



LM, the global pathway to Australian investment solutions

LM Australian Quarterly Economic and Property Report

31 December 2011

LM provides a range of Australian asset based products and funds, which are distributed and available for investment only via an independent global client network of financial intermediaries and financial institutions throughout some 70 countries.

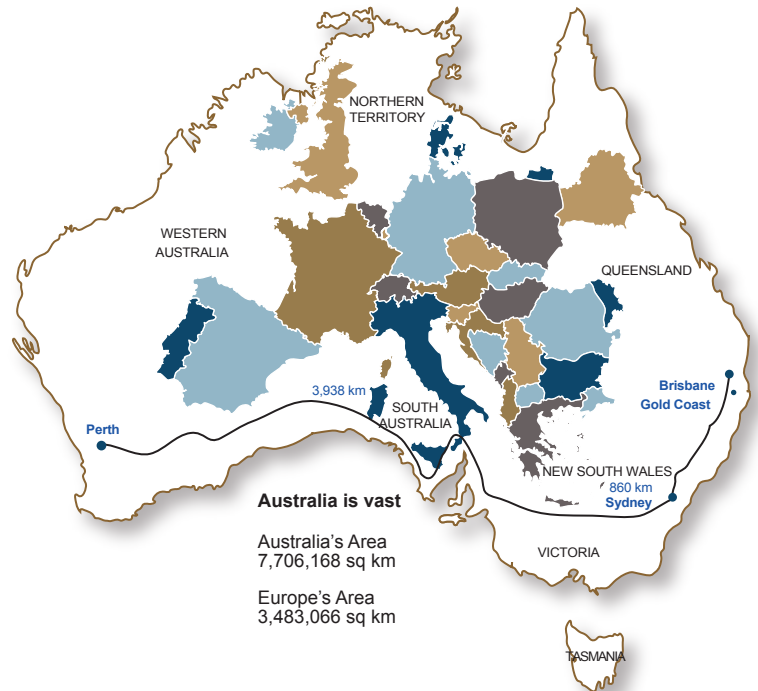
Our active involvement in Australia's property and business sectors affords us the direct opportunity of gathering research and intelligence across Australia's property sectors and on the Australian economy. This research is proactively utilised by our investment committees when assessing the Australian assets for our income funds.

Each quarter, LM provides an update on Australia's economy and property markets.

Please find following the report for the December 2011 quarter.

Snapshot of the Australian Economy

- ▶ Australia remains better placed than most advanced economies for resilience, despite the recent intensification of global concerns. Part of Australia's robustness is due to its strong public balance sheets, plenty of room to apply monetary policy if required and strong growth links with emerging Asia.
- ▶ If global risks threatened the financial system, then the expectation would be for Australia's central bank, the Reserve Bank of Australia (RBA) to act swiftly and hard. With Australia's official cash rate being substantially higher than the other advanced economies, there would be plenty of room for such strategy to be applied. Throughout the latter part of 2011, the RBA dropped the official cash rate twice, cutting it a total 0.5%. Currently at 4.25%, we could see the RBA announce one further official rate decrease of 0.25% over the next couple of months, as insurance for the economy in the face of any downside global risk. However, the solid medium term view for Australia remains intact, with an expectation for the RBA to adopt a neutral policy throughout the year.
- ▶ The growth forecast for Australia is over 3% in 2012 and the expectation is for such growth to be sustained over the next two years.
- ▶ Lending rates remain flat to falling.



- ▶ The AUD remains strong against all major currencies. It is trading at all-time highs against the Euro, and near all-time highs against Sterling and USD. While this is partly due to the structural weaknesses in these other currencies, it is also primarily a reflection of the very positive Australian economy. It is expected that the relative strength of the AUD will be maintained for the time being.
- ▶ AUD is considered a genuine alternative currency for foreign exchange reserves in many foreign central banks, and is the world's sixth most traded currency.
- ▶ Recent data reveals where to find stable and relatively high returns in the face of volatility. The resilience of Australia, Switzerland, Canada and Scandinavia has placed them into an elite group of developed economies, having achieved "sustainable safe yield".
- ▶ Resource and infrastructure investment are to remain strong with a surge expected.

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Snapshot of the Australian Economy (cont'd)

- ▶ In 2011, Australia again ranked second in terms of economic resilience (*Austrade Benchmark Report 2011*).
- ▶ According to Australian Bureau of Statistics (ABS) December data, Australia's economy grew faster than expected in the September quarter. ABS figures show 1% GDP growth during this time in seasonally adjusted terms, which is 0.20% higher than economic forecasts. Growth was driven by construction and mining. Construction contributed 0.5% (up 5%) and mining contributed 0.3% to the result (up 3.70%), mostly due to large mining projects in Western Australia and Queensland. (www.au.finance.yahoo.com, 'GDP figures show economy expands', 7 December 2011).
- ▶ Australian incomes are rising, and unemployment remains low when compared to the rest of the developed world, currently at 5.20%.
- ▶ Australia's public debt levels remain very low, at about 7% of GDP compared to over 80% in the US and Europe.
- ▶ In 2013, it is expected that Australia's Federal Budget will achieve a surplus, making it the first developed economy to achieve a surplus since 2008/2009.

Australian Property Markets

Australia's residential and commercial property markets continue to be driven by domestic demand and growing foreign investment interests, with most property sectors reporting stable values. Affordable home borrowing rates, combined with low unemployment levels and a growing rate of net migration, support Australia's broader market values.

Residential

- ▶ Supply and demand determine property market performance. Housing construction has fallen behind population growth over the last 5 years, resulting in housing shortages across most capital cities. 200,000 new homes per year are required to satisfy demand, however a prevailing shortage of new homes is expected to continue over the next few years.
- ▶ In Australia's most populous state, New South Wales, underlying demand for new homes (measured annually) averaged around 41,000 between 2000 and 2005, increasing to 45,000 from 2006 to 2011. Demand is estimated to remain at around 48,000 per annum up until 2016 but in the 12 months to June 2011 only 31,300 dwellings actually commenced.
- ▶ Residential vacancy levels remain at, or around historic lows in Australia's state capital cities, with current actual vacancy rates typically between 1% and 2%.
- ▶ Affordability is also a key component for understanding the fundamentals of the value of Australian residential property. Housing affordability in Australia has been broadly unchanged over recent years and has in fact trended towards improved levels of affordability since 2009. When measuring the National Average Dwelling Price against the National Average Household Disposable Income in December 2009, the household price equated to 4.7 times disposable household income. By March 2011, this ratio improved to 4.2 times, due to stable household prices and continuing increases in disposable income.
- ▶ Whilst sales are generally taking some time to achieve, the absence of need for any discounted selling has protected prices and values.
- ▶ The housing shortage has driven very low vacancy rates which in turn have seen rental increases.
- ▶ The labour market is forecast to strengthen into this year and 2013.
- ▶ Flat to falling mortgage rates strengthen the owner-occupier and investor markets.
- ▶ Fundamentals of undersupply, population growth, relatively high incomes, low unemployment and low interest rates form the basis of an optimistic medium term view on housing prices across Australia generally.
- ▶ The expectation is for some increases in housing prices in the latter part of 2012.

Commercial Office

- ▶ In 2010, Australia experienced its highest levels of foreign investment inflows since 1994. 24.30% of all commercial property transactions in Australia were to offshore purchasers.
- ▶ The cost of prime office space in Australia, when using an average of all major Australian cities, is among the most competitively priced in the world and compares favourably to other major regional and global financial services centres.
- ▶ Australia's continued resilient economy provides tenant confidence.
- ▶ Economic performance bodes well for tenant absorption.
- ▶ Supply is still restrained somewhat, due to tight credit conditions.
- ▶ Vacancy rates remain at near all-time lows.
- ▶ Rents are set to rise.
- ▶ Yields are expected to firm on the back of positive fundamentals. This will provide upside to capital values.
- ▶ Despite the strength of the AUD, foreign investment interest remains strong.
- ▶ Favourable pricing and underlying property fundamentals provide a glaring contrast against most of the developed world, with a resultant expectation for a continuation of foreign capital investment.

Retail

- ▶ Has proved fairly resilient.
- ▶ Solid household income and domestic economy augur well for the sector.
- ▶ Beware the consumer shift to "on-line" shopping.

LM, the Global Pathway to Australian Investment Solutions

LM provides established investment products, with a range of flexible investment options available for investment in all major currencies.

Investment options include:

- ▶ Cash;
- ▶ Conservative income – debt security;
- ▶ Enhanced income – debt security;
- ▶ Capital and income guaranteed – Australian index-based;
- ▶ Savings Plan;
- ▶ Luxembourg domiciled SICAV-SIF;

LM also has the ability to structure specifically mandated portfolios for institutional clients.

Please contact LM for further information.

The content of this report has been compiled by LM Investment Management Ltd from information drawn from a variety of sources within and external to LM, including www.abs.gov.au, Austrade Benchmark Report 2010 – Australia: A Global Financial Services Centre; www.news.com.au, www.bloomberg.com, www.rba.gov.au, 2010 IMB World Competitiveness Yearbook, World Economic Forum Development Report 2009, BIS Shrapnel Housing Outlook Report 2010:2013. This report is provided for information purposes only. Whilst the information contained in this report is believed to be accurate and reliable, LM does not guarantee or warrant the accuracy, reliability, completeness, currency or usefulness of the information and is not responsible for or liable in respect of any loss, damage, cost or expense suffered as a result of reliance on that information by any person. Past performance is not an indicator of future performance.

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