

Is the bubble likely to shift?

In economic terms, the word 'bubble' describes assets that have artificially high prices and are therefore subject to being burst (or falling dramatically). In recent years, this phenomenon has been aligned to the housing market, and now that housing prices are easing, the query is whether or not the bubble is shifting to the share market.

We would argue that this is not possible, since the factors that have driven the housing market are quite different from the drivers of share markets. In the housing bubble, prices soared primarily due to the ready availability of money – usually either mortgage loans or inherited funds. So it was not that property values were rising, it was that people had greater access to money and were competing for prime realty (especially seaside) by bidding higher and higher. Other factors in the property boom included government grants, exemptions for welfare benefits for a primary residence, and low interest rates.

In the share market, most of those factors are not relevant. People rarely borrow money to invest in shares – although gearing is becoming more popular – to the same degree as they borrow for housing. Most of the investment in shares is by institutions, Super Funds, and individuals with surplus funds. With, for example, the 9% Employer Super Contributions constantly flowing in there is naturally a constant demand for shares. And the number of available shares on offer is reducing due to company buybacks and fewer company floats.

The interest rate on loans does not reduce the amount of money available for share purchases. Interest rates only affect the share market insofar as investors assess the risk/reward equation – is the return on fixed interest better than the total return on shares? While the Australian share market is relatively small, there is scope for lots of diversity, which is the key to sound investment strategies. The Government benefits are not about grants or exemption from pension deeming, but rather the taxation benefits due to Franking Credits – which many investors value highly as a means to reducing personal income tax.

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Is the bubble likely to shift? cont...

So, if the basis for any bubble is supply and demand, we would contend that shares are in limited supply and the demand is steadily growing as investors, institutions, and Super funds have more available cash. In addition, most companies have used the good operating conditions of late to reduce debt, improve Balance Sheets, and generally be better propositions for investor confidence. The valuations of both the property market and the share market seem to have defied gravity in recent years, but the essential difference is that the share market has rebounded from depths of despair with improved market conditions, better corporate behaviour, and higher investor confidence. On the basis of all the factors that can be forecast and analysed, there seems little doubt that shares are fairly valued at present and, while growth may not continue at the same pace as in 2004, do not appear poised for any major correction.

DON'T WAIT

Do not wait until the last minute to arrange Spouse Contributions, Co-contributions or other Super strategies. Contact your FAS advisor so that you will not be pressured on 30 June to take last minute steps. Please do it now!

DON'T WAIT

Strategies to keep pension entitlements

The introduction of Term Allocated Pensions in 2004 was a further step in the Federal Government's Retirement Incomes Policy that encourages people to preserve benefits so that dependency on welfare is reduced.

Many pensioners are having their entitlements reduced as the impact of market performance over recent years increases deemed assets. While extended deeming provisions introduced in the 1990s was a great improvement in the planning process for pensioners, there is still a fundamental flaw – pension assessment is based on past investment performance. Therefore, under the assets test, most investors will have a higher value than last year, which is going to reduce their pensions this year. Then, as the value of a portfolio falls due to withdrawals (or even losses) the pension will not increase until that is reported next year.

Your FAS advisor is always up-to-date with CentreLink and DVA matters, and is able to adjust investment affairs in anticipation of pension impact – thereby creating a smoother income flow. So if you are experiencing fluctuations in your pension entitlements, make an appointment to discuss your situation to determine action that might make your income a little more stable.

"Never invest your money in anything that eats or needs repairing."
Billy Rose



Performance is just the cream

Superannuation has undergone many changes over the years, with one of the most significant being the obligation to contribute being shifted from employees to employers. Add to this the impressive investment returns of recent years, and there is now a generation of workers who expect that employer contributions and investment earnings are going to automatically provide them with a comfortable nest-egg for retirement.

Conventional wisdom would suggest that success is 90% perspiration and 10% inspiration. In financial terms, this adage reminds us that sufficient retirement resources are mainly the result of personal endeavour and sacrifice, rather than other factors like investment earnings. Yet some people approach retirement age with a fear of underachieving financial resources, and they look for investment earnings to make up for a lack of personal contributions (especially in the important decade leading up to retirement), to make up for drawing on Super pre-retirement (to finance business or private ventures), or to make up for a lifestyle beyond the provisions made.



Some people expect investing to do more than it is designed to do – investing is an activity that is designed to build an existing portfolio at a rate greater than inflation, thereby increasing the purchasing power of a nest egg. Even though there have been some brilliant investment returns, it is not realistic to expect investment earnings to compensate for inadequate funding, premature drawings, or a lifestyle that is inconsistent with the level of funds held. It is intended to be the cream on the cake, not the cake itself!

FAS advisors are qualified beyond simply investing funds. They are fully acquainted with methods to build retirement savings through strategies that might include schemes recently introduced by the Federal Government as an encouragement to Australians to save more towards their own retirement. So if you would like to explore the benefits of co-contributions, spouse contributions, or other funding methods (without necessarily sacrificing current lifestyle), call your FAS advisor for an appointment soon.

Transport now a retirement budget issue

Macquarie University has recently undertaken research into transport issues for retirees, with some interesting results.

According to the researchers, baby boomers (those born between 1945 and 1960) are much less likely to swap the use of their cars for public transport in retirement. This is largely due to the fact that baby boomers are the first group of people to have grown up with a reliance on the motor vehicle to cope with urban sprawl. Also, these people are living longer and healthier and so are able to hold their licenses for more years. And they are wealthier than previous generations so have the financial capacity to maintain a private vehicle – or two in many cases. All this is making them much more mobile, with a greater propensity to join the SKI Club (Spending Kids Inheritance) by also using caravans and mobile homes.



Retirement for baby boomers is filled with learning experiences, part-time or voluntary work and varied recreational activities, as well as taking care of the grandchildren while the children are working. These numerous activities result in patterns of transport that are more demanding than public transport timetables can cater for, and hence make today's retiree quite car-dependent.

Busy lives are best serviced by having your own car, and just because a person is retired does not mean that they have any less need for convenience, flexibility, control, and timesaving benefits that only a car provides. The relevance of this is that retirees need to factor into financial plans the cost of owning, servicing and fuelling at least one vehicle, to say nothing of the cost of remaining healthy enough to continue holding a drivers license.

One of the many advantages that your FAS advisor can bring to your benefit is the experience of others in similar situations, and also to recognise the importance of funding for vehicles well into a person's 80s and even 90s.

Hearts of Gold



The recent tragedies of the Asian tsunami and the Eyre Peninsula bushfires have met with a huge response from the Australian community – government, companies and the general public alike. Yet a number of long-established charities within Australia are now anxious about the degree to which that giving is going to diminish donations and in turn impact on their programs.

Most Australians have a regular list of charities that they support regularly, and we would like to think that the huge donations to the recent tragedies was giving above and beyond – that the regular giving will continue. In a healthy society, giving is a virtue. Charitable organizations rely on Government funding for about one-third of the \$5.5 billion expended by all charities (although this amount is only 6% of total expenditure on social welfare and charity payments by government). More than 800,000 Australians over the age of 14 years get involved in charities to the tune of \$2.5 billion per year. The remaining third comes from corporate donations and fund raising activities.

There are many views about charities. One of the most common is criticism about administration costs. However, the fact that Governments inject such a large amount to charities reflects their confidence that charities are generally equipped to handle many community needs far more efficiently than bureaucracy can. Another is that there are far too many charities in a country the size of Australia, and that they try to do too many things that dilute their effectiveness in key areas. Yet the challenge is to consolidate and rationalise charities for operating efficiency while at the same time stopping them from turning into immovable bureaucracies that gobble up too much in administration costs.

As this process is unfolding, Australians continue to demonstrate their willingness to help others by donating funds to the less fortunate. Tax concessions may help to stimulate donations in emergencies, but are rarely the only reason for giving even though it creates a win-win proposition. Philanthropy in different forms is now a feature of many people's financial plans, and FAS will be pleased to help clients in this worthy pursuit.



Rising Interest Rates-good news?

The Governor of the Reserve Bank, Ian McFarlane, in a speech on February 18th forecast rises in interest rates when he noted that far too much money has flowed into property speculation and not enough into increasing productivity or improving infrastructure.

Rising interest rates are a method of controlling debt levels. As noted in the last edition of News and Views, household debt has now increased to 140% of household income, almost 3 times the level of a decade ago. It serves as a poignant reminder to consumers for a reality check. The permissive financial climate that has characterised the past decade is ending, and with it the property bubble. We will need to accept a period of more subdued growth, begin working to pay off debt rather than absorb it in increased property valuations, and reallocate resources to production rather than just consuming passions.

It is interesting however, that the media focus when interest rates rise is purely on borrowers – there is never a mention of the benefit for long-suffering depositors. Many people now in the 60s endured the exceptionally high mortgage rates of the early 1980s and 1990s, and now get a pittance for their savings. So at least higher interest rates will result in good news for depositors getting a fairer return on their savings.

CHOICECHOICE

Super - the dilemma of choice

The Federal Government has introduced legislation to take effect from 1 July 2005 that provides many employees with the freedom to choose their own Super fund. For many employees, the dilemmas associated with having some control over their Super will be stressful.

Firstly, it is expected that the majority of people will elect for the default option – usually a balanced investment fund. They will not have the expertise to choose for themselves an investment option that is commensurate with their situation, needs, and objectives. They will not understand the risks that each option carries, and while they will continue to be naively happy during periods of high returns, will be surprised and annoyed when the economic cycle brings occasional negative returns.

Secondly, many people have an unhealthy attitude towards Super because of its complexity and regulatory controls. It is surprising how many people believe that Super is an investment, when it is truly just a regulatory provision for taxation and other relief as people save for retirement.

Thirdly, while the range of options will initially be wide, there will undoubtedly be rationalisation in due course. It is expensive to run Super Funds, and more so when the number of small balance accounts is huge. More accounts will usually mean lower average balances, and that means higher costs on a pro rata basis. So having a wide range of options will lead to higher costs, which in time will lead to some options being closed because they will become unviable. Then people will have to make another choice about where to place their Super.

One of the core roles of FAS advisors

is to provide advice that helps client make well-informed decisions. The new Super environment that will exist after 1 July 2005 will not diminish the need for quality, unbiased advice – on the contrary, it will substantially increase the demand for such services. Our pledge is to help clients with these (and other) decisions in a way that provides comfort and understanding – and in turn a peaceful night's sleep!



International shares looking sound

Since the tech-wreck of 2001, and the resultant weakening of the US share market and the US dollar, Australian investors have preferred to keep their funds predominantly within our shores. During the last half of the 1990s, International Shares were the outstanding performer, with returns well in excess of any other asset. It was sad that many people 'shut the gate after the horse had bolted' by investing overseas too late – failing to appreciate that currency fluctuations had a huge impact on performance, and that basing investment decisions on past performance is never an option. Hence, the view of many people to International investing is tainted by poor timing and unfortunate results.

The situation is now the reverse, and while we still do not want to use past performance as a future indicator, the outlook for International investment appears quite positive. With the first year of a newly elected administration, much of the uncertainty that affects investor behaviour has been removed. Sustained economic growth is supported by low interest rates, strong company Balance Sheets, and employment growth. The US share market has been rather subdued in recent years, with resultant valuations now at reasonable levels. Finally, the exchange rate of the US/Australian dollar has reached a level where there is likely to be a positive effect on returns rather than negative.

Many Fund Managers operating in Australia have overseas parentage or connections – all of them with expertise that can add to client benefits. While we remain confident that positive returns are promised for both Australian and global shares during 2005, we feel that each client might review the mix that exists within their portfolio and a view to capitalising on likely improved International performance.

Client Survey Client Survey Client Survey

We are keen to ensure that our client services are consistent with expectations, and invite clients to let us know their views on our resources, services, facilities and processes. To that end, we have commissioned an independent firm to conduct a random survey of clients over coming months. So if you are contacted for that purpose, your identity will be kept anonymous, and we hope that you will be open and constructive in assessing FAS.

Even if you are not contacted, you are always welcome to give us your opinions about FAS and those opinions will be respected. *Thank you.*

