

Green Associates Newsletter

November – December 2009



The Australian sharemarket has rallied strongly since its lowest point in March this year. AXA's Chief Investment Officer Mark Dutton looks at what's behind the rally to help assess its sustainability over the longer-term.

A rally from the bottom of the market can create a false signal that markets have rallied too far and too fast, so it's worth being clear on the numbers. We are not even half way back yet.

After reaching an historic high of 6854 on 1 November 2007, the Australian All Ordinaries Index fell by 55 per cent to its lowest point of 3112 on 6 March 2009.

From this low point to the present level of 4541, the index has risen by 46 per cent. But the current level is still 34 per cent lower than its November 2007 high. In other words, the rally has only recovered a little more than one third of the decline. The Australian sharemarket still needs to rally another 51 per cent from current levels to return to its previous high.

Phase 1 – disaster to just plain difficult

We are progressing through a series of phases in what can amount to an extended recovery. The first phase of market recovery, from March to July, came as it became increasingly apparent that policy measures were proving to be effective at stabilising the global financial and economic system. During this period, the risk outlook changed from 'disaster' to just plain 'difficult'.

While the outlook at this stage was not highly positive, the relative change and cheap valuations were enough to justify the relative increase in the sharemarket valuations.

Phase 2 – pricing in recovery potential

The second phase of the rally, from July to now, reflects an increased willingness to price in a recovery in company earnings. During this period, confidence was boosted by the positive mid year reporting season as well as the emergence of stronger than expected economic data.

Profit results which deviate from consensus expectations are often referred to as earnings surprises. The August reporting season revealed 44 per cent positive surprises, 38 per cent on target and 18 per cent negative surprises. In other words, more than 80 per cent of companies met or exceeded expectations.

These positive trends were needed to support the view that an earnings recovery has commenced, and have subsequently led to an upward revision of analysts' forecasts for 2010.

Better than expected economic growth and business investment data also helped validate sharemarket performance.

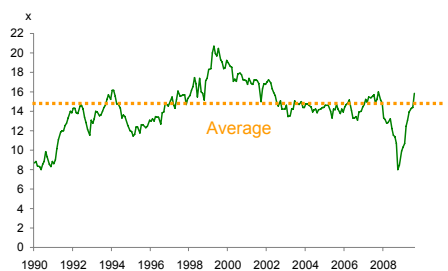
How sustainable is the market rally?

Looking at Australian equity valuations, the market rally has pushed the forward price to earnings ratio (p/e ratio) just past its longerterm historical average, suggesting that the Australian sharemarket is trading at around fair value.

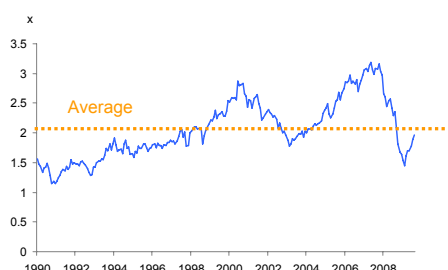
For example, the below figure shows the Australian sharemarket p/e ratio on a 12 month forward consensus earnings is at almost 16 times expected earnings, which is not too far from its longer-term historical average.

On this view, while the market no longer looks 'cheap', it is important to note that we are currently working with below average profit levels and depressed asset values.

Providing earning fundamentals continue to improve, the market still represents good value at today's levels.

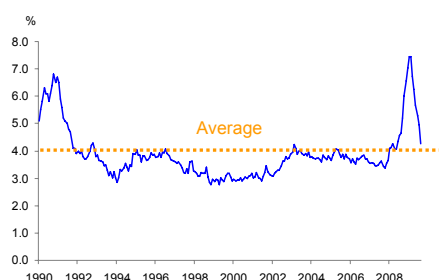


The Australian sharemarket indicates fair value on other measures, such as price to book ratio (p/b ratio) and historical dividend yield. Below shows p/b ratio is reverting back towards its longer-term average. [Continued on page 2...](#)



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Below reveals that while the dividend yield has fallen a long way, its current level is consistent with longer-term historical trends.



At current levels, dividend yields including franking credits represent an attractive source of return, especially when compared with current low levels of interest rates.

What this means for investors

The Australian sharemarket has plenty of ground to make up to get back to previous highs.

However, in the next phase of the recovery, there is likely to be more divergence of individual stock returns, as those companies which fail to meet expectations are punished, and those with strong profit growth are favoured by the market.

In this phase, we can expect to see a continuation of recent trends. Consumer, business and investor confidence is likely to continue to increase as the global economy moves nearer to exiting recession.

However, investors will need to be cautious of becoming overly optimistic in the short term. The underlying fundamental issues of too much global debt (leverage) still remain and need to be unwound.

Having said this, the Australian sharemarket still offers high return potential even if recovery significantly slows down.

For example, if it takes another three years for the Australian sharemarket to return to its previous high, this equates to an annual average return of 14.7 per cent (plus dividends).

Over an even longer time frame of seven years, this equates to a healthy average annual return of 6 per cent (plus dividends).



Dollar cost averaging – for the smart investor

Dollar cost averaging is a useful investment strategy that can help smooth the ups and downs in a volatile market.

The extreme volatility of share prices over the past year has eroded many investors' faith in the markets. Substantial daily fluctuations have made it very difficult to pick the best time to invest.

One weekend in October 2008 provided a snapshot of the extreme turbulence. On Friday 10 October the All Ordinaries Index suffered its worst daily percentage loss for more than two decades, shedding 8.3 per cent. But the following Monday a market rebound saw the index post its biggest one-day gain for 11 years, jumping 5.5 per cent.

With this degree of unpredictability, investors could be forgiven for being wary of dipping their toes back into the sharemarket. But playing a waiting game can backfire.

Missing out

During periods of market volatility, some investors try to guess when share prices have reached rock bottom, trying – and usually failing – to time their investment. Other investors can end up paralysed by inaction, only reinvesting when a recovery is obviously underway.

Either way, you can miss out on the bulk of the market recovery by coming in too late when prices have already firmed.

That's exactly what happened during the last market downturn in 2003. Investors moved in large numbers to 'safer' defensive assets such as cash and fixed interest offering low returns exactly at the wrong moment. The market rebounded strongly by more than 20 per cent in the space of a few months, leaving these cautious investors behind.

Staying in the hunt

In uncertain times, it's understandable if you're loath to invest the bulk of your savings all at once. But there is another strategy that could reward you.

It involves making regular contributions into a particular investment – shares or a managed fund – over a set period of time. Your fixed investment buys more shares or units when the price is lower, and fewer when the price is higher.

Dollar cost averaging is a deceptively simple strategy that can reap surprising rewards. It can help reduce risk over a period of market volatility, compared with investing a lump sum. While you won't necessarily obtain shares at a bargain price, you won't pay too much either. And it also saves you worrying about how much to buy or when to buy, giving you peace of mind.

Dollar cost averaging will smooth out the effects of short-term market volatility.

Dollar cost averaging at work

Let's have a look at how dollar cost averaging can work in practice. Imagine you have \$100,000 to invest in a managed fund. You have two options:

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Option 1. Invest the whole amount at once. Your unit price fluctuates to finish at \$1.10 at the end of the period. Your initial investment gains 10 per cent to finish at \$110,000.

Year	Amount invested	Unit price	Units purchased	Value of investment at end of period
1	\$100,000	1.00	100,000	\$100,000
2	\$100,000	0.80	0	\$80,000
3	\$100,000	0.70	0	\$70,000
4	\$100,000	0.90	0	\$90,000
5	\$100,000	1.10	0	\$110,000

Option 2. Stagger the investment in regular payments over a set period of time, for example \$20,000 each month. As the unit price falls, your regular \$20,000 investment buys more units. When the price increases, the investment purchases fewer units. At the end of the period, your initial investment has increased by more than 25 per cent to over \$125,000 – a significant advance on the lump sum investment. Each unit has cost an average of \$0.88.

Year	Amount invested	Unit price	Units purchased	Value of investment at end of period
1	\$20,000	1.00	20,000	\$20,000
2	\$20,000	0.80	25,000	\$36,000
3	\$20,000	0.70	28,571	\$51,500
4	\$20,000	0.90	22,222	\$86,214
5	\$20,000	1.10	18,181	\$125,371

The difference in the initial investment at the end of the period shows that dollar cost averaging has smoothed out the effects of short-term market volatility.

Smooth passage

Dollar cost averaging doesn't guarantee a profit and isn't necessarily the optimal strategy for every investor in every situation. Investing a lump sum can still be advantageous under certain market conditions.

But dollar cost averaging can help smooth out the ups and downs of market volatility and allow you to stay in the market while minimising your risk.

And the regularity of the payments means you can easily incorporate the strategy into your monthly budgeting.

Contact our office for more information on how dollar cost averaging could benefit your financial situation.

Making the most of redundancy

Where do I start?

Redundancy is a common occurrence – most people have either been made redundant in the course of their career or know of someone who has been made redundant.

However, when it's you facing redundancy, it's often difficult to remain calm and rational. Everyone's circumstances will be unique, and we can help you make the most of any payments that you receive as part of your redundancy.

Restructuring your financial affairs can be the first step to achieving a sense of direction and order in your life.

What payments will I receive?

You may receive a termination payment from your employer. The amount of money you receive will depend upon a number of variables, such as the industry you work in and the number of years you've been employed.

Your redundancy payment will generally consist of:

- ♦ a tax-free amount
- ♦ an employment termination payment (ETP), and
- ♦ leave entitlements.



What about tax?

It may be tempting to use your entire redundancy payment to pay off the mortgage, go overseas or invest in the share market. However, it's also important to consider the tax implications of any payments that you receive, which could substantially reduce the amount of money you actually take home.

We recommend you contact our office to discuss the specific tax implications of your redundancy payment, as they will be unique to your circumstances.

Employment termination payments

ETPs can no longer be contributed into superannuation (other than for individuals who qualify to use the transitional arrangements outlined in the following section). As a result, these payments must be cashed and are subject to tax depending on your age and the ETP components.

The tax on the payment will depend on your age. The following table outlines the tax treatment of the taxable component, which includes the Medicare levy. There is no tax payable on the tax-free component.

Age at financial year end	Tax on the taxable component
Under 55	♦ Under 55 Up to \$150,000 – taxed at a maximum rate of 31.5% ♦ Excess over \$150,000 – taxed at 46.5%
55 or over	♦ Up to \$150,000 – taxed at a maximum rate of 16.5% ♦ Excess over \$150,000 – taxed at 46.5%

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Transitional termination payments

From 1 July 2007 to 30 June 2012 (inclusive), the rate at which an ETP is taxed is different if the ETP is paid under a transitional arrangement.

A transitional termination payment is one where:

- ♦ you were entitled as at 9 May 2006 to a payment on termination of employment under a written contract, Australian or foreign law, legal instrument or workplace agreement made under the Workplace Relations Act 1996, and
- ♦ the payment is made before 1 July 2012.

A payment under a transitional arrangement can be:

- ♦ paid in cash as a transitional termination payment
- ♦ contributed to a superannuation fund, or
- ♦ used to buy a superannuation annuity before 1 July 2012.

What should I do with my payout?

There's no standard answer to this question as it depends on your individual circumstances. However, if you think you're likely to have trouble meeting any immediate repayments please contact us to discuss ways of restructuring your finances.

Redundancy may lead to a period of uncertainty, and liquidity is often important during this time. Be wary of tying up your payout until you know when you will be receiving a regular income again.

What else should I consider?

Personal insurance

If you have:

- ♦ personal insurance provided by a super fund into which your employer has been contributing, or
- ♦ sick leave or insurance provided by your employer outside super,

these may cease once you have been made redundant. It is important to review your needs as soon as possible to make sure you and your family are adequately covered. Some super funds allow you to continue with your insurance through a continuation option after you have left your employer – your super fund administrator can help you with this.

If you have any queries about redundancy, we can help you assess your options and determine a suitable plan of action that fits in with your ongoing financial goals.



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