f3 update
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A newsletter from F3 Financial Services
f3 Financial Services

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Investing for the Long Term

The year of 2008 was an eventful and volatile year for global financial markets and world economies. Annual investment returns were the worst for years with average superannuation funds losing almost 18% of their value. Australian and International equities suffered a decline in value of almost 40%.

The reasons for the market turbulence have been well documented. Looking forward, there is reason to be optimistic about the future:

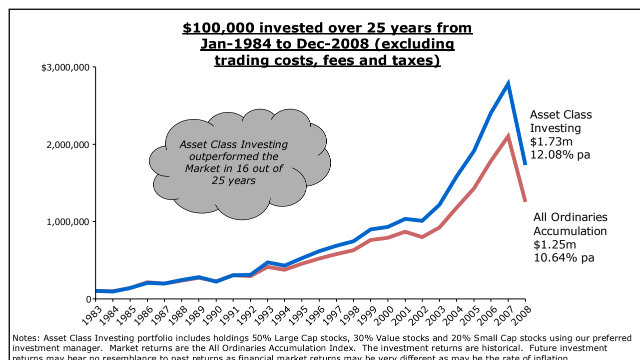
- Interest rates are low (with room to move in Australia)
- Governments around the world have been quick to act
- Stable & profitable banking system in Australia
- Employment levels are sound (~95% employed)

It is easy to become emotional regarding the short term returns from investment markets – the challenge is to stay on course according to your own situation and use facts rather than emotion to guide your decisions.

Our analysis of equity returns over a longer period of time (25 years ending December 2008) provides a somewhat different perspective to both media speculation about market turbulence or results from one single year.

Australian Equities

Over the last 25 years, the All Ordinaries Accumulation index has returned 10.64% per annum with $100,000 growing into $1.25 million. These returns have been achieved even after the unprecedented decline that was experienced in 2008.

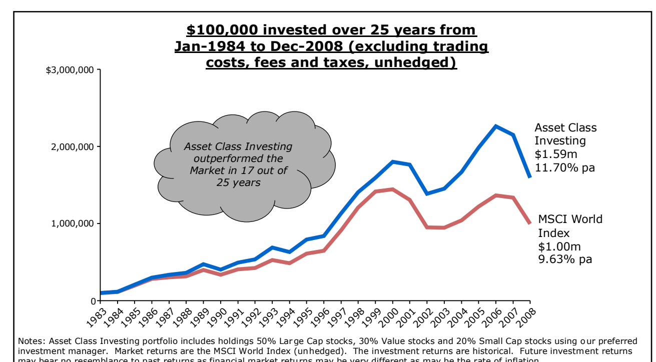


The Asset Class investment portfolio* has returned 12.08% per annum – 1.43% pa above the benchmark index over the same period. With the magic power of compounding, the $100,000 assumed starting point would have grown to $1.73 million.

* *Please contact us if you would like further information regarding how F3 Financial Services constructs Asset Class investment portfolios.*

International Equities

The experience in global equities has been similar to the Australian results. Over the last 25 years, the MSCI World Index (unhedged) has returned 9.63% per annum with $100,000 growing to $1.00 million.

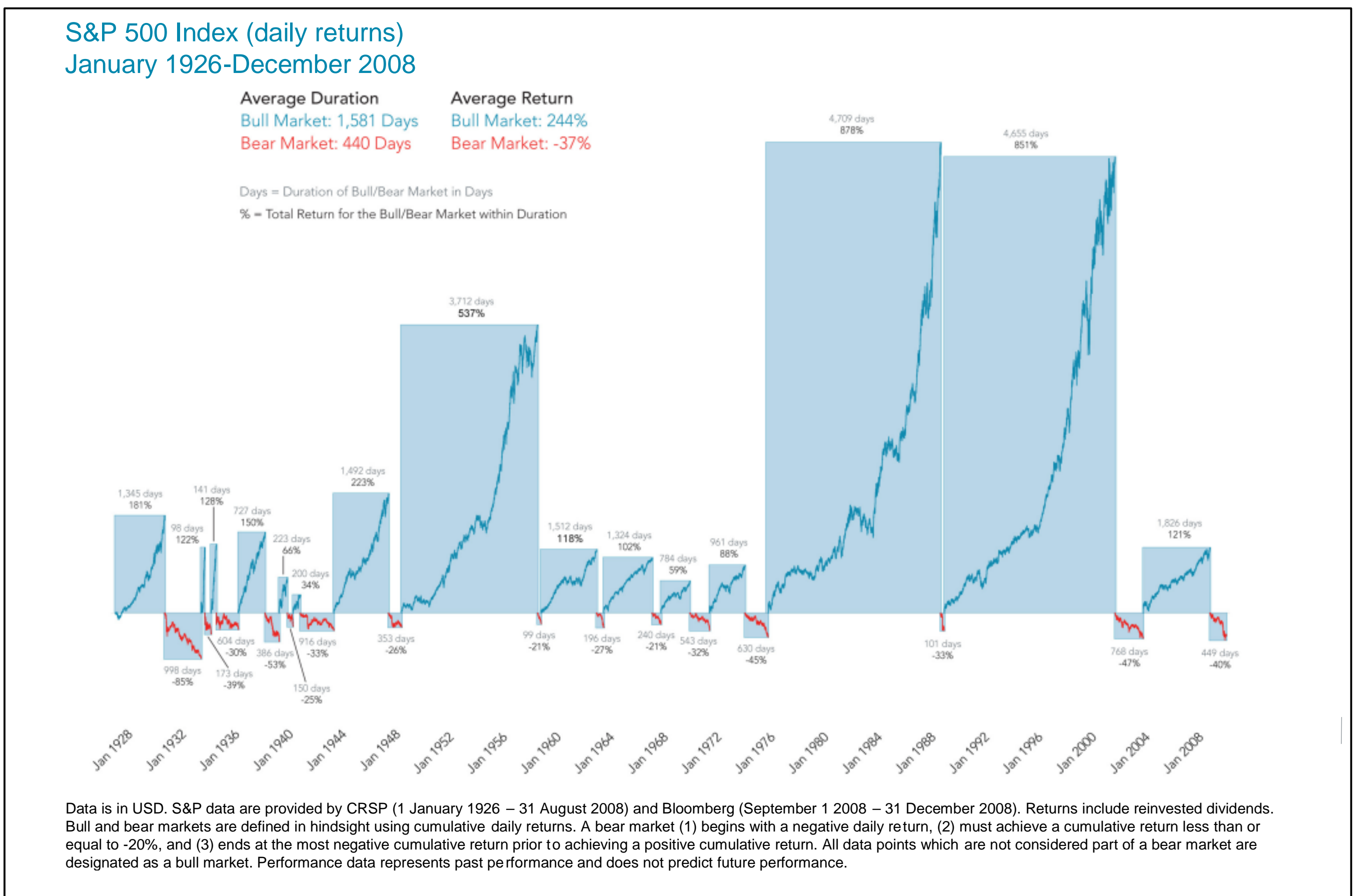


The international Asset Class investment portfolio has returned 11.70% per annum – 2.07% pa above the benchmark index over the same period. The $100,000 assumed starting amount would have grown to $1.59 million.

Future Outlook

There's no crystal ball to help determine how equity markets will perform over the short term, or when market volatility will reduce. What we can gauge from history and facts however is:

- Switching between investments and investment strategies can be costly. Missing out on only a handful of the best performing days can place a significant drag on overall returns.
- Investors should set realistic investment expectations rather than benchmark their returns on 2003-2006 when equity markets returned more than 20% per annum. In the last century, equity market returns of 6%-7% per annum above inflation represented the norm.
- From year-to-year, equity market returns will be volatile. Markets in the short term go up <u>and</u> go down in value.
- Equity markets tend to rebound mid-way through a recession rather than waiting for the economy to turnaround.
- Valuations of equities are currently at historic lows – when looking for example at Price-Earning multiples or Dividend Yields.
- Although we prefer to take a long term perspective, equity market returns tend to bound back strongly after a significant negative period. The following diagram provides some insight into the magnitude and term of bull markets (rising equity markets) compared to bear markets (falling equity markets).



Data is in USD. S&P data are provided by CRSP (1 January 1926 – 31 August 2008) and Bloomberg (September 1 2008 – 31 December 2008). Returns include reinvested dividends. Bull and bear markets are defined in hindsight using cumulative daily returns. A bear market (1) begins with a negative daily return, (2) must achieve a cumulative return less than or equal to -20%, and (3) ends at the most negative cumulative return prior to achieving a positive cumulative return. All data points which are not considered part of a bear market are designated as a bull market. Performance data represents past performance and does not predict future performance.

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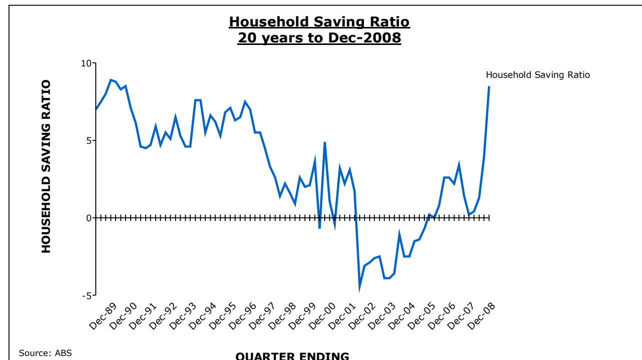
To Save or Not To Save

As the economy in Australia slowed in the last twelve months, Australians have stopped spending and starting saving. The Household saving ratio prepared by the Australia Bureau of Statistics each quarter has increased to 8.5 in the December quarter. This is the highest it's been since September 1990.



Under the threat of a recession and rising unemployment, Australians reduced their spending. At the same time, most households had better cash income than they did the year prior – through tax cuts, government handouts, declining petrol prices, higher salaries and significantly lower mortgage rates. As a result of these two forces, cash has been flooding into the major Banks with new money placed on deposit and used to reduce debts.

The improved savings ratio is a double edged sword. For an individual household, it's a good thing to save and either invest or reduce debts. The downside however is that a result of Australians slowing their spending quickly and collectively, it increases the risk of business distress, unemployment and a recession.

In March / April 2009, the saving v. spending dilemma will again be in the spotlight as the next round of government spending flows through to ordinary Australians. These payments include:

- Up to $900 for people who paid tax in 2007/2008 financial year and had a taxable income less than $100,000,
- $900 for Family Tax Benefit Part B recipients (Single Income Family Bonus), and
- $950 per child aged 4-18 where the family receives Family Tax Benefit Part A (Back to School Bonus).

As an example, a single income two parent family with two school aged children could potentially receive a payment of up to $3,700. Here are some ideas with what to do with the money:

- Reduce or repay non-deductible debts such as credit cards, personal loans, car loans or housing loans. It's usually worth starting with the loans that charge the higher rates of interest.
- For people with housing loans, 100% offset accounts can be a smart way to save on interest costs and retain future access to the money.
- Online savings accounts are offered by most of the major banks and a number of smaller organisations. The rates on these are still in the range of 4%-5% pa. Read the fine print if "bonus" interest is being paid.
- For individuals with assessable income less than $30,342, the government co-contribution scheme can help generate an additional risk free benefit of up to $1,500. If your income is up to $60,342, reduced benefits may still be available.
- Consider long term growth investments including shares and property. You will need to decide whether you want to invest in or out of superannuation, and also what type of investment is appropriate for you.
- For first home buyers, First Home Saver Accounts offer tax concessions and a government contribution of up to 17% on the first $5,000 contributed during a year. That's a potential benefit of up to $850.
- Increase personal insurances to protect your family in event that you are ill, injured or die – preventing you from earning income.

Do Bank Fees Eat Your Savings

Australian households are paying billions of dollar each year in bank fees. A recent report by Fujitsu Consulting (Bank Fee Survey 2009) has stated that the average household is paying nearly $1,000 a year for their banking services – with some segments in the community paying more than $1,600 per year average. These fees are mostly associated with transaction deposit accounts, housing loans and credit cards.

Total bank fees have been increasing over the last ten years at a rate more than twice that of inflation. In part, this has been offset by the reduced interest margins on loans and higher credit interest offered for deposit accounts.

Banks are not entirely to blame for high fees however. Most households do not necessarily need to pay these levels of fees. They can be reduced significantly through:

- Structuring accounts and loans appropriately based on personal situation and needs,
- Understanding and reviewing the fees that both are charged and maybe charged in the future, and
- Making small changes to how bank facilities and accounts are used. (For example, using other Bank or foreign ATMs for balance enquiries and withdrawals is often simply a bad habit, rather than a necessity.)

It is likely in the future that Banks will continue to increase fees in response to declining profits and reduced competition in the industry. We can't really control the fees Banks charge, but we can stay on top of what we have and how we use it.

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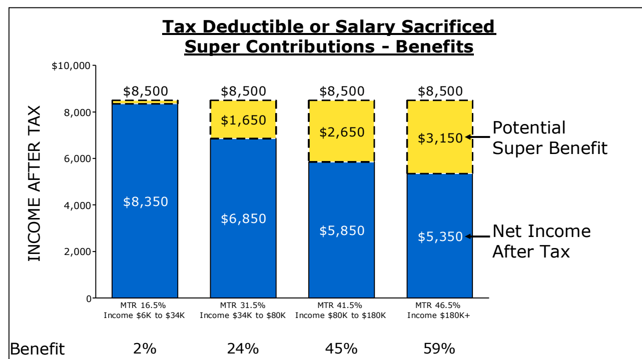
How Does a 59% Pay Rise Sound

If you ask the average person in the street whether they're interested in a 10% pay rise, their eyes will usually light up and they start spending their new wealth.

Making tax deductible or salary sacrificed contributions to superannuation can produce an effective after tax benefit of up to 59%. The amount of the benefit depends upon the individual's taxable income and marginal tax rates.

If, for example, you contribute $10,000 of income to superannuation by way of deductible or salary sacrificed contributions, your super fund will receive a net amount of $8,500 - after allowing for a 15% contributions tax. However, if you receive the money personally, the net income after tax will usually be less.



For the average Australian wage earner who has taxable income between $34,000 and $80,000 per annum, there is a financial benefit of approximately 24%.

For individuals in the highest marginal tax bracket, the benefits are greater - as much as 59%.

Two of the common myths or misconceptions regarding superannuation are:

- It's not mine – simply because there are restrictions on when you can access superannuation money doesn't change who the owner is. It's common for someone to know exactly how much is in their savings account, but have little idea how much superannuation they have, how it's invested and what fees apply. Your money is your money, irrespective of whether it's in the bank or in superannuation.

- It's riskier – when investing in growth assets such as shares or property, there's always the issue that in the short to medium term, investments can and will fluctuate in value. They fluctuate up and down, but history has shown that in the long term, these investments have performed better than income based investments such as cash and fixed interest. As not everyone is suited to investing in growth assets, there's no fixed rule that says superannuation money must be invested in shares and property. As an example, conservative investors have the option of locking in their tax savings using superannuation and investing the entire amount in government guaranteed cash deposits.

We Don't Mean To Scare You....

Using statistics, we have the ability to predict the likelihood that one person in a couple will either die, suffer a total and permanent disability or a critical illness (eg. cancer, stroke, heart attack...) before a certain age. Here are some examples based on different ages.

Current Age of both Husband and Wife	Probability of Death, Total and Permanent Disability or Critical Illness before Age 65*
Age 25	56%
Age 30	55%
Age 35	54%
Age 40	52%
Age 45	50%
Age 50	46%
Age 55	41%

* Source: MLC Insurance Risk Calculator based on Australian Life Tables 2003-2005 and MLC historic experience.

These and other unexpected events can cause significant harm to the financial wellbeing of a family. Personal risk insurances can't repair your health and wellbeing, however they can protect your finances and make sure there's one less thing to worry about.

"Achieving a Successful Investment Experience"

F3 Financial Services is currently offering a one-on-one no obligation education session to learn how to build successful investment portfolios. In the one hour session we will answer questions you have about your current investment and superannuation strategy, and explore topics such as:

- **Different investment styles**
- **How to product reliable returns**
- **Enhancing your investment returns**
- **Minimising fees and taxes**
- **Investment risk, and**
- **The importance of diversification**

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