Investment Solutions

Summer 2010

New Year, New Direction

What's inside:

Snippets

Avoid Christmas in the red

Traditionally a time of fun and giving, Christmas can sometimes be stressful and frustrating too. What can you do to reduce stress and start the new year out of the red?

Budget
Be realistic about what you can afford and don't overspend. Work out how much money you can spare and spend within your budget.

Gifts
Reduce the stress and the cost of Christmas by agreeing to buy presents only for children or set a limit on cost per present.

Take advantage of internet shopping. You'll generally find items cheaper than they retail in the shops and because you're shopping from home it's far less stressful.

Food
If you're getting together with family or friends for Christmas dinner, suggest that everyone shares the cost by either bringing food or pooling money to buy it.

Donations
Don't forget the less fortunate Australians who will be relying on charity over the holiday period. Just a few dollars can make a difference and you get satisfaction from knowing your money will be used to help others. See page 4 for more information about charitable donations.

Risk perception post-GFC

The public's perception of risk has significantly changed since the global financial crisis (GFC), according to a recently published report[1]. On the other hand, risk tolerance levels (the extent to which the investors are comfortable with the risk of losing money on an investment) remained constant.

Before the GFC during a bull market, most investors surveyed perceived little risk. After the share market decline however, 33% of investors saw the market as enormously or considerably more risky and 41% saw it as somewhat more risky, according to the survey. This is despite the fact that markets have since recovered and are currently showing less volatility.

Your financial adviser can help explain market risk to you and check you're investing in accordance with your risk tolerance.

Scratching Australia's surface

As an economy that relies heavily on its natural resources, it's interesting to hear that the Government has pumped a further $23 million[2] into an initiative designed to help Governments, universities, research and science agencies better understand what lies beneath Australia's land.

The funds have gone to AuScope, a non-profit organisation previously awarded $42.8 million in 2007 under the Government's National Collaborative Research Infrastructure Strategy.

One of the specific goals of AuScope is to get a clearer picture of Australia's subsurface, using core samples and tapping into satellite imaging to learn about the continent and its seas from far above. Data is stored in AuScope's National Virtual Core Library and mined for further research, passed along to the industry and educators and used to inform Government policy.

AuScope's infrastructure allows researchers to collaborate in their efforts to study issues such as climate change, groundwater resources, mineral and energy resources, land use and natural hazards. And that's got to be a good investment for our future.

[1] Risk Perception and Risk Tolerance, Changes Attributable to the 2008 Economic Crisis: A Subtle but Critical Difference. Michael J. Roszkowski and Geoff Davey July 2010.
[2] National observing system to probe earth. Media Release, Senator the Hon Kim Carr, 29 Jun 2010 www.auscope.org.au

New year's resolution

We're already halfway through another financial year. It's time to start planning ahead, setting goals for the new year and making sure your financial plan is on track to meet them.

Everyone has goals – the secret of success is knowing exactly what it is you want to achieve and putting a plan in place to achieve it.

Budgeting

A budget is an important aspect of your financial plan and probably your starting point. After paying all other unavoidable monthly expenses, what's left over?

By setting specific goals, you'll have a focus for your excess cash. Instead of spending whatever you have left each month, your goals give you a solid reason for investing it.

Set the goals

When you're defining your goals you should be specific. Name your goal, decide a timeframe for achieving it and estimate how much it will cost.

For example:

1. Goal

Six weeks round-the-world trip

↓

2. Time to achieve it

18 months

↓

3. Estimated cost

$12,000

The satisfaction you get from achieving a goal acts as a strong motivator. If you get into the habit of setting goals and achieving them, you're on the road to a healthy financial future.

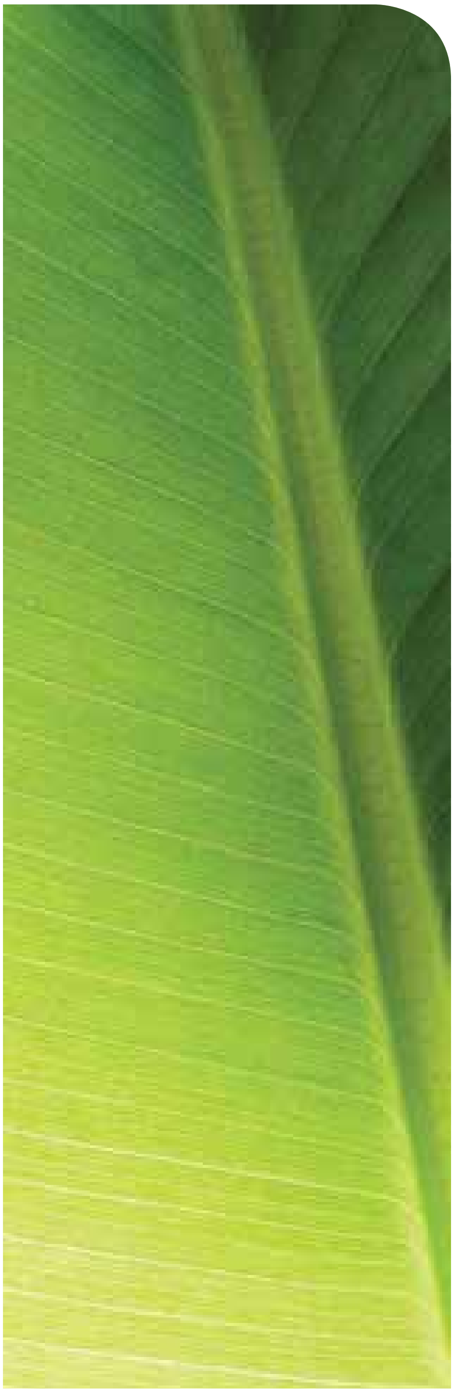
Your investment strategy

If you have a specific goal for the near future you may need to adjust your current investment strategy to meet it. To fund a short-term goal, such as the holiday in our example provided, you may need to start a regular investment plan, sell existing assets or divert cash to more liquid investments.

For longer-term goals, such as building wealth to support your chosen retirement lifestyle, you'll want to take advantage of new investment opportunities to maximise returns.

Different goals require different strategies so it's important to review your strategy regularly.

Your financial plan should always take into account both your short and long-term goals. If you're setting new goals, need help budgeting for them or would like to know more about maximising investment opportunities, talk to your financial adviser.



The art of giving

If you have a philanthropic nature, you'll know the satisfaction you can get from sharing with others. In this article we examine donations to charity, financial planning for your beneficiaries and splitting super with a spouse.

Donations

Giving money to a charity can be a reward in itself. The good news is the Australian Tax Office (ATO) also rewards donors by making some donations tax-deductible. So, for example, if your taxable income is $100,000 and you donate $1,000 to an eligible charity this financial year, you'll pay $370 less in tax when you claim the deduction. So your donation only actually costs you $630.

Any deduction you claim for a gift cannot add to, or create, a tax loss for you. To overcome this restriction the ATO allows you to spread deductions for certain gifts over a period of up to five years.

To be tax-deductible your gift must be made to a deductible gift recipient, so check the ATO website for eligible recipients before making any donations.

Financial planning for the younger generations

There will be an estimated $600 billion transferred from one generation to the next over the next decade. It's also estimated that each estate in Australia has an average of 2.7 beneficiaries[3]. Are you confident that your young beneficiaries will invest their inheritance wisely?

The earlier young adults learn to manage money, the brighter their financial future can be. So why not give them the gift of a financial planning session? You could give this as a Christmas gift or when a young relative starts work or starts a family.

Talk to your young relative before arranging a session with your financial adviser. After the first session, he or she should come away with a to-do list. That should include drawing up a budget to help reduce any debt and increase savings, and setting short and longer-term goals as a motivation.

Consider arranging a follow-up visit a year later. If your young relative has accomplished just one of the things on their to-do list, you can consider your gift a success.

Boost your spouse's super

Contribution splitting involves transferring certain contributions made into your super fund to your spouse's fund. You can split contributions made by your employer, salary sacrificed amounts and any personal contributions you may have claimed a tax deduction for.

There are a number of benefits of this strategy, particularly if you're thinking about retirement:

- If you and your spouse are aged between 55 and 59 and permanently retired, each of you can withdraw the first $160,000 of the taxable component of your super tax-free for the current financial year. By splitting your before-tax contributions with your spouse you can effectively double the amount of tax-free super benefits that you and your spouse receive before you turn 60.
- If you and your spouse will be relying on super to fund your retirement, splitting contributions with an older spouse gives your spouse earlier access to the super than you would have if it were kept in your fund.
- Centrelink will generally ignore super held by individuals who are under Age Pension age so you could manage your entitlement to benefits by splitting contributions with a younger spouse.

Your financial adviser can help you with strategies suitable for your particular circumstances.

[3] 'Philanthropy Focus: A New Era for Family Philanthropy in Australia': Goldman Sachs JBWere report published in the Australian Journal of Political Science (8 Feb 2010)

New Government, new direction?

After weeks of deliberation the Gillard Labor Government finally emerged to continue its leadership of the country. But as a minority, the Government will rely on support from the Independents.

Before the election, the Government had proposed some changes to Australia's financial landscape following the Cooper and Henry Reviews.

The Cooper Review looked into the governance, efficiency, structure and operation of Australia's superannuation system. The Henry Review examined Australian and State Government taxes, making recommendations to position Australia to deal with the demographic, social, economic and environmental challenges that lie ahead.

The Government's future of financial advice reforms were designed to improve the trust and confidence of Australian retail investors in the financial planning sector.

Pre-election proposals

In relation to the Cooper Review we know that prior to the election the Government had announced its intention to follow through on the My Super proposal in relation to the low cost superannuation fund for a majority of members in Australia who aren't actively engaged in managing their superannuation.

In July, Prime Minister Julia Gillard said the 'My Super' scheme would potentially lower fees by up to 30% and lift retirement savings for a 30-year-old worker by $40,000. This, combined with the Government's pledge to lift the compulsory super contribution from the current 9% to 12% by 2020, would mean workers could save up to $150,000 more for their retirement.[4]

The Government was also committed to banning commissions and the introduction of an annual 'opt in' arrangement for financial advice under its future of financial advice reforms.

A new direction?

The Labor Party does have a good working relationship with the Greens and the Greens are committed to the same level of reforms as the Government. While the Government intends to carry through with its pre-election agenda, it will be reliant on the Independents in the Lower House in order to get these proposals through.

The Government has confirmed past the 2010 election that it will continue to pursue its reform agenda in the financial services sector and have instructed Treasury to work towards its original timeframes, which includes targeted consultation with the financial services industry for the balance of 2010. We expect Treasury to conduct a further round of discussions with the general public early in the new year with draft legislation being released in the first half of 2011.

However, if the Independents aren't willing to back the Government on their pre-election proposals, we could see a totally new direction for the future of financial services in Australia. Stay tuned.

[4] 'Gillard makes pledge on low-fee super scheme': Emma Rodgers, ABC News, 1 August 2010

Spotlight on the Aussie dollar

Why is the Australian dollar so strong recently and what does this mean for investors?

In October 2010, the Australian dollar reached parity with the US dollar and levels not seen since it was first floated in December 1983. The move against other major currencies such as the Euro and British pound has been just as significant.

Strength in numbers

The Australian economy continues to grow faster than the rest of the world, and hasn't suffered to the same extent other developed markets did from the global financial crisis.

Australia is currently a great place to invest – for both domestic and offshore investors. With higher relative interest rates compared to the rest of the world, a cash rate and 10 year bond yield higher than other economies, Australia is very attractive for investors seeking yield on their investments, and that's created an increased demand for our currency.

There's also an ongoing demand for Australia's mineral and energy resources. While these investments are traded in US dollars, the by-product of the resources demand creates ongoing demand for the Australian dollar.

What it means for investments

There is always a 'currency impact' on the return from global investments because there are two components to the total return:

1. the return generated from the underlying investment
2. the return generated from the movement in the Australian dollar against that foreign currency.

Investors can 'hedge' investments ('lock in' the foreign exchange rate at which the returns generated from the offshore investments will be converted back into Australian dollars).

The performance of the hedged global equity market has been superior to that of investing in (unhedged) global equities over the six-month period to 30 September. This is because the exchange rate between, for example, the Australian and US dollars at the start of the period was lower compared to the value of the currencies at 30 September.

But a 'fully hedged' investment doesn't guarantee a higher return as it will depend on the movement of the Australian dollar over the investment period.

Winners...

The upshot of the strong Australian dollar means there are both winners and losers. The winners are:

Shoppers buying goods from overseas like electronics and cars. These items should be cheaper if retailers pass on savings from new stock. Buying online from the US and UK will be much cheaper.

Travellers overseas will see their holidays less expensive; they'll have more buying power for everything from hotels to shopping. If airlines pass on savings for fuel bought in US dollars, flights should be cheaper.

Importers will find supplies from overseas are cheaper. Businesses will either pass savings onto their customers or generate increased profits.

...and losers

Exporters such as farmers and winemakers will struggle as their goods are more expensive for overseas buyers. Companies operating overseas and bringing profits home will also lose out.

Manufacturers competing with and selling its products overseas will find business tougher.

Tourism operators will see fewer travellers choosing to come here as Australia becomes a relatively expensive destination. Hotels and souvenir shops will also suffer.

Educators – our universities could suffer as studying in Australia becomes more expensive compared to the US or UK.

Talk to your financial adviser about investments that are suitable for you, taking into account the current economic climate.

Market commentary

Financial markets returned into positive territory in the September quarter. With improving investor confidence, both equity and bond markets rallied whilst the US S&P 500 index recorded its biggest single month increase in over 50 years.

Economic overview — September 2010 quarter

Investor confidence returned during the September quarter with both equity and bond markets rallying providing a positive backdrop after the June quarter. However, world equity markets remain below the recent highs of April 2010.

Financial market volatility is set to remain high for an extended period as global growth moves through a transitory phase. The extent and speed of recovery in the US and other developed economies continues to hamper investor confidence and current economic data is providing mixed signals as to the strength of the global recovery.

Australia continues to be well-placed. Unemployment has bottomed, but the medium-term outlook remains positive. While inflationary expectations remain within target, the Reserve Bank of Australia raised the official cash rate by 0.25% to 4.75%.

Globally, inflation remains under control with accommodative monetary policy set to remain for an extended period.

Outlook by asset class

Australian shares

With continued concerns about the speed of a synchronised global recovery, we expect that market volatility will remain elevated. While market confidence declined at the back end of the quarter we expect that 'market lows' are now moving higher, providing some investment opportunities.

International shares

The outlook for the global economy remains mixed. While economic data was mixed over the quarter, trend growth remains positive, albeit at a slower rate. Employment growth continues to remain constrained. Growth in Asia has slowed, mirroring the broader macro backdrop.

Diversified property

While the outlook for the sector continues to improve, we continue to expect that the performance of the sector will remain constrained relative to 2009. Investment returns will be driven by yield and not capital growth.

International bonds

Global sovereign markets remain at multi-year lows, with the performance of the market at odds with equity markets over the quarter. While yields have the potential to move lower, we believe they will ratchet higher as we move through the cycle and continue to look expensive at current levels.

Australian bonds

Despite a solid domestic economy, bond yields have fallen in line with global bond markets on the back of concerns about the strength of the global recovery. With yields at current levels, we continue to believe that sovereign bonds are looking expensive, particularly relative to the yield on equities.

Commodities

While we expect that commodity prices have the potential to move higher over time, given the speed and extent of the recent rally, we expect some short to medium-term pull back.

Currencies

With favourable technical factors, we expect the Australian dollar to trade between the US dollar 0.90 – 0.95 over the short term. This is above our secular long-term view of the Australian dollar, so we expect that as the global macro environment improves, there is potential for the Australian dollar to depreciate.

The Australian dollar was up against all major currencies (except the Euro) for the quarter. The underlying strength in the Australian dollar now makes foreign investments 'cheaper' to finance and provides the opportunity for additional returns should the current level not be maintained over the medium term.

Disclaimer

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