



Riding the ups and downs

Shares are volatile, the money market is in crisis and property could be stalling. Yourmoney asked a pool of experts: What now?

SHARE MARKET

IF you recently invested in the market, or heaven forbid leveraged into the market, chances are you'll be licking a few wounds.

Could this be the end of the share market as we know it? Will this be the start of an ongoing bearish trend? Or will everything soon bounce back to normal?

To put this fall into perspective, we only need to go back to early 2003, when this bull market started.

Without including dividends, the Australian share market has rallied 108 per cent.

So as unpleasant as the recent fall may be, long-term investors are still sitting on very healthy gains.

Over the long term our share market has an impressive track record for building wealth.

In fact, if you are a long-term investor, falls like the one we are currently experiencing bring rare buying opportunities, which often occur no more than once or twice

a year.

So what caused the sell off?

Investors first became nervous in August last year, when we started to learn that sub-prime lending practices in the US were in trouble.

Before long, lenders and investment banks were reporting multi-billion dollar write-downs from loans they now expect would never be paid back.

It wasn't long before we had a fully fledged financial crisis and the massive US economy edging toward recession. To make matters worse, high commodity prices meant inflation around the world had risen. But there is some good news among all this.

The big themes that have driven our market to record highs are still very intact. China and India now account for one third of the world's population and they continue to develop at breakneck speed.

That means demand for Australian commodities should remain quite strong. The chances of this boom continuing are higher than its chances of abruptly coming to an end.

So while the market will more likely remain volatile during 2008, the long-term investor who buys on the dips should still be rewarded.

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Have the courage to buy quality stocks when others panic.



Surviving the ups and downs

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In nervous times, businesses with strong, widely recognised brands tend to perform the best.

As we now know, the off-balance sheet lending and financial engineering of some firms confused even the best financial analysts in our market.

Supermarkets, retail outlets, healthcare, miners, and the big retail banks have simple businesses that don't require financial wizardry to keep afloat. Even in an economic slowdown we will all continue to eat, buy movies, see the doctor, and use our bank account.

The chance of these companies going under is very low.

— Simon Guzowski, wise-owl.com.au

■ **WHAT NOW?** Have the courage to buy quality stocks when others panic. If you are a long-term investor, the best opportunities will come when everyone else is most worried.

PROPERTY

The fallout from the share market could be good news for the property market. According to valuer WBP Property Group a large number of people who are frightened away from the share market will probably now seek property to invest in.

"In the short term, many people who have borrowed money, particularly in terms of margin lending, in the past couple of years to buy shares have had to sell their shares to meet margin calls," WBP chief executive Greville Pabst said.

But that could be a double-edged sword. On one hand, those people dumping their shares could turn to the property markets; however, others who have had to pump more money into the share market

to rebalance their margin loans will no longer have that money available for other assets.

"It could mean people will be a bit more cautious when considering a renovation for example or they may have to delay a buying decision," Mr Pabst said.

Other investors who used the share market's rapid returns to help build their house deposits might also now be facing big falls in value, which will further delay their home buying.

"Inflation figures are also not too good, which is bad news for interest rates, so in general both the share market and property as asset classes will see a loss of confidence," Mr Pabst said.

Another interest rate rise, however, will have its biggest affect on home owners.

"Typically, it is people who own property in the outer fringes in the new estates, that are at greater risk of mortgage stress. They are more susceptible to change in economic climate than people in the inner and middle ring suburbs, who generally have a higher proportion of equity in their homes," Mr Pabst said.

"In the short I think there certainly could be a shift of funds out of equities into property. Generally, when there is a stock market correction people are more comfortable with bricks and mortar.

"If interest rates rise there will be losers but it could also be good bargain hunting time, so there'll also be winners. Affordability will drive investors wider and further for opportunity."

— Karina Barrymore, *Herald Sun*
Yourmoney editor.

■ **WHAT NOW?** Don't panic, property is a natural hedge to stocks and shares. Generally, conditions are quite strong.

MANAGED FUNDS

It was easy to make money when all markets were going up. But the tide has turned and it's time to see if the claims by fund managers really stack up.

The first decision of any investor should be their comfort level for risk and return.

The past three months have seen the first serious downturn for about five years. Some managers will have managed this reversal brilliantly and others would have failed miserably.

When you select a managed fund you want to ensure it is designed to meet your requirements and the manager remains true to label.

If you buy a balanced or growth fund or you select sector funds in each area you will want to check that they are within the risk parameters you are comfortable with, particularly if markets have further to fall.

To do this you need to know your asset allocation. You also need to know what variation of returns are expected and if the manager has excessive exposure to stressed assets.

It is only now, in a volatile market, that any cracks will start to appear in funds.

In the property funds sector many have fallen far more than the average because of excessive borrowings or exposure to property development.

This is not just well known funds such as Centro or MFS. Macarthur Cook Property Securities Fund is supposed to be diversified across a range of listed trusts and it has fallen in price from \$1.07 to 50 cents.

Its Product Disclosure Statement says it has no long-term debt but now we find it has \$68 million borrowed through OCBC which looks like 38 per cent of its net



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tangible assets.

In the fixed interest sector there are also many ugly exposures still to come to light in the high-yield, mortgage and hybrid sector.

Fixed interest should be used as a dampener of volatility for a portfolio.

Understand there is often a conflict of interest between

the business owner of a fund's management company and you as an investor.

You might be interested in holding for the long term but the primary goal of a fund manager is to constantly be up in the monthly performance figures.

This has led many of them to take extra risk, extra turnover

and incur unnecessary tax for short-term gain.

– Kevin Bailey, *The Money Managers*

■ **WHAT NOW?** Now is the time to measure fund managers for both risk and return and to ensure you are getting value for money. Most advisers can conduct this analysis for a reasonable fee.





COMMERCIAL PROPERTY

"Retail shops have been a white hot market over the past two or three years," valuer WBP's Mr Pabst said.

"Demand by investors – often mum and dad or first-time investors – has forced investment yields down to as low as 3 per cent in some of prime strips.

He said often in times of economic uncertainty the first thing to go is people's discretionary spending.

"If we are asking where do we think the retail property investment clock is, it would have to be about five minutes to midnight," Mr Pabst said.

The suburban office sector, however, is quite strong and there are shortages in some areas.

Commercial office yields have gone down to as low as 6 per cent because of demand.

– Karina Barrymore

■ **WHAT NOW?** Retail could be overpriced. Look for bargains in up-and-coming industrial sector.

SUPERANNUATION

People who DIY or actively manage their superannuation could end up worse off than people who just let their super ride the ups and downs.

The vast bulk of Australians have their super housed in the default investment option of a big super fund.

Generally, that is a balanced fund with about 70 per cent invested in growth assets and 30 per cent in defensive assets.

"Funds employ asset consultants and are always reassessing their strategy, but I wonder what is happening in the self-managed sector?" Australian Institute of Superannuation Trustees chief executive Fiona Reynolds said.

People who borrowed to take advantage of last year's tax-free "million-dollar window" could also now be facing big problems.

"Some people geared pretty heavily to put money into super prior to June 30, 2007," Stephen Rowley from London Partners said.

"That was a big strategy for many people getting close to retirement and I would think a lot of that was in self-managed funds. Clearly, today many of those people will be sitting on a big paper loss."

Super Concepts spokesman Graeme Colley, however, argues that most SMSFs are structured much like the balanced option in a large super fund.

SMSF trustees, however, should examine individual investments and reweight the super portfolio if the weighting to shares has dropped.

"If they are in a position to make their annual contributions today, they should do so and use that cash to reweight their portfolio," Mr Colley said.

– Jason Bryce, Your Money journalist

■ **WHAT NOW?** Decide if your investment option is right for you. Ask your fund or fund manager to switch to another option if you are not comfortable with the risk you currently have. Get advice.



Time to tighten belts

RBA tipped to raise interest rates

SIMON GUZOWSKI, a senior equities analyst with investment research house Wise-owl.com, writes exclusively for the Tweed Daily News on tomorrow's Reserve Bank meeting, expected to generate another interest-rate hike. Increased mortgage payments is the last thing many home owners need, especially after weekend revelations of up to 300,000 families facing mortgage stress so severe many could lose their homes.

RUMOUR has it the Reserve Bank is gearing up for another interest rate rise when it meets to decide interest-rate policy tomorrow.

If it does, Australian interest rates will rise to their highest level in close to 12 years, as the Tweed, along with the rest of our great nation, leaves a period of historically low interest rates behind.

Adding fuel to the interest-rate fire has been record-low unemployment of just 4.3 per cent, and an inflation rate at an uncomfortable 3.6 per cent.

The RBA's primary goal is to keep inflation between 2-3 per cent, so they'll be reluctant to let inflation continue around current levels.

The bond market, which is often used to decipher the future direction of interest rates, is also pointing to an interest-rate rise.

Bonds are pricing in a 70 per cent chance of interest rates rising by 0.25 per cent when the RBA meets.

While interest rate medicine can be difficult to swallow, the good news is it comes on the back of a booming Australian economy.

High commodity prices with record levels of demand from China have given Australia a dream run on the economic front. Key trading partners like China have been able to maintain impressive economic momentum.

China recently reported GDP growth of 11.2 per cent over the

December quarter, down modestly from 11.5 per cent in the previous quarter, suggesting that the US subprime crisis is yet to have a significant impact on growth.

Yet despite China's resilience, an interest-rate rise isn't a sure thing just yet.

Recent turmoil in financial markets and the US economy could still stay in the RBA's hands for now.

Not only has our stock market just suffered one of the largest falls of recent history, all of the major banks have independently lifted their mortgage rates by between 0.12 per cent and 0.25 per cent since the RBA last met.

The fact that interest rates have risen independently of an RBA rate rise will reduce the urgency of any action from the RBA.

Driving these rises from our banks has been a credit squeeze since the US subprime crisis took hold.

Funds for banks to lend have become progressively harder to get hold of, which is making it more expensive for banks to lend money.

To gain funding for loans, banks now have to pay higher interest rates in wholesale debt markets, which in turn are forcing them to lift the interest rates they charge customers.

In the US, unemployment is edging higher, and housing foreclosures are rising at break-neck speed.

Despite the rise of China, the

US economy remains the world's largest, so we can't discount the impact this may have on the broader global economy.

The fact that the US Federal Reserve has been aggressively cutting US interest rates also suggests that this economic giant is facing head winds.

If the RBA lifts rates by the expected 0.25 per cent, it will add \$60 a month to the average \$250,000 mortgage.

This is no small amount when you consider that the typical interest rate on a mortgage has already risen by between 0.62 per cent and 0.75 per cent over the last six months from two RBA rises, plus an additional rise from the banks to cover wholesale funding costs.

That leaves most households footing a much larger interest-rate bill which could start to bite into spending habits.

For the sharemarket, all news is bad news lately, so there is room for a rise to be perceived in a bad way.

However, an interest-rate rise is already widely expected, which means the market is unlikely to be affected by it.

As strange as it may sound, an absence of any rise could be viewed more negatively than a rise, as it would point to the RBA being concerned about the global economy which is essential for our growth.

It seems the time to tighten our belts is upon us.

SIMON GUZOWSKI,
Wise-owl.com
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Confession time for earnings



SHAREHOLDERS appear to be facing an even gloomier outlook. As market prices continue to tumble, analysts are forecasting a potential new round of earnings downgrades.

With corporate Australia starting its six-month reporting season, investors are bracing for bearish forecasts for the full year and the spectre of reduced dividend payouts.

Although most first half profit results should still come in quite strong, "unfortunately they won't be enough to get everyone safely through the reporting season", according to Wise-owl senior equities analyst Simon Guzowski.

"This reporting season could shape up to be a confession season," he said.

"Any company which has been waiting for the right chance to release unfavourable news has run out of time," Mr Guzowski said.

"I would not want to be a chief executive who even has to whisper a word on debt, credit due for renewal, or anecdotal evidence of a slowdown.

"The market is nervous and unlikely to warm to anything other than the most bullish of news," he said.

With such an uncertain global situation company outlook statements are expected to be cautious.

"I wouldn't be surprised to see management teams reluctant to put

their neck on the line with a bullish outlook. Caution is likely to prevail until the dust in financial markets starts to settle," he said.

Concerns also remain high about the possibility one of the local banks could report an unexpected sub-prime or lending exposure.

However, the first measurable impact of the sub-prime crisis on local profits is not likely to hit until the next six months.

Sectors most at risk of disappointing results are the miners, manufacturers, financials, property trusts and transport companies, Mr Guzowski said.

Sectors that could surprise on the upside are retailers, IT services, oil and gas producers, as well as mining services. Companies that rely more on mining volumes rather than commodity prices.

Apart from the global and economic problems, on a confidence basis another risk is the wealth effect of a falling share market.

"Australians have very high levels of share ownership. As they see their portfolios shrinking in value, they might decide to tighten the belt until things improve," Mr Guzowski said.

Earnings expectations have weakened globally according to the latest data from Merrill Lynch.

Expectations are worst in the US but are still resilient in Asia Pacific, with the strongest sectors being those with a defensive tilt such as energy, telecommunications, consumer staples and utilities, Merrill

Lynch said.

But after five years of very strong profit growth it was inevitable Australia would slow down, EL & C Baillieu director Ivor Ries said.

"Still we expect company profits to be up 7-8 per cent this year," he said.

"Given the impacts of the sub-prime loans debacle, the higher Australian dollar on exporters and the weather — floods and cyclones — on mining exports, the level of underlying profit growth is actually not that bad," Mr Ries said.

However, he said the market was now starting to see the beginning of a "two-speed economy".

"Companies with low levels of debt and good business franchises will still deliver 10-15 per cent profit growth," he said.

"But companies with high levels of debt are feeling the pinch of higher borrowing costs foisted on Australia by bad American lending practices. As companies like Centro and MPS have shown, shareholders in companies with too much short term debt will have a truly miserable year.

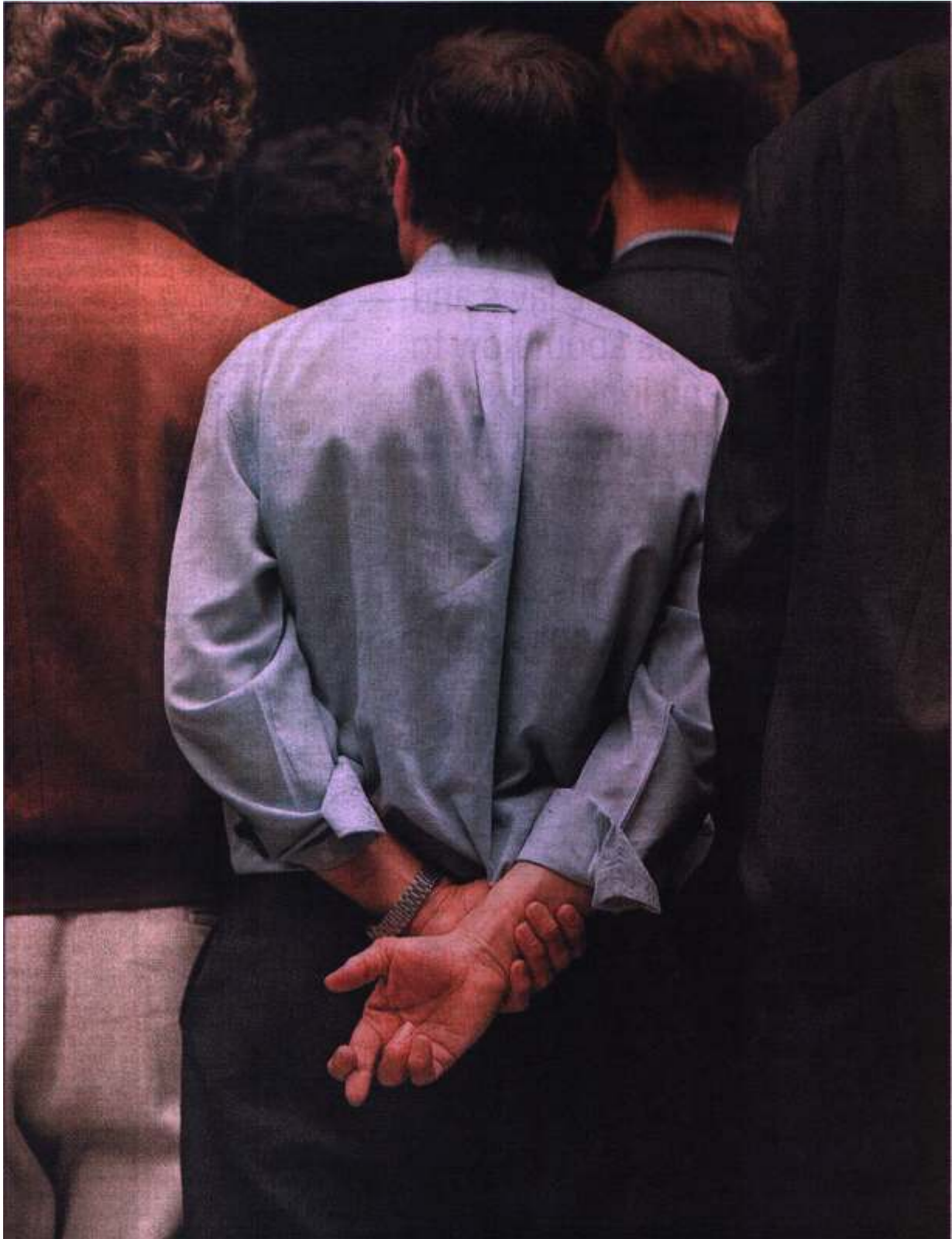
"So far, we are fortunate that Australian consumers have not shut their wallets as a result of global turmoil and therefore the retail sector has held up relatively well."

Should consumers become spooked and stop spending, profit growth could drop back to 3-4 per cent, he said.



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Say a little prayer: shareholders will be hoping company profits can ride out the bumpy market