Ready, Steady, 2013!

Most equity markets ended 2012 on a high note, recording double digit gains for the year, even as negotiations ran down to the wire on the US Fiscal Cliff.

News flow generally improved over the last month, with the US unemployment rate falling to a near 4 year low of 7.7%, China's manufacturing activity expanding for a third consecutive month, Euro Area ministers approving Greece's aid package, Greece's €10bn bond buy back, and the RBA cutting rates by another 25bp.

Looking ahead, for 2013, our base case assumes the US averts the majority of the Fiscal Cliff, and China continues to recover. In such a scenario, we forecast a 10% capital return. Equities are more expensive than they were a year ago, but we see room for further gains based on 6 positives for the market – 1) attractive valuation; 2) a further 25-50bps of RBA rate cuts, 3) improved sentiment towards equities as confidence improves; 4) a consequent reduction in multi-decade high cash weightings; 5) low equity issuance; and 6) an inflection point in earnings.

Fiscal Cliff and debt ceiling debates are likely to dominate market direction early in the year, but in our opinion, the magnitude of the downside has reduced as action by various policymakers from European Central Bank to the US Fed have mitigated the tail risks. Under our bear case scenario, where an extended US fiscal deadlock hits growth, we believe further global liquidity injections and a more aggressive RBA will limit the downside to ~10%.

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Market Performance

Market Performance

	Dec-12	Nov-12	1 MTH	FULL YEAR 2012
ASX20	2,867	2,771	3.4%	17.0%
ASX200	4,649	4,506	3.2%	14.6%
ASX200 Accum	37,135	35,929	3.4%	20.3%
S&P500	1,426	1,416	0.7%	13.4%
MSCI World - ex Aus	1,341	1,318	1.7%	13.1%
AUDUSD	1.039	1.043	-0.4%	1.7%
Oil (WTI)	91.73	88.93	3.1%	-7.2%
Spot Gold	1,674.95	1,714.68	-2.3%	7.1%
AUS CASH RATE (%)	3.00	3.25	-25bp	-125bp
AUS 10Y BOND YLD (%)	3.27	3.16	11bp	-40bp
US 10Y BOND YLD (%)	1.76	1.62	14bp	-12bp

Source: IRESS, MSWM Research. Closing prices as at 30 November and 31 December 2012

ASX20 Stock Performance – Top 5 and Bottom 5

		Close Price	Return (mth)			Close Price	Return (mth)
Top 5				**Bottom 5**			
RIO	$	66.01	12.4%	NCM	$	22.18	-13.5%
MQG	$	35.49	8.3%	QBE	$	10.90	-0.4%
BHP	$	37.10	7.9%	STO	$	11.10	-0.4%
ORG	$	11.62	5.8%	WOW	$	29.33	0.2%
SUN	$	10.17	5.0%	WPL	$	33.88	0.2%

Source: IRESS, MSWM Research. Prices as at 31 December 2012

Equity Views

The good, the weak and the cheap!

Every month we like to update clients on any standout performers (and three not so good) within our recommended strategies in addition to adding colour to their movements.

Markets are indeed still exceptionally volatile and very uncertain but we are still unwavering in our belief that 2013 and beyond will *substantiate our thesis*: the global economy will be supported by the continuing build up of a middle classes in the growth economies. This unprecedented movement of masses moving from below the poverty line into middle class in China, greater Asia, India, Africa, Russia and many others who should provide support for commodities (and the production of it) for years to come.

In our view, growth is not dead as the bears like to claim, it's just taking a breather before the next decade of growth...

The Good

Overall over the last 6 months, defensive stocks (e.g. banks, staples, infrastructure) have held up well in portfolios while growth stocks leveraged towards resources, energy and industrials have been weak. We believe this trade will begin to reverse itself by next Easter 2013.

AMP Limited (AMP) has outperformed the market by over 4% the last quarter finally receiving support for what we think is still a very attractive long term valuation. We believe the stock offers an alternative to the 'expensive' banks and a much better growth story with close to equivalent yield in the coming 2 years. AMP recently surprised the market by showing stronger resilience against the MySuper (new regulatory regime) margin squeeze anticipated. With leverage to the equity markets (i.e. Funds under management) we see this as a 'beta' play for a recovering market play.

Austbrokers (AUB) on the back of an impressive result and acquisitions announcement in late November, AUB continues to receive strong investor support. The stock has outperformed the market by 31% over the last year and 5% over the last month.

We believe there are not many 'lower risk' options in the small cap space and hence leave fund managers with few options for investment. This gives us confidence the stock will continue to perform and find price support even in soft markets.

The Weak...

QRxPharma (QRX) has finally begun to find some price support. We are still aware of a few forced sellers (e.g. Venture Capital Charitable funds winding down which was happening before their surprise announcement in June 2012) but that appears to be dissipating to some degree now. The stock is now up 36% off its low and has finally broken the $0.90 barrier. We are very confident in this stock's eventual 2013 recovery with pending news in regards to the FDA approval process. Feedback from the company (and FDA in the USA) has been very positive to date with no further testing required but simply a re-submission of existing data not originally included in the first application. We are hopeful for a July approval with sales beginning in late September 2013.

Newcrest Mining (NCM) over the last quarter has given back its stock price recovery on no real news as to why. Outside of a legal claim by another exploration company (which is not an uncommon event for this space), delays to production pushed back further into 2013 (which was known already) there is no real reason for the pull back that we know of except sentiment towards GOLD during the period. Over the long term, we believe we are entering into a long term high inflationary environment (globally) so this should be very supportive of GOLD in the future. We are happy to continue to support this world class miner.

Industrials: ALS (ALQ), Mineral Resources (MIN), and Bradken (BKN) after an aggressive sell off late last year, we are finally seeing the price support (or value hunting) we thought would begin to come through by Easter. Just recently the Wall Street Journal published an article[2] talking about how 2013 could be the year for Industrials in the mining space citing an example of how Fortescue (FMG) canned its plans for their Kings Iron Ore Pilbara project but have now decided to restart as a likely sign of better things to come. There is no question in our mind that negative sentiment that all new mining projects was overdone (priced into stocks like MIN, BKN, NWH) and where unfounded. *Bargain hunters are now on the prowl.*

The Cheap...

NRW Holdings (NWH), probably one of the strongest companies in its class having been rewarded with many awards including Rio Tinto’s services company of choice, was hit hard by Fortescue’s decision to shelve their major Solomon Mine project but seems to now be finding support (probably on the back of a sentiment change towards the sector lead by Fortescue’s decision to restart their Kings Iron Ore project) has bounced very hard off $1.26 in the last month to almost $2.00.

We see NRW Holdings as a well managed business with a strong balance sheet and good cash flow generation is simply too cheap trading at only 6.5 times earnings (e.g. BHP trading at 15.8x; Woolworths at 15.7x; Market around 13x). Not for the faint hearted in this volatile environment but a great business still turning a profit. The company should make at least a few heads turn.

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. "North America Road Ahead 2013 – Keen on Thirteen" - Citi Research, 17 December 2012
2. "Fortescue Restart Heralds Mining Investment Revival, Says E&Y" – Wall Street Journal 2 January, 2013

Important information