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Is Australia headed for a recession?

Most economic commentators say we are not, regardless of the slowdown in consumer and business confidence over the past six months. Increasing interest rates (monetary policy) is intended to slow our spending patterns and higher interest rates left unchecked would eventually cause a recession if historical evidence is an indication. It appears that the rate increases and other price increases have already had the desired effect and the Reserve Bank is tipped to reduce the official rate in coming months. There are a number of reasons Australia may not slip into recession this time. Firstly, the Australian economy compares well to others and our banks are not self destructing. There were 30,000 jobs added last month, unemployment dropped to 4.2%, nearing a 30 year low, and with a budget surplus of \$21.7 billion in May, the government has adequate surplus to stimulate the economy (fiscal spending policy) if need be. If the Reserve Bank cuts rates that will stimulate the market again as it always has and ward off a broad recession however the last thing the reserve needs to do is fuel another property price gain so we believe they will be conservative in handing out a rate reduction. Another reason that's keeping a recession at bay is world demand (in particular Chinese consumption) for our resources. Our export revenue is tipped to be up 50% over the next year.

Some commentators warn about a slowdown in the Chinese economy but their economy grew by 10.4% in the 1st half of the year, so it is likely this may continue for some time yet. Lastly we can look at the stock market. There has been a substantial correction since the end of October 2007; the broad All Ordinaries index has dropped 30%. By comparison, the Shanghai stock market is down more than 50% since the start of the year, while India has taken 40% off its listed market value. The party goes are suffering a hangover and dividend value has reappeared in Australia for those wise enough to look beyond the index news.

General Comments on the market performance and recovery

During the April - June quarter, the performance of the Australian stock market really wasn't that bad, with the All Ordinaries index falling less than 2%. However it is when we look at the monthly results that the anxiety and excitement is created.

The **All Ordinaries Index** provided the following monthly closes during the quarter:

➤ March	5396	
➤ April	5657	+4.4%
➤ May	5773	+2.0%
➤ Jun	5332	-8.3%

In May, the All Ords reached a intra month high of 6035 (19th May), followed by a 11.6% fall in the last 5 weeks of the quarter returning to similar levels experienced at the start of the quarter.

32 Logan Road, Woolloongabba Qld 4102 PO Box 1186, Coorparoo DC Qld 4151

Phone (07) 3891 6218 Fax (07) 3891 5255

admin@life.com.au www.life.com.au

From the above we can conclude that it was not such a bad quarter but more so a bad month to end the quarter. In fact it was the worst month of June since 1940. The main catalysts for the late tumble in the quarter were:

- Higher interest rates – slowing consumer spending – impacting on-essential or discretionary goods and services in particular.
- Rising Fuel Costs – hurting both consumers and businesses alike.
- Further USA bad news – in terms of further losses in US banks and the prospect of no more US interest rate cuts.

Sector Level

Some of the best and worst sectors in the volatile month of June:

- The energy sector managed to pull off a positive 1.6% for the month against the negative trend of all other sectors of the ASX.
- Consumer discretionary sector was down 14.5% for June.
- Financials sector followed global sentiment dropping 12.1% for June
- Healthcare sector was down 10.7%
- Smaller companies sector fell 11.3% in June (culminating a yearly fall of 20.5%). However separating the Industrials (36.5% fall for the year) from the resources (up 20.1%) paints a clearer picture of what actually happened.

Australian shares (as measured by the S&P/ASX 300 accumulation index) have seen seven market downturns greater than 10% since 1980. The average decline in market value was 21.3% and that took place over an average of eight months. That was followed by a recovery period that took 16 months although that average is affected by the time it took to recover from the October 1987 crash which was 63 long months. If you exclude that 1987 crash then the average recovery time halves to eight months. In the gloom it is hard to imagine the recovery but it has always happened.

For **International shares** (measured by the MSCI World ex Australia Index in \$A) there have been six falls of more than 10% with an average decline of 22.1% over 13 months. Average recovery period was 17 months, although it is still recovering from the 2003 downturn, not helped by our rising AUD\$ against US\$. Looking at the US market in US dollar terms, where most of the concern is at the moment, there have been five declines with the average fall in value of 24.2% and average recovery time of 15 months.

One particular sector that led the way down in Australia was the **Listed Property sector** and it has only had two declines of more than 10% in the past 27 years – including this event. This just underscores what extraordinary run investors have had in property securities over the past 27 years and the fact that an event will eventually trigger a return to a realistic value level.

Now, any fall of 20% plus hurts when you look at your investment balance, but price falls for whatever reason have always been part of the long term growth trend. The only way to avoid it altogether is to not invest at all.

The good news for investors is that historically the good times have lasted longer than the bad. The Australian sharemarket has only delivered two consecutive negative performances in the last thirty financial years.

At present investors stand the greatest possible chance of recovery or gain by being 100% in Share market funds, in particular index funds. Over 5 years share funds have outperformed balanced funds even following the recent downturn. Recent value drop presents renewed buying opportunity for investors when their investment \$ buys more units at lower unit prices. More units equal more dividend income. Often dividend income is the forgotten element.

As a result of lower prices current dividend yields are up (income from share portfolios are very strong comparatively). ASX 200 is yielding 4.69% on July 31 and the financials sector is yielding 7.42%, while the CBA yield was 9.48% pre tax. Financials make up app 20% of index, which means their market capitalisation has a strong influence on market performance and overall dividend yield.

Any investment strategy should look to accumulate and retain wealth over the medium to longer term and not on the basis on what has happened in a 6-12 month period. The end game is what matters – being in a position to become self funded through a passive income stream, which will allow you to draw an income to fund your lifestyle.

As a Practice we forecast long term returns at 6-7% as it relates to your overall strategy and by working together over time, we are very confident of achieving this and delivering on your objectives.

The market will continue to go up and down but as the worlds most successful investor (Warren Buffett) states:

“The future is never clear, and you pay a very high price in the stock market for a cheery consensus. Uncertainty is the friend of the buyer of long-term values”.

“In uncertain times wealth transfers from the impatient to the patient!”

The discipline of doing nothing can seem courageous at times like these. The human personality tempts us to do exactly the opposite what the numbers show us we should be doing!

If you wish to see further research, feel welcome to contact our office and request or visit our website www.life.com.au.

Kind Regards from the Team at Lifetime Financial.

Some material resourced from: ASX, AFR, Hudson research institute, Vanguard investments, David Koch finance columns.

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