ISSUE THREE CHANGE

CHANGING DEMOGRAPHICS IN AUSTRALIA / ASIA

THINKING OUTSIDE THE SQUARE

FIVE THEMES TO HELP YOU CREATE A BETTER FUTURE

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THOUGHT PIECE

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THINKING OUTSIDE THE SQUARE

FIVE THEMES TO HELP YOU CREATE A BETTER FUTURE

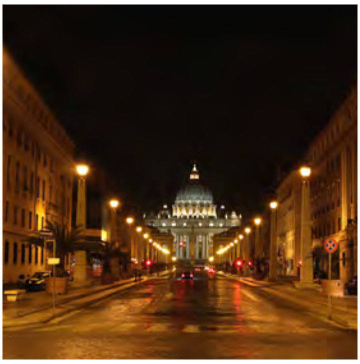
GLOBALISATION

NEW INVESTMENTS & INVESTMENT STRATEGIES

GLOBAL FINANCIAL CRISIS

SOVEREIGN RISK AND DEBT

CHANGE



WE BELIEVE THAT ALL ROADS LEAD TO INCOME!

At the end of the day, regardless of gender, age, relative financial security, employment or retirement, we all seek the same thing as the product of our investment strategy: income.

Put more simply the reason we invest is so that we can have sufficient income to live and hopefully live well at the time when we choose, or someone else chooses that we no longer will receive income from employment.

Balmain Funds over the period ahead will make available a series of "thought pieces" designed to provoke new thinking on why we invest the way we do, challenge investment orthodoxy, such as "modern portfolio theory", posit and in some cases guess at future risks and opportunities. The overall aim however is to help you create a better future for you and the ones you love.

We have identified five themes that we believe will impact your ability to achieve the income you want. These are:

1. The Global Financial Crisis
2. Sovereign Risk(s)
3. Change
4. Globalisation, and
5. New Investments and investment strategies

We will over time populate these themes with "thought pieces" that are designed to inform you, challenge and provoke your investment thinking and from that hopefully assist you in making better investment decisions.

ABOUT BALMAIN

Using our staff of 140 located in 8 offices in Australia and New Zealand we arrange and deliver financing solutions to Australian and New Zealand commercial property developers and investors. Balmain originates between $2b and $4b p.a in transactions ranging from senior debt to mezzanine and preferred equity.

Over the years Balmain has arranged commercial loans to over 140 lenders, banks, institutions, managed investment schemes and high net worth individuals / family offices. It currently manages over $8b of ongoing loan relationships with over 100 of these organisations.

Balmain is Australia's 5th largest commercial mortgage fund manager, who on behalf of over 8000 Australian investors, we manage over $800m in commercial mortgage loans.

Balmain in its own name and via AMAL (in which Balmain has a substantial shareholding) provides special servicing skills to loan portfolio owners covering both residential and commercial loans.

CHANGING DEMOGRAPHICS IN AUSTRALIA/ASIA AND HOW IT'S IMPACTING YOUR INVESTMENTS

Forget climate change, a bigger demographic transformation is upon us and will bring far-reaching consequences to investors. Balmain Corp investigates how demographics in China vs Japan and Australia's aging population will impact on your investments.

Is China in 2010 the Japan of 1990? Is China peaking?

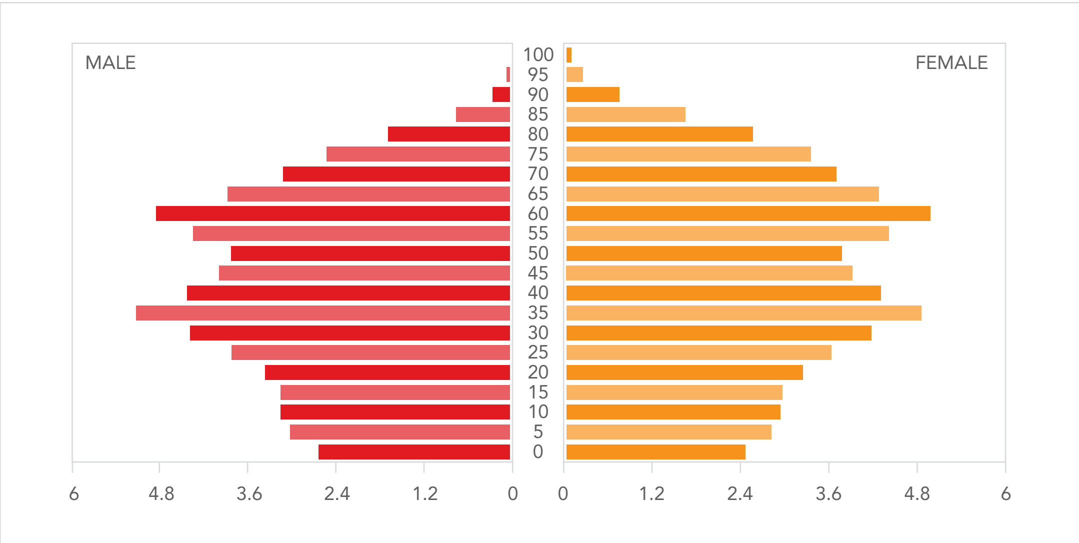
Japan's stock-market and property boomed in the late 80s before peaking in 1989 and 1991 respectively. This was a time when its working age population represented the bulk of the country's population. It was a time of 'The Japan that can say no,' a widely reported essay about the successful rise of the Japanese way of business and a critical examination of US business practices.[1]

The chart below shows Japan's population pyramid in 1990. Note the relatively small number of children and elderly compared to workers aged 20 – 60, meaning revenues from workers did not have to be spent on raising the young or looking after the elderly. It was a time of prosperity, a time when Japanese firms and pop-stars bought hotels and properties in Australia.

It's been downhill for Japan since then.

FIGURE 1: JAPAN - 1990

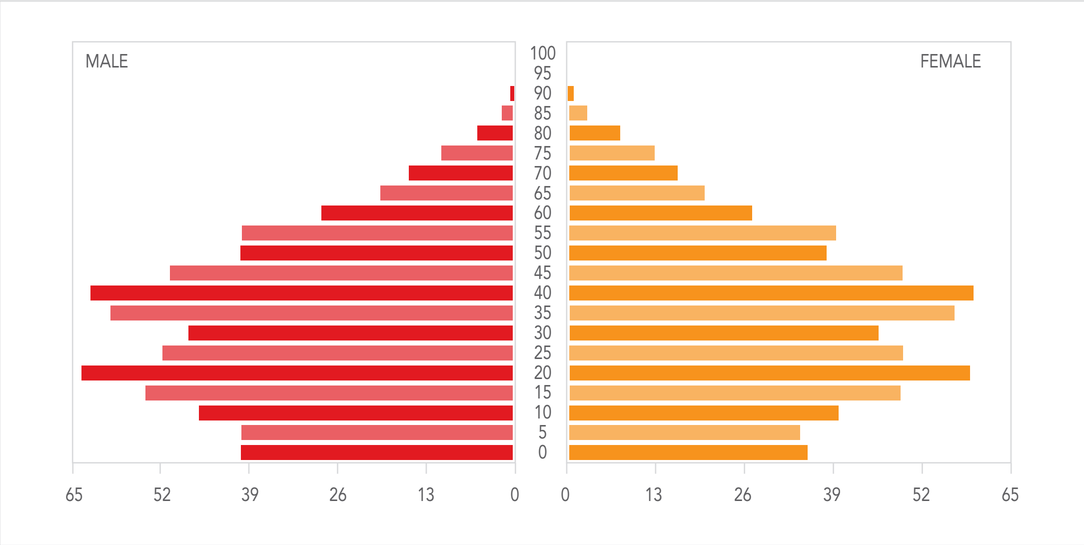
Population (in millions)



Now take a look at China's population pyramid in 2010. It looks very familiar? Today is China's time in the sun, with a booming property market, outward investments, and trade surpluses. (Although its stock-market is only half of its peak in October 2007.) Today, China's demographic is remarkably similar to Japan in 1990 but with a more pronounced bulge in its working population, suggesting even greater current prosperity for the nation.

FIGURE 2: CHINA - 2010

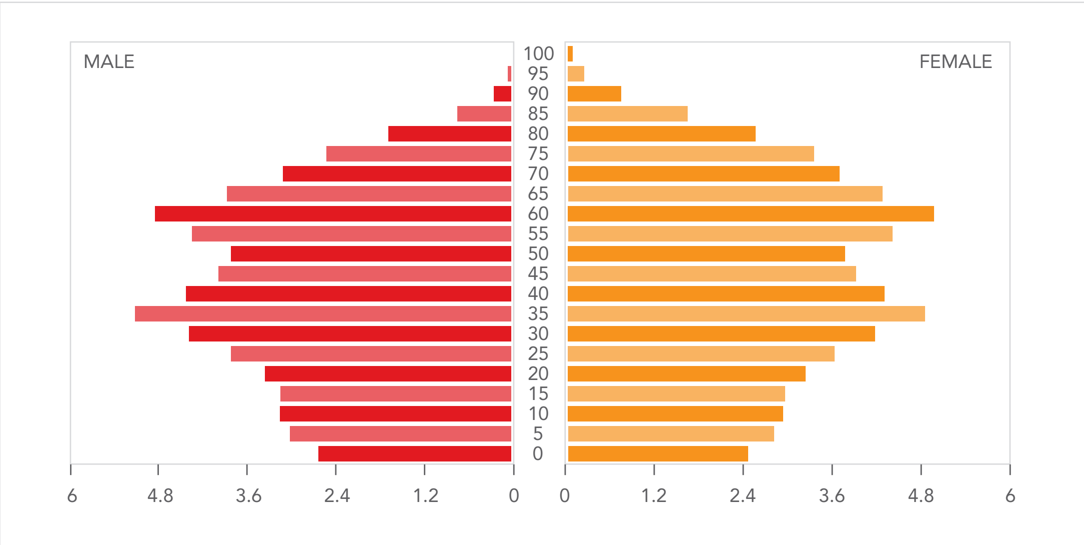
Population (in millions)



Fast forward to Japan in 2010, and take a look at its demographics. Note the rise in the population over 60 that coincided with zero population growth and the 'lost decades' (economically speaking), of Japan in the 1990s and 2000s. Today, more than 22.6% of its population is over 65.[2]

FIGURE 3: JAPAN - 2010

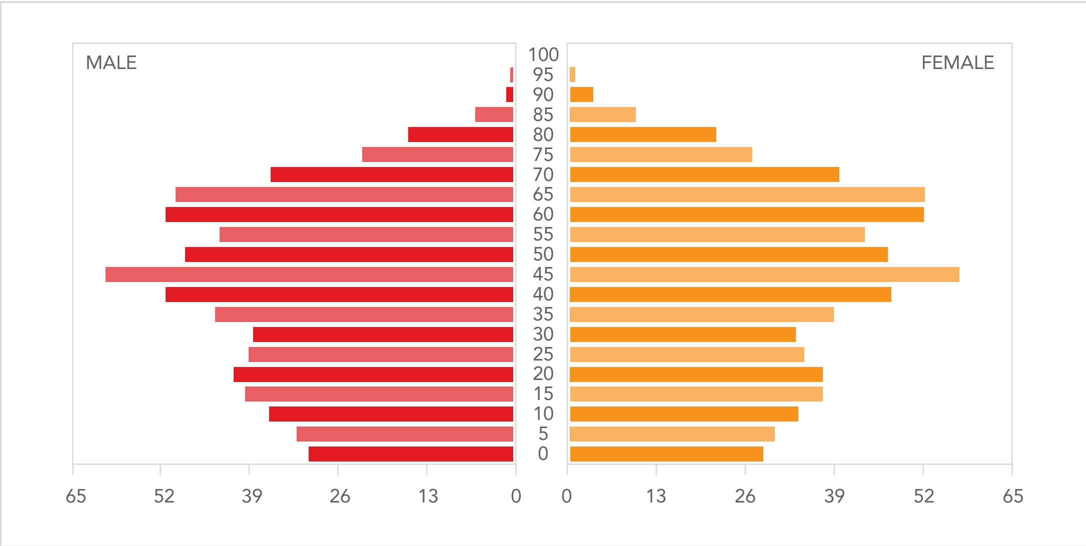
Population (in millions)



China will face a similar population pyramid in 25 years time as the table below shows. Will it also be downhill for China from here on in?

FIGURE 4: CHINA - 2035

Population (in millions)



There is however one major difference between China and Japan. China is developing from a much lower economic base compared to Japan, so Chinese growth has been and will likely remain substantial in the immediate term.

Nevertheless, demographics is destiny, and with neither country having significant immigration programs to alter its population pyramid, China is likely to face similar pressures caused by a smaller working population (relative to total population) over the coming decades.

What does this mean for Australian investors?

Like Japan in the late 80s and early 90s, China is now reaping its demographic dividends. And Australia has been benefiting from China's rise by exporting its minerals, energy and increasingly agri-produce (meat, seafood). Tourism from China is another export industry that could take off soon in Australia. Australia is currently basking in China's glow.

But how long will this last? Are we seeing the peaking of China now? Australian investors need to remain alert to China's demographic destiny, particularly as the popular wisdom is that now is China's moment, (a time for some contrarian thinking?) just as the early 90s was seen as Japan's heyday.

Australia's aging population

Five years ago, Australia had 757,000 people aged 65-69. Five years from now, there will be 1,161,000 people in that age bracket – that's a 53% jump in 10 years. The percentage increase for Australians aged 60-64 is also a whopping 37%. See table below.

Age	Population in 2005 (thousands)	Population (forecast) in 2015 (thousands)	% increase
30-34	1520	1532	0.8
35-39	1484	1475	-0.6
40-44	1540	1597	3.7
45-49	1469	1532	4.3
50-54	1341	1551	15.7
55-59	1240	1449	16.8
60-64	945	1294	36.9
65-69	757	1161	53.4
70-74	626	842	34.5
75-79	548	617	12.6
80-84	390	439	12.6

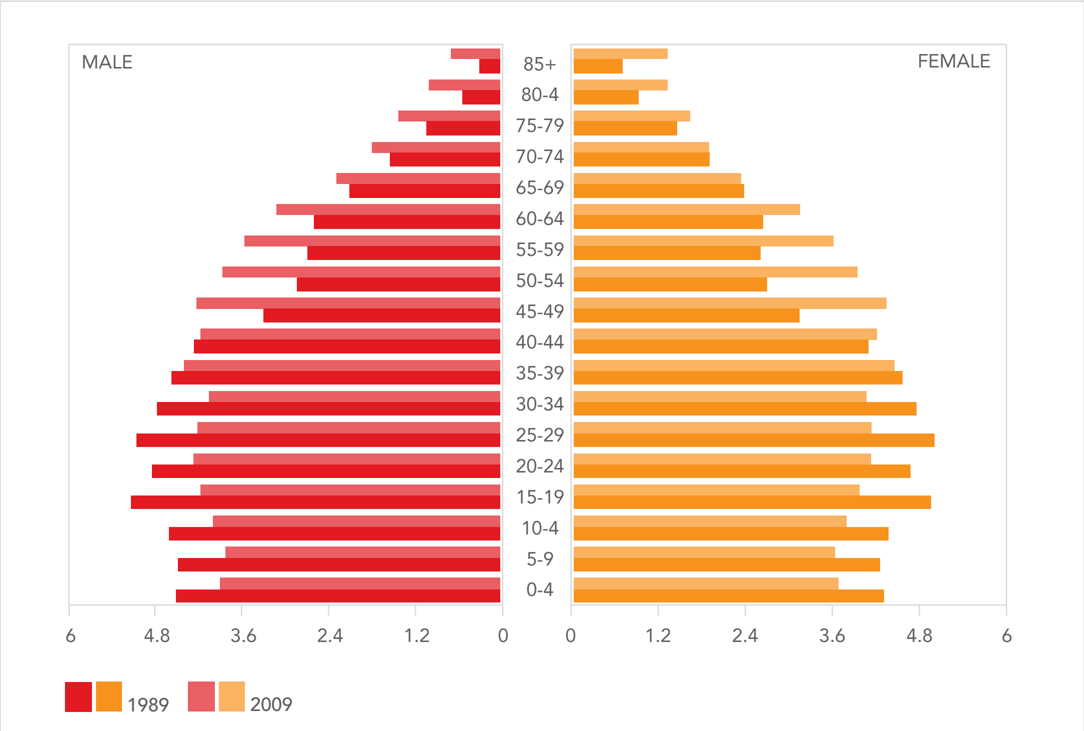
Source UN Population Division http://esa.un.org/unpp/

Businesses and investments targeting 'active retirees' (travel agents, providers of 'income-focussed' investment products, health-food) are currently seeing their client base dramatically increasing.

The rise is even more substantial when compared to clients in younger age groups. For example, the number of people aged 30-34 will rise just 0.8% and those 35-39 will fall 0.6%.

The table below provides another snapshot of the current change in demographics, comparing the population structure in 1989 to 2009 for the different age groups. Note the smaller numbers in the 0-39 groups in 2009 compared to 20 years earlier.

FIGURE 5: AUSTRALIA - 1989 and 2009



This big rise[3] in the 60-69 group is due to the aging baby boomer generation, the same generation that initiated major societal changes[4] in West as they aged from children (Barbie doll 50th anniversary in 2009) to teenagers (RocknRoll) to adults ('greed is good' investments/careers/home-ownership) to maturing adults (denial of aging!).

Once again, we can expect them to make major societal changes as they enter retirement. Investment products and services catering to the older baby boomers (those born in 1946 -1955 who will be aged 60-69 in 2015 and mostly out of full-time work) will mushroom as this population segment booms.

What does this mean for the investor?

6. As the cohort of baby boomers retire (who have the most wealth by age and by sheer weight of numbers), their risk appetite will wane as their preference will be for income stability rather than capital growth.
7. Therefore, there will be a switch out of higher volatility listed investments into lower volatility investments. This suggests a steady selling pressure on equity markets, a preference for 'safe' dividend paying stocks over the 'penny dreadfuls,' and increased demand for term deposits, leading to lower deposit rates being offered by financial institutions to take advantage of this increased demand.
8. More demand for reverse mortgages (to fund retirement incomes while staying in existing home). Increased demand for the product could result in more competitive interest rates.
9. Spending of assets in retirement and less passing of wealth to the next generation. Perhaps this will be the boomers legacy –the 'most self absorbed generation' continuing into old age, which means the retirement services industry (travel, health, entertainment) will flourish as baby boomers see little need to save it for their offspring.
10. An increased supply of family-sized homes and take-up of smaller apartments/sea-change or tree-change due to increased down-sizing. (although a recent survey[5] has found that retirees are delaying their downsizing decision due to their preference to stay in their existing homes and the little net benefit after agents fees and stamp duty of switching homes)
11. Sea or tree change increases in areas that offer a substantially lower housing entry cost (to offset stamp duty/agents fees in selling existing home). For example, could South Coast properties boom due to a surge in baby boomer retirees in Canberra doing the sea-change?
12. Increased number of investment properties owned by baby boomers being sold to fund retirement incomes. (but if positively geared, may be held for rental income, and to postpone capital gains tax until other savings are depleted in their 70s/80s

Conclusion and Action

China's demographic in 2010 is remarkably similar to Japan in 1990. And like Japan in 1990, China is today reaping its demographic dividend.

However, investors should be wary that China's demographic is also following Japan's and will by 2035 be similar to Japan's demographic today.

This suggests that we could be at or close to the peak of China's economic success with the country potentially looking at its own 'lost decades' in the near future.

There are however, differences. China is growing off a lower base and has much more to develop in terms of infrastructure, domestic consumption and the creation of a larger services industry. China has more natural resources to tap, including little explored regions in Mongolia and its western hinterland. China has a different business, political and social culture to Japan - a Japanese culture that arguably prevented the country from making drastic changes in the 1990s/2000s to cope with its changing economic and demographic circumstances.

Nevertheless, demographics is destiny, a powerful force that will impact on China, and therefore Australia's economic future. Investors should be aware of this and watch for signs on whether China's differences (as noted above) to Japan will be able to withstand the pressures of its population trends.

Meanwhile, Australia also has its own demographic destiny. The nation's aging population is occurring now, not sometime in the distant future. The number of 60-69 year olds in 2015 is forecast to jump a massive 53% from 2005 as baby boomers age.

As a consequence, the appetite for safer, less volatile investments will likely grow, particularly from this wealthy age-group. Their appetite for higher risk, capital growth focussed listed investments will decline.

Investors should be aware that this will place an added sell pressure on the stock market – a pressure that was not as significant a decade ago. Investors should also be aware that income-focussed products, including term deposits, will grow, suggesting that deposit taking institutions could lower their deposit rates due to this higher demand.

In the developed world, fertility rates are now far below population replacement levels of around 2.1 children per woman. Japan is the 'oldest' nation and its population is beginning to drop (No more construction for new housing, new roads, new schools etc) as the country has minimal immigration. Europe is not far behind.

Selected countries. 2010-2015 projected total fertility rates

Australia	1.83
USA	2.02,
China	1.78
Japan	1.27
Indonesia	2.01
India	2.54

Germany, Spain, Greece, Italy have rates of 1.38 to 1.50. (France and UK are both 1.85)

Source http://data.un.org/Data.aspx?d=PopDiv&f=variableID%3A54

1. http://en.wikipedia.org/wiki/The_Japan_That_Can_Say_No
2. http://en.wikipedia.org/wiki/Demographics_of_Japan
3. In comparison, between 1995 and 2005, population in the 60-64 age group from increased by only 8.8%
4. http://en.wikipedia.org/wiki/Baby_boomer
5. http://smh.domain.com.au/real-estate-news/the-great-housing-dilemma-20100830-13y5n.html

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