Code	Share Price (as at 31 July 2006)	Valuation	Short Term Recommendation	Long Term Recommendation
Australian Foundation Investment	AFI	\$4.77	\$4.72	n/a	BUY
Australian Gas Light Company	AGL	\$19.02	\$18.30	Not Rated	NR
Australian Infrastructure Fund	AIX	\$2.05	\$2.43	Marketperform	BUY
Aristocrat Leisure	ALL	\$12.06	\$15.35	Outperform	BUY
Alinta	ALN	\$10.34	\$11.64	Not Rated	NR
Alesco Corporation	ALS	\$9.10	\$9.69	Marketperform	BUY
AXA Asia Pacific Holdings	AXA	\$6.35	\$5.95	Marketperform	BUY
Billabong International	BBG	\$14.45	\$15.40	Outperform	BUY
BHP Billiton	BHP	\$27.77	\$25.61	Outperform	BUY
Brambles Industries	BIL	\$10.86	\$11.15	Outperform	BUY
Commonwealth Bank of Australia	CBA	\$44.80	\$41.40	Underperform	HOLD
Coca-Cola Amatil	CCL	\$6.85	\$7.80	Underperform	HOLD
ConnectEast Group	CEU	\$1.15	\$1.41	Marketperform	BUY
CFS Retail Property Trust	CFX	\$1.86	\$1.97	Marketperform	BUY
Coles Myer	CML	\$11.37	\$11.82	Marketperform	HOLD
Centro Properties Group	CNP	\$6.94	\$6.38	Marketperform	HOLD
Cochlear	COH	\$53.08	\$51.21	Outperform	BUY
Computershare	CPU	\$7.86	\$6.60	Marketperform	HOLD
Crane Group	CRG	\$11.00	\$14.30	Outperform	BUY
David Jones	DJS	\$3.02	\$2.90	Outperform	HOLD
DB RREEF Trust	DRT	\$1.55	\$1.46	Marketperform	HOLD
Envestra	ENV	\$1.13	\$1.10	Marketperform	HOLD
Excel Coal	EXL	\$8.75	\$6.82	Marketperform	HOLD
Foster's Group	FGL	\$5.38	\$6.30	Marketperform	BUY
Felix Resources	FLX	\$2.35	\$2.77	Marketperform	HOLD
Fairfax (John) Holdings	FXJ	\$4.00	\$4.10	Marketperform	HOLD
GPT Group	GPT	\$4.52	\$4.34	Marketperform	BUY
Hills Industries	HIL	\$4.83	\$4.45	Outperform	HOLD
Healthscope	HSP	\$3.90	\$4.56	Marketperform	HOLD
Investa Property Group	IPG	\$2.29	\$2.15	Marketperform	HOLD
James Hardie	JHX	\$7.00	\$9.82	Marketperform	HOLD
Kimberley Diamond	KIM	\$1.18	\$0.82	Marketperform	HOLD
Macquarie Communications Inf.	MCG	\$6.06	\$6.75	Outperform	BUY
Macquarie Goodman Group	MGQ	\$5.97	\$5.00	Marketperform	SELL
Mirvac Group	MGR	\$4.27	\$4.25	Marketperform	HOLD
Macquarie Infrastructure Group	MIG	\$2.72	\$3.10	Underperform	HOLD
Mirrabooka Investments	MIR	\$1.95	\$1.95	n/a	BUY
Macquarie Office Trust	MOF	\$1.37	\$1.32	Underperform	HOLD
Metcash	MTS	\$3.92	\$4.60	Marketperform	BUY
Multiplex Group	MXG	\$3.57	\$3.45	Outperform	BUY
National Australia Bank	NAB	\$35.90	\$36.99	Marketperform	BUY
News Corporation, Inc	NWS	\$25.95	\$27.80	Outperform	BUY
Origin Energy	ORG	\$7.55	\$7.62	Marketperform	HOLD
Publishing & Broadcasting	PBL	\$17.10	\$17.65	Outperform	BUY
Promina Group	PMN	\$5.49	\$5.65	Marketperform	BUY
Perseverance Corporation	PSV	\$0.34	\$0.38	Underperform	HOLD
QBE Insurance	QBE	\$22.05	\$22.20	Outperform	BUY
Ramsay Healthcare	RHC	\$9.22	\$10.46	Outperform	HOLD
Rinker Group	RIN	\$13.17	\$19.51	Outperform	BUY
Rio Tinto	RIO	\$74.36	\$53.35	Outperform	BUY
Rural Press	RUP	\$10.54	\$10.60	Marketperform	HOLD
Southern Cross Broadcasting	SBC	\$11.54	\$11.45	Marketperform	HOLD
St George Bank	SGB	\$28.65	\$31.04	Outperform	HOLD
Stockland	SGP	\$6.84	\$6.85	Marketperform	HOLD
Singapore Telecommunications	SGT	\$2.14	\$2.80	Marketperform	BUY
Sonic Healthcare	SHL	\$12.63	\$14.07	Marketperform	HOLD
Smorgon Steel Group	SSX	\$1.72	\$1.60	Not Rated	NR
Symbion Health	SYB	\$3.07	\$3.28	Marketperform	BUY
Tabcorp Holdings	TAH	\$15.35	\$16.70	Underperform	HOLD
Timbercorp	TIM	\$3.14	\$3.48	Underperform	HOLD
West Australian Newspapers	WAN	\$8.49	\$8.50	Outperform	BUY
Westpac Banking Corporation	WBC	\$22.00	\$22.53	Marketperform	HOLD
Westfield Group	WDC	\$18.40	\$19.12	Outperform	BUY
Wesfarmers	WES	\$35.40	\$36.39	Marketperform	HOLD
Woolworths	WOW	\$19.04	\$20.15	Outperform	BUY
Zinifex	ZFX	\$10.55	\$10.34	Outperform	BUY

All valuations and Prices in A\$ unless otherwise stated

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
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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 themes 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 50 Index (Gross) and not the S&P/ASX 200 index.
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Short Term	Overall	Corporate relationship* in last 12 months	Long Term	Overall	Corporate relationship* in last 12 months
Underperform	13%	13%	Sell	6%	5%
Marketperform	63%	63%	Hold	61%	61%
Outperform	24%	24%	Buy	33%	34%

* 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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