



# Personal Wealth



Summer 2009

A Quarterly Newsletter for

**Lifespan Clients**

## Markets Waiting for the Economy to Catch Up

Continued signs of an improving global economy have driven major rallies in worldwide equity markets. In Australia, the equity market (S&P/ASX 200) hit a 13 month high of 4,859.9 on October 15. Up until then it had risen for 7 consecutive months before falling 2.1% in October. The improving outlook was reinforced by the Reserve Bank of Australia (RBA) which has again revised growth estimates higher for the local economy. For instance, the growth estimate (GDP) for the year ending in 2010 was increased to 3.25% from 2.25%. Also unemployment which was tipped to exceed 8% only 6 months ago now looks likely to peak at far less than 7%. In fact Australia has been one of the standout economies in the developed world.

### Interest Rates Heading Higher

In our last note we said that we thought that we have seen the low in short term interest rates. This proved to be correct with the RBA raising interest rates on 2 occasions to 3.5%. Current interest rates are still regarded as stimulatory by the RBA which has indicated it wants to withdraw this stimulus. We expect a gradual rise in short term interest rates to more "normal" levels. Our best guess is that short term interest rates will be between 4.5% and 5.0% by late 2010.

### It's All About Earnings

Australian equities rallied over 54% from the March lows to be up about 21% in the year to the end of October. However at their mid October peak they were looking fully priced at over 16 times 2010 earnings estimates. It would be fair to say that market had gotten ahead of itself and it subsequently fell about 7%. As we said in our previous note, at current valuations we believe equities are now closer to fair value than representing outstanding value.

We believe the market will probably drift higher over the medium term but this will depend on earnings growth actually coming through. Analysts have high expectations of over 20% earnings growth in 2011. If earnings disappoint then so will the equity market. **The major positive since our last note is that we now seem to be in an earnings upgrade cycle, i.e. equity**

**analysts are increasing their earnings estimates for Australian (and global) companies.**

Since the stock market now depends on increased company earnings to drive performance, the gains going forward are expected to be more muted than recent gains. That is to say, the 'easy' gains have now been made and we think we are now in a more normal investment environment. The chart shows the ISM survey of manufacturing activity in the USA (in blue) which has been rising. More to the point it also shows (red line) that analyst earnings estimates in the USA are now rising after a steep fall.

One note of caution for Australian equities is that our dollar has risen about 10 cents, from \$0.83 to \$0.93 against the US dollar since our last note. This will be a drag on companies with overseas earnings. Tactically investors may want to increase

their allocation to global equities since you are now getting more for your dollar.

Australian listed property (ASX 200 REITS) suffered a fall of 9% in October. One reason for this is that the estimated 2010 distribution yield for REITS was not sufficiently far above the 10 year bond yield. The estimated distribution yield for 2010 is now about 6.7% (UBS). We would still not chase listed property at current levels.

We still remain cautious on fixed interest as an improving global economy and large deficit spending should lead to rising bond yields and lower prices. Australian 10 year government bonds were largely unchanged from the previous quarter at about 5.6%. However we still think it is likely Australian 10 year government bonds will be yielding over 6% in 2010. Fixed interest returns for the last year were 4.89%, well down on the 15% returns we saw earlier in the year.



Source: Perpetual and Morgan Stanley as at 21 September 2009.



## Bottom Line

There are still risks, particularly in the US as that recovery is very tentative. While the markets are now returning to a state of normality, the flipside is that valuations are also higher. Given the size of the recent rally, we would not be inclined to be aggressive with equities at current levels as returns are expected to be much lower over the next 6 months. Investors should instead dollar cost average into the market over a period of time, and also take advantage of any volatility to add to positions. Above all you should remain diversified.

## Investment Returns to October 31, 2009 (%)

Asset Class	1 month	3 month	1 year	3 years	5 years
Australian Shares	-2.1	10.9	21.4	-0.5	8.8
Global Shares	-4.1	-2.7	-14.5	-11.1	-1.5
Listed Property	-9.0	15.9	-7.3	-21.1	-6.6
Fixed Interest	-0.1	1.37	4.9	6.3	5.7

Source: van Eyk

## Identity Fraud and You

Were you aware that in 2008 Australians lost \$1 billion through fraud? The Australian Bureau of Statistics indicates that over 380,000 Australians were caught by credit card fraud last year.

All of us need to review our own security arrangements to ensure that our identities and our security details are protected from scammers looking for an opportunity to make an easy killing.

There are several steps that you will need to consider:

The first step is to make sure that your

account numbers, user names and passwords are securely stored and known only to you. The way you structure your passwords is important. Avoiding common passwords such as birthdays, spouse name, home telephone number, and home address are common strategies. Always try and create an alpha numeric password that is unique.

Consider what you do with personal and confidential documents and how they are disposed off. Dumping them into the bin could be asking for trouble as it is not uncommon for fraudsters to go through bins looking for confidential information.

When using internet sites for purchases, ensure that the sites are adequately protected. Avoid going to websites to purchase items that appear to lack adequate security protection.

I have lost count of the number of times I have received e-mails from my supposed bank asking me to verify my account details. Just hit the delete button.

Internet fraud is on the increase and if you are not careful you could be one of the next unsuspecting victims.

## It will never happen to me!

We all hope the nasty things won't happen to us, but what if something did? These people held the same belief until...

**Patrick** started his own business servicing computers last year after working for a major company for many years. He loved the freedom and control it gave him. Unfortunately a truck ran into his car and he received a severe whiplash injury. He couldn't work for two months and the loss of income made life hard for his young family. He didn't think to arrange income protection insurance to replace the sick leave he had with his ex-employer.

**Paul and Sue** worked hard to reduce their mortgage, and once they had some equity in their home they used it to borrow in order to buy an investment unit. It was tenanted and had the potential for long-term capital growth. Sadly, Paul died suddenly from a stroke. On a reduced income Sue couldn't afford to keep paying the interest on the investment loan. The unit had to be sold quickly at a loss. They did not think to increase Paul's life insurance when they borrowed for the unit.

**Karen** is successful in business and prides herself in managing her personal finances well. She has a well-diversified portfolio of property and shares. Last year she contracted breast cancer and her work was disrupted with tests and hospital treatment for over five months. She has now recovered but the medical bills made a severe dent in her finances so she was forced to sell some excellent shares at short notice. Karen did not know that trauma insurance would have paid her a lump sum if she was diagnosed with a critical illness.

### Three important lessons from these cases.

Firstly, the unexpected can happen to anyone.

Secondly, take the time to review your insurance arrangements at least once every year. Note if there are changes in your circumstances – new job, new loans, family changes, etc.

Thirdly, talk to Your Lifespan Adviser. There are many different choices in insurance and it pays to have a specialist analyse your needs and find the most cost-effective solution for your circumstances.





## Retirement trends of the future

Over the last few decades, we have seen many employees take a package, retire from work and disappear off into the sunset – fishing, golfing, travelling - fulfilling their dreams. The prospect looks attractive when you reach the right age. But hold on – maybe the working world as we know it has changed. Already there is proof that early retirement may be a thing of the past.

Firstly, employers are starting to be concerned about a “skills vacuum” – there won’t be enough working people to keep businesses and the economy prospering. Access Economics has estimated that in the 2020s, Australians will only produce 125,000 new workers in the entire decade. At present, the workforce grows by 170,000 jobs a year! Who will fill the extra thousands of jobs?

Secondly, governments are concerned about affordability – we need more taxpayers to support social services, health and aged care programs.

Lastly, some early retirees have realised that there may be more to life than 35 years of fishing and golf!

These issues are not unique to Australia ... many developed countries are searching for solutions to exactly the same problems. These solutions are likely to involve a stick and carrot approach. For example, making superannuation inaccessible until age 60, and there have been proposals to increase the age when the pension is payable. With the massive restructuring in the 1980-90s, there is now less scope for employers to offer “retirement” packages.

As far as carrots are concerned, some early retirees have recognised the advantages of staying in the workforce by running their own businesses, consulting or contracting out their services. Businesses are looking for more creative employment practices to entice workers to stay on.

For example, you could phase into retirement by working part time or working full time in a job with lower responsibility, or taking time off for travel or education before returning to work again.

One of the financial advantages of phasing into retirement is that you keep earning income so your retirement savings will last longer. The social advantage is that it allows you more time for your favourite hobbies, also being active is better for your health and well-being.

Individuals who would like to reduce their working hours while limiting the impact on their cash flow situation should consider implementing a transition to retirement strategy. This uses your superannuation assets to supplement your employment income. We recommend that you consult with your Lifespan Adviser to find out how this strategy can benefit you.

## When to Refinance - Deferred Establishment Fees

### Why Consider Refinancing

As lenders improve their loan products there are options to refinance and save interest on your home and investment loans. Savings can amount to hundreds and even thousands of dollars per year and one of the best ways to accelerate the reduction of your home loan balance is to make extra repayments. If the savings you make are directed back into the loan as an additional repayment, you will reduce the life of your loan and the interest charged over time. Refinancing to a cheaper rate or more appropriate product can also free up cash flow for investments. You should speak to your Financial Planner about these opportunities!

### What to Consider when Refinancing

Typically, lenders do not make a profit on loans for the first few years. As a result, Deferred Establishment Fees (DEF's) are charged if a new loan is paid out in full or refinanced within the first three to four years from the settlement date. Each lender varies in the way DEF's are applied to loans and in recent years there has been a trend toward a flat fee (anywhere from \$700 upward), as opposed to a percentage of the loan amount, which in the past has been the favoured method of charging the fee.

Deferred Establishment Fees are quoted and published at the time of loan enquiry and are confirmed in the Lender Loan Agreement, they should be considered when selecting a new lender or considering a refinance. While most borrowers stay with a lender for more than the three or four year period, the average life of a loan (before refinance) is decreasing and DEF's should be considered so that they can be avoided where possible.

Some loan products do not have DEF's, so if you think a loan may only be required for a shorter period, let your broker know and the most appropriate products can be presented to you.

The key to refinancing is to ensure the product and lender you are moving to will offer a more suitable loan for your situation, and that any costs incurred are offset by the savings which will be generated.





# Tips to Pay Off Your Mortgage Faster

If you take out a mortgage, chances are that you will have it for a while. Here are some simple tips to help you pay it off as quickly as possible!

## Professional Package Loans

Professional Package loans usually carry an annual fee (fees vary from lender to lender) which will cover all banking costs including phone and internet banking, offset account transactions, and an annual credit card fee. Professional Package loans may provide a discount on the interest rate, and the savings from having all facilities under one package can outweigh the annual costs for the package.

## Consolidate

If you are carrying high levels of Credit Card debt you can potentially save money by consolidating this debt into your home loan. Credit Cards traditionally have much higher interest rates than home loans, so 'dollar for dollar' you are paying more interest on credit card debt than home loan debt. The money you are losing on your credit card expenses could be going onto your loan as an additional repayment, and paying the loan off faster.

## Switch to a lender with a lower rate

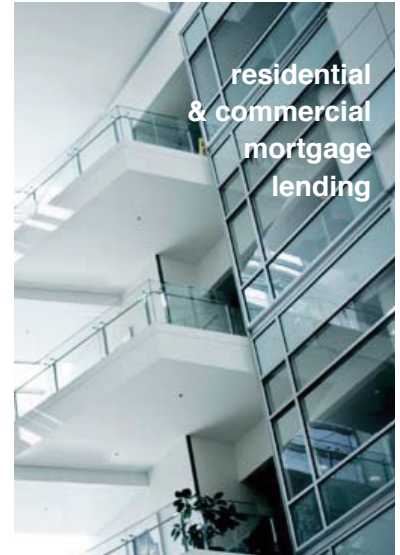
Lenders change rates and products from time to time. Provided there are no Deferred Establishment Fees or penalties to leave, there may be an opportunity to save money by switching to a cheaper lender, or more appropriate loan product.

## Link an Offset Account

Talk to your Financial Planner or Quay Finance about a Mortgage Offset account. Offset accounts allow you to reduce the interest charged on your home loan by depositing your salary and savings into an account linked to your home loan. The savings you hold 'offset' the interest which is charged on the loan account.

## Win the lottery!

It's tough to plan for, but proves to be very effective if you get it right!



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Level 1, 20 Loftus Street Sydney NSW 2000, PO Box R686 Royal Exchange Sydney NSW 1225

Tel: 02 9252 2000 Fax: 02 9252 2330 Email: info@lifespanfp.com.au Website: www.lifespanfp.com.au

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