

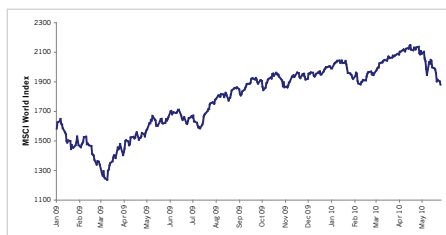
turmoil in Europe masks bright spots

Investors who are overly pre-occupied by economic turmoil in Europe may miss opportunities elsewhere.

As we expected, the biggest game in town for economists this year has been predicting how the huge government stimulus spending of 2008/09 would unwind. So it's no surprise that what began as a debt crisis in Greece, has caused investors to ask questions not just about Europe, but the UK and US too.

Shares have fallen (see chart) with European markets hit hardest. A 'flight to safety' has seen investors ditch the Aussie dollar and turn to high-quality bonds – vital for effective diversification and a core part of diversified portfolios.

share markets have fallen



source: Datastream, MSCI World Index (net dividends reinvested) in local currency. Data to 25 May 2010

turmoil in Greece

Greece entered the 2007-08 decline in poor shape and investors were surprised both by misrepresentation of the size of its debt, and budgeting errors that would embarrass a suburban household.

Investors hate surprises and started to worry that problems in Greece would affect European banks and destabilise the European economy, and social fabric.

Unfortunately, because of its poor track record, no-one was eager to lend to Greece. And as a member of the

European Union (EU), it was unable to depreciate its currency – the usual way to stave off domestic disaster.

It was only when the International Monetary Fund and EU came up with a €750b support program with emergency funding for Greece, that the situation showed signs of stabilising. In return, Greece has to go through a very painful belt tightening, which is causing severe social problems.

Periods of pain like this are usually when real economic reforms are made so, while this is a difficult process, the medium-term economic outlook will improve as a result.

meanwhile back home...

Our own economy, of course, is more closely linked to China than Europe – and China has been tightening its economic policy to address fears of a bubble in some areas of its property market. While it's not clear China is aiming to slow growth much, markets are fretting about the risk.

If Chinese growth slowed, this could impact our resource sales to China. The recently announced 'super profits' tax is just another reason for investors to shun resources stocks of late.

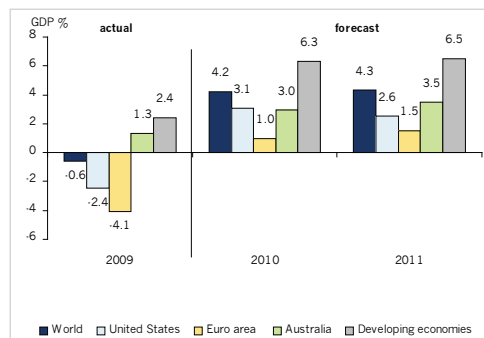
opportunities emerging

In newspaper headlines this is often where the story ends – but it's by no means all doom and gloom.

In Australia, many listed companies are now generating good cash flow helped by significant cost cutting during the downturn. There are signs that corporate revenue is also on the rise helped by a strong economy both

domestically and in the region. That's good news for future profits and good news for medium term returns.

growth forecasts are positive



source: IMF; World Economic Outlook. Data as at April 2010

In addition, signs of improved economic growth in the US have also been overlooked and emerging economies are powering ahead. So a fair chunk of the world economy is doing well, or at the least improving on last year.

These events follow a pattern we are likely to see in the coming 18 months – periodic bouts of fear (which for quality stocks represent long-term buying opportunities), followed by optimism about the outlook for company profits.

It's important not to let those periods of pessimism affect your long-term financial strategy. Share markets are well priced to deliver good medium-term returns, and the portfolios are well diversified to help manage uncertainty, and profit from opportunities in recovery.

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