

InvestWell with Financial Lifestyle Managers

WARNING: DON'T CONFUSE FINANCIAL MARKETS WITH THE ECONOMY!

And remember: the share market invariably recovers before the economy does.

Financial and economic outlook for 2009

As at January 2009

Felix Stephen, Senior Investment Strategist at Investment Solutions, shares his outlook for 2009 and explains why he thinks that the worst appears to be behind us, and 2009 looks set to see some optimism restored, with markets expected to show positive, albeit modest, returns.

The outlook for 2009 is cautiously optimistic. Global central banks and governments have been quick to act in their efforts to try to stem the fallout from the US sub-prime crisis. Interest rates are at or near historical lows, and authorities vow to do whatever is necessary to restore confidence in the financial system. Government stimulus plans are in place and are constantly being expanded. The impact of these measures is very likely to be felt by the middle of 2009.

Global growth is anticipated to be around 2% in 2009, from an estimated 3.7% in 2008. Emerging economies will be the key drivers of growth, growing at around 3.7% for the year. Advanced economies are expected to lag behind, contracting at -0.7%. For Australia, growth is expected to be a modest 1.3%.

Financial Market Outlook

Australian shares: The ASX 200 Australian equity market index is expected to trade within a 3400 to 4300 range, with a fair amount of volatility during the first six months of 2009. We expect the market to shift into a higher 4300 to 5000 range during the second half of 2009 as global and domestic growth traction becomes more visible. There is a strong possibility that the index could move into a 5100 to

5900 trading range around early to mid-2010 as global growth accelerates, thanks to strong policy initiatives implemented by authorities.

International shares: We anticipate the US S&P 500 index trading in a range between 800 and 1100 over the next six months and an eventual upside breakout to shift the index to trade in a 1100 to 1450 range. A similar pattern is likely to be established in most major global equity markets. On a regional basis, it is expected that the European stocks are likely to outperform the US. The weaker Sterling Pound is likely to support UK stocks relative to European stocks while Japanese stocks should move in tandem with the US market initially and then gather upward momentum with economic growth traction being gained in the Asian emerging economies. Emerging market countries with financial flexibility and policy credibility, such as China and Mexico, should perform well while Central Europe, Korea, India and Indonesia are likely to be laggards.

Diversified listed property trusts: It is likely the global listed property market will offer relatively good value for investors in the short to medium term due to the relatively attractive distribution yield on offer. However, there could be concern that the subdued economic outlook and the increased cost of capital will have a negative impact on the asset class. While an equity market rally will no doubt be supportive of listed property securities, declining direct property values and the increased cost associated with rolling over existing credit facilities will eventually have a heavy negative impact on the asset class.

Global property securities should offer better value relative to domestic listed property through efficient diversification and country allocation that results from uneven economic growth and varying earnings outlook across the world.

International bonds: We expect global sovereign bond yields to move higher sometime during the second half of 2009, taking the US bellwether 10-year note to reach around 4.0% to 4.25% levels during the sell-off. A rise in yields of around 2.0% to 2.25% from present levels is consistent with similar moves in the past. Most global bond markets are likely to suffer when safe haven capital flows that have been parked in Government bonds are reversed, particularly when financial institutions add risk to their asset base or banks recommence extending credit to their customers.

This is the quarterly magazine of:

**Investwell with
Financial Lifestyle Managers Pty Ltd**

Level 2, 552 Lonsdale Street,
Melbourne, Victoria 3000

plan@investwellfp.com.au
www.investwellfp.com.au
advice@flm.com.au
www.flm.com.au

***You don't need to be wealthy to invest.
You need to Invest Well to be wealthy.***

Financial and economic outlook for 2009 cont.

Australian bonds: Australian bonds, such as global sovereign bonds, are vulnerable to a sharp sell-off some time during the second half of 2009. The Australian 10-year bond may reach the 5.0% to 5.5% level during this sell-off. It is possible that the bond curve will “Bear Steepen” while the spread of 10-year US Treasuries may narrow from the present 2.0% level to around 1.5%.

Alternative assets: Broadly, absolute return, multi-strategies, market neutral equity strategies, equity long/short, global infrastructure, convertible arbitrage, credit long/short and fixed income arbitrage, etc, would fall within this category. These strategies have the capacity to deliver “alpha” that is not usually correlated to other major asset classes and are excellent risk diversifiers. However, we are cautious on this asset class and would urge investors to be ultra-vigilant when employing such strategies, ensuring that such strategies are liquid, transparent, and that they are managed by institutions with strong balance sheets.

Commodities: The view on the commodity complex in the medium to long-term remains positive. We expect that once global economic growth gains some traction and growth visibility emerges from the prevailing doom and gloom, commodity prices should accelerate higher. The prevailing commodity prices could be a good entry point to this asset class or, if already invested, it is an asset class that should be re-weighted higher. On specific sectors, agriculture and livestock should perform well in the short term to be joined by energy and industrial materials in the medium to long-term.

Currencies: Broad weakness in the US Dollar would imply that the Australian Dollar is most likely to appreciate against the US Dollar and even against the Euro and the Japanese Yen. Watch for a modest depreciation against the Sterling Pound from current levels. It is likely that the Australian Dollar will remain modestly strong against emerging market currencies in the early part of 2009 and then gradually depreciate against them as the emerging economies gather strength. ✿

Source: Focus issue 19, St George Margin Lending

Industry super fund returns under pressure

The performance gap between industry superannuation funds and their retail counterparts is likely to narrow as the economy – and property values – deteriorate, experts argue.

In 2008, the average super fund lost a record 22 per cent of its value, but industry funds outperformed master trusts by 6 percentage points, up from about 2 percentage points in previous years.

Research firm Chant West attributed the industry funds’ relative success to their large holdings of unlisted assets, reigniting concerns that not-for-profit funds are failing properly to revalue investments in unlisted assets such as property, hedge funds, and infrastructure.

Despite a 39 per cent plunge in the benchmark S&P/ASX 200 and a 57 per cent fall in the local property index in 2008, the net asset value of unlisted property funds was unchanged, while infrastructure assets rose slightly.

While the average unlisted property fund did decline five per cent in the three months to December, the director of investment strategy at Russell Investment, Andrew Lill, predicts the value of unlisted property assets could fall by up to 30 per cent by June this year.

Listed assets are unlikely to fall by the same degree, which should mean that equity-laden master trusts should perform relatively better.

Chant West principal Warren Chant said he thought the performance gap between the master trusts and industry funds would close.

AustralianSuper deputy chief executive Mark Delaney agreed that valuations for unlisted assets were likely to fall further: “The trend is for lower valuations, particularly given

the likelihood of very weak economic conditions over the next six months,” he said. “I wouldn’t expect the six percentage point gap to be sustained.”

Industry funds invest in an average of 25 per cent in unlisted assets, and some as high as 60 to 70 per cent, against 7 per cent for master trusts, according to Chant West.

Mr Lill also warned that industry funds’ dynamic asset allocation strategy had not yet stood the test of a complete investment cycle. ✿

Source: The Australian Financial Review, 10 February 2009.

INSURANCE NEEDS HIGHLIGHTED

As uncertainty continues in investment markets, many Australians are focusing on insurance to give them peace of mind that their families have some financial security.

But the majority of Australians are still underinsured and the need for adequate insurance cover has been highlighted following the devastating fires that swept across country Victoria in February.

When we have a home and income, and our families are comfortable, it’s easy to think that nothing can happen to take away this security. February’s events show how quickly and unexpectedly lives can be shattered.

If you think you may be under-insured, talk to your financial adviser to arrange adequate insurance cover.

Is it over yet?

This is the big question investors around the world are putting to their financial planners.

After a year of pain where the S&P/ASX 200 Accumulation Index finished down 28.4 per cent and the MSCI World Index returned -24.9 per cent, investors are asking their planners some hard questions and they want to know whether they can expect further anguish ahead.

As MLC investment strategist Brian Parker notes, “There is no point in sugar-coating it to clients – this is the worst financial crisis the world has endured in 75 years.”

But despite the dire performance of markets last year, almost nobody is prepared to predict when this bear will head back into its cave. However, the experts do believe the year ahead will offer better opportunities.

“We are closer to the bottom than we were three months ago,” said Lincoln Indicators CEO Elio D’amato.

Glen Franklin, an associate director at research house Zenith Investment Partners, believes trying to choose the low point is pointless. “We never try to pick the bottom of a bear market and we believe it is not realistic to try,” he said.

Light at the end of the tunnel?

The market volatility and rapid downturn in 2008 has left even the experts surprised. In his year-end review, AMP Capital Investors head of investment strategy and chief economist, Dr Shane Oliver, admitted he did not expect ‘anywhere near the severity or the duration of the panic that occurred’. He believed markets would improve in the second half of 2008.

The unexpected nature of the crisis has left market-watchers wary, even as governments around the world continue to pump massive amounts of fiscal stimulus into slowing economies.

On average the return over the three years directly following the end of a bear market was 62 per cent (or 17.4 per cent per annum). A large proportion of this return came in the six months directly following the end of the bear market.

“The global economic outlook for 2009 comes with much greater than normal uncertainty,” Oliver said. “Pressure to reduce debt levels means that there is a risk the economic slump could drag into 2010, but an unprecedented global policy response suggests that it’s more likely to see a gradual recovery become evident by the end of 2009.”

The volatile geopolitical environment and increased interaction between a globalised world are also making predictions difficult.

“Everyday we are closer to the end, but it depends on what

happens in the US and when confidence returns,” Franklin said. “Hopefully the worst is over, but there are still surprises coming through. So until confidence returns, the market is not going to turn.”

Parker believes governments hold the key. “The bear market will end when people become confident that policymakers have done enough, and the market becomes cheaper,” he said.

Franklin hopes there may be light at the end of the tunnel. “We are 14 months into a bear market, so we like to think that we are closer to the end than the start,” he explained.

History provides only a rough guide to what is likely to happen in the months ahead. A study by Zenith into the six bear markets (a decline of 20 per cent or more over at least a two-month period) since 1969 found the average decline for each was 37 per cent and each one lasted 16 months on average. Once the bear market ended, on average it took 33 months to exceed the previous market high and the return over the three years directly following the end of a bear market was 62 per cent (or 17.4 per cent per annum). According to Franklin, an important statistic for planners and their clients to remember is that a large proportion of this return came in the six months directly following the end of the bear market.

“For those investors that temporarily allocated away from shares to cash and missed the 28 per cent share market return in the first six months of the market recovery, their average total return in the three years following a bear market would drop dramatically from 62 per cent to 35 per cent (or 10.5 per cent per annum),” he explained.

Continuing volatility

While the white-knuckle fear displayed by markets in October 2008 appears to have subsided, investors expecting things to return to the smooth ride of the last decade are likely to be disappointed.

Most experts are predicting ongoing market volatility and continuing surprises as companies take the opportunity to make further ‘confessions’ in the upcoming reporting season. “The first quarter of 2009 will exhibit volatility as investor confidence recedes in the face of weaker forecasted earnings from companies,” D’Amato said.

Parker agreed: “Even in a mild recession you get a big fall in [corporate] earnings.”

With the local economy slowing, D’Amato believes things are likely to appear worse before they get better, but pointed out that the market is already factoring in “depression-like conditions in its pricing”. “We expect to see more bad news than good, and we may retest the lows, but we are now seeing proactive action by governments. The market will take comfort and it shows someone is at the helm”.

Is it over yet? cont.

Oliver also believes the picture may appear darker in the months ahead before improving in the second half. “Further downside in equities and credit is possible in the first half of 2009, but both should end the year stronger than now. Having outperformed listed assets over the last year, unlisted assets may be relative underperformers over the year ahead,” he said.

Great opportunities

While considerable caution remains, many believe the market rout has created terrific bargains, especially for investors with a longer-term investment horizon. For brave investors, D’Amato believes the current market environment offers great opportunities to buy quality stocks. “Despite the fact that global markets are unlikely to recover their pre-credit crunch position in the near future, we expect the market to rally in 2009 as the stock market presents a ‘once in a lifetime’ opportunity for the long-term investor,” he said.

Franklin agreed there are bargains to be had. “Valuations are quite attractive relative to where they were,” he noted. “Bear markets are a good opportunity to buy into the market at a cheaper price than in the past.”

D’Amato believes large cap stocks will lead the market recovery as investors become more confident the worst is behind them. “Many of these companies often exhibit softer landings and quicker rebounds given their diversified exposures,” he explained. “Stable dividend payouts and low market prices also make many of these companies attractive for income investors, particularly in an environment of falling interest rates.”

Investment managers will also have a chance to show they are worth their fees. “This is the time when active managers should be really shining and picking out those companies that will succeed,” Parker asserted.

Although there are bargains around, investors and their advisers will need to do careful research to determine which investments are likely to thrive in the tougher economic conditions. “While there are fundamental reasons for the share price declines of many companies, there are others that have only fallen in sympathy. Therefore, the issue at hand is to identify the stocks that are best positioned to both survive through our current crisis and recover when market conditions improve,” D’Amato said.

“Now is a good time to look at quality companies whose price has fallen in nothing but sympathy with the broader market.” ❁

Source: Janine Mace, Financial Planning magazine, February 2009.

IS THERE ANY GOOD NEWS OUT THERE?

Oil and food prices have dropped; there is coordinated central bank action to revive the credit markets; and governments globally are providing fiscal stimulation packages.

Domestic demand in Australia is dropping, which takes the pressure off inflation and gives the Reserve Bank the flexibility to lower interest rates, which is good news for homeowners paying off a mortgage.

Disclaimer:

Material contained in this publication is a summary only and is based on information believed to be reliable and received from sources within the market. It is not the intention of Frank Blundell, Louise Parker, Michael Russell, Ben Crowe, Monica Lip, Heidi Schwegler or Investwell with Financial Lifestyle Managers Pty Ltd (IFLM) (ABN 71 131 424 550) that this publication be used as the primary source of readers’ information but as an adjunct to their own resources and training. No representation is given, warranty made or responsibility taken as to the accuracy, timeliness or completeness of any information or recommendation contained in this publication. Frank Blundell, Louise Parker, Michael Russell, Ben Crowe, Monica Lip, Heidi Schwegler and IFLM will not be liable to the reader in contract or tort (including for negligence) or otherwise for any loss or damage arising as a result of the reader relying on any such information or recommendation (except insofar as any statutory liability cannot be excluded). This publication has been prepared for general information and not having regard to any particular person’s investment objectives, financial situation or needs. Accordingly, no recommendation (express or implied) or other information should be acted on without obtaining specific advice from an authorised representative. Past performance is not indicative of future performance. For legal and taxation matters, we recommend you seek advice from a suitably qualified professional.

Disclosure:

In the event of any person subscribing for any financial services referred to in this publication, such subscription may result in Frank Blundell, Louise Parker, Michael Russell, Ben Crowe, Monica Lip, or Heidi Schwegler receiving a commission, fee or other benefit or advantage. Precise details of any such benefits can be obtained from Frank Blundell, Louise Parker, Michael Russell, Ben Crowe, Monica Lip, or Heidi Schwegler who are authorised representatives of Securitor Financial Group Ltd ABN 48 009 189 495 AFSL 240687.



Frank Blundell, Louise Parker, Michael Russell, Ben Crowe, Monica Lip, and Heidi Schwegler are
Authorised Representatives of
Securitor Financial Group Ltd ABN 48 009 189 495 AFSL No 240687
Level 7, 530 Collins St, Melbourne VIC 3000

