

investment outlook

Can it get any worse? And what should I do with my investments?

what now for markets?

After making waves in 2007, the global financial crisis hit our shores with the force of a tidal wave last year. It translated rapidly into the slump in the real economy that we are seeing now – job losses, drying up of credit and company closures. It even picked up its own acronym – GFC.

For investors, the fallout was felt in heavy falls in share markets around the world. Share-based portfolios were particularly hard hit. Rises in government bonds were not enough to reduce the impact by much. Now cash interest rates have also fallen to 40-year lows leaving those approaching retirement, in particular, with nowhere to hide.

The questions everyone is asking are: Can it get any worse? And what should I do with my investments?

Neither is easy to answer. But while there may still be dark days ahead, there are also glimmers of light at the end of a long tunnel.

investment markets – where to from here?

The current crisis has seen an unprecedented response from governments around the world. Eager to avoid the mistakes of the past, particularly the 1930s and 1970s, economic policies have been introduced to restore confidence and spending and stabilise markets.

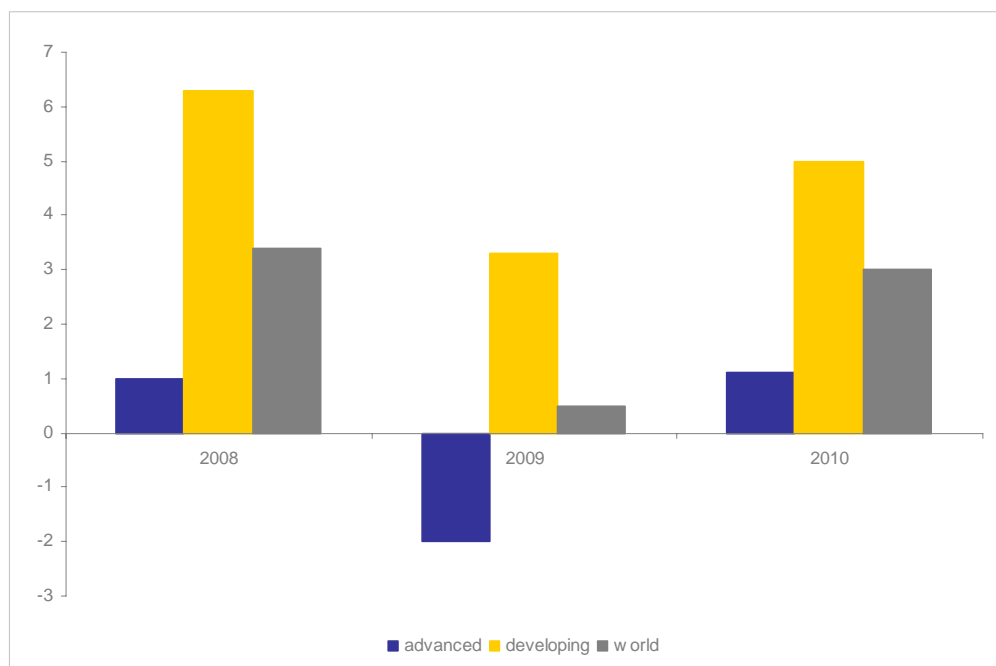
In Australia these measures have included huge injections of cash to buoy the retail sector and save and create jobs. It will take time for these measures to work – you don't spend \$42 billion overnight – and there is a long way to go before business and investor confidence is restored. But it's a start.

The outlook for 2009 is for continued slowing in economic growth, and rising unemployment in most economies with major industrialised countries pushed into recession.

Beyond 2009, our long-range view is for signs of recovery in the global economy to emerge in 2010 under the influence of the massive stimulus described above. Investor confidence should begin to re-emerge and investors, who are currently showing a preference for bonds and cash over shares, will return to equity markets. Volatility will eventually subside. More resilient financial companies and banks will survive the current crisis and emerge stronger than before.

If the global recession becomes more protracted, however, recovery will take longer and it will be harder for companies to make a profit and deliver good returns to shareholders for a longer period.

The chart below shows the International Monetary Fund's projections for global growth. The IMF expects a slow recovery to begin in 2010, after a sharp slowdown this year.



source: IMF. Data as of January 2009.

cash or shares?

Given the scale of the crisis, it's tempting to think share markets will never come good – and thus to consider switching all investments to cash. This is where your timeframe for investment is most important.

What we do know is that over the majority of long periods in the past, a broadly diversified global share portfolio has done better than cash – in many cases significantly better. However the timing and sequence of returns from both shares and cash is unpredictable.

Eighteen months ago, for example, it seemed that half of Australia was struggling to fix their mortgage interest rate at around 8 – 9%. Now some are looking into the break fees (how much they need to pay) to move back to much lower variable rates.

There is no doubt that 2008 was an extraordinary year, and over the short-term share markets are likely to remain volatile. However, this short-term relief may come at a high price over the long term. By settling for a certain, but very low, return investors risk:

- ~ turning a paper loss into an actual loss when shares are cashed in
- ~ being out of the market when the share market recovers. It's important to note that history shows recovery can come without warning.
- ~ missing out on dividend income. Even when share prices fall, many good quality companies still pay meaningful dividends. In Australia, falling share prices have pushed historic dividend yields on the All Ordinaries Index to more than 6%. At the same time, the cash return is now 3.25%, and likely to go lower. Shares potentially provide a better income return and potential for capital growth.
- ~ failing to achieve investment objectives over the long term. Even if it takes the Australian share market as long as 10 years to recover to its 2008 high, this still equates to an average annual return of 6.3%. Add dividend reinvestments to this, and the return is likely to be much higher, and a much healthier figure than the current cash rate.

‘Over the long-term share markets are placed to recover, generating much healthier returns for investors than can be expected from cash.’

a tale of two investors

ipac compared two investors. Both have seen the value of their \$100,000 investment in Australian shares fall to \$75,000 following the market downturn. Investor A chooses to move to cash while Investor B stays invested in Australian shares. The table below uses ipac’s medium-term return forecasts for cash and Australian shares to estimate the time frame for each investor to recoup their losses in real terms after taking inflation and tax into account. The investor has a tax rate of 31.5% (including Medicare) and inflation is estimated at 2.5% per annum.

	investor A (invests in cash)	investor B (invests in Australian Shares)
real value after 5 yrs (A\$)	77,412	100,878
real value after 20 yrs (A\$)	85,124	245,475

assumptions: Cash return is 4.6% (all income), Australian shares return is 8% per annum (income component is 3.5%), franking level on income from shares is 70%, inflation is 2.5%.

how are ipac portfolios positioned to recover?

ipac will be constantly monitoring conditions to look for opportunities and ways to protect portfolios. Based on current indicators our outlook for the major asset classes is:

- ~ **bonds** – ipac managers acted early to take advantage of mis-pricing opportunities in corporate bonds. Market distortions have caused extraordinarily low prices to be set for good quality corporate bonds.
- ~ **shares** – we expect Australian shares to show solid returns in the medium term. We are invested in companies with strong, fundamental qualities and which are likely to benefit from industry consolidation. Within Australian shares the bulk of money is in assets with strong fundamental qualities. Woolworths, for example, is one of the major holdings.
- ~ **listed property trusts** – returns from listed property were severely dented during 2008, however we believe that property values are reasonably well balanced with a fairly good outlook over the medium to long term. ipac’s property security portfolios hold high-quality companies that should recover and we believe our securities managers will capitalise on opportunities in the current market.

questions?

If you have any questions, please contact your financial adviser or call ipac on 1800 626 881.



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