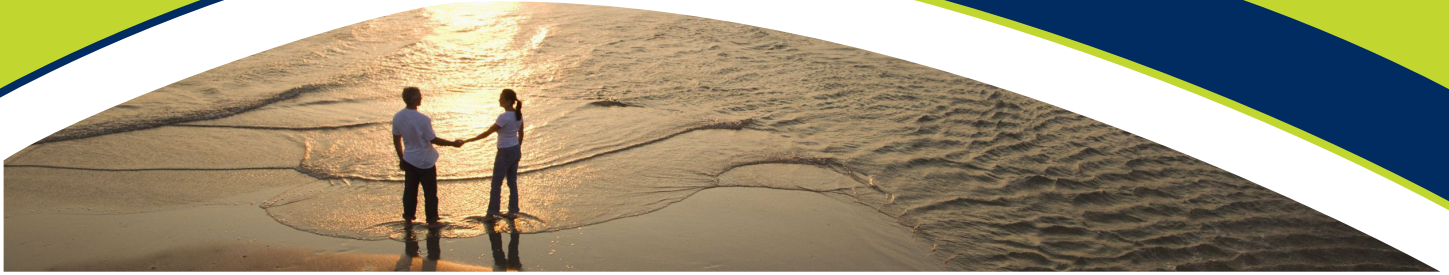


According to us

newsletter

Winter 2011



History repeating?

by Geoff Greetham, Executive Director

Volatility in a share market can be confronting for an investor. Whilst it has always existed, it is now better understood by a greater mass of investors, who have endured significant gyrations in their portfolios over the past three years. We look at the three years representing the early stages of the recent bear market (March 2008) to the end of the second year after the market low point of March 2009 i.e. March 2011.

Whilst recently published performance numbers for Accordius showed, in the face of this volatility, that we had outperformed over these past three years, a number of people noted that, if not for that outperformance, their reward for just investing in the market had been zero. The market itself has, over this timeframe, effectively 'run and up down on the spot'.

Questions are inevitably raised then as to whether the market will recover its poise and generate, aside from the skills of the investment manager, the generally superior investment returns to other asset classes, as has historically been the case.

What causes us to remain positive is the fact that the market is running close to form in terms of bear market recoveries (refer to the chart below) for the following reasons:

- The second year of recovery is always tougher. The rebound rally from the trough in the first year is where the easier gains are made. The second year (March 2010 to March 2011) often represents more a year of correction or consolidation.
- The second year is typically punctuated with an increase in volatility. Given the market is not as undervalued in an overall sense than the 12 months prior, it is more reliant on earnings growth to drive it, along with the uncertainty this entails.
- The third year, on average, produces above market gains.

Bear Market	% decline in All Ords	% gain in first year from low	% gain in second year from low	% gain in third year from low
May 51 – Dec 52	-34	8	13	5
Sep 60 – Nov 60	-23	12	-2	18
Feb 64 – Jun 65	-20	8	11	67
Jan 70 – Nov 71	-39	49	-25	-33
Jan 73 – Oct 74	-59	54	16	-4
Aug 76 – Nov 76	-23	6	21	27
Nov 80 – Jul 82	-41	39	9	36
Sep 87 – Nov 87	-50	35	5	-19
Sep 89 – Jan 91	-32	39	-9	46
Jan 94- Feb 95	-22	25	8	10
Mar 02 – Mar 03	-22	28	24	16
Average	-33	28	6	15
Nov 07- Mar 09	-55	53	4	?

Source: Bloomberg, AMP Capital Investors



That said, there are still a myriad of issues in positioning our clients' portfolios for this 'hoped for' outcome and Paul Kasian, our Chief Investment Officer, covers one of these – the 'Dutch Disease' – later.

Whilst FY11 is coming to a close, and you would have received from us in the course of the last month or so, a brief précis on announcements in the recent Federal May Budget of relevance and a pre 30th June financial checklist, Jackie Cook covers the issue of Binding Death Benefit Nominations in relation to superannuation in this edition.

The recent completion, in conjunction with our clients' accountants, of FY10 tax returns for many of our clients with Self Managed Superannuation Funds revealed some issues in this regard. As Jackie points out the rules are simple but the costs significant if not addressed properly. If you wish to discuss this in more detail with us, we would welcome the opportunity.

And if the volatility I referred to earlier is causing some heartache, it may also be opportune to contact us so we can address how much volatility and risk you are comfortable with – because there's no reason to believe market gyrations won't continue.

Having said that, a recent article I read provided some observations on volatility and the important role of patience in investments. I trust you find this interesting.

Once again if you have requests for information and suggestions for topics you would like addressed in future editions, please call or email me.

We look forward to working with you in FY12!

Binding death benefit nominations: looking after your loved ones

by Jackie Cook, Financial Strategist

Many people believe that if they have a valid Will in place, the arrangements for the distribution of their assets upon their death are covered. Unfortunately, in most cases, it is not that simple. Yes, the assets that you legally hold in your own name, otherwise known as estate assets, are distributed in accordance with your Will. However, most people also hold non estate assets, which do not automatically flow to your estate to be distributed in accordance with your Will. Superannuation is one of the most common non estate assets. Given that superannuation, after the family home, is typically a person's most valuable asset, it is crucial to provide for the optimal passing of your superannuation to your beneficiaries.

This is where a binding death nomination can be of utmost importance as it provides certainty that your superannuation will be distributed as per your wishes (providing binding death benefits nominations are allowed by the Trust Deed of your fund). A binding death benefit nomination is a binding direction to the trustee(s) on where to pay your superannuation in the event of your death. You can nominate any of your dependants as defined under the superannuation law – i.e. a current spouse (including defacto), a child of any age (including step, adopted or ex nupital), a person financially dependent on you (i.e. your mother-in-law who is living with you) or a person with whom you had an interdependency relationship at the time of your death. You can also nominate your estate, in which case the superannuation death benefit becomes an estate asset and will be dealt with by your Will.

If a binding death benefit nomination is not made, the trustee of your super fund decides on the dependants who receive your superannuation death benefits. In the case of a Self Managed Superannuation Fund, superannuation death benefits are typically paid out at the discretion of the fund's remaining trustee(s) or director(s) of the corporate trustee. Where the last member has passed away, the member's legal personal representative (i.e. typically the executor of their estate) will make this determination.

A significant factor that needs to be considered is the tax implications on your nominated beneficiary. Superannuation death benefits that are paid to a tax dependent as a lump sum will be received entirely tax free, whereas a lump sum that is received by a non tax dependent could be taxed at up to 31.5%, depending on the tax components of the fund, as shown in the table below.

Recipient	Superannuation Component	Tax Treatment
Tax Dependent	Tax Free	No tax payable
	Taxable (taxed element)	No tax payable
	Taxable (untaxed element)	No tax payable
Non Tax Dependent	Tax Free	No tax payable
	Taxable (taxed element)	16.5% (includes Medicare Levy)
	Taxable (untaxed element)	31.5% (includes Medicare Levy)

A dependent under tax law includes a spouse (including de facto or former), a child under age 18 (including step, adopted or ex nupital), a person financially dependent on you or a person with whom you have an interdependency relationship. Children aged 18 and over are not considered dependents under tax law.

A tax dependent also has the option to receive the superannuation death benefit as an income stream. The tax treatment of this income stream will differ based on

the age of the deceased, the age of the recipient and the tax components of the benefit as shown in the following table. Note that a non tax dependent is not able to receive the superannuation death benefit as an income stream.

Age of the deceased	Age of the recipient	Superannuation Component	Tax Treatment
Aged 60 & over	Any age	Tax Free	No tax payable
		Taxable (taxed element)	No tax payable
		Taxable (untaxed element)	Marginal tax rate with a 10% tax offset
Below age 60	Aged 60 & above	Tax Free	No tax payable
		Taxable (taxed element)	No tax payable
		Taxable (untaxed element)	Marginal tax rate with a 10% tax offset
	Below age 60	Tax Free	No tax payable
		Taxable (taxed element)	Marginal tax rate with a 15% tax offset
		Taxable (untaxed element)	Marginal tax rate

When an income stream is commenced from superannuation prior to death, this can be set up with a specific stipulation that upon the death of the pensioner, the income stream will continue to be paid to another person (usually the spouse). This is known as an auto-reversionary pension. This is a good way of ensuring that your pension will continue to your spouse in the event of your death. However, this can cause uncertainty if your binding death benefit nomination conflicts with your auto reversionary pension nomination. Therefore it is important to ensure that your binding death benefit nomination is consistent with your auto reversionary nomination.

You may want to consult us, in conjunction with your lawyer, to determine any tax and legal implications and to ensure that you achieve the optimal financial result for your dependants.



Patience is not only a virtue but also financially productive

by Geoff Greetham, Executive Director

Late last year, Andrew Haldane, Head of Financial Stability at the Bank of England delivered an interesting paper, which, at its heart, looked at the role of patience in decision-making and the difficulties we, as human beings, have in balancing as he described the 'patience gene' and the 'impatience gene'. Both genes, he points out, have a neurological basis so none of us are immune from this internal trade-off.

Haldane noted that countless empirical studies, over time, had consistently confirmed economic theory that patient savings by households, which in turn finances investment by companies, led to capital accumulation and enhanced future economic growth.

The flipside is that under-saving or its nom-de-plume, over-borrowing, led to under-investment and thus lower levels of economic growth. This colloquially speaking is bringing forward tomorrow's spending to today.

Despite this, what he also posited was that, when it came to investments, we, as a society, were perhaps becoming more impatient.

As evidence to support this, he undertook various analyses, one of which looked at the volatility of share prices. Plotting US equity prices back to 1880, he concluded that "on average over the past century, US stock prices have been over three times more volatile than fundamentals". Interesting, but what was even more telling is that "up until the 1960, prices were around twice as volatile as fundamentals. Since 1990, they have been anywhere between six and ten times more volatile. Excess volatility in equity prices has risen as financial innovation has taken off."

He extended this looking also at the degree to which share prices move away from underlying fundamentals, with the result being "up until 1960s, the average absolute deviation of US equity prices from fundamentals was just over 20%. Since 1990s the average absolute deviation has been well over 100%. Misalignment correlates with innovation and liquidity."



An obvious by-product of the above would tend to be shorter holding periods for stock, which Haldane further explored. And which was the case – “In 1940, the mean duration of US equity holdings by investors was around seven years. For the next 35 years up until the mid 1970s, this average holding period was little changed. By the time of the stock market crash in 1987, the average duration of US equity holdings had fallen to under two years. By the turn of the century, it had fallen below one year. By 2007, it was around seven months. Impatience is mounting.”

The period covered by Haldane has been one of increasing market innovation and liberalisation and with it has come greater information and liquidity in financial markets. Both of these – information and liquidity – have been a help and a hindrance. Information has enabled the long term investor to buy with more confidence but has also seen performance calculated over ever decreasing time periods giving rise to short-termism. Meanwhile, liquidity has increased market transparency and efficiency but also provided a quicker and easier exit for the impatient investor.

On this latter note, he also analysed, in the face of decreasing trading costs, the rise of HFTs – high frequency traders – noting they “operate in size and at speed. HFT firms are believed to account for more than 70% of all trading volume in US equities, 40% of volumes in US futures and 20% of volumes in US options”. He also pointed out that “these fractions have risen from single figures as recently as a few years ago. And they look to continue to rise”.

One area of scrutiny was CEO tenure, with it not surprising that, for the world's largest 2,500 companies, the average time at the top has reduced from just less than a decade, in 1995, to around six years by 2009. CEO positions are obvious targets with the market's focus on short term performance. He cheekily pointed out that this trend for declining tenures was also prevalent amongst football managers in the English Football League. And that, only two managers of 92 football league clubs had been in the position longer than the average departing CEO referred to above – Sir Alex Ferguson of Manchester United and Arsene Wenger of Arsenal, whose clubs have won three-quarters of the Premier League titles. Maybe there's still hope for Mick Malthouse of Collingwood!

In investment terms, Haldane provided then the investment results from the Sage of Omaha, Warren Buffet, whose investment's firm is noted for its long term perspective and the proposition that maybe incentives were required to force investors into longer holding periods and thus save them from their ‘self-destructive impatience’. One of the proposals raised during the Global Financial Crisis, a financial transactions tax to curb speculative trading, maybe one such avenue .

The Chinese proverb quoted at the outset

**“One moment of patience may ward off great disaster
One moment of impatience may ruin a life”**

certainly encapsulates Haldane's treatise and provides food for thought.

Will Australia suffer from Dutch Disease?

by Dr Paul Kasian, Executive Director

The term ‘Dutch Disease’ is used to describe the massive decline in the Netherlands in the 1960's that resulted from the discovery and exploitation of vast natural gas deposits in the North Sea. The problem arose as the significant increase in foreign earnings flowing into the Netherlands resulted in a large appreciation of the Dutch Guilder. This meant that the cost of exports (other goods manufactured in the Netherlands) were significantly higher when translated into other currencies and thus were uncompetitive against similar products made offshore.



The other problem that is associated with the ‘Dutch Disease’ is that factors of production (inputs) required by the resources sector benefiting from the boom causes costs to rise across the economy and thus make other industries less profitable. For example, the increased demand for skilled labour by resource companies can lead to higher wages across the economy and so industries not benefiting from the boom still have to pay their workers higher salaries.

There is now evidence that Australia is showing signs of suffering from the same fate with its current commodities boom. With the Australian dollar now at its highest level since it was floated in 1983 the competitiveness of the manufacturing, education, tourism and agricultural sectors has reduced. The full impact of this could take years to play out. In the Netherlands the manufacturing work force declined by 25% over a 20 year period.

Some commentators are less concerned about Australia facing the same degree of problems as experienced by the Dutch. Unlike the Dutch the demand we are experiencing is across a large number of commodities and that the life of the underlying reserves are much longer. The Treasury department has estimated that this increased demand for our resources could last until 2050. However just because demand may remain strong it doesn't necessarily mean that commodities prices will also remain strong. Already we are seeing China making large investments in African countries encouraging the discovery and development of new sources of commodities. If successful we could see China eventually buying commodities from us at reduced levels and lower prices. A significant fall in commodity prices could see Australia face some significant economic challenges given that the current budget is still a year or two away from being in surplus despite record commodity prices.

So what can Australia do to reduce the risk of feeling the full effects of the ‘Dutch Disease’? There are many approaches that could be taken by the Government to ameliorate the problem and I do not propose to tell the Government how to go about its business. One option available to the Government would be to spend less (i.e. run a larger surplus than planned) which would reduce the stimulus in the economy. This in turn would take some pressure of the Reserve Bank to raise rates and thus may see the exchange rate reduce over time. Another option would be to set up a sovereign fund. For example, Norway quarantines most of the revenues derived from their minerals sector and invests them offshore. Norway's fund is estimated to be around half a trillion US dollars.

From an investors point of view, while we can only hope that this issue eventually gets more attention than it currently does, we can also make sure that our investments are skewed towards resource based companies and away from those industries suffering from a rising interest rates and a high Australian dollar. The former includes the retail sector while the latter includes the manufacturing sector.

Please note that the information in this publication is for general use only. We would be pleased to talk with you in regard to your particular circumstances should you wish to explore any particular aspect further. Any tax planning matters should be discussed with your accountant before proceeding.

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