January's Predictions

January has usually been a good predictor of the rest of the year – at least for the US. Statistics show that in 82% of cases since 1900, when monthly performance in January has been positive, the S&P500 has also finished the year higher.

The numbers are less persuasive in Australia, where since 1937, in 65% of cases, a positive January has been a harbinger of full year gains. Nevertheless, the year has got off to a flying start, with most key markets up over 5%. Citi's measure of risk aversion has reached a new post-GFC low –signaling buoyant risk appetite.

Australian equities have seen a decent re-rating in the last 6 months from a Price to Earnings multiple of 11x to 13.5x – equivalent to the average over the last 25yrs. The market remains supported by the prospect of further rate cuts and potential liquidity inflows, but going forward, it would be difficult to justify a further significant re-rating without a demonstrated improvement in earnings. On that note, Australian earnings reporting season is due to begin this month, and in our view, with expectations having been re-based lower over the last few months, the risk of significant disappointment should be low. Inside we provide a list of dates for stocks in the ASX100 that are reporting in February.

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Market Performance

	Jan-13	Dec-12	1 MTH	LAST 12 MTHS
ASX20	3,009	2,867	5.0%	17.2%
ASX200	4,879	4,649	4.9%	14.5%
ASX200 Accum	38,974	37,135	5.0%	20.1%
S&P500	1,498	1,426	5.0%	14.1%
MSCI World - ex Aus	1,407	1,341	5.0%	13.3%
AUDUSD	1.042	1.039	0.3%	-1.9%
Oil (WTI)	97.38	91.73	6.2%	-0.9%
Spot Gold	1,663.49	1,674.95	-0.7%	-4.3%
AUS CASH RATE (%)	3.00	3.00	0bp	-125bp
AUS 10Y BOND YLD (%)	3.46	3.27	19bp	-26bp
US 10Y BOND YLD (%)	1.98	1.76	22bp	19bp

Source: IRESS, MSWM Research. Closing prices as at 31 December 2012 and 31 January 2013

ASX20 Stock Performance – Top 5 and Bottom 5

		Close Price	Return (mth)			Close Price	Return (mth)
Top 5				**Bottom 5**			
AMP	$	5.32	10.6%	RIO	$	66.36	0.5%
NAB	$	27.36	9.4%	BHP	$	37.48	1.0%
QBE	$	11.92	9.4%	CSL	$	54.94	1.9%
MQG	$	38.50	8.5%	WES	$	37.60	2.0%
ORG	$	12.59	8.3%	CBA	$	64.45	3.7%

Source: IRESS, MSWM Research. Prices as at 31 January 2013

Discussion on Managed Funds

How to Save Money on Fees and Improve Performance...in one swift move.

Since the invention of the Managed Fund scheme, investors around the world gained access to markets, strategies and diversification on a scale never seen before. There are now over 7,000 Managed Funds in the US alone! They are a very powerful investment tool for sure. This is why we are so frustrated when we see them misused.

The biggest benefit Managed Funds provide to the majority of investors is diversification for more modest investment portfolios. They provide a more ‘user friendly’ approach to diversify a portfolio as to pay brokerage for each transaction for a balanced portfolio would simply be too cost prohibitive. But as the investment portfolio grows, that benefit breaks down as the fees remain the same percentage no matter how much you invest. Investors can “Grow out of managed funds”.

For example: a Managed Fund fee of between 1-2.5% is very economical for a $50,000 or smaller portfolio. But beyond $100,000 or more, that becomes a very expensive ongoing fee. It makes much more sense than to go towards direct ownership. No sense paying someone else to own something you can own yourself!

How Managed Funds are abused

Quite often we see investment portfolios with five, ten sometimes up to 30 different managed funds. This is at the detriment of the client and their performance. This is why: managed funds (especially the big ones) rarely take a position of more than 2 or 3% in any one stock and quite often own a 100 (we’ve seen up to 200) stocks. Once you have more than two Managed Funds in the same asset class, you have effectively diluted away the majority of the expertise of the fund manager and most likely made your portfolio look like an index fund with 100’s of stocks mishmashed together.

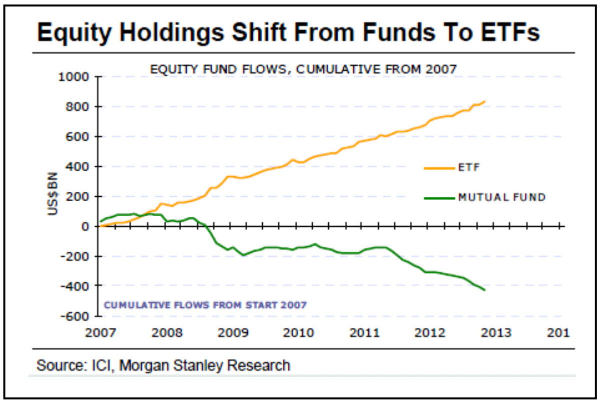
So who benefits from this type of investment strategy? Not the client. Only the multitude of Managed Funds you are invested (with their high MERs) and your advisor who put you into this spread of managed funds. As you can quickly deduce, once you have all these funds within the same asset class, you literally own 100’s if not 1000’s of stocks. At this point you look just like an Index Fund - but with really high fees!

What’s an Index Fund? An index fund is a low cost version of a managed fund with fees around 0.1% to 0.6%. They simply mirror the index they are tracking (i.e. the ASX 200 is an Index of the largest 200 companies on the Australian Stock exchange. An index fund just owns these companies in exactly the same weighting and their performance will be almost identical to the ASX 200 or the “Market).

The trend is not a Managed Fund’s friend!

Since 2007, the trend is clear: investors are choosing to track the market and not try to beat it. This could be for a number of reasons we can only speculate on but they may include:

- a desire to reduce investment fees
- a disappointment in performance by fund managers
- a change of investment philosophy (i.e. can’t beat the market, why try?)



How to get better performance with Managed Funds

First of all, don’t over dilute your portfolio. Study the fund managers you are investing in and back the best one (or the one most closely aligned with your risk profile or investment style). If you don’t know how to do this, pick an advisor who can help you or alternatively just invest in an Index Fund.

Second, pick different fund managers for different asset classes. Quite often a “Fund of Funds” managed fund will have 10 to 20 different fund managers (i.e. a Fund Manager who picks multiple funds to invest in for you across all the asset classes). If you wonder why this approach doesn’t work well - please revert back to “How Managed Funds are Abused”.

Third, try to avoid investing in more than 2 Managed Funds per asset class (i.e. Cash, Fixed Income, Domestic and International Equities, and Property).

How to Save Money Investing in Equities and Bonds

Once your portfolio has reached critical mass (in our view, this can be as little as $50,000-100,000), we recommend clients ‘go direct’. Building a diversified investment portfolio isn’t as hard as many would think. With the right advice and cost effective enough platform to execute, it can be pretty straight forward.

Get your own personal fund manager cheaper than a Managed Fund

The investment services sector is changing fast in Australia. In the United States and Europe you quite often find only two platforms for investment execution: online discount brokers (i.e. eTrade, CommSec) or full service “Wrap Platforms” (i.e. no brokerage). They each have their place. People are quite often surprised though to find how cost effective a full service “Wrap Platform” is. This is especially important for investors seeking a cost effective professional solution to outperform the market over the long term.

For example: with a \$50,000 - \$100,000 portfolio, it’s not uncommon to see an annual fee as low as 1% (plus GST). This is actually much cheaper than the majority of Managed Funds out there! The key is finding an advisor who delivers the right type of portfolio construction advice for your risk profile and objectives, will continue to work with you on an on-going basis and can find you a cost effective platform to manage your portfolio on.

Regards,

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STRATEGY CHANGES

COMPANY	SECTOR	REASON	ACTION
No changes	NA	NA	NA

OUR SELECTION PROCESS

- The stocks selected seek to be profitable today with high Return on Invested Capital (ROIC), high gross margins and low capital intensity.
- High profitability that seeks to be sustainable for the long term, with the support of powerful intangible assets such as strong brands, products or services with high barriers to entry.
- The companies must have high quality management teams committed to maintaining the high returns through focused investment and innovation with careful stewardship of capital.

OUR BENCHMARKS

- ASX200
- Morningstar Balanced
- MSCI Global

TEAM PROFILE

David Leon (Investment Adviser) is a Certified Portfolio Manager® from the School of Engineering and Applied Science from Columbia University, New York, USA. David primarily advises Family Offices, Medical Professionals and Corporate boards within the Aged Care Sector. David began his finance career working as an analyst for a boutique investment banking firm in Chicago that executed underwritings and placements for state and local government entities. While still working in Chicago, he was invited to join UBS as a private client adviser and financial planner. In early 2007, David and his Australian wife moved closer to her family in Australia. David was recruited by Goldman Sachs where he held the title of Director. David graduated with honours from Northwestern University in Chicago, has an Advanced Diploma of Financial Planning, is an ASIC Accredited Derivatives Adviser and is licensed to trade equities, globally. David is also a Governor of the American Chamber of Commerce.

Geoff Smith (Strategic Financial Planner) is a Certified Financial Planner® with over 25 years of experience in Financial Planning and Investment Advice. Prior to joining Morgan Stanley Wealth Management, Geoff was a leading Financial Adviser and principal of Adelaide based financial advisory firm Prescott Securities. In addition to this experience Geoff holds a Diploma of Financial Planning and a Diploma with the Australian Insurance Institute. Geoff specialises in providing quality strategic and investment advice and portfolio wealth management both to individuals and to tax exempt organisations.

Jawad Ahmad (Financial Planner) is a Certified Financial Planner® and has been in the financial service industry since 2006. He has a strong technical background and has vast experience in holistic financial advice. Prior to joining Morgan Stanley Wealth Management, Jawad worked as a Financial Planner and Para planner with Godfrey Pembroke based in Adelaide. He holds a Bachelor of Finance (University of Adelaide), is an ASIC accredited Derivatives planner and has a Graduate Diploma in Global Wealth Management (University of Adelaide) for which he was awarded the most distinguished graduate award in 2007.

ABOUT MORGAN STANLEY WEALTH MANAGEMENT

Morgan Stanley Wealth Management has over 17,000 financial advisers in 830 offices world-wide. In Australia, we have over 190 financial advisers, managing over $21 billion in client assets and five offices in Sydney, Melbourne, Brisbane, Adelaide and Perth. Morgan Stanley's Australian Research Team ranked #1 In the Institutional Investors Survey for the second year running. Our global presence and expertise allow us to provide our clients with financial advice, integrated solutions and intelligence across all the world's major markets.

Please contact your financial advisers to obtain a copy of the full research reports listed or refer to our website at www.morganstanley.com.au.

Research sourced from:

1. Down Under Daily, "The Great Hope", - Morgan Stanley Research, 31 Jan 2013

Important information