



Informed investor

A Market Update - August 2011

Ratings agency S&P downgraded the US long-term rating on the weekend from AAA+ to AA+. Simply, a country's credit rating is, like a personal credit history check, an assessment of the likelihood a country will make timely and regular payments on its debts.

The main messages

1. Don't panic.
2. Investors will react in knee-jerk fashion to the downgrade by S&P. Bear in mind that the other two major ratings agencies have not followed suit, and this really tells us nothing that we didn't already know. Nevertheless, consumer sentiment—already fragile - will be affected, so the chance of a US “double dip” recession has increased slightly. However, BT chief economist Chris Caton says he would still estimate the likelihood of that happening at less than 1 in 4.
3. Look at long-term as really being long-term. Short term volatility is normal market behaviour, but you need to put this in perspective with long-term performance. BTFG investment specialist Michael Bailey said:
 - The average 1-year bounce from a severe market fall has been more than 30 per cent in Australia and the same in the US.
 - History says there will always be a bounce back.
 - The long-term direction of the share market is up.
 - You don't realise a loss unless you have to sell assets.
 - To put it in perspective, compared to the falls in 1987 where the market fell 40% in a day, our market has fallen 7% this month, similar to the US and some European markets have fallen 10%.
4. This fall highlights the need to get financial advice early. You will not need to sell and realize a loss in assets if your long term strategy still holds and you have sufficient cash holdings to fund your immediate needs.

Background: What happened – why is the market crashing?

- The lifting of the US debt ceiling last week and the subsequent downgrade by ratings agency S&P on Friday confirmed a fall in confidence in the US political system and its ability to react quickly to decisions regarding its fiscal system.
- This came on the back of a series of weaker than expected US economic numbers, which established a view that US growth forecasts for coming quarters were way too high. Previously, the prevailing view was that slowing US growth was due to the knock on effects of the Japanese earthquake and seasonal issues, but this view has now shifted to an expectation of slower growth for longer and the market has responded accordingly.
- Last week the the European sovereign debt situation also deteriorated further, with Italian and Spanish bonds in the spotlight although the ECB (European Central Bank) has now stepped in to buy Italian and Spanish bonds.
- Further selling is likely in the short-term if economic data continues to disappoint and initiatives to curtail the sovereign debt problems are not seen as sufficient.

What it means for Australia – and my investments

The Australian share market is likely to be influenced by these macro (global) issues for the short-term so you can expect returns to mirror US and European markets rather than stock specific issues.

The Australian market is arguably more insulated from the global issues.

- Our market is more reliant on emerging markets, which are less affected by current global market falls.
- The large amount of investment in the resources sector is likely to continue, providing a solid base for earnings for next year for many companies.

Other positives for Australia

- Australia doesn't have a huge government debt burden compared with the US.
- Australia is also able to use monetary policy to cut interest rates if necessary.
- Any sell off in the Australian dollar is likely to help the Australian market.
- Stock market fundamentals for the market are still strong.
 - Stock valuations are supportive.
 - Companies with solid earnings records and prospects have been sold off in the general uncertainty, which means that there are bargains out there for discerning investors.
 - It's business as usual for many companies. The RIO buyback and announcement bid for Coal & Allied this morning demonstrated that those with cash are prepared to spend.

Differences between now and 2008

- Australian companies have strong balance sheets – not crippled by debt even if interest costs increase many companies are cashed up.
- Valuations in Australia are attractive.
- We have a better understanding of the scale and size of issues than in 2008.

What can we expect in the short-term with our investments

- We're living in a world that is highly uncertain, volatile and extremely vulnerable to shocks of this nature.
- It is likely that the volatility will continue this year and the early part of next year.
- The debt issues have brought global leaders together having discussions. There is more to the discussions than is reported in the papers.
- There is a coordinated effort by global governments to stem the rout that's taken place in the marketplace and attempts to steer the global economy onto a more sustainable growth path.
- There has been much written about Australia's two speed economy with the domestic economy facing headwinds of higher interest rates, the higher currency and cautious consumer sentiment. Much of this sentiment has been factored into share prices already, so any further short term weakness may present some good buying opportunities down the track.

If you have any queries about your investments, please feel free to contact me on 02 6620 0300.

Source: BT Financial Group - 8th August 2011

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