



Economic & Market Outlook

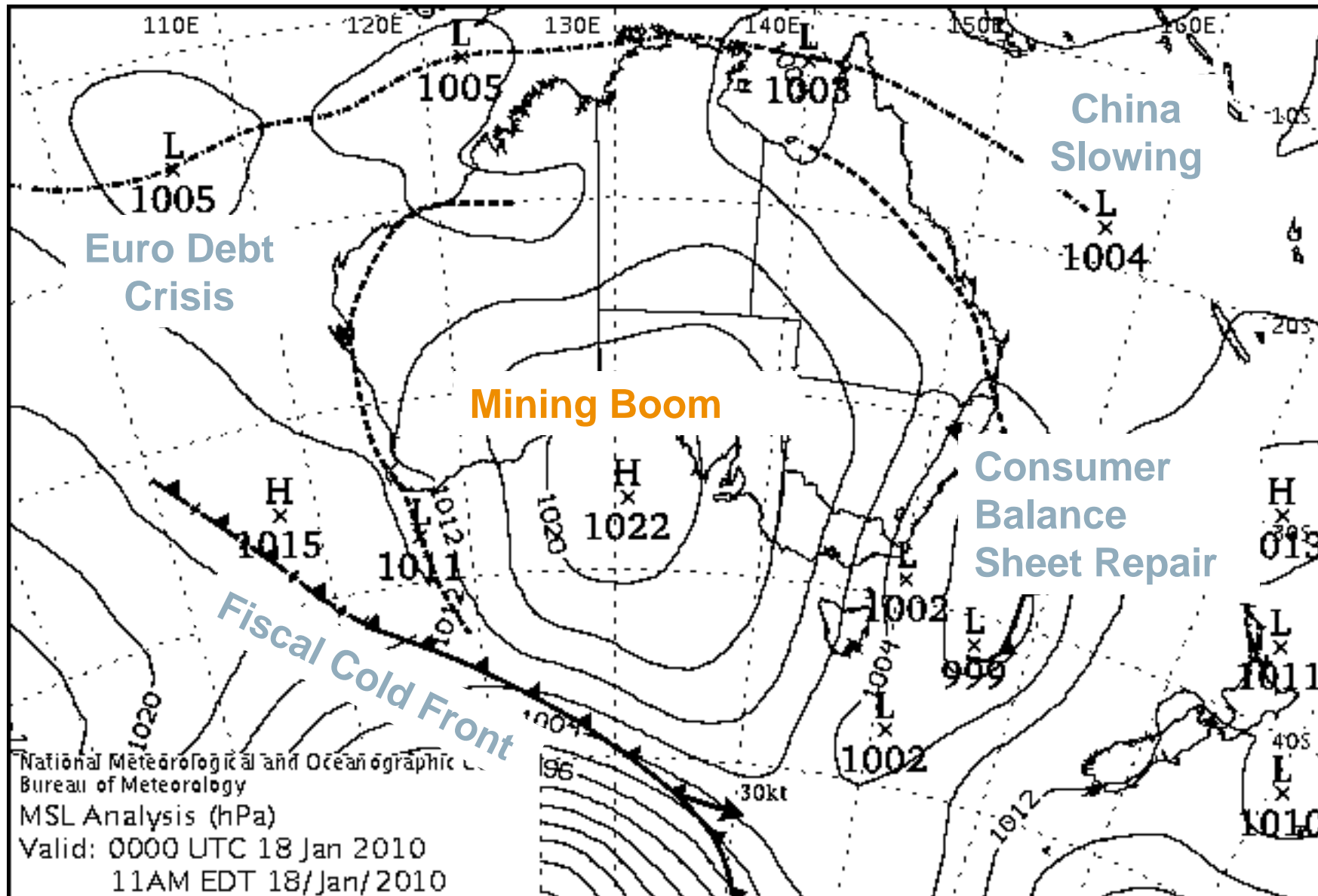
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December 2011

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What's Brewing?

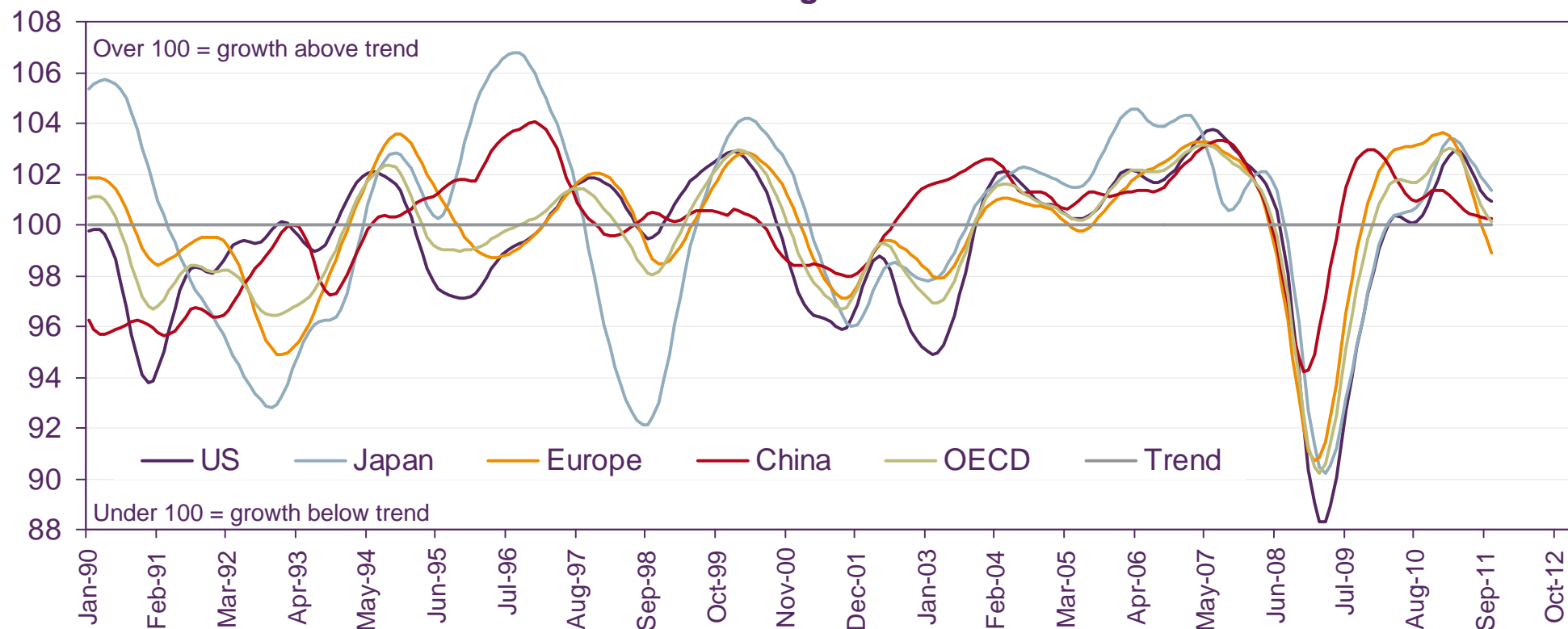


Agenda

- Economic Update
 - Offshore
 - Australia
- Market Outlook
 - Interest Rates
 - Australian Shares
 - Exchange Rate
- Wrap Up

- The developing European Sovereign debt crisis has introduced another shock for policy makers.
- The response outside Europe has been to try and insulate home economies from any fall out via a range of defensive (Swiss franc peg to euro) and pro-cyclical (ease monetary conditions) policies.
- The ball is in Europe's court and good policy can still avert a major crisis.
 - October 26 package: Greek rescue package of €130 billion that included a 50% face value haircut. Recapitalise European banks to meet a 9% Tier 1 capital ratio by mid 2012. EFSF, proposal to increase its leverage 4 to 5 times.
 - ECB cut rates, 1.5% to 1.25% in early November. More cuts needed urgently.
 - Early December: Momentum building for a solution to the crisis based on a model of fiscal integration. Such an approach would pave the way for a greater role for the ECB.

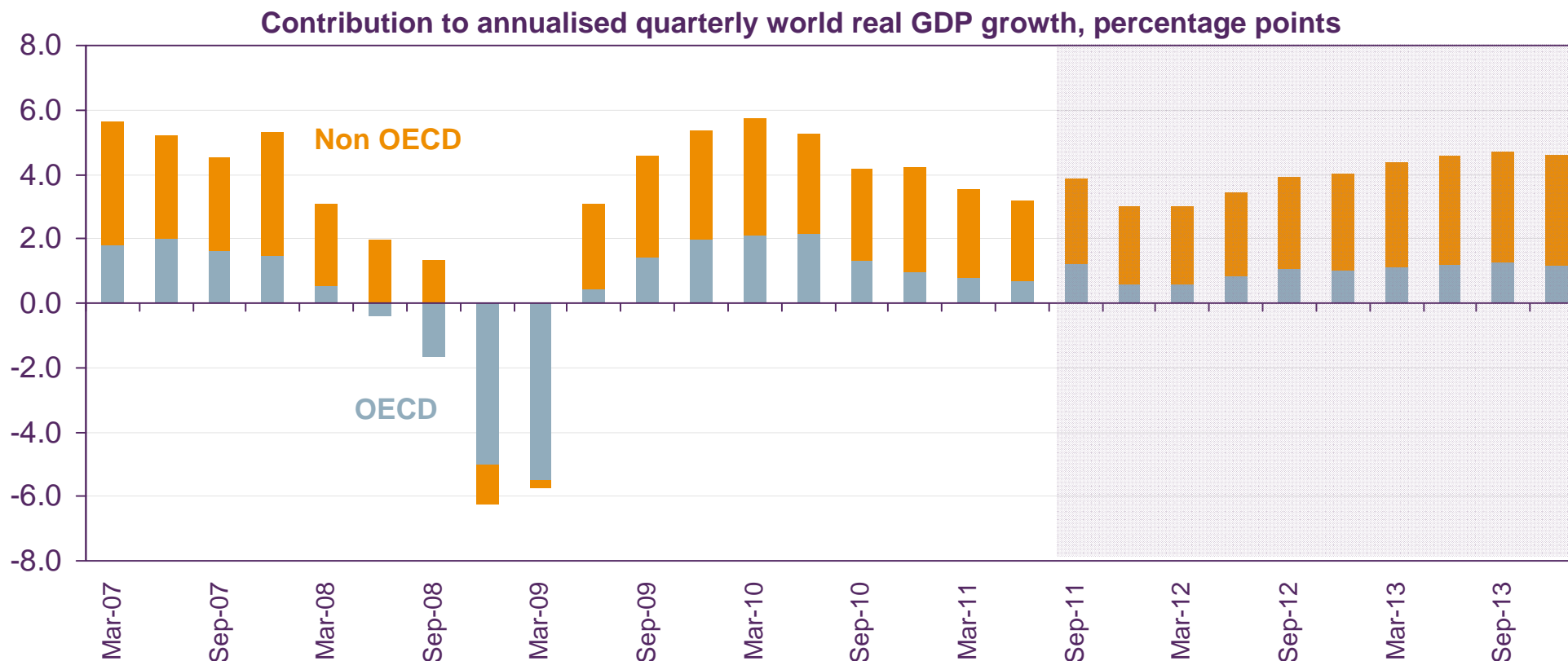
OECD Leading Indicators



- Leading indicators point to a weaker start to the first half of 2012.
- A recession is in store for Europe and is likely to have begun late 2011.
- Policy tightening in China has coincided with European weakness and Chinese growth could be quite soft in Q1 2012 before recovering over the year.

Euro Wobble Sees Growth Impact

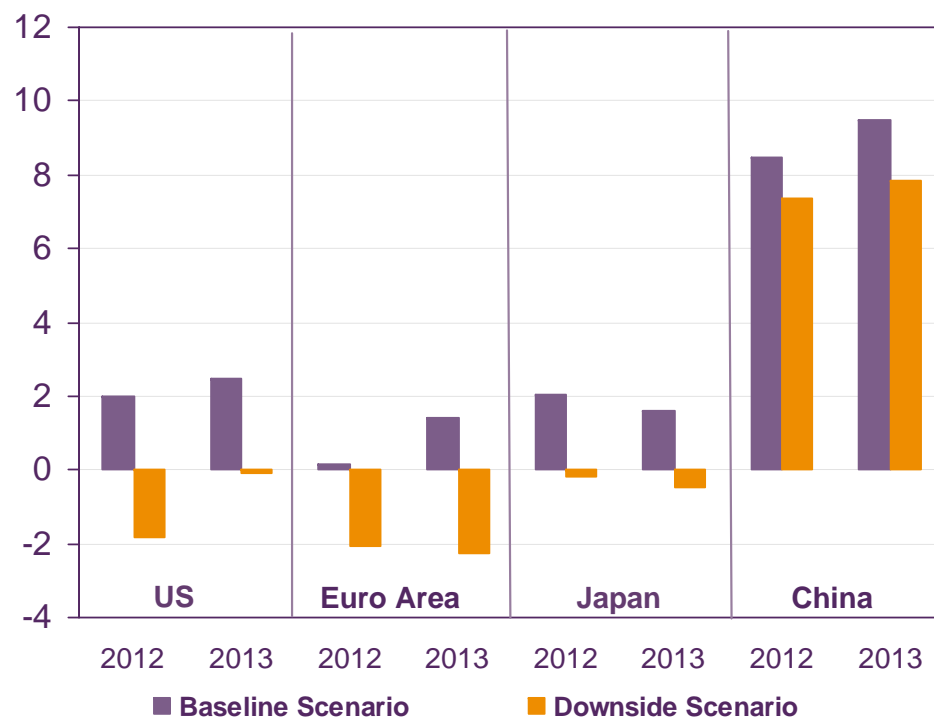
OECD Growth Forecasts



- OECD “muddle through scenario” assumes no disorderly sovereign default, systemic bank failures and excessive fiscal tightening.
- Sees mild European recession slowing growth in Q4 and Q1 '12 and enough sensible policy steps to see a weak recovery in growth over the later half of 2012. Emerging and developing economies do the heavy lifting on growth.

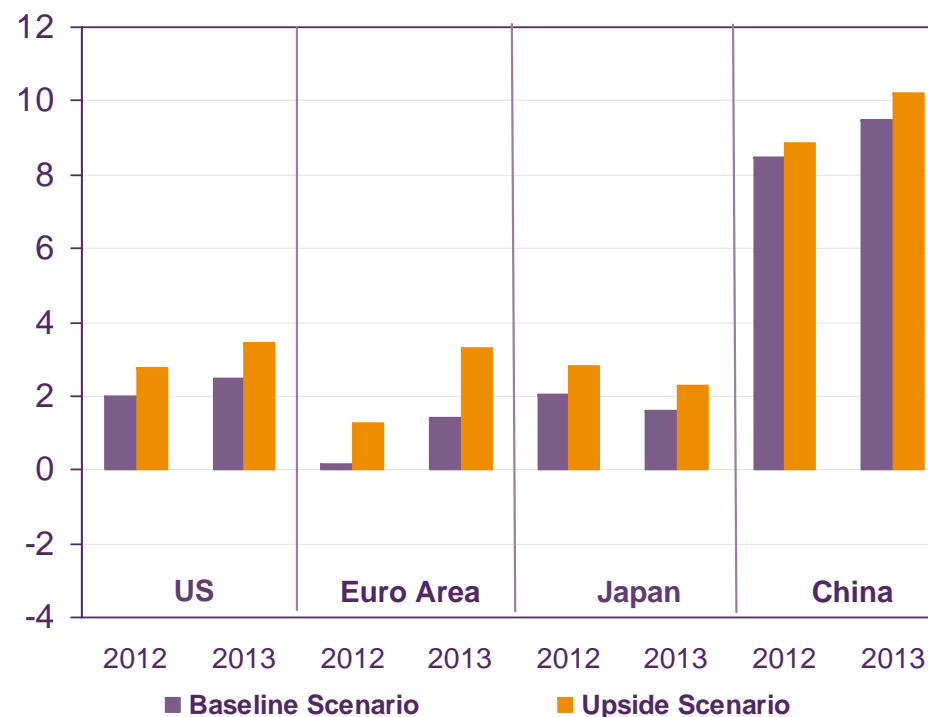
Which Fork In The Road?

OECD Downside Scenario
GDP growth %, percent per annum



- Add a shock from disorderly sovereign default or systemic bank failures with an inappropriate policy response and G-3 recession results.

OECD Upside Scenario
GDP growth %, percent per annum



- Confidence building reform in Europe puts the world on a stronger growth path.
- Needs Oct 26 European package to be passed and long term credible fiscal reform in the US.

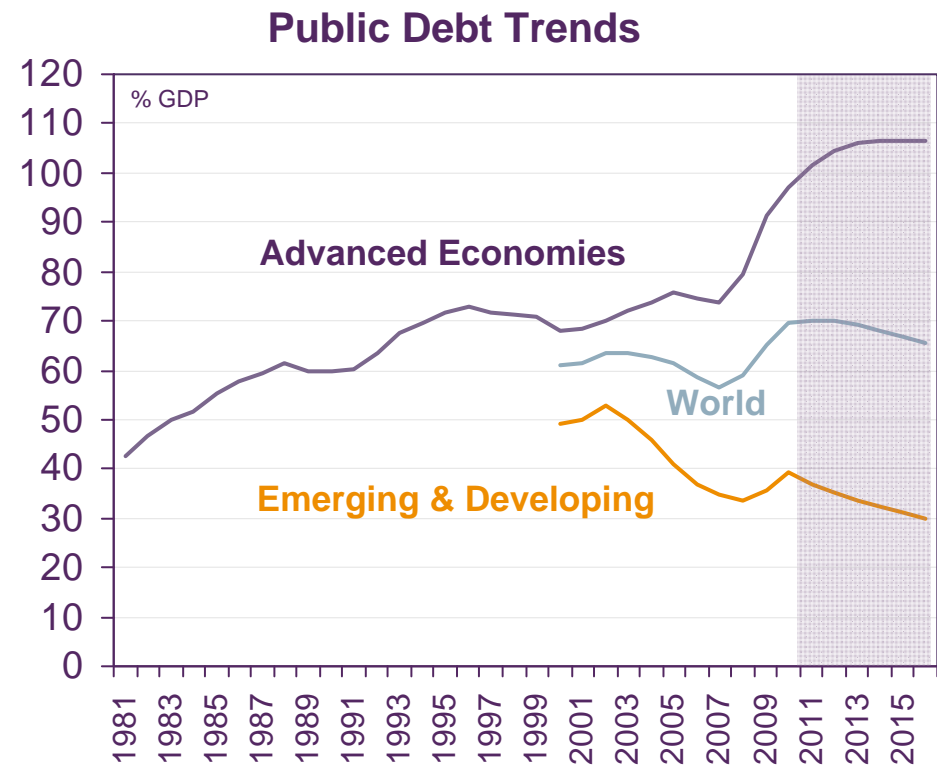
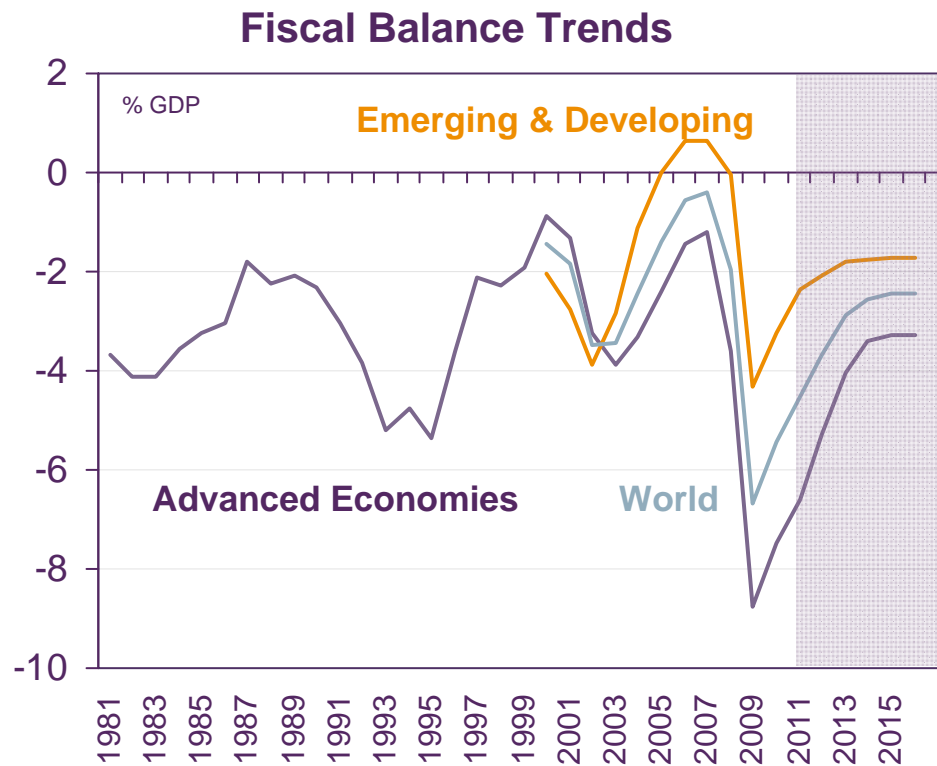
Euro Gap: Structural Reform Needed

Unit labour costs: 2000=1



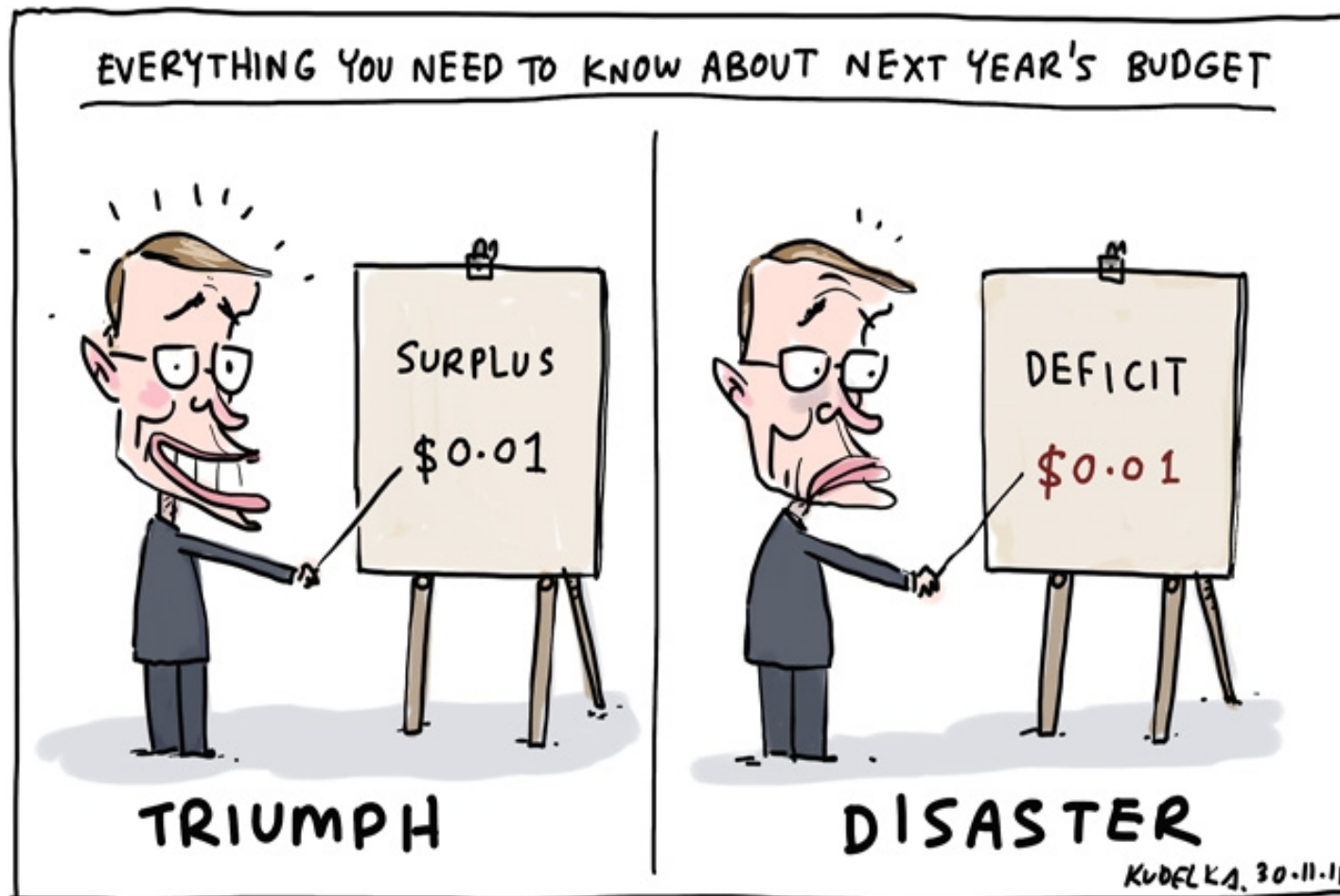
- Regardless of the form of greater fiscal union, Germany has set the structural benchmark and the others need to introduce product and labour market reform to catch up.
- Change will be difficult but good reform will help raise potential growth rates and help stabilise debt to GDP ratios over the longer term.

Cyclical Easing vs Structural Tightening



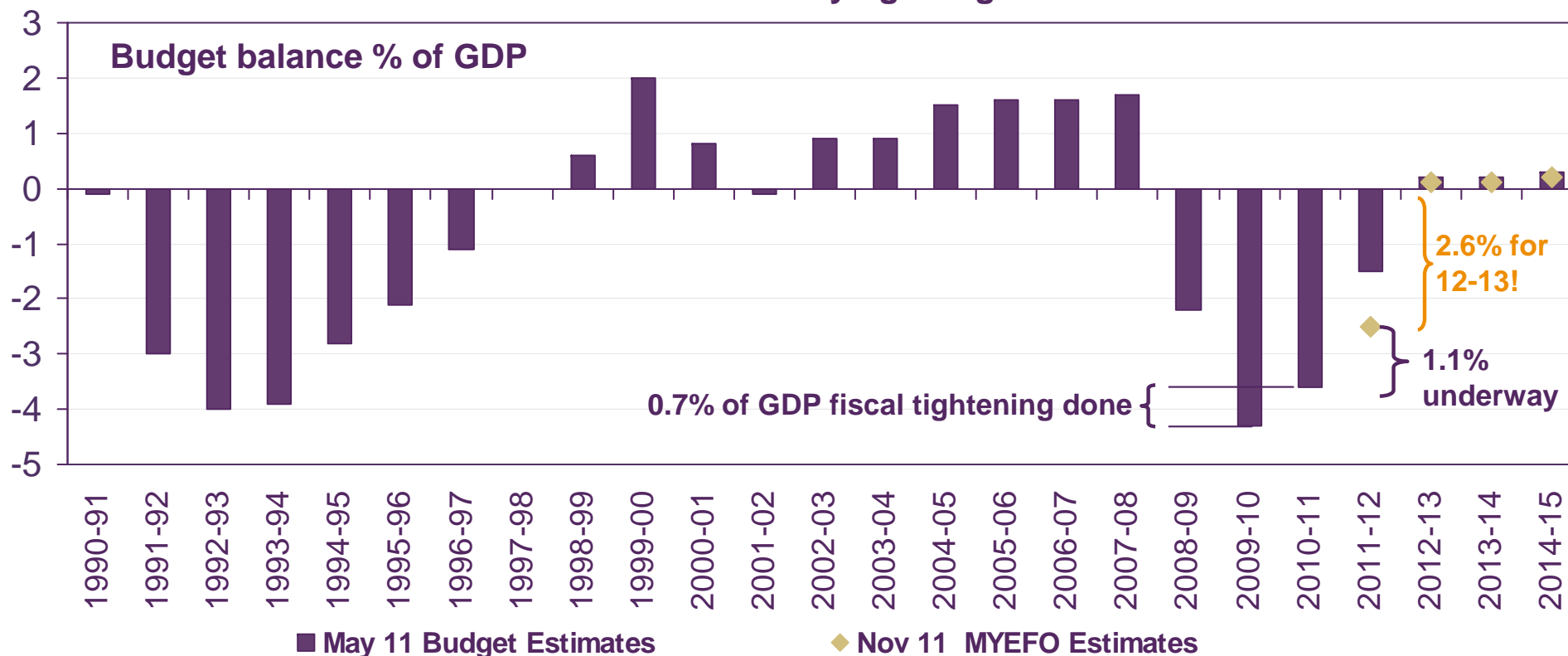
- Advanced economies are facing the conundrum of needing to tighten fiscal policy to stabilise and ultimately reduce debt to GDP ratios at a time when growth is cyclically weak.
- A *credible* medium term programme is needed to anchor expectations.
- Emerging and developing economies remain in a stronger fiscal position, with public debt to GDP ratios projected to contract.

Australia's Fiscal Focus



Projected Path To Surplus

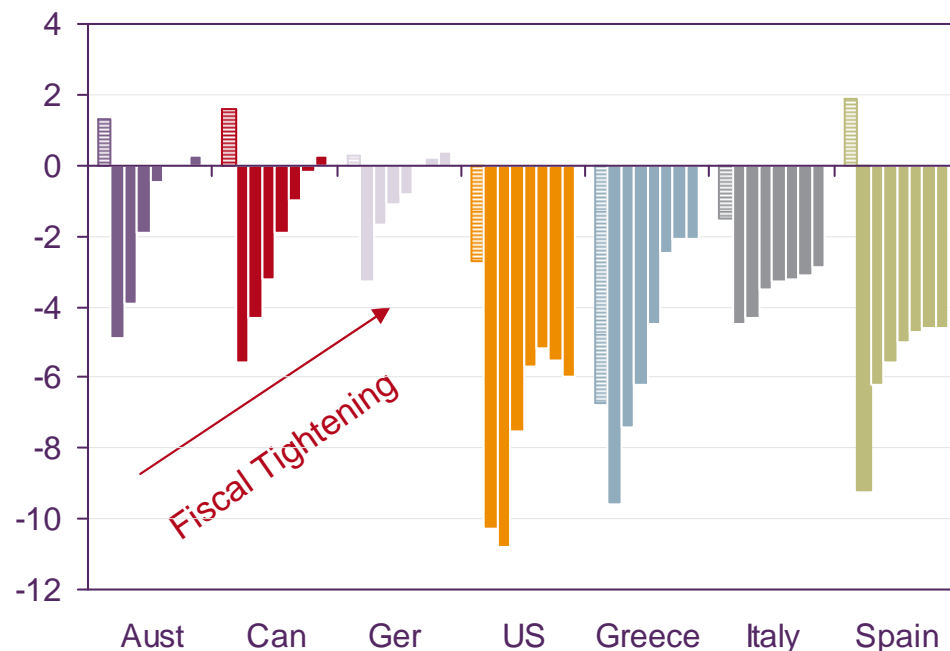
Trends In Australia's Underlying Budget Balances



- The government remains focussed on achieving a budget surplus in its political timeframe.
- This means a significant drag from fiscal policy over the next 18 months and although not 'new' news, it is a drag that the RBA will bear in mind when setting monetary policy given the higher starting point.
- The drag from fiscal policy stops from 2012/13 and the RBA will have to be mindful of not "over easing".

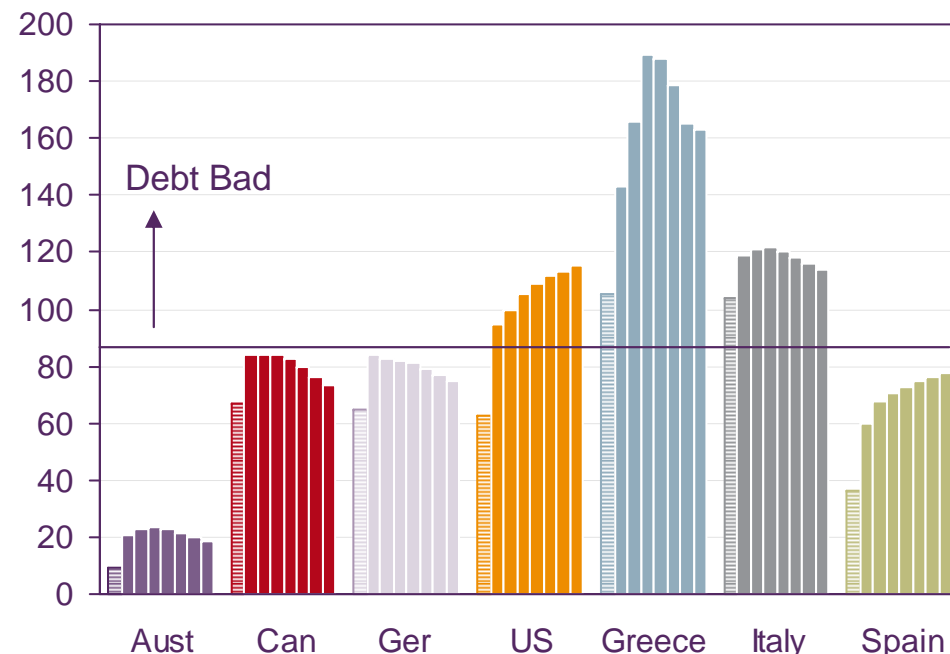
Dealing With Post GFC Blues

Trends In Budget Balances: % GDP



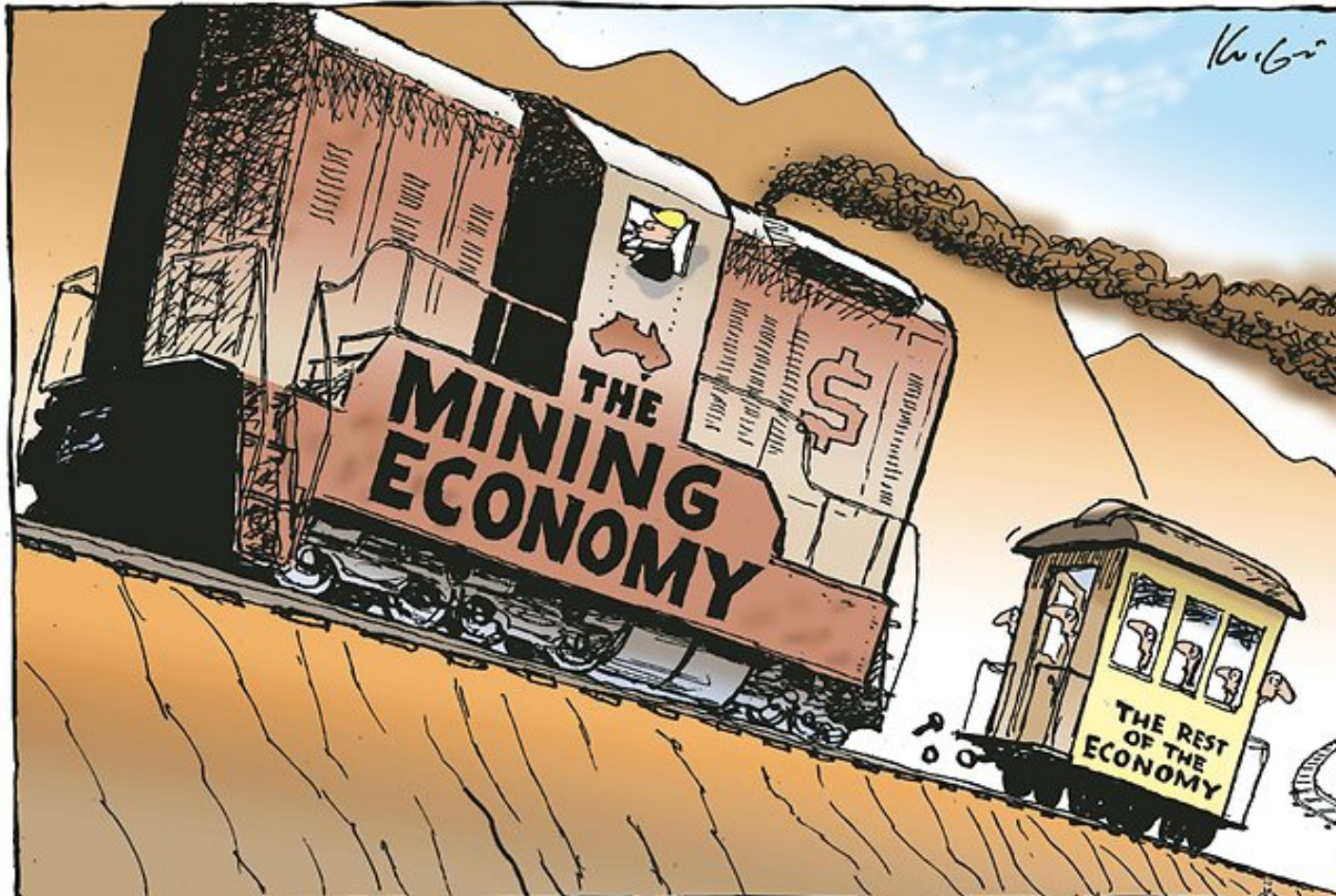
2007 and 2010 to 2016

Govt Gross Debt Trends: % GDP



2007 and 2010 to 2016

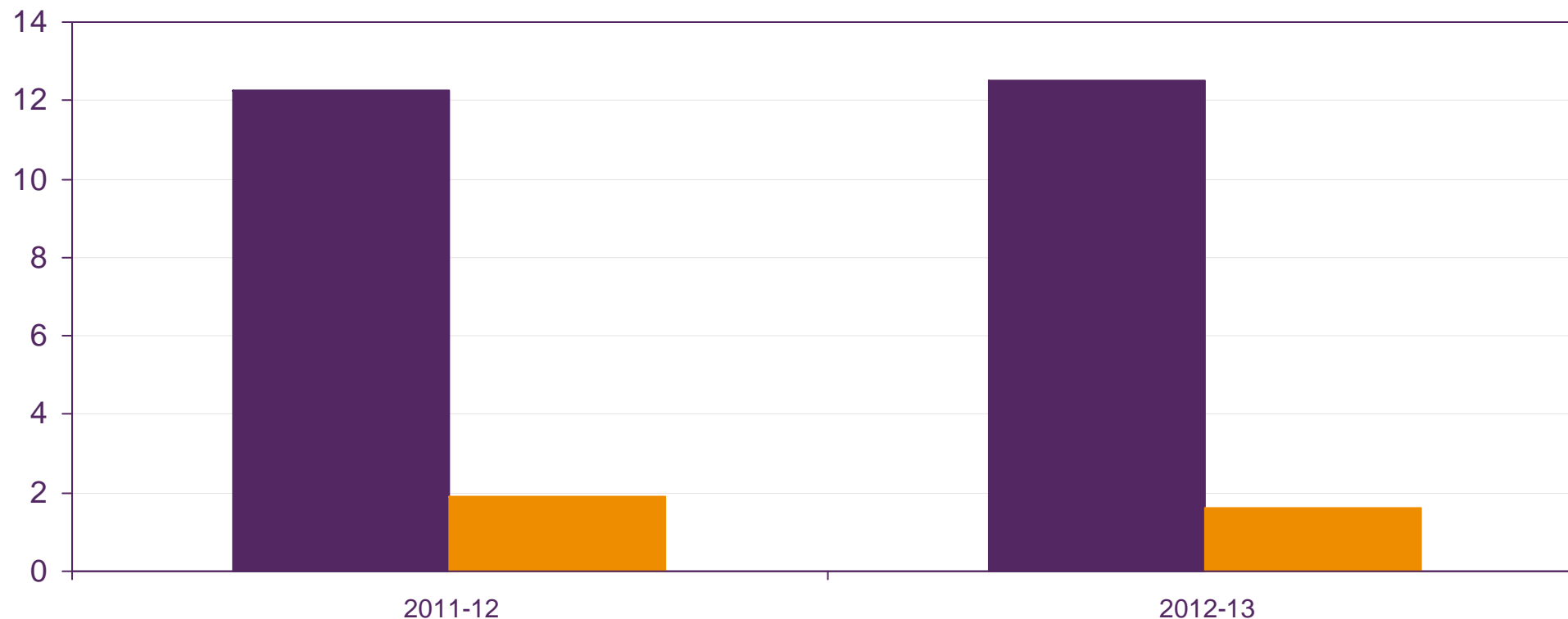
- Some countries are managing to payback GFC borrowing and stabilise/cut debt to GDP ratios in preparation of the ageing onslaught. Others are struggling and face major fiscal challenges.
- Australia is among the virtuous fiscal nations with others facing headwinds.
- The OECD warn that pre-programmed fiscal tightening could derail a weak US recovery and how the US goes about finessing conflicting cyclical and structural objectives will be a key factor shaping the outlook for 2012.



Is It As Dramatic As This?

Mining vs The Rest

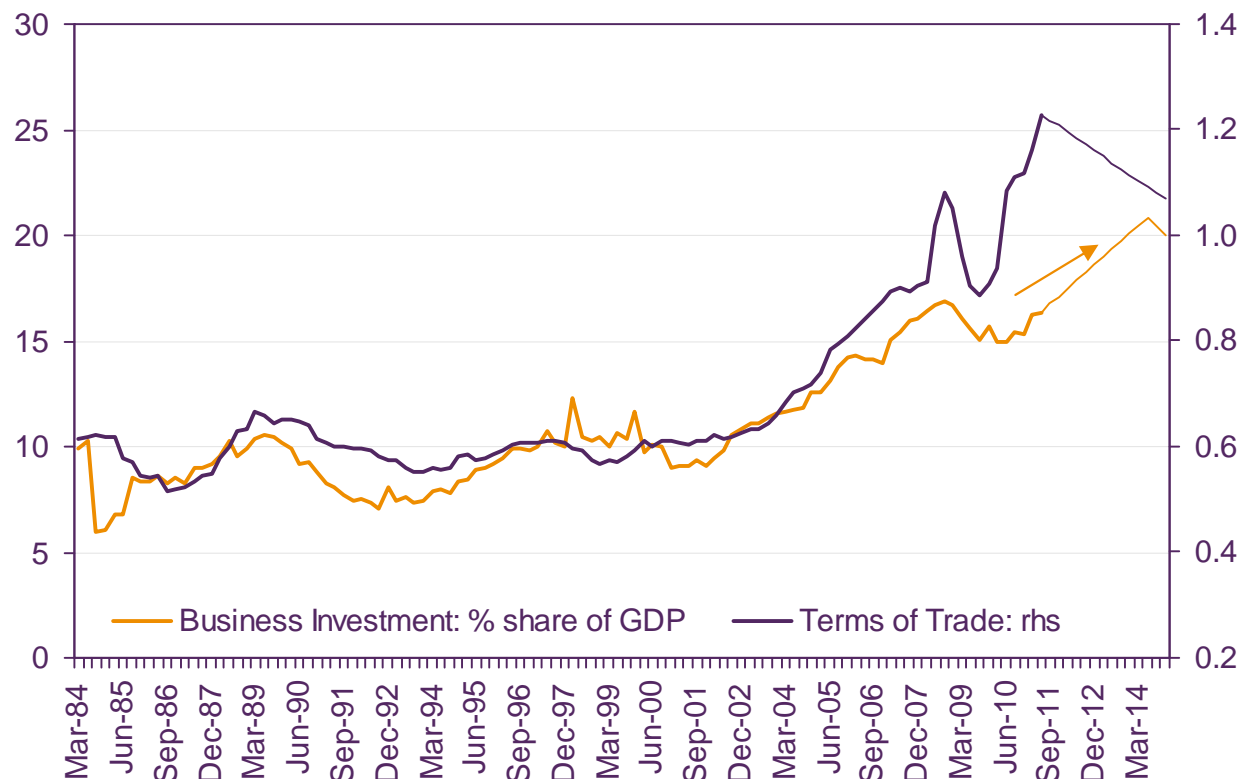
Growth in Mining & Non Mining %



- Mining & related accounts for around 15% of GDP, but will be growing at 10%+ over the next 2 years.
- If you are in the other 85% of the economy, growth is around 1¾%.

The Great Investment Boom

Business Investment and The Terms of Trade



LNG Projects for 2011 – US\$ bn

Committed

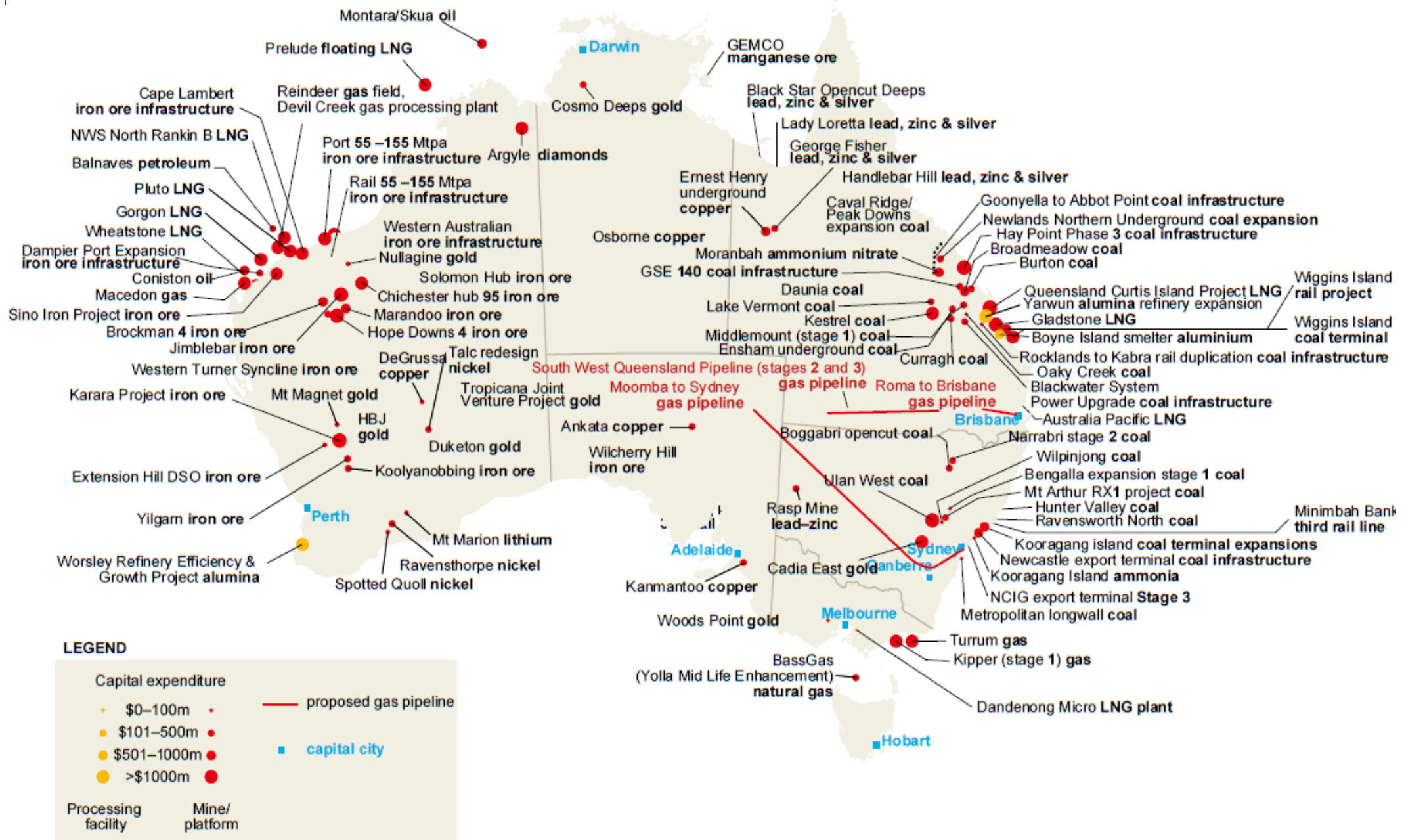
Gladstone LNG	16
QLD Curtis LNG	15
Aust Pacific LNG (phase 1)	14
Prelude LNG	12
Wheatstone LNG	25
Total	82

Non LNG - \$A bn

Olympic Dam (2012)	30
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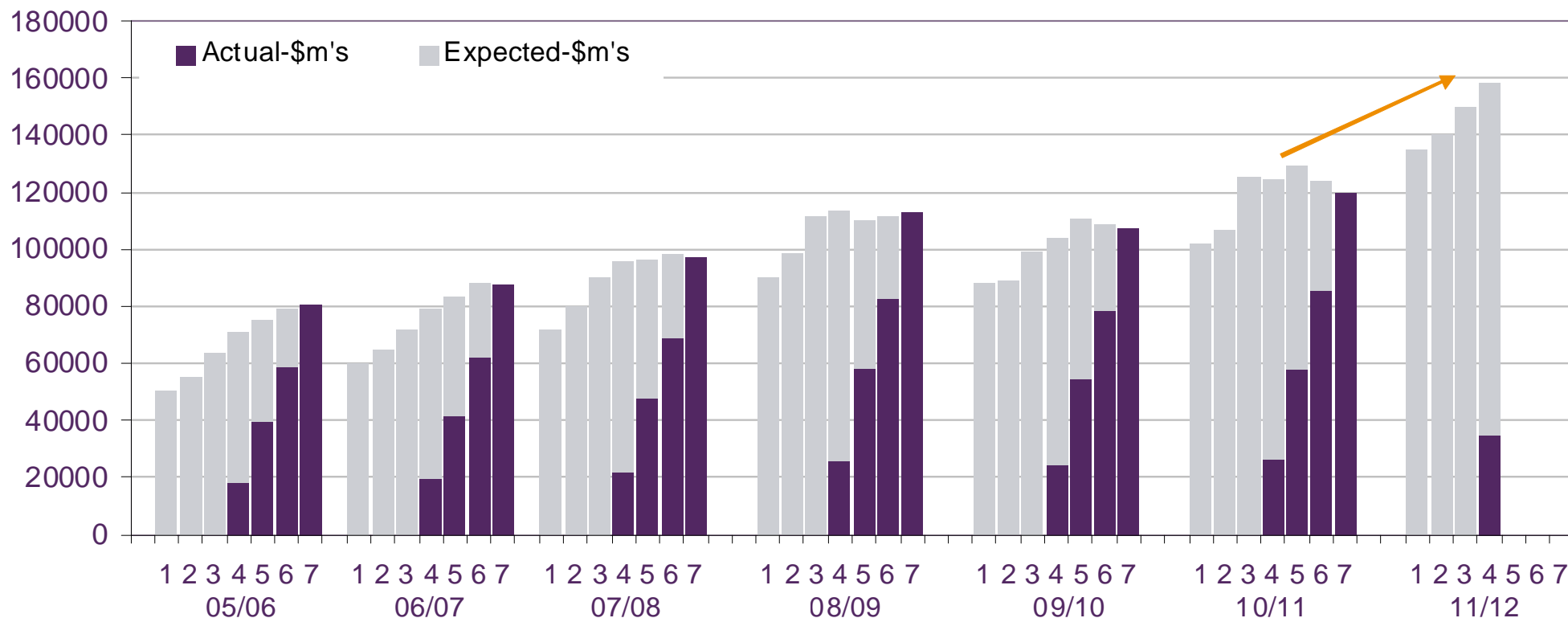
- The supply side of the economy continues to respond to powerful price signals. Mining investment as a share of GDP is expected to jump from just over 3% in 10-11 to around 5% over 11-12!
- Rising global energy demand is behind a surge in LNG investment which will see the sector potentially grow from 0.5% of GDP to 3% of GDP by 2013-14.
- You can add the Olympic Dam expansion to the list of resources projects.

Where It Is Happening



Capex Intentions Remain Strong

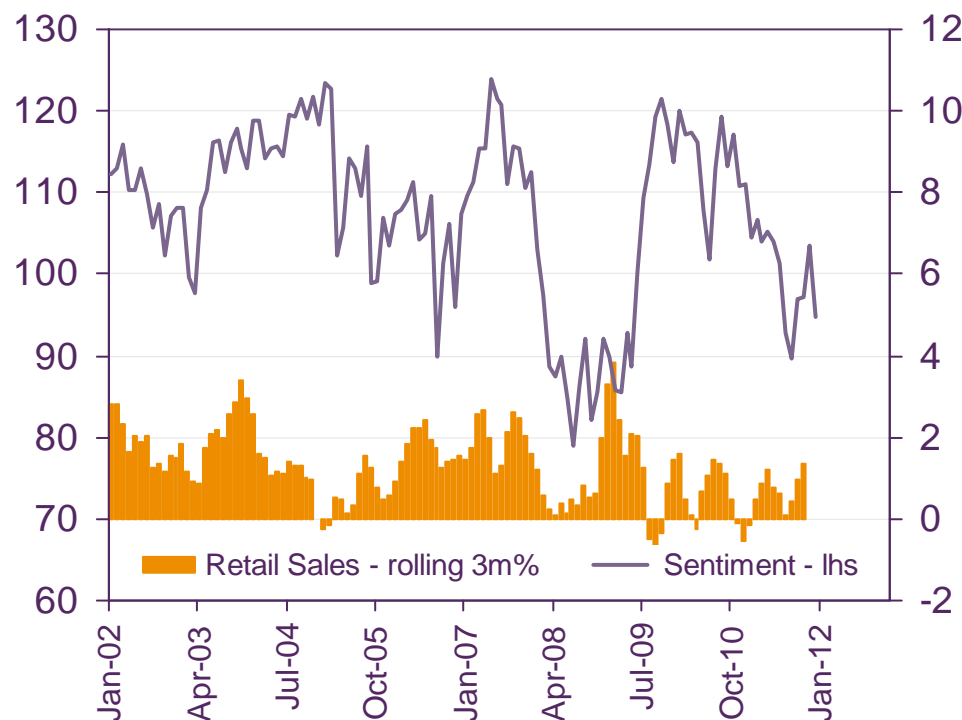
Capital Expenditure Plans



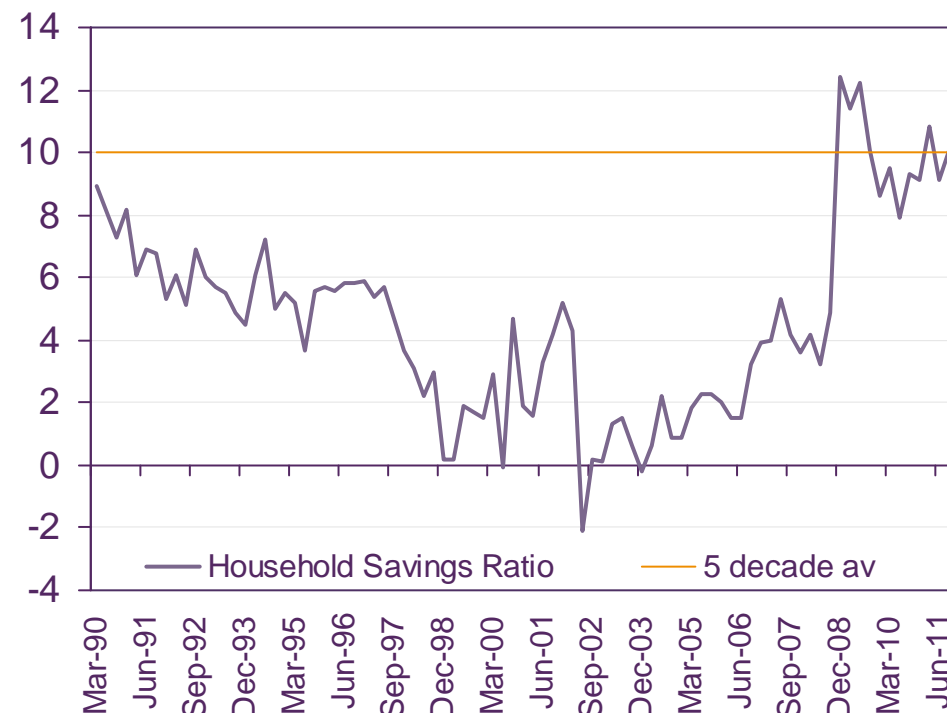
- The latest capex survey shows no sign of the investment boom letting up despite European problems.
- Estimates for the total 11-12 spend have been revised up from \$150bn last quarter to \$158bn in Q4.
- Of the \$158bn, building and structures accounts for 64% of the spend with the balance made up by plant and equipment. By industry, mining accounts for 55% of the spend, manufacturing around 9% with the rest accounted for by 'other'.

Consumption: Modest Lift

Consumption Indicators



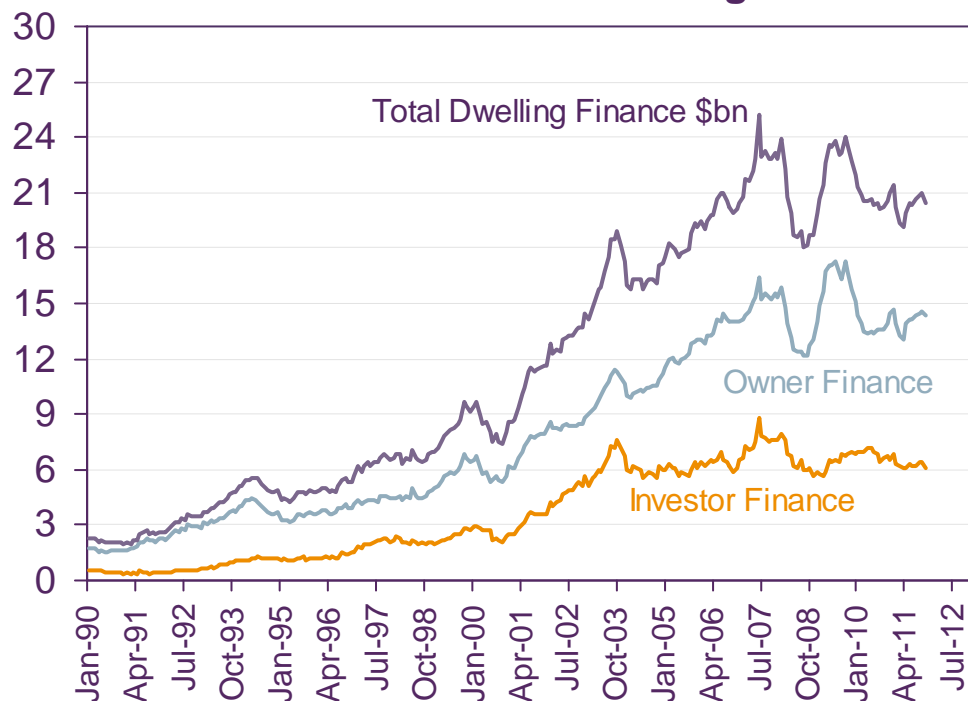
Household Savings Ratio - %



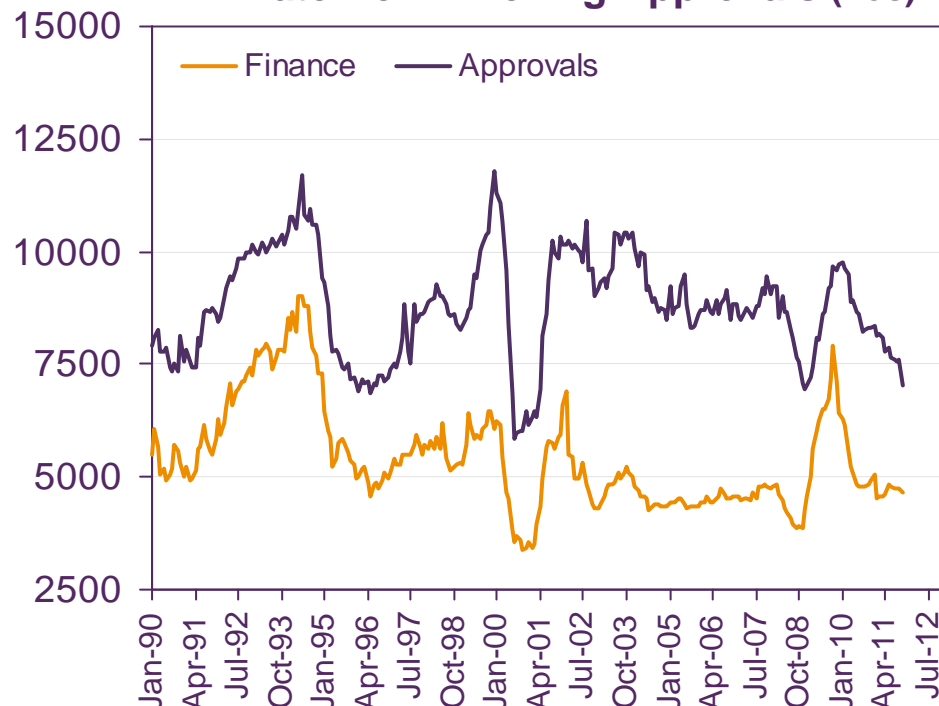
- Renewed Euro problems in early December and fears for the year ahead led to a sharp fall in consumer sentiment in December, despite another easing from the RBA.
- A fragile consumer mindset will only reinforce the need for precautionary savings going into 2012.

Housing Wallowing

Credit Demand Cooling



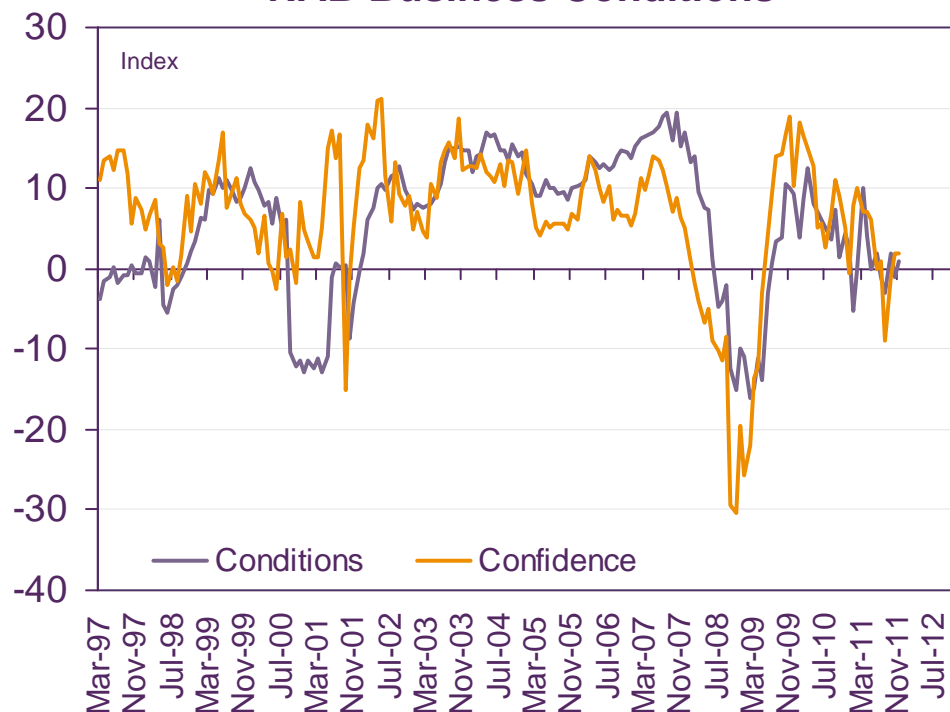
Private New Dwelling Approvals (nos)



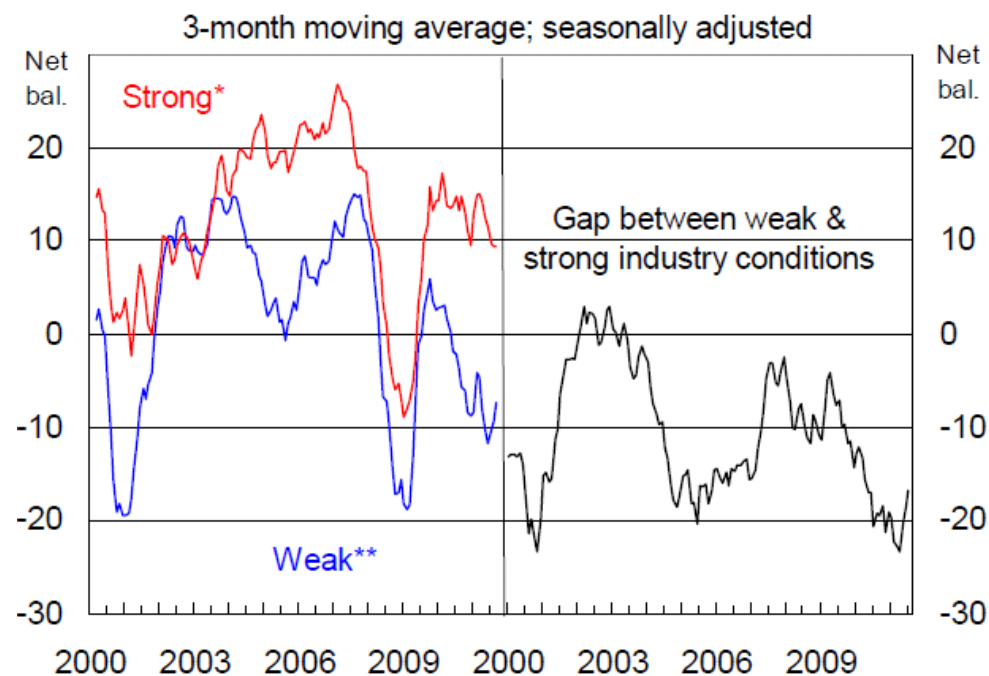
- Moderating house prices and increased consumer caution are seeing more subdued demand for the finance of new private dwellings, there was also a worrying fall in new private dwelling approvals for October.
- RBA monetary easing should help stabilise the outlook for the sector over 2012.

Business Turning The Corner?

NAB Business Conditions

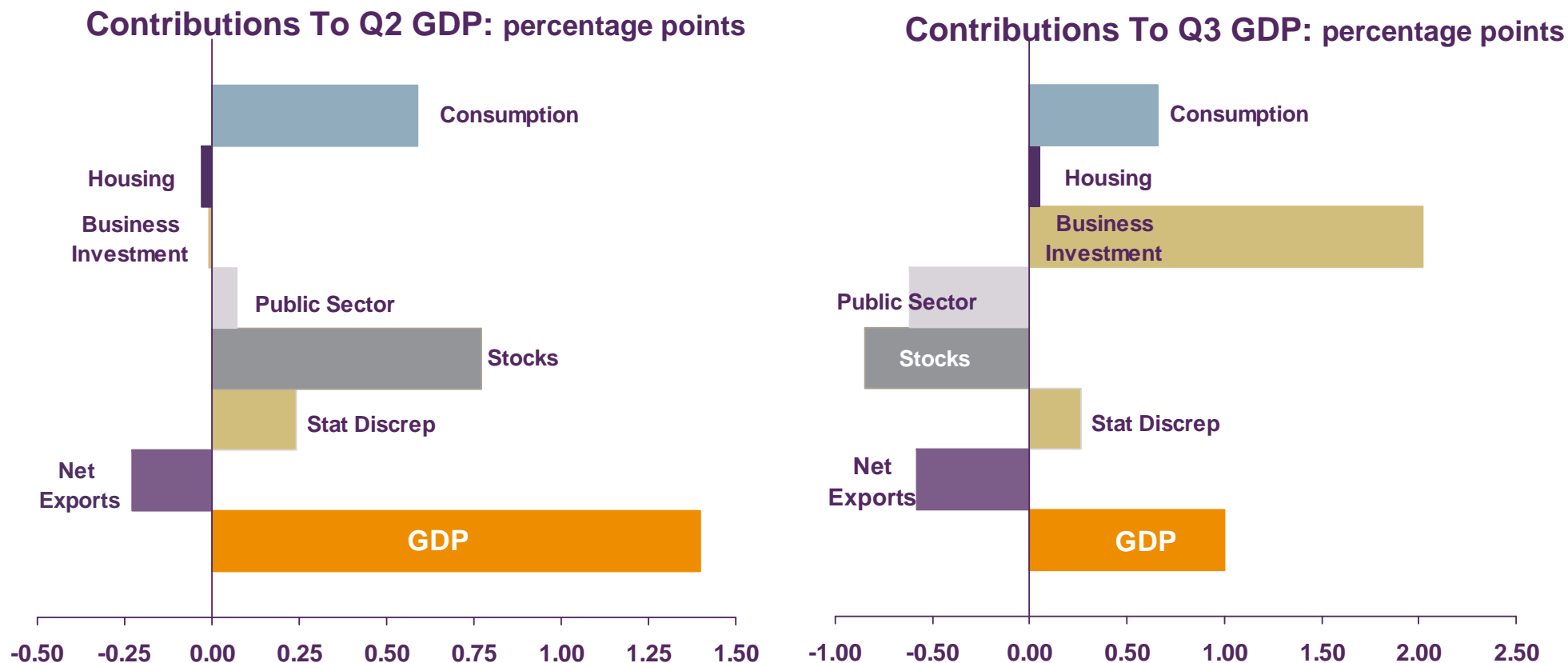


NAB Business Conditions



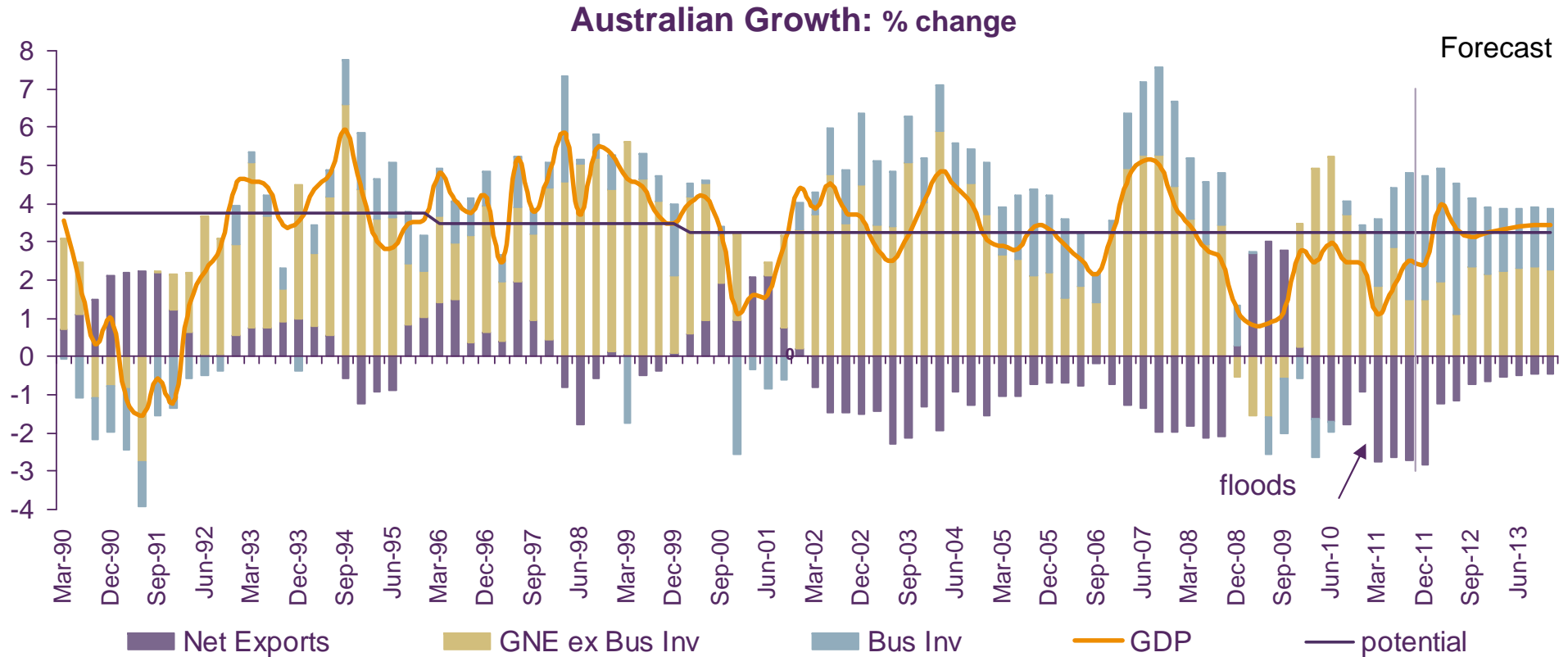
- Business conditions levels consistent with growth of around 3.25-3.50% annualised for Q4.
- The economy remains multispeed and driven by structural change. **Strong/Expanding** = mining, transport & utilities, recreation & personal services, finance/business/property. **Weak/Contracting** = retail, mfr, construction, wholesale.

All Adds Up To A Diverse Growth Story



- GDP rose by 1% in Q3 following a gain of 1.4% in Q2.
- Behind the headlines, consumption has been solid and business investment boomed in Q3. The public sector is beginning to become a drag on growth as the GFC fiscal pulse unwinds.
- While early days, Q4 GDP should rise between $\frac{3}{4}\%$ and 1%.

Offshore Events Take Us Back To Trend

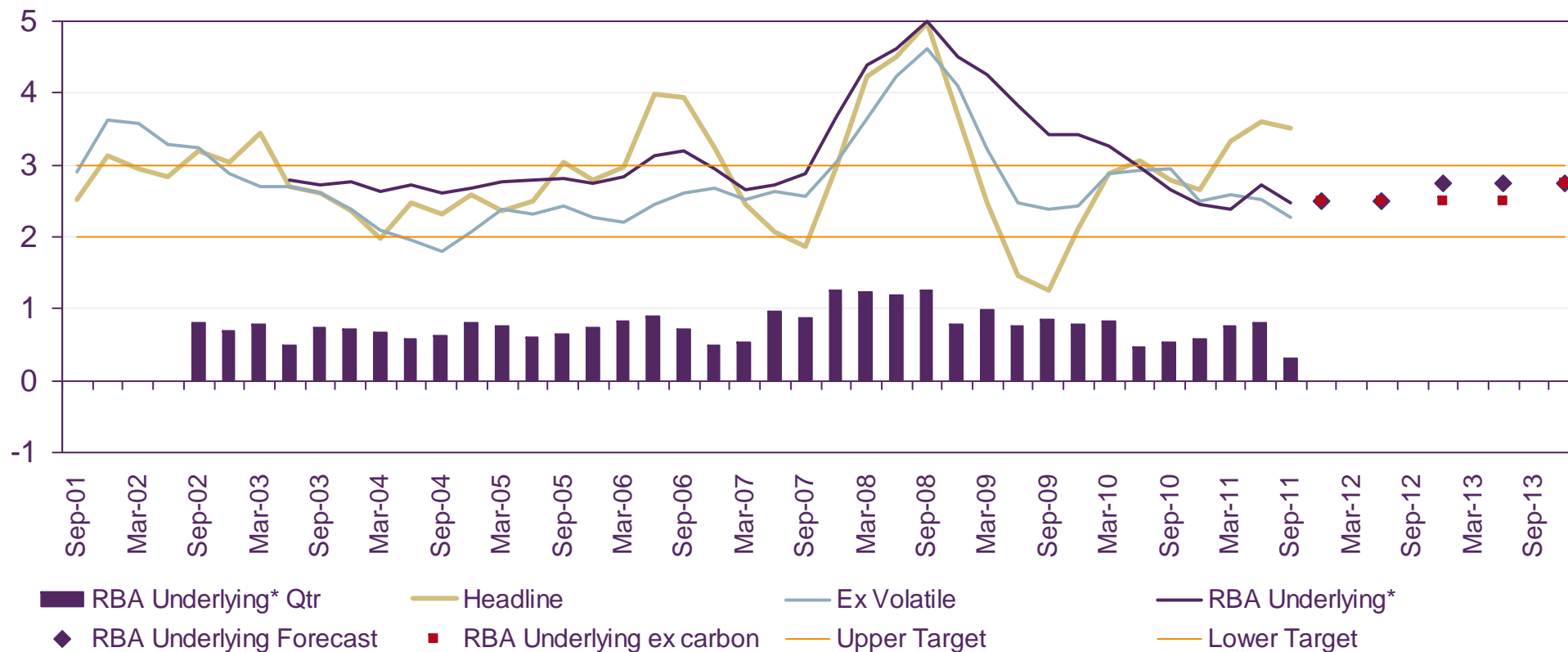


GDP Forecast Round Up

	2010/11	2011/12	2012/13	2013
• Treasury (yr av basis %)	2.0	3.25 (-0.75)	3.25 (-0.5)	3.00
• RBA (yr av basis %)	2.0	3.25 (-0.75)	3.25 (-0.5)	3.25
• Perennial (yr av basis%)	2.0	3.00	3.25	3.25

Underlying Inflation Settling Mid Band

Inflation Trends -y/y%



- Q3 headline inflation rose 0.6% over Q3 or 0.4% on a seasonally adjusted basis. The headline yearly rate remains high at 3.5%.
- Underlying measures were up 0.3%, the lowest quarterly rise ever in this series and helped pave the way for monetary easing in November and December 2011.

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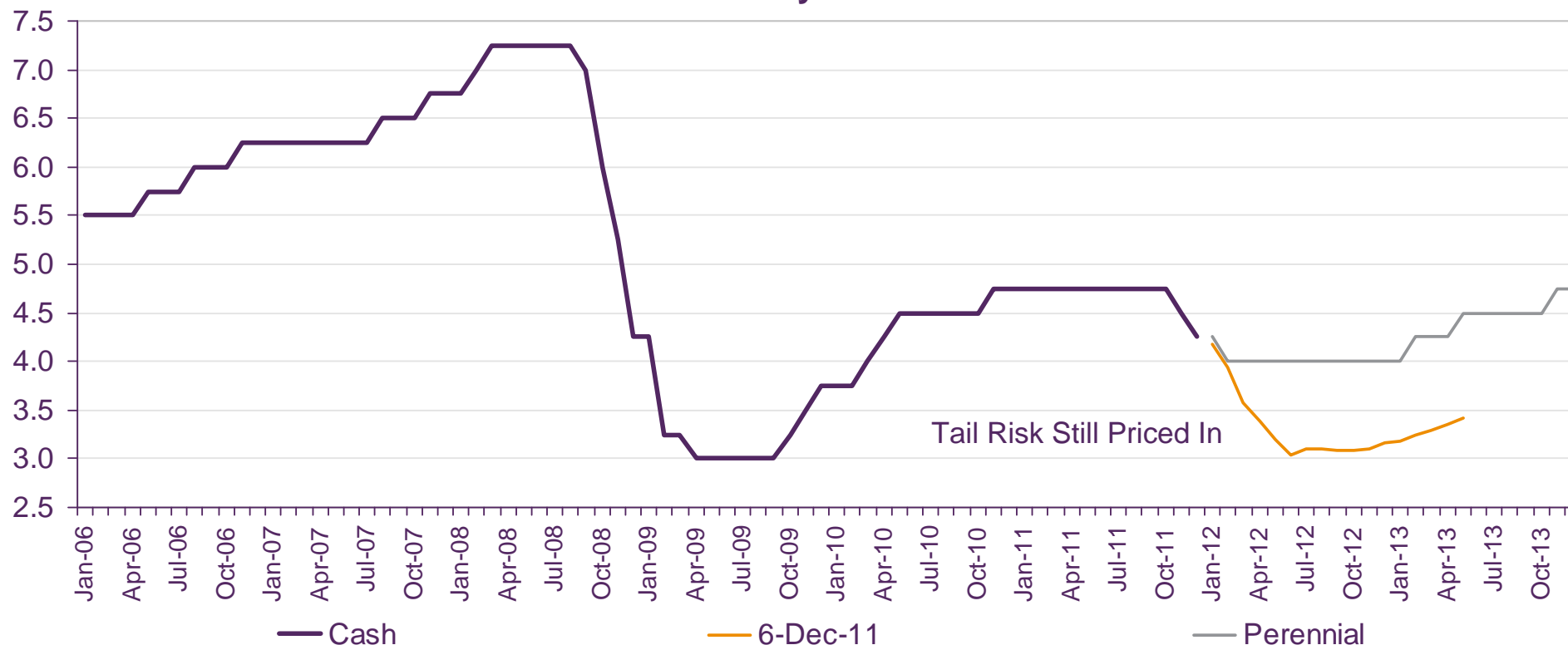
RBA Heading Towards Easy Policy Settings



- The RBA cut again in December, taking the cash rate from 4.5% to 4.25%.
- Once lending rates adjust, they will move below longer run average levels.
- We expect one further cut in February 2012. This would take the cash rate to 4% and monetary settings to slightly accommodative.
- The RBA's strategy appears to be to provide the economy with a front end loaded buffer against negative offshore developments and provide relief to the non-resources sector of the economy which is experiencing sub trend growth.
- The front end loaded nature of the easing, suggests that the interest rate sensitive sectors of the economy should be responding towards the end of 2012. As we go through 2013, the drag from fiscal policy begins to dissipate and suggests that monetary conditions will need to tighten slightly over 2013.
- Markets continue to discount a cash rate of around 3% mid 2012, implicitly factoring in a catastrophic event in Europe that tips the world into recession. This is a risk, but not the most likely outcome.

Heading To Easy Monetary Settings

Australian Cash Rate & 30 Day Interbank Cash Rate Futures

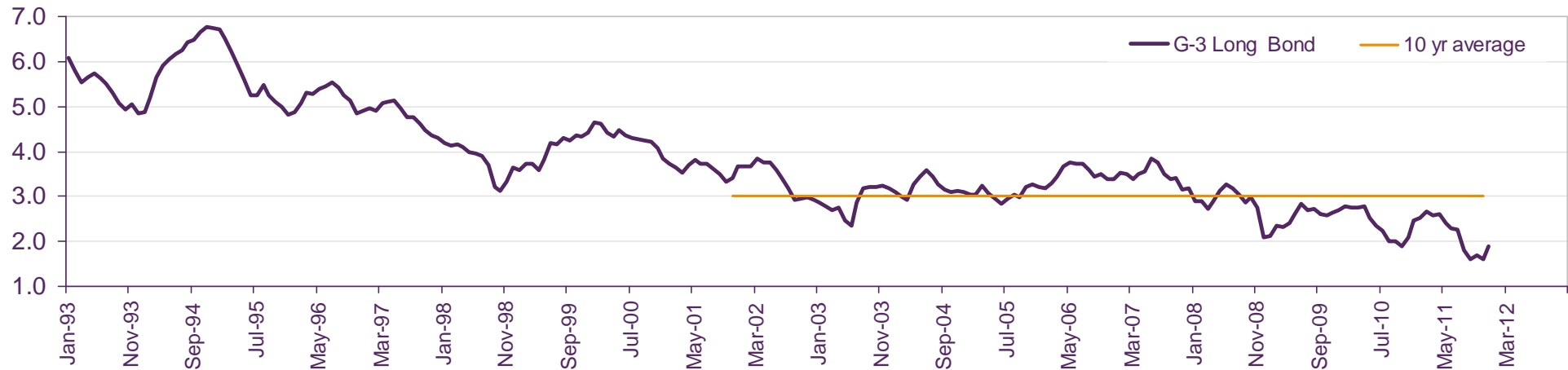


- The RBA is providing a front end loaded buffer against the growing risk of a cyclical slowdown offshore caused by European Sovereign debt contagion. One further cut likely in February 12 to 4%.
- Thereafter, the RBA is likely to pause with monetary settings mildly accommodative before returning monetary conditions to more normal levels over 2013.
- Markets continue to price in the tail risk scenario of a systemic shock emanating from Europe.

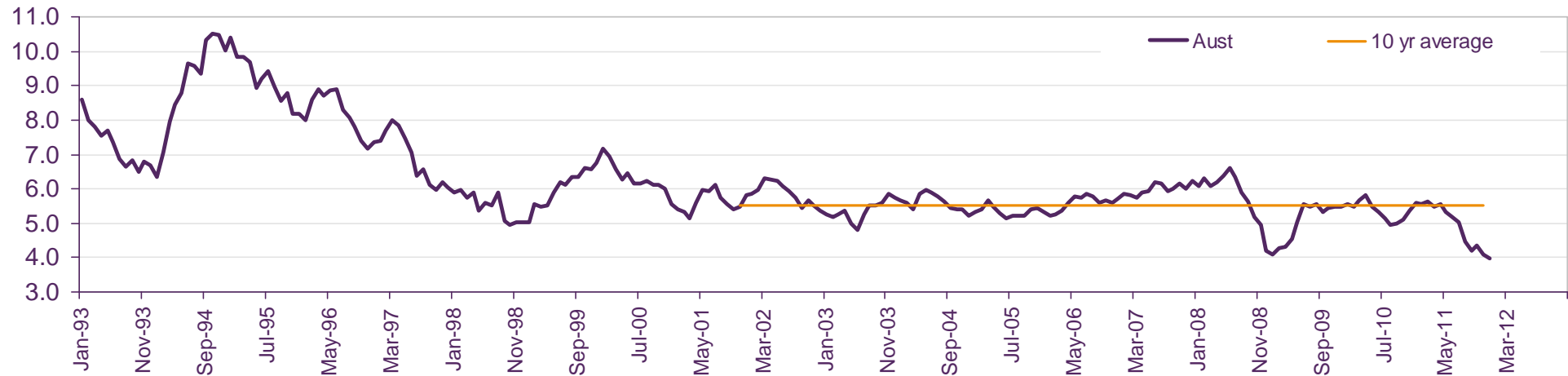
- The sector continues to look expensive with yields across the curve still well below fair value levels.
- At the shorter end of the curve, markets continue to factor in more easing than is suggested by the outlook for growth and inflation.
- At the longer end of the curve, flight to quality flows have pushed government bond yields to well below fair value levels, even allowing for Australia's better fiscal position.
- There is increasing risk of capital loss from any recovery in risk appetite flowing from credible progress in Europe on its fiscal and financial sector challenges.

From Relatively Attractive To Expensive

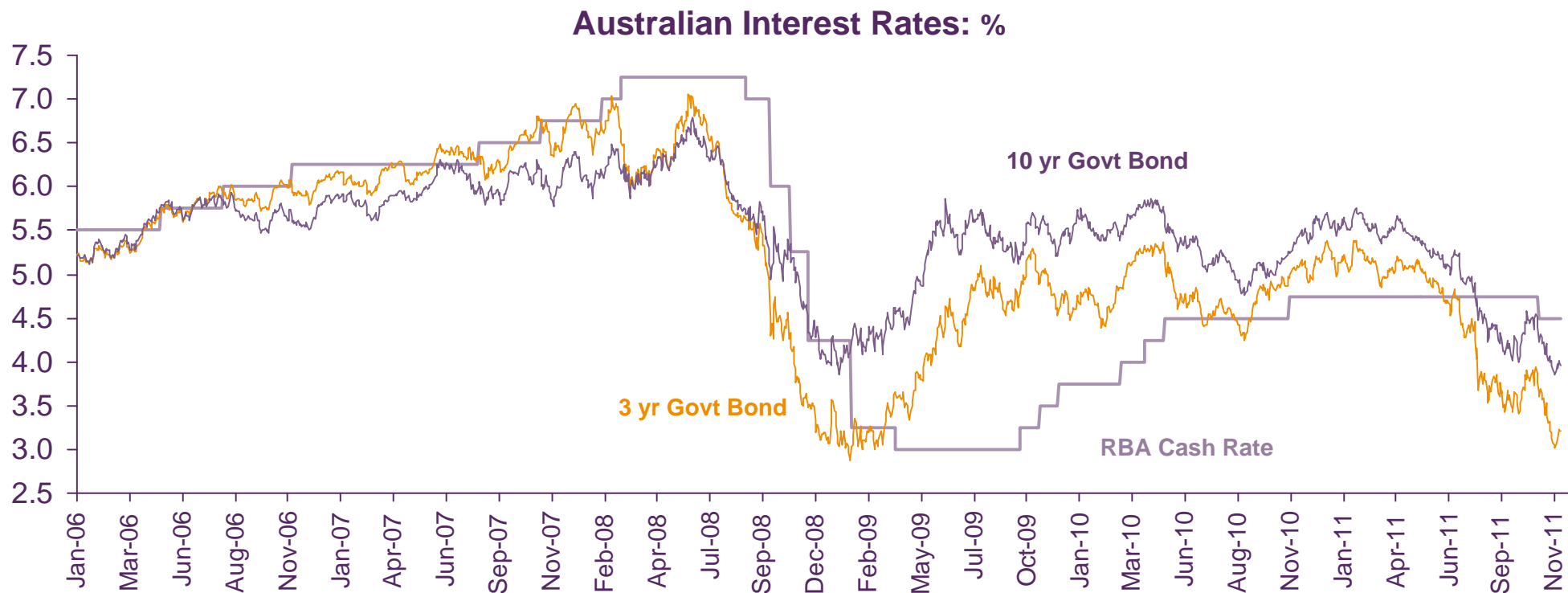
G-3 10 Year Government Bond Yields: %



Australian 10 Year Government Bond Yields: %



Fixed Interest: Very Expensive



- Yields have rallied hard on flight to quality flows on sovereign debt problems.
- While some modest monetary easing appears prudent, yields continue to factor in a very aggressive easing cycle.

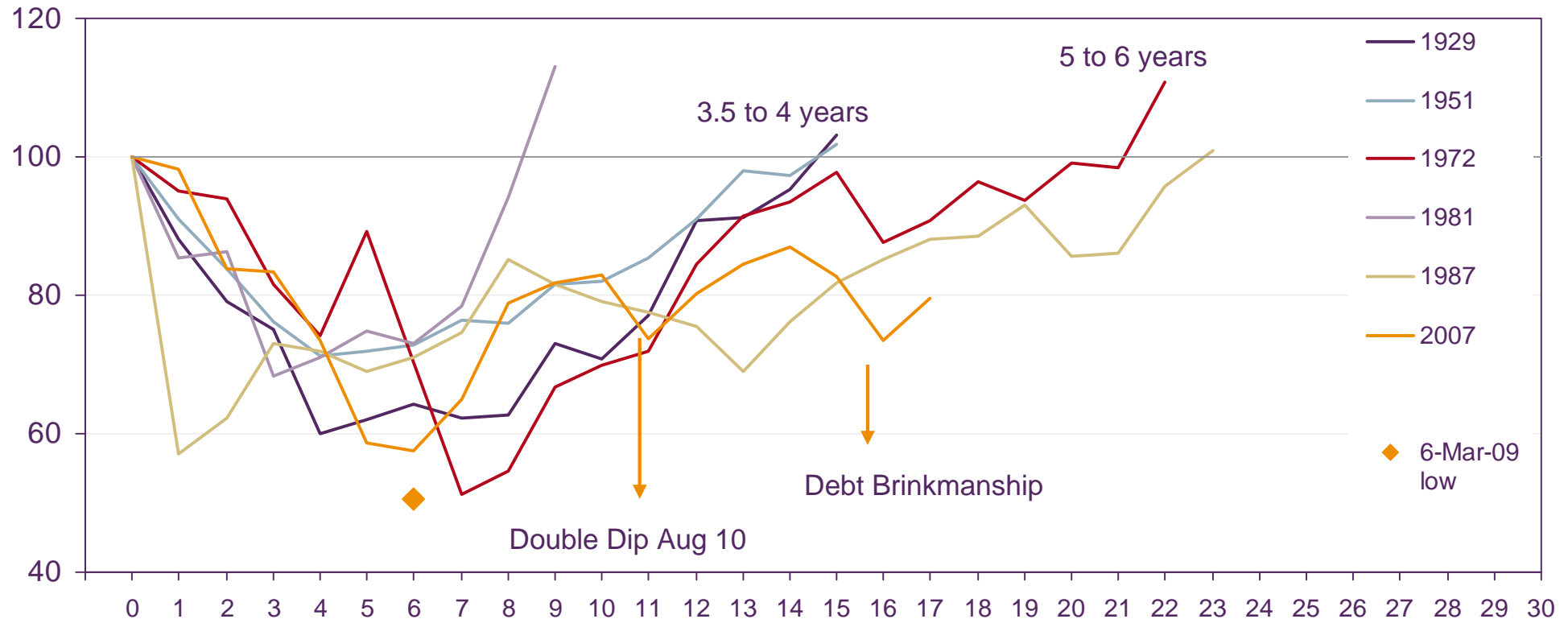
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- The latest “sell off/mini bear market” is the second since the peak of the market in Nov 2007.
- Strong value abounds:
 - Risk premia are extremely high, close to GFC levels.
 - Yearly returns drop below 1 std deviation of long run returns.
 - Forwards P/E very low.
 - If market pricing of a 3.0% cash rate by mid 2012 is correct, the Australian economy will boom.
- We remain tactically overweight in multi sector funds.

Various Bear Market Cycles

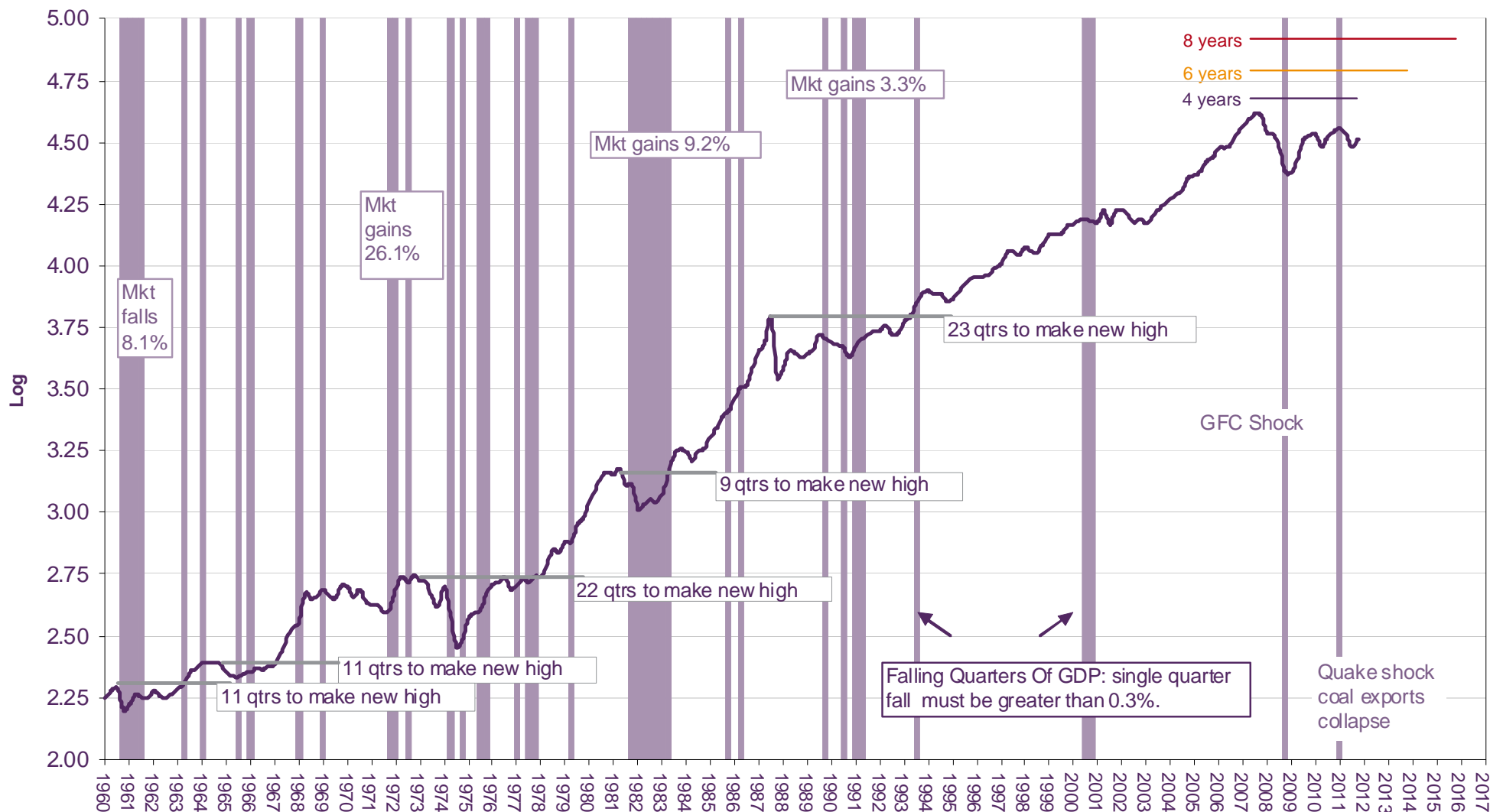
All Ordinaries Accumulation Index (Q'tly Data): 100=Cycle Peak



- Another “mini bear” market has evolved and it looks like the recovery to the previous high will be more consistent with those that take 5 to 6 years.
- Both pull backs have been driven by external factors and come against the backdrop of a favourable terms of trade shock. Natural disasters have not helped either this time round.

Maybe This Time?

Recession & The All Ordinaries Accumulation Index



Returns from 6 March 09 low to previous high Sep 07.

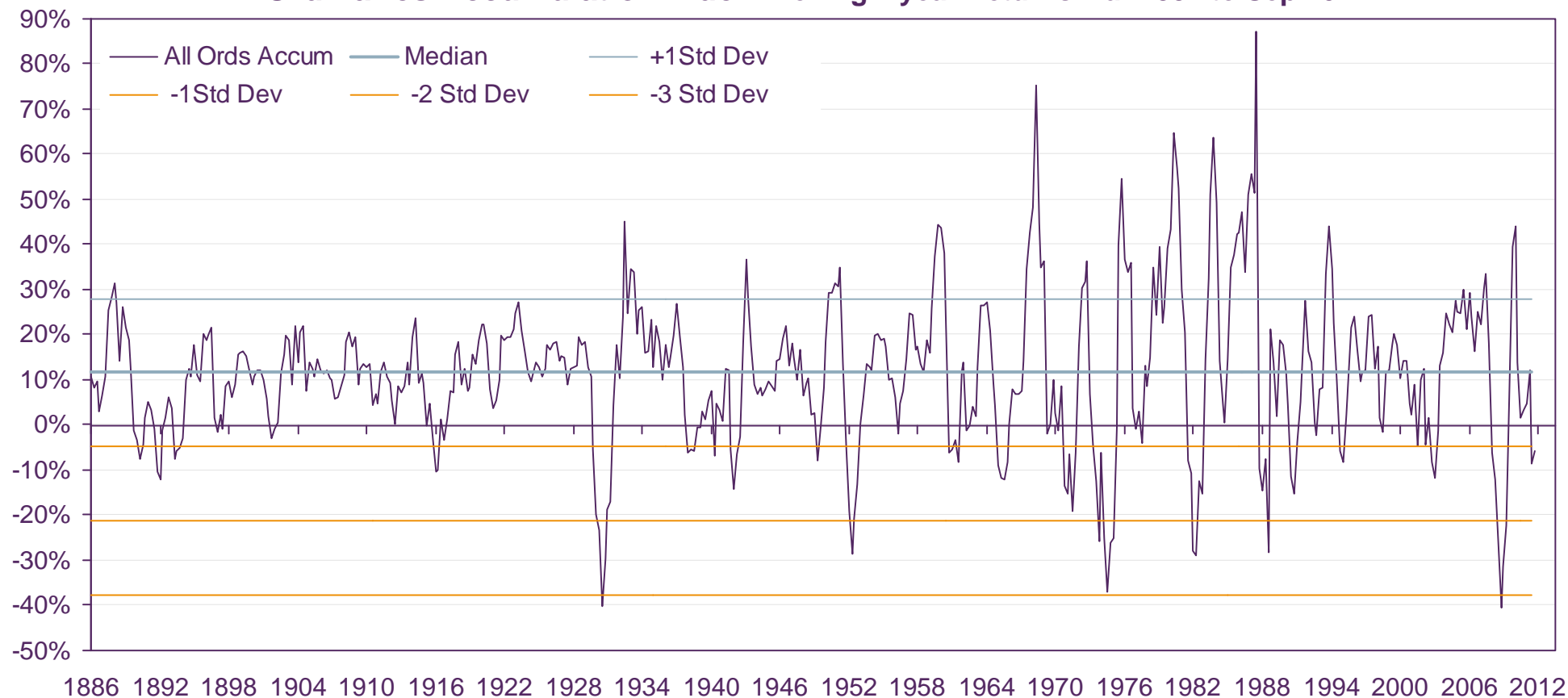
- 4 yrs to Sep 11: 31.3% p.a.
- 6 yrs to Sep 13: 16.3% p.a.
- 8 yrs to Sep 15: 11.0% p.a.

Returns from Dec 5 11, after 57.2% rally off Mar 09 low, to previous high.

- 6 yrs to Sep 13: 13.9% p.a.
- 8 yrs to Sep 15: 6.3% p.a.

A Buying Opportunity?

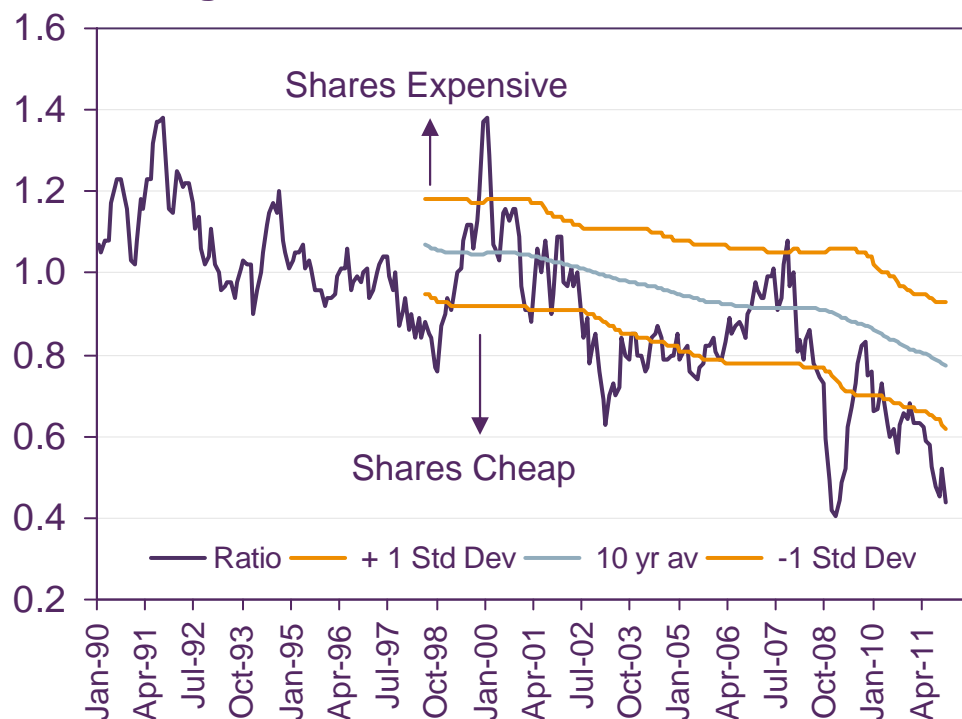
All Ordinaries Accumulation Index: Rolling 1 year Returns Mar 1884 to Sep 2011



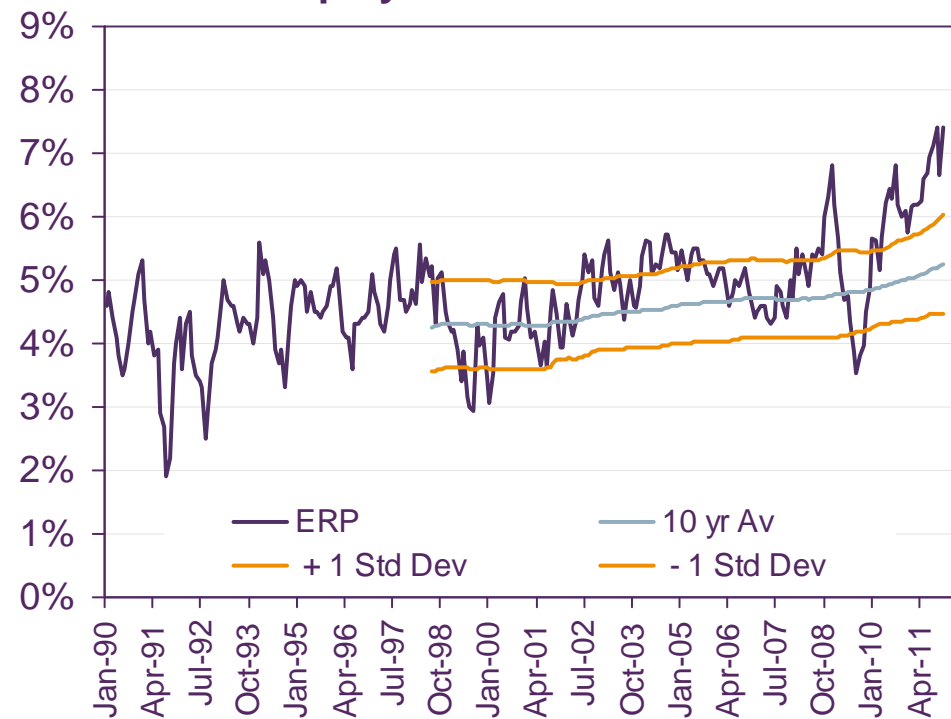
- The latest sell-off sees the yearly return drop to below 1 standard deviation – historically this puts the All Ords into buying territory.

Risk Premia At Extremes

Long Bond/12m Forward Industrials Yield



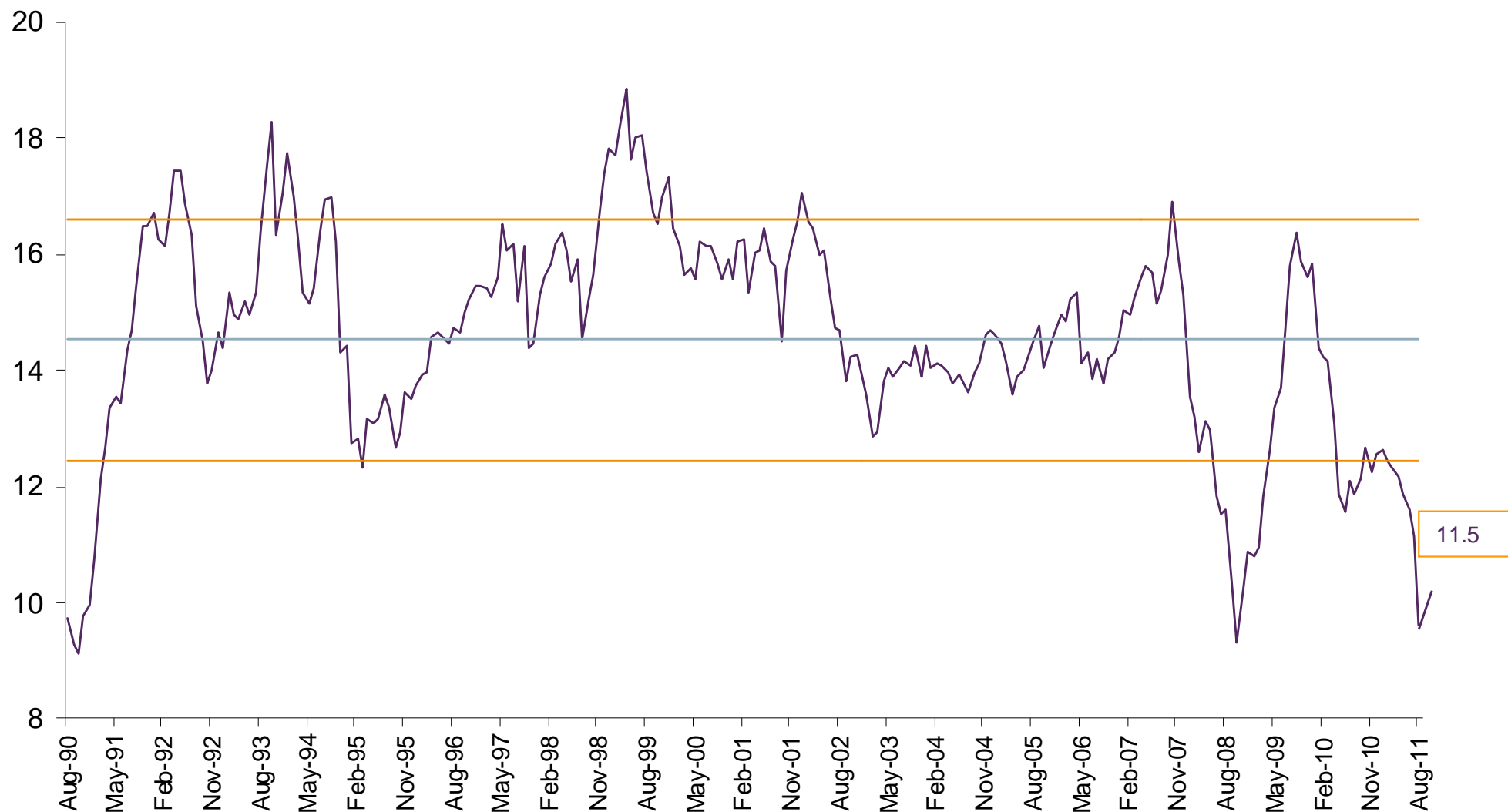
Equity Risk Premium %



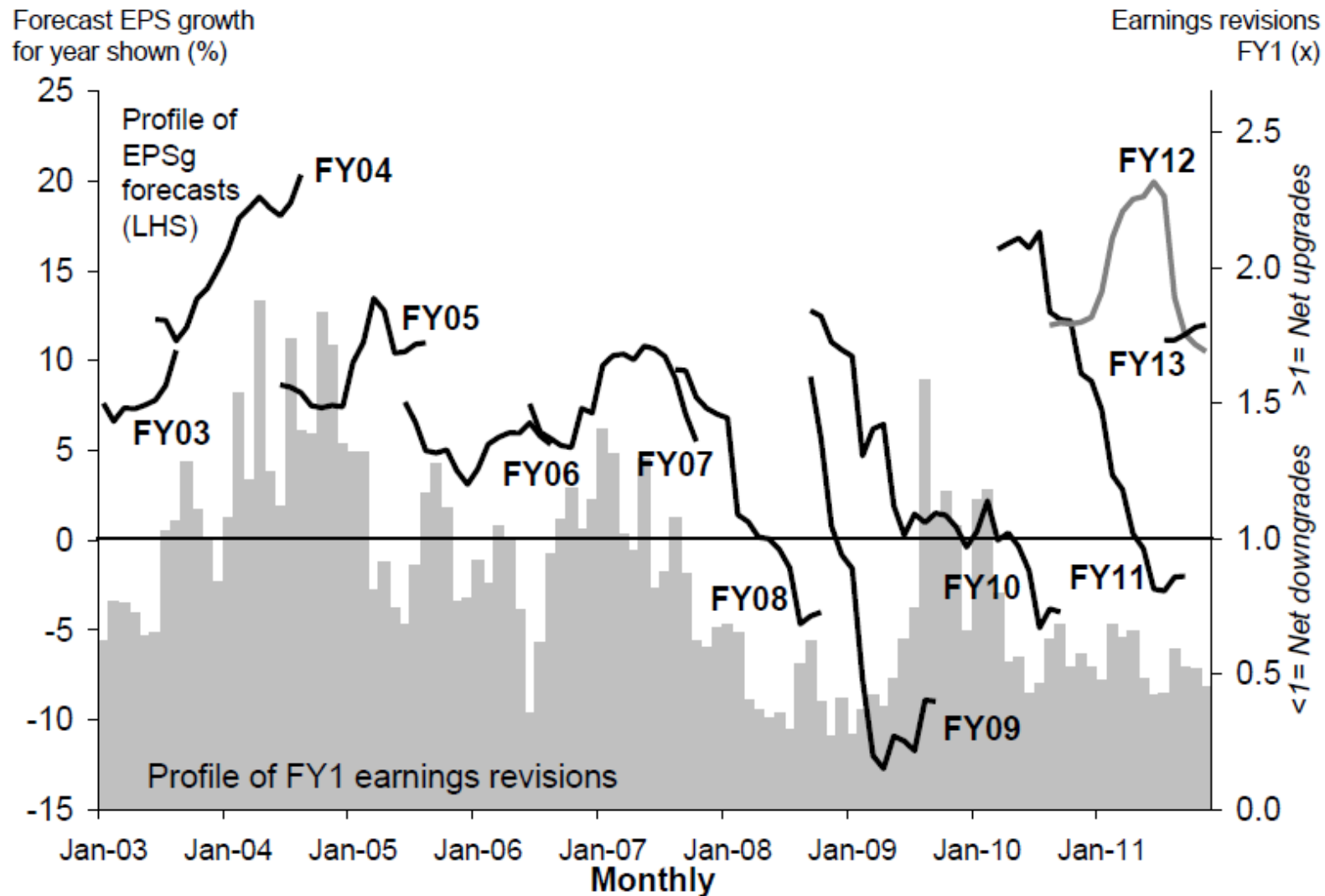
- The recent sovereign debt/recession fears driven rout in equities markets has periodically pushed valuation metrics to extreme measures.
- Government bond yields are extremely expensive in a relative sense.

Not Paying Much for Earnings

ASX 200 Forward PE



But It Is Hard To Make A Buck



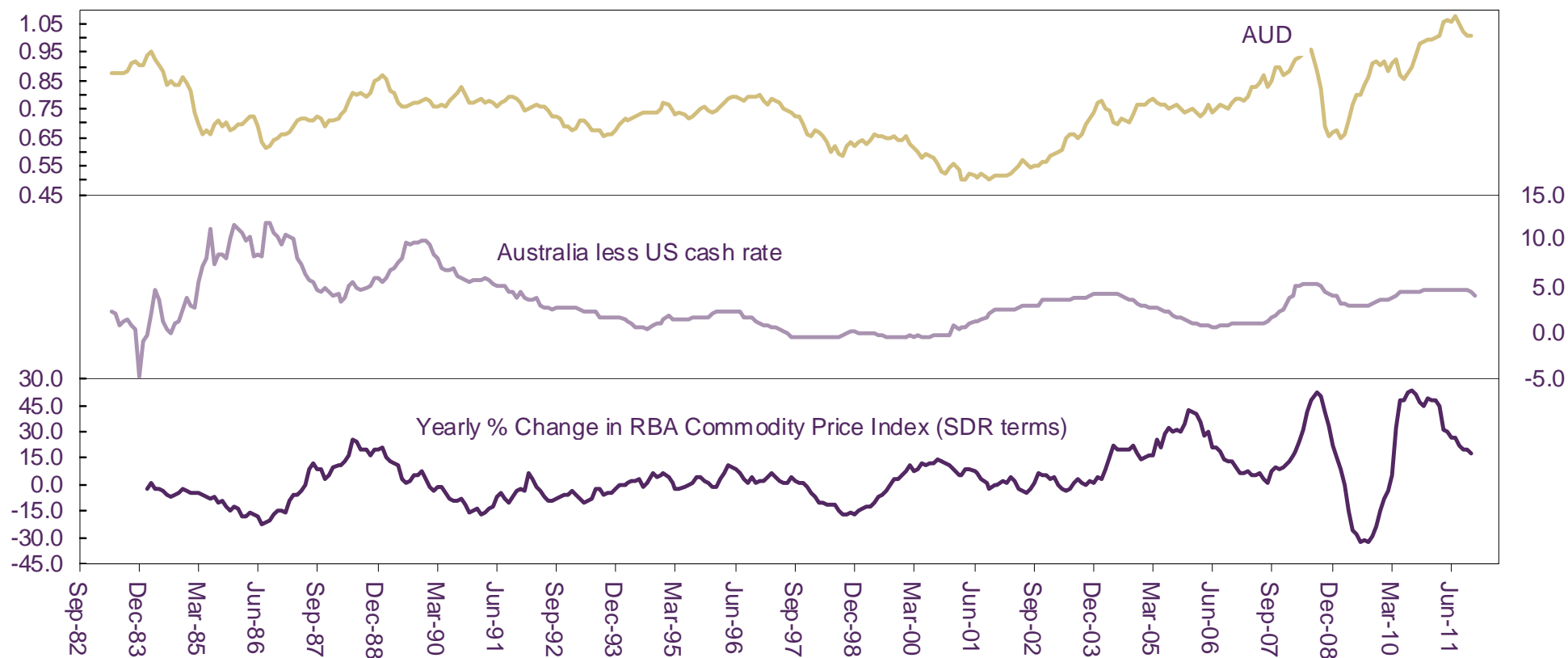
- Softness in the non-resources sector has seen earnings growth harder to come by, but recent monetary easing should help.

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Cyclical Support Turn

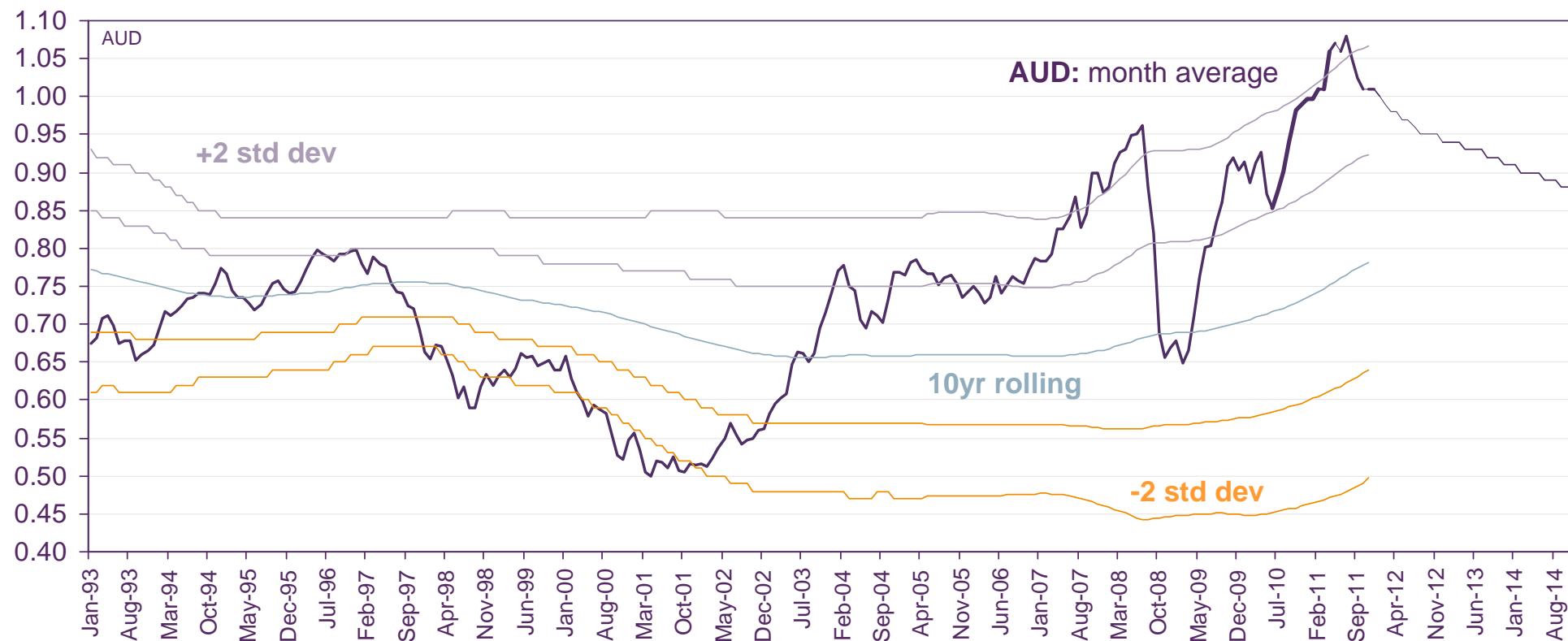
Aussie Dollar Drivers



- Cash spreads begin to narrow, reducing one of the cyclical supports under the currency.
- Commodity price growth looks to have peaked and very weak global growth in H1 2012 points to further moderation.

Currency Profile: Modest Falls

Exchange Rate Trends



- AUD cyclical factors have turned negative with interest rate spreads narrowing and global growth slowing in the first half of 2012.
- On the structural side, the terms of trade have peaked pointing to some fall in the real exchange rate.
- However, the AUD is finding support from offshore central banks as they increase the weight of Australian assets in their portfolio. This should be a background positive over the next 2 years.

- Prospects for a Euro fiscal pact are building and a credible result that brings the ECB into play would help underpin risk appetite.
- Global growth will start 2012 with a stumble before building momentum as recent pro cyclical policy steps kick in.
- The Australian economy remains well positioned but with disparate growth rates across the various sectors of the economy.
- RBA to ease again February 2012 then pause at 4%.
- The Australian fixed interest sector looks outright expensive.
- Australian shares excellent value offering very high reward for risk.
- Scope for modest A\$ depreciation over the medium term.

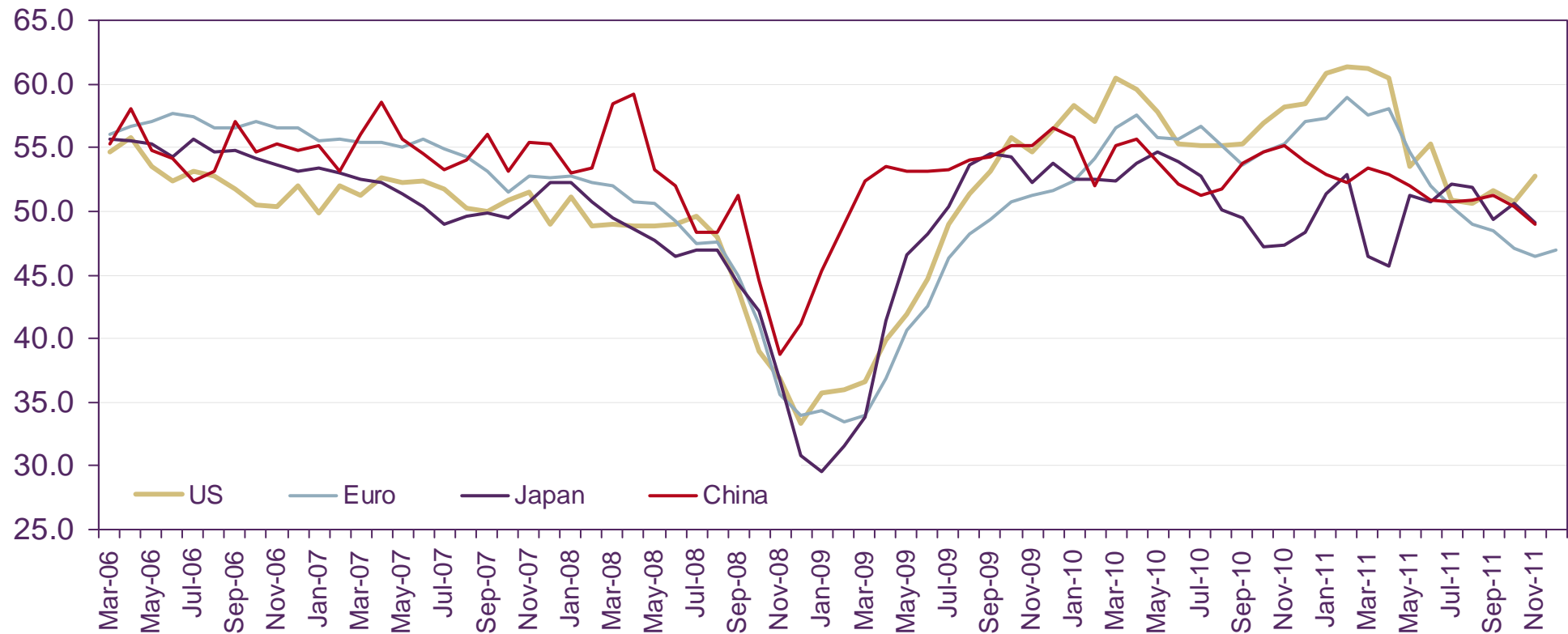
Economic Forecasts

Base Case Perennial Forecasts

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	2009	2010	2011	2012	2013	2008/09	2009/10	2010/11	2011/12	2012/13
Real Sector Outlook	<i>Quarterly Forecasts</i>									<i>Annual Average Growth</i>									
												est	fcst	fcst				fcst	fcst
Household Expenditure	0.70	0.80	1.04	1.17	0.80	0.77	0.76	0.76	0.79	1.03	2.91	3.55	3.41	3.15	0.05	2.53	3.13	3.76	3.14
Dwelling Investment	-1.93	-1.38	-0.55	0.93	-0.73	0.21	0.72	1.61	1.65	-4.39	4.21	-1.77	1.76	6.75	-1.48	1.18	0.94	-0.95	4.81
Business Investment	3.41	5.12	-0.05	12.92	2.39	2.62	2.64	2.10	2.04	-4.58	-1.15	16.86	14.71	8.59	2.34	-5.14	6.52	21.10	9.32
Public Final Demand	0.20	0.07	0.30	-2.54	-0.16	0.09	0.15	0.08	0.19	0.72	8.68	-0.89	-1.04	0.73	3.71	6.64	3.05	-2.28	0.50
Private Final Demand	0.87	1.49	0.69	3.51	1.04	1.14	1.17	1.11	1.12	-0.45	2.04	5.49	5.65	4.58	0.09	1.01	3.29	6.78	4.59
Stock Contribution To Growth %	0.57	-0.33	0.77	-0.85	0.43	0.05	0.02	-0.02	0.02	-0.78	0.40	0.43	0.15	0.02	-0.73	-0.11	0.63	0.05	0.14
Domestic Demand	1.28	0.82	1.34	1.23	1.18	0.95	0.96	0.86	0.93	-0.84	4.14	4.34	4.23	3.73	0.29	2.39	3.87	4.64	3.80
Exports Of Goods & Services	2.71	-6.43	2.87	1.97	2.48	1.42	1.16	1.39	1.56	2.13	5.83	-1.64	7.09	6.55	1.72	5.27	0.25	4.33	6.12
Imports Of Goods & Services	2.88	2.46	3.50	4.26	2.93	1.98	1.72	1.76	1.73	-8.58	14.08	11.54	10.06	7.35	-3.29	5.63	10.42	13.01	7.57
Net Export Contribution To Growth	-0.07	-1.80	-0.23	-0.58	-0.20	-0.19	-0.18	-0.15	-0.11	2.19	-1.52	0.00	0.00	0.00	1.00	-0.08	-2.03	-1.98	-0.60
Statistical Discrepancy	-682	270	1046	1926	1000	1000	1000	1000	1000										
- contribution to growth %	-0.40	0.29	0.24	0.26	-0.28	0.00	0.00	0.00	0.00	-0.17	0.07	0.30	-0.02	0.00	0.00	0.00	0.10	0.28	-0.07
GDP - quarter %	0.82	-0.68	1.39	0.95	0.74	0.80	0.81	0.75	0.86	1.39	2.57	1.97	3.41	3.40	1.37	2.33	1.95	3.04	3.27
GDP - year on year %	2.38	1.10	1.86	2.49	2.41	3.93	3.34	3.13	3.25	2.73	2.38	2.41	3.25	3.43	0.86	2.99	1.86	3.34	3.40
Current Account Deficit																			
- \$ bn	-8.471	-11.190	-6.659	-5.635	-10.910	-12.977	-14.047	-15.464	-16.566	-53.17	-38.46	-34.39	-59.05	-78.01	-36.97	-56.15	-33.48	-43.57	-68.51
- % GDP	-2.56	-3.41	-2.00	-1.68	-3.23	-3.81	-4.09	-4.47	-4.74	-4.2	-2.9	-2.6	-4.3	-5.5	-2.93	-4.34	-2.54	-3.21	-4.88
- 12m rolling sum	-38.5	-32.3	-33.5	-32.0	-34.4	-36.2	-43.6	-53.4	-59.1										
Prices & Wages - qtly %																			
Total Export Deflator	-3.11	4.20	5.91	2.35	-3.00	-1.50	-0.50	-0.50	-0.50	-11.37	7.28	11.89	-1.97	-1.99	19.80	-15.28	17.03	4.79	-3.11
Total Import Deflator	-3.52	0.31	0.10	-0.21	0.00	0.25	0.50	0.50	0.50	-2.00	-7.69	-2.21	0.93	2.02	10.95	-11.57	-3.10	-0.63	1.76
Terms of Trade	0.42	3.87	5.80	2.56	-3.00	-1.75	-1.00	-1.00	-1.00	-9.48	16.40	14.40	-2.87	-3.92	7.95	-4.08	20.75	5.43	-4.79
CPI - Underlying/Ongoing	0.06	0.88	0.55	0.76	1.14	1.00	1.14	0.90	0.78	2.62	2.81	2.68	3.93	3.00	3.59	2.66	2.63	3.31	3.68
- year on year %	2.49	2.58	2.51	2.26	3.37	3.49	4.10	4.25	3.88										
CPI - Headline	0.40	1.55	0.91	0.62	0.82	1.00	1.14	0.90	0.78	1.82	2.85	3.60	3.70	3.00	3.13	2.33	3.10	3.62	3.60
- year on year %	2.65	3.33	3.60	3.52	3.95	3.39	3.62	3.92	3.88										
Financial market - Qtr Average																			
TWI	74.00	74.80	77.50	75.90	74.60	72.38	71.65	70.17	69.43	70.10	74.00	74.60	69.43	67.21	61.70	69.60	77.50	71.65	68.69
AUD	0.987	1.004	1.062	1.050	1.010	0.990	0.973	0.953	0.947	0.91	0.99	1.01	0.95	0.91	0.76	0.88	1.06	0.97	0.93
Cash	4.67	4.75	4.75	4.75	4.50	4.08	4.00	4.00	4.00	3.50	4.67	4.50	4.00	4.67	3.00	4.42	4.75	4.00	4.42
10 Year Bond	5.35	5.55	5.34	4.57	4.23	4.28	4.40	4.58	4.75	5.46	5.35	4.23	4.75	5.00	5.04	5.54	5.34	4.40	4.75
Weighted G2+Euro - cash	0.25	0.25	0.28	0.32	0.28	0.22	0.17	0.17	0.17	0.25	0.25	0.28	0.17	0.37	0.26	0.25	0.28	0.17	0.17
Weighted G2+Euro - 10 Year Bond	2.15	2.59	2.44	1.89	1.67	1.71	1.73	1.75	1.77	2.63	2.15	1.67	1.77	2.03	2.63	2.56	2.44	1.73	1.92

Waiting For A Solution

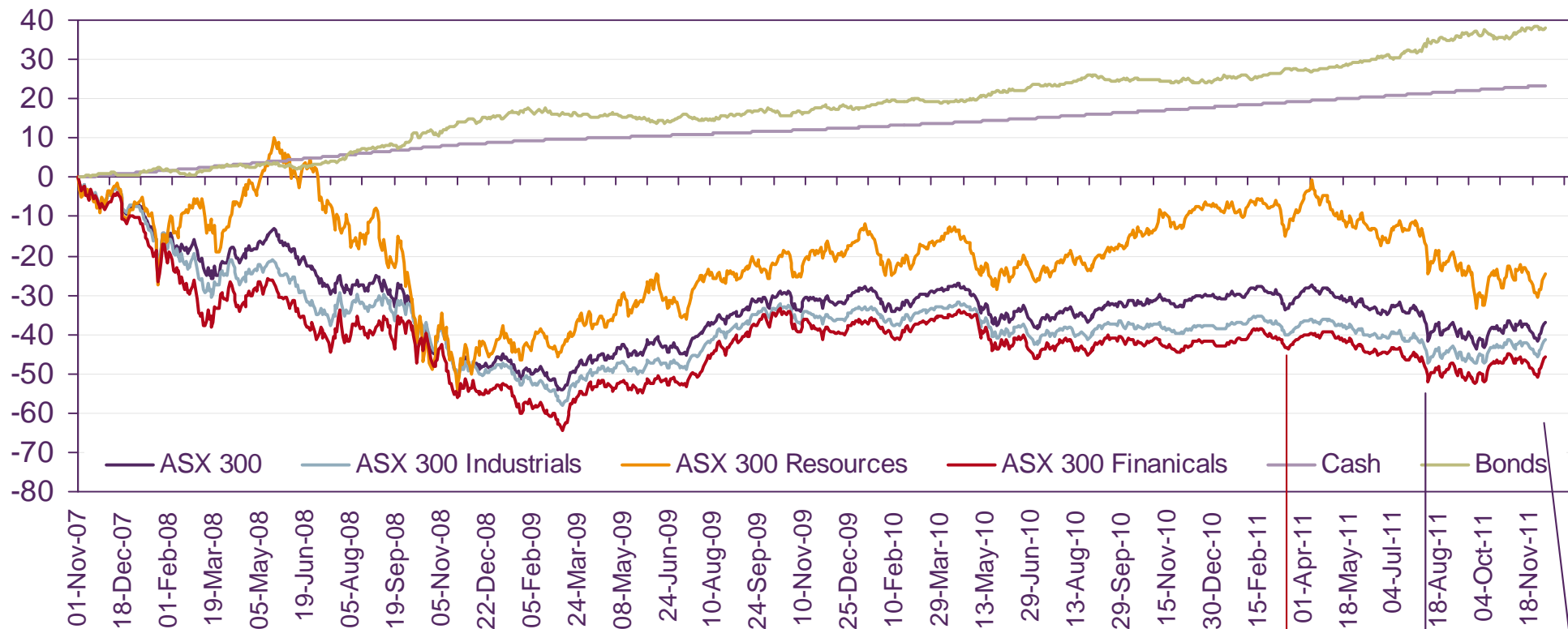
Global PMIs



- *The Chinese and US PMI's kicked up slightly in September, an encouraging result given financial market volatility and speculation of a double dip US recession.*
- *Europe's sovereign debt crisis appears to be having an impact on activity levels with the Euro PMI slipping over the last couple of months.*

Growth Assets Shackled

Asset Class Returns Since 1 November, 2007

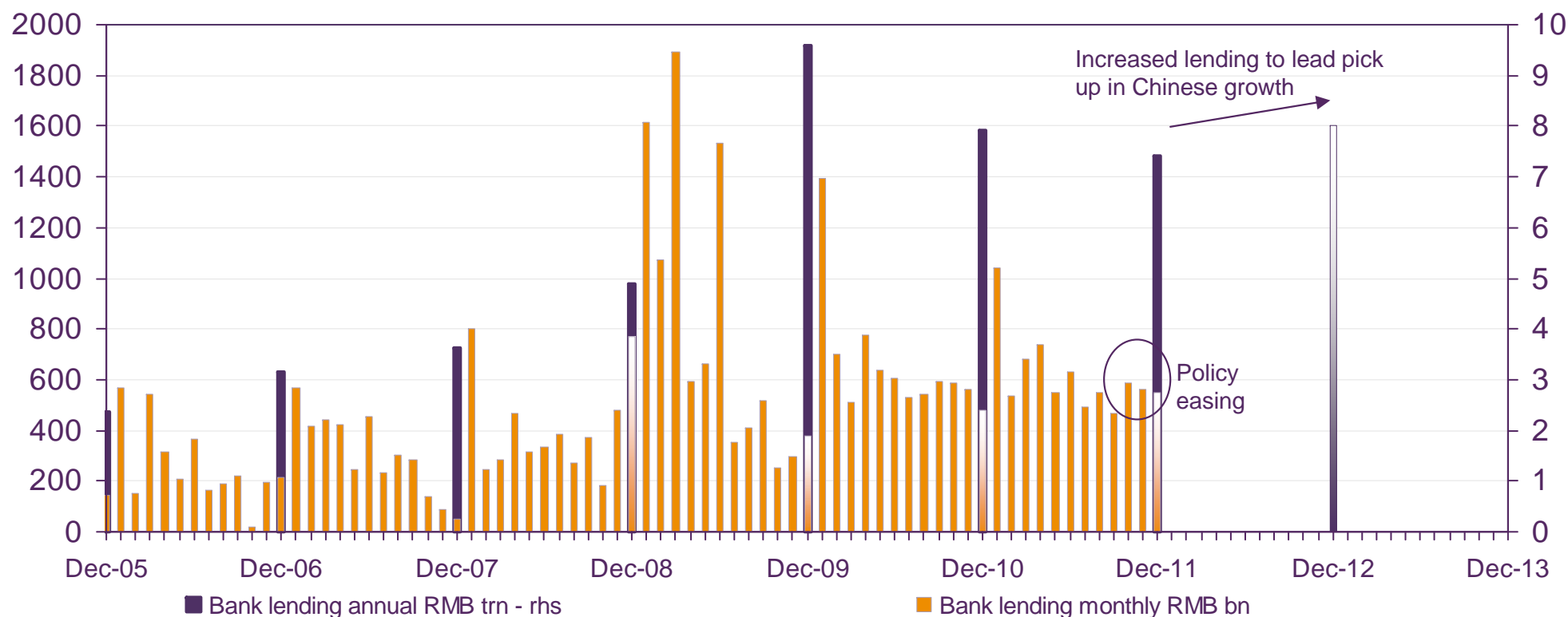


Sub Prime & China Decoupling	GFC & Recession	Policy Push	Debt/Growth Worries
			Japan Earthquake
			Debt Brinkmanship
			Euro deal?

Source: Bloomberg, ASX are prices indices, fin index not available on accum basis, Perennial, end point 5 Dec 2011

China: Watch Lending Early 2012

Chinese Bank Lending - RMB



- After several years of winding back bank lending, Chinese authorities allowed a lift in lending late 2011 to support the growth outlook.
- Total bank lending of 8 trn RMB is targeted for 2012 after around 7.4 trn RMB in 2011, up around 8%.
- Favoured lending areas are SME's with authorities still trying to suppress commodity housing at the expense of social housing. A strong lending start to 2012 would help support Chinese growth.