

Winter 2008



Time for investors to keep CALM

With concerns around oil, inflation, the US housing market and sub-prime woes investor sentiment has certainly taken a turn for the worse. As a result share markets around the world have dropped marking a dramatic end to a volatile Financial Year. During this period the media have continued to pump out negative stories that sensationalise current events. Whilst no one likes seeing their nest egg decline in value, investment markets unfortunately do go through these cycles. Provided you have a high quality, diversified portfolio the best strategy is to stay calm and not panic.

How to stay CALM in this environment

Media sensation sells: Running stories with graphs of red lines plunging down means good business for the media, but unsettles everyone else. By spooking people with headlines the media can influence people to make investment decisions they may not otherwise have considered.

Look beyond the share price: The general consensus is that the economic fundamentals of the Australian economy are sound and companies are profitable. Investors should look at the company and whether it has sound management practices and positive profit forecasts. Often good companies can get over sold during times like these. Remember excellent companies are not in abundant supply in the Australian market and their prices can turn quickly once confidence returns.

Focus on the quality of your investments and the income they generate: There is a view that as long as you are investing in good quality shares with strong balance sheets and focus more on dividend yields, movements in share prices are irrelevant. Shares have historically shown growth over the long term. Shares paying dividends will continue to add value to an investor's portfolio.

Accept risk: To achieve a higher return than cash over the longer term, there will be negative returns from time to time. Since 1982 the Australian sharemarket has produced, on average, a negative return every 6 1/2 years. What we are experiencing now is the painful part of a normal investment cycle.

Retirees should fund their income stream payments from their income investments: Volatility in share markets creates concern for investors, especially retirees who receive regular payments from a retirement income stream such as an allocated pension, transition to retirement pension or term allocated pension. To preserve capital when shares are suffering we usually recommend that these clients maintain sufficient amounts of funds in income investments such as cash and mortgage funds. This allows retirees to draw on these income investments for their regular income payments—ideally for a period of 6 months to 3 years, leaving the shares intact for when the market recovers.

Diversification: Diversifying amongst and within asset classes helps reduce your risk and the impact of ups and downs in any one particular asset or asset class.

Long-term approach: Investors with a long-term objective should take a long-term view. Investing in growth assets such as shares and property pays off over the long-term. These investments are designed to meet long term objectives, not to make a quick buck.

Stay the course and don't get spooked: One of the main issues with volatility is that it is unpredictable, and sometimes irrational. Investors should not get blown off course by volatility in investment markets, but stick with their long term strategy. Investors who maintain their exposure to shares through thick and thin, will find that their patience is rewarded in terms of growth to their portfolio over the long term.

Don't panic: Perhaps the worst thing to do, during these volatile times, is panic and pull out of the share market, making paper losses into real losses. While it's a natural reaction to want to sell investments during market down turns, investors should pause and think. Markets continually fluctuate, but over time they trend upwards. By staying in the market investors can ride out the lows and access its potential growth when it recovers. Markets can move quickly and if you are not invested for the full period you can miss out on the eventual recovery.

Sharemarkets always go through rough patches, and sometimes they are deeper than anyone would like. However history also shows that over time, markets rebound and the patient investor is likely to reap the rewards in the long term.

Can Superannuation Funds Borrow?

In recent months there has been a lot of media coverage about the ability of superannuation funds (including self-managed super funds) to borrow money to invest.

By way of background, many superannuation funds have historically invested in financial products known as installment warrants. These products involve the payment of a deposit followed by the balance being paid at an agreed later date. The very nature of an installment warrant means the investor has entered an arrangement with the promoter of the installment warrant that involves borrowing money.

Under superannuation legislation, superannuation funds are prohibited from borrowing money except in a number of very limited circumstances. In order to cater for borrowings associated with installment warrants, a new "installment warrant exemption" was introduced into superannuation law effective from 24th September 2007.

This has become particularly appealing to people who operate their own self-managed superannuation fund (SMSF).



As the law currently stands, a superannuation fund may now borrow money for the purposes of acquiring assets. However the scope of the changes in the borrowing rules requires very strict adherence to a number of specific conditions.

In broad terms, the SMSF is able to borrow money to acquire an asset, provided:

- The asset to which the borrowings apply are held on trust for the super fund,
- The super fund has a right to acquire the asset on payment of the final installment,
- The lenders recourse is limited to the asset to which the borrowings apply, and not the other assets of the super fund.

Because of the complexity of the rules, it is essential to seek advice before borrowing, we would be happy to assist you in this area.



We would like to remind you that we are always available to discuss any issues relating to you or your family's financial well being.

Also, feel free to recommend us to any friends or family members who you believe may benefit from our professional financial advice.

The outlook for investment markets

Asset class	Short-term prospects
Listed property	The Australian real estate investment trust (REIT) sector has been severely beaten back from overvalued levels following the near collapse of Centro Property Group. Nevertheless, pockets of value remain. For example, uncomplicated office trusts (exposed to recovering office markets, especially in Sydney) and select retail stocks representing significant value. On the whole, however, the sector continues to trade around fair value and investors may be better served by the significant discounts on offer with global REIT's.
Residential property	Residential property remains sluggish after the exhaustion of the nationwide housing bubble and the impact of rising interest rates as the economy approaches full capacity. We continue to expect house prices to remain sluggish as the "irrational exuberance" of recent years and high house-price to disposable-income and rental ratios continue to make their inevitable adjustment. Whilst limited supply has propped up the residential market, inflationary concerns have pushed the Reserve Bank of Australia (RBA) to a much tighter than expected monetary stance. This may cause some near-term pressures.
Cash	Rising interest rates are now making cash rates look relatively attractive at 7.25%. Whilst the RBA has paused on further rate hikes for the time being, a high march quarter inflation figure suggests that further increases cannot be ruled out quite yet.
Bonds – Australian and international fixed interest	The recent increase in non-government bond yield reflects a more realistic return premium for investors. With most of the rise in yields behind us and company balance sheets generally in good shape, selected corporate bonds offer good value.
Australian shares	The Australian sharemarket has fallen from its November highs as the ripples from sub-prime crisis in the US began to be priced in. The banks have borne the brunt of the sell-off. Banks' reputation as defensive investments has lost some of its glamour, though they are in much better shape than their US counterparts. At the same time, banks are also benefiting from the crisis with borrowers turning to them once again as confidence in mortgage lenders and wholesale money markets wanes. The benefits of widening profit margins and wealth management should become evident in the medium term once the current crisis is over. Meanwhile, resource companies have been almost completely immune to the crisis as the China boom rolls on. Unsurprisingly, quality industrials with strong market positions and pricing power have generally had the best results during the reporting season.
International shares	Global sharemarkets continue to grapple with the sub-prime fallout and Western world financials have yet to put the crisis behind them. Whilst write-downs have exceeded \$200 billion in this sector, financial losses could still reach \$400 billion once the full extent of the US housing downturn is factored in. Outside of the financials bubble, many global companies represent extraordinary value. Attractive investments include companies with strong market positions that are pursuing policies of higher dividends, share buybacks or sensible growth strategies. European stocks remain relatively inexpensive, although the full force of sub-prime and the soaring Euro may yet take their toll. Meanwhile, Japan represents a relatively safe-haven for investors looking to shield themselves from the global credit bubble, especially given Japanese consumers and companies remain relatively debt-free. Asia, Eastern Europe and South America remain attractive markets for long-term investors with an appropriate risk appetite.

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