Quarterly Asset Class Forecast Report

APRIL 2012

PURPOSE OF REPORT

- This report provides **10 year forecast return expectations** for all major asset classes as well as a range of **short term asset class valuation considerations**. The report is designed to help financial advisers explain long term risk/return expectations to clients as well as provide some short term market information for discussion. The data contained in this report is at 30 March 2012.
- Return expectations in the following table are set by assigning a **risk premium** for each sector in the form of a return above a risk free investment (10 year government bond yield). The risk premium reflects the fundamental judgment we make about how much risk we see in an asset class and what price we attach to that risk. These risk premiums are determined by historical observation of asset class returns versus risk free investments. The risk premium is then combined with an expectation **for active management** value add, which is derived in part by the historical performance of Zenith's recommended investments. After tax impacts are also considered including an estimate of **franking benefits** for domestic equity investments.

LONG TERM (10 YEARS) EXPECTED RETURN, HISTORICAL RISK, CURRENT YIELD

SECTOR	10 YR FORECAST TOTAL RETURN (%P.A.)	10 YEAR STD DEVIATION (%P.A.)	CURRENT YIELD* (%P.A.)	NOTE
CASH (CMTS) FUNDS	3.37%	0.33%	4.33%	
AUSTRALIAN FIXED INTEREST FUNDS	5.30%	2.77%	4.43%	
GLOBAL FIXED INTEREST (HDGD $A) FUNDS	5.40%	2.85%	*6.58%**	*NOTE 1
AUSTRALIAN EQUITIES FUNDS	8.50% (9.87%)	13.23%	4.95% (6.32%)	*NOTE 2
AUSTRALIAN SMALL CAPS FUNDS	10.50% (11.00%)	18.81%	3.03% (3.53%)	
GLOBAL EQUITIES (UNHEDGED $A) FUNDS	8.50%	12.34%	2.81%	
GLOBAL EQUITIES (HDGD $A) FUNDS	9.00%	15.40%	*6.98%**	*NOTE 1
EMERGING MARKETS (UNHEDGED $A) FUNDS	9.50%	16.72%	3.02%	
AUSTRALIAN REIT FUNDS	7.58% (7.68%)	17.90%	6.56% (6.66%)	
GLOBAL REIT FUNDS (HDGD $A) FUNDS	7.98%	23.53%	*8.03%**	* NOTE 1& 3
TERM DEPOSIT REFERENCE RATE - 1 YEAR	-	-	5.00%	* NOTE 4
TERM DEPOSIT REFERENCE RATE - 3 YEAR	-	-	5.30%	* NOTE 4

*Current Yield Includes estimate of the pickup from currency hedging and is based on current interest rate differentials

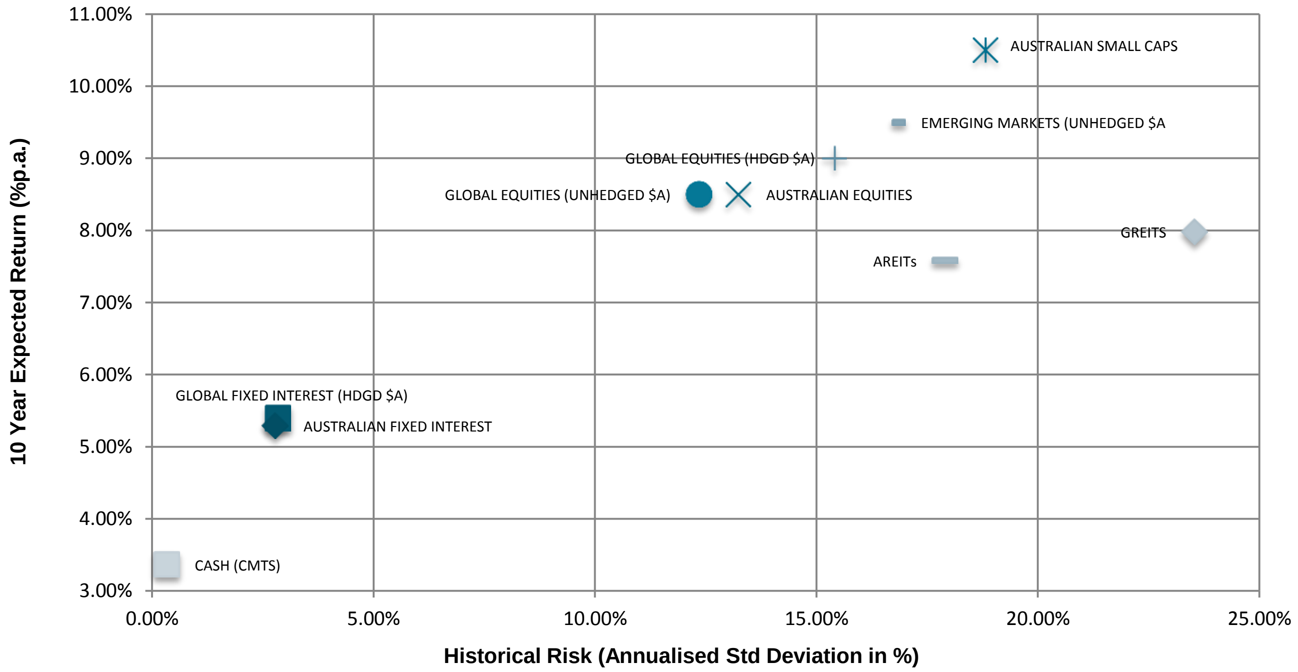
Note 1: Based on interest rate differential between Australian and offshore markets, investors may receive a pickup in yield from currency hedging. We have estimated the impact to income levels based on interest rate differentials. Please note that this income enhancement is not guaranteed and should not be relied on.

Note 2: The figure in brackets includes the current franking rebate yield of the relevant Index as at 31 December 2011. The extent that investors can claim this rebate yield is dependent on the marginal tax rate of the investor. We have also made assumptions for franking credits for Australian Small Caps and AREITs.

Note 3: The EPRA / NAREIT Index used in this analysis doesn't have a 20 year history (inception 2005). We expect a lower volatility profile going forward.

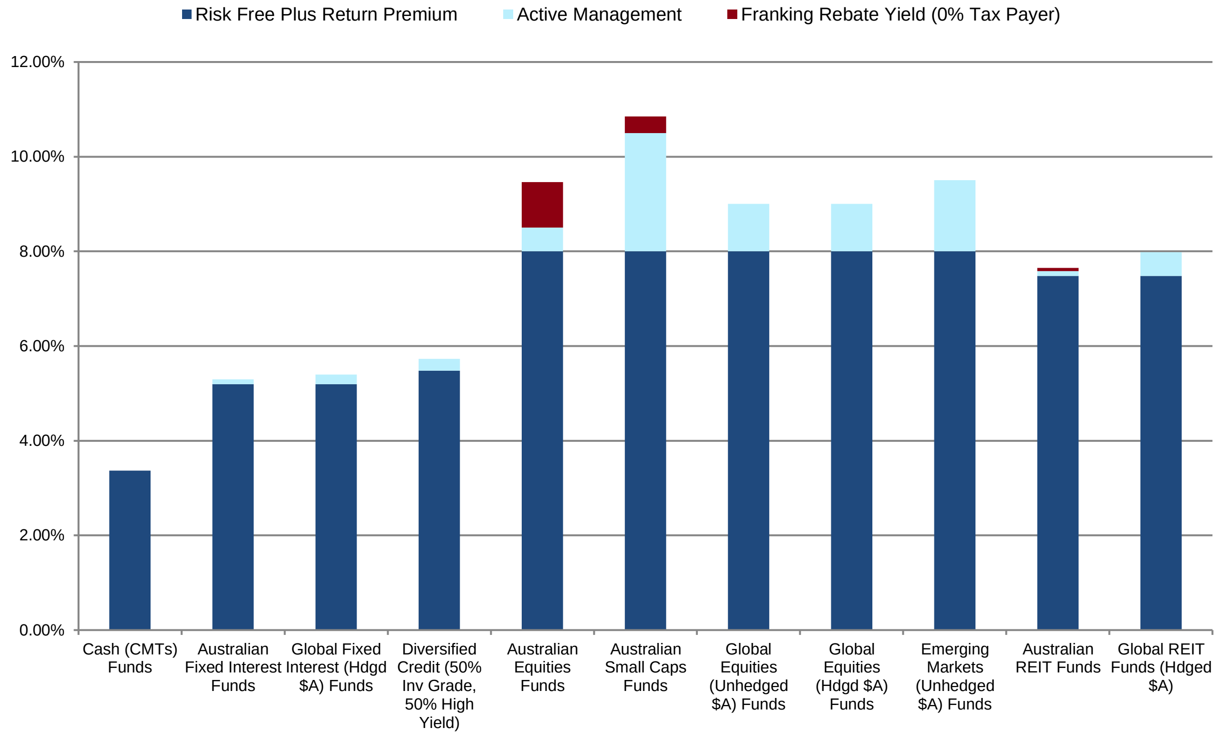
Note 4: The current rate is based on information sourced from the RBA.

10 YEARS EXPECTED RETURN VS HISTORICAL RISK CHART (EXCLUDING FRANKING CREDITS)

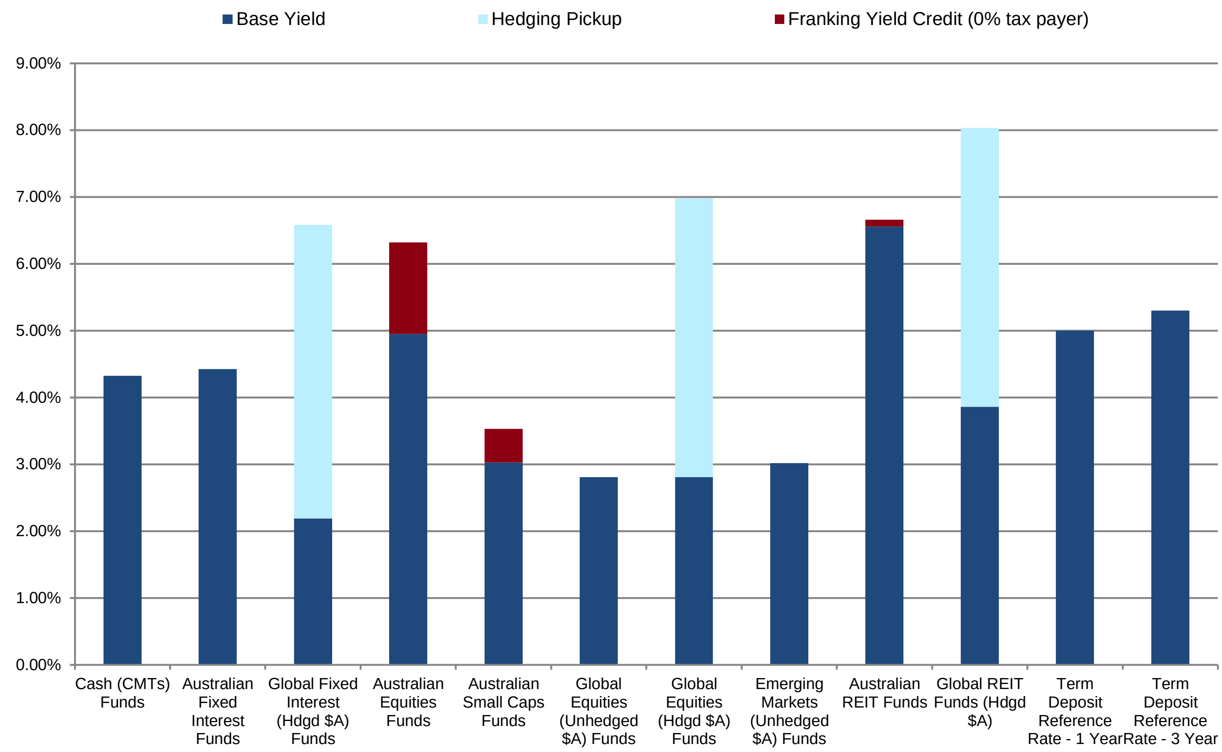


Expected Return and Current Yield Decomposition

EXPECTED RETURN FORECASTS DECOMPOSITION (INCLUDING FRANKING CREDITS)



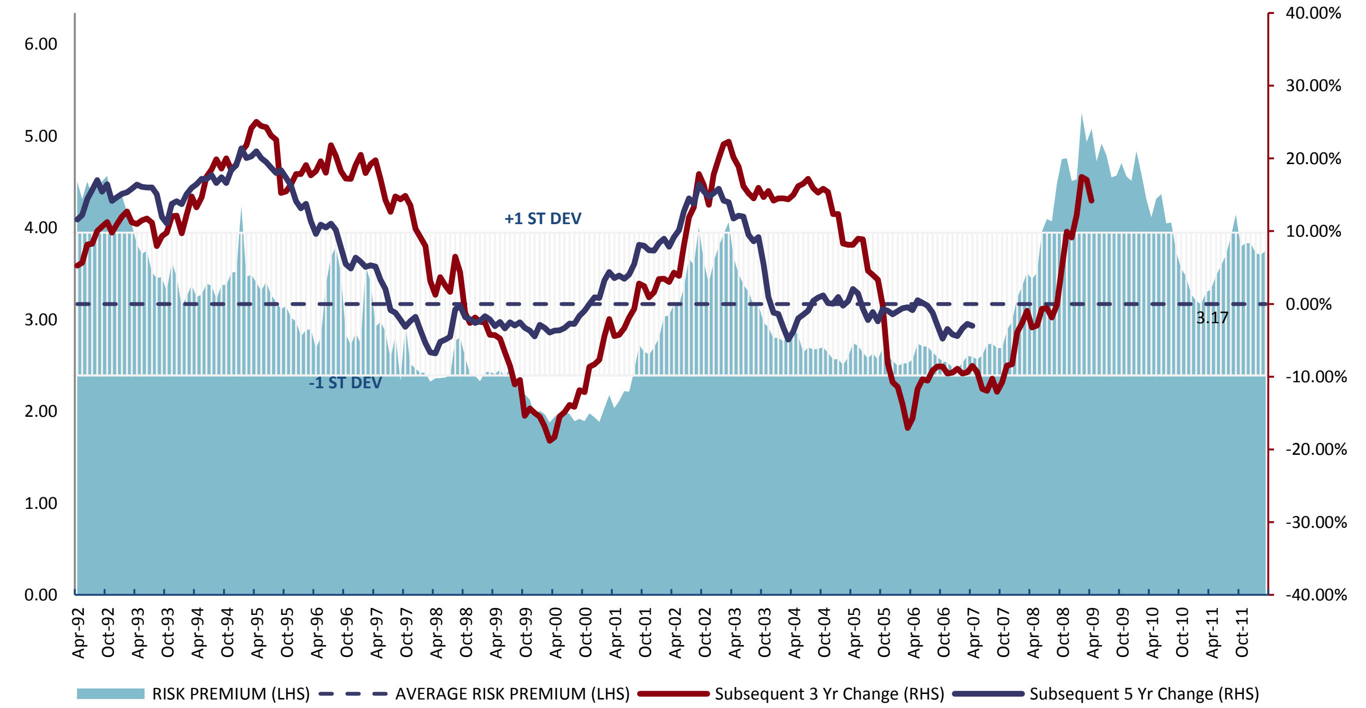
CURRENT INCOME YIELDS DECOMPOSITION (INCLUDING FRANKING CREDITS)



Introducing Zenith's Forward Looking Equity Model

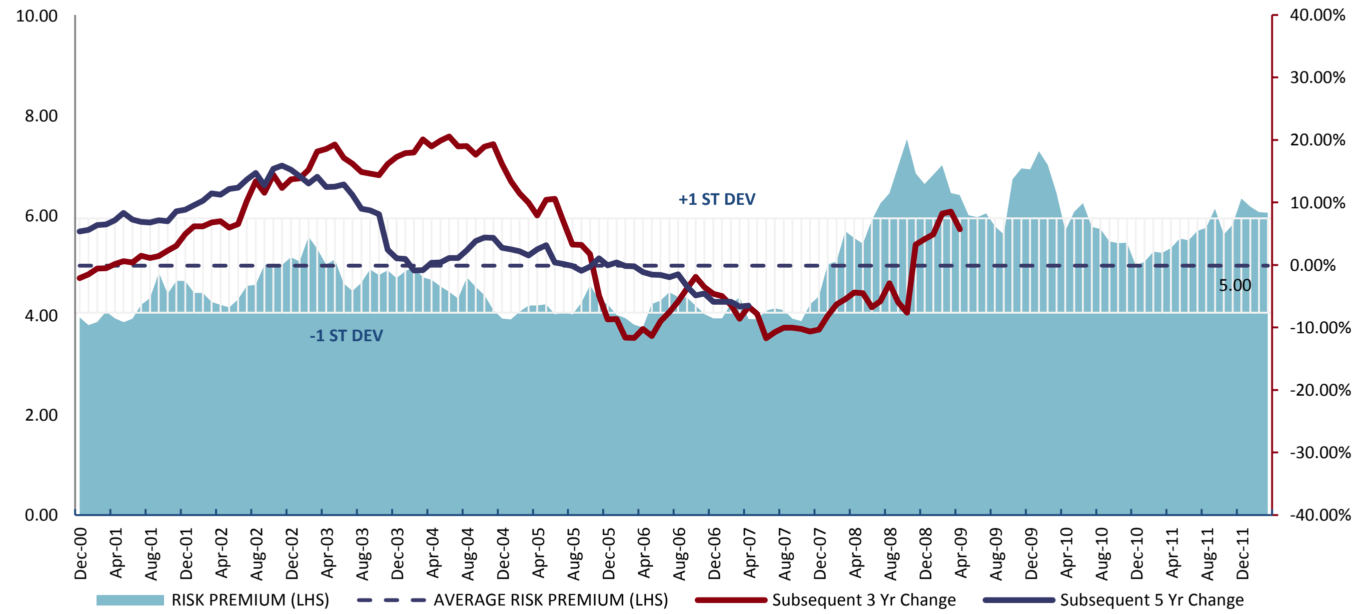
- In setting asset class forecasts on the first page Zenith has assigned a risk premium for each asset class based on historical returns versus risk free investments. To complement these forecasts, we have introduced a **forward looking model** that incorporates 12 and 18 month forward analyst **consensus earnings estimates** and reconciles these with current index prices as well as dividend and interest rate levels to imply a current risk premium estimate for that asset class through a derivation of the Dividend Discount Model.
- The forward looking model we have used is a derivation of a model developed by Ashwath Damodaran in his paper titled *Equity Risk Premiums (ERP): Determinants, Estimation and Implications – (The 2012 Edition*). The key difference between Zenith's model and Damodaran's is that he estimates a free cash flow yield (which he bases on current dividend yield plus a share buyback yield) while we use the current dividend yield. While extending our analysis to include potential dividends (i.e. free cash flow analysis) instead of actual dividends (i.e. current dividend yield) would improve the output of the analysis [globally firms have only paid out half of their free cash flow as dividends over the past decade], share buyback yield information is inherently difficult to collect, especially across an entire index. While this limits the usability of using the risk premium number as a forward looking return expectation (i.e. higher dividend paying regions like Australia will have a higher risk premium estimate under our approach), we believe our analysis still provides a signal to the future **DIRECTION** of equity asset classes when our current risk premium estimate is compared to a historical average for that market.
- The following two charts illustrate the output of this analysis for Global Shares and Australian Shares, measured by the MSCI World Index and S&P/ASX 200 Index respectively. The chart shows the implied risk premium based on our analysis since 1992 for global shares and since 2000 for Australian Shares. The dark blue and red lines then show the resultant 3 & 5 year returns for the asset class based on these estimates.
- **These charts show that subsequent returns are at their strongest when the equity risk premium is above average and at their weakest when the equity risk premiums at below average. The analysis is also more insightful for global shares than Australian shares as subsequent returns have tended to closely follow the direction of the risk premium estimate in that market. The analysis also indicates that current risk premium estimates for global and Australian equities are supportive of the view both equity markets are cheap at current levels based on the fact that current risk premiums are higher than their historical averages.**
- While Zenith has added this analysis as a further service to clients, it is important to note that we still philosophically believe that professionally managed Global Macro & CTA strategies provide the optimal TAA overlay solution to clients and recommend clients adopt this approach rather than singularly relying on the output of one forward looking equities model. However, we do believe this analysis is a useful tool in determining the timing of how new clients should move to recommended equity SAA weightings and may provide a warning signal when risk premiums are significantly below long term averages.

GLOBAL EQUITIES ZENITH RISK PREMIUM ESTIMATE & SUSBEQUENT RETURNS



Introducing Zenith's Forward Looking Equity Model

AUSTRALIAN EQUITIES ZENITH RISK PREMIUM ESTIMATE AND SUBSEQUENT RETURNS



Short Term Asset Class Investment Considerations

The following sections provide some shorter term valuation considerations for the larger asset classes. Please note, that this section is designed as provide some short term market information for discussion, not to necessarily drive short term investment decisions. Zenith maintains that the use of well-constructed, fully diversified portfolios based on a medium to long term investment timeframe (10 year forecasts) produce the optimum risk/return benefit for the majority of Australian investors and that timing the market based on short term valuations can be dilutionary in most instances. Please note, we have removed the manager positioning information from this section as it slowed down the production of this report.

SECTOR	VALUATION	HISTORICAL 3 MTH PFM (DIRECTION)
CASH	-	UP (+1.12%)
AUSTRALIAN FIXED INTEREST	STRONGLY OVERVALUED	UP (+0.78%)
GLOBAL FIXED INTEREST	STRONGLY OVERVALUED	UP (+1.21%)
AUSTRALIAN EQUITIES	UNDERVALUED	UP (+8.58%)
AUSTRALIAN SMALL CAPS	FAIR VALUE	UP (+14.98%)
GLOBAL EQUITIES	UNDERVALUED	UP (+11.32% HDGD)
EMERGING MARKETS	UNDERVALUED	UP (+12.90%)
AUSTRALIAN REITs	FAIR VALUE	UP (+7.14%)
GLOBAL REITs	FAIR VALUE	UP (+12.61%)

TABLE METHODOLOGY

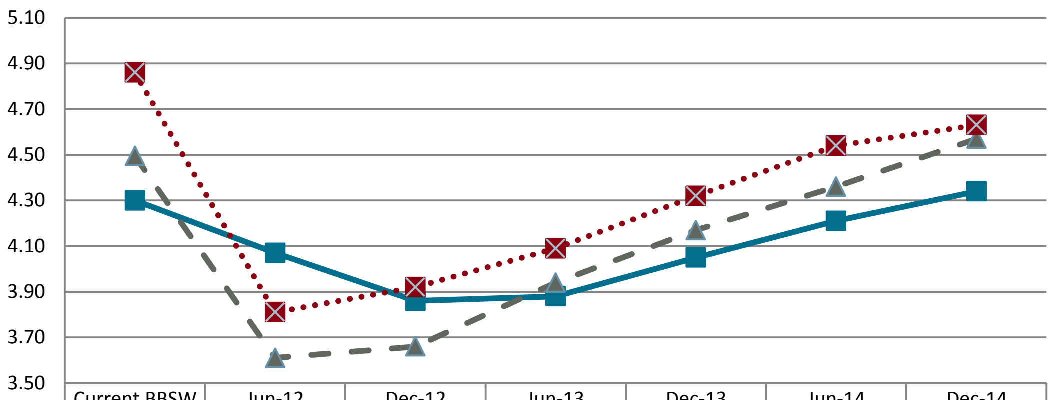
The methodology underpinning the above table is as follows:

- The Valuation for each sector is based on the quarter end valuation of the relevant sector index (using Price/ Earnings for equities, Running Yields for Bonds) relative to each sector's long term historical average. If the valuation lies within a half a standard deviation (+/-) of the long term average, the sector has been listed as Fair Value. If the valuation is between a half and one standard deviation (+/-) from the long term average, the sector has been listed as Overvalued or Undervalued, depending on the direction. If the valuation is more or less than one standard deviation from its long term average we list the valuation as Strongly Overvalued or Strongly Undervalued, depending on the direction.
- The Direction reference is simply based on the 3 month performance of the sector in absolute terms. If the performance has been less than 0%, we list the sector as being Down. If the performance is greater than 0%, we list the performance as being Up.

Cash Valuation Considerations

- Based on the current yield curve interest rate cuts are expected to occur during the remainder of 2012 before rising in late 2013.
- Compared to the yield curves of 3 and 6 months ago, interest rates cuts are expected to be less aggressive in short term, no doubt influenced by the risk rally in early 2012 which was led by stronger economic data out of the US.
- While interest rate rises are expected in 2013 & 2014, the yield curve has flattened over the past 3 months reflects expectations of more subdued forward looking economic growth

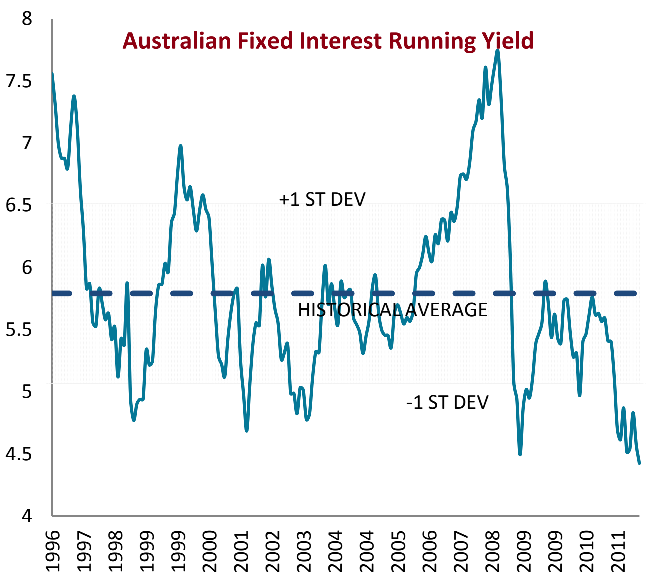
AUSTRALIAN YIELD CURVE (AS IMPLIED BY CURRENT BBSW AND 90 DAY BBSW FUTURES CONTRACTS)

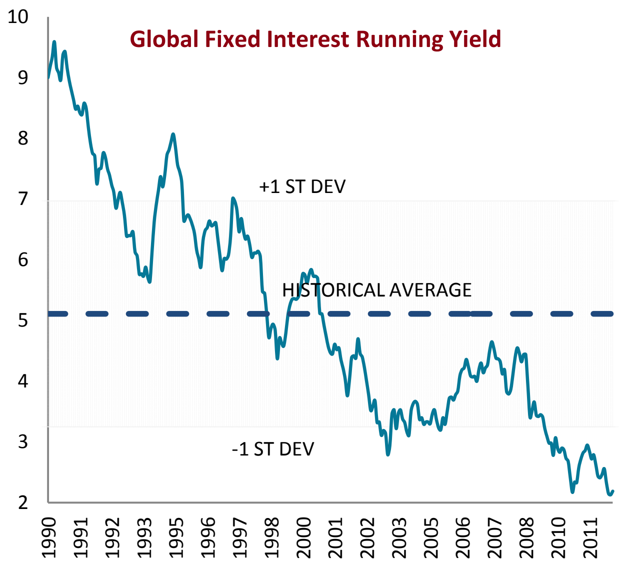


	Current BBSW	Jun-12	Dec-12	Jun-13	Dec-13	Jun-14	Dec-14
Current	4.30	4.07	3.86	3.88	4.05	4.21	4.34
3 Months Ago	4.50	3.61	3.66	3.94	4.17	4.36	4.57
6 Months Ago	4.86	3.81	3.92	4.09	4.32	4.54	4.63

Fixed Interest Valuation Considerations

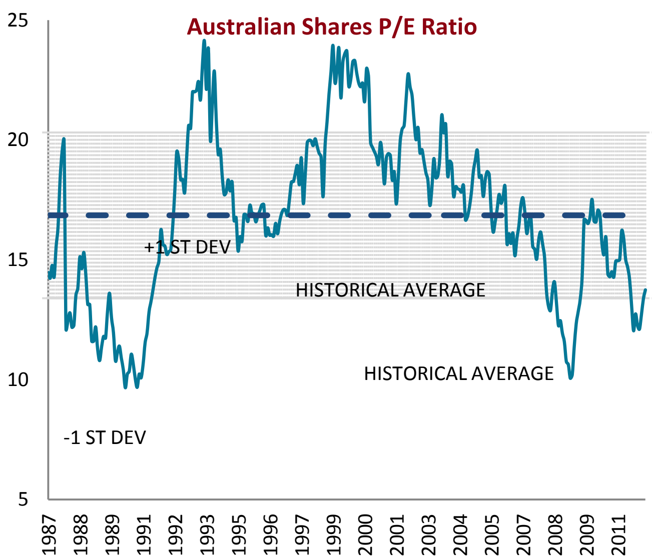
- Bond running yields for Australian and Global bonds are at all-time lows, significantly below long term averages
- Returns from bond funds have been excellent in this falling yield environment with domestic bond and global bonds (if hedged to the $A) producing returns in excess of 10.0% over the past 12 months.
- Going forward we believe index and index aware funds may struggle, especially if we enter a rising rate environment.
- Accordingly, we believe investors need to be allocating their defensive assets to flexible, diversified fixed interest managers with a broad investment toolkit.

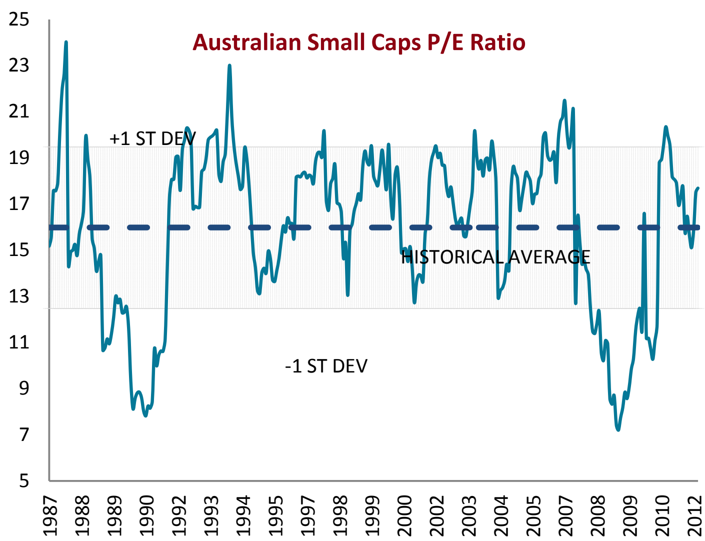




Australian Shares Valuation Considerations

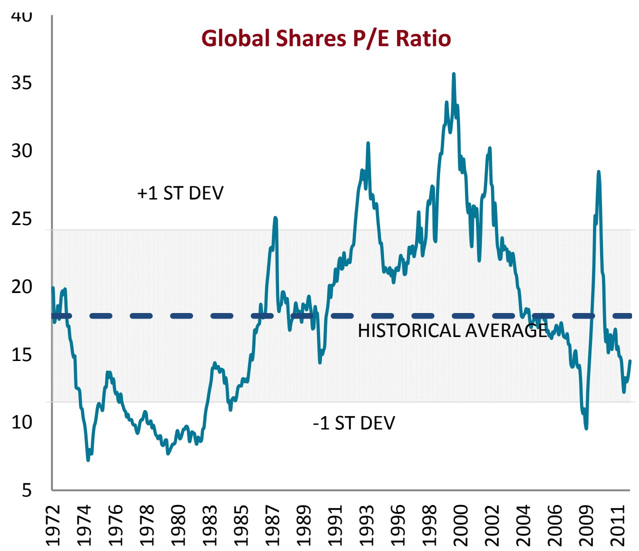
- Australian Equities remain cheap relative to history trading at a P/E ratio of 13.75, nearly one standard deviation from their long term average of 16.86 (1987-2012). Based on IBES consensus figures, earnings for the ASX 200 are expected to grow by around 11% over the next 12 months, which implies a forward P/E of 11.43.
- Macro news is clearly driving markets at present. Concerns surrounding China's growth prospects and further sovereign debt concerns, now emanating from Spain, will continue to impact short term performance. Furthermore, of the stocks in the S&P ASX 200, there were 70 downgrades to analyst 12 month forecast EPS growth forecasts versus 40 upgrades in March 2012 alone, suggesting weakening conviction by analysts in upcoming earnings forecasts. These concerns are being magnified by a range of market commentators who continue to suggest earnings estimates remain overly bullish.
- Small caps look expensive relative to large caps, although the number is skewed by a few stocks with very high P/Es. Most small cap managers we recommend tend to have portfolios with P/Es similar to the large cap average, suggesting the segment is not as overvalued relative to large caps as the index valuations appear.

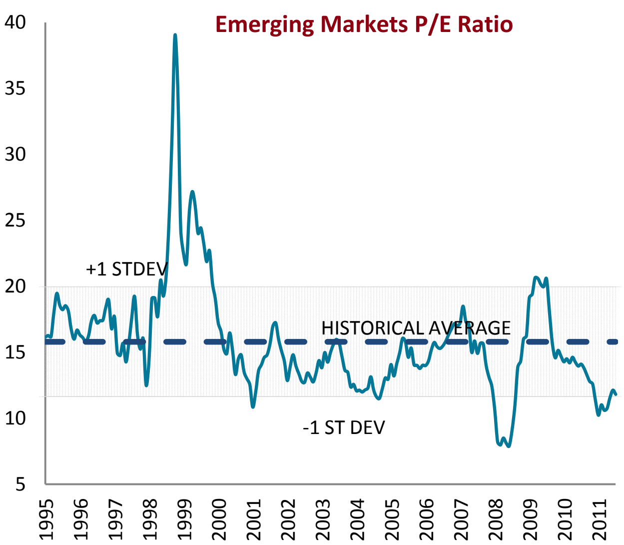




Global Shares Valuation Considerations

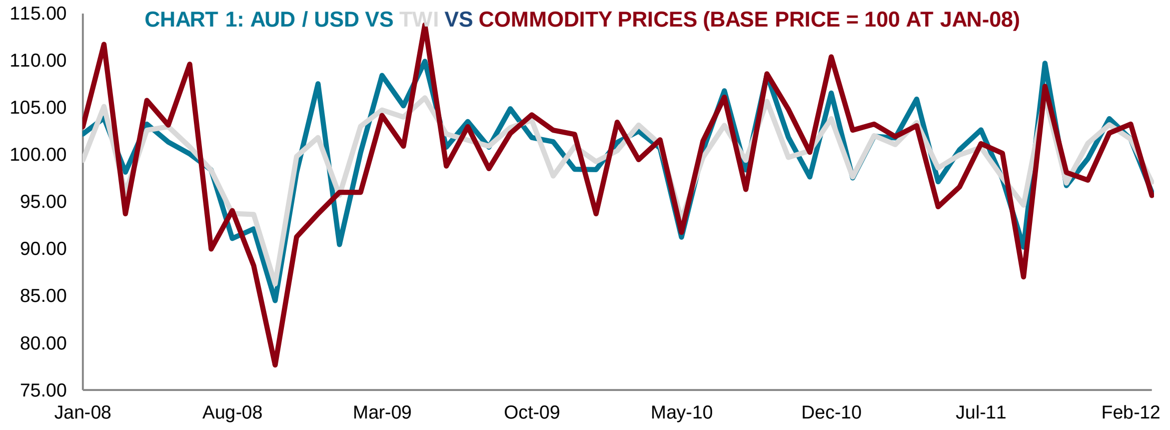
- Global Equities are slightly more expensive than Australian Shares, but remain cheap at around 14.53 versus its historical average (1972-2012) of 17.85. Analysts expect earnings to grow at 12.94% over the coming year, implying a 1 year forward P/E of around 12.43. Unlike Australia, the ratio between analyst upgrades and downgrades was roughly 1:1, suggesting more confidence in global earnings prospects.
- Emerging Markets appear to be compelling value relative to developed markets, trading at around 11.8 earnings and around 1 standard deviation below their long term average of 15.80
- Again, macro sentiment will most likely influence short term movements in equities, however from a valuation standpoint longer term investors should draw confidence from current valuations

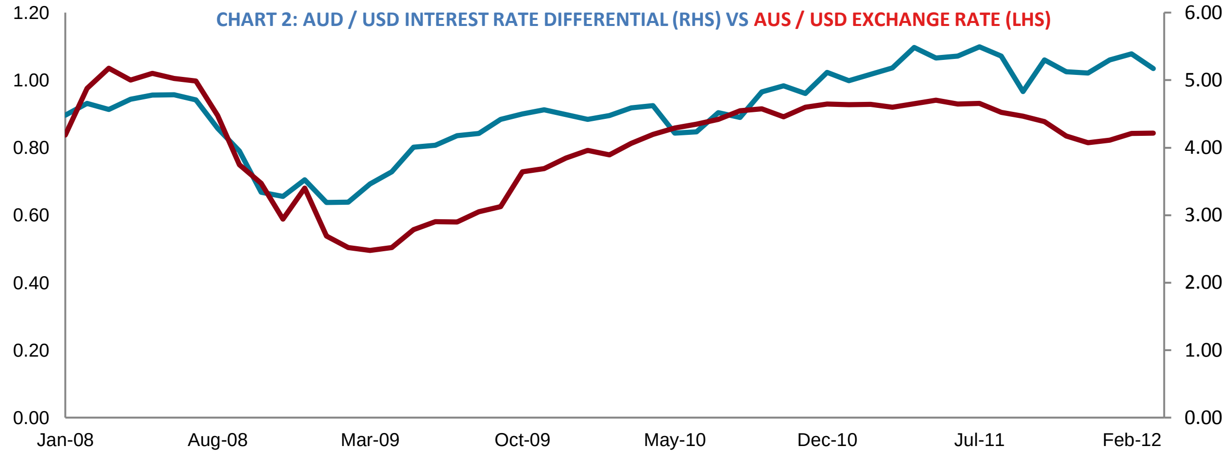


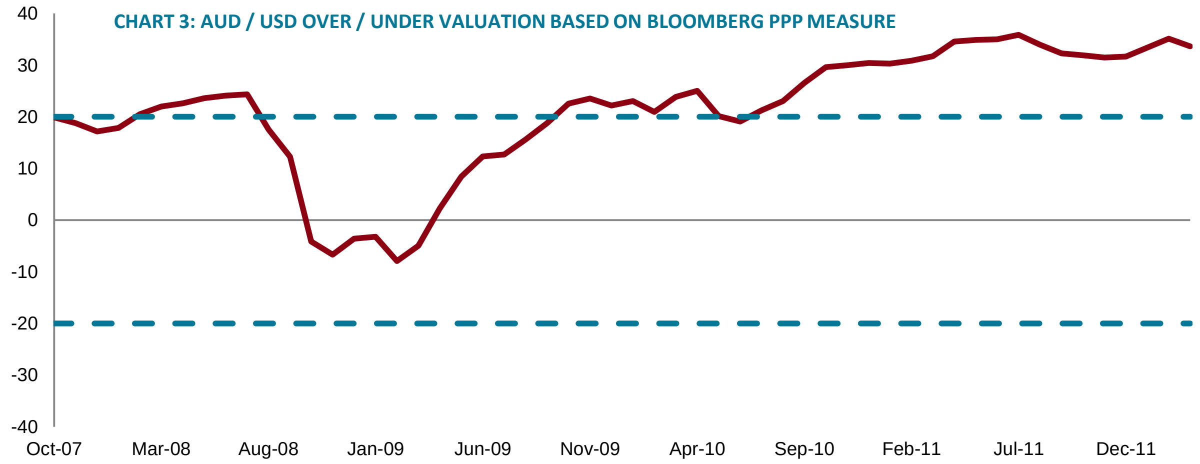


Aussie Dollar Valuation Considerations

- Australia's exchange rate has historically been linked to commodities prices. As illustrated in the first chart, commodities prices have weakened recently and the Aussie Dollar has moved in line with this weakness.
- The carry trade based on Australia's higher relative interest rates has also supported the Australian Dollar. Domestic interest rates are expected to fall over the next 12 months, however positive interest rate differential should still be maintained between Australia and key international peers. This characteristic will continue to support Australian investors receiving a hedging pickup when they hedge their overseas investments.
- On a Purchasing Power Parity (PPP) basis the Australian Dollar is now trading significantly above its fair value estimate of approximately 75 cents. While PPP theory makes intuitive sense, it has not been a good indicator of the Aussie Dollar for an extended period, as indicated by the bottom chart.







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Data source: Bloomberg