

Heading to the Polls

Australia and Germany head to the polls on the 7th and 22nd of September respectively. Barring any surprises, we expect the outcomes in both cases are unlikely to upset markets.

While a change in Government here is anticipated, in Germany, current polling suggests Angela Merkel should win a third term as Chancellor, but may have to form a Grand Coalition with another of the mainstream opposition parties. Our economists believe though, that with most of the major parties broadly agreeing on European issues (and differing mainly in tone), there should be limited change to Germany's approach to Euro Area issues.

Europe itself has shown tentative signs of improvement recently. Reports show the region emerged from a recession in the June quarter, with GDP growth of 0.3% (above forecasts of 0.2%).

We are cautiously optimistic and feel the worst is over, but Europe's recovery is still fragile and the level of public debt remains a burden.

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Market Performance

	Aug-13	Jul-13	1 MTH	YEAR TO DATE
ASX20	3,234	3,194	1.3%	12.8%
ASX200	5,135	5,052	1.6%	10.5%
ASX200 Accum	42,231	41,200	2.5%	13.7%
S&P500	1,633	1,686	-3.1%	14.5%
MSCI World - ex Aus	1,483	1,520	-2.4%	10.6%
AUDUSD	0.890	0.899	-1.0%	-14.3%
Oil (WTI)	107.62	105.15	2.3%	17.3%
Spot Gold	1,394.80	1,325.00	5.3%	-16.7%
AUS CASH RATE (%)	2.50	2.75	-25bp	-50bp
AUS 10Y BOND YLD (%)	3.90	3.72	18bp	63bp
US 10Y BOND YLD (%)	2.79	2.58	21bp	103bp

Source: IRESS, MSWM Research. Closing prices as at 31 July and 31 August 2013

ASX20 Stock Performance – Top 5 and Bottom 5

	Close Price	Return (mth)		Close Price	Return (mth)
Top 5			Bottom 5		
ORG	\$ 13.25	13.0%	QBE	\$ 15.20	-6.2%
STO	\$ 14.92	10.2%	BXB	\$ 8.80	-3.1%
NCM	\$ 13.26	8.4%	ANZ	\$ 29.69	-0.2%
WOW	\$ 35.67	7.1%	MQG	\$ 43.86	-0.1%
AMP	\$ 4.74	4.9%	CBA	\$ 72.84	0.8%

Source: IRESS, MSWM Research. Prices as at 31 August 2013

Recent Highlights from Research

Telstra is Too Expensive...Downgrade to Underweight

Morgan Stanley Research, 9 August 2013

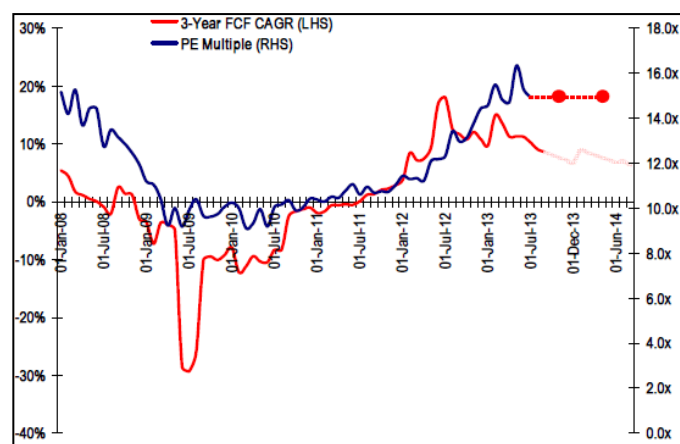
Telstra's (TLS) FY13 result showed a small revenue beat (+1%), but earnings quality declines. A strong mobile result (revenue +6% on the previous corresponding period) mitigated TLS's Public Switched Telephone Network declines. However, accounting changes added up ~6% to FY13 EPS with changes in asset useful lives and mobile handset accounting treatment.

We expect TLS's PE multiple to contract due to a slowing free cash flow (FCF) growth profile not supporting its current multiple. TLS's 3-year FCF Compound Annual Growth Rate (CAGR) is forecast to slow from its current 12-15% to 7-8%. Historically a 3-year FCF CAGR is a predictor of multiple expansion hence a slowdown means compression. We expect TLS' PE multiple to de-rate to 14x.

We move to Underweight on new price target of A\$4.40.

Dividend is attractive. We have increased TLS's FY14e dividend to 30c, which adds 40bp to yield; but 10-year government bonds have risen 90bp over the last 13 months from 2.9% in July 2012 to 3.8% in August 2013 ... hence TLS's dividend attractiveness is decreasing vs. safer bond assets.

Telstra's 3yr FCF CAGR is Slowing...yet Consensus Still Expects it To Maintain its PE Multiple



Source: Thomson, Company data, MS Research

Commonwealth Bank: Tax Rate Change Could Trigger Large Special Dividend in FY14

Citi Research, 26 August 2013

Commonwealth Bank's (CBA) Regulatory Adjusted Profit (i.e. organic regulatory capital generation) was ~\$4.4bn in 2H13, versus a reported profit of ~\$4bn. We see scope for CBA to generate ~55¢ per share surplus capital by end FY14. In addition, we estimate a further ~50-60¢ per share of capital could be released via sale of the bank's property management business. CBA presently has a franking credit (FC) surplus of ~46¢ per share which gives it sufficient FCs to fully-frank a ~\$1 per share distribution.

The Coalition has announced a policy which, if implemented, will reduce the corporate tax rate to 28.5% from 1 July 2015, a move which would reduce the value of FC by ~7%. This change may therefore be a catalyst for CBA to utilise its present FC surplus in the near-term. While a distribution relating to an exit from the property management business might be eligible for treatment as a "capital return" rather than a dividend, we expect it would be made via a fully-franked special dividend given the FC surplus. FY00 is a precedent.

Our forecasts imply a 12 month prospective ~5.4% fully franked dividend yield with an additional ~1% yield equivalent possible via surplus capital returns. Beyond this, we forecast surplus capital generation equivalent to ~10% of our base case Dividend Per Share forecasts in outer years, after allowing for full Dividend Re-investment Plan DRP neutralisation. **We expect that this superior capital generation in combination with low rates and stable asset quality will continue to see the stock well supported.**

Protecting your wealth, is just as important as building your wealth

When we think of wealth many of us will think of an asset or assets that we own or we control, such as the family home, a business, share portfolio, investment property, holiday home, etc.

But how many think of an asset that could be worth millions? The asset I'm talking about here is your ability to earn an income.

Consider the statistics below compiled by the Australian Bureau of Statistics:

- 90% of Australians insure their cars.
- 60% of us insure our home.
- 30% of us take out the extended warranty on a new TV!

But only a small percentage of us insure what for some could be their largest asset – their ability to earn an income.

How do I protect my income?

The simplest way is to take out some form of income protection insurance.

It covers up to 75% of your pre-tax income if you're off work due to accident, illness or injury. And cover can be provided for periods of 2 years up to age 65.

This can be taken out either within your superannuation fund or outside of superannuation.

Benefit periods and waiting periods

With income protection, you need to consider the waiting period – the period you can't claim if you are injured or ill which is usually between 14 days and two years.

The benefit period – the period of time that the policy will pay benefits if you are ill, injured etc which is usually from 2 years up to age 65 (or in some cases age 70).

Premiums

There isn't any one size fits all approach with the cost of insurance. Factors such as your age, your occupation, your income, your health and the length of cover you take out will all determine the final premium paid.

However, it's important to consider the cost in relation to what you could potentially receive. That is; if you pay say \$2,000 per annum for your insurance but that has the potential to protect \$2m of income; then the premium is only 0.1% of the potential benefit.

Finally, income protection insurance premiums are tax-deductible.

The \$2,000 premium is only costing \$1,230 after tax if you're on a 38.5% marginal tax rate.

We're here to help you

Morgan Stanley Wealth Management financial planners are able to review and advise across aspects of personal insurance including life, disability, trauma and income protection.

We are not tied to offering you one insurance provider; we have up to 10 insurers who we use to ensure our clients receive a policy that suits their needs.

We will offer you a free review of your existing insurance policies to see if there is a 'better deal' for you either for more cover at the same price or the same cover at a lower price.



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STRATEGY CHANGES

COMPANY	SECTOR	REASON	ACTION
NA	NA	NA	NA

OUR SELECTION PROCESS

- The stocks selected seek to be profitable today with high Return on Invested Capital (ROIC), high gross margins and low capital intensity.
- High profitability that seeks to be sustainable for the long term, with the support of powerful intangible assets such as strong brands, products or services with high barriers to entry.
- The companies must have high quality management teams committed to maintaining the high returns through focused investment and innovation with careful stewardship of capital.

OUR BENCHMARKS

- ASX200
- Morningstar Balanced
- MSCI Global

TEAM PROFILE

David Leon (Investment Adviser) is a Certified Portfolio Manager® from the School of Engineering and Applied Science from Columbia University, New York, USA. David primarily advises Family Offices, Medical Professionals and Corporate boards within the Aged Care Sector. David began his finance career working as an analyst for a boutique investment banking firm in Chicago that executed underwritings and placements for state and local government entities. While still working in Chicago, he was invited to join UBS as a private client adviser and financial planner. In early 2007, David and his Australian wife moved closer to her family in Australia. David was recruited by Goldman Sachs where he held the title of Director. David graduated with honours from Northwestern University in Chicago, has an Advanced Diploma of Financial Planning, is an ASIC Accredited Derivatives Adviser and is licensed to trade equities, globally. David is also a Governor of the American Chamber of Commerce.

Geoff Smith (Strategic Financial Planner) is a Certified Financial Planner® with over 25 years of experience in Financial Planning and Investment Advice. Prior to joining Morgan Stanley Wealth Management, Geoff was a leading Financial Adviser and principal of Adelaide based financial advisory firm Prescott Securities. In addition to this experience Geoff holds a Diploma of Financial Planning and a Diploma with the Australian Insurance Institute. Geoff specialises in providing quality strategic and investment advice and portfolio wealth management both to individuals and to tax exempt organisations.

Jawad Ahmad (Financial Planner) is a Certified Financial Planner® and has been in the financial service industry since 2006. He has a strong technical background and has vast experience in holistic financial advice. Prior to joining Morgan Stanley Wealth Management, Jawad worked as a Financial Planner and Para planner with Godfrey Pembroke based in Adelaide. He holds a Bachelor of Finance (University of Adelaide), is an ASIC accredited Derivatives planner and has a Graduate Diploma in Global Wealth Management (University of Adelaide) for which he was awarded the most distinguished graduate award in 2007.

Please contact your financial advisers to obtain a copy of the full research reports listed or refer to our website at www.morganstanley.com.au.

Research sourced from:

- “TLS is Too Expensive...Dividend Yield & FCF Can No Longer Support its Multiple; Downgrade to UW”- Morgan Stanley Research, 9 August 2013
- “Commonwealth Bank: Tax Rate Change Could Trigger Large Special Dividend in FY14” – Citi Research, 26 August 2013

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