DEBT CEILING, WHAT A BORE!

The US in its predictable fashion increased the debt ceiling for the 11th time since 2001, extending the Government's borrowing authority until February 7th 2014. To the detriment of the US Government, the failed plan (verging on blackmail) by Republicans to use the debt ceiling as a political tool was met with worldwide scrutiny questioning both its willingness and ability to meet their obligations. The problem here is any threat, perceived or real, in its ability to meet obligations would result in unfavorable adjustments in interest rate markets which it did momentarily. An untimely situation for a country holding the world's largest debt balance and who have only just started to gain traction after years of loose monetary policy.

Although not an immediate threat, political brinkmanship as shown by the US aids support in favor of those seeking to "De Americanize" the world, such as the largest foreign holder of US debt, China. To put a lid on this rather quickly and restore faith in the world's reserve currency the US defends its paper currency by attacking its ultimate hedge, Gold. Effectively, by selling paper futures the US can achieve two major objectives, defend the dollar and buy the physical at a lower price to meet its obligations to countries who have requested gold holdings from Fort Knox be repatriated, such as Germany. Coincidence or conspiracy, Gold fell 9.5% from the 1st September until the US debt ceiling was lifted on the 17th October.

From a market perspective the players are mind numbingly bored of the debt ceiling debate and its predictability; hence leading up to the deadline the market treaded water rather than send itself into a tailspin which we experienced in 2011. In addition the market players concluded prior to the debt ceiling deadline, the Fed is not ready to pare back its stimulus program this year and was ready to chase higher returns through risk assets. Once interest rate markets received confirmation of the lift in the debt ceiling this lead to bond market participants to price in lower yield expectations and the markets have continued to outperform since. In line with our expectations we have seen the overall market move higher and have noticed both a shift in sentiment towards mid-cap companies including sectors such as the small industrials and improving trade volume in small cap companies.

Locally, in anticipation of the $300 million debt limit being exceeded this coming December, a direct consequence of Labor running our finances (btw where have they all disappeared to?), Joe Hockey has increased the debt ceiling by $200 million to $500 billion in a move to ensure Australia isn't faced with a standoff as experienced by the US. Rating agencies have confirmed the move will have no effect on the Triple A credit rating because they expect the incumbent to remain on target to achieve a budget surplus in 2016-2017, eliminating for now a degree of uncertainty and consequently any additional upward pressure on interest rate markets and the AUD that would have resulted otherwise.

CASH RATE TO REMAIN STEADY

The headline inflation rate lifted 2.2% through the year to the September Quarter, compared with a rise of 2.4% last quarter, well within the RBA target range of 2-3%. The main contributors were felt in areas which hit Australian people the hardest:

- Fuel + 7.6%
- Electricity + 4.4%
- Property Rates and Charges +7.9%
- Water and Sewerage + 9.9%

With the Australian dollar holding at 94.58 cents against the US dollar the RBA remains concerned with the effects it will have on the economic prosperity and welfare of the Australian public. In the immediate term however it's taking a hand off approach and betting lower Chinese growth over the longer term and lower commodity prices will lead to a falling terms of trade (the relative price paid for imports versus price received for exports), an outcome they assume is inevitable. Considering companies like BHP, RIO, FMG have been breaking production records, if this trend continues it will offset lower commodity prices. To what degree only time will tell, but this assumption is likely to face headwinds and we will find ourselves forever fighting the two speed economy.

THE PRICE EARNINGS RATIO, SHARE PRICES AND EARNINGS YIELD

We have had a number of enquiries regarding Price Earnings Ratios (P/E Ratio) in relation to Share Prices and if they indicate a company is over or undervalued. A valid question given the share price and P/E ratio increases we have seen to date, in particular on the higher yielding stocks. The answer is well kind of, it won't tell you everything you need to know about a stock, nor will it give you a definite conclusion if a company's share price is over or undervalued, however if you take into consideration the following you will be that step closer in determining if a stock represents good value at any given point in time:

- Comparing the company's current P/E ratio to its own historical P/E ratios
- Comparing the company's current P/E ratio to companies in the same Industry
- Considering the company's current P/E ratio given market expectations and your own

The P/E Ratio is simply a function of a company's share price to its earnings per share. It generally tells you how much the market is willing to pay for a $1 of a company's earnings. It also gives you an indication on how long it's likely to take you to get your money back if you invested in the company at today's price. Any change in reported earnings per share, share price and the ratio outcome will be adjusted accordingly. In addition any change in the **expectations** of company's earnings and other influential factors (economic cycles, market outlook) **will influence price** and in turn the P/E ratio will expand or contract. For example, if the market expects higher earnings growth in a stock then the market will be buyers of the stock, resulting in a higher share price and consequently a higher P/E ratio.

The chart below is for ANZ limited. The **GREEN** line reflects the P/E Ratio for the company whilst the **BLUE** line represents the share price at any given time. When the GFC hit the ASX, calamity ensued because no one could ascertain the true impact of the events that transpired. Hence market expectations on earnings were negative leading to lower prices until the share price and the P/E ratio settled to the levels reflected in the **RED** box.

On the assumption of the historical **banking sector** average being a P/E ratio of 12 x earnings, the red box shown above reflected P/E ratios of under 8 x earnings, much lower than the historical average. Value investors at this level the stock consider the stock to be oversold and consequently attracted them to buy the company at the lower share price.

The trend leading to the **GREEN** box reflected higher expectations in ANZ's earnings outlook and as the trend developed the P/E ratio hit a new high of 16.8 x earnings not seen since pre-GFC. This reflected confidence in the bank earnings outlook, and demand for yield as interest rate markets declined. Eventually earnings met market expectations and P/E ratios proceeded to readjust to lower levels.

Today however we are faced with a conundrum represented by the **BLUE** box. The higher share price and its P/E ratio have to date been justified by the positive upward trend in company earnings. The P/E ratio reflects general market sentiment of cautiousness and so it's difficult to determine if the stock is trading at a fair value. Without a crystal ball how can we attempt to justify buying at these levels? Let's consider the **Earnings Yield**.

The **Earnings Yield** is the inverse of the P/E ratio. It is often compared to the prevailing 10-year commonwealth government yield. If the earnings yield for a company is less than the underlying 10-year bond yield it is considered overvalued compared to bonds. If the earnings yield for a company is higher than the 10-year government bond yield, the stock could be undervalued compared to bonds. This is because an investor should demand a couple of percentage points higher to justify the risk taken when investing in the equity market. The earnings yield for ANZ is trending towards the 10-year government bond yield of 4.0073%, currently sitting at 6.8%. This in our view reflects the banking sector is at risk becoming overheated near term and as a consequence we would recommend (if you were considering ANZ as an investment) allocating a lesser proportion of your total investment, holding the remainder to take advantage of any pullback in the share price short term.

THANKS FOR THE POCKET MONEY

In this day and age surely 82 deposits amounting to AUD$309 million dollars into a company account run by a 29 year old with no previous earnings history, personal or otherwise might have raised a little red flag somewhere in the banking system. But instead it didn't and the customers of fallen gold trader Genneva Malaysia are still out of pocket, four years after the offices were raided by the Malaysian Central Bank and the operation shut down. The alleged masterminds of the scheme being the directors and their family members, including a director's daughter who was the recipient of the AUD$309 million dollars now find themselves fighting 926 charges of alleged money laundering, tax evasion and misconduct. To date customers are owed over AUD $1.7 billion from the fallen scheme and are no closer to getting any funds or bullion back.

IT SOLUTIONS, SERVICES AND WEBSITE DESIGN

SETTLE TRADES WITH DIRECT DEBIT/CREDIT FACILITY

Make your life easier and utilize the direct debit/credit facility we have available to settle your trades. Trades are settled direct to your nominated account on the day of settlement and are a lot easier than having to line up at the local bank to make a deposit or risk not settling in time waiting for a bank cheque to clear. Save yourself time and contact Jess at the office to organize.

Performance of Key Indices

Equities	*Close*	*Change (M)*	*Change % (M)*
All Ordinaries	**5420.30**	**+150.20**	**+2.85%**
S&P/ASX200	**5425.50**	**+149.60**	**+2.84%**
Dow Jones (US)	**15545.75**	**+272.49**	**+1.78%**
NASDAQ	**3919.71**	**+158.61**	**+4.22%**
S&P500	**1756.54**	**+63.77**	**+3.77%**
FTSE 100 Index	**6731.43**	**+179.90**	**+2.75%**
Nikkei 225 (Japan)	**14327.94**	**-292.59**	**-2.00%**
10-year bond rate (US)	**2.56%**	**-0.00075**	**-2.83%**

Upcoming RBA Events

Reserve Bank Board Meeting – 5th November
Statement on Monetary Policy – 8th November
Minutes of the RBA meeting – 19th November

ABS releases March

Retail Trade (September) – 4th November
International Trade in Goods and Services (September) – 6th November
Housing Finance (September) – 11th November
Lending Finance (September) – 12th November
Labour Force (October) – 14th November

Upcoming US Economic Releases

ISM Manufacturing Index – 1st November
GDP – 7th November
US Employment Situation (October) – 8th November
International Trade – 14th November
Retail Sales – 20th November
FOMC Meeting Announcement – 20th November
Consumer Price Index – 20th November
Producer Price Index – 21st November
Housing Starts – 26th November
Durable Goods Orders– 27th November
GDP – 26th November
Jobless Claims – Weekly Basis