The Rock
INVESTMENT PLANNING LIMITED

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Editorial

With only one month to Christmas the silly-season (and summer) is definitely upon us.

In this issue we cover:

1. The Aussie battler and burgernomics
2. Christmas shopping
3. Investment briefs

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The Australian dollar

The Australian dollar continues to climb and is currently trading at around $US0.72. It wasn't too long ago that currency forecasters were expecting the dollar to fall below $US0.40. What has changed and what does this mean for us?

Currencies prices are generally linked to the perceived strength or weakness of the underlying economy and interest rates. With the decision by the RBA to increase interest rates there has been a flow of foreign money into Australia as professional investors chase higher returns for their cash, without taking on much (or any) risk.

We say investors have taken on next to no risk as the Australian economy is not only strong, but it has shown itself to be remarkably buoyant and resilient over the past couple of years. While many countries have been experiencing economic slowdowns our economy has continued to grow. Further, our western democracy is the sort of political economy investors favour.

International investors need to convert their foreign dollars into Australian dollars in order to be able invest here. This results in demand for the Australian dollar increasing, and the price of the Aussie dollar rising.

This is both good and bad. It's good for consumers because the price of international goods has fallen in comparison to last year, but bad for exporters as their goods are now more expensive in the international market. Competing with lower priced goods of comparable quality will have a negative impact on the earnings of companies that generate significant revenue overseas.

Investors are also affected, because a rising Australian dollar means that when international investments are converted back into Australian dollars they are worth less.

Although the US government has been making noises complaining about the fixed exchange rate in China, you won't hear them complain too loudly. While the US dollar remains low they can export their goods quite cheaply. If the US dollar remains low for long enough we could see an export lead recovery in the US economy. If this happens we would expect to see interest rates rise and foreign dollars flow back into the US.

Burgernomics

The Big Mac index commenced in 1986 as a light-hearted way to compare whether currencies are over or undervalued. Economic theory (in the form of Purchasing Power Parity) holds that $1 in Australia should by as many goods as $1 in the US. The Big Mac Purchasing Power Parity index measures the exchange rate that would leave burgers from different countries costing the same as in America. Comparing this with the actual exchange rate is a way of determining whether a currency is over or under valued (*source: www.economist.com/markets/Bigmac/Index.cfm)*

Although the index is a simple measure it is beginning to develop some credibility for two main reasons: the first is that the index is gaining the attention of economists; and the second is that it has been shown to be quite accurate.

In the most recent study (April 2003) the Big Mac PPP undervalued the Australian dollar by 31 per cent, which compares to the Swiss Franc that was overvalued by 54 per cent and the Chinese Yuan which was undervalued by 56 per cent. Interestingly, from April 22 to November 24 the Australian dollar has risen 18 per cent against the US dollar. Perhaps there is something in the Big Mac index after all.

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Christmas shopping

Usually at this time of year the media is reporting that retailers are preparing for a quiet Christmas with forecast sales well down on the previous year. This year however, indications are that consumers are cashed up and looking to spend.

The Australian Retailers Association is predicting Christmas related spending to increase by 5.1 per cent or $5.4 billion this year. This comes on top of a 4.7 per cent rise in retail turnover compared to last year *(source: www.theage.com.au 19/11/2003)*. This is further evidence of a strong domestic economy and a growing and maturing retail sector. Lower import prices (especially with electronic goods) should further fuel the spending binge.

Stocks such as Harvey Norman, JB Hi-Fi, Coles Myer, and Woolworths are all well placed to take advantage of a strong Christmas period.

On the other side of the coin are the risks to the sector. One of the biggest is the potential for another rise in official interest rates. Many commentators are of the view that interest rates will rise after the RBA's next board meeting on December 2. Digressing for a moment, although it appears the RBA acted outside their mandate of keeping inflation between two and three per cent when they raised interest rates last month, this was probably a good move. A small increase or two today is a lot easier to cope with than a couple of larger rises in the future. Maintaining control over the economy is as important as controlling inflation.

If interest rates do rise by another 25 basis points or more, we suspect retailers may not have such a good Christmas as originally expected.

Investment briefs

Western Mining (**WMC**): A failed heat exchanger at its Olympic Dam site is costing it an estimated $1.5m per day (total cost expected to be $34m).

Telstra (**TLS**): Buyback closed over subscribed and at the lower end of the offer ($4.20).

Toll Reset Preference Shares (**TOLPA**): Trading at around $105 after listing at $100.

Australian Leisure and Hospitality (**ALH**): Disappointing float. Detracting from this was the omission from the Australian prospectus that the underwriters received $230m shares at $2, while most others paid $2.50.

Aristocrat Leisure (**ALL**): Still treading water. Growth in Japan more than offset by a slowdown in its US and NZ operations. New CEO has been appointed to this troubled company.

Seven (**SEV**): The final of the Rugby World Cup was the highest rating TV show of the year. Its other offerings, however, continue to disappoint and it remains a laggard in the ratings race. Seven is launching 14 new reality TV shows in 2004, but expects only 2 or 3 to be hits. An interesting strategy.

The three TABs (**UTB**, **TAB**, **TAH**): This will be an interesting battle with TAH aggressively pursuing TAB. UTB may be left out in the cold (again). Regulatory issues still need to be met and this merger battle looks set to heat up. Watch this space.

Village Roadshow (**VRL**): The Victorian Supreme Court rejected the move by Village to buy-back its reset preference shares. Village continues to struggle even though the movie industry continues to grow.

Virgin Blue (**VBA**): Due to list on the ASX on December 8. Will be interesting to see if it bucks the recent disappointing trend and lists at a premium.

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