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Interest Rate Outlook

Stamford Capital is pleased to provide a commentary on the interest rate outlook for the from Russell Maisner, principal of Global Treasury Risk Management Pty Ltd ("GTRM").

Russell has over 20 years' experience at a senior executive level in financial markets, specifically capital markets sales and treasury risk management. Russell has expertise in assisting clients with all their treasury risk management requirements and has worked with organisations across ASX 200 as well as having guided a number of mid-tier clients through solutions of their interest rate risk management and currency exposures.

GTRM is available to all Stamford clients – please contact Stamford Capital in order to arrange an appointment to discuss your interest rate risk management requirements.

Key points:

- Window for lower rate long term swaps has narrowed - but is not closed.

Since our last Interest Rate Outlook in December 2011, the first quarter is just about completed and the world did not implode as was forecast last year based upon Europe's troubles, well at least not at this stage. The focus appears to be shifting to the Middle East and the correlation of higher oil pricing is being evidenced. Whether this becomes sustainable or an aberration of price is yet to be determined.

Home issues appear to be cloudy for the economy with a clear softness in some sectors and continuing strength across resources, albeit with some caveats from our largest miners.

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Given the recent RBA commentary by the Governor, we will review interest rates by comparing the movements from late last year, to present rates. This depiction should assist with any decisions and can be used in an effective measure of relative value.

AUD Implied Cash Rate **14-Dec-11**			AUD Implied Cash Rate **22-Mar-12**			**Difference**
Date	Rate %	Adjustment	Date	Rate %	Adjustment	
Mar-12	3.64	-0.61	Mar-12	4.25	0.00	**-0.61**
Apr-12	3.35	-0.90	Apr-12	4.19	-0.06	**-0.84**
May-12	3.15	-1.10	May-12	4.07	-0.19	**-0.92**
Jun-12	3.04	-1.21	Jun-12	3.99	-0.27	**-0.95**
Jul-12	2.92	-1.33	Jul-12	3.92	-0.34	**-1.00**
Aug-12	2.88	-1.37	Aug-12	3.91	-0.35	**-1.03**
Sep-12	2.88	-1.37	Sep-12	3.80	-0.45	**-0.92**
Oct-12	2.87	-1.38	Oct-12	3.80	-0.46	**-0.93**
Nov-12	2.94	-1.31	Nov-12	3.80	-0.45	**-0.86**
Dec-12	3.00	-1.25	Dec-12	3.73	-0.52	**-0.73**

In the above comparison table, the market has now all but totally discounted changes to the RBA cash rate by around 100 bpts in the middle of the year, compared to its expectation of rate reductions in December of last year i.e. there is a 100% probability of a rate reduction by .25% in the middle of the year.

The other aspect that should be considered as stated by the Assistant Governor is:-
The cash rate set by the Reserve Bank Board is the short-term interest rate benchmark that anchors the broader interest rate structure for the domestic financial system. It is the front end of the risk-free yield curve off which other financial assets are generally priced. When the cash rate is adjusted up or down, the whole structure of interest rates in the economy moves up and down, with the effect most direct at shorter maturities.

But the cash rate is clearly not the only determinant of the rate structure in the economy.
Two examples cited by the Assistant Governor are:-

- As one moves out along the term structure of the risk-free curve, term premia play an increasing role.
- Risk premia are an important component of borrowing costs for private sector entities, including the banks.

So how has this significant shift of sentiment and anticipated emergency measures which have all but dissipated affected the current fixed rates? Perhaps we should also compare these from last year.

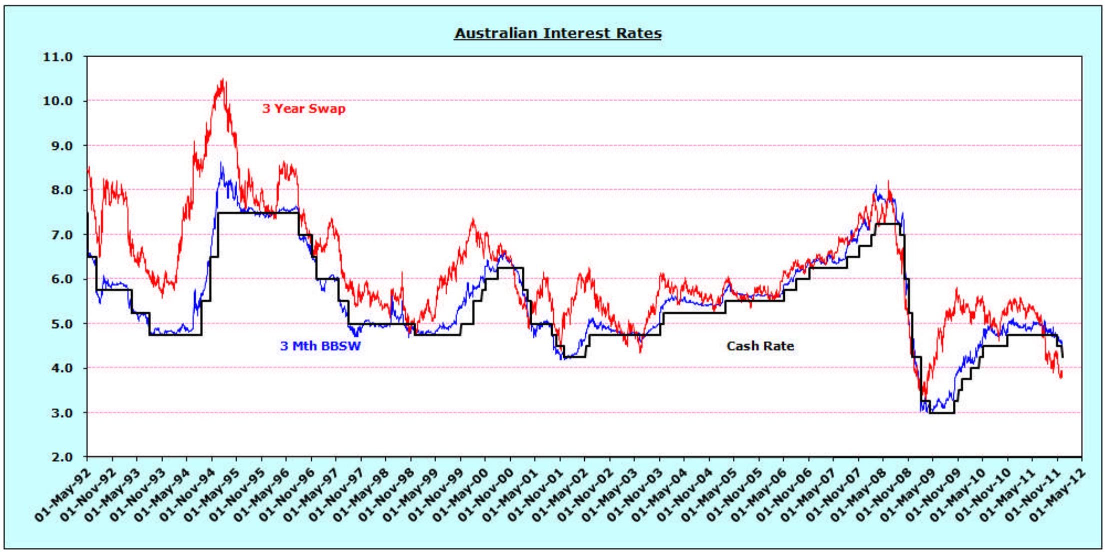
Swap Rates as at 14/12/11			Swap Rates as at 22/3/12			Shift in
Mat	Basis	Yield-mid	Mat	Basis	Yield-mid	Fixed Rates
1 YR	Q/Q	3.74	1 YR	Q/Q	4.25	-0.51
2 YR	Q/Q	3.76	2 YR	Q/Q	4.28	-0.52
3 YR	Q/Q	3.86	3 YR	Q/Q	4.36	-0.50
4 YR	S/S	4.15	4 YR	S/S	4.58	-0.43
5 YR	S/S	4.30	5 YR	S/S	4.68	-0.38
7 YR	S/S	4.54	7 YR	S/S	4.88	-0.34
10 YR	S/S	4.72	10 YR	S/S	5.07	-0.35
12 YR	S/S	4.85	12 YR	S/S	5.18	-0.33
15 YR	S/S	4.95	15 YR	S/S	5.26	-0.31
20 YR	S/S	4.97	20 YR	S/S	5.30	-0.33
25 YR	S/S	4.85	25 YR	S/S	5.18	-0.33
30 YR	S/S	4.75	30 YR	S/S	5.10	-0.35

So the shift in RBA monetary policy isn't an exact correlation to fixed rates, and for the sake of this outlook, there is probably not much value in providing that correlation. However, the key movement identifies a shift of approximately .50% higher in the part of the curve where most corporate borrowers participate i.e. 1-5 years.

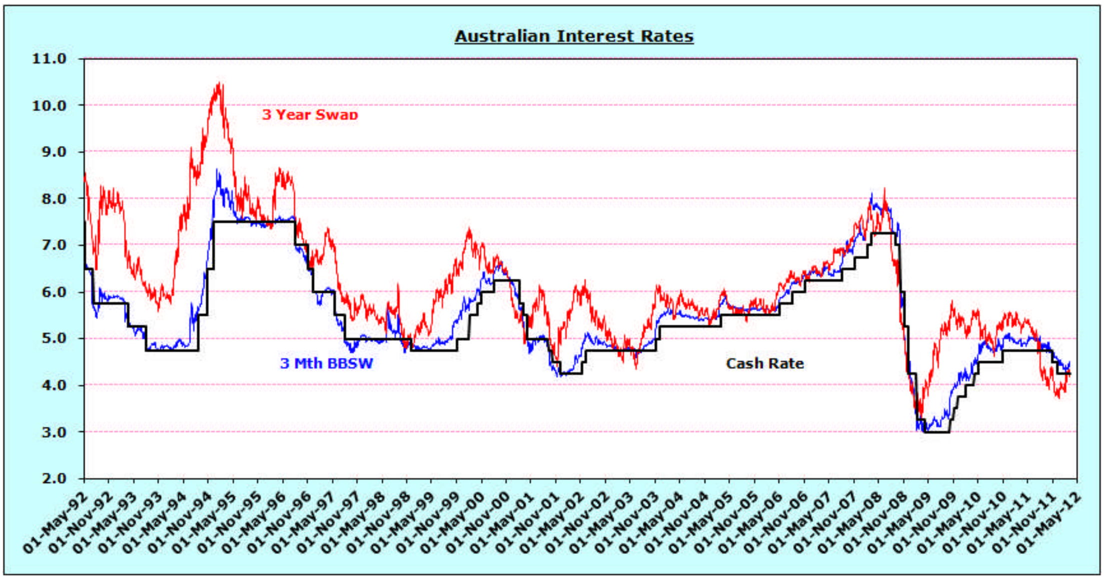
Does this signify the bottom of the rate cycle and the low of fixed rates? To answer this, there can be many permutations, but the reduction of perhaps another .25% in the cash rate may have only small bearing on the fixed rates, all other things being equal (which often are not). As a borrower, it can be easy to start to become an interest rate forecaster, when identifying opportunity to lock in fixed portions of debt. The high risk with this approach, means that lower rates are always aspirational, without determining parameters on both the downside and upside of rates. Therefore, if a particular level is targeted and not realised, whereby is the opposite trade of a stop loss?

In effect, corporate borrowers can turn into interest rate speculators which defeats the purpose of risk mitigation. The other facet to this type of strategy invariably results in missing the opportunity and then self punishment of abstaining from any action as a result. I have witnessed this for many years and can only offer prudent risk management guidance. With this in mind, there are two charts to reflect upon:-

14-Dec-11



22-Mar-2012



In reviewing the above graphs, a couple of points seem clear:

- The 3 year swap rate has risen from December 2011 to now (April)
- That this move is only around 50 bpts
- There is still only one point in the past twenty years when the fixed rate was lower -2009 GFC
- That whilst a low may have been established in this cycle, on a historical basis, a fixed rate in the low to mid 4.00% range is still very attractive from a risk mitigation perspective.
- The window of opportunity is not closed, but has narrowed.

We still stand by our previous forecasts for $A interest rates in allocating a 75% probability to a further cut (May), with a further 25% probability of another rate cut later this year. The caveat on all this of course, is no further unexpected events which may de-stabilise the global and domestic economies further.

If you have debt and are unsure how to approach a strategy, please contact us so we may be of assistance across all of your risk management concerns.

Regards
Russell Maisner

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