



MARGIN LENDING STAR RATINGS

Report No. 20

November 2008

IN THIS REPORT WE LOOK AT:

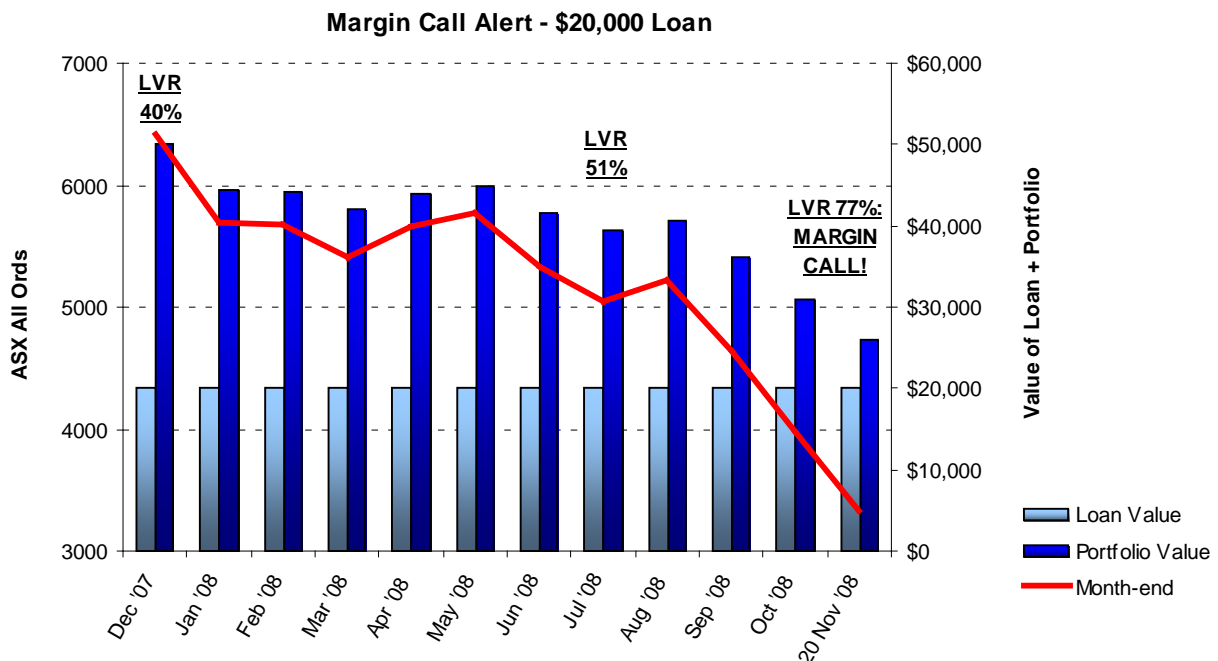
- ★ Oh no, the phone is ringing!!!
- ★ Investors batten down the hatches
- ★ Interest rate cuts: good news or not?
- ★ Is this the right time to enter the market?
- ★ New investor profiles
- ★ Choosing the best margin loan



OH NO, THE PHONE IS RINGING!!!

A reluctance to answer the phone is just one of the side effects of the downturn in global markets. Aside from their shares plummeting in value, many investors are living in fear of getting 'that' call ... the margin call that gives them the gloomy news that their shares have sunk to below the acceptable loan-to-valuation (LVR) ratio and they have a certain amount of time to either sell a share parcel or deposit funds into the account to restore their LVR.

Margin calls reached a five-and-a-half year peak during the third quarter of this year. On average, two clients in five would have received a margin call during this period. CANNEX estimates that during the last month around half of all margin lending clients have either been faced with a margin call, or had to take direct action to prevent one – either by topping up their investment or by selling stock. Even investors with what they thought were safe, diversified portfolios are not immune. Keeping an eagle eye on your portfolio constantly and adjusting investments, as necessary, is essential if you want to overcome phone phobia and avoid that margin call.





The chart on the previous page illustrates the effect of stock market volatility on a geared investment. In the above example, our investor entered the market at the start of 2008, with a \$20,000 margin loan invested into an ASX All Ords tracker portfolio, with an initial portfolio value of \$50,000, which corresponds to a fairly conservative LVR of 40%. The X axis shows the effect of a specified percentage change in the portfolio value on the ongoing LVR for this investor:

- The first half of the year saw the portfolio value edge down, losing around 10% of its value by the end of May. Following further falls through the middle of the year, our investor still has a fairly cosy LVR of 51%.
- The market began to fall more sharply from September, to the point where by the time of the most recent trough – November 20th, our investor is in margin call territory, with an LVR of 77%.
- So for our example investor, simply being inactive through such extreme market conditions has led – or is very likely to lead - to a margin call. Options available would now include a further investment into the portfolio, or a reduction in holdings, both of which would return the LVR to a lower level.

INVESTORS BATTEN DOWN THE HATCHES

The stock market storm has hit and statistics from the RBA tell the story, as margin lending clients scramble for the lifeboat of debt reduction.

- During the July-September Quarter the number of client margin loan accounts shrunk (from 206,000 to 202,000) for the first time since 2003.
- Perhaps more telling is that the average loan size has dropped by 28% since the beginning of the year (from \$189,000 to \$136,000).
- What is also interesting is the increase in protected equity loans which have almost doubled over the last 18 months, now accounting for 10% of the margin loan market.

INTEREST RATE CUTS: GOOD NEWS OR NOT-SO-GOOD NEWS?

Among all the bad news, one glint of light for investors has been the cuts in official cash rates. However, margin lenders have not been as quick to pass on the rate cuts, or pass them on in full. The average variable rate on a \$50,000 loan has fallen just 0.63% in the six months to November. At the time of writing, however, it is likely we will see at least a portion of the 0.75% official November rate cut passed on in December.

As an impartial observer, it is hard to blame the margin lenders for not passing on the full 1.75% rate cut immediately whilst the ramifications of the dramatic market falls continue to play out. However, for most share investors any good financial news would be extremely welcome.

IS THIS THE RIGHT TIME TO ENTER THE MARKET?

The Australian market has lost roughly half its value since the start of the year. Without a crystal ball to gaze into, the answer to the timing of share recovery varies wildly, depending on who you talk to.

Commonly expressed opinions are:

- Someone's loss is another's gain – present share market prices offer unique buying opportunities.
- This year's price dives simply represent a long-term re-pricing of shares under tighter credit conditions.
- No way I'm going near speculative investments. My money's safer under the mattress.



It is fair, if not obvious, to say that share price recovery most likely depends on the duration of the slowdown and whether the new risk-averse environment has dented share prices for the long term.

In any case, what sort of Armageddon scenario would be necessary to drag share prices through the mire any more than they already have been? Could a global slowdown see many major institutions – or perhaps even governments – hit the wall? That would surely be the next stage of the credit crunch, if there is to be a next stage. Then we might see investors sell off equities to an even greater extent – and this is where economics disappears into the haze of the crystal ball forecasting.

NEW PROFILES – SHARE INVESTOR vs. MANAGED FUND INVESTOR

CANNEX has for a long time been assessing margin lenders against each other on a one-size-fits-all basis. However, the increasing sophistication both of margin lenders and of investors continues to see greater diversification across alternative product options.

In addition to standard margin loan products, many lenders now offer alternatives such as:

- Gearing products (usually aimed at smaller investors)
- Diversified portfolio products (requiring a minimum number of stocks to be held in a portfolio), and
- Online products, where the account holder can trade online – perhaps exclusively, depending on the product.

In due course, CANNEX may take a product-oriented approach with its *margin lending star ratings*. However, this report heralds a major change to its methodology. Our margin lending assessment is now based on two investor profiles – the share investor and the managed fund investor.

Most investors initially decide to take an advisory or non-advisory approach to investing. Taking advice usually involves a stockbroker or financial planner to provide information on investment possibilities and choice. Treading the non-advisory path leaves investors to make their own decisions. They typically favour shares rather than managed funds and naturally, each type of investor values different features in a margin loan.

The new Star Ratings approach is to focus on what matters most to share investors versus managed funds investors. Each of the two new profiles considers certain features to be more important than others. For example, we have assigned a heavier weighting to advisor services and instalment gearing facilities for the managed fund investor compared with the share investor. For the share investor profile, direct trading services assume greater importance – for instance, the capacity to trade directly online or to short-sell a stock.

CHOOSING THE BEST MARGIN LOAN

Eleven institutions offer margin loans in Australia. These are analysed by CANNEX for no less than 252 features, including the number of Australian and International stocks allowable in each case and the various interest rate options available. The CANNEX *margin lending star ratings* gives you a reliable guide to all available products, rated from 5 stars down to 3 stars. It offers an invaluable resource tool to the consumer looking to make a short list of margin lending products of interest to the share investor and the managed fund investor.



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Margin Lending Star Ratings: Share Investor Profile

November 2008 Summary Report

Company	Score			Interest Rate \$50k (%)		Info Line	Website
	Pricing	Feature	Total	Variable	1-Year Fixed interest prepaid		

★★★★★

"superior value"

Colonial Margin Lending	45.53	48.64	94.17	9.1	7.99	1800 252 351	www.colonialgearedinvestments.com.au
Commonwealth Securities	45.94	47.61	93.55	8.99	8.85	13 17 09	www.commsec.com.au
St George Margin Lending	47.12	46.37	93.49	9.85	8.95	1300-304-065	www.stgeorge.com.au

★★★★

"excellent value"

ANZ	46.00	46.22	92.22	9.75	9.49	1800 639 330	www.anz.com.au
BT Margin Lending	46.32	45.25	91.56	9.75	8.75	1800 816 222	www.btfunds.com.au
Goldman Sachs JB Were-ML	50.00	42.03	92.03	9.95	8.95	1800-780-809	www.jbwere.com.au
Leveraged Equities	45.94	45.76	91.70	9.95	8.9	1300-307-807	www.leveraged.com.au
Macquarie Bank	44.98	47.25	92.23	10.15	11.01	1800025735	www.macquarie.com.au

★★★

"strong value"

Citigroup Margin Lending	45.52	42.84	88.37	10.55	10.55	1800 062 794	www.ssmb.com.au
nab	46.69	37.48	84.17	9.95	9	1300-135-145	www.national.com.au
Suncorp	47.53	41.99	89.51	9.75	9.1	1800115211	www.suncorpmetway.com.au



Margin Lending Star Ratings: Managed Fund Investor Profile

November 2008 Summary Report

Company	Score			Interest Rate \$50k (%)		Info Line	Website
	Pricing	Feature	Total	Variable	1-Year Fixed interest prepaid		

★★★★★

"superior value"

BT Margin Lending	46.32	48.09	94.40	9.75	8.75	1800 816 222	www.btfunds.com.au
Colonial Margin Lending	45.53	49.87	95.40	9.1	7.99	1800 252 351	www.colonialgearedinvestments.com.au
Commonwealth Securities	45.94	49.54	95.48	8.99	8.85	13 17 09	www.commsec.com.au
Macquarie Bank	44.98	49.75	94.73	10.15	11.01	1800025735	www.macquarie.com.au

★★★★

"excellent value"

Goldman Sachs JB Were-ML	50.00	40.94	90.94	9.95	8.95	1800-780-809	www.jbwere.com.au
Leveraged Equities	45.94	46.88	92.82	9.95	8.9	1300-307-807	www.leveraged.com.au
St George Margin Lending	47.12	45.78	92.90	9.85	8.95	1300-304-065	www.stgeorge.com.au

★★★

"strong value"

ANZ	46.00	43.46	89.46	9.75	9.49	1800 639 330	www.anz.com.au
Citigroup Margin Lending	45.52	40.67	86.20	10.55	10.55	1800 062 794	www.ssmb.com.au
nab	46.69	38.14	84.84	9.95	9	1300-135-145	www.national.com.au
Suncorp	47.53	42.26	89.79	9.75	9.1	1800115211	www.suncorpmetway.com.au



Margin Lending Star Ratings: Product Features

November 2008 Summary Report

Company	Min Loan Amount	No of AU Shares/Managed Funds		Buffer Shares/Managed Funds		International Shares	Property Security	Instalment Gearing	Protected Loan	Option Trading Available			
										Long Call	Short Call	Long Put	Short Put
ANZ	20000.00	1119	947	5%	5%	X	X	✓	✓	X	✓	✓	X
BT Margin Lending	2500.00	536	2216	10%	10%	X	X	✓	✓	X	✓	X	X
Citigroup Margin Lending	No min	568	941	5%	10%	X	X	✓	✓	✓	✓	✓	X
Colonial Margin lending	No min	564	2230	10%	10%	✓	✓	✓	✓	✓	✓	✓	✓
Commonwealth Securities	No min	564	2230	5%	5%	✓	✓	✓	✓	✓	✓	✓	✓
Goldman Sachs JB Were-ML	50000.00	2000	800	7.50%	7.50%	✓	X	✓	✓	✓	✓	✓	X
Leveraged Equities	20000.00	390	1988	10%	10%	X	✓	✓	✓	✓	✓	✓	✓
Macquarie Bank	No min	709	2312	5%	5%	✓	✓	✓	✓	✓	✓	✓	✓
nab	No min	444	1062	5%	10%	X	X	✓	✓	✓	✓	X	X
St George Margin Lending	No min	635	1311	10%	10%	X	✓	✓	✓	X	✓	X	X
Suncorp	20000.00	522	1225	5%	10%	X	X	✓	✓	X	X	X	X



What is the CANNEX *margin lending star ratings*?

CANNEX *margin lending star ratings* is a sophisticated rating methodology, unique to CANNEX, that compares both the Cost and Features across margin lenders. CANNEX star rated lenders represent a short list of quality institutions. This short list narrows the search for consumers to lenders that have been independently assessed and ranked. Five star lenders are considered to offer Superior value for money. Lenders are rated every six months.

CANNEX's rating methodology is transparent and extensive. The methodology compares all types of margin lending products for an array of characteristics such as:

- Interest Rates
- Fees and charges
- Loan to Value Ratio (LVR)
- Features
- No of shares/funds available

The results are reflected in a consumer-friendly 5-star concept. The *star ratings* from the CANNEX *margin lending star ratings* are described as follows:



SUPERIOR



EXCELLENT



STRONG

How are the 'stars' calculated?

CANNEX ranks margin lenders based on value-for-money measures and then awards a star rating according to rank. Typically the top 3 lenders will be awarded a 5 star (or superior) rating. The number of lenders awarded each of the 3 to 5 star ratings will ultimately depend of the dispersion of final scores.

Scores are awarded to each lender on the basis of rates, fees, services and list of approved securities. The methodology is revised and parameters are updated on a regular basis to make sure that the products are analysed using the most up-to-date information capturing all industry developments. A detailed methodology is provided below.

For the first time, CANNEX has assessed margin lenders from the perspective of two different consumer profiles: the Share Investor, and the Managed Fund Investor. Each profile assumes that the consumer will have a preference over one of these forms of security against the other, but will also seek some content from their secondary security type.

To arrive at the total score CANNEX applies a weight (w) against the Pricing score (P), Features score (F) and Acceptable Securities List score (A). This method can be summarised as:

$$\text{TOTAL SCORE (T)} = w_1 \text{PRICING (P)} + w_2 \text{FEATURES SCORE (F)} + w_3 \text{ASL SCORE (A)}$$

Pricing (P)

CANNEX accounts for both current and historical interest rates in the calculation of the PRICING (P) component of each product's overall score, which comprises of:

1. **Standard 1 Year Fixed Rate in Advance** – rates at June 2008 for \$50,000, \$250,000 and \$500,000 loan amounts;
2. **Historical Performance of Standard Variable Interest Rates** – average of rates over the past 12 months for \$50,000, \$250,000 and \$500,000 loan amounts.

The products with the lowest cost receive the highest score in the scenario analysis.



CANNEX star ratings methodology

Features (F)

CANNEX allocates points for over 150 Features (F) of a margin lending product. These include flexibility, operating terms and conditions, investor tools and imposed product parameters. The points are totalled for each product and then indexed to determine the product’s Feature ranking.

Features have been assessed separately for the two investor profiles (Share Investor and Managed Fund Investor), to take into account the fact that each of these two main categories of investor will have differing priorities when choosing their margin lender.

Acceptable Securities List (A)

CANNEX currently reviews the Acceptable Securities List (ASL) for only those securities that have either an APIR (Managed Funds) or ASX (Australian shares) code. International shares are not included in the calculation of the ASL score.

The score for ASL is comprised of:

- A product’s average LVR for Managed Funds; and
- A product’s average LVR for Listed Shares.

This score is adjusted to take into account the difference in the number of securities on a product’s menu. A higher number of funds and shares on a menu will result in a higher score. Contribution of shares and managed funds to overall ASL scores will be reviewed in relation to their market size for each star rating.

As with Features, the ASL score is assessed differently for the two investor profiles, with scoring weighted towards the more relevant of the two main security types in accordance with the profile.

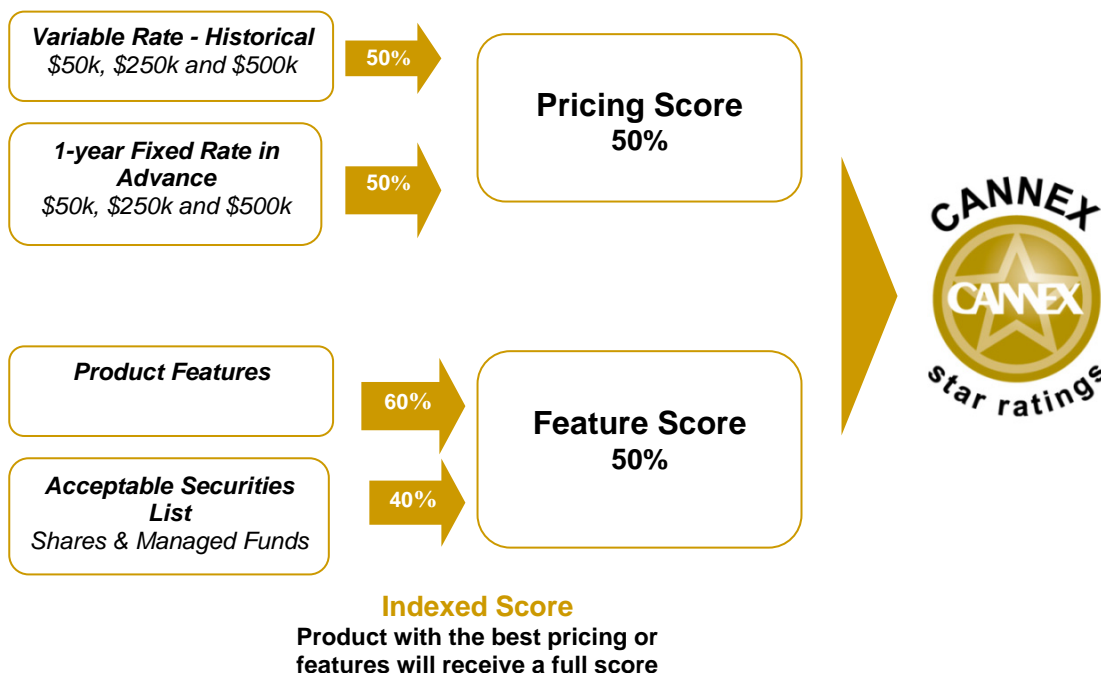
Weightings

The Pricing (P), Features (F) and Acceptable Securities List (A) are weighted for each product to reflect the relative importance of each component in the determination of value for money. Current weights are:

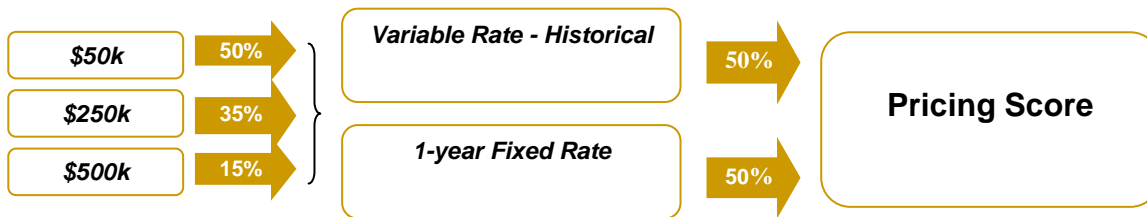
- Pricing (P)** 50%
- Features (F)** 30%
- Acceptable Securities List (A)** 20%

Total Score

The Pricing (P) plus Features (F) plus ASL point scores (A) are indexed and then totalled to provide the Total Index Points. Stars are awarded according to the Total Index Points.

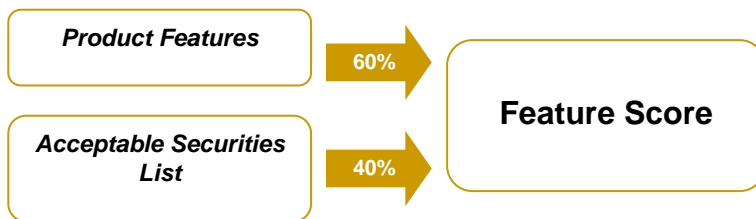


Pricing Score:

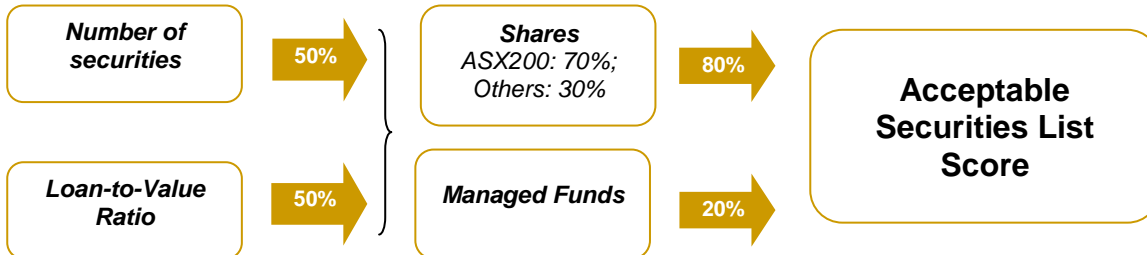


Feature Score:

This score differs according to which investor profile is being assessed. The methodology is the same for both profiles, the weightings within each methodology differ, as indicated below:

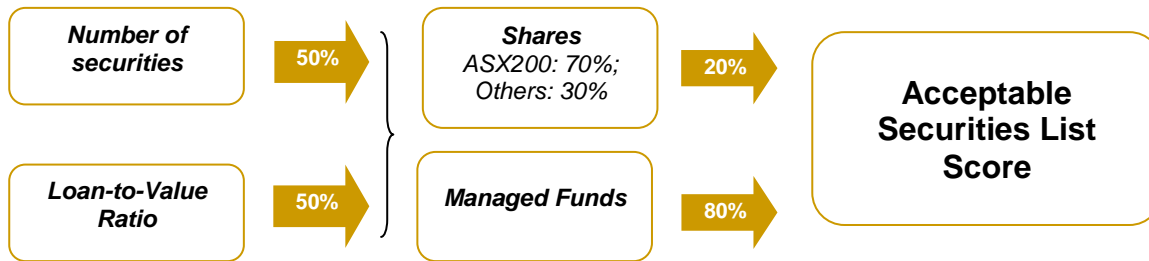


Share Investor Profile:



Product Feature Weightings – Share Investor		
Categories	Weights	Selection of features included
Direct client services	13%	Online support system, historical transactions view, personal acct manager
Lending Terms	10%	Interest rates, loan application amounts, prepaid interest refunds, regular gearing availability
Margin loan trading	10%	Internet/phone trading, short-sell facility, real-time trading availability
Repayments	9%	Early repayment fees, payment facilities available
Margin information	8%	Margin call notification method and notice period, buffer margin
Transaction costs	7%	Costs associated with different asset classes. Number of free transactions
Fees and charges	6%	Application & stamp duty fees, service fees eg margin call of balance falling below minimum
Options Trading	6%	Number and variety of options available to buy & sell
Advisor services	5%	Online support system, education material, historical transactions view, personal acct mgr
Protected Equity Facility	5%	Protected loan availability, early loan repayment fees
Security	6%	Single-stock and LVR restrictions, asset class conditions
International shares	4%	Accessibility of international investments
Portfolio Platforms	3%	Number of providers available through platform, information available through one platform
3rd party trades	1%	Possibility of proceeds/purchases being allocated to entity other than margin loan holder
Cash advance	1%	Availability and immediacy
CMT	1%	Link between cash management trust and loan account
Discount broker partnerships	1%	Availability and extent
Dividend distribution	1%	Possibility of using dividends to reduce loan amount, or deposit them directly into bank acct
Progressive drawdowns	1%	Associated availability & costs
Split/Combination features	1%	Advance/arrears and variable/fixed interest rate payment provisions
Switching	1%	Associated fees

Managed Fund Investor Profile:



Product Feature Weightings – Managed Fund Investor

Categories	Weights	Selection of features included
Advisor services	13%	Online support system, education material, historical transactions view, personal acct mgr
Instalment Gearing	12%	Availability & flexibility, minimum start-up & ongoing contributions, automatic payment facilities
Lending Terms	10%	Interest rates, loan application amounts, prepaid interest refunds, regular gearing availability
Repayments	9%	Early repayment fees, payment facilities available
Direct client services	7%	Online support system, historical transactions view, personal acct manager
Fees and charges	6%	Application & stamp duty fees, service fees eg margin call of balance falling below minimum
Margin information	5%	Margin call notification method and notice period, buffer margin
Margin loan trading	5%	Internet/phone trading, short-sell facility, real-time trading availability
Protected Equity Facility	5%	Protected loan availability, early loan repayment fees
Transaction costs	5%	Costs associated with different asset classes. Number of free transactions
Options Trading	4%	Number and variety of options available to buy & sell
Security	4%	Single-stock and LVR restrictions, asset class conditions
International shares	3%	Accessibility of international investments
Portfolio Platforms	3%	Number of providers available through platform, information available through one platform
Cash advance	1%	Availability and immediacy
CMT	1%	Link between cash management trust and loan account
Discount broker partnerships	1%	Availability and extent
Progressive drawdowns	1%	Associated availability & costs
Split/Combination features	1%	Advance/arrears and variable/fixed interest rate payment provisions
Switching	1%	Associated fees



CANNEX star ratings methodology

Does CANNEX rate other product areas?

YES. CANNEX also rates credit cards, rewards programs, mortgages, low-doc home loans, reverse mortgages, personal loans, deposit accounts, package banking, business banking and car insurance products. The star ratings use similar methodologies to the margin lending star ratings methodology. This guarantees the quality and transparency of these other star ratings. The use of similar star ratings logos also builds consumer recognition of quality products across categories. Please access the CANNEX website (<http://www.cannex.com.au>) if you would like to view the latest CANNEX star ratings reports of interest.



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