



## It's a Long Way To The Top

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Governments of industrial countries have a challenge ahead of them. For many, the conundrum exists in that they have unusually high debt (due in-part to massive stimulus spending through the Global Financial Crisis ('GFC')) and improving but still fragile economies that could benefit from further support. As the world has begun to show signs of recovery, governments are now facing the reality that they may need to enforce tighter fiscal policy (i.e. reduce government spending) which could slow down the pace of the recovery.

According to Bloomberg, rich nations will reduce their primary budget deficits by a record 1.6% next year<sup>1</sup>. The cost of this will be 0.9% reduction in Global Gross Domestic Product ('GDP' – which measures the growth of an economy) in 2011. That is quite a significant drop. However, Bruce Kasman, Chief Economist at JP Morgan, still expects global GDP growth to post a solid 2.8% in the first half of next year (down from 3.8% from the quarter just ended)<sup>2</sup>.

This is risky business for a number of reasons.

Firstly, if governments move too hard and fast they could overstep their mark and induce a recession. Obviously this is not a desirable outcome (except to fulfil the prophecy of economists from the doom and gloom camp who have been talking up a double dip recession for some time).

Secondly, interest rates in the US, Europe and Japan are already at or near zero giving those governments no room to loosen monetary policy (i.e. reduce interest rates to help stimulate the economy).

Thirdly, the capacity for governments to continue to borrow, as they did through the GFC, has diminished somewhat.

If governments get it right however, we should see sustained and moderated growth which is ideal for long-term prosperity. For example, Australia's GDP has grown at an average annual rate of 3.6% for the past 15 years and has rewarded us with one of the best standards of living in the world<sup>3</sup>.

Compare that with GDP for the past 12 months for emerging markets such as China (11.9%), South Korea (8.1%) and Brazil (9.0%)<sup>4</sup> and you get an instant feel for where a large proportion of our growth is coming from. With our Asian neighbours growing at such a rapid pace, their hunger for natural resources to feed their rapidly growing property and infrastructure sectors will provide our economy with support for some time to come. However, this doesn't mean that things will be rosy for the Australian economy from here to eternity because history tells us that developing economies can be very volatile.

For the developed world, in particular Europe and the US, there have been a number of effects which may result in what some refer to as an anaemic or slow recovery. One explanation for this put forward by van Eyk Research refers to a feedback loop in which lower perceived levels of household wealth lead to higher savings rates, lower consumption and therefore lower economic growth<sup>5</sup>. It will be a long road back to prosperity for these countries with a few risks along the way.

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1 Source: Bloomberg, July 2010.

2 Source: Bloomberg, July 2010.

3 Source: EquitySuper research, July 2010.

4 Source: Franklin Templeton Investments, 2010.

5 Source: van Eyk Research, July 2010.

For sharemarkets, the past two months have been driven by uncertainty. Investors seem reluctant to see share prices as attractive at present valuations, and as negative sentiment builds momentum (as we have seen over May and June) sharemarkets tend to retest recent lows.

For the astute investor this can present opportunities for investment. The EquitySuper Investment Committee has identified a number of opportunities that should bring investors continued outperformance relative to other Superannuation Funds. For the 2009-10 financial year to the end of May, our Balanced Fund has outperformed its competitors by 4.04% on average according to the Morningstar Peer Group Wholesale Super Multisector Balanced index<sup>6</sup>. This outperformance was achieved through a disciplined risk management overlay that is maintained by the Investment Committee.

Without risk there is no reward, and growth assets such as shares have inherent and unavoidable risk. It takes patience and discipline to avoid emotional decision-making and to then reap the rewards of long-term sharemarket returns. Emotional decision-making will, more often than not, detract from overall portfolio performance. The common issues that arise from regular switching include:

- Increased investment cost due to additional transaction costs;
- Failure to accurately time the market resulting in underperformance; and
- Incorrect asset allocation leading to potentially higher investment risk.

No investor (professional or amateur) has successfully and continually picked the highs and lows of the sharemarket, so it is somewhat surprising that some investors try their hand at this technique. Generally it is based on a hunch or sometimes just following the herd, but above all it is usually driven by fear. Bear in mind that it is not timing the market, but time in the market that rewards the astute investor.

Ian Huntley, Editor of Huntleys' Your Money Weekly at Morningstar predicts the Australian All Ordinaries Index could reach as high as 10,000 by 2016 from its current level of just over 4,400 (at time of writing) representing a 127% return over that time period<sup>7</sup>. On the surface this may seem like an extraordinary prediction, but history shows us that the average bull market recovery during a low inflation environment over the past 60 years has returned around 160% on the All Ordinaries from trough to peak. Since the commencement of the current bull market in March 2009 we have seen the All Ordinaries improve by 44% which suggests we may still have a long way to go...

## Financial advice

For any further information or to discuss your financial situation, please don't hesitate to contact me on **0413 244 733** or email **simon.whiteley@eqtsuper.com**. I look forward to hearing from you.

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<sup>6</sup> Source: Morningstar Research, July 2010.

<sup>7</sup> Source: Morningstar Research, July 2010.

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