

## Market update

Happy New Financial Year? In recent weeks we've watched share markets weaken all over the world, with the exception of a few emerging markets. At the time of writing, the Australian share market is down more than 14% and will almost certainly record its worst performance in 26 years.

And there wasn't much, if any, money to be made in other asset classes. There was, in a sense, no place to hide, except in cash. For the year, even balanced funds are likely to show a negative return, and it's been six years since we've seen that happen.

What's past is prologue, of course. What can investors expect in the year ahead? Perhaps the first thing that we need to do is to look at the factors that made 2007/08 such a poor year, and try to figure out how important they still are.

### 2007/08 financial markets in retrospect

In my mind, three clear problems (admittedly with some overlap) beset financial markets last year. It all began with the sub-prime mortgage crisis in the US. This morphed into an extraordinary dislocation of credit markets, and into major problems for the US financial sector.

More recently, markets have had to grapple with the implications of the levitating price of oil, both directly and because of its effects on overall inflation (and hence potentially on interest rates).

Thirdly, the US economy has weakened significantly, which is never good for share markets.

So where do we stand on these issues? I have written about them all in the not-too-distant past, so some of this

will read like revision, but what better time for that than the end of a year?

### Where to for sub-prime, oil prices and the US economy?

First, I continue to believe that the Federal Reserve is "on top" of the financial-sector issues. There will still be foreclosures and falling house prices, but the worst of this issue is past.

Second, I remain agnostic about further substantial rises in the oil price. Some of the rise in the past year must be speculative, the fundamentals of supply and demand simply haven't changed that much. So I wouldn't be surprised to see a significant fall in oil prices (and at the pump!) in the near future, although oil is unlikely ever to be cheap again. If this turns out to be correct, then inflation will eventually begin to fall, both in Australia and abroad. That said, the peak effect of oil, and food, on inflation has not yet been reached.

That leaves the state of the US economy, and that's not getting any clearer. If one looked only at the labour market (six months of falling private-sector jobs and a one percentage point rise in the unemployment rate in the past year), one would have to conclude that the world's largest economy was in recession. Other indicators such as industrial production and consumer confidence have also been at recessionary levels. But total output continues to grow, helped in part by the weakness of the US dollar, which has stimulated growth.

### The good news: markets love recoveries

For some time, I have thought that the recession in the US could well be mild ('U shaped') in which case that may well have been the low point in markets in mid-March. Note that even if this is the case, until greater clarity emerges, market volatility will continue but the trend should eventually be upwards.

I have also thought that the biggest risk to this view was that the US economy takes a further turn for the worse (the recession is V shaped), in which case the low point in share markets is probably still ahead of us.

I now think there is another risk; that the economy struggles along in a weakened state, with analysts still uncertain whether to call a recession for several months yet (a saucer shape). If this eventuates, then markets will continue to wander aimlessly for some months.

There is, however, some good news. Every US recession has ended (I looked that up!), and just as markets hate recessions they love recoveries. Whether it's a U, V or saucer, there is almost certain to be a recovery some time in 2008/09, which augurs well **eventually** for investment returns.

In the past seven economic recoveries in the US, their share market has averaged 33% growth once the bottom has been reached, and ours has probably done about as well. For various reasons, I wouldn't be inking that sort of performance just yet, but I am reasonably confident that the second half of this New Financial Year will be better than the first half!

Chris Caton, BT Chief Economist

### Some quick facts...

- Early in 2008, there was concern the 'credit crunch' and a weakening US economy would lead to a significant slowdown in global growth.
- The outlook for global growth now appears better than anticipated, helped by continued strong commodities demand from emerging markets.
- However, strong demand for commodities (particularly oil) means strong commodity prices – a key contributor to upward inflationary pressures.
- Combating rising inflation has now become a key concern for the world's central banks.
- Rising volatility has seen the Australian share market fall 10% in the 11 months to 31 May 2008. Markets have continued to fall during June.

- Market volatility has affected all markets, not just Australia (US -6.8%, UK -8.4%, Europe -15.9%, Japan -20.9%). But the markets are still up 123% over the last 10 years.
- Over the last 12 months all 'growth' sectors have been hurt (Australian property -33.2%, Intl property -18.8%, Intl shares -16.7%, Australian shares -6.7%).
- Australia will continue to benefit from the continuing urbanization in China and India. That's driving productivity increases throughout the region, boosting the performance of our big miners, such as BHP and Rio Tinto, and underpinning Australia's growth rates.
- The income return from Australian shares is now much more attractive than that from bonds, which should provide an additional boost for share prices.
- It's easy to get caught up in short term market movements - **keep the end goal insight.**

## Getting more from your super

Since 2005, the now well-known Transition to Retirement ('TTR') strategy has become embedded as the key financial strategy for increasing retirement benefits for those approaching retirement.

Put simply, the new 'TTR' rules now allow working Australians limited access to their superannuation money before they retire from the workforce. Previously, most people under age 65 needed to formally retire to access any of their superannuation money.

When combined with the 'Simpler Super' changes introduced last year, TTRs are allowing many 'pre-retirees' to remain in the workforce either on a full-time or part-time basis.

Depending on your perspective, the option to delay full-blown retirement can have a number of 'quality of life' and financial benefits. As financial advisors, we're witnessing a complete re-write of the traditional retirement 'script', helped along by strong employment, a healthier population and the desire to live well.

In addition to the obvious 'work-life' advantages there are also some more down-to-earth based reasons to consider TTRs.

### How can you benefit from a TTR pension?

A core benefit of establishing a superannuation pension is its favourable taxation treatment when compared to income generated through other means. However, depending on the TTR strategy implemented, you could benefit in different ways...

1. You could reduce tax on income by paying just 15% contributions tax on pre-tax super contributions (such as via a salary sacrifice arrangement) as compared to personal marginal income tax rates of up to 45%.
2. You could receive tax-free pension payments from age 60 as compared to income derived from salary and wages, which is usually fully taxable.

Moving to a pension environment from superannuation will generate tax-exempt investment earnings (note - money in superannuation generally attracts 15% tax on earnings within the fund).

3. Before attaining age 60, you could receive tax-free pension payments on the tax-free component of the pension. Also, pension income (under 60) benefits from a 15% tax offset as compared to salary and wages, which are fully taxable.

Along with the other major improvements to superannuation introduced last year, While the original intention of the TTR rules was to assist workers

approaching retirement to gently 'transition' towards retirement (by reducing their work hours and supplementing reduced employment income with pension income), this is not the only benefit.

As there is no requirement for a reduction in working hours to commence a TTR pension, other strategies can be legitimately utilised by people who are not scaling down their work activities. So other than supplementing a drop in take-home pay TTRs can also be used to...

- Boost super savings in the lead up to your retirement without reducing your income or
- Give your income a boost while you are working full time to access more money today.

TTR strategies have been popular with many clients since they were introduced. But now, with pension payments being tax-free for those aged 60 or over, TTR pensions are even more attractive and we expect the use of TTR strategies will continue to strengthen over 2008/09.

### Strategy review

With the arrival of your end of year statements, July and August is usually an ideal time to review your strategies (investments, tax/retirement/estate planning, cash flow etc) for the coming year. So if you would like to discuss your situation with us in more detail, please feel free to call or make an appointment.

While Westmount Securities believes that the information contained in this document is reliable no warranty is given as to its accuracy, and persons who rely on it do so at their own risk. In so far as this document contains material from other sources, Westmount Securities has not checked those sources and accepts no responsibility for the accuracy of that material. This document is intended to provide background information only and does not contain any personal advice or recommendation. The mention of any particular investment or security should not be taken as a personal or general recommendation to the reader. This update was completed on 24 June 2008.

**Westmount Securities Pty Ltd** AFSL No. 225715 **T:** +618 9322 7699 **E:** [info@westmount.com.au](mailto:info@westmount.com.au) **W:** [www.westmount.com.au](http://www.westmount.com.au)