Selector Australian Equities Fund
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In this quarterly edition we review performance and attribution. We provide our thoughts on the banking sector many are calling cheap when looking at price to earnings ratio and yield. Cover shot. Macro flags again?

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About Selector

We are a boutique fund manager and we have a combined experience of over 60 years. We believe in long term wealth creation and building lasting relationships with our investors.

Our focus is stock selection. Our funds are high conviction, concentrated and index unaware. As a result we have low turnover and produce tax effective returns.

First we identify the best business franchises with the best management teams. Then we focus on valuations.

When we arrive at work each day we are reminded that;

"The art of successful investment is the patient investor taking money from the impatient investor".

Our fund is open to new subscriptions. Please forward to us contact details if you would like future newsletters to be emailed to family, friends or business colleagues.

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Dear Investor,

In a recent Australian Financial Review interview, successful US investor Charles Brandes, who started his investment fund management business, Brandes Investment Partners in 1974, noted that when he invests, he doesn't invest in the sharemarket; he invests in businesses. It may sound rather odd that someone would see the need to make such a clear distinction but history is very much on his side.

It is rather appropriate that when confronted with the big global issues facing investors today; China, the US economy, Europe's debt woes and sovereign risk, he offers "So, what's new?" He continues "There's nothing new going on...the issues of employment, inflation, are all pretty much the same worries we always have. I think it's a good thing investors are concerned about something. To me, it's more of a worry if investors aren't worried. Then there is something to really worry about, as everyone thinks there is blue sky and no one can lose money."

It may not be new, however investors are clearly worried. Global markets are once again in a spin and investors are rattled about the fallout from what may or may not eventuate. These are difficult times, however staying focused on businesses rather than markets makes perfect sense and something we have consistently spoken about in past newsletters. Such an approach doesn't suggest avoiding the issues but rather controlling something more important, an investor's emotion to do something.

As Brandes notes, "I try not to look at Wall Street, I don't want to invest in shares. I don't care what shares on the Dow do each day. I want to invest in businesses. Businesses that I understand and think will do well. That way, I am not going to get shaken out or nervous and emotional when the price falls from $38 to $15. Because I really know the management and what they are doing, I will be in a position to understand why they have fallen, what they are doing and will then decide to buy more as I won't be feeling emotional about the fall in price."

In this quarter's newsletter we review the local banking sector and cast an eye over the burgeoning energy market. Both are undergoing significant change and the long term consequences are uncertain. In addition we focus on the Fund's current portfolio makeup and why we are confident on their business prospects. For the 2011 financial year, the Fund recorded a 2.6% positive gain despite a particularly difficult last quarter, where the index recorded a decline of 4.8%. While the first half gains were eroded, the Fund's performance since the financial crisis in 2008, of a positive 3.4% gross compound annual return compared to the index return of a negative 0.2% over the same period is nevertheless very pleasing.

We extent our best wishes to all our investors and trust that you enjoy this latest quarterly report.

Regards
Tony Scenna
Corey Vincent

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June 2011

In a similar vein to Brandes, we focus our attention on the businesses and the management teams who run them. As our top 10 business holdings highlight, they represent a collection of companies operating in all facets of industry. Importantly they have a few things in common, which makes us very comfortable in owning them.

Firstly, many operate as either leaders in their industry or enjoy a cost competitive advantage over rivals. Secondly, management have been instrumental in their success either as founders of the business or as key executives, where remuneration is largely linked to the company's success.

Thirdly, the financials and the track record delivered thus far suggests they have a winning formula, largely built around organic growth and augmented with complementary bolt on acquisitions.

And finally they understand that the owners of the business are indeed the shareholders. As such they run conservative balance sheets and are prudent with their capital spending. During the 2008 financial crisis, none of these businesses needed to raise new capital to survive, thus avoiding the painful dilutive period that affected so many other listed companies. In fact, six of the top ten businesses held, hold healthy cash balances, underscoring the strength of the business.

While these are all wonderful business traits, they don't protect against failure or disappointments. Understanding what makes a business worth what it is and having the confidence to hold on when the world is unsteady is in short not an easy thing to do but an important discipline all investors should strive for.

As Table 1 illustrates, the majority of these businesses are reporting solid profit numbers, with one year forward estimates guiding to reasonable earnings growth, undemanding PER multiples and attractive dividend yields. Importantly, the returns generated on capital employed are high and management have steered the businesses prudently in the past and our expectations are that this will continue for the foreseeable future.

Market sentiment is extremely cautious at the present time and macro events, be they China, Greece or ongoing commentary from our Reserve Bank surrounding local interest rates, are collectively having a direct and powerful impact on investor confidence. While these periods create wonderful buying opportunities, they also require nerves of steel and a balanced view of the world.

During the June quarter, the Fund's large exposure to healthcare related businesses took a share price hit with investors concerned about the impact the rising Australian currency would have on profits and in the case of Pharmaxis, the unexpected negative vote from the European

Medicines Agency (EMA) regarding the company's marketing application for its flagship cystic fibrosis drug Bronchitol. While we had expected a positive decision, we were also mindful that regulatory bodies are conservative in nature and additional reassurance may have been required before any final European approval was granted. As such we reduced our portfolio position by some 60% prior to the EMA decision at around the $3.00 share price mark thereby substantially protecting our downside.

Table 1: Top 10 Holdings

Financial Screen	Earnings	Earnings	Earnings	Valuation	Valuation	Financial Leverage	ROCE	Share Price
Business	**2010(a) NPAT $m**	**2011(e) NPAT $m**	**2012(e) NPAT $m**	**2012(e) PER**	**Div Yield %**	**Net Debt (cash) $M**	**ROCE %**	**2011 % Move**
Blackmores	24.3	26.4	28.7	15.3	5.0	26.0	38	+21.4
Cochlear	155.2	180.6	220.6	17.6	4.2	17.3	43	-1.3
Flight Centre	139.9	170.6	186.9	10.9	4.6	(83.9)	33	+35.8
IOOF Holdings	79.3	110.0	118.0	11.9	8.0	(123.4)	16	+13.0
IRESS	57.2	62.0	69.2	16.1	5.5	(143.5)	221	+7.8
News Corporation	2,770.0	3,354.3	3,879.6	11.8	1.2	4,611.0	13.0	+30.0
ResMed	190.1	212.4	251.8	17.8	-	(551.8)	22	-19.9
Sirtex Medical	11.3	7.8	13.0	21.3	1.4	(41.4)	79	+2.5
Whitehaven Coal	55.1	18.2	184.3	14.6	3.4	(49.8)	9	+25.1
WorleyParsons	291.1	351.2	421.7	16.2	3.8	533.0	17	+33.2

The Fund continues to hold Pharmaxis in the portfolio and having examined the reasoning behind the negative vote, we remain confident that the company has an extremely strong case to address the EMA's concerns, which does not to extend to any safety concerns regarding the drug, but more around how to interpret the trial data results.

Under the appeal process that is currently under way, Pharmaxis will re-submit its reasoning for approval to a separate body – the Scientific Advisory Group – allowing for experienced clinicians to examine and report back to the central body of the EMA. A final decision from the regulators is expected in October 2011 and assuming a positive recommendation, Pharmaxis would be open to sell Bronchitol throughout the 27 countries that comprise the European market, thus joining Australia, which was granted marketing approval by the Therapeutic Goods Administration in February this year.

At the current share price of $0.93, it is our intention to increase our Fund's holding in the company as we consider the share price sell off over done and the company's strong data profile compelling. ***SFM***

Banking profile

Banking backdrop

In this review we take a look at the banking scene in this country and ask whether investor expectations need to be recalibrated. While the Fund has never held an investment in any of the retail banks, the reasons for this have varied over the years. Our reluctance to invest in this sector initially centred on the multitude of better investment opportunities available at the time. However in more recent years our reasoning to avoid this sector has firmed, primarily due to a string of industry concerns. In isolation these trends may not manifest into much but collectively they have the potential to cause considerable heartburn even for the most vocal of supporter.

Over the past four decades the banking landscape has changed considerably. Below we provide our own snapshot on how the banking world has changed and how this has damaged the business moat underpinning the traditional banking franchise.

1970's

During the 1970's and perhaps going back decades before, banking was considered a special relationship between a banker and his customers. In order to obtain credit, customers needed to show complete loyalty stretching over considerable years. If and only if you met these hurdles were you then considered for a loan, accompanied by all manner of personal guarantees. With such a captive audience, banks were able to exploit the relationship as only bankers do.

In banking circles, the term spread refers to the difference between the level of interest it pays for deposits and other sources of funds, and the level of interest it charges its borrowers. It should not come as any surprise that in keeping deposit rates low and borrowing rates high, banks enjoyed very attractive spreads. Also known as net interest margins, they sat above 4%, illustrating how profitable the banking business could be and how wide and deep the banking moat had become.

1980's

If there was a decade of change for the banks it probably was the 1980's. In fact it was a tumultuous time all round. The Hawke-Keating Labor Government set off a series of events following their election victory in 1983. In December 1983, the Australian dollar was floated allowing the currency to find its own level. This was followed by the issuing of forty new foreign exchange licences and thereafter sixteen new banking licences in 1985. With a string of new competitors, banks were forced to compete for customers and new business deals.

Deregulation was sold as a positive development and in theory it made sense, however the back half of the decade highlighted some disturbing realities that often accompany new levels of competition – lax lending practices. The term negative pledge (unsecured lending) soon took on new meaning and its impact was felt with the collapse of property giant Hooker Corporation in 1989 owing creditors, who were mainly the banks, over $1.8 billion.

Bank Statistics*	ANZ	CBA	NAB	WBC	Combined
Share Price ($) 8 June 2011	21.14	49.25	24.17	21.60	
Cash NPAT (SM)					
2010	5,024	6,101	4,581	5,879	21,585
2011 (e)	5,623	6,848	5,404	6,308	24,184
2012 (e)	6,067	7,318	5,835	6,566	25,787
Net Interest Margins (%)					
2010	2.46	2.10	2.25	2.22	2.26
2011 (e)	2.45	2.14	2.21	2.19	2.25
2012 (e)	2.35	2.13	2.13	2.16	2.19
Cost to Income Ratio (%)					
2010	45.5	45.0	45.4	41.1	44.2
2011 (e)	45.5	45.0	45.4	41.1	44.2
2012 (e)	45.6	44.3	44.9	40.2	43.7
Return on Equity (%)					
2010	15.5	18.7	13.5	16.2	16.2
2011 (e)	16.4	19.7	14.9	16.0	17.0
2012 (e)	16.4	19.6	14.9	15.6	16.8
Core Tier 1					
2010	8.04	6.86	6.80	7.50	7.26
2011 (e)	8.68	7.58	7.30	8.26	7.91
2012 (e)	9.11	8.13	7.88	8.90	8.46
Cash EPS (¢)					
2010	194	380	213	192	-
2011 (e)	212	421	247	203	-
2012 (e)	226	441	262	209	-
Dividend (¢)					
2010	126	290	152	139	-
2011 (e)	139	319	173	155	-
2012 (e)	146	336	186	165	-
PER (x)					
2010	10.9	13.0	11.3	11.3	
2011 (e)	10.0	11.7	9.8	10.6	
2012 (e)	9.4	11.2	9.2	10.3	
Dividend Yield (%)					
2010	6.0	5.9	6.3	6.4	
2011 (e)	6.6	6.5	7.2	7.2	
2012 (e)	6.9	6.8	7.7	7.6	
Price to Bank Book Value (x)					
2010	1.6	2.2	1.5	1.8	
2011 (e)	1.5	2.2	1.5	1.6	
2012 (e)	1.4	2.1	1.4	1.5	

**Source UBS*

1990's

The aftermath of the 1987 share market crash impacted business and banks in general. While the local property market took off immediately after the crash, it was short lived and it and the rest of the economy hit the skids in the early part of 1990, leading Treasurer Keating in November 1990 to now famously remark that Australia was in a recession that Australia "had to have". The consequences of such were felt deep and wide, leading to a number of bankruptcies that almost included one of the major four banks, Westpac.

In 1992, the bank recorded a $1.6 billion loss, which was the largest loss for an Australian corporation, dismissed staff and raided its own superannuation fund to sustain its viability. Having come close to insolvency, the bank survived with an injection of new capital before undertaking a series of acquisition that now has it placed as the number two bank in terms of market capitalisation.

Westpac's near death experience was a massive wake up call to banks and regulators in general. Lessons that had been forgotten were soon remembered as the banking industry rediscovered new ways of making money. While competition was still pronounced, banks focused on building profits on two fronts, by cutting costs and lifting charges. Such has been the banks' success on this front, that they now boast on average operating margins of about 55% (with a costs to income ratio average of 45%), and non interest income (measured as income other than interest income) now making upwards of 25% of the banks' total operating income. So despite the slip early in the decade, banks quickly regrouped, benefitting from an extended period of strong credit growth and underpinned by a buoyant housing market.

2000's

Having fended off the crisis of the previous decade, banks embarked on driving growth, fuelled by strong credit demand. To meet the needs of the market and compete effectively with new entrants, the banks saw the need to ramp up its own balance sheet leverage thereby reducing its need to raise more equity. From a regulator's point of view, maintaining such strict levels of capital, defined as Tier 1 and Tier 2 capital, measures the bank's financial strength and is held to protect against unexpected losses. Holding a buffer for a rainy day makes perfect sense, however if the past is any guide to the future, when things do get nasty there just doesn't seem to be enough capital in reserve to meet all the dud loans written.

Unfortunately events since the start of this decade typify how exposed banks and investors are when the economic climate changes for the worse. The explosive use of offshore wholesale funding that fuelled more securitisation lending accompanied by a drop in the risk capital that banks needed to hold against residential mortgage loans, benefited them handsomely as they delivered higher profits with lower levels of capital employed. It is little wonder banks' reported returns of capital employed in excess of 20% and indulged in paying the vast majority to shareholders via fully franked dividends.

The events post the 2008 financial crisis highlight how exposed banks are when things go wrong. As it turned out, things went horribly wrong and while our banks have reportedly done very well in comparison to our offshore competitors, the scrabble to raise additional new capital saw the banks undertake massive raisings with commensurate earnings dilution for shareholders who chose not to participate. The lessons for investors unfortunately are that a banks' business model is one of leverage, both on the up, when super profits are on offer and on the down, when write-offs occur en masse.

And now

Bank bashing has become a popular sport among politicians, regulators, financial analysts and disgruntled customers. However if the truth been known, the glory days of strong credit growth and lax regulatory supervision is off the radar for the near term at least. So where do the banks go from here?

The Australian Financial Review due diligence article dated 30 May 2011 is reproduced below as it pinpoints, in our opinion the central issue facing the banking sector, that of housing.

"Banks feel the chill wind of housing" – Australian Financial Review 30 May 2011

"For all their mind-boggling complexity, banks are largely a play on house prices. During the past two decades, house prices have risen and so has the size of mortgages. As people get more equity in their homes they feel richer and spend more on their credit cards. This has made for a brisk turnover of ever-larger mortgages. Ten years ago people stayed in their mortgaged house, on average, for seven years. Now it's just over four years. House prices are now either falling or going nowhere. The effect on Australia's banks will be profound.

As one senior banker explains, when mortgage credit growth was running at 15 per cent, a bank could get 10 per cent revenue growth "even if you weren't any good. You just had to be in the market. Suddenly we hit a wall about two years ago. You're not getting the earnings growth anymore and it's really only coming through now," he says."It does change a lot of the assumptions about how you make money in banking."

There has been a lot of focus on the tepid state of the business credit market, but housing is the bigger worry. Housing credit is growing at its slowest pace in 30 years. The most recent Reserve Bank of Australia figures show total mortgage credit grew by 6.6 per cent in the 12 months to March. In the decade and a half between the early 1990's recession and the financial crisis, it grew between 10 per cent and 20 per cent every year.

More than any other factor a series of housing booms is what has fuelled the growth in banks' profits. Mortgages are banks' single biggest asset class (including mortgages offshore they make up 65 per cent of total assets at Commonwealth Bank and Westpac, 55 per cent at ANZ and 50 per cent at National Australia Bank). They are also more profitable than any other type of loan. The average margin on a mortgage for a big four bank is a neat 1 per cent. For small and medium business loans the margin is higher, about 2.15 per cent, but so are the loan losses and the capital that must be held. The retail arms of banks typically deliver a return on equity (ROE) of 25 per cent but the business lending divisions deliver 18 per cent.

Some simple numbers illustrate the pickle the banks are in. According to the Australian Prudential Regulation Authority, there was just over a $trillion of mortgages sitting in the banking sector in March. Growth at 6.6 per cent means $66 billion more mortgages in 12 months. Applying a one percentage point net interest margin – the difference between the rate at which a bank borrows money and lends it – means the entire banking sector can expect $660

million in additional revenue in the next 12 months from mortgages. If housing credit growth was running at 15 per cent, as it did for most of the last two decades, the additional revenue would be $1.5 billion. That's just under $900 million that is no longer trickling into the banks, and most of it would have gone straight to the banks' bottom line.

There is no way an increase in business lending will plug the gap. First, there are less business loans around, about $800 billion in total. Secondly, the rosiest predictions of business credit, such as those of NAB's economist, have business credit growing in line with housing, not faster. The lack of new customers is sending many assumptions on how to make money from banking out the window. One of them is how banks treat each other's existing customer base, known as the bank book. Mortgage exit fees coupled with similar rates meant customers rarely moved. The bank book was sacrosanct. But banks desperate for new customers, especially NAB, are going out on poaching raids.

If you're a Westpac customer paying 7.16 per cent on your variable mortgage (allowing for the 0.7 of a percentage point discount that everyone gets) then NAB's rate of 6.97 per cent looks pretty attractive. NAB will also pay switching fees. Last week, NAB started offering a mortgage rate of 6.59 per cent for customers who bring their mortgages from elsewhere and buy their new mortgage through NAB's ultra low cost online subsidiary Ubank. Banks do not like to confirm it, but they are now forced to offer discounts to existing customers to keep them from switching. And this is starting to show up in their results. The margin in Westpac's retail and business bank where its home-loan business lies, fell from 2.08 per cent in September 2010 to 2.05 per cent in March. That came despite relatively steady funding costs and Westpac pushing through an additional 0.1 of a percentage point rise to it standard variable rate last November".

Having just succeeded in getting a mortgage rate cut we can confirm that banking competition is alive and well. Net interest margins for banks average around 2%, a far cry from the above 4% level experienced in earlier decades. And while many may be punting on housing being the banks ongoing saviour we feel that this asset class will struggle to gain further traction. As the article implied, the harsh reality for banks is that the banking "cow" has been milked for all that it is worth and the way forward it less obvious.

We commented in earlier newsletters that the brand damage inflicted by the banks on business customers from 2008 onwards, would be long lasting. The evidence thus far certainly supports that view and the situation is unlikely to change anytime soon. Business demand is down and more importantly many have re-thought their long term exposure to banks. Instead business leaders have turned to alternative funding channels including offshore debt raisings, shareholder equity raisings and use of long-term debt financing.

Banks have done themselves enormous damage and business leaders clearly now acknowledge the risk of having too much debt on the balance sheet that is owed to banks.

This will not be the end of banking and the substantial profits that are made. But the truth is plain to see that the banks are particularly exposed, carrying small amounts of capital to offset

the possibility of increasing levels of loan defaults. While the default levels remain benign, the case for banks as an investment is supported by current valuations and attractive dividend yields. However, in our opinion we suspect that the banks have entered an era unlike previous periods. Having pulled every revenue lever it is hard to imagine what further options are available. It now appears that changing investment patterns will dictate less need for traditional banking in the volumes that existed some years back.

And while volumes are unlikely to rebound anytime soon the real risk for investors is the degree to which banks drop their lending standards to achieve revenue and profit targets. Hopefully the scars of the last serious recession in 1991 are still etched in the minds of some of our senior bankers but equally, investors should not think that banks are never ending profit machines. Unfortunately they certainly give that impression, until something goes wrong and when it does, it tends to go wrong big time.

And investors do need to take heed. A look at the share market index would confirm what we all know, that banks form a material part of an investor's portfolio. While BHP Billiton represents the largest single stock in the ASX200 index with a 13.4% weighting, the big four major banks namely, Commonwealth Bank, Westpac, ANZ and National Australia are all individually ranked in the top five in terms of market weightings and collectively represent just on 23% of the overall index.

Banks have weathered many storms in the past and we expect that they will do so in the future. However their sizable exposure to major segments of the market, particularly housing, warrants caution. At this junction the jury is still out, but already there are sufficient markers to suggest that investors should proceed with added caution. ***SFM***

Energy

Why is it that just when all the pieces seem to be falling into place an event occurs that throws everything into disarray? Perhaps we can put it down to a fortuitous wakeup call that helps to put things into some perspective. In the case of the world's increasing energy demands, the events at Japan's Fukushima Daiichi nuclear power plants have certainly thrown things upside down. Figuratively speaking the nuclear fallout has already spread to China and Europe's industrial powerhouse, Germany.

China announced it has temporarily suspended approval of nuclear power projects, including those in the preliminary stages of development. With plans to build 28 new reactors, equivalent to 40 per cent of the world's total plants under construction, the significance of the announcement should not be lost on anyone.

However while many doubt that this event will seriously derail China's nuclear expansion the situation in Germany is somewhat different. Following its announcement in late May that it will now shut down all its nuclear plants with a phase-out due to be wrapped up by 2022, it becomes the first major industrialised power to take this step. With 17 nuclear reactors

currently in place, atomic energy provides the German economy with its largest energy source, sitting at 23 per cent. This is followed by lignite also at 23%, hard coal at 20 per cent, natural gas 13 per cent and wind at 6.7 per cent. Some may argue that this is a knee jerk reaction, however if Germany sticks to this path it will need to ramp up other energy sources significantly and quickly.

In Australia, the political debate around a carbon tax continues. This has led to a call to tax coal mining in particular and promote cleaner energy sources including that of gas. Already the International Energy Agency has given Australia the big thumbs up, predicting that it will become the world's largest producer and exporter of liquefied natural gas (LNG) by 2020, earning $36 billion annually by then. Little wonder then, that LNG providers including Woodside and Oil Search are spending vast sums on bringing more production capacity on stream. However the big spend is in the Eastern States of Australia, centred on the development of unconventional gas, more familiarly referred to as coal seam gas (CSG). This gas which is mostly methane is trapped in the coal seams typically 300 to 600 metres below surface, with the gas being held in place by water. When it is extracted, there are two pipes – one for gas and one for water.

Presently four planned projects in Queensland account for almost $80 billion worth of upfront investment. They include The Gladstone LNG (GLNG) project, a partnership between Santos, Petronas of Malaysia and French petroleum group Total, targeting two trains to produce 7.8 million tonnes of gas a year beginning 2015.

The second, The Queensland Curtis LNG project (QCLNG), owned by the BG Group (formerly British Gas) has permits to operate up to five trains but will initially build two trains targeting 8.5 million tonnes of gas a year with production also expected to start in 2015.

The third advanced project is The Australian Pacific LNG (APLNG) – a joint venture between Origin Energy and US based petroleum giant ConocoPhillips – with the aim to process 16 million tonnes a year using up to four trains, with a start date of production in 2014.

Finally the Shell Australian LNG (SALNG) project proposes two trains, each with a capacity of four million tonnes, however it is still awaiting environmental approval.

The numbers involved are mind numbing and the players involved vast but despite all this, there still remain serious environmental concerns that need to be addressed. Secondly, while almost everyone is in agreement that gas is the energy of the future, all these projects need to generate an adequate capital return. And as the events in Japan have shown, accepted wisdom can change quite suddenly. In the case of CSG, the environmental issues may pose a serious threat down the track but perhaps more importantly are the economic risks to the models that justify the huge upfront capital spend. And perhaps the two big external risks revolve around eventual LNG pricing and competitive responses from other suppliers. Left field events are the wildcards and they have a nasty habit of turning up just when everyone is hailing the next boom industry.

For this fledging industry the potential wildcard in the world's demand supply equation could come in the form of shale gas. Most pronounced in the US, shale gas has transformed the US from a market dependent on imports into a potential major exporter of energy. Official estimates of US shale gas reserves were recently doubled to 827 trillion cubic feet – enough to cover domestic gas consumption for the next 36 years.

And as the Australian Financial Review recently noted, "Australia's $220 billion liquefied natural gas industry may have just met its strongest match: the US shale gas industry, which in theory can deliver gas at far leaner prices than those on offer in Asia and Europe". BHP Billiton, which failed in its attempts to build an LNG facility in the US in 2007, has seen fit to enter the shale business, splashing out $5 billion acquiring the Fayetteville shale gas acreage from Chesapeake Energy in February.

This followed ExxonMobil's $31 billion acquisition of shale operator XTO Energy in 2009. BHP Billiton have commented that they believe US shale breaks even at a gas price of just under $US4 per million British thermal units (Btu) while Australian LNG requires $US8 per million Btu before it makes money.

At the other end of the scale, coal looks to be in serious strife if the headlines regarding the carbon tax are any guide. However, our sense is that the demand and use of coal will remain in place for many years to come. So much so that the Queensland Government has turned to the private sector to assist in the funding of a $6.2 billion expansion of Abbot Point coal terminal in North Queensland. This would lift capacity by 120 million tonnes to a combined 300 million tonnes, making it one of the world's largest coal terminals and importantly opens up further access to the rich coal deposits of the Bowen and Galilee Basins.

Ultimately the energy choices available are limited but as developments in Japan and the US illustrate, investors need to consider the business implications of when something goes wrong or something new emerges. In the case of nuclear, it clearly goes into the too hard basket for now, for CSG a wait and see approach would seem to make good sense, while for coal, any talk of its demise seems to be some time off. ***SFM***

Memorable comment on Europe's debt crisis – Scott Minerd Guggenhelm Partners

At the height of the debt crisis during June, the following comments summed things up well in our opinion.

"Is the European Union going to step in and come up with a permanent solution for Greece and the rest of the problem nations in Europe, or are they going to try to keep kicking the can down the road and see if the market can sort it out for them," asked Guggenhelm Partners chief investment officer Scott Minerd. "The bottom line is, if they keep kicking the can down the road, we are going to face a disaster – and I think that's the path we're on."

And then the counter view – Citi's Willem Buiter

Citi's global chief economist, London based and former advisor to the International Monetary Fund Willem Buiter, offers a counter view.

"The notion that we are helpless and have to kick the can down the road because the sovereign default would be the end of the world as we know it, is complete nonsense. When sovereigns go broke, countries don't shut down, they do not get broken up, they don't get put up for sale. To compare Lehmann with what will happen if and when Greece, Ireland and Portugal restructure is, I think both uninformed and quite irresponsible. If the European Central Bank steps in and makes its own resources available they can bail out the entire euro zone."

His approach is that "Europe must move towards a break it, you own it, covenant. Government that borrowed too much will either have to suffer fiscal pain, or suffer the consequences of a default and investors would heed the losses." ***SFM***

Time's Up for the Reserve Bank of Australia (RBA)

We have no doubt that many will disagree with our views regarding the role of the Reserve Bank of Australia. However our concerns expressed in previous newsletters including our March 2008 and the more recent March 2010 articles, seem to have some justification judging by the latest monthly update from the RBA. Our gripe is not that monetary policy hasn't a role to play in keeping things on track but rather that the policy makers are so far removed from what is actually happening and so enamoured with their own economic modelling that they miss the big picture. For months, the signs of economic stress on business life have been obvious. Our discussions with business leaders coupled with our own sense of the growing pressures families and the general population are feeling led us to one realistic conclusion, that economic growth would slow and that the constant focus on interest rates settings would temper any desire for business to expand beyond conservative limits.

Offsetting these concerns have been the coming resources "boom". Unfortunately while Australia's terms of trade are hitting all time highs, thereby driving our dollar higher, many mining projects still require serious capital investment. And the cracks are now appearing, with cost blowouts and project time delays likely to result in some not getting off the ground.

Not surprisingly the RBA's latest monthly update in early July has them less buoyant on the economy's outlook, downgrading Australia's economic growth and effectively putting interest rates on hold.

Unfortunately, these updates whilst endeavouring to promote transparency and confidence in the RBA's policies, plays havoc with those running businesses and managing daily financial decisions. Critical to any investment decision is the confidence to act and the constant will we, won't we stance that the RBA has embarked on in regards to setting interest rates is just bad policy and deserves a serious rethink.

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As we wrote in March 2010, "Unfortunately, monetary policy is a blunt tool and the danger is that in trying to stem excessive behaviour in one asset class we choke off investment in other more productive fields of the economy. We remain hopeful that the RBA is sensitive to these issues and has learnt from its previous actions in raising rates based on historically pre-determined formulas". On the evidence thus far this doesn't seem to be the case. ***SFM***

Company visit diary June Quarter 2011

April

NVT	Navitas UBS emerging companies conference	06/04/11
SVW	Seven Group Holdings UBS emerging companies conference	06/04/11
FLT	Flight Centre UBS emerging companies conference	06/04/11
FXL	Flexigroup UBS emerging companies conference	06/04/11
IFL	IOOF Holdings UBS emerging companies conference	06/04/11
FWD	Fleetwood UBS emerging companies conference	06/04/11
ORL	Oroton Group UBS emerging companies conference	06/04/11
PXS	Pharmaxis Q3 conference call	14/04/11
SRX	Sirtex management hospital site visit	19/04/11
RMD	ResMed Q3 conference call	29/04/11

May

SEK	Seek investor day	03/05/11
REA	REA Group Macquarie conference	04/05/11
SKE	Skilled Group Macquarie conference	04/05/11
CPB	Campbell Brothers Macquarie conference	04/05/11
COH	Cochlear Macquarie conference	04/05/11
AGK	AGL Energy Macquarie conference	04/05/11
TGA	Thorn Group Macquarie conference	04/05/11
CDD	Cardno Macquarie conference	04/05/11
FLT	Flight Centre Macquarie conference	04/05/11
SGH	Slater & Gordon Macquarie conference	05/05/11
SUL	Super Retail Group Macquarie conference	05/05/11
SMX	SMS Management & Technology Macquarie conference	05/05/11
CCL	Coca-Cola Amatil Macquarie conference	05/05/11
BPT	Beach Energy Macquarie conference	05/05/11
RMD	ResMed Macquarie conference	05/05/11
NWS	News Corp Q3 conference call	05/05/11
SKC	Sky City Entertainment Group Macquarie conference	06/05/11
N/A	Volkswagon Group Macquarie conference	06/05/11
ARP	ARB Corporation Macquarie conference	06/05/11
EPW	ERM Power Macquarie conference	06/05/11
SRX	Sirtex management site visit	11/05/11
OTH	Onthehouse management meeting	24/05/11
PPT	Perpetual market update management meeting	26/05/11
CPB	Campbell Brothers management results meeting	27/05/11
PXS	Pharmaxis management meeting	30/05/11

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June

ASZ	ASG Group BBY IT conference	01/06/11
DTL	Data#3 BBY IT conference	01/06/11
PAB	Patrys management meeting	02/06/11
COF	Coffey International management update	08/06/11
N/A	Hunter Immunology IPO presentation management meeting	14/06/11
SMR	Stanmore Coal RBS coal conference	15/06/11
MTE	Metrocoal RBS coal conference	15/06/11
BWD	Blackwood Corp RBS coal conference	15/06/11
N/A	Ambre Energy RBS coal conference	15/06/11
GUF	Guildford Coal RBS coal conference	15/06/11

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