

Member Update

- The outlook for the Australian economy has deteriorated markedly
- Policy makers continue to launch measures to support economic growth
- Equity markets remain volatile, while Australian bonds gain ground
- Listed property was the worst performing asset class over the month
- Bank bill yields continue to fall, with interest rates likely to head lower

Issued: March 2009

Market Review for January 2009

Economic data continued to disappoint in January, with the IMF forecasting that global growth for 2009 will be the lowest since the Depression seen in the 1930s. The IMF now expects global growth to be just 0.5% this year. The outlook for Australia has also deteriorated markedly, following a sharp slowdown in growth in China and the rest of Asia.

Around the world, policy makers are continuing to launch measures to try and support financial systems and encourage growth. Some countries are still able to cut interest rates, but other nations, in particular the US, are now having to look at other policy options.

Official US interest rates now remain on hold in a target range of 0-0.25%. The US Federal Reserve has acknowledged that, given prevailing economic conditions, rates may remain at this low level for some time. It may now look to expand its balance sheet further, by buying up government bonds and debt issued by government agencies. All of these actions are aimed at reducing inter-bank and corporate borrowing rates.

Nevertheless, corporate access to finance remains tight, hindering trade and investment. In the US, the availability of credit to the housing and consumer finance sectors has also slowed.

In Australia, the collapse of commodity prices and worsening terms of trade are undermining the outlook for investment and exports, particularly within the mining sector. Adding to the negatives, Treasurer Wayne Swan admitted at the end of January that the Commonwealth Government was likely to fall into deficit over 2009.

However, the government believes that a temporary deficit is the best way to ensure a quick return to economic growth, as money is spent to stimulate the slowing economy and create jobs. With that in mind, the Commonwealth Government announced an A\$42bn National Building and Jobs Plan – a fiscal package (equivalent to 3.8% of GDP) to be spent over the next four years.

Asset Class Returns

Australian bonds were the only asset class to make a positive return over January, up 1.4%. Global bonds were weaker over the month, down 0.6%.

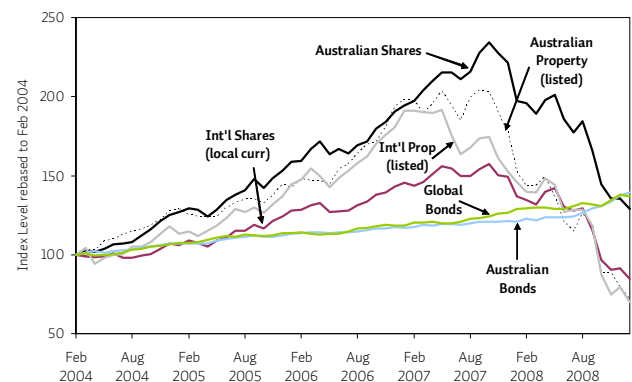
The news from equity markets continues to be poor. Global equities were down 7.18% in local currency terms, although the falling Australian dollar meant that returns were up 0.2% in AUD terms. Australian equities followed the lead from global markets, dropping 4.84%.

On the currency markets, the Australian dollar dropped by 9.27%, to US\$0.636. A combination of weak Chinese growth, risk aversion and expectations of further rate cuts from the RBA all weighed on the currency.

The US dollar gained ground against other major currencies except for the Japanese yen, which remains a key beneficiary of a move towards 'safe haven' investments. The yen now appears somewhat overvalued, given Japan's rapidly deteriorating economic fundamentals.

Property was the worst performer over January. Global REITs fell by 13.3% and Australian REITs were down 9.6%.

Fig. 1 – Asset Class Benchmark (Index) Performance (5 Yrs) to end-February 2009



Source: Index returns sourced from Bloomberg

Cash returns

Bank bill yields fell further over the course of January. 90-day yields closed the month at 3.41%, down 0.74%, while 180-day yields were down 0.59%, at 3.11%.

Australian Shares

The ASX 300 experienced another volatile month in January, driven lower by renewed concerns over the viability of financial institutions in the UK and the US. The ASX300 Accumulation Index tested the lows it hit in November 2008 before a modest rally at month-end. That said, the index was still down 4.84% on the month.

Sector returns were mixed. Investors initially took refuge in defensive sectors, although there were signs of the market starting to show resilience to poor news flow by month-end.

Healthcare, telecom and staple sectors outperformed, while industrials, banks and REITs lagged, amid a fresh round of profit warnings and further government rescue packages for US and UK banks.

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International Shares

Global equities (as measured by the MSCI World ex Australia, in local currency terms) fell 7.18% in January, as the economic news out of the US and Europe continued to disappoint.

In the US, the Dow Jones Industrial Index was down 8.84%, while the S&P500 fell 8.57%. European markets were also lower, with the DJ Euro Stoxx index down 8.61%. The UK market was also down by 6.42%, despite a sharp cut in interest rates.

Elsewhere, emerging markets fell by 6.6% in USD terms (but up 3.5% in AUD terms). Emerging European share markets have been particularly hard hit, as regional governments try to work through financing issues at a time of slowing economic growth.

Listed Property

Global property markets fell in January, weighed down by declines in the UK, the US and Germany. The UBS Global Investors (ex Australia) index finished down 13.3% on the month. Refinancing issues continue to plague the sector, with global demand for property falling as economic growth slows.

The S&P/ASX 300 Property Accumulation Index was down 9.6% on the month. Profit downgrades, refinancing concerns and a weaker economic outlook have all undermined investor confidence. Westfield's downgrading of their 2009 profit and earnings expectations also weighed heavily on the listed property market.

To help overcome the challenging financing conditions, the Federal Government announced the establishment of the Australian Business Investment Partnership. The aim of this new body is to provide liquidity support for the commercial property sector, which is likely to find refinancing difficult as offshore banks reduce lending in the Australian market.

Bonds

Global bond markets were weaker over the month, despite the poor global economic outlook and lower interest rates. Investors were instead focused on the likelihood of an increase in bond supply over the coming months as governments around the world seek funding for expansive fiscal policies. The return on the Barclays Capital Global Aggregate Index was -0.6% over the month.

US 10-year bond yields ended the month 0.5% higher, at 2.8%, amid uncertainty as to when the US Federal Reserve will announce concrete plans to start purchasing government bonds as a policy tool.

European and UK bond yields were also higher over the month. That said, global 10-year bond yields remain at low levels, supported by the large investor demand for safer investments.

In Australia, 10-year bond yields also trended higher, to finish the month at 4.1%.

Getting good advice can make a big difference



Michael Heffernan is head of GESB Financial Advice and has 25 years experience in the finance industry. We asked Michael for his view on the value of getting professional advice and what GESB members can expect

I am always interested to hear people's opinions about how they view 'financial advice'. Some common responses from those who have never had professional advice are: "I don't need it", "I can't afford it", "It's for wealthy people with complicated situations". However, those same people seem happy to talk about mortgages, credit cards, and other finances with their friends, family and neighbours.

The questions you need to ask yourself are: Am I getting the best value or accurate information for my own situation by talking to friends, family or neighbours? Will I get better value from talking to a qualified adviser?

The answer I offer to you is: A qualified financial adviser can offer you much better value than information you get from an unqualified source.

Many GESB members who have met with an adviser from GESB Financial Advice admit that they had been meaning to tidy up their finances for years but kept putting it off.

Read full article

http://www.gesb.com.au/cps/rde/xchg/internet/site/FinancialAdvice_4071.html

Establishing and maintaining a Will is important

Most of your life is spent working to build up assets such as your home, car, boat, superannuation, insurance policies and other investments so that you can provide the kind of lifestyle and security you want for yourself and your family's future.

But what will happen to all of those assets when you pass away? More importantly, who will take ownership of those possessions? Developing and maintaining a Will is important to ensure that your loved ones are cared for and your wishes are taken into consideration when you pass away.

If you were to die without leaving a Will, your estate would be divided according to the law. This means that you will have no say on how or to whom your assets and treasured mementos are distributed. All it takes for peace of mind is a little planning.

Read full article

http://www.gesb.com.au/cps/rde/xchg/internet/site/FinancialAdvice_4071.html

~ Call GESB's Member Service Centre on 14 GESB (4372) and speak to a service consultant or visit gesbfinancialadvice.com.au and take control of your financial future.

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Sharon Hicks
Chief Investment Officer

There has been considerable debate in the media recently about the differing investment performance of superannuation funds and how holding *listed* and *unlisted* assets may have contributed to this gap in performance. How does this topic impact fund performance? What does it mean for GESB's investment portfolio?

First of all, we need to explain what we mean by listed and unlisted assets.

Listed Assets

Superannuation funds have exposure to a diversified portfolio of assets comprising shares, bonds, cash, property and other strategies. Assets such as shares and bonds are typically traded daily on stock exchanges or through other market or broker mechanisms. These listed or broker/dealer traded assets are referred to as listed assets.

Unlisted Assets

However, many assets within superannuation fund portfolios are in unlisted assets or funds. Unlisted assets are those which are not listed on a stock exchange or not typically tradable on a daily basis. Such assets can include private equity, infrastructure or property and often these can be held by listed entities and traded daily. However, many of these assets are held directly by superannuation funds or via unlisted funds and tend to be valued much less frequently than listed assets, perhaps on a quarterly, six-monthly or sometimes even an annual basis.

This then begs the question: Do the current prices of unlisted assets (which may not have been revalued in nearly a year) truly reflect the price at which these assets could be bought or sold today?

Example

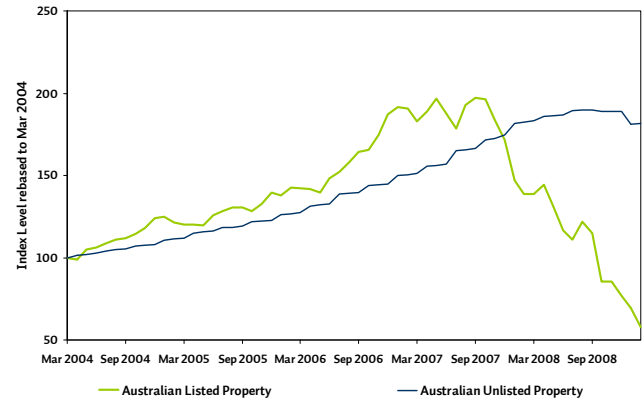
To make a comparison, let's consider the example of our own home. In considering whether to sell our home, we may seek out a real estate agent or a valuer to provide an assessment of our home's worth. The agent or the valuer will make certain assumptions about the home's condition, location and perhaps what it can be rented for. Yet it remains just that – a valuation. It is not until you actually sell your home that its *true* worth is determined. And if market conditions deteriorate or the economic outlook is bleak, then the difference between the valuation and the actual sale price can be very significant.

It is useful to continue to use property to further demonstrate that the market can reflect different prices for largely the same assets.

Listed property assets sit inside a listed trust (also known as LPTs) and the market assesses the valuation based on what investors are prepared to pay for it. Whereas, with unlisted property, the valuation is based on what a third party thinks the asset is worth, based on certain assumptions about rental growth, interest rates, and other factors. On this basis, the listed market is going to give you one valuation answer and the unlisted market could give you another answer. And, perversely, it can often be the case that a listed trust and an unlisted trust will have part ownership of the same asset, say a major shopping centre. Yet the price at which the listed trust is trading at implies a much lower valuation for the shopping centre than the unlisted trust. So what is the right answer? Only time will tell. Perhaps the listed trust is undervaluing the shopping centre? Perhaps the unlisted trust is overvaluing the shopping centre?

Generally though, the listed market is quicker to respond to the influence of prevailing economic and market conditions than the unlisted market. This is clearly illustrated in Fig.1. Valuations of the two asset classes shown have diverged considerably but, eventually, they are expected to converge once unlisted property asset revaluations take effect.

Fig. 1: A significant decline in Australian listed property trusts versus Australian unlisted property



Source: Mercer MPA Wholesale Database, S&P/ASX 300 A-REITs Index and Mercer Unlisted Property Index

So, what does all this mean for GESB's investment portfolio?

GESB's investment portfolio comprises mainly traditional, liquid asset classes such as cash, listed equities, bonds and *listed* property funds. GESB has a relatively small exposure to unlisted assets, comprising a diversified private equity programme of around 5% of total assets. It is largely for this reason that GESB's investment performance may today compare unfavourably to some other funds which may hold up to 50% of their portfolios in unlisted assets.

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For example, GESB has no holding of direct or unlisted real estate and derives its property exposure from liquid global real estate trusts. The previous chart demonstrates the significant decline in Australian listed real estate trusts. If the listed market is correct, then some very sharp reductions in the valuations of Australian and international real estate will occur in the period ahead. Once the pricing convergence takes effect, members should see the performance of comparable investment plans within super funds converging also.

GESB's Chief Investment Officer, Sharon Hicks, was very clear when asked: "*Should investors and fund managers steer clear of unlisted assets?*"

"Definitely not," says Sharon. "This issue is not one of listed versus unlisted. One is not better than the other. The issue that members need to understand is that unlisted valuations tend to lag listed valuations. So a fund such as GESB with a large, highly liquid portfolio of predominantly listed assets is seeing its assets priced by the market for today's conditions. Funds with larger exposures to unlisted assets may undergo a period of apparent *out-performance* while unlisted valuations catch up with prevailing market conditions. The *out-performance* is likely to be temporary and not permanent.

Indeed, GESB, in formulating its investment strategy is mindful of the likely contraction in unlisted valuations, and may seek to increase its exposure to certain unlisted strategies in the future. However, in doing so, GESB is particularly mindful of protecting the liquidity of the portfolio and member equity. Large exposures to infrequently valued unlisted assets run the risk of distorting equity between new members entering the fund and existing members, particularly during major asset class or market shocks. This is especially important because GESB members have the ability to transact daily, for example retiring members requesting to draw their benefit or members switching across investment plans. Therefore, any exposure to unlisted assets will be appropriately limited to ensure the portfolio remains sufficiently liquid and member equity is preserved."

5 March 2009

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