

INVESTMENT SOLUTIONS

Spring 2015

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Welcome

In this edition, we analyse the recent drop in Chinese equity markets and how that may impact investments over the short, medium and long term.

We also look at the recent fluctuations of the Australian dollar and how it can affect not just the holidays you may be planning but your investment portfolios as well.

Our regular Market Update from Piers Bolger, Head of Diversified Portfolio Management at BT Financial Group, looks at the performance of overseas and local markets.

Finally, we share six valuable steps that can ensure your child's education is heading in the right direction.

Until next time – happy reading.



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Market update

BT Financial Group's Head of Diversified Portfolio Management, Piers Bolger, looks at what's happening in investment markets at home and around the world.

The outlook for the global economy remains mixed, with growth through the second half of 2015 likely to be below average. Australian economic growth is also expected to be subdued thanks to slower growth from China. As such financial markets are gyrating around multiple and divergent themes.

Global overview

The June quarter proved challenging and equity and bond markets struggled to deliver positive returns. There continues to be significant challenges for the global economy and financial markets.

The economic slowdown in China is producing volatile equity markets and in August the People's Bank of China (PBOC) devalued the Chinese Yuan to support the economy, particularly exports. This highlights the fragile nature of China's growth outlook.

In Europe, the decision by the Greek parliament to meet creditors' demands enabled the country to receive funding to avoid a collapse of its financial system. But there is still the potential for Greece to exit the European Union at some point. Its debt burden remains perilous and the country is experiencing a massive recession, so long-term challenges remain in place.

The US economy continues to improve, albeit at slightly below trend levels. However, a broader recovery is still taking place, highlighted by solid jobs growth and an improving wage environment. This should mitigate any potential drop in consumer confidence once the US Federal Reserve begins to normalise cash rates.

At home

We believe the domestic economy will continue to moderate further. The medium-term outlook remains challenging and will be linked to global macro events.

The RBA maintained cash rates at 2.0 per cent over the June quarter. The Reserve Bank of Australia's (RBA) most recent minutes contain scant commentary around the Australian dollar, which may indicate it is comfortable with the value of the currency. While the RBA has not ruled out the possibility of future rate cuts it seems it is going to take a wait and see approach as the economy transitions. We continue to expect the RBA will reduce rates by at least 0.25 per cent in the second half of 2015 given the current domestic outlook.

House prices in both Sydney and Melbourne continue to show good growth compared to the rest of Australia, although recently residential prices have started to stabilise. While the low interest rate environment is supporting higher house prices, we remain concerned about a potential medium term imbalance that could occur, given the current debt levels, should the economic outlook continue to deteriorate.

It's been a mixed bag for the equity market, with the ASX 200 down 6.6 per cent for the June quarter, although it is up by 1.2 per cent year-to-date, which highlights the volatility challenges facing the market.

The local market continues to be buffeted by weaker data out of China, along with demand/supply imbalances across a number of key commodity markets including iron ore and oil as producers look to maintain high levels of production.

While any further domestic interest rate cuts are likely to provide a positive tailwind across the higher yielding sectors, investors need to remain focused on the quality and sustainability of company fundamentals. In August all eyes were on reporting season. As anticipated, cost and expense management remained core themes, consistent with prior reporting season updates.

Earnings growth is set to be relatively modest at 5 to 6 per cent, which does make it a challenging period for the market to move materially higher in the near term.

The China syndrome: What's next?

Although the troubles in Greece's economy have been the main event in global share markets in recent times, there's a more pressing worry in international markets that's closer to home.

The past couple of months have seen the Chinese share market lose more than 20 per cent of its value, which equates to around US\$2 trillion. As it is Australia's largest trading partner China's fortunes have a range of implications for investors.

China has seen extraordinary economic growth over the past 20 years, driven by aggressive investment in infrastructure and population movement to urban areas.

The stock market, however, has been volatile over this time. It underwent one boom-bust cycle between 2006 and 2009, with share values rising five-fold between 2006 and 2008, before most of those gains were lost. The stock market was then relatively subdued until late last year when it started bubbling again.

Before 2006, Chinese households directed most of their investments towards the property market. But this focus shifted to the equity market when the government introduced measures to curtail property investment.

Today, the renewed interest in the stock market again reflects a switch out of the property market by households. There is also a perception the government has supported the stock market by allowing more trading accounts and margin lending.

These factors have seen retail investors in China dominate the share market. This is in contrast to share markets in other countries, which tend to be led by institutional investors.

This is an important consideration given retail investors tend to speculate more than institutional investors and have a poorer understanding of what they are investing in, which can make for a more volatile market.

The current situation

As the share market rose rapidly thanks to the flood of retail investors entering it, the Chinese government became concerned about the potential for a bubble and introduced measures to control it. Here are some examples:

January

- Minimum amount of cash required to trade on margin loans was raised.

- Strict enforcement of margin trade regulations.

April

- Ban introduced on brokers helping clients to evade limits on margin trading using specially designed financial products.

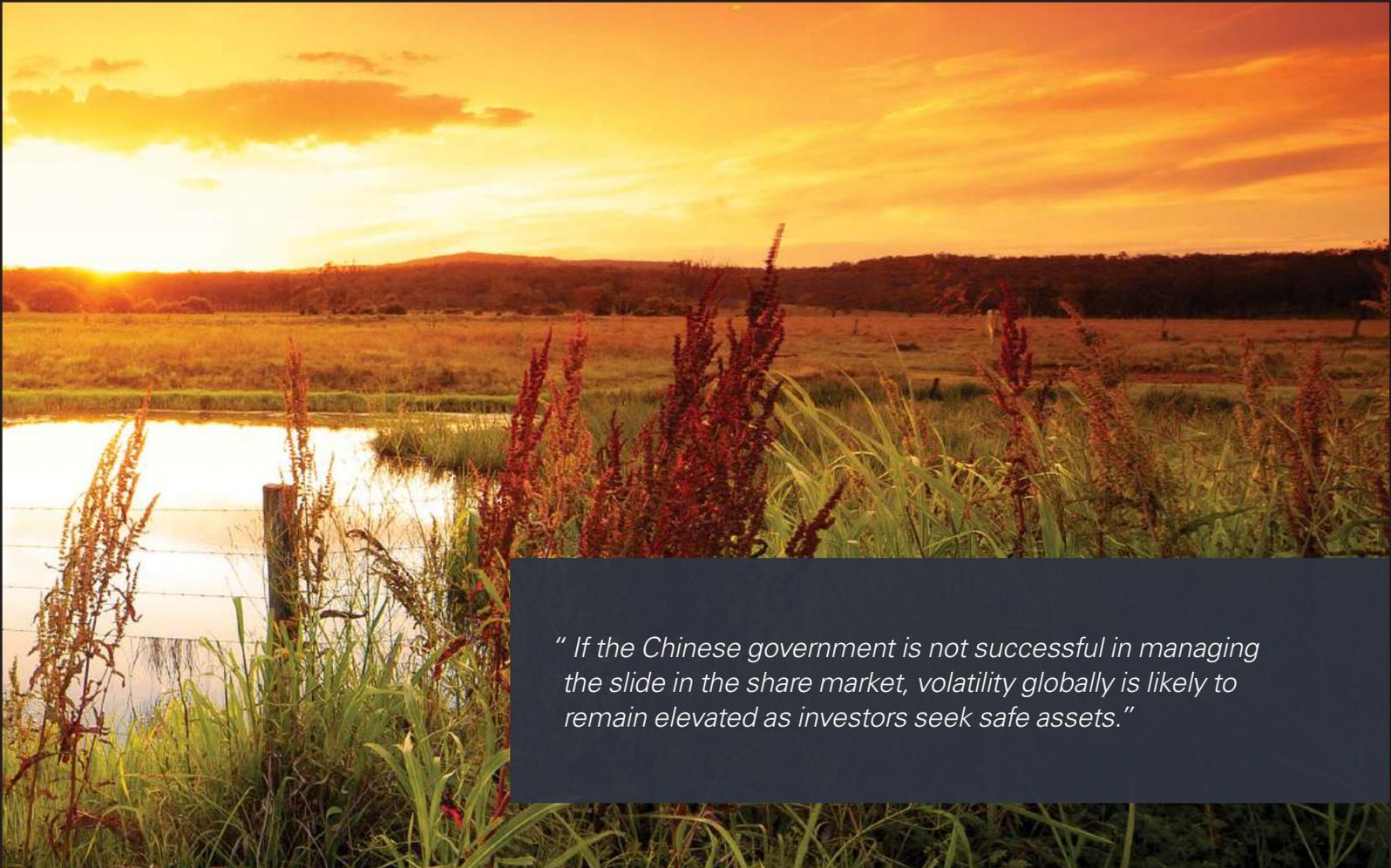
June

- Volume of margin lending stock brokers can do limited.
- Ban on using financial products to get around the limits on margin trading reinforced.

The Chinese share market has rapidly declined following the introduction of new regulations. There has been a trickle-down effect to other markets, with commodities in particular affected by the Chinese share market sell down.

Government intervention

Following the decline of the share market, the Chinese government responded by introducing a number of interventions to restore share market confidence.



“ If the Chinese government is not successful in managing the slide in the share market, volatility globally is likely to remain elevated as investors seek safe assets.”

One of the most significant initiatives has been a \$US42 billion investment by the Chinese government in the share market via brokerage firms. This has been in addition to the Securities Association of China pledging money to invest in the Chinese market. In addition, the government reduced the official cash rate to encourage borrowing to invest in equities.

On top of this, China reduced limits on margin lending and allowed investors to use their houses as collateral for investing in shares. At the same time, a cap was introduced on short-selling of shares to help reduce the downward trend. Additionally, pension funds and social security funds have been encouraged to invest more money in shares.

Other temporary measures

There have also been other measures introduced on a short-term basis to help support Chinese share prices. For instance, a number of new initial public offerings have been postponed and companies have also been allowed to suspend trading in their shares. To stabilise the market the government also ordered all large shareholders

with stakes of more than five per cent in a company not to sell their shares for up to six months.

These measures have not completely stemmed the flow of funds out of shares. But there are tentative signs the downward trend is slowing and China is likely to continue to introduce new measures until the market does stabilise. This is because it recognises fully functioning capital markets are critical to the country's economic outlook and further development.

Implications of intervention

If the Chinese government is successful in managing the slide in the share market, in the short-term volatility across markets should ease and commodity prices should recover, which will benefit Australia. Longer term, the support measures will need to be rolled back otherwise they could eventually cause another surge in the equity market.

If the Chinese government is not successful in managing the slide in the share market, volatility globally is likely to remain elevated as investors seek safe assets. This sort of market

can be challenging. But it can also create opportunities for alternative investment strategies. It might also produce buying opportunities for blue-chip shares whose prices have fallen with the market.

However, it's worth noting Bloomberg's figures for July indicate the Chinese share market has risen by more than 80 per cent compared to 12 months ago. So the current downturn could be a correction to true value, and the market may begin to stabilise from this point.

It's important for investors who wish to gain exposure to the Chinese market to seek advice before taking a decision to invest. So talk to us today about the dynamics of the Chinese market and how it could impact your portfolio over the short, medium and long-term.

Unpacking the dollar: How the falling AUD may affect more than just your planned overseas trip

Keeping an eye on the value of the Australian dollar has always been a sensible approach for travellers and it's something investors should also keep sight of too.

Anyone who invests in international assets, from shares to commodities, is exposed to foreign currencies, and feels the impact of how these are valued against the Australian dollar and against other assets. This can add or remove value from your portfolio depending on market activity.

The value of a dollar

The Australian dollar can be influenced by a number of factors:

- Inflation
- Commodity price levels
- Financial market sentiment
- Volatility in asset markets
- Global investment flows
- Movements in interest rates
- Speculator positioning

All these factors work together to determine a price for the Australian dollar, which fluctuates against other world currencies.

High or low

Australia's economy typically benefits from a lower Australian dollar compared to the US dollar (though online shoppers may dispute this). A lower Australian dollar assists in supporting our export markets as countries can purchase more for a lower cost, and can offer a welcome boost to tourism as a traveller's coin extends further.

While the Australian dollar rose over the latter part of the global financial crisis, it has started to return to lower levels. This is welcomed, and supported, by the Reserve Bank of Australia.

But while it may be positive on the whole for the state of the economy, the sentiment may not be same for investors in overseas assets.

Currency and the value of international investments

When making overseas investments, you can take two approaches.

1. Invest wholly into the investment, for example, 100% into international shares.
2. Invest into a hedged investment which means that a portion of your investment is allocated specifically to manage the risks that the currency of the investment decreases against your own currency.

Investors generally select an option based on their view of whether the Australian dollar is likely to increase or decrease.

For example, if you think the Australian dollar is going to decrease, you may choose the first option, to be completely invested. This would mean that, assuming consistency in value of other global currencies, if you redeemed your investment you would hope to gain extra value from the currency conversion, aside from any growth in the investment.

On the other hand, if you thought the Australian dollar was going to increase, you may choose the second option. This would mean you are seeking to minimise value loss from the currency conversion.

Which option is correct is not necessarily as simple as the direction of the Australian dollar given its relationship with other global currencies. Currency fluctuations can be short or long term depending on market activity and the domestic situation of a country. The constant changes mean it can be difficult to manage currency in your investments and having expert advice or investment managers can be invaluable.

Combining approaches for the best of both worlds

Some investors use both approaches in their investment portfolios. This means they might receive extra returns from currency conversion as well as helping to reduce losses if the currency goes in the other direction.

It's worth talking to us about how currencies impact your portfolio, so give us a call today, we're here to help.

Start now to give your children the best start

Everyone wants the best for their children. Providing a good education is a huge part of preparing them for the best possible future. But as education becomes more expensive, planning and budgeting for these costs becomes essential.

If you're planning to send your children to a private school, you are probably already juggling a mortgage, ongoing household expenses and the day-to-day costs of raising children such as sports and other activities. It's not easy to save extra while still maintaining the lifestyle that you enjoy.

Here are some steps to help you get on the right track to fund their education.

1. Start now

The sooner you start saving the better. Consider a regular investment plan to take advantage of compounding interest.

2. Make sure your insurances are adequate and up-to-date

Think about income protection, life insurance and cover for extended illness.

3. Pay as much as you can afford into your mortgage with an offset/withdraw facility

This will help reduce the interest and then have the option to redraw to pay for school fees.

4. Work out how much you need to put aside

The table shows a rough guide to the costs of primary and secondary education. These figures represent the upper ranges that parents can reasonably expect to pay, although fees vary across states, ages and schools.

5. Make the most of gifting

For grandparents and those wanting to give something special, a savings account could be a great way to give a new baby something that will grow with them.

6. Pre-pay education expenses

If you already have children at school, check if the school allows you to pre-pay fees at a discounted rate. If you are able to pay upfront, it may help reduce the worry about rising costs into the future.



Primary	Secondary
Government primary school: \$500 – \$3,000	Government secondary school: \$900 – \$4,000
Systemic primary school: \$3,000 – \$6,000	Systemic secondary school: \$8,000 – \$11,500
Private primary school: \$9,500+	Private secondary school: \$13,000+

Source: Australian Scholarships Group (ASG)

Take a moment to make sure you're on the right track. Get in touch with us today about what you can do straight away to ensure your child's education is the best it can be.

Source: http://www.asg.com.au/assets/files/asg_edcosts_schoolcosts_2012_nat_metro.pdf



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