

Your money Your future

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To fix or not to fix – that is the question

In an environment of concerns about continued rises in inflation and interest rates, more Australians are opting for fixed-rate home loans.

Australian Bureau of Statistics figures show the number of people with fixed-rate loans increased to 24 per cent, or nearly one in four, in November 2007, compared to 21 per cent in the previous month¹.

Fixed-rate loans have an interest rate that stays the same for a set period, usually one to five years, compared to variable-rate loans where the interest rate rises or falls in line with market conditions.

When interest rates are rising, a fixed rate can give you the security of

knowing your ability to meet mortgage repayments won't be affected by interest rate increases.

Quite often though, fixed-rate loans don't have the flexibility of variable-rate ones. And switching from a variable to a fixed rate may attract fees. If market rates fall below your fixed rate, you will continue to be locked into your higher, fixed rate.

One option to capture benefits from both strategies is to choose a 'split-rate' loan, where the interest rate is fixed for part of the loan and variable for the rest.

Contact us to work out the best option for your circumstances.

1 ABS 5609.0 – Housing Finance, Australia, Nov 2007



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Do you invest with your head or your heart?

One of the most surprising facts when it comes to investing is that the difference between success and failure is not necessarily what happens in the market. It turns out that one of the big differentiators is how investors perform, not how markets perform.

Independent US research conducted by DALBAR Inc found that:

- between 1985 and 2005 the US S&P 500 Index delivered average annual returns of 11.9 per cent, and
- the average share fund investor over the same period earned just 3.9 per cent.

Why did so many investors fail to achieve even average investment returns?

The answer is simple. People buy and sell investments at the wrong time. That is, they move their money out of low-performing share funds just before a recovery in performance and move into high-performing funds just before a fall.

Irrational investing and the fear of losing money

But why do people make poor buying and selling investment decisions?

According to Daniel Kahneman and Amos Tversky, who studied the emotional impact of investment loss and profit, the answer is people's natural fear of losing money. In fact, they found the pain of loss was roughly twice as great as the pleasure of an equivalent gain.

Instead of investing rationally, people make emotional decisions based on short-term market happenings that can end up costing them long-term investment returns. And, by being risk-averse, these investors:

- seek to avoid short-term regret; hence, they fail to take calculated investment risks and end up negatively impacting their portfolio returns, and
- hold losing investments too long – to avoid the regret of crystallising the loss, investors hold losing investments too long, hoping they'll come good, which inevitably leads to greater losses.

Research conducted in Australia in 2007 similarly found that the most significant factor holding back many people's financial ambitions with their retirement savings was the fear of losing money. In fact, 58 per cent of Australians said they should be doing more with their retirement finances but more than two thirds of respondents said they didn't have the confidence to invest for greater investment growth.

Profiting through long-term planning

Fortunately, your financial adviser can be a great source of objective and independent investment advice. They can help you avoid making emotional investment decisions and provide a systematic approach to building a long-term and rational investment plan that is based on your personal risk profile.

For more information, make an appointment to speak us today.

Q: What is... gearing?

The term gearing refers to using borrowed money to buy assets. Broadly, there are three types of gearing:

1. **Negative gearing** – when an investment is purchased with the assistance of borrowed funds and the annual income (after the deduction of expenses) is less than the interest commitment on the borrowing. Typically, this loss results in a tax deduction.
2. **Positive gearing** – this is the reverse situation where annual investment income is greater than the interest commitment on the borrowed funds. This will produce income for an investor.
3. **Neutral gearing** – when investment income is equal to the interest commitment on the borrowed funds.

Gearing can help you accumulate wealth more rapidly if the purchased assets increase in value. Conversely, it is important to understand that gearing also has the potential to magnify losses if the investments decrease in value. The

associated costs of borrowing are tax deductible when the borrowed funds are invested for income-producing purposes.

Your suitability to gear investments will depend on your individual circumstances, including:

- your marginal tax rate
- your personal risk tolerance
- your investment timeframe

- the amount of money you wish to invest, and
- your profit (or loss) expectations.

Contact us for more information on whether gearing may be beneficial in your individual circumstances.

We can also advise on the most appropriate gearing arrangement for any borrowing strategy you may pursue.

