News

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Investor repression and counter measures

The concept of financial repression was last discussed in this newsletter in September 2011. Essentially, financial repression occurs where governments maintain policies that channel capital into debt markets, thereby driving down interest rates.

By David Bryant

The beneficiaries of these policies are borrowers, such as governments or industry, while the party that bears the cost of repression are investors seeking a return on their capital. Strictly speaking then, this is investor repression.

In a series of market interventions, central banks from the world's most advanced economies and emerging economies have, over a four-year period, collectively and persistently hit the print button. Since 2008, the managers of the world's money supply have undertaken the largest wave of money printing in history.

After adjusting for inflation, interest rates set by central banks are currently around zero.

Since the onset of the global financial crisis, total assets held by the world's central banks have more than doubled and now stand at US$18 trillion. This represents an amount equal to around 30% of global GDP.

The central banks of advanced economies have used monetary policy to set low short-term interest rates, and then money creation to acquire bonds to reduce long-term yields and further stimulate their economies. Meanwhile, central banks of developing nations have accumulated foreign exchange reserves to prevent currency appreciation, thereby maintaining the competitiveness of their export industries.

The purpose of these initiatives is commendable: the protection of existing jobs and the creation of new jobs. And since money can be created by central banks for free, why not let the digital money presses keep rolling?

The difficulty is that these exceptionally accommodative policy settings have had the effect of reducing the returns that investors can achieve on their savings to their lowest levels in at least 200 years. These policy settings are causing investor repression.

Central banks' policies have joined forces with uncertainty, to lower yields on long-term government bonds in key economies to their lowest level since industrialisation. Bond markets now represent a one-way bet: negative real income and the prospect of substantial capital losses when conditions improve.

Uncertainty that is the result of extraordinary and unsustainable government debt has destroyed investor and consumer confidence, with its consequences being evident in four years of negative real equity returns. This, then, is an extraordinarily difficult environment for investors seeking to generate reasonable returns on their savings.

Before suggesting some alternatives, two other pieces of adverse information must be presented.

China is slowing

Several papers including those published by Roubini Global Economics (an economic research firm), point to a number of challenges in the Chinese economy.

China escaped the global financial crisis through an extraordinary debt funded stimulus package. This has contributed to a property investment bubble, with land prices increasing five fold in Beijing and Shanghai since 2004. Residential sales are now contracting whilst heavily indebted local governments depend on property transactions for 50% of their revenue.

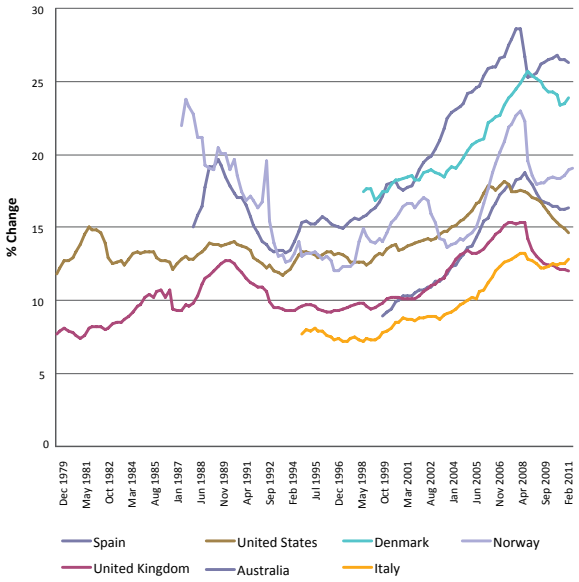
The combination of defaulting property developers and defaulting local governments could create US$1.4 trillion of bad debts and wipe out around half of the equity in the Chinese banking system. The Ministry of Railways is nearly insolvent, making it the emblem of Chinese unproductive debt-financed investment. These problems are landing at the same time as peak labour: the Chinese working age population is forecast to peak at 991 million in 2014.

China is forecast to slow to a headline GDP of 4-6%, which will feel like a recession compared to recent times. And if China sneezes, will Australia catch SARS?

Australians are in debt

According to data compiled by the Bank for International Settlements, Australian households have the highest debt service ratio of any significant economy on the planet. A debt service ratio is the sum of annual principle and interest payments divided by income.

Chart 1:
Household debt service ratios, 1979-2011



Source: Annual Report 2011/2012, Bank for International Settlements

Chart 1 tracks household debt service ratios over thirty years, and demonstrates that Australian households have found a way of servicing more debt than their counterparts in other advanced economies – at least for the time being. Thankfully credit growth in Australia has slowed to a modest 1.21% per annum over the past three years; incidentally, the same figure for China was 18.76% per annum.

Countermeasures

Australian investors are presently confronted with several challenges: investor repression, a slowing Chinese economy, and an indebted household sector. How then, does an investor make money in this environment?

Given this environment of slower growth it would appear that Australian residential real estate as an alternative investment may at best move sideways. And if the Reserve Bank has to cut rates to support a slowing economy, this will further repress fixed interest returns for investors.

What, then, are the prospects for equities?

During the three secular bear markets that occurred during the 20th Century, equity markets took on average 18 years to recover to their previous peak in real terms, while in each case they began sustained recoveries at around 14 years after their peak. Therefore if history is any guide, we could be waiting until 2021 for equity markets to enter a sustained bull market.

While share values may oscillate around their present value for many years, dividend yields from many Australian listed companies and property trusts are presently very attractive.

There are defensive stocks selling food or beverages trading on forward yields of 5-6% fully franked. Many of these businesses have a record of steady earnings growth, which should provide some indexation of future dividends.

The Australian equity market also includes some quality property trusts trading on similar yields, but without franking. These trusts generally have indexation clauses in their rental agreements which also provides a source for future increase in distributions.

While investment in equities may not provide substantial capital gains, a policy of acquiring quality stocks during market downturns has a better chance of protecting your portfolio from the erosion of inflation than an excessive exposure to fixed interest. It will also provide you with an acceptable income stream, whilst putting you in the right place for when a bull market finally arrives.

Another countermeasure being deployed by some of the world's largest pension and endowment funds is an asset allocation to unlisted alternative assets such as infrastructure, timberland and agriculture. Unfortunately access to these asset classes for retail investors is often difficult – except in the case of agriculture.

RFM RiverBank

(RiverBank) ARSN 112 951 578

Daniel Edwards, Business Manager – RiverBank

RiverBank's performance totalled 11.62% inclusive of franking credits for the year to 31 May 2012, continuing the fund's history of providing reliable returns to Unitholders. RiverBank has delivered an outstanding 13.91% total return inclusive of franking credits since inception in 2005.

RiverBank opened to new investment on 23 October 2011, and recently surpassed its minimum subscription of $4 million. Daniel Edwards, Business Manager – RiverBank, says: "It's very pleasing we have passed the minimum subscription.

"We can now begin to allot Units and use this new capital to complete vendor finance obligations, and strengthen the financial position of the fund."

RFM recently received asset valuations for the fund with a modest reduction in the value received. Daniel says: "There was a decrement to the forecast June 2012 valuations of around 5.5%."

This small decrement in valuations has resulted in the Application Price under the current RiverBank offer being reduced from $1.1353 to $1.0586, providing new investors with further potential for significant capital growth. The RiverBank Offer will remain open to the public at the discounted price until $7.5 million has been reached.

RiverBank continues to undergo capital improvements, with sprinkler systems currently being installed across the Mooral and Yilgah almond orchards. Daniel says: "The sprinklers provide additional protection against frost, which can damage the almonds. We've focussed on installing sprinklers in exposed areas of the orchard which are more susceptible to frost damage.

"As the orchard has matured and the trees have grown larger, we've also begun tying the upper branches of the trees with rope. This helps prevent the branches breaking off and the tree collapsing under the weight of a large crop."

Finally, there has been significant progress in the leasing of RiverBank's 'Steak Plains' property. Daniel says: "We're currently completing the documentation to lease 320 hectares of olives planted on Steak Plains to a new tenant. It is expected that this lease will be completed by the beginning of the new financial year.

"This is good news for RiverBank investors, as the lease will provide an additional revenue stream for the fund over the long term and makes use of an otherwise unutilised asset."

Update your contact details

Have you moved house recently, or changed your email address? It is important that RFM has current and accurate contact information for all investors so that we can notify you of developments concerning your investment and keep you updated on all RFM news and upcoming events.

By providing updated contact details and a current email address, RFM can ensure that communication costs to investors are kept to a minimum.

Providing RFM with your email address will not only save valuable environmental resources, it will also minimise fund costs and ensure you receive information in a timely and effective manner.

You should also tell RFM if you change your financial adviser, or if you no longer have a financial adviser. We will update our registry with your new adviser details to ensure we only supply information to persons properly entitled to receive it.

A change of details form is available at the RFM website at: www.ruralfunds.com.au/investor-adviser-centre/forms/. Alternatively, you can update your contact details by contacting Investor Services on 1800 026 665 or email investorservices@ruralfunds.com.au.

RFM StockBank

(StockBank) ARSN 153 436 803

David Thomson, Business Manager – StockBank

StockBank, RFM's first liquid agricultural investment offering, operates in the Australian sheep and cattle markets, purchasing livestock to fatten and finish on properties owned by third parties and then selling the animals for a profit when they reach a marketable weight.

David Thomson, Business Manager – StockBank, says: "We've acquired around 8,700 cattle and 23,200 sheep, and sold around 4,300 cattle and 13,900 sheep to date.

"Since launching StockBank to retail investors, we have identified enhancements to further protect investor returns. We see this as a positive move given Australian investors are now actively seeking investments which generate consistent yield. This is particularly important given the current volatility of traditional investment markets and the impact that the European crisis is having on investment portfolios.

"Our original cattle forecast was for the animals to gain one kilogram per day, however some herds experienced slower weight gains which have impacted upon returns. In response to this, we have now put in place mechanisms to protect returns against lower weight gains."

The structure of StockBank will change slightly so that the majority of the risks of lower prices and weight gains are effectively transferred to the Landowner where the cattle are fattened.

Over recent months, prices in both sheep and cattle markets have declined. The structural changes have been designed with this in mind.

David says: "The new arrangement means that StockBank returns are less sensitive to weight gain and price. In addition, the Landowner will also be responsible for the cost of transporting and inducting the cattle. This means StockBank's capital outlay is reduced, which means we can buy more cattle."

Administration of livestock purchase and sale has also been revised, with RFM electing to change from a sole agency arrangement to having the benefit of a small panel of agents from which to engage. This will improve the geographical diversity of the Fund.

Moving forward, David is confident the fund will emerge as one of RFM's greatest success stories. David says: "StockBank provides investors with the opportunity to truly diversify their portfolios, with access to a market where returns are not correlated with traditional investment products. The short transaction cycle also means investors have regular liquidity opportunities, which is a feature investors really value in today's financial climate."

If you would like further information about investing in StockBank, please contact James Powell, National Sales Manager, on 0420 279 374 or email JPowell@ruralfunds.com.au.

Alternatively, please contact Investor Services on 1800 026 665 or email investorservices@ruralfunds.com.au.

Further information is also available on our website: www.ruralfunds.com.au/investment-products/stockbank.

RFM Chicken Income Fund

(CIF) ARSN 105 754 461

Adriaan Shields, National Manager – Poultry

The RFM Chicken Income Fund (CIF) remains a reliable source of income for Unitholders coming into the new financial year, with total distributions inclusive of franking credits reaching 11.60% for the year to 31 May 2012. The CIF'S regular distribution payments have been funded through earnings and capital movements such as depreciation, deferred taxation and negative movements in the value of interest rate hedges. This has resulted in a total fund return of 3.38% inclusive of franking credits for the year to 31 May 2012.

The CIF's on-farm performance at Griffith, New South Wales and Lethbridge, Victoria has continued at a high standard. The experience and industry knowledge held by the CIF operational team is evident when reviewing the key indicators of farm performance; the Performance Index Factor (PIF) and Feed Conversion Ratios (FCR).

The PIF provides an indication of the relative performance of a chicken growing operation and is based on the FCR, mortality rates and average live weight of the birds. The average PIF for the CIF's farms has steadily increased since 2011 from 286 to 329, reflecting improvements in processes and efficiencies which the team has worked hard to achieve.

A steadily declining average FCR has contributed significantly to improvements in the PIF; the average FCR has decreased from 2.02 in 2011 to 1.83 in 2012. This means that changes to feed mixes and shed conditions have improved the birds' ability to convert feed into weight gain.

Adriaan Shields, National Manager – Poultry, says: "We're continually looking at ways of improving our performance on the farms, because it really does translate to tangible benefits for the investors. For example, we're currently implementing new broiler management software in the sheds, which should significantly increase the efficiency of the management process."

This software, designed by MTech and known as the 'Broiler Information Manager' or 'BRIM', provides an automated central database for growing information such as feed consumption, weight gain per day, shed inventory and flock profiles.

Adriaan says: "The system will give the farm managers much more detailed and up-to-date information about what is happening in the growing cycle for each shed. This means they can make better management decisions about variables such as feed and shed temperature, which should result in an improved production process. The software will also allow us to monitor and control expenditure more effectively in key areas such as gas and electricity."

Another successful change to farm management has been the introduction of contract managers for the farms, rather than engaging full time staff employed by RFM. The contractor model has been rolled out across all Griffith farms and has provided a number of cost savings to the CIF, and additional benefits to the farm managers themselves.

Adriaan says: "We've seen a change in the attitude of the managers since the introduction of the model; they now actively strive to optimise their growing results because of the financial incentives in place for farm managers who perform well. Given this success, we will begin to convert the Lethbridge farms to this system from now until the end of July 2012."

RFM Land Trust

(Land Trust) ARSN 128 112 443

Daniel Edwards, Business Manager – Land Trust

RFM continues to liquidate Land Trust assets, with the aim of winding up the Trust and returning capital to Unitholders. As part of that process, Land Trust Unitholders received a distribution of $250 per unit in April this year.

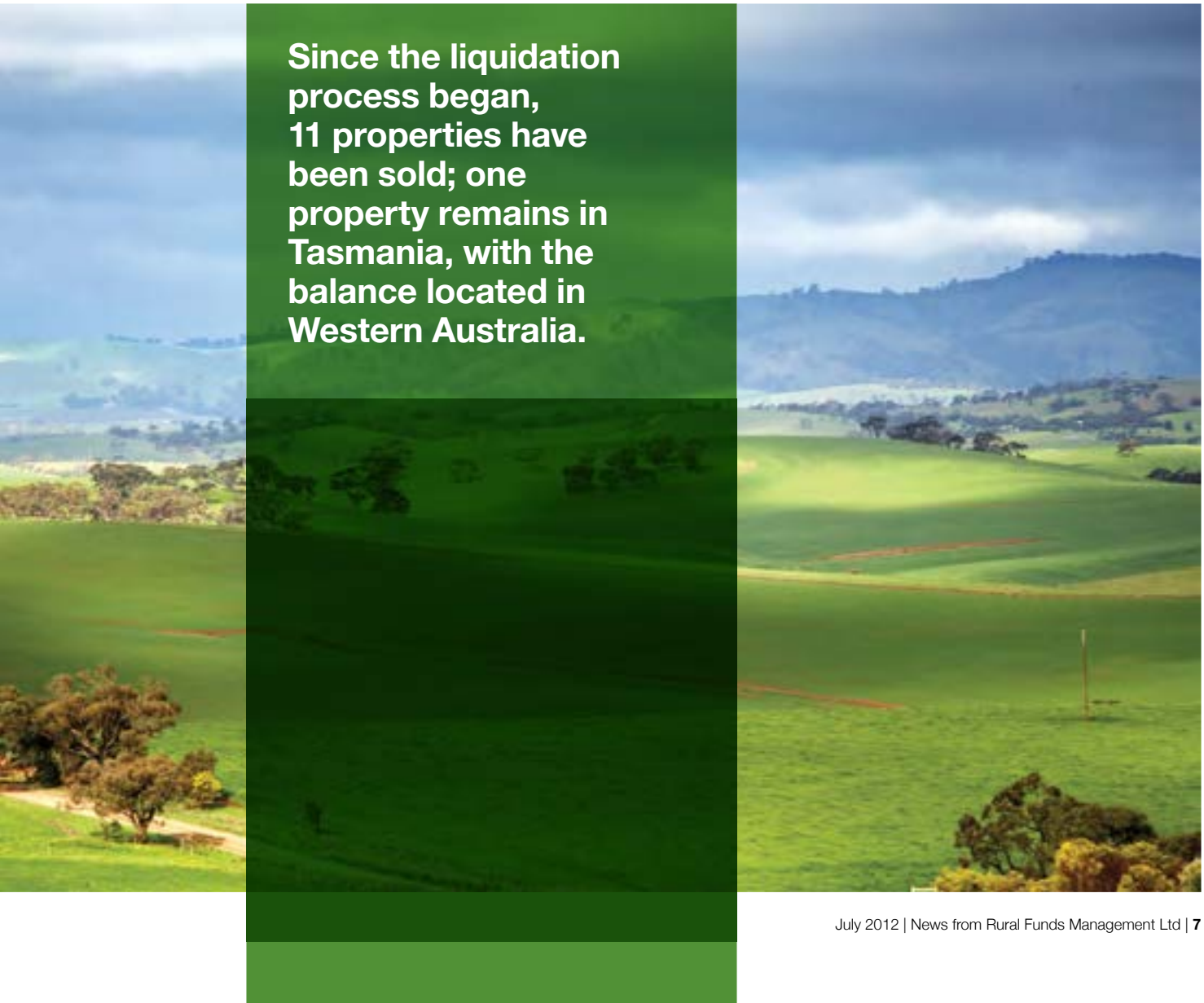
The Land Trust assets originally comprised 22 properties across Western Australia, South Australia, Tasmania and Victoria. Since the liquidation process began, 11 properties have been sold; one property remains in Tasmania, with the balance located in Western Australia. The Western Australian properties are currently leased to Gunns Limited, Australia's largest integrated hardwood and softwood forest products company.

RFM aims to complete the liquidation process by mid-2013, however this time frame will depend upon the outcome of the current uncertainty surrounding Gunns Limited. In order to maximise sale values of the Western Australian properties, RFM will delay sales until this situation becomes clear.

Daniel Edwards, Business Manager – Land Trust, says: "Whilst there is still uncertainty regarding Gunns' future business plans, the Western Australian properties continue to generate cash flow for the Land Trust through lease payments."

RFM once again urges Unitholders who have not already done so, to provide bank account details to RFM and update their contact details, including email addresses.

This will ensure distributions can be paid in a timely and cost effective manner. Unitholders who wish to update their details, or have any additional queries, should contact Investor Services on 1800 026 665 or investorservices@ruralfunds.com.au.



Since the liquidation process began, 11 properties have been sold; one property remains in Tasmania, with the balance located in Western Australia.

RFM Australian Wine Fund

(AWF) ARSN 099 573 485

David Murdock, National Manager – Viticulture

The AWF operations team have now completed the 2012 harvest, with David Murdock, National Manager – Viticulture, pleased with early indications of a good result.

David says: "Overall, I was very happy with how harvest ran this year. The process went smoothly, and we were lucky to escape the worst of the heavy rainfall that occurred around the southeast of Australia in February and March.

"It appears that across the industry, yields are looking slightly lower than average. However, the quality of our produce is as high as ever, so I'm hopeful the prices we receive for this harvest will help offset this diminished yield to some extent.

"Of course, we won't know the grades achieved until we receive the final harvest grading results from the wine makers in July." RFM will provide an update on its website, www.ruralfunds.com.au, once quality results are known.

Since completing the harvest, it has been "tools down" for most of the operations team in South Australia and Victoria.

David says: "After harvest, there is only a little activity in the vineyards themselves until early July, when we begin pruning. To minimise expenses as much as possible and protect the bottom line of the fund, the team in the field have some time off while management tidy up the budgets and accounts ready for the new financial year.

"It's a good feeling getting everything ready for the next season; we start to look forward to a new crop and there's a sense of excitement around the vineyard about what the season will bring."

Update: At the time of print, harvest results had been received. Please find these results at www.ruralfunds.com.au.

Since completing the harvest, it has been "tools down" for most of the operations team in South Australia and Victoria.

RFM Almond Funds

RFM Almond Fund 2006 (AF06) ARSN 117 859 391
RFM Almond Fund 2007 (AF07) ARSN 124 998 527
RFM Almond Fund 2008 (AF08) ARSN 127 947 960

Daryl Winter, National Manager – Almonds

The 2012 almond harvest at Hillston, New South Wales, is complete, with all areas of the orchard now clear of crop. Daryl Winter, National Manager – Almonds, says: "All produce was shipped out of the orchard by the first week of June. After the difficult harvest we had this season, everyone out here was certainly very relieved to see harvest finalised."

In early March, heavy rainfall and resulting inundation put a halt to harvest operations at the RFM almond orchard. The most significant impact of the rainfall was the difficulty caused in getting the almonds off the ground. Daryl says: "The heavy rain meant that a lot of the almonds fell off the trees and into the mud below. Once the orchard floor had dried and we went through with the sweepers, we found the nuts were stuck in the ground and required a fair bit of work to get them out.

"This certainly impacted on yields; there were some nuts that we just couldn't pick up no matter what we did. The frost experienced in spring last year also contributed to the decreased yield. It was very disappointing that this event took more of a toll than we originally anticipated."

Final quantities harvested reflected the extremely difficult season experienced; the AF06 groves had an average yield of 1.71 tonnes per hectare. The AF07 and AF08 Groves had average yields of 1.41 and 1.42 tonnes per hectare respectively.

The team at Hillston is now looking towards the 2013 season. Daryl says: "At this time, we've come to the end of the 2011/12 operations and are beginning the 2012/13 management plans. The gap between the two is quite defined; the trees go rather dormant for three to four weeks and then around mid-July we begin to see bud swell.

"To prepare for this, we're taking care of all the maintenance jobs around the orchard. We're doing a lot of soil preparation, levelling the rows where harvest equipment has run through, and performing equipment maintenance ready for spraying, which will happen as soon as we start to see bud swell."

Daryl and the team are positive about the upcoming season as the trees grow closer to maturity. Daryl says: "There's a real sense of anticipation for us, because the trees are reaching full productive capacity and the number of buds on the trees indicates the likelihood of quite a heavy crop to come. Almond trees generally alternate between light and heavy seasons, so we are due for a big one."

A big crop brings new challenges, for which preparations are now taking place. Daryl says: "A heavy crop means the trees need more nutrients and more water, so we're doing some maintenance work to make sure our irrigation and fertigation systems are up to the job. We're also tying some of the larger trees to prevent branch breakage and possible tree collapse where the weight of the nuts could get too heavy; this involves putting a string around the top third of the tree which prevents the tree from slumping or bending down.

"All in all, we can't wait to see what this new season brings. It's a really exciting time and we're looking forward to seeing our hard work in maintaining the orchard and growing it to maturity, start to pay off for the investors."

Matt Mitchell

PROFILE

A dual role managing RFM's cotton operations and providing technical and operational support for RFM's almond orchards at Hillston, New South Wales provides the lifestyle and environment in which Matt Mitchell, always wanted to raise his family.

Matt Mitchell, RFM's National Manager – Cotton, and Technical and Operations Manager, has always pursued a life on the land. After finishing high school, Matt moved to Wagga Wagga, New South Wales to pursue his interest in farming, completing a Bachelor of Agricultural Science.

Matt says: "Once I had some theoretical knowledge behind me, I wanted to put it to good use. In 1994, I started working as an agronomist with Twynam Agricultural Group in Warren, New South Wales.

"The company expanded their cotton area to include Hillston, so I moved to take on a new role there. At the time, cotton crops were a new thing in the area; there was only one other grower around then, so it was a really interesting time and I learnt a lot. I grew up in Leeton, New South Wales, so it was also nice to be a bit closer to home."

After almost ten years with Twynam, Matt was offered a position with RFM as senior agronomist. Three years later, Matt took over as National Manager – Cotton and Technical & Operations Manager, a role he has thrived in since then.

Matt says: "There was a transition period where we reduced the area planted to cotton and replaced the crop with almond trees, so I had some cross-over with helping Daryl Winter (National Manager – Almonds) managing the orchards as well. Now, I split my time between both almonds and cotton; it mixes the job up a bit and keeps things interesting. The plant, soil and water relationships between both crops are very similar and having those years of experience with this soil type has been a great help."

Matt's main focus for the almond orchards is water management and delivery, a crucial aspect of the growing cycle. Matt says: "We start each season by determining a water budget for the orchard and confirm which water sources can deliver these requirements. Hillston is quite unique in that it has two water sources: groundwater (pumped from bores) and surface water.

"This initial budget is largely based on the maturity of the trees. However, we also consider what an 'average' summer peak requirement could be and allow for an extreme heat event.

"Ensuring we have sufficient water availability during the hottest parts of the Hillston summer is of particular importance. Most other irrigation plans are based on accommodating the highest average temperature. However, whilst the highest average temperature is around 32 degrees in Hillston, we know that we can experience a number of days in a row at over 40 degrees, so we need to make sure our irrigation system can handle these conditions."

Matt assists RFM's irrigation managers over the course of the season in monitoring irrigation delivery, to ensure the almonds are getting adequate water. Matt says: "The initial plan is certainly not fixed; we respond to variations in climatic conditions as necessary.

"The team uses soil moisture probes and other tools to monitor crop requirements as the season progresses and adjusts irrigation accordingly."

Matt also assists the almonds team with nutrition, fungicide and herbicide program planning and delivery: "As with the irrigation, this is never a set plan and we manage the trees' nutritional requirements based on the crop potential seen as the season progresses. We also carry out soil, leaf and almond hull tests at certain intervals in the growing cycle; this helps us better plan the nutritional requirements for the coming crop."

As for the cotton, Matt's day to day work changes depending on the seasons. Matt says: "Cotton is a summer crop, so in the warmer months there is an almost daily focus on delivering crop requirements and maintaining the crop's development.

"Due to the seasonal nature of the crop, the growing model we use is based on utilising contractor workers where possible. So, I'm also kept busy in the summer months with managing contractor arrangements and ensuring staffing requirements are met.

"In the off-season, our focus really turns to capital expenditure, or 'capex', projects and it is crucial that there is a real focus on water delivery infrastructure. We also carry out our preventative maintenance program on all the irrigation bores and usually grow some small areas of winter crops; predominantly wheat.

"I honestly get a real buzz out of growing the highest yielding crops I can; I see it as a personal challenge and strive every day to get better at it. And there's no better feeling than actually pulling it off!"

Assisting Matt in this challenge, are the technological developments that have occurred in the cotton industry in recent years. Matt says: "It's a very innovative industry, with a big focus on research and development. I'm always looking to keep abreast of the latest advances in cotton production, and my background in agricultural science has

really contributed to my ability to understand and implement the latest advancements in technology effectively."

An example of this is a project the team are currently implementing, where management have begun to incorporate compost from the production process into the crop nutrition program. Matt explains: "The seed cotton we produce needs to go through a ginning process which separates the seed from the lint. The by-product of this process is cotton trash, which is a combination of plant material and cotton lint.

"This waste product has turned out to make great compost fertiliser, which recovers a lot of the fertiliser we had applied when growing last season's crop. We've also begun to use chicken litter from the RFM chicken sheds in Griffith, New South Wales, as an additional source of fertiliser. It's all about maximising production from what you have available to you."

As for the company itself, Matt says that RFM's focus on their staff is the main reason he has enjoyed his time at Hillston: "At the end of the day, it was the reason I joined RFM in the first place. We have some incredible assets and to manage them is a fantastic opportunity, but RFM's commitment to looking after the people that manage those assets is second to none. We have a great corporate culture here and it makes such a difference to the working environment."

Life in Hillston also provides Matt with the environment he always hoped to raise a family in. Matt says: "My wife and I have always loved the outdoors and the country way of life. We just had twins, so that makes five kids in total: we need plenty of space for them to run around, and Hillston offers nothing if not space!"

"I'm very lucky; I do the work that I enjoy and that allows me to support my family, but also allows me to enjoy the country lifestyle I've always known and loved. Now, I have the opportunity to raise my kids in that same environment. I hope they learn to love it as much as I do."

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