UPDATE

9 January 2009

Private Wealth Management

Portfolio Strategy Review - December 2008

Equity Strategy | Australia

Key Points:

- The ASX200 finished the year on a slightly more positive note declining by only -0.3% in December, bringing the total return for calendar 2008 to -38.0%; a truly "annus horribilis". Despite the pervasive negative sentiment surrounding the market, the ASX200 finished the year 11% above its low, with some tentative signs of stability emerging (volatility and TED spread declining). Investors continued to be hit by capital raisings as companies (led by the Banks) sort to improve their balance sheets ahead of 2009.
- Investors added some cyclical risk to portfolios in December with the Tech, Consumer Discretionary and Industrial sectors outperforming. The REIT, Telecom and Financial sectors lagged reflecting further concerns about financing/property values; Telstra's surprise exclusion from the NBN tender process and further equity raisings by the Banks.
- 2008 proved to be a historic year in many ways not the least being the unprecedented declines incurred across the majority of asset classes. Investors were provided with a timely reminder of the risks associated with leverage, and commodity price/resource sector cycles. Goldman Sachs downgraded global growth forecasts for 2009 to 0.6%, similar to growth rates last achieved in 1982 while the outlook for the OECD is the weakest since data was collected in 1961. Commodity prices, led by oil, retraced sharply during H2 2008 in line with weaker demand. For 2008 the Healthcare (-11%), Energy (-19%) and Telecom (-23%) sectors outperformed while REITs (-57%), Consumer Discretionary (-56%), and Industrial (-49%) sectors lagged. The best performing stocks in the ASX100 were ORG (+88%), AGK (+19%) and CEY (+18%) while the worst were BNB (-98%), BBI (-92%) and BLY (-90%).
- The 2008 year also saw unprecedented fiscal stimulus packages combined with aggressive interest rate cuts as governments and central banks attempted to flood the global economy with additional liquidity in order to stave of a full blown global debt deflation cycle. The RBA cut interest rates in early December by a further 100bp to 4.25%, bringing the total easing in the last 4 months of 2008 to 300bp. Consumer confidence improved following the fiscal stimulus package (and lower oil price) while employment growth started to decline. The AUD finally found some support in December finishing the month at 69.3¢ (+3.9¢), after trading through 70¢ intra month.
- The key issues facing investors heading into 2009 remains the trade-off between ongoing poor macro news flow (economic and earnings); versus increasingly attractive valuations for equities. While identifying market bottoms remains difficult we believe valuations are attractive and sentiment sufficiently negative to warrant an increasing allocation into domestic cyclicals, including financials and materials. A subdued recovery or prolonged slowdown remains the key risk. We continue to monitor opportunities in the Resources ahead of an expected improvement in news flow from China in 2009.

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Performance Table – December 2008

	Accumulation Index Performance Since		
	30/11/2008	30/06/2008	31/12/2007
S&P/ASX 200	-0.3%	-26.8%	-38.4%
S&P/ASX 200 Industrials	-1.0%	-18.5%	-39.4%
S&P/ASX 200 Resources	1.7%	-41.7%	-35.4%
S&P/ASX Small Ordinaries	4.2%	-42.0%	-53.2%

	Relative Index Performance to S&P/ASX 200		
	1 Month	6 Months	12 Months
Consumer Discretionary	8.4%	1.6%	-15.5%
Consumer Staples	-0.3%	15.8%	11.3%
Energy	2.5%	-8.6%	21.8%
Financials	-2.7%	7.1%	-5.2%
Healthcare/Biotech	0.3%	30.1%	29.4%
Industrials	7.2%	2.9%	-7.2%
Information Technology	19.3%	12.3%	17.3%
Materials	1.6%	-16.9%	-2.3%
REITS	-10.2%	-6.9%	-15.5%
Telecommunication Services	-5.2%	18.0%	21.0%
Utilities	-0.6%	12.6%	8.2%

Source: IRESS, GSJBW Research estimates

ASX 200 Leading Contributors in December 2008

Top & Bottom 10 Pts Contributors over December - ASX 200

1.	NCM	20.4	CBA	-33.6
2.	QBE	9.7	WDC	-17.3
3.	LGL	8.5	WBC	-12.1
4.	NAB	7.7	RIO	-11.8
5.	ANZ	4.8	TLS	-11.6
6.	QAN	2.8	BHP	-9.5
7.	CWN	2.7	CSL	-2.9
8.	TCL	2.6	GMG	-2.8
9.	SUN	2.6	SGP	-2.7
10.	CSR	2.6	ORI	-2.6

The ASX 200 Index decreased by 21 pts in the month of December

Source: IRESS

ASX 200 Leading Contributors for 12months ended December 2008

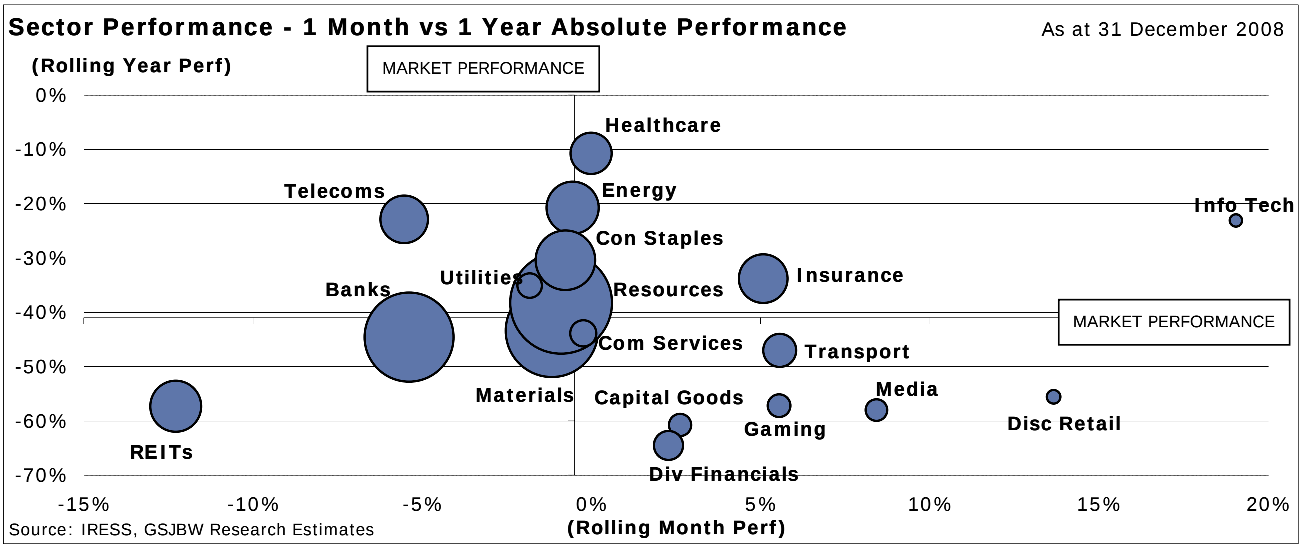
Top & Bottom 10 Pts Contributors for CY2008 - ASX 200

1.	ORG	32.0	CBA	-200.7
2.	AGK	4.2	BHP	-161.0
3.	STO	2.1	NAB	-139.2
4.	ILU	1.4	RIO	-133.3
5.	NCM	1.0	ANZ	-118.2
6.	ANN	0.3	WBC	-100.5
7.	KAR	0.3	WES	-84.0
8.	CEY	0.2	WDC	-70.4
9.	MTS	0.0	MQG	-65.0
10.	GBG	-0.1	WOW	-45.2

The ASX 200 Index decreased by 2618 pts in CY2008

Source: IRESS

Sector Performance for month and year ended December 2008



REVIEW OF 2008

2008 proved to be a historic year for global equity markets and the Australian equity market in particular. The five year bull market, lead by the Resources boom, moved rapidly into one of the worst bear markets on record, with the ASX200 declining by 38%; with its rolling 12 month price performance to the end of November (-43%), its worst on record. The performance of the Australian equity market during 2008 eclipses the overall performance of the "great" bear markets in 1929/30; 1982/83 and 1990/91. Only the bear market of 1973/74 is more significant in the decline from top to bottom.

The initial driver behind the sharp reversal in sentiment and subsequent decline in markets was the emergence of a global financial crisis, driven by the continued fall out in the US sub-prime debt market (which began to unravel as early as mid 2007). A significant restriction in credit availability (as financial institutions started to hoard capital) ultimately led to the complete shut down of global credit markets and the demise, rescue and nationalisation of a large number of over leveraged major global financial institutions. The restriction of credit resulted in a sharp fall in global growth, initially sending the majority of the advance nations into recession and causing the emerging markets, including China, to "re-couple" to the global economy. Global growth expectations finished the year at the lowest level since the 1982 recession (+0.6%). Commodity prices, led by oil, retraced sharply in line with weaker demand while the resource sector decline significantly as global investors reduced exposure to what was a consensus and highly leveraged trade across global markets.

The year ended with governments and central banks attempting to flood the global economy with additional liquidity by way of significant fiscal stimulus packages combined with aggressive interest rate cuts in order to stave of a full blown global debt deflation cycle. The US Federal Reserve moved to quantitative easing (printing money) in late September in order to pre-empt the potential risk of deflation emerging in 2009.

Volatility across all asset classes hit extreme levels during 2008 as risk aversion hit record highs and investors rushed into cash and bonds. The oil price hit record highs of US$145/bbl mid year before declining >70% to sub US$40/bbl. The AUD also traded up to 98¢ (highest level since the float in the early 1980's) by mid year before declining to 60¢ (-39%) in 3 months.

Financial stocks and those with excessive levels of gearing were the initial casualties driving the market lower up to mid year. The resource sector finished H1 CY08 higher as commodity prices remained firm with the majority of investors expecting China would remain immune ("de-couple") from the emerging slowdown in advanced economies. The oil price was a major contributor to this performance hitting record highs of US$145/bbl in mid July.

Resources drove the market lower during H2 CY08 of the year as commodity prices, once again lead by oil, retraced sharply in line with ever diminishing global growth forecasts. The fall in the resources was exacerbated because it was a consensus and highly leveraged trade across global markets. The increased leverage was courtesy of significant levels of margin lending across the sector, and the hedge funds which had expanded significantly during the preceding 4-5 years of the bull market.

Consistent with all major bear markets, all sectors declined during 2008. The sectors which bore the brunt of the selling were those most exposed to the unwinding of the excessive level of leverage across the market. This was particularly the case where the operating model was dependent on leveraging equity return to increasing asset prices (REIT's, Diversified Financials, Infrastructure); and those most exposed to expected deleveraging of household balance sheets (Consumer Discretionary) and the slow down in economic growth (Media, Gaming, Building materials).

Defensive sectors outperformed during 2008 as investors became increasingly risk adverse reducing exposure to both earnings and financial risk. The key defensive sectors in the Australian market proved to be Healthcare, Telecom, Utilities and Consumer Staples (including beverage stocks). Earnings volatility across these sectors remained low while balance sheets were in general, conservatively geared.

CONSUMER DISCRETIONARY

Media

News Corporation (+14.7%) shares ended the month higher. In the UK, newspaper groups and broadcasters have announced a host of cuts in recent weeks, as the downturn in advertising eats into revenues. **Fairfax Media (+21.1%)** shares rose during the month following: (1) the resignation of CEO David Kirk and appointment of new CEO Brian McCarthy; (2) reduced payout ratio to 20% for the interim dividend to preserve capital and facilitate debt reduction; and (3) announced intention to "return to its policy of a payout ratio of approximately 80% through the cycle as soon as economic conditions permit".

Retail

Billabong (-25.9%) declined following the release of a profit warning early in the month. **Harvey Norman (+23.3%)** traded higher during the month as it reported an improving trend in comparable store sales (based on a rolling 28 day period) from Franchised Harvey Norman stores in Australia. **David Jones (+27.2%)** traded higher over the month on no company specific news flow. We note that the Government's Fiscal Stimulus of $8.4bn was received on 8 December and appears to have contributed to sales during the month (*DOW Jones Newswires 26/12/08*).

Gaming

Tabcorp (-0.3%) shares ended the month flat despite the State Government announcing it will increase gaming machine taxes at Queensland casinos from 1 July 2009. **Tatts Group (+10.7%)** ended the month higher following a month of light news flow.

Aristocrat (-1.3%) shares drifted lower. During the month, the company announced that Dr Rosalind Dubs has been nominated by the Board as a Non-Executive Director and Jamie Odell as CEO and MD, subject to regulatory approval.

CONSUMER STAPLES

Woolworths (-0.5%) was largely unchanged at the end of December. **Metcash (+12.9%)** traded higher during December following the release of a solid 1H09 profit result. MTS reported 1H09 NPAT (pre-NRI's) rose 13% to $97.3m. **Goodman Fielder (-1.1%)** ended the month lower on limited news flow.

Wesfarmers (-3.2%) traded lower during December. **Lion Nathan (-2.8%),** is pursuing a merger with **Coca-Cola Amatil (+6.2%).** There was limited news on **Foster's (+0.4%)** pending its Wine Review due in February 2009.

ENERGY

Oil prices continued to slide in December, reaching a 5-year low of US$30/bbl (intra month), driven by ongoing weakness in oil demand. This was despite OPEC's decision to cut production of 4.2m bbl/day (from the actual September 2008 OPEC-11 production of 29m bbl/day), effective from 1st January 2009.

Woodside Petroleum (+1.8%) ended the month higher. **Santos (-1.5%)** reached an agreement to sell its 18% non-operating interest in the Brantas PSC (Indonesia, site off the Banjar Panji exploration well and associated ongoing mudflow) and receive a release from direct future liabilities from project participants - although potential third party exposures still exist. The interest was sold to Minarak, a company associated with the operator/majority owner of project Lapindo for US$22.5m.

Oil Search (-5.7%) shares ended the month lower. **Caltex (-2.8%)** shares fell during the month when the company provided an update of its CY08 profit guidance, upgrading its 2008 RCOP guidance to $135-155m (up from $115-145m), largely as a result of lowered tax forecasts by the company (based on lower profitability during 2008). CTX also indicated an additional ~.$215m of inventory losses (these are realised cash losses) due to falling crude oil prices since October 2008.

FINANCIALS ex PROPERTY TRUSTS

Banks

Westpac (-5.1%) ended the month lower after completing a $2.5bn equity raising at $16.00 to strengthen its balance sheet and take advantage of organic growth opportunities. **Commonwealth Bank (-15.2%)** shares fell during the month driven by an equity raising, a rise in bad debt and disclosure issues. **ANZ Banking Group (+3.3%)** and **National Australia Bank (+4.3%)** ended the month higher with little material news flow during the month and no announced capital raisings. Both banks' AGMs were held during the month, commenting that whilst conditions remain tough, the underlying franchises continue to perform well.

Macquarie Group (-3.0%) shares fell this month, driven by negative news flow on international investment banks: (1) S&P rating downgrades; and (2) tough 4th qtr trading conditions.

Insurance

After a flurry of announcements in November, the sector was relatively quiet this month. **Insurance Australia Group (+6.3%)** announced the sale of its "mass market distribution businesses" in the UK for a total price of £73.5m (~$165m), in line with the plans it announced earlier in the year. Excluding a one-off loss of £40m ($90m) in FY09, this should have little impact on earnings and marginally improves IAG’s capital position. **QBE (+8.7%)** made further progress on a number of previously announced transactions (completing its acquisitions of ZC Sterling and PMI Asia, finalising its capital securities exchange offer, and releasing the details of its share purchase plan). **AMP (+0.9%)** also completed its share purchase plan, raising $109m, slightly more than its $100m target. There was little news flow around the other companies: **AXA Asia Pacific (+9.8%), Suncorp (+7.0%)** and **Tower Australia (-5.6%)**.

Diversified Financials

Like insurance, this sector was relatively quiet after a busy November. **ASX (+8.3%)** continued to experience lower trading patterns, particularly in futures. As with previous months, IPOs were practically non-existent but secondary raisings were very strong, helping ASX to earn fees on this front. **Perpetual (+16.6%)** held its annual operations briefing but there was no material new news.

REAL ESTATE INVESTMENT TRUSTS

The AREIT sector continued to underperform the equity sector in December, down nearly three times as much as equities even after allowing for the late December ex-dividend status for the majority of the REITs. **ING Industrial (-65.5%)** and **Macquarie DDR Trust (-21.3%)** both fell throughout the month after announcing to the market that they were now attempting to seek asset/portfolio sales to address debt maturity issues. **Bunnings (-3.6%)** and **Mirvac (-4.5%)** were both lower at month's end and paid a 6.65¢ and 2.8¢ interim dividend respectively. Two small REITs which are outside the 200 index, **Centro (+20.6%)** and **Reckson New York (+34.1%)** posted positive returns for the month.

A number of a REITs announced asset revaluations during December with varying levels of asset declines typically ranging from zero to -10% which in turn caused implied NTA's to soften. **Stockland (-5.0%)** provided a business update and announced a 17¢ interim dividend along with a DRP scheme which would be c.50% underwritten.

Debt financing continues to be a factor weighing heavily on the REIT sector, and there continues to be a number of short term debt extensions which are not giving investors confidence that longer term financing flexibility is returning. Centro finally achieved a level of resolution regarding its debt but at the cost of diluting its existing equity holders by an estimated 85% (company estimate) over time. **Valad Property Group (-3.6%)** shares fell but recovered mid-month after announcing it had raised A$138.7m from balance sheet asset sales to repay debt. **Tishman Speyer Office Fund (-23.9%)** announced that it would not pay a December half year dividend and would instead retain cash to strengthen its balance sheet.

Goodman Group (-12.9%) fell during the month despite announcing over $1.2b in new fund management initiatives and a 9.65¢ interim dividend.

HEALTHCARE

Balance sheets remained a focus in the sector with **SHL (+8.7%)** refinancing its A$500m debt tranche, which was due to expire on 15 March 2009. Still on refinancing, **SIP (-15.6%)** ruled out any asset sale in order to refinance its $200m debt expiring in September 2009.

CSL (-2.9%) held its R&D Day during the month. Consistent with previous guidance, the company expects to spend $270m on R&D in FY09 – this includes $20-30m per year for post-marketing trials (Phase IV) of flu vaccines in the next 2 years. In terms of Gardasil, Merck expects worldwide sales (ex-Europe) to be flat in CY09 (US$1.4bn – 1.6bn). The guidance assumes that Gardasil will be approved for women aged 27 to 46 and males.

Private hospital stocks, **RHC (+15.6%)** and **HSP (+5.5%)**, ended the month up. The Federal Government renewed a new five-year healthcare agreement with the State Governments. Under the agreement, the Federal Government will increase funding for state hospitals by 7.3% to a total of $64bn over five years.

INFORMATION TECHNOLOGY

Computershare (+18.4%) shares bounced from last month's fall on limited news flow.

INDUSTRIALS

Agriculture

GrainCorp (+6.4%) rose during the month after finalising a series of agreements with Rabobank Australia, ANZ and the NAB that secured working capital and inventory finance requirements for 2009. News flow surrounding **AWB (-25.5%)** and **ABB (+2.8%)** continued to be dominated by the merger discussions between the two grain companies. However, during December, it was announced that talks of a union had ceased.

Capital Goods

United Group (-1.2%) and **Downer EDI (-8.4%)** finished the month lower despite both companies announcing significant contract awards in the infrastructure sector. **Boart Longyear (-25.9%)** saw a month of volatile trade with its shares falling below $0.20; driven by news of mine production and capex cuts both in Australia and overseas. The global Engineering & Contractors sector continues to be impacted by the falling oil price; **WorleyParsons (+5.3%)** ended the month higher, broadly trading in line with the oil price.

Chemicals

Incitec Pivot (-6.0%) shares traded lower in December. During the month, IPL confirmed that its wholesale prices for nitrogen (eg urea) and phosphate based products have been lowered in line with reductions in global pricing. Early in December, **Nufarm (+14.9%)** rose on the back of positive commentary from its AGM. Meanwhile, **Orica (-9.8%)** continued to weaken on a string of negative news on the near term outlook for hard commodity prices and fears that the current global de-stocking process will put increased pressure on mining companies to cut production.

Transportation

QAN (+13.4%) rose early in the month as the company confirmed it was in talks with British Airways (BA) about a potential merger via a dual-listed structure though discussions ended two weeks later.

Near the end of the month, **Toll Holdings (+6.9%)** announced that it had completed the $12m sale of its 50% share in TenixToll Defence Logistics, the joint venture contracted to provide DIDS defence logistics in Australia.

Asciano (+44.5%) rose in December despite container volume growth slowing in November compared with recent months; Melbourne +1.4% on pcp, Sydney +8.6%, Brisbane +4.6% and Fremantle –1.2%.

Infrastructure

Both **Macquarie Airports (+25.1%)** and **Australian Infrastructure Fund (+23.8%)** rose this month despite reporting weaker traffic growth across several airports during November. We believe the market is more focused on the positive implications of the declining oil price.

Macquarie Infrastructure Group (+3.4%) ended the month higher after announcing that it had effectively sold 25% of WestLink to a financial buyer at around NTA. **Transurban (+10.9%)** shares rose after reconfirming its distribution for the six months ended 31 December 2008. TCL also advised that it would be looking at its options around MIG's sale of its interests in Westlink.

ConnectEast (+3.8%) finished the month higher after announcing its traffic growth numbers for November and a reduction in the average toll from $3.15 to $3.10. During the month, CEU also completed its $450m capital raising comprising of a 3 for 8 pro-rata entitlement offer and institutional placement at 55¢ per unit.

MATERIALS

Building Materials

During the month, **CSR (+29.4%), James Hardie (+22.9%)** and **Boral (+15.8%)** all rose on news that the NSW Government would slash developer levies by up to $64,000 a property in an attempt to boost the NSW housing sector. The changes mean that developers who may have been paying up to $94,000 to develop a lot may pay as little as $30,000.

During the month, **Leighton Holdings (+13.7%)** announced plans to suspend construction at the $2.9bn Trump Tower project in Dubai. Fears of a looming construction slowdown in the Middle Eastern emirate were partly offset by the announcement a week later of LEI's involvement in a 4.9bn dirham ($2bn) building contract for Dubai Airport's expansion. The contract is worth $800m to Al Habtoor or $360m to Leighton. In December, LEI also won a $460m contract to construct Queensland's Eastern Busway.

Steel

Company debt levels were a key driver of share price performance in December. The announcement by **BlueScope (-12.5%)** of a $3.10 equity raising and production scale backs weighed against its share price. This triggered market concern about **OneSteel's (-4.3%)** debt and refinancing obligations. Adding to this negative sentiment was ongoing concern regarding a deteriorating global economy and further steel price declines. Performing relatively stronger in December was **Sims Group (+26.6%),** which avoided the markets debt-related concerns (due to its low gearing) and rallied on the back of a recovery in scrap prices.

Diversified Resources

Further deterioration in the outlook for commodities saw both **BHP Billiton (-1.8%)** and **Rio Tinto (-18.5%)** fall during December. RIO fell early in the month but recovered after announcing a number of measures to reduce its net debt by US$10bn by the end of 2009, including the reduction of planned capex and the reduction in global headcount of 14,000. BHP outlined production cuts at its Samancor Manganese operation due to weak market conditions.

Other Metals and Coal

December was generally a poor month for the base metal equities. **PanAust (-46.9%)** fell due to both a weakening copper price and risks surrounding its current refinancing. **OZ Minerals (0.0%)** went into voluntary suspension at the beginning of the month as a result of its refinancing negotiations. OZL is currently seeking extension of a US$420m and a US$240m debt facility.

Mount Gibson (+48.3%) rose following FIRB's decision to allow APAC Resources and Shougang Concord to underwrite the rights issue and the placement to Shougang Concord.

Coal stock performance through the month of December was mixed. **Macarthur (-18.3%)** ended the month lower after announcing production cuts and lowering its half year guidance (after announcing last month that it was "on track"). **Centennial (+27.2%), Felix (+60.0%)** and **Whitehaven (+39.3%)** ended the month higher as the outlook for thermal coal contracts prices.

Gold and Platinum

Newcrest (+38.0%) and **Lihir (+36.8%)** led the way for the gold stocks on positive gold price movement (+6.2%*), with gains across the board with the exception of **Avoca (+6.5%).** Better performers were **Dominion (+28.1%), Kingsgate (+32.6%)** and **Apex (+26.5%)** who poured its first gold from its new commissioned Wiluna operations during the month.
*Note: * Reflects USD price movements*

TELECOMMUNICATION SERVICES

Telstra (-5.7%) fell after the government’s NBN Expert Panel (NBNEP) excluded Telstra from further participation in the NBN RFP process. The NBNEP believes Telstra failed to indicate how Australia and NZ SMEs are included in the design/construction of the NBN (one of five mandatory requirements within the RFP). The NBNEP is due to make its recommendations by the end of January 2009.

UTILITES

AGL Energy (-0.3%) shares were flat despite announcing it had acquired the Gloucester Basin coal seam gas project in NSW for $370m in cash from Molopo and AJ Lucas.

Origin Energy (+0.75%) shares were broadly flat during the month as it continued with its on-market buyback of up to $1.275bn. By the end of the month, it had spent ~$200m.

APA Group (+11.1%) rose after successfully establishing its unlisted investment vehicle called Energy Infrastructure Investments Pty Ltd. APA will use the funds released from the transaction to reduce debt by $647m, taking gearing to ~69% (from ~73%).

The regulated utilities, **SP AusNet (-7.8%), Spark Infrastructure (-6.5%)** and **Envestra (-27.7%),** all fell in December following the release of the Australian Energy Regulator's Draft WACC review. The Draft was below GSJBW expectations with the main areas of difference being:

- Debt Risk Premium (Credit Rating) of A- vs GSJBW BBB+
- Risk free rate based on 5 yr Govt bond vs GSJBW 10 yr
- Gamma 0.65 vs GSJBW 0.5

The final review is due to be released by 31 March 2009.

Market Analysis: The Changing Mix of Equity Investing

We often refer to market weightings in discussion on domestic equities, but for those not as attached to these markets, the sector weightings may get lost in the midst of time.

In the figure below we have shown the major sector weighting and how they have changed in the past decade.

Sectors are broadly defined:

Description	S&P300(%)	Largest Security
XKO 25 Discretion	3.86	NWS
XKO 10 Energy	7.55	WPL
XKO 40 Financials	37.24	WBC
XKO 35 HealthCare	4.33	CSL
XKO 45 Info Tech	0.64	CPU
XKO 20 Industrial	6.72	BXB
XKO 15 Materials	23.34	BHP
XKO 30 Staples	9.16	WOW
XKO 50 Telecom	5.48	TLS
XKO 55 Utilities	1.69	AGK

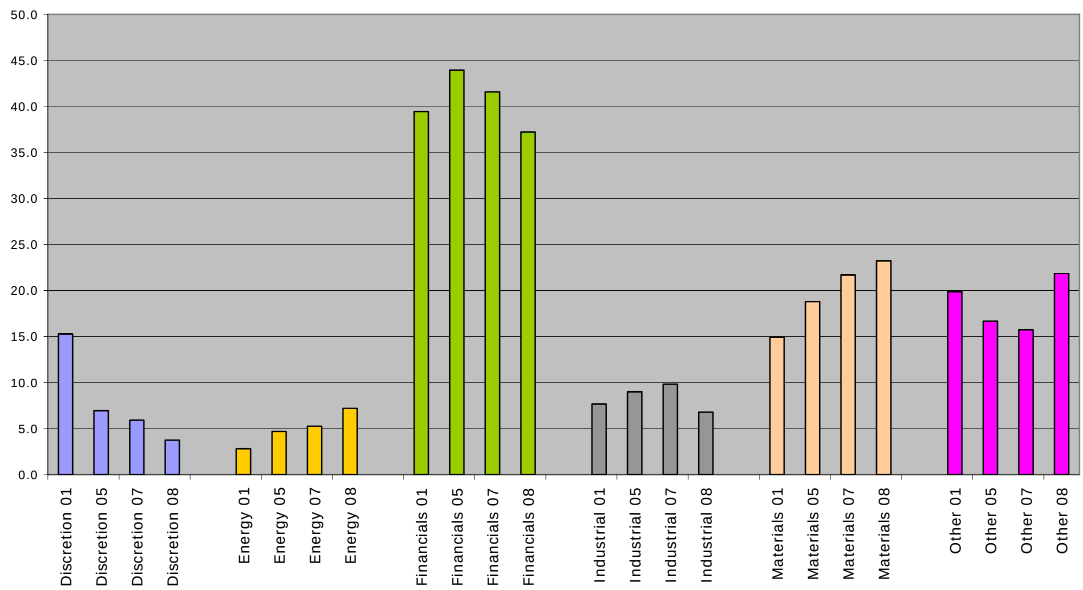
Source: IRESS As at 9th Jan 2009

Financials; includes Banks, Insurance, REITs.
The large banks (WBC, CBA, NAB, ANZ, BOQ, BEN) represent approximately 55% of this index.
Materials; includes Resource, Building Material and Steel companies.

The Australian market is notably heavy in two sectors, that is, financials and materials. This exposure limits the investment opportunities in other sectors and can over expose portfolios to outcomes from these two industries. We therefore recommend global exposure in our allocations given most international markets are substantially more diverse than Australia.

In recent times the performance of the materials (resources) sector has seen it increase it's weighting in the market overall. Energy has been another sector that has grown reflecting the increased capitalisation of companies such as ORG. However note that AGK is represented within utilities ('other' in the bar chart)

ASX Key Sectors as % of total All Ords



Source: IRESS

Conversely, the discretionary index component has fallen sharply. This part of the index includes media stocks, specifically NWS (which has performed relatively poorly in recent years), gaming and selected retail companies. 'Industrials' includes a wide range of stocks with the largest BXB, MIG, MAP and UGL. It is the recent performance of these counters that has resulted in a reduction in overall representation. Best performing out of the remainder of the index has been the staples, healthcare and telecom where the largest stocks – WOW, CSL and TLS have held up well during 2008.

The table below shows the number of stocks in each of these segments in the ASX300.

Sector	Number of Stocks 2001	2008
Discretion	37	29
Energy	13	29
Financials	77	58
Industrials	36	46
Materials	47	76
Other	90	62

Source: IRESS

Resource and energy stocks have increased the most in number, at the expense of financial and industrial companies.

The purpose of the comments above is to make investors aware of weightings and what they mean. As the relative performance of stocks changes over time investor portfolios may become unrepresentative of the equity market. This is not necessarily a negative outcome, but clearly exposes the performance to risks if that overweight position does not perform consistently.

The second purpose is to remind investors of the nature of the Australian market. The heavy weighting in some sectors will inevitably result in some bias in performance compared to other markets. In recent years this has been most obvious in the robust outperformance of the Australian market relative to world indexes in large part due to the strong resource sector. Of course, the opposite can also be the case. Once again, we remind investors of the greater diversity in international markets.

As an example, the weightings for the US market are given below.

Sector	S&P 500
Consumer Staples	13.3%
Health Care	14.5%
Materials	2.9%
Telecom Services	4.0%
Information Technology	15.1%
Financials	13.1%
Utilities	4.2%
Energy	13.3%
Consumer Discretionary	8.5%
Industrials	11.2%

Source: Goldman Sachs Research

Stock Analysis: Coal Seam Methane – A Risky Business?

Coal seam methane (CSM) occurs naturally within coal deposits/seams. Water trapped within the coal seams applies pressure, trapping the gas as a thin film on the surface of the coal. Removal of the water allows the gas to escape in most instances; however this process is highly complex and requires the application of sophisticated technologies.

Australia is known to have large reserves of CSM resources, however extracting meaningful quantities of the gas depends on the quality of the reserve and the available technology. During the late 1980's and early 1990's, several companies attempted to derive CSM resources under the guise that using United States exploration and production practice they would be successful. Hematite Petroleum and North Queensland Energy and Conoco to name a few spent about $200 million on CSM projects that were not successful. What they demonstrated was that if exploration was not done to define reservoir conditions, and if the wrong production techniques were employed, then the economic production of gas from coal was unlikely to be achieved.

These risks are ever present today and we believe investors should be well informed of them prior to gaining exposure to this theme. Without going into the enormous detail that is available, the conditions that must be met in order to achieve a financially viable CSM project depends on how much gas is present in the coal deposit, the relative permeability of the coal, how easy it is to remove the water trapped in between the coals, and whether or not suitable technology is available to exploit the CSM (typically this technology is very costly to employ – especially during the exploratory drilling phase where specialist equipment and expertise is needed).

In addition to the risks mentioned above, the quality of liquefied gas that can be produced out of CSM has been subject to much speculation. A recent report suggested that liquefied gas derived from CSM was least preferred by Japanese utility customers. The news item, documented in the 'Dow Jones LNG intelligence report' highlighted that "Japanese utilities are unwilling to buy liquefied natural gas made from Australia's budding coal-bed methane gas production because of its relatively lower calorific value" (the calorific value of gas impacts its ability to burn hotter and more efficiently).

Despite the inherent risk of CSM projects, also hampered more recently by a lower oil price (making alternative sources of energy to oil less attractive), the overall thematic continues to develop momentum in line with strong long term demand for alternative energy sources.

In late December 2008, corporate news-flow in the CSM arena continued to make headlines, with Arrow energy taking over Pure Energy (a Queensland CSM producer) in a $623M transaction. Earlier in December, AGL Energy (AGK) increased its exposure to the CSM thematic, having purchased the Gloucester Basin CSM assets from AJ Lucas and Molopo for $370M in cash.

Investors considering exposure to the CSM theme will benefit from becoming more familiar with the terminology on gas reserves and pricing. The reserves are classified into 2P and 3P. A 2P reserve is classified as 'probable' where this is an approximately 50% degree of confidence that the resource can be produced. A 3P reserve carries less certainty of production, therefore it is only possible that production may occur (an approximately 10% degree of confidence).

The reserve multiples paid by AGK, an important factor for comparison, is $2.11/GJ (2P) and $0.97/GJ (3P). Based on expected 1H CY09 reserves its paying $0.74-0.93/GJ (2P) and $0.46-0.53/GJ (3P) (source: GSJBW research estimates).

To put AGK's transaction in context, we have included the below table. The numbers illustrate that AGK's transaction is approximately at the mid point compared to similar CSM acquisitions, while the transaction multiples of Santos and Origin are at the upper end. While arguably a diminished oil price and sluggish commodity outlook (at least for the first half of 2009) has dampened some of the enthusiasm around CSM corporate multiples, the large and scalable nature of the Origin and Santos reserves best explains the higher multiples paid.

Company	Trans Date	2P Reserves (PJ)	3P Reserves (PJ)	CSM EV (A$m)	Price/ 2P Res (A$/GJ)	Price/ 3P Res (A$/GJ)
Recent Transaction Multiples						
BG/QGC	Feb-08	1,317	3,116	2,075	1.58	0.67
Petronas/Santos[1]	May-08	538	1,600	2,114	3.93	1.32
Shell/Arrow	Jun-08	791	2,790	2,147	2.71	0.77
QGC for SHG	Aug-08	469	1,097	849	1.81	0.77
ORG/Conoco[2]	Sep-08	4,795	10,182	14,348	2.99	1.41
BG for QGC (net re:	Oct-08	2,162	5,682	4,432	2.05	0.78
Average of Recent Transactions					**2.51**	**0.95**

1. Excludes US$500m conditional payment on FID; 2. Includes A$1,150m carry payment to FID but not US$500m payment for
3. 20% of reserves owned by BG Group; 4. Rest of ORG = $16.47 per share; 5. Rest of STO = $13.31 per share
Source: Company data, IRESS, GSJBW Research estimates

To summarise the above, despite the risks, we believe global demand for energy will drive the CSM theme, however we caution investors to beware of the risks involved, in particular where unrealistically high premiums are paid for CSM assets that are yet to be exploited.

What are the predominant CSM exposures?

Origin Energy (ORG), Santos Limited (STO) and AGL Energy Limited (AGK) all have exposure to CSM.

For Origin, we believe that the ConocoPhillips (COP) transaction has significantly 'de-risked' their plans to develop CSM capability. ORG is receiving $6 - $7bn of cash up front. As the company does not have to inject its own capital initially, it is able to leave its balance sheet intact, allowing for flexibility, such as increasing dividends. Conoco has extensive experience in both CSM and LNG projects which compliments the experience of ORG.

As we have discussed in detail above, the potential risks to the CSG LNG project include a depressed long term outlook for oil/gas prices, execution risk including project start up and budgetary constraints, financing risk (debt markets remain challenging especially if more borrowing is required) and reserves risk (the probability that the reserve does not contain sufficient extractable quantities of the resource).

For investors that would like a flavour as to what potential impact these risks would have on our valuation scenarios for ORG, our energy research team have complied the following table which outlines five risk scenarios.

In the table, our analysis assumes a $17.00 valuation for Origin excluding the CSM assets (note in the table, Coal Seam Methane is referred to as CSG or Coal Seam Gas, which is global convention, however locally we refer to it as CSM). Holding the ORG ex CSM valuation constant, we adjust for changes to the CSM component. The outcome for the overall valuation and current share price can be demonstrated as follows:

GSJBW Research - ORG Two Train CSG LNG Valuation Scenarios

ORG Valuation Scenarios	ORG CSG ($/share)	Rest of ORG ($/share)	Total ($/share)	Prem/(Disc) to GSJBW Val'n (%)	Prem/(Disc) to Current Price (%)
Base Case*	**7.30**	**17.00**	**24.30**	**0%**	**52%**
Implied CSG Valuation at Current Share I	**-1.03**	**17.00**	**15.97**	**-34%**	**0%**
% of GSJBW CSG Valuation	-14%				
Valuation Scenarios					
Scenario 1: US$70/bbl Oil Price = $14.50/C	4.24	17.00	21.24	-13%	33%
Scenario 2: Capex Increase of 30%	5.80	17.00	22.80	-6%	43%
Scenario 3: WACC 1% higher	5.97	17.00	22.97	-5%	44%
Scenario 4: 12 month delay to start	6.09	17.00	23.09	-5%	45%
Scenario 5: Reserves 33% less than estima	5.64	17.00	22.64	-7%	42%

* Assumes 2 x 3.5 mtpa CSG LNG Trains commences in FY15; Source: IRESS, Company data, GSJBW Research estimates

AGL Energy has recently increased its exposure to the CSM thematic as we highlighted previously, having purchased the Gloucester Basin CSM assets in New South Wales. AGK however may face the same issues as other producers in developing these assets into meaningful facilities.

We do however favour AGK's strategy to increase its upstream exposure to gas, be it in the form of LNG or CSM reserves. The company also has the benefit of balance sheet capacity to further increase its upstream gas interests, or alternatively take an interest stake in the NSW electricity generation sector, should the privatisation of those assets go ahead.

We acknowledge the attractiveness of AGK's defensive earnings and balance sheet capacity of ~$800M. However, we believe AGK is fairly priced at current levels and have some concern that on a 12-month view it will be left behind as the market switches from a defensive bias to growth.

Santos also has substantial scalable CSM reserves, and has recently entered into a strategic partnership with Petronas* to develop these resources. Akin to the Origin-Conoco Phillips deal, we believe this to be a positive development for STO, due to the expertise that Petronas has demonstrated in the CSM domain. STO also has interests in other non-CSM LNG projects and in oil exploration, and as such is not limited to CSM developments alone.

In the meantime, we maintain our neutral view on the stock. While we are attracted to Santos' strategic gas position and strong balance sheet, it has strong EPS leverage to oil prices – where we forecast extended weakness in oil over the next several quarters.

* Petronas is a Malaysian based company owned by the Malaysian Government with broad interests in the global petroleum sector

Stock Recommendation Summary

STOCK RECOMMENDATION SUMMARY

Code	Name	Price ($) 9-Jan-09	Recommendation
AGK	AGL Energy Limited	13.97	HOLD
ANZ	Australia and New Zealand Banking Group Limited	15.20	HOLD
AXA	AXA Asia Pacific Holdings Limited	5.12	HOLD
BBG	Billabong International Limited	8.20	HOLD
BEN	Bendigo and Adelaide Bank Limited	10.41	HOLD
BLD	Boral Limited	4.55	BUY
BOQ	Bank of Queensland Limited	9.63	HOLD
BXB	Brambles Limited	6.90	HOLD
CPU	Computershare Limited	7.50	BUY
CSL	CSL Limited	32.91	HOLD
HSP	Healthscope Limited	4.13	BUY
MAP	Macquarie Airports	2.32	BUY
MCG	Macquarie Communications Infrastructure Group	0.89	BUY
MCU	Mitchell Communication Group Limited	0.48	BUY
MIG	Macquarie Infrastructure Group	1.76	SELL
MLE	Macquarie Leisure Trust Group	1.11	BUY
MQG	Macquarie Group Limited	31.38	BUY
MSL	The Mac Services Group Limited	0.91	BUY
NAB	National Australia Bank Limited	21.00	BUY
NCM	Newcrest Mining Limited	30.65	HOLD
NWS	News Corporation	13.82	BUY
ORG	Origin Energy Limited	16.08	BUY
ORI	Orica Limited	14.49	BUY
OST	OneSteel Limited	2.61	BUY
QBE	QBE Insurance Group Limited	26.20	BUY
STO	Santos Limited	14.47	HOLD
TLS	Telstra Corporation Limited	3.72	HOLD
TOL	Toll Holdings Limited	6.29	HOLD
UGL	United Group Limited	9.16	BUY
WBC	Westpac Banking Corporation	16.50	HOLD
WDC	Westfield Group	13.81	HOLD
WES	Wesfarmers Limited	18.95	BUY
WOW	Woolworths Limited	26.23	HOLD
WPL	Woodside Petroleum Limited	35.98	HOLD

Source: IRESS, GSJBW Research

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EVA™ Trend: [1]	EVA™ trend forecast for coming 2 years. Designed to reflect "turnaround stories" or to highlight companies Goldman Sachs JBWere analysts believe will allocate capital poorly in the estimated timeframe.
Earnings Momentum:	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
Catalysts:	A qualitative and quantitative assessment of a company's long term catalysts 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

EVA™ Trend: [1]	ROE is used as a proxy for EVA. Rating takes into account the expected level and trend of ROE over the next 2-3 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

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Yield:	Yield relative to the REIT sector average. Used instead of Earnings revision.

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