

FINANCIALLY SPEAKING

A SEASONAL NEWSLETTER FROM LONSDALE FINANCIAL GROUP LIMITED



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< Keeping cool in a market crisis

Economies and markets are often affected by unexpected economic, political or natural calamities, like the current US sub-prime mortgage crisis. So how should investors approach these events?

Stay calm

Don't panic. History tells us that events – however catastrophic – are soon swamped by the longer term trend. The chart below shows what we mean. It shows the performance of international sharemarkets (MSCI World Index) since 1987. As you can see, a whole range of events – the 1987 crash, the Asian currency crisis, the Russian bond market default and September 11 – have all been blips on the long-term ascent of sharemarkets.

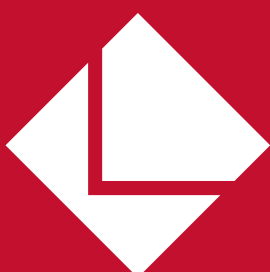
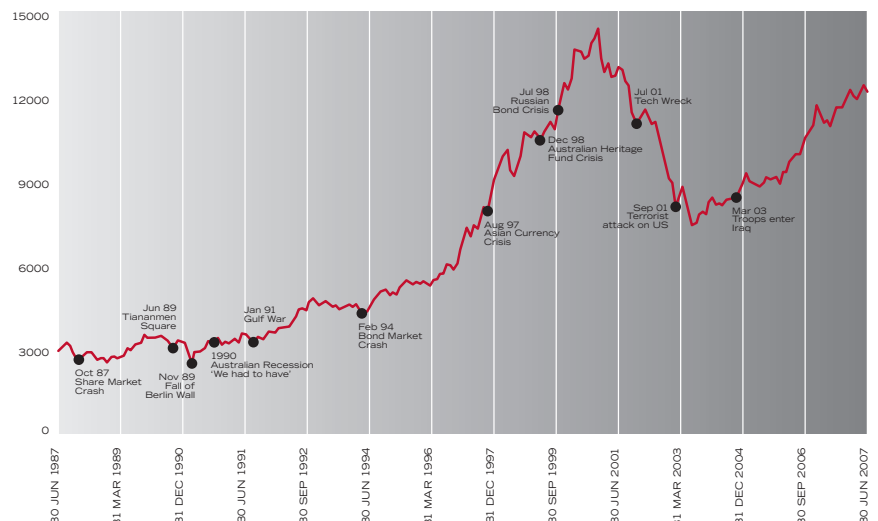
This chart illustrates how important it is for investors to think long term when crisis strikes. There is compelling evidence that panic selling is bad for your wealth in the short term as well.

Plunge, then bounce

After the terrorist attacks on 11 September 2001, US markets stayed closed until 17 September. In the five days following the re-opening, the S&P 500 index fell 11.6%. In a warning against short-term panic, legendary investor Warren Buffett said, "Whatever you thought about the stock market before the World Trade Center is what you should be thinking now".

CHART

Impact of key market events on global shares since 1987



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LONSDALE FINANCIAL GROUP LIMITED
 ABN 76 006 637 225
 AUSTRALIAN FINANCIAL SERVICES LICENSEE
 LICENCE NUMBER 246934

◀ Keeping cool in a market crisis continued

As usual, he was right. By 15 October, the S&P 500 and the NASDAQ indices were back near their 10 September levels. Investors who panicked simply crystallised losses rather than protecting capital.

Sharemarkets do react, often sharply, to crises. Yet they tend to snap back quickly as investors reassess the real economic impact of these events. During the Iraq invasion of Kuwait in 1990, the S&P 500 dropped around 5% within a month. Within six months, the market was up almost 16%. Within a year, it had leapt 26%.

Coping with crisis

Economics, nature and human nature being what they are, we will undoubtedly face another market-mauling crisis in the future. Yet we know that over the long term, the effect of these crises will fade. In the late 1980s, the Asian economies were the scourge of world markets. Today Asia is the key to rising commodity prices, cheaper consumer goods and one of the reasons Australia's share market has been booming over the past two years.

Yet there are still sensible precautions any investor can take to deal with a future crisis. The most important is to have a financial plan – a written document that reminds you why you're investing, what your objectives are and how long you plan to invest for. Such a plan is the perfect antidote to the tendency to panic, a reminder that long-term investors have nothing to gain from short-term reactions.

Understand risk

Coping with crises such as those outlined above should form part of your risk management plan. By understanding risk, you will be in a better position to manage it in times of calamity – plus benefit from risk over the long term.

One way to manage economic and political risk is to diversify your investments across different types of investments. Both the initial impact and repercussions of a major event will affect each type of investment differently. Property, fixed interest and shares may react differently to the prevailing economic and political conditions. By investing in a number of different markets, you reduce the effect a fall in one market has on your overall portfolio.

Your financial planner can assist you in planning for your future. Call your financial planner today.

SOURCE: BT FINANCIAL GROUP



Seasonality or volatility?

Seasonal patterns in listed markets are commonly recognised over long term market cycles. Every now and then, other forces come into play and trends can turn upside-down. Our portfolio managers reveal where they think seasonal effects are heading this year and what type of investment strategies they will focus on.

Shares and the 'January effect'

The regular ebb and flow of investor demand for shares relative to their supply through the course of the year frequently yields seasonal patterns. The 'January effect', where January typically provides the best gains for US stocks is well known. Dr Shane Oliver, Head of Investment Strategy and Chief Economist at AMP Capital Investors, highlights the key drivers:

- US investors selling underperforming stocks to realise tax losses (to offset against capital gains) towards the end of October, their tax year. Capital raisings and, consequently supply, are normally solid at this time.
- US investors buying back in November and December when capital raisings are often winding down into year end.
- The tendency for US investors to invest their bonuses early in the New Year, refocus on the future, put any past disappointments behind them and down-play bad news, all at a time when capital raisings are still relatively low.

Indeed, the January effect is part of a broader seasonal pattern that is positive for US shares from around October to May, with January often the strongest month. In recent years, anticipation of the January effect has caused buying to move forward into December, pushing up end of year returns as well. From 1985 to 2007, the US share prices for December and January have each produced an average 2% monthly gain – a much higher return than the average monthly gain of 0.9% across all months over the same period.

Although December and January usually provide above average gains, the January effect is not as strong in Australia. The most likely reason is that we have a different financial year to the US. Australian share markets, until recent years, have been inclined to weaken during tax loss selling in June and subsequently strengthen in July.

Disruptions ahead

Shane Oliver warns that with all the recent market volatility, this is one year when seasonal patterns are likely to be overshadowed or even reversed. Late 2007 failed to produce the usual 'Santa Claus' rally. Poor US economic data saw markets tumble over November and December, with falls continuing into January. Shane expects continued high volatility in the first half of 2008, especially for shares, which may see markets weaken further. But by the second half of the year, they should settle down, helped by a bottoming in the US housing market and lower US interest rates.

Interest rate cuts are also expected in Europe and Japan. This should restore brighter economic prospects in these markets toward the end of 2008 and into 2009, and may help reestablish the usual seasonal share market patterns. The main risk to this scenario is the US presidential election. Normally the electoral cycle produces reasonable gains in shares during the election year but if the incumbent loses, markets can react negatively as investors are generally not open to change.

Seasonality in listed property

Seasonality trends influence listed property markets as well and in most cases they share the same patterns as Australian equities. Globally, August stands out as the quietest month for property markets generally, with investors and fund managers in the Northern Hemisphere out of the market and on holidays instead.

One pattern unique to the Australian listed property market is the distributions paid in June and December. Due to the significant yields at which listed property trusts trade, the market traditionally sees increased demand in the weeks leading up to the distribution payment as investors chase income. Arguably, this effect has become more pronounced in recent years due to greater numbers of yield-focused investors, especially from Japan. However, as with shares, seasonal patterns failed to emerge this time around. The underperforming Centro Properties Group sparked off a wave of volatility in listed property markets in the lead-up to Christmas 2007, wiping out any potentially positive seasonal forces. While Centro's poor performance won't necessarily affect other Australian listed property trusts over the course of 2008, the situation has created greater market uncertainty.

The first half of 2008 is likely to be reasonably challenging. The sub-prime issue is far from over, with low liquidity in credit markets putting upward pressure on borrowing costs and downward pressure on listed property trust prices. However, later in the year, lower interest rates in the US and Europe should help improve investor confidence and reignite merger and acquisition activity. All of these have the potential to stimulate market confidence both domestically and globally.

< Seasonality or volatility? continued



Bonds behave differently

There are no definitive seasonal patterns for bonds, either government or corporate. Demand drivers in bond markets are mainly policy-based or marked by changes in interest rates. This year bond markets rallied over the first few weeks of January. However, as the probability of recession in the US increases, together with the anticipation that growth will slow in Australia by the second half of the year, we may see bonds put in a reasonable performance during 2008.

Investing during market volatility

Although empirical evidence suggests that seasonal patterns in markets do exist, their unreliability and inexact nature means that it is difficult to trade on them successfully. And, as discussed, every now and then economic and market events can completely overshadow seasonal effects. Seasonality or not, what does all this mean for our investment strategy during this current uncertainty? Two elements that certainly stand out during periods of severe volatility are caution and quality.

Shares

During a cyclical bull market, we're comfortable buying shares during market dips or corrections and then letting the rally run its course. More volatile conditions tend to mean investors sell and take profits more opportunistically. This would normally result in taking a more defensive position within our portfolios.

However, Michael Anderson, Director of Sustainable Funds at AMP Capital Investors, emphasises that adopting a more cautious and defensive position is proving more difficult than normal. In the past a typical defensive portfolio would include sectors like REITs (Real Estate Investment Trusts), telecommunications, consumer staples, utilities, banks and healthcare. In this current downturn, a number of these sectors have been compromised by the credit crunch due to investor fears over higher borrowing costs and reduced credit availability.

Michael says a sector to watch in 2008 may be resources which he believes will continue to benefit from an industrialising China. The world's limited ability to rapidly step up commodities production, further strengthens this sector's attractiveness.

However, while potential takeover activity continues to be a positive factor for resources, the US downturn and its effect on global growth and commodities demand is a risk factor in limiting resource stocks' performance in 2008.

Listed property

For our listed property portfolios, we continue to maintain defensive positions in terms of our regional allocations and stock selections. This means being overweight Australia and maintaining a solid position in North America, the two most mature property securities markets. We are also overweight Asia in order to benefit from the strength of their direct property markets while keeping a close eye on any after-effects from a slowdown in the US economy.

Although underweight, we maintain selective positions in Europe and the UK and will be watching carefully for any value bounce or merger and acquisition activities. Any growth opportunities will be carefully monitored. We tend to favour the more defensive sectors or those which are less dependent on economic growth, such as healthcare and selected retail stocks.

Our focus continues to be those companies with high quality income streams, premium assets and well-respected management teams. Our detailed analysis includes the type, level and structure of borrowings – factors that have recently received increased attention from the markets. Increasing financing costs will generally impact profitability and potential growth prospects and that's definitely something to watch for.

Bonds

Globally, interest rates are expected to come down in 2008. In the Australian market, though, there is the risk of one last interest rate hike. So strategically, we are avoiding one-year securities and focusing on three to five-year securities. Over ten years, the outlook is uncertain so we will remain underweight the longer term bonds. On the credit side, we are still cautious over corporate debt but believe selective value does exist.

Direct assets

Shane's view is that infrastructure and private equity provide some of the few hedges from falling financial markets. While unlisted property is also looking strong, particularly in Australia, it's important to be aware of both higher capitalisation rates (or yields) in response to higher borrowing costs, putting downward pressure on property prices. This is particularly true for lower quality property sectors and assets.

< The age gap may help spouses take advantage of some super benefits

Are you lucky enough to have an older or younger spouse?

If you are lucky to have a spouse who is older or younger than you, perhaps a super splitting strategy is worth considering, even under Simple 'Better' Super?

The age gap can be an advantage when planning your super. Splitting super may help maximise retirement benefits and provide an avenue for spouses to share creatively in superannuation benefits.

Since 1 July 2007 super benefits are paid tax free after age 60. This means that you no longer have to consider accessing two separate reasonable benefit limits (RBLs) and the advantage of two low rate tax thresholds remains only for members who are aged between 55 and 60 when they receive their super benefit. So why would people still consider splitting super with their spouse?

The answer is simple. People may be able to increase age pension entitlements, it may allow access to more tax free income sooner, or enable spouses to top up their super when they experience employment breaks.

Increasing your age pension entitlements

✓ An older spouse may qualify for a higher age pension

By splitting super to a younger spouse to shield assets from Assets Testing, you may qualify for a higher age pension entitlement. Assets held in super by pensioners and allowees who are between 55 and age pension age are exempt under both the Income and Assets Test.

Access tax free income from age 60, sooner

✓ A couple with a spouse who is aged 60 or over

In the case of a couple with one partner aged 60 or more, splitting contributions to the older spouse may enable earlier access to tax free income. This is because effective from 1 July 2007 super benefits are paid tax free after a person attains the age of 60 and retires.

This strategy can help increase the total income a couple is living off simply through splitting their contributions to the older spouse. The younger spouse splits their contributions with their older partner who once attaining the age of 60 is able to access these additional contributions earlier and tax free. This may benefit the couple by effectively reducing their overall assessable income.

Top up you spouses super

✓ Your spouse has less super than you or needs super to cover relevant insurance premiums

Most couples have significantly different superannuation balances due to different work patterns.

Women in particular often experience breaks in their employment through child bearing as an example, and therefore their superannuation also experiences a break from ongoing contributions. A spouse can help adjust this situation through super splitting adjusting for the time a woman has not been earning an income.

Another benefit of super splitting is that if insurance is held through a spouse's super account, splitting contributions to that spouse can then be used to fund ongoing insurance premiums, regardless of whether that spouse is contributing to super, or not. There is also the option of taking out additional cover without worrying whether benefits will exceed concessional tax limits.

A super splitting strategy may also be of particular benefit to low income or non working spouses by allowing them to control their own super and have their own income in retirement.

Some legislative risk

Though super splitting is still a relevant strategy available under the Simple Super system, as with all superannuation legislation there is a risk that the rules could change in the future under this or a new government, so speak with your financial planner.

SOURCE: MARINER FINANCIAL LIMITED



< The 5 big trends shaping your long-term

Trend No. 1

China and other developing economies

For more than a decade the American consumer has been the most important driver of world economic growth. Yet according to Morgan Stanley Chairman, Stephen Roach, while US consumption currently totals over 19% of world GDP (at market exchange rates), their share is falling. International Monetary Fund (IMF) Deputy Managing Director, Takatoshi Kato recently commented¹ that “emerging markets are the engine of growth” and this year, for the first time, China will be responsible for the largest part of the increase in global growth.

BT Chief Economist, Chris Caton, says there is still a lot more to come from China. While significant, China’s growth is not unprecedented. Both Singapore and Taiwan were growing more rapidly at the same stage of development.

But this is more than a China story. Emerging Asia, Africa, Central and Eastern Europe and the Middle East all posted high levels of growth for the past six years. While many investors once steered away from emerging markets because they thought them risky, failing to invest in the world’s fastest growing markets may – in the long run – be more risky.

Trend No. 2

The US economy

The current uncertainty and volatility in the market continues to spread. Major US banks including Citigroup, Wachovia and Morgan Stanley have written down significant sub-prime mortgage debts. Financial market unrest and falling house prices could cause US consumers to stop spending, dampening both US and global growth.

Falling investor confidence in the economy and mounting concern over both the US current account and Government deficits has seen the US dollar nosedive this year. This not only weakens the competitiveness of exporters in Europe and Australia. It may also lead to a re-alignment of global currency markets (the world’s highest paid supermodel now wants to be paid in Euros!). This trend could have major long-term implications if the world moves away from using the US dollar as its ‘reserve currency’. (The US dollar is used to price major commodities like gold and oil and many Central Banks hold significant US dollar reserves).

Trend No. 3

Renewable energy

Both the price of oil and the costs of reducing carbon emissions are growing and pushing up energy prices. As a result we’re seeing increased investment in renewable energy. According to the Intergovernmental Panel on Climate Change, if the carbon price rose to around \$50 per ton², the market share of renewable energy could double. We have already seen a rapid increase in the amount of money being invested in renewable energy and energy efficient industries – growing from US \$80 billion in 2005 to over \$100 billion in 2006³.

Companies who specialise in energy efficient technologies or have taken strides to adapt to these changes stand to gain substantially. Interestingly, just as many big companies harnessed the power of the internet to beat the dotcom upstarts, the big oil firms have made some of the largest advancements in renewable energy technology. Perhaps paradoxically, they may benefit from a world where carbon has a cost.

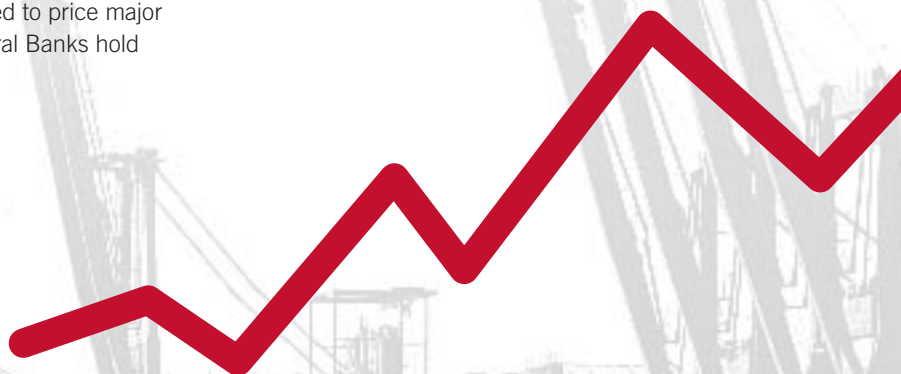
Trend No. 4

Choice of investment structure

Most of the developments driving investment markets are out of our hands – while we can follow them and invest accordingly, there is little we can do to influence them. What you can control, however, is your approach to investing. By structuring your investments in the most efficient manner, you may boost your long-term returns significantly.

We have recently had some of the most dramatic changes to Australian superannuation legislation in a generation. For people aged 60 and over there may be some significant tax savings as lump sum or income stream payments from a taxed source are tax-free.

By making better use of the new ‘simpler super’ environment, you may get better access to your money and achieve higher returns on your savings because super is often a more tax efficient investment vehicle.



returns

Trend No. 5

Technology

Robert Solow won the Nobel Prize in Economics in 1986 because his 'Solow growth model' proved that technological progress drives economic growth.

Technology also affects *how* we invest. Modern technology has created a whole new realm of products and approaches to investing. The growth of alternative investments is a case in point. The growing use of sophisticated trading methods in hedge funds now makes it possible for ordinary investors to enjoy positive returns even in falling markets.

The rise of boutique investment managers is also partly the result of new investment technology that allows small firms to compete with funds management behemoths. Companies like BT are now working to capture the benefits of both styles. BT's new multi-boutique investment structure offers investors the flexibility and innovation typical of boutique managers whilst retaining the security and service benefits of a big investment firm.

Of course, its important investors don't get caught up in technology hype. No matter what technology you apply, markets will always have the final word. Yet used wisely, enhancements to investment technologies can make investing safer, easier and more effective.

The global investment environment is constantly changing and these long term trends can fundamentally shift the outlook for economies, markets and returns. While investing for the long-term is your best chance of success, investing is never static. It requires constant research, discipline and professional advice, so speak with your financial planner for more information.

SOURCE: BT FINANCIAL GROUP

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- 1 IMF World Economic Outlook: Globalization and Inequality, October 2007, executive summary page XV.
- 2 United Nations Environment Programme (UNEP), Press release – Investors Flock to Renewable Energy and Efficiency Technologies, June 2007.
- 3 'Challenges to the International Monetary System: Rebalancing Currencies, Institutions, and Rates' Presentation by Mr. Takatoshi Kato, Deputy Managing Director, IMF, Salzburg Global Seminar, Salzburg, Austria, September 30, 2007.

'She'll be right' attitude great – but leaves Aussies underinsured

Australians feel less threatened than most other people in the world when it comes to life risks such as serious illness, accidents and disasters according to a global report released on 10 October 2007 by life insurer AXA.

The 2007 AXA Protection Report is a global study that compared attitudes to life's risks and rates of individual insurance take-up between Australia, Belgium, France, Germany, Hong Kong, Italy, Japan, Spain, Switzerland, the United Kingdom and the United States.

The report found Australians know they're taking life risks but don't like thinking about them and are underinsured against them. It also showed two in three Australians are fully aware that their level of insurance coverage is either inadequate or nonexistent.

Asked which serious life accidents might happen to them, Australians were the least concerned in 8 out of 10 categories including serious illness, serious car accident, serious financial problems, domestic or sports accidents, unemployment, natural disasters, work accidents and terrorism.

The survey showed that 64 per cent of Australians are failing to adequately insure their most important asset – themselves. On average, we are underinsured by \$112,000.

Michael Rogers, General Manager Financial Protection at AXA says: "We are taking on more and more debt in Australia with our mortgages, cars and credit cards. Serious accidents and illnesses do occur and it's important for Australians to think about how they would protect both themselves and their families if they couldn't repay their debts."

Clinical psychologist John Cheetham says this report should challenge our long held attitude of 'she'll be right mate'.

"Our laidback culture shines through in this report. Much about Australia's carefree attitude to life is admirable but when it starts to affect our families and our lifestyle, it can develop into something that looks more irresponsible and financially hazardous.

"Underinsurance may well challenge the psychological health and wellbeing of many Australians.

Unlike house and car insurance, life insurance isn't protecting something tangible, so the risk isn't as obvious as a scratch on the car or the house being broken into," he said.

Cheetham says those under 35 years of age in particular are blissfully ignorant about hard economic times; "If you entered the workforce after 1992 you would have never experienced a major

< ‘She’ll be right’ attitude great – but leaves Aussies underinsured continued

economic downturn, hence their positive outlook on life and the economy,” he said.

Another key finding was the false sense of security that Australians have when it comes to their insurance needs and reality.

“Most of us think about insuring the major bread-winner but if something was to happen to the primary carer of the home, the financial consequences are often dire,” he said.

Although the survey found the level of underinsurance globally was a concern, Australia was the most adequately insured in the survey.

“The first barrier to protection insurance products is simply that people never thought of getting insured. Surprisingly the cost of insurance is not the barrier.”

Mr Rogers points out that life insurance is less expensive than most insurance products we take out on our cars, homes and health.

For a 40-year-old non-smoking male to take out \$500,000 of life insurance, it would cost \$7.85 a week and for a female it is even cheaper at \$6.36, but for a home valued at \$600,000 insurance can cost between \$17.30 and \$24 per week and for a standard new vehicle anywhere between \$12.10 and \$26.90 per week.

“Like all types of insurance, life cover can give you peace of mind, but it is alarming to discover the number of Australians who don’t consider protecting their lives,” he said.

“Many of us have a minimum level of cover through our employer, but in most cases this is not enough because it does not take your personal circumstances into consideration,” he said.

The report also identified the ‘trigger points’ when life insurance is considered, such as getting married or buying a house. It showed that Australians only tend to think about financial risk when they assume a high level of responsibility, for example 17 per cent once they buy a house and 16 per cent when starting a family.

John Cheetham said: “It is sad to see that only a small percentage of Australians think about financial risk. Unexpected events in our lives create accelerated levels of anxiety and re-evaluating our financial protection is a very practical way of helping to alleviate anxiety in troubled times.”

The survey also found:

- When asked what they cared about most, health was the number one issue for Australians and for the 10 other countries surveyed, followed by lifestyle in retirement and home ownership
- Asked about which life accidents might occur to them, serious illness topped the list
- Australians were more active than respondents from any other country surveyed, 54 per cent said they exercised to stay healthy
- Australia is the only country to show a distinct pattern of discussing life risks with third parties over family and friends when compared to the global average. 33 per cent said they would talk about life risks with a financial adviser, third behind France and the United Kingdom
- 60 per cent of Australians said they had a will, well ahead of the UK (49 per cent) and the US (48 per cent).

SOURCE: AXA



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