

**Issue: Summer 2009**

## Introduction

The past year has highlighted several lessons for investors.

Market cycles remind us that periods of great returns are always followed by a fall, so when returns look too good to be true they probably are, as high returns always come with high risk.

Sentiment plays a huge role in investment markets. History demonstrates that the crowd always pushes to extremes. Also be skeptical of hard-to-understand products as the biggest losses came from complex products with poorly understood risks and high fees.

Remember to diversify. Hedge funds were seen as alternatives to stodgy, low-yielding funds, but now they're in big trouble while government bonds are the star performer.

Finally, the wild gyrations in markets highlight the difficulty in timing short-term moves and remind us that the best approach is to focus on a long-term strategy.

## Cash is king or of late the whole royal family!

Equity markets around the world are continuing to fluctuate with extreme daily ranges. The credit crunch and liquidity crisis have clearly steered global economies into uncharted waters. Governments and central banks have responded in unprecedented unison. In Australia the Federal Government's bank deposit guarantee has had some unintended consequences.

Whether you agree or not with government and central banks' decisions, around the world, in responding to the financial crisis, it is hard to argue against the fact that action of such a co-ordinated nature has been both swift and sizeable. Central banks have responded aggressively in the lowering of official

interest rates with the Reserve Bank of Australia cutting rates from this year's high of 7.25% to 3.50% with further cuts expected before the end of the year.

Fiscal policy spending features in the Australian Federal Government's policy to protect as best as possible a lapse into a recession. In this regard, Australia has been better positioned (a more robust economy and greater scope to reduce interest rates) than many other nations. Expansionist policy is likely to provide a meaningful force in avoiding the fatalistic recession to which several countries have already succumbed. Unintentionally however, it seems the Government's monetary policies have directed investors down a one way street to cash investment.

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## Words of Wisdom

'The market is an incredibly effective mechanism for transferring wealth from the impatient to the patient.'

Warren Buffet



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## Cash is king or of late the whole royal family! (cont.)



Looking through the financial mist surrounding us, there are some positive rays of light. Risk awareness has returned, attitudes to debt are more conservative, there is greater scrutiny of complex investments and equity valuations are clearly more attractive (albeit cold comfort to most of us!).

Probably the biggest impact, largely unforeseen, in our investment markets is the Government's guarantee on cash products from Authorised Deposit-taking Institutions. The primary impact was the significant increase in levels of redemptions from many managed funds, causing redemption suspension or standard redemption policy to be altered.

The guarantees were introduced primarily to free up liquidity and encourage inter-bank lending. The Prime Minister has said that Australian banks are well regulated and well capitalised and the guarantee was not implemented as a result of concern over the safety of deposits. The guarantees do, however, provide an additional comfort to investors in products covered by the guarantee.

Rightly or wrongly there is no doubt that investors have jumped into products or investments that fall within this guarantee. One need only look at the proportion of inflows within Aviva's administration platform that have been directed to term deposit investments covered by the guarantee. In the year to September 2008 flows into term deposits (including switches from within the platform) as a proportion of total funds flows stood at around 10%. This had increased by more than two fold in the September 2008 quarter alone, to almost 25%.

Has the huge influx of investment dollars into cash based products occurred once all factors have been considered in making the investment decision? Have initial investment plans and strategies been interrupted and turned on their head? Has an appropriate assessment of institutions' credit ratings and returns been made? Are the income needs and requirements of the investor still being met given that term deposits, in particular only, pay income/interest at maturity? In short have all the relevant factors

been appropriately considered in the investment decision? In many instances I would think not.

Is cash really going to provide what investors want or more importantly need? For those who secured term deposit rates offered three or four months ago, the returns may be adequate, but at current levels, which are expected to move even lower, the equations has changed significantly.

Many other investments including Australian shares, at current prices, offer relatively attractive yields – assuming the company's income projections are met! Today's much lower interest rate environment paints a different investment landscape for investors. It's a landscape which highlights the benefits of diversification across asset classes – not only for risk diversification, but also for potentially higher longer term return.

Relative yields of other asset classes against cash are now much more attractive than even three months ago. It is worth noting that in the last 20 calendar years cash as an asset class has provided the highest return in only one year (1994 at 5.4%) and the lowest return on seven occasions\*.

A potential negative of investing in cash, especially for an extended period of time, is that investors may miss out on the rebound in equities when it occurs.

The huge investment flows into term deposits is only one side of a two sided decision. Another decision needs to be made as to when to re-enter the market. You may be lucky to get one decision right but it is quite easy to get both wrong!

\* Asset classes assessed were Australian shares (S&P/ASX All Ordinaries Accumulation Index), international shares (MSCI World Gross Accumulation Index in \$A), Australian listed property (S&P/ASX Listed Property Trust Accumulation Index), Australian fixed interest (Commonwealth Bank Bond Accumulation Index), international fixed interest (UBS Global Government Bond Index in \$A) and cash (UBS Warburg Australian Bank Bill Index).

## Removing the risk with insurance

*Being under-insured is a risk you simply don't want to take.*

But it's an alarming reality that many Australians are in exactly that position, especially when it comes to being protected for personal injury and death.

While most of us have basic life insurance and sometimes total and permanent disability insurance (TPD) included through our superannuation fund, it's important to look at the level of cover you have and determine whether it would be sufficient to look after your needs.

For example, if you have TPD cover and are severely disabled due to ill health or an accident, would your level of cover be enough to pay the bills if you were unable to work, either on a temporary or permanent basis?

Worse still, what would happen to your dependants, if on your death, your life insurance payout was not enough to generate an income stream that effectively replaced the family income provided while you were alive? It's a scary thought, but unless that level of financial support is available your dependants may be put into a difficult position.

### Is it really worth the risk?

The cost of medical assistance is often substantial, and restrictions on work and education can severely affect your capacity to earn a living.

Also, changes to your lifestyle, including home and mobility, can be costly to manage, and the need for long-term care is generally very expensive.

In a family situation, if you are the main salary earner in the household, your partner and children will be significantly affected by any disruption to your income. When a primary income earner is disabled, the financial cost of care flows on because it is generally the other family members who need to take on the main support functions. This reduces their personal capacity to engage in paid work.

The financial costs of disability can be high. One of the best ways to prepare for this cost is to transfer the risk to an insurance company.

### Life insurance cover

In the event of your death, a life insurance lump sum will potentially be a lifeline to your family – to pay the mortgage repayments, other outstanding loans and even to generate a recurring income stream to cover everyday living costs. There are different types of policies available that can provide either straight life insurance, or a combination of protection for if you become critically ill, disabled or lose your life.

It's good to see a professional financial adviser to work out what level of cover will be needed to cover.

### TPD insurance cover

TPD insurance covers you for disabilities that permanently prevent you from ever working again. TPD is normally paid as a lump sum. Note that many TPD insurance policies require up to six months of total and permanent disability before paying a benefit. Payouts can provide you with a high percentage of your monthly income if you are unable to perform important income-producing duties of your regular occupation.

Your adviser can talk to you about structuring your insurance payments so they come directly from your superannuation, which will make them much more tax effective.

### Trauma insurance

Trauma insurance can help you cope financially with the effect that medical trauma, such as a stroke, can have on your life. Trauma insurance normally paid as a lump sum and can be used to pay for changes to your lifestyle or for care that you may require because of the trauma.

### Child trauma insurance

Some insurance policies contain a children's trauma option. This can cover (often to a set maximum) up to five of your children or grandchildren (usually from age two up to 16 years of age) if they become critically ill or lose their life.

### Talk to us

As professional financial advisers, we want to ensure you are completely aware of the various insurance options that are available. We can advise on the most appropriate protection and level of cover to help you to get cover in place quickly.

Call your adviser today to discuss your needs in more detail.



## Market volatility – frequently asked questions

The recent sharp negative performance of equity markets around the world and the questionable financial viability of several companies, has many investors concerned about their own investments.

At times of such market uncertainty and negative sentiment, people often think the worst. The following information is aimed to dispel some myths and to provide an update in relation to client investments.

### Is my money safe as I've heard that some companies might go broke?

While share investments in particular have been the hardest hit and have fallen in value recently, if you hold a diversified range of shares it is extremely unlikely that you will lose all of your investment.

Being diversified in shares can simply mean that you invest across a range of different shares rather than just in one or two. And this is what managed funds do.

### How does a managed fund work?

A managed fund, also known as a unit trust, is a vehicle that pools your money with that from a number of other investors. These funds are then used by the fund manager to purchase assets – in the case of an Australian equity fund this is predominantly shares listed on the Australian Stock Exchange.

### So I'm not investing in the company who is offering the managed fund?

Most of the time, no you're not. Your investment in respect to an Australian share fund, for example, is usually spread across a range of anywhere between 20 and 60 different shares. This may include names such as BHP, Westpac, Qantas and Woolworths.

### I guess it's unlikely then that I would lose all that I've invested in an Australian share fund?

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Yes, it is very unlikely. A fund may hold between 60 to 80 stocks and these would all need to go into bankruptcy. This is one of the benefits of investing in a managed fund; you've diversified your investment across a number of different assets or companies.

### What if the company offering the managed fund goes broke or into liquidation?

This does not mean that your investment in the related fund will be lost. The assets (eg shares) held in the fund are held on trust for you as the beneficial owner. So it is you, the investor, who holds the ownership rights to the assets via units in the fund.

The legal owner responsible for administering the fund and the assets is known as the Responsible Entity. If the company offering the fund does go into bankruptcy the Responsible Entity can be replaced. The fund will continue to exist along with your investment in the fund and its related assets.

### Even if I'm unlikely then to lose all of my investments, they have fallen so much that it may be quite some time before they recover in value?

No one can give you guarantees about when and how quickly markets will recover. It is interesting though to look

at previous events that caused equity markets to fall and how long it took for markets to recover. Some examples follow:

- **1987 sharemarket crash** in the United States when the market fell by around 30%. It took 22 months for the Dow Jones to return to its pre crash level.
- **September 11, 2001** the terrorist attack sent panic through investment markets which immediately fell in value. It took the Australian equity markets (S&P/ASX 300 Accumulation Index) only 22 days to recover to the pre September 11 level.

Source: IRESS/ING 2008

Most of the funds invested in the sharemarket have a medium to long term (5 year) investment profile. It is important to remember that this type of investment is likely to experience periods of negative returns from time to time, but over the longer term, returns have historically outperformed other asset classes. Investment decisions should take this long term view into consideration and be made in consultation with your financial planner.

Every event and related impact on financial markets is different and so too is the time that it takes for the market to recover to pre event levels.

### What if I'm just about to retire and planned on having the full amount of my investment to retire on?

Superannuation investment earnings are taxed at 15% and are not taxed if transferred into a pension account, after retirement. On average, retirees have a life expectancy of around 20 years which is a good period of time to allow for a recovery in financial markets. Your financial adviser can discuss the best approach for your particular situation.