Authorised Representative of Hudson Gore Pty Ltd

Summer Newsletter 2013/14

Christmas Holiday Period

Hudson Gore will be closed from the 20th December until the 17th January. If you have any inquiries please email paul.hudson@hudsongore.com.au

Paul, Michael, Ian & Kim would like to wish you all a joyous and safe festive season. We look forward to working with you in 2014 & beyond!

Financial fortune telling

Paul Hudson Managing Director

As we contemplate enjoying the festive season with our loved ones, we can also reflect on a solid year for growth investments. Most importantly, we are witnessing what appears to be sustainable growth in the US and the start of a turnaround in Europe. Japan, the best performing equity market in the world has embarked on a massive stimulus program, while China continues to grow resolutely. There is certainly more optimism then we had last year.

Domestically, the glass appears to be half empty or half full:- depending on your personality type.

We have a recovering housing market, but little construction. Consumer spending is increasing, but so are imports.

Equity markets have had a good year, but underperformed global equities significantly.

To finish the year, I have resorted to throwing a lot of tables at you. (You know I love them!) I have also attempted to come to some conclusions of what they mean for the future. There is still a large degree of uncertainty in world markets which should be taken into account when reading predictions of the future.

Is the growth sustainable?

While there is reason to be optimistic in regards to global growth there are still significant headwinds. The US has gorged on unprecedented stimulus which has resulted in a significantly undervalued dollar and artificially low interest rates. Neither are likely to remain after the stimulus program is curtailed. On the flipside the US is regaining some of its competitive advantages that will auger well for the future.

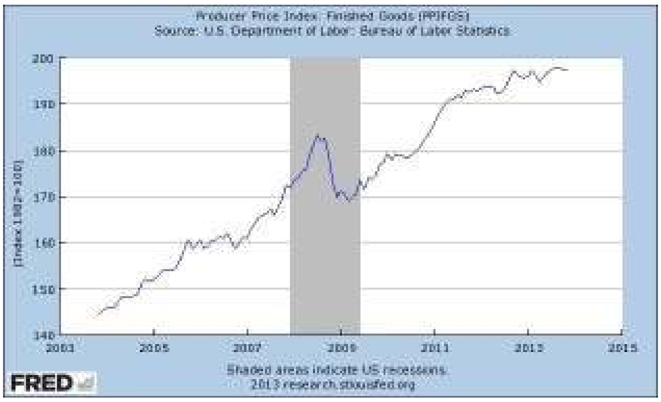
United States Outlook

The US is the largest economy in the world and by far the most important economy in the world. China and Europe are important economies but the US remains the financial engine of global growth. Manufacturing in the US is the heart of the nation which was built on the back of the steel industry at the turn of the last century. The US manufacturing Industry alone is valued at $1.9T.

To give one a scale of how big this is: The US manufacturing value would rank 10th between Italy and India when compared to the countries of the world's GDP.

The graph below shows the US PMI Composite Index over the last 10 years. When the index is above 50; manufacturing is expanding and the opposite below 50. Since the depths of the GFC, growth in manufacturing has been solid with some seasonal weaknesses. Over the last 6 months manufacturing has expanded strongly. This has corresponded with stronger job numbers, construction starts and consumer sentiment.

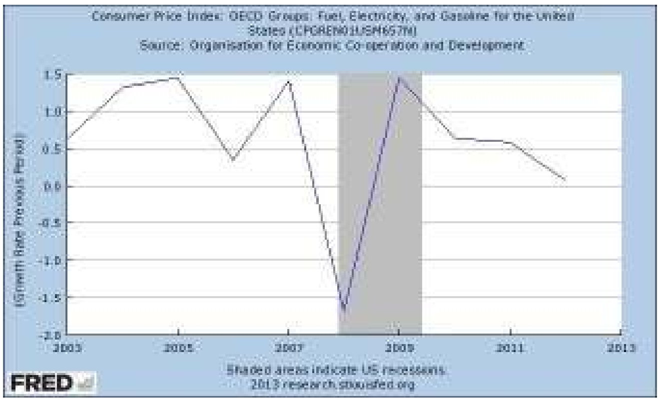
The sustained growth in manufacturing gives one hope, but most interesting to me is the productivity increases over the same period as shown below. Productivity is the key to economic growth.



What is driving US productivity?

The graph below shows the declining costs of energy in the US. The driver of this decline is the cost of natural gas. "The shale gas phenomenon" has been a game changer for the US. Of the natural gas consumed in the United States in 2011, about 95% was produced domestically; thus, the supply of natural gas is not as dependent on foreign producers as is the supply of crude oil, and the delivery system is less subject to interruption. The availability of large quantities of shale gas should enable the United States to consume a predominantly domestic supply of gas for many years and may indeed result on the US being a net exporter for the first time in 70 years. The control of supply, the massive turnaround on imports of energy, all have massive connotations for the US future foreign and defense policies. The impact on productivity is profound.

The *U.S. Energy Information Administration's Annual Energy Outlook 2013 Early Release Report* projects U.S. natural gas production to increase from 23.0 trillion cubic feet in 2011 to 33.1 trillion cubic feet in 2040, a 44% increase. Almost all of this increase in domestic natural gas production is due to projected growth in shale gas production, which grows from 7.8 trillion cubic feet in 2011 to 16.7 trillion cubic feet in 2040. This growth is likely to ensure that US energies costs remain amongst the lowest in the world for the foreseeable future.



The head of Germany's largest utility has warned it will be years before Europe can hope to counter the US's growing advantage in energy costs and predicts that the disparity will lead heavy industry to abandon the continent.

Johannes Teyssen, chief executive of Eon, said there were no obvious options for Europe to narrow the US advantage – whether by drilling for shale gas, importing more liquefied natural gas or importing inexpensive US supplies.

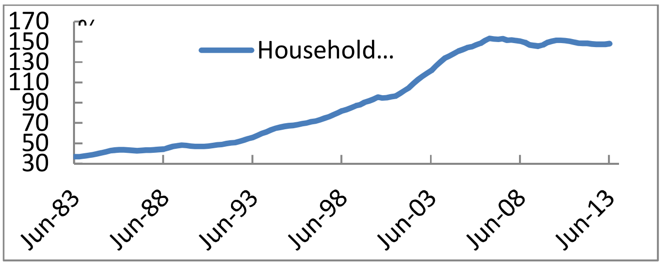
"There is a competitive advantage for America that we cannot prevent, at least for some time," Mr. Teyssen told the Financial Times. He said it was "a dream" for politicians to suggest otherwise. "It will take years and long years of innovation before we can start to shrink it," he added.

The above graph illustrates the already competitive advantage the US has and shows where Australia sits with its global peers. While the US outlook is positive Australia is looking for its next growth engine.

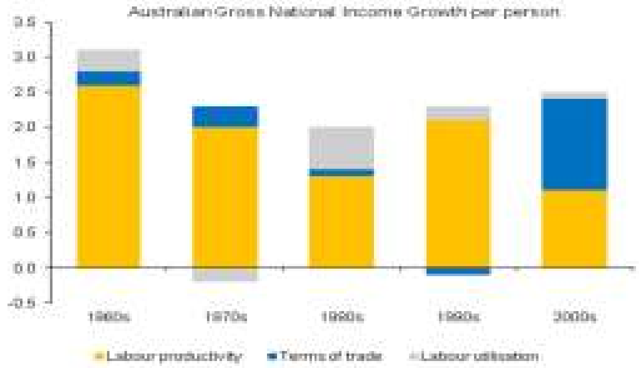
Australia:- The lucky country?

The GFC resulted in hardship in some parts of the world not seen since the great depression. Many parts of Southern Europe continue to suffer, yet Australia has sailed through the GFC with just one quarter of economic retraction. Over the last 20 years our economy has grown strongly:-the envy of the western world. What has been the engine of Growth?

The graph below shows that in 1983 that household debt to disposable income was 33%. In other words most people actually had the money before they purchased an item, which is a bizarre concept in 2013 where we are running at about 160% of debt to income. This figure has plateaued since 2003.



It was the expansion of household balance sheets that was one of the drivers of growth from 1983 to 2003, but it came at a cost. The graph below shows the components of Australian Gross National Income as related to GDP.



It can be seen that in relation to our income, it is productivity (yellow) that is the main component, while Terms of trade (Blue) has had major impacts at different times. Hours worked per person is a measure of labour utilisation (grey) Note: it's not hours worked per worker, it's the total hours worked during a week divided by every person in the population. The ramp up in debt in the 80's coincided with the increase in hours worked. The debt increase also turned our small banks in to some of the largest and most profitable banks in the world. The graph below illustrates how increasingly important the finance sector has become to Australia.

Since 2003, the mining boom as shown in terms of trade has become the engine of growth. It can be seen that labour productivity has declined considerably. We have now witnessed the end of peak spending of the boom and while mining exports will remain higher than usual the blue part of the bar is likely to represent a much smaller part for the next decade.

The question is: if borrowing was the catalyst for growth in the 20 years to 2003 and the mining boom was the catalyst for the last 10 years: what is going to drive Australia forward in the future?

This is a real source of concern for us all. Australia is in dire need of some strong leadership to ensure Australian living standards are maintained. The enviable fall in the Australian dollar will assist in our competitiveness but if our exports are too heavily reliant on raw materials, living standards will not be maintained. Like the US we have abundant conventional and un-conventional gas reserves and there is an opportunity to retrain mining workers to this sector. Australia has high energy costs which is a clear deterrent to investment in secondary industry, yet we have some of the highest reserves of gas in the world.

Australia's terms of trade are predicted to blow out to a deficit of $100b in 2014. Unemployment is expected to increase to 6.2%. It is therefore very hard to see rate increase for the duration of 2014. This would likely change if there is a large fall in the Australian dollar.

Our greatest rate of growth was the 1960's and was a result of the highest productivity growth in Australia's history. This is driven my education and competition. The swinging sixties sound good to me!

What does it all mean?

In summary my expectations for 2014 are:-

1. The Australian economy will struggle for at least the first half of 2014. The economy needs a shot in the arm which is why RBA governor Glenn Stevens is attempting to talk the AUD down.
2. The US economy is on track for growth. I believe tapering of Qualitative Easing (QE) will start in March. Equity markets could be weak in this period.
3. The beginning of the end of QE is already starting to force long term treasury notes up and will almost certainly result in a higher USD in comparison to AUD. As such I believe that this will cause the AUD to fall below $0.85USD in 2014, not the rhetoric of Glenn Stevens.
4. If the dollar falls further the outlook for inflation is positive and we may see monetary policy start to tighten i.e. interest rate increases at the end of 2014, early 2015.
5. Well run Australian companies with positive exposure to the USD will likely prosper in 2014.
6. International Equities are our preferred growth selection.
7. Bond funds remain out of favour as interest rates start to increase in many western economies.
8. The Japanese stimulus programme and continued living standards increases in China should be positive for Asian equities. Commodity prices should remain supported in this environment.
9. The sequel to Greece may well be showing in 2014. I cannot see how this is anything but inevitable. Like all sequels it will be much worse than the original. The EEC will have some major decisions to make.

Conclusion

Like its predecessors, 2014 will have its highs and lows. Conditions remain for solid returns in equities but some retraction is likely in the early part of 2014. I continue to believe that we are 2 years into a secular bull market cycle that will reward long term equity investors. Conditions for cash and bond investors remain benign for 2014 but will hopefully start to pick up in 2015.

Health Matters 2013

Michael Gore, Director

A few months ago I was watching television, flicking around the 100 channels on offer & bumped into the science program "Catalyst" on the ABC. It was an episode titled, "the Heart of the Matter" & I was fascinated! As I deal with insurance for Hudson Gore & advise clients on the risk of things like heart disease to their financial lives I was astounded at the content of the program. In summary it examined the link between cholesterol and heart disease and concluded that the link purported by many medical professional in the past was purely a myth. It seemed convincing to me, (the bona fides & commercial interests of the doctors interviewed has since been questioned) and resulted in people stopping heart medication (statins) recommended by their own doctors. The next day I couldn't believe that such radical assumptions would be on peak time ABC programming without more discussion, analysis & dispute. This has since changed (Google; Catalyst, Heart of the Matter) and the ABC & particularly the producers of the program are under heavy attack.

I thought of this as, at this time of year, we receive summaries from insurance companies on what diseases were most prevalent over the past year (often the statistics are calculated using the previous year's data). As Paul has summarised our finances for the year with *"numbers from the markets"* I will summarise our health with *"numbers from the insurers'* outlining what diseases have been most prevalent over the past year.

Leading Causes of Death	2011/12	
Cause of death and ICD code	**# No.**	**Rank**
Ischaemic heart diseases (I20-I25)	21 513	1
Cerebrovascular diseases (I60-I69)	11 251	2
Dementia and Alzheimer disease (F01, F03, G30)	9 864	3
Trachea, bronchus and lung cancer (C33-C34)	8 114	4
Chronic lower respiratory diseases (J40-J47)	6 570	5
Diabetes (E10-E14)	4 209	6
Colon, sigmoid, rectum and anus cancer (C18-C21)	4 087	7
Blood and lymph cancer (including leukaemia) (C81-C96)	3 978	8
Heart failure (I50-I51)	3 488	9
Diseases of the urinary system (N00-N39)	3 386	10
Prostate cancer (C61)	3 294	11
Breast cancer (C50)	2 937	12
Influenza and pneumonia (J09-J18)	2 492	13
Pancreatic cancer (C25)	2 416	14
Intentional self-harm (X60-X84)(c)	2 272	15
Skin cancers (C43-C44)	2 087	16
Accidental falls (W00-W19)	1 845	17
Hypertensive diseases (I10-I15)	1 802	18
Cardiac arrhythmias (I47-I49)	1 612	19
Cirrhosis and other diseases of liver	1 589	20

ISCHAEMIC HEART DISEASE (blockage of the cardiac arteries) accounted for 15.0% of the burden of disease in Australia based on years of life lost (YLL). The burden of disease attributable to ischaemic heart disease was slightly higher for men compared to women (16.1% vs. 15.0%). Based on YLL and single disease cause, ischaemic heart disease is the single largest burden of disease in Australia, more than double any other cause of premature death.

ATTRIBUTABLE RISK FACTORS: The list below indicates the main risk factors related to ischaemic heart disease:-

1. High blood pressure
2. High total cholesterol
3. High BMI
4. Physical inactivity
5. Tobacco
6. High fasting plasma glucose

Dietary Risks:

1. Diet low in omega 3 fatty acids:
2. Diet low in fruit:
3. Diet high in sodium:
4. Diet low in vegetables:
5. Diet high in trans fatty acids:

It seems therefore what we all knew & have read over the years hasn't changed too much. We are aware that high blood pressure and high cholesterol are still a major problem.

Cholesterol

As we know high cholesterol is caused primarily by our lifestyle. We can maintain cholesterol at a healthy level by a combination of a healthy diet & regular exercise. However cholesterol isn't always linked to lifestyle. Some people will develop raised cholesterol thanks to the genetic patterns they get from their parents. This is known as familial hypercholesterolemia, or FH.

Our bodies contain genes which control how cholesterol is metabolised, and FH is essentially a malfunction (defect) in one of those genes. The defective gene typically comes from just one parent and it affects around one in every 500 people. In this case the risk of developing CVD later in life can increase four-fold. However, it is also possible for the defect to come from both parents and this will massively increase the risk of CVD. Fortunately, this is an extremely rare condition.

Signs of FH

The tell-tale signs of FH are the same, whether it comes from one or both parents include:

- High cholesterol in the immediate family
- A fatty deposit around the elbows, knees, buttocks and tendons, which are known as xanthomas. If this occurs in a first-degree relative (biological parent or sibling), there is a strong chance you may have FH too
- The cornea of the eye may have a pale ring around it, which is known as arcus senilis
- Noticeably high levels of cholesterol – total cholesterol higher than 7.5 mmo/L and LDL cholesterol above 5.0 mmo/L

- Premature cardiovascular disease in your personal or first-degree family history – under the age of 50 for men and 60 for women.

What's the treatment?

Although FH is caused by genetics you still need to be healthy! This ensures that LDL levels do not rise any higher than they are naturally through the body, while the protective HDL level will be at the highest possible level.

Obviously the dietary risks above should be heeded BUT your diet should also be low in saturated and trans fats, and contain healthy levels of unsaturated and omega fats. Also eat plenty of soluble fibre.

Exercise is also crucial. At a minimum half an hour of brisk walking a day. Ideal BMI should be below the recommended limit of 25.0.

Alcohol should be consumed at a healthy level (no more than 21 units a week for men and 14 for women) AND no smoking.

However, if lifestyle choices aren't enough to show a significant effect on your cholesterol, there is medical treatment available. This is a likely scenario for people with FH. Your doctor will decide the best course of treatment for your condition, but there are numerous options available.

Conclusion

Hate to put a dampener on Christmas Lunch … One Break Out a Year Won't Hurt!!

BUT watch out for Numbers 17 & 20 on the death list as well.

Pictures that matter..