Staying Constructive

Highly accommodative policy, reasonable valuations and good earnings momentum leaves us comfortable on equity markets.

Accommodative conditions in the US look set to continue. US fiscal policy is likely to remain gridlocked, with limited pressure to reach a "grand bargain", but neither do we see an incentive for either side of politics to de-rail the economy in an election year.

The recent shutdown should have a limited impact on GDP growth (estimate ~0.4 percentage point annualised on 4th quarter GDP growth), while risks of another shutdown are reduced with a committee aiming to negotiate a deficit reduction plan by mid-December.

Furthermore, the hard deadline on the debt ceiling could be pushed back to July, if Treasury utilises accounting measures and successfully navigates through the February and March tax refund season.

Meanwhile the US Price to Earnings multiple of 15x appears reasonable as corporate earnings improve – c.50% of S&P500 companies by market cap have reported third quarter results, and aggregate earnings are tracking around 5% ahead of expectations.

In Australia, equities hit new 5-year highs, encouraged by several pieces of local data - job ads rising for the first time in 6 months; business confidence lifting to a 3½ high; manufacturing expanding for the first time in 2-years, rising house prices; and a stabilising of earnings.

In this issue:

- *Navitas*
- *Consumer Staples*
- *Amazon*
- *Michael Kors*
- *Discussion on Super Contributions*

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Market Performance

	Oct-13	Sep-13	1 MTH	YEAR TO DATE
ASX20	3,423	3,274	4.6%	19.4%
ASX200	5,425	5,219	4.0%	16.7%
ASX200 Accum	44,873	43,158	4.0%	20.8%
S&P500	1,757	1,682	4.5%	23.2%
MSCI World - ex Aus	1,612	1,553	3.8%	20.3%
AUDUSD	0.946	0.933	14%	-9.0%
Oil (WTI)	96.24	102.33	-6.0%	4.9%
Spot Gold	1,322.30	1,328.40	-0.5%	-21.1%
AUS CASH RATE (%)	2.50	2.50	0bp	-50bp
AUS 10Y BOND YLD (%)	4.03	3.81	22bp	76bp
US 10Y BOND YLD (%)	2.56	2.61	-5bp	80bp

Source: IRESS, MSWM Research. Closing prices as at 30 Sept and 31 Oct 2013

ASX20 Stock Performance – Top 5 and Bottom 5

		Close Price	Return (mth)			Close Price	Return (mth)
Top 5				**Bottom 5**			
ANZ	$	33.84	9.9%	NCM	$	10.30	-12.0%
CSL	$	69.50	8.6%	WDC	$	10.82	-1.7%
CBA	$	76.08	6.8%	WOW	$	34.90	-0.3%
MQG	$	50.95	6.3%	STO	$	15.17	0.6%
BHP	$	37.66	5.4%	QBE	$	14.80	0.9%

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

Recent Highlights from Research

Navitas: Leverage Takes a Gap Year

Morgan Stanley Research, 28 October 2013

A very strong Northern Hemisphere Enrolment outcome has been diluted by the up front investment in costs ahead of what we see as a multi period return of positive volume growth for Australia. We stay overweight (positive) on compelling medium-term upside appeal.

The strong enrolments were diluted by the company flagging significant investment in both growth related operating costs and some one off impacts that frame the establishment of an expected EBITDA earnings range of $138m-$148m. The top of the range is some 6.5% below our forecast and 4% below consensus.

Overweight Retained: We retain our Overweight recommendation on NVT and Price Target (which was based on FY15e estimates) at A$7.70/share. Next catalyst will be Australian 3rd Semester 2013 enrolments - expected to be released late November.

We move to Underweight on new price target of A$4.40. Dividend is attractive. We have increased TLS's FY14e dividend to 30c, which adds 40bp to yield; but 10-year government bonds have risen 90bp over the last 13 months from 2.9% in July 2012 to 3.8% in August 2013 … hence TLS's dividend attractiveness is decreasing vs. safer bond assets.

Australia Consumer: Outlook Improving, But Be Selective (WOW, WES, CCL, TWE)

Morgan Stanley Research, 25 October 2013

Key Investment Debates Driving Consumer Sector and Stock Performance:

1. Consumer Cycle is Improving

Past the worst of the retail cycle: Most cyclical drivers of retail spending are improving; the housing market, equity market performance, interest rates and consumer confidence. A lower A$ reduces online and tourism leakage. We think the retail environment will improve in 2014.

RBA policy has shifted to support the consumer: Interest rates at 30-year lows, an improving housing market and potentially a retracing household savings rate should all support the consumer in 2014.

2. Avoid exposure to supermarkets

Publically stated store rollout plans are very bullish: Industry space growth will be 3.5% p.a. over the next three years, well ahead of population growth of 1.6%. Supermarket space growth has outpaced population growth in each of the last 10 years too. And incremental returns are now declining.

Price deflation returning: Coles reported an acceleration in fresh food deflation. The elevated A$ and greater competition looks to be driving deflation.

Supermarket valuations are now stretched. Woolworths and Wesfarmers P/E multiples have expanded by 2-3 points over the past year as investors have become attracted to stable earnings and dividend yields. Arguably, earnings certainty has reduced and P/E multiples look stretched.

3. Treasury Wine (TWE) key consumer staple pick

Improving global wine industry wine outlook: Global wine production at 40+ year lows and rising global consumption as consumers switch from beer to wine should drive wine prices and wine producer profits higher. TWE is a pure play on the improving global wine cycle.

Divesting US production assets is strategically and financially logical: TWE currently generates no profit from its US production assets given its exposure to the bulk wine market and sub-scale position. The tangible asset backing of these assets is A$1bn – which might actually be a conservative valuation.

Amazon (AMZN): Hitting the Long Ball; Price Target to $380 (USD).

Morgan Stanley Research, 25 October 2013

North America continues to outperform international. Net sales in North America accelerated for the third quarter to 31% Y/Y ex-FX (30% Y/Y in CQ2) while international sales growth stayed sequentially flat at 20% Y/Y ex-FX despite a 100 bps easier comp.

Prime membership growth is a positive long term: We are raising our 5-yr revenue CAGR to 22% from 20% as Amazon.com disclosed (for the 1st time) that it "signed up millions of new Prime members {over the past 90 days}." We believe that Prime adoption could be accelerating in the US, as its value proposition improves through constant additions to Prime Instant Video and the Kindle Lending Library. This should drive long-term revenue growth upward in the US.

Michael Kors (KORS): 2Q Looks Like it's in the Bag; Raising Estimates and Price Target

Morgan Stanley Research, 14 October 2013

We raise our price target to $83 ahead of the quarter on robust channel check indicators, Kors brand Google search growth, and on-going strength in wholesale. We also raise our 2Q EPS estimate 6% to $0.68. At 22x CY14 P/E, valuation looks inexpensive.

We expect another beat and raise quarter. At 22x CY14, we think KORS remains the best growth story in retail: We think KORS has a good chance of achieving our $120 (USD) bull case (87% upside).

A Case for Delaying Large After-tax Contributions to Super Until Next Financial Year.

For many clients (particularly those approaching retirement and age 65), it's common to make large Non-Concessional Contributions (NCC) into superannuation.

With an annual cap of $150,000 per person or a 'bring forward' averaged NCC cap of $450,000 for those under age 65, it can be a very effective strategy to build retirement savings in superannuation.

But, there may be a bigger opportunity by waiting until after 1 July 2014 to make these large contributions. An opportunity valued at $90,000! Let me explain.

The law on calculating contribution caps

Income Tax legislation says that the NCC cap is six times the standard Concessional Contributions (CC) cap. (The higher $35,000 cap for those over age 60 is a temporary cap and not relevant here).

This financial year the standard CC cap is $25,000. $25,000 times 6 = $150,000 (NCC cap).

Taking this one step further, the 'bring forward' averaged NCC cap is three times the NCC cap. So $150,000 times 3 = $450,000.

Now that we know how important the Concessional contribution cap is, let's explore what happens when it increases?

Indexation and CC cap

It is a little known fact that the Concessional (pre-tax) superannuation cap is indexed annually in line with Average Weekly Ordinary Times Earnings (AWOTE), but only increased when the cumulative indexation exceeds $5,000.

What happens when the standard CC cap is increased to $30,000?

The annual NCC will increase to $180,000 (six times $30,000) and the flow-on is the 'bring forward' averaging NCC cap will increase to $540,000 (being $180,000 times 3).

The table below summaries the potential cap implications for a $5,000 increase to the CC cap via indexation from 1 July 2014.

Relevant Cap	FY13/14	FY14/15	Difference
CC cap	$25,000	$30,000*	**$5,000**
NCC cap	$150,000	$180,000	**$30,000**
'Bring forward' NCC cap	$450,000	$540,000	**$90,000**

*Based on AWOTE estimates used by Treasury to forecast cap indexation

Waiting could give you an extra $90,000 of cap

If you can afford to wait until next May/June to make the contribution (by then we will know what the CC cap for 2014/15 will be) you could benefit by being able to contribute an extra $90,000 into superannuation – all within your 'bring forward' averaged NCC cap!

Who should wait to contribute and who should contribute this year is something you should discuss with one of our financial planners by contacting them on 13 13 70.

There are both legislative aspects and personal circumstances to consider that will impact that decision.

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STRATEGY CHANGES

COMPANY	SECTOR	REASON	ACTION
NA	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.

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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:

- "Navitas: Leverage Takes a Gap Year" Morgan Stanley Research, 28 October 2013
- "Australia Consumer: Outlook Improving, But Be Selective" Morgan Stanley Research, 25 October 2013
- "Amazon: Hitting the Long Ball; Price Target to $380" Morgan Stanley Research, 25 October 2013
- "Michael Kors: 2Q Looks Like it's in the Bag; Raising Estimates and Price Target" Morgan Stanley Research, 14 October 2013

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