



## Paul Clitheroe

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# all cashed up with nowhere to go?

I don't know about you, but I'm looking forward to the day where the backyard barbecue is dominated by talk of hot summer days and the latest cricket sledging scandal. Don't get me wrong, I love the world of money and investing. But some of the talk I've been hearing lately, particularly about cash investments, really concerns me.

The past year has been a disaster for anyone investing in growth assets like shares, pretty much anywhere in the world. My portfolio, no doubt like yours, is well down. But much as the past might hurt, it's what we do now that matters.

### Cash is king for short-term

Cash is generally the right choice for short-term needs. You need to align your time horizon for investments to when you need your spending money. That's why I'm a big fan of retirees keeping two or three years worth of income in cash – so you're not forced to sell quality investments when their prices are down.

That's one risk that I'm seeing now. Some people seem to be saying "enough pain" and looking to cash out and take a big loss. If you really can't sleep then this approach might help, but think carefully because for many people, what seems like short term relief could lead to even bigger problems down the track. In fact, I'd go so far as to say the worst investment decisions are often made

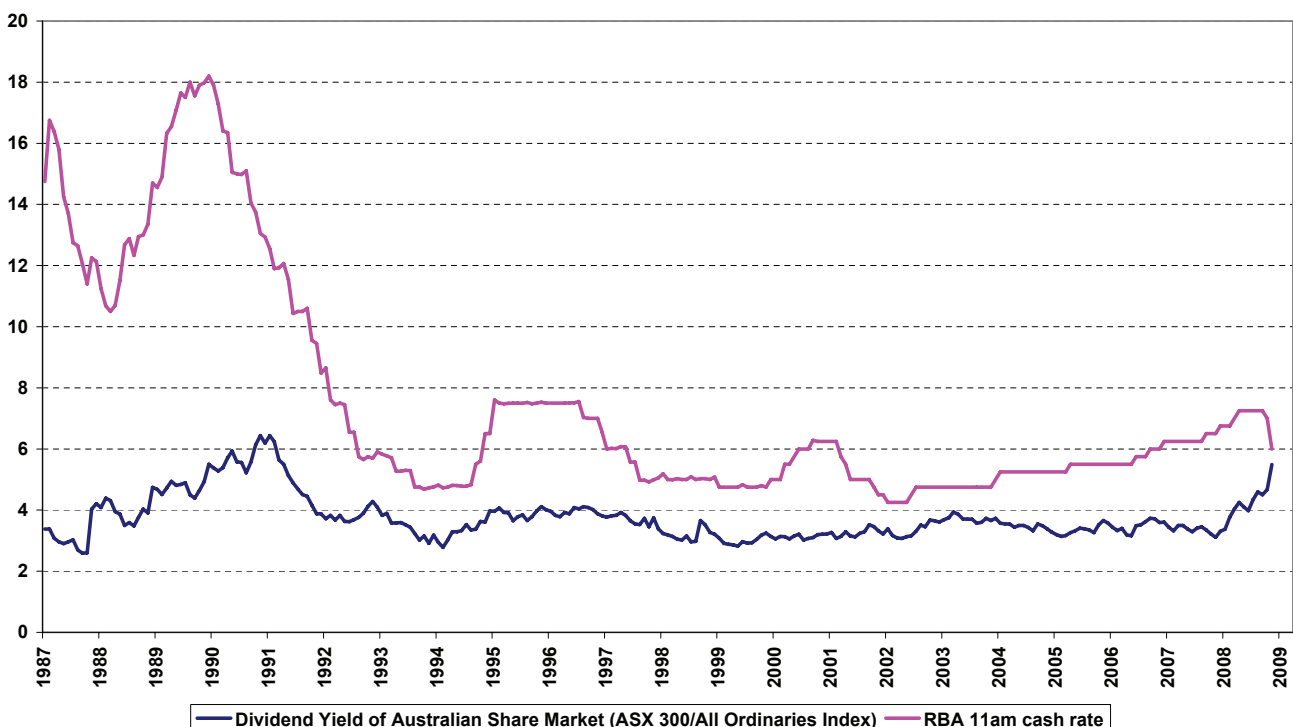
at times like this. Here's a quick scan of the current situation.

~ **Cash is paying low interest.** The official cash interest rate is 5.25%, but will go lower. Term deposits might pay a percent or two more, but when you allow for inflation and tax, you're looking at a much lower real return from cash. That might sound good compared to losing money on shares or property but while cash is secure, it does not look so good after tax and inflation.

~ **Quality companies are still paying dividends.** Even if shares kept falling, the best companies will continue to pay dividends. Dividends could fall, of course, and probably will. But at the moment the income from quality companies is only slightly lower than income from savings accounts. The S&P/ASX 300 Index dividend yield was around 5.5% per annum in November. So unless you need access to your cash in the next few years, "buying the bank" rather than putting deposits into it could be a better long-term choice.

The chart below shows that typically cash interest rates have been significantly higher than the dividend yield for the Australian share market over the past 20 years but the gap between them is now much smaller than usual.

Dividend Yield of the Australian Share Market (ASX 300) vs Cash Interest Rate



- ~ **It's almost impossible to time the market.** Let's face it, if you or I could time the market we wouldn't be having this conversation now. The simple fact is, apart from the odd lucky guess, we can't. So even if you switch all your money to cash, unless you're really prepared to adjust your living standards dramatically, you'll probably want to move back to growth investments later.
- ~ **Recoveries come without warning.** Plenty of people think "I'll wait until things settle down" before re-entering the market but that can mean missing a large rebound. A scan of all the big bear markets of the past century shows that, 12 months after the low in the market, markets bounced back in every case by between 15% and 129% in the next 12 months – often when the economy was still struggling, as the share market looks to the future.

Now I don't have a clue what markets will do in the next 12 months or even three or five years but I'm prepared to back what seems likely. Over periods of five years or more, in an overwhelming majority of cases in the past, quality shares have outperformed cash by a fairly decent margin.

Even if markets take a long time to reach their former highs, investors would still benefit. For example, from the table below, if it takes the Australian share market ten years to recover to its high of last year, this would give an average annual return of 7.0%.

	Australian shares	US shares	UK shares
	ASX 300	S&P 500	FTSE 100
Current level*	3482.8	806.58	4005.68
Highest point	6845.4	1565.15	6730.7

number of years to return to previous high	annualised return	annualised return	annualised return
1	96.5%	94.0%	68.0%
3	25.3%	24.7%	18.9%
5	14.5%	14.2%	10.9%
7	10.1%	9.9%	7.7%
10	7.0%	6.9%	5.3%
15	4.6%	4.5%	3.5%

\* as at 18 November 2008

source: Bloomberg, ipac

Believe it or not, for most working Australians, I reckon the best way to overcome the current market turmoil is not by changing investment options but rather, by keeping up your voluntary super contributions. Those still working may want to invest some extra in super to take advantage of the current low prices, if you have a decent amount of time before you need to use your super. If you're living off your super, then the key is to keep as much intact as is reasonable by using other cash or making a few household spending cuts, so you don't have to sell long-term investments while they're down.

Another concern about cash is anecdotal evidence that some retirees are bailing out of super altogether in favour of government guaranteed bank deposits.

This worries me because the minute you take money out of super you lose all the tax concessions associated with the superannuation environment. For the over-60s, that means any income you earn on investments held outside super is fully taxable. And if you're aged over 65 and not working, you need to think very carefully about exiting the super system because once you leave you cannot re-enter.



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