



# Summer 2009

## Welcome

Welcome back summer, after a long, cold financial winter! In this end of year issue we ask whether international diversification of your investment portfolio is justified at this time – given that the Australian economy is currently outperforming the rest of the world. Our answer is that the investment fundamentals have not changed and the only way to benefit fully from a worldwide recovery is to stay invested in international markets.

We also look at the difference between good debt and bad debt. Bad debt can drag your financial security down like an anchor. Good debt can grow your investment capital and returns and generate valuable tax concessions – it is vitally important to distinguish between the two.

And finally, we put New Year's resolutions under the microscope to discover why they fail and what you can do to make sure you keep yours. Happy New Year!

Please note our office will close on Friday 18th December, 2009 at 5pm and will re-open on Monday 4th January, 2010.

Cheers



The team at Eclipse

## Latest news

It seems that Santa is about to deliver us a recession buster of a Christmas this year!

The Australian share market is up more than 48 per cent since its low in March. The dollar is up from US61c in October 2008 to above US90c. Unemployment is much lower than was feared 6 months ago. Some superannuation funds are already back in the black. The iron ore ships and coal freighters are queued up outside our ports in what looks like a new resources boom.

Frankly, if racing for the end of the Global Financial Crisis was an international Olympic event, we'd be in line to win gold! (And gold broke through the US\$1,000 an ounce barrier for the third time ever last September.)

The recent interest rate rise is the only cloud on our horizon, but we all knew that the Reserve Bank had only dropped the rate to keep credit flowing in hard times. So this rise is actually a sign of our economic recovery and a very welcome Christmas bonus for retirees living on fixed investments. Naturally we all hope that the recovery continues, that the rest of the world soon follows Australia, and that we're not going to be hit by a significant spate of interest rate rises in 2010.

In the mean time, please have yourself a merry little Christmas, you've earned it!

# Don't ignore a world of opportunities

**One year after the global economy plunged into the worst recession in decades, Australia has cemented its reputation as the Lucky Country. Investors could be forgiven for asking why anyone would live or invest anywhere else.**

In fact, Australia is the only advanced nation to escape recession this year. According to figures from the International Monetary Fund, Australia's economy is on track to grow by 0.7 per cent in 2009, compared with an average of -3.4 per cent for the top 33 economies.

The economy is in such good shape that the Reserve Bank of Australia (RBA) has gone out on a limb and started lifting interest rates.

As a result, overseas investors have been piling into Aussie dollars, shares and bonds. The Australian share market recovered 48 per cent from its low in March to the end of October and the dollar managed a similar feat, up 50 per cent from its low in October last year.

While there's no question that Australia is a great place to live, there are compelling reasons why it is as important as ever to build a diversified investment portfolio with a range of asset classes and geographic locations.

## **The attraction of international investments**

When it comes to investing, size matters. The US accounts for more than one fifth of the world's gross domestic product (GDP), twice that of China, and one third of world equities, real estate and debt securities.



Australia accounts for just 1.2 per cent of GDP and 1.7 per cent of world assets.

Choice is another reason to look beyond Australia's shores. If Australians want to share in the future profits of global heavyweights such as Microsoft, Google, Sony, Toyota, Johnson & Johnson, Nokia and British Petroleum they have to invest overseas, even if they do so via an Australian-based managed fund.

Timing and market cycles should also be taken into consideration. While Australian shares are enjoying their moment in the sun, at some point they will be eclipsed by other markets. As the past year proves, it is impossible to predict what lies ahead. So it is prudent to ensure you are not overly exposed to a single market or investment.

Asset consultant Mercer believes overseas shares have been undervalued for the past year. In its October market valuation report it points to the stronger outlook for earnings growth in the US and notes that while Australian shares are fair value, they are no longer trading at bargain basement prices.

We're not suggesting selling Australian shares to buy US shares. Far from it. There is still good reason to buy Australian.

We have the good fortune to be a major exporter of commodities in a region where demand is high.

The better-than-expected performance of company profits means Australian shares have been able to recover a significant amount of lost ground.

While company profits were actually down around 15 per cent in the year to June 30, the market had been bracing for worse.

The rapid rise in the Aussie dollar has also increased the attraction of Australian shares for local investors.

## **How do currency fluctuations affect the mix?**

While it's prudent for Australians to diversify their investments beyond the local market, currency fluctuations add another layer of complexity. When the Australian dollar strengthens, investment earnings measured in foreign currencies, especially the US dollar, are worth less when converted into Australian dollars.

For example, while the MSCI global market index excluding Australia jumped 17.1 per cent in the year to October 31, in Australian dollar terms it actually fell by 14.5 per cent. This occurred because the Aussie dollar moved higher over the period.

Of course, the currency effect works both ways. When the Australian dollar weakens, foreign investment earnings are worth more when converted back into Aussie dollars. Hedging can help to reduce the impact of currency fluctuations, especially for Australian investors with a stake in international markets.

In other words, investing is always a case of swings and roundabouts with good reason to diversify your investments while you stay the course. If you want more information about the extent to which your investments are diversified just give us a call.

# The good, the bad and the ugly



**There's good debt and there's bad debt, and then there's the good debt that can get pretty ugly if it's not managed properly. In a nutshell, good debt is when you borrow to buy an appreciating asset and bad debt is when you borrow to buy a depreciating asset or to meet day-to-day expenses.**

The trouble with bad debt is that you can often be paying for it long after you have forgotten what it was you bought in the first place! And if your bad debt is on a credit card, then it can be all too easy to let the debt roll over each month.

Good debt, meanwhile, can provide you with a platform to accelerate the growth of your wealth. Borrowing to buy an appreciating asset such as a share portfolio or property means you can get more for your money, and then leverage off that larger slice of the pie. In many instances you can claim tax deductions on the interest paid on good debt borrowings.

The equity you have built up in your home can increase either by making additional repayments while interest rates are still low or simply through rising property prices. If you then take out an investment loan with that equity as security and invest, say, in a share portfolio, you can use the dividends you earn from your share portfolio — your good debt — to make extra payments on your mortgage.

This can accelerate paying off your home loan. Each year as you pay off more of your mortgage, you can extend your investment loan, so the investment loan increases while the mortgage decreases. Once your mortgage is paid off, you can

either sell your portfolio to clear the investment loan, or keep the portfolio going and use future income from your dividends to reduce the loan.

Margin lending can also be in the good debt basket. As long as you are not too highly geared, the market needs to fall by a significant amount before you would be asked to make a margin call to bring your loan-to-valuation ratio back into line.

To make doubly sure you are not hit for a margin call, consider making regular interest payments and reinvesting income from your investments rather than capitalising the interest (adding the interest to your loan amount).

Margin lending has become more attractive since the reduction in the caps on deductible contributions to super. Since July of this year, the maximum concessional contribution to super has been slashed from \$100,000 to \$50,000 each year — and to \$25,000 if you are under age 50.

As a result, you may find you need other ways to accelerate your wealth, particularly in light of the share market shakeout we have experienced over these past 22 months. Leveraging through margin lending can provide that option but it is not suitable for all investors. Margin lending can be considered as one part of an overall long-term strategy with a time frame

of at least seven years.

Whether debt is good or bad, it's always good to clear it as quickly as possible. It is wise to pay off your bad debt before your good debt as you should be able to take advantage of the tax concessions available with your good debt.

In years gone by, it was common to wait until you had saved up for what you wanted. Nowadays the ease of obtaining credit cards and loans can lead to reckless behaviour. But there's still an important place for good debt. Given most of us will have a lot more years in retirement and would like to be self funded, borrowing to accelerate wealth can prove to be a very successful investment strategy.

It's just important to remember to keep bad debt to a minimum and make sure you use good debt wisely — otherwise it can all turn a little ugly.





# WHY A NEW YEAR **Revolution** *is better* THAN A NEW YEAR RESOLUTION

**It happens every 31st of December. Millions of people all over the western world promise themselves to improve at least one important aspect of their lives and make it their New Year's Resolution to do so.**

According to Wikipedia, the most popular resolutions remain unchanged year after year, drawn from a list that includes getting out of debt, saving money, getting a better job, getting fit, reducing stress, drinking less alcohol, and quitting smoking. Sound familiar?

These are all important and worthwhile goals, but here's the sad thing. Research indicates that by January 7th of the new year, 25 per cent of these resolutions will already be broken. And this attrition rate will continue, so that up to 80 per cent are likely to have been abandoned before March 1st.

So how can you make sure that you will be one of the minority who do not break their new year's promise to themselves? We think the answer is a New Year Revolution instead of a New Year Resolution — a whole new way to approach this important commitment.

The first thing you should do is decide whether or not you have the time and energy available to achieve the change you want, because if your life is already overcommitted you are more likely to fail than to succeed. If your day is already overcrowded, for example, it is unlikely that you will find the extra 30–60 minutes each day to jog, swim, ride a bike or go to the gym unless you drastically reorganise things.

It is also important to prepare yourself long before New Year's Day. Don't promise yourself to start eating healthier food from January 1st and then do nothing about it until after feasting at Christmas.

Start investigating a healthier eating plan now, source suppliers of healthier foods like an organic home delivery service, see a nutritionist if you need to, and be ready to start your healthy eating plan on January 1st.

Similarly, if you are resolved to achieve a healthier work-life balance in 2010 by giving more time to your partner, family, social life or personal fitness, you are going to have to work out how to implement your new priorities well before the new year starts. Isn't the December break a great opportunity to experiment with some new routines and make some key decisions about how

you can spend fewer hours at the office without sacrificing the quality of your work?

As you can see, the difference between wishful thinking and real behavioural change is commitment and a plan, and this is never more important than when planning a brighter financial future.

In a famous Yale University survey, graduates were asked if they had ever written down a financial plan. Only 3 per cent said Yes. Twenty years later, they quizzed the same graduates about their financial worth. The 3 per cent who had taken the trouble to write down a plan were richer than the other 97 per cent put together. (It also helps if you can automate the plan — a bank transfer to place part of your salary to an investment account every month, for example, eliminates the need for willpower.)

And finally, tell all your friends about your resolution so you can earn their praise if you succeed and feel their scorn if you fail — peer pressure is a powerful incentive!

**Commit, plan and make your commitment public:** three simple steps to staging a New Year's Revolution in 2010!