# INVESTOR UPDATE:
# JUNE 2010

Dear Shareholder,

We are pleased to provide you with your June 2010 Premium Investors Limited Quarterly Investment Update as provided by the Premium's lead portfolio manager, Treasury Group Investment Services Limited[1] (TIS).

**Tom Collins**

Chairman

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The June quarter was disappointing for investors, as equity markets corrected following the strong rally in the 12 months to March 2010.

The Premium Investors (PRV) NTA outperformed the domestic and international markets in the June quarter, declining 4.7% against a fall in the S&P/ASX 200 of 11.8%. The investment committee took a cautious approach during the quarter, maintaining exposure to our value oriented managers. While we outperformed the local index, it is disappointing to report a negative quarter. Since the completion of the off market buyback in October 2009, the NTA has risen 5.6% and two dividends (of 3.5 cents in October 2009 and 1.5 cents in February 2010) have also been declared.

**Development of the investment advisory committee**

During the quarter, PRV was pleased to announce the formation of a new Investment Advisory Group by Treasury Group Investment Services Limited. We noted that we expect global economic volatility to continue and that a more active approach to allocation between our managers is warranted in this environment. While we see equities offering solid returns over the medium term, allocating between managers, domestic and offshore assets and currencies, will be an important additional support to PRV's returns. PRV will continue to focus on a conservative investment approach targeting a combination of capital growth and consistent income. The Investment Advisory Group will provide the Treasury Group Investment Services (TIS) investment committee with advice on the future direction of global economic activity, the likely returns from equity, currency markets and recommendations on expected returns for different investment management styles. This additional input will support the TIS investment committee's decisions on allocation between investment managers.

**The members of the new group are:**

- David Bassanese – the economist and Australian Financial Review (AFR) columnist who has extensive experience having previously worked for Macquarie Bank and Bankers Trust. He brings a unique level of experience to PRV and will be focused on providing views and opinions on the future direction of the global economy. If you have not previously read David's columns in the AFR we would recommend them to you for their insight and timely views;
- Paul Winter – Equity strategist at Investors Mutual Limited (IML). Paul also has extensive experience both in Australia and offshore; and
- Mark Burgess – Managing Director of Treasury Group and previously Executive Vice Chairman and Global head of equities and multi-assets at Credit Suisse Asset Management in Europe. Mark has considerable experience working in both Australia and offshore, most recently returning from over a decade in London as a senior investment management professional.

# ECONOMIC OUTLOOK

PREMIUM INVESTORS LIMITED

## As we noted last quarter, much of the economic recovery which is taking place in 2010, had been priced into equity markets.

There was a risk of a set back in equity prices in the short term while the 12 month gains to March 2010 were digested. In the quarter we also saw additional worrying developments, particularly in Europe, where the weakness of the Euro area structure became apparent as the weaker countries (notably Greece but also Spain, Portugal and Italy), were thrown into the spotlight as their government deficit positions became apparent – many of these countries had overspent in the good times, record keeping was opaque and a contraction in government programs was required. Investors were focused on the limited ability of these governments to reduce deficits while sustaining economic growth. Under the Euro structure, all countries are subject to the strength or weakness of the Euro and therefore the ability of any one country to manage its affairs during a crisis is limited and may not be offset with a weaker currency if other Euro countries (such as Germany and France) are performing well. Investors were also concerned that European banks held excessive holdings of the weaker countries' bonds.

To offset this concern, European authorities aggressively moved to stabilise the system with the European Central Banks and Euro countries moving to support the affected bond markets and develop a mechanism for the banking system should any one bank require support. This has stabilised the situation and we believe the European authorities (despite their complex approach to decision making) now have a structure to deal with this risk. With investor sentiment moving to an excessively pessimistic position we believe the equity markets were overly discounting the risks.

So looking globally there remain many concerning trends and issues to be resolved. Importantly though, investors are largely fully aware of these risks, and policy makers are focused on containing the issues. In investing, a fair rule is that – if the topic is widely discussed, it is probably priced into the market. It is the unknown, or ignored issues that you need to be wary of: European debt, US housing, derivatives (CDO's and other complex issues) were largely unknown to the average investor in 2006 and 2007. Today they are well known, well understood and largely under control through aggressive policy action undertaken in the past two years. This does not mean that the outlook will return to the bull market environment we experienced before 2007, but it also does not mean we will return to the panic driven markets of 2009. Our view is somewhere between these extremes – a moderate growth environment with moderate – but attractive – returns on growth assets. An 8-9% return year will be the "new normal" as a number of pundits now describe the environment looking forward - equities will be attractive, while holding cash is likely to disappoint many.

## What gives us confidence in the difficult but more positive investment environment?

Although growth in developed markets will be moderate and there will be set backs as further restructuring is required, the imbalances in the developed markets are being resolved through cheaper prices and pro-active government policy. Against that, emerging markets will remain relatively robust and there will also be some further cyclical recovery in developed markets. In particular, we would make the following observations:

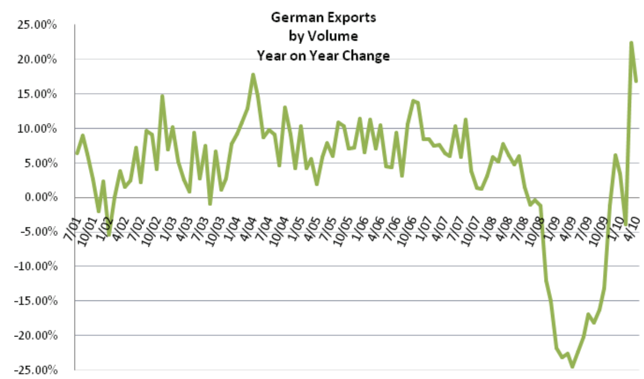
- Historically the direction of the US and developed economies were the primary drivers of global economic growth. It was said: "if the US coughs, the world catches a cold". This is no longer as simple as it once was. As we have seen during the global financial crisis (GFC), developments in the US (such as the collapse in their housing market) will still have a direct effect on global activity. But we have also seen from our unique vantage point in Australia, that China, Asia and other developing markets, have grown to be important offsets to the influence of the US and other developed markets. We have faith that emerging markets (while subject to cyclical corrections) will continue to grow – which sets a foundation for global economic activity that did not exist 30 years ago. Developed markets will recover, and emerging markets will provide the additional cyclical strength to sustain that recovery;

- Excessive debt – there is no question that the world is still awash with excessive debt and future growth will be capped by the need to reduce debt and sustain a higher level of saving (particularly by consumers in the developed markets). While this will moderate world economic activity, we note the following:
    - US and other developed economies have been weak for some period, savings rates have been rebuilt, and the future reduction in credit growth can be moderate, sustain a reasonable growth rate while still reducing the overall credit problem. We think a "muddle through" correction in consumer credit is more likely – enough to sustain moderate growth;
    - Government debt and deficit levels are more concerning in the short term. There is a push across Europe and the US to reduce government deficits and cap the growth in government debt/GDP ratios. This will again slow economic growth, but not in and of itself necessarily cause a recession. Government deficits are also cyclical and will benefit from the moderate economic growth that we expect to see. So reduced government spending will slow growth but not cause an outright recession;
    - Monetary policy will remain supportive. While central banks have increased their holdings of government and other debts, and they will need to reduce these positions over time, we expect over the medium term that Central Banks will keep interest rates low, supporting underlying economic growth;
    - The corporate sector has been the net winner in recent quarters – strong profit growth and extremely healthy balance sheets. As economic growth picks up, corporate capital spending (including a technology upgrading cycle) will support economic growth. The corporate sector is in an unusually strong position;
    - Emerging markets have the ability to also drive growth. Emerging markets are generating very high levels of cash flow which can be reinvested into the economy. As noted above, the underlying strength of emerging market growth should not be underestimated.

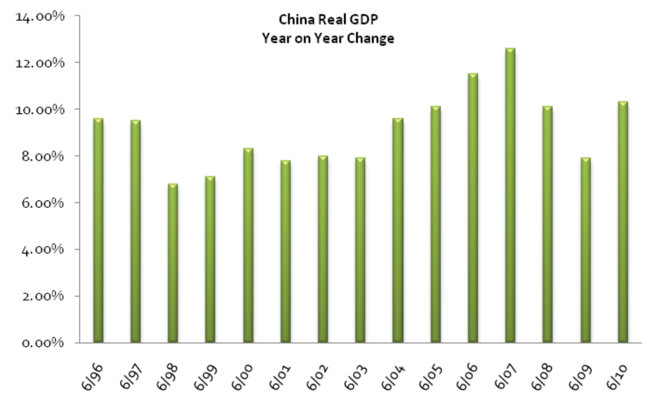
- China – for Australian and global investors the health of the Chinese economy is of particular importance and interest. We believe China needs to slow its rate of economic growth and there are underlying issues now emerging about the health of the recent credit surge by banks which was the key factor in improving growth during the GFC. There is no doubt in our opinion that the rapid growth in bank lending has resulted in many non-performing loans and projects which are uneconomic. The loans made to local governments and municipalities are of particular concern but we believe the central government and banking system are aware of these issues and in a position to resolve any capital problems. The housing market now appears to be slowing and the speculative environment in real estate and equities has cooled. While steering the Chinese economy is not as easy as many assume, we believe the authorities will be in a position to sustain growth into 2011 and therefore support global growth. The Chinese story needs to be closely monitored;

- Europe – while Europe will struggle under the weight of reducing government debts and imbalances (particularly in countries like Greece, Spain and Portugal), the core European countries (such as Germany and the Netherlands) are benefiting from a weak currency and the strength of emerging markets. German exports have for example recovered sharply.

## German exports recover – Euro weakness supports growth




## China growth will moderate

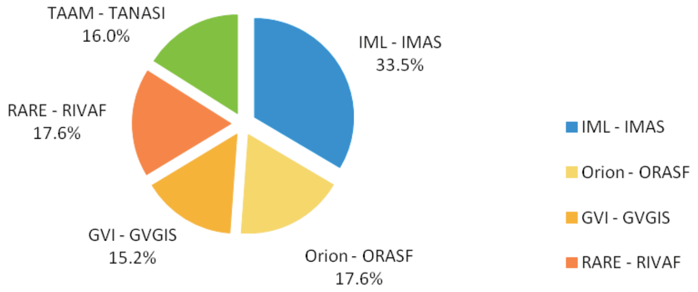



So based on these observations, our expectation is for moderate growth, but in a challenging environment. With equities being fairly priced, corporate profits healthy and emerging markets recovering, equity returns for the upcoming year (and hence the returns for PRV) should be attractive.

As we noted in our March report: the net result of this environment will be periods of growth improvement – such as the outlook for the next 9-12 months, followed by periods of moderation. This rolling cycle of economic acceleration, followed by moderate growth, will warrant an active approach to allocating assets.

# CURRENT POSITIONING OF THE PREMIUM INVESTORS LTD PORTFOLIO

During the quarter PRV's investment manager held a conservative position in the portfolio maintaining an above average weighting towards our value managers. We are likely to reduce this position in the September quarter as we diversify towards growth investing at a time when growth companies should perform well.




During the quarter we held an above average weighting to IML, a value manager who focuses on buying high quality Australian companies at good prices. We also held an unchanged weighting between Australian and offshore assets (52% Australian equities, 48% international) as we expected the Australian market (particularly through our investments with IML and Orion) to outperform. Our international exposure was also weighted to funds that hedge against a rise in the Australian dollar.
As the attached chart shows, the allocation to managers during the June quarter was largely unchanged from the position at the end of March. IML remained our largest exposure and PRV benefited from outstanding relative performance from the IML team. As we reported last quarter, IML has recently merged its investment team with Cannae Capital Partners, giving IML further research depth and senior investment leadership. Anton Tagliaferro (the principal of IML) and Hugh Giddy (the principal of Cannae) have got off to a flying start and the feedback from the clients and researchers has been extremely positive.

Our moderate Australian equity bias, is reflective of our view that Australian assets are likely to continue to perform well when compared with global equities, as Australian economic growth will remain firm while global activity will be more difficult. China has moved successfully to slow its economy and is likely to be able to engineer a relatively soft correction to activity while removing some of the excesses that have developed in that market. Australian authorities have also correctly raised rates (although they remain at moderately low levels) which will create a more sustained growth environment.

Our international exposure remains well spread – 15% managed by Global Value Investors (GVI) – who search globally for high quality investments with strong yield characteristics; 18% in RARE Infrastructure (RARE) – the global listed infrastructure group, and 16% in Treasury Asia Asset Management (TAAM) – our Asian equity specialist. The exposure of RARE and GVI are both hedged back into Australian dollars (offering some protection against any rise in the Australian dollar).

Looking forward we are likely to move our allocation during the September quarter to increase our weighting to overseas assets and growth style investing in particular. Although the markets will remain difficult, we believe that a moderate economic growth environment suits investments that are focused on companies that can grow at an above average or GDP rate. Generally the value of companies with above average growth characteristics is attractive particularly as we believe above average growth deserves a valuation premium in a world where economic growth is difficult to find. Typically a growth style manager will also perform well during this phase of an economic recovery.

# A REVIEW OF INDIVIDUAL MANAGER POSITIONING:

PREMIUM INVESTORS LIMITED

IML INVESTORS MUTUAL LTD

## IML's conservative investment approach offered protection against the decline in Australian equities, significantly outperforming the fall.

Over the quarter IML held a conservative position with high cash weighting for most of the quarter and holdings in high quality yielding companies. This resulted in significant out performance against benchmark during the period and over the financial year to June 2010.

IML's heavy weighting to Telstra performed strongly, as Telstra rose 9% over the quarter. This followed the announcement of an $11bn non-binding agreement with the government regarding its participation in the National Broadband Network (NBN). The transaction comprises $9bn for the use of Telstra's copper network and a further $2bn for the government to take over the company's regional obligations.

The other holdings in the portfolio also generally performed well, as high quality companies with strong yields (the focus of much of IML's portfolio) offered protection against an uncertain environment. By holding a higher than average exposure to IML's fund, PRV's NTA gained exposure to this out performance. The team at IML remain cautious on the global economic outlook as they believe the structural imbalances will continue to hurt global growth. The support from quality companies with positive yields should offer continued protection against some of these risks.

| IML TOP 10 HOLDINGS AT 30 JUNE 2010 | |
|---|---|
| Westpac | 8.17% |
| BHP Billiton | 7.90% |
| CBA | 6.95% |
| Telstra | 6.68% |
| NAB | 4.61% |
| Amcor | 4.45% |
| CSL | 4.38% |
| Origin Energy | 3.40% |
| Insurance Australia Group | 3.19% |
| Woolworths | 3.17% |
| **Top Ten Stocks** | **52.90%** |
| **Other Stocks** | **40.87%** |
| **Cash** | **6.23%** |
| **Total** | **100%** |

# A REVIEW OF INDIVIDUAL MANAGER POSITIONING:

PREMIUM INVESTORS LIMITED

ORION asset management

## Orion has a more positive view on the investment outlook for the second half of the year.

Orion performed well over the quarter against benchmark as they retained some cash during the market decline. They hold a generally positive outlook for Australian equities, noting that major government policy errors are absent and a significant profit recovery should be expected in the global equity markets (particularly the US). As results have been released in the early part of July, this profit recovery is clearly apparent and generally corporate balance sheets are in good shape globally. Orion also notes that European companies have gained significant competitive advantages with the decline in the Euro and their exposure to Asian and emerging markets means that export growth should remain strong. With the view therefore that a dip into a second round of serious slowing of economic growth is unlikely, they are of the view that equities should offer good returns.

In Australia, corporate activity (including offshore bids for Australian companies) is likely to continue. Orion is cautious however on the outlook for Australian banks as they require internal funding to support credit growth. They also note that an increased investment in Australian domestic infrastructure is likely and they are positioned towards companies that will win from that growth. The portfolio also holds companies with a bias to improving US economic growth.

GLOBAL VALUE INVESTORS

## GVI's focus on quality global companies with strong franchises and dividend paying ability, led to out performance in a difficult market.

While GVI was not pleased to announce a decline in the value of their holdings over the quarter, their portfolio did outperform the global markets as quality companies held up against the weakness in equity markets. It has been a frustrating 12 months to March 2010 for GVI as many low quality companies sharply rallied as the markets recovered from the panicked lows of March 2009. GVI has remained faithful to its investment process and this is now paying off in more turbulent markets. The longer term track record also remains positive.

GVI does however see the global economy stabilising, albeit in difficult circumstances. They are therefore positioning the portfolio with a balance between cyclical and defensive companies. They are focused only on high quality cyclical companies (such as Singapore Airlines, 3M and Deere) which can generate strong profits and dividend yields as the economy recovers and defensives (such as Kraft, Kelloggs and Nestle) that have strong balance sheets and high levels of cash generation.

# A REVIEW OF INDIVIDUAL MANAGER POSITIONING:

PREMIUM INVESTORS LIMITED

GLOBAL VALUE INVESTORS

| GVI TOP 10 HOLDINGS AT 30 JUNE 2010 | | | |
|---|---|---|---|
| **Company** | **Country** | **Type of company Portfolio** | **Weight** |
| Singapore Airlines | Singapore | Industrial -Global Airline | 2.18% |
| Nestle | Switzerland | Staple -Branded Foods | 2.06% |
| Singapore Telecom | Singapore | Telecommunications | 2.05% |
| Daimler | Germany | Discretionary - Automaker | 1.95% |
| Johnson & Johnson | USA | Diversified Healthcare | 1.92% |
| Linde | Germany | Materials - Chemicals | 1.90% |
| AT&T | USA | Telecommunications | 1.87% |
| Roche | Switzerland | Pharmaceutical | 1.86% |
| Novartis | Switzerland | Pharmaceutical | 1.86% |
| GDF Suez | France | Integrated Utility | 1.84% |

# A REVIEW OF INDIVIDUAL MANAGER POSITIONING:

PREMIUM INVESTORS LIMITED

RARE

## The defensive characteristic of listed global infrastructure offered some protection against capital loss although infrastructure markets also weakened over the quarter.

RARE's global listed infrastructure exposure also declined during the quarter as the sell off in equities was widespread although the portfolio outperformed broader equity benchmarks as infrastructure is a more stable long term asset. During the quarter we did see some increased regulation in the sector as governments, under financial pressure themselves, have tightened regulation and pricing. While the RARE team believe that this regulatory environment will offer challenges in select markets, they do not see risk across the sector. An active approach to stock selection supported by deep level of research and understanding of the local regulatory environment will be critical to adding value in the global infrastructure asset class. Supporting RARE's positive story is the continued round of mergers and acquisitions in the sector as long term investors see both the long ter.m benefits of owning infrastructure assets combining with the attractive valuations of the listed infrastructure market.

| RARE TOP 10 HOLDINGS AT 30 JUNE 2010 | |
|---|---|
| ITC HOLDINGS CORPORATION | 5.6% |
| ABERTIS INFRAESTRUCTURAS SA | 5.4% |
| NATIONAL GRID PLC | 5.2% |
| VINCI SA | 4.5% |
| RED ELECTRICA CORPORATION SA | 4.1% |
| TRANSCANADA CORPORATION | 4.1% |
| NORTHEAST UTILITIES | 4.1% |
| SHENZEN INTERNATIONAL HOLDINGS LIMI | 4.0% |
| SES | 3.9% |
| SPECTRA ENERGY CORP | 3.3% |

# A REVIEW OF INDIVIDUAL MANAGER POSITIONING:

PREMIUM
INVESTORS LIMITED

## TREASURY ASIA ASSET MANAGEMENT

### Asian stocks stabilised earlier in the global equity correction, reminding investors of the attractiveness of having Asian equity exposure.

Although the Asian equity markets were caught up in the global equity sell down in the June quarter, it did stabilise in June as investors recognised the attractiveness of both the underlying growth rate of Asia and the valuation of Asian equities.

TAAM remains of the view that the Chinese economy is beginning to slow but will have a soft landing which will remove many of the excesses that have built up in the economy during the stimulus program. It has however been TAAMs' view that while the areas such as the Chinese housing market have some excesses, a bubble has not developed in the pricing or growth of the market. Recent action by the authorities to cool the price rises will help to stabilise the market, and remove a potential risk that may have developed (if house prices had continued to rise). Overall the days of excessive Chinese growth (above 10% p.a. Real GDP growth) are over but a more moderate growth rate around 8% will still be healthy. Importantly Chinese authorities are aware of the excesses that had developed (including excessive credit growth) and are pro-actively managing through this correction process.

| TAAM TOP 10 HOLDINGS AT 30 JUNE 2010 | |
|---|---|
| BOC Hong Kong (Holdings) Ltd. | 3.9% |
| Industrial & Commercial Bank of China | 3.5% |
| Samsung Electronics Co. Ltd. | 3.2% |
| China Petroleum & Chemical Corp. | 3.1% |
| Yuanta Financial Holding Co. | 3.0% |
| Sinofert Holdings | 2.9% |
| Beijing Enterprises Holdings | 2.9% |
| Singapore Airport Terminal Services | 2.8% |
| DBS Group Holdings | 2.5% |
| Chungwha Telecom | 2.5% |
| **Total** | **30.4%** |



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Accessing
Treasury Group expertise