

AVENUES MARCH 2009



Welcome to Avenues

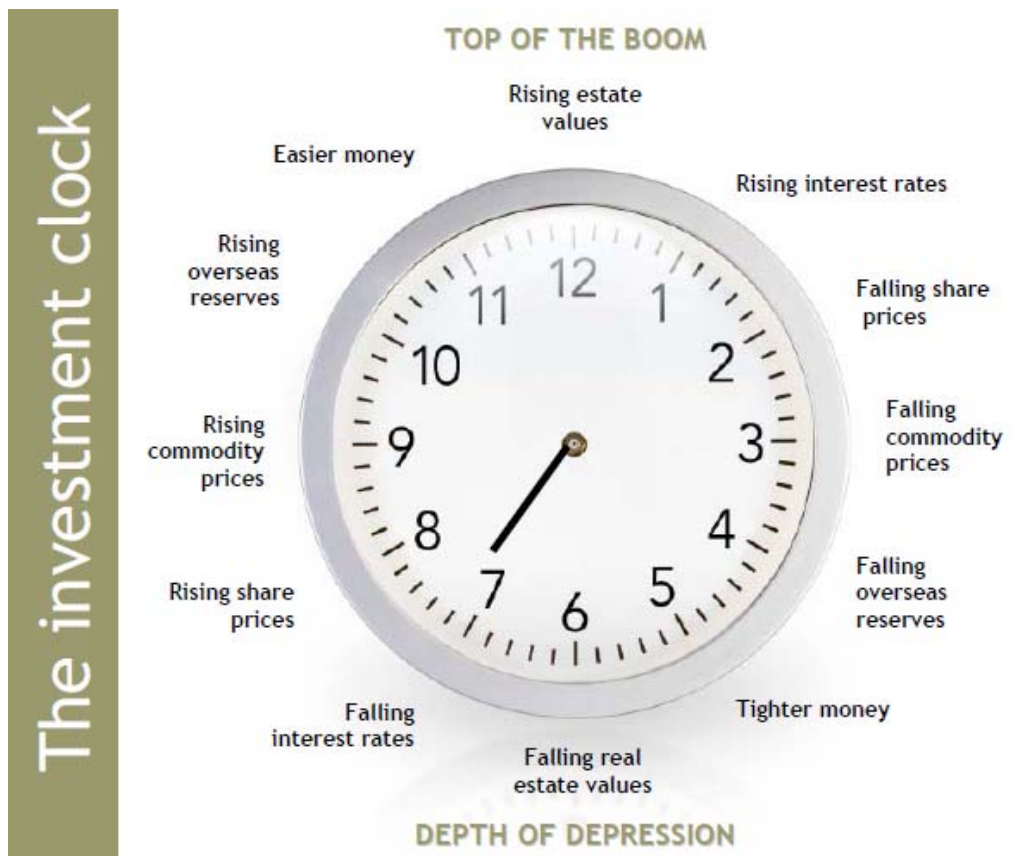
They say that those who forget the lessons of history are destined to repeat their mistakes.

In this edition of Avenues we look at history to see what changed in previous downturns and what we might expect from the current turmoil.

What time is it?

Economies go in cycles. Although no 2 are the same, there are recurring patterns.

The investment clock shows the typical cycle of fall and recovery. It's a general indicator, and although we can't tell exactly what time it is, it's a simple way to view the relationship between investments such as property, shares and fixed interest, and the order they tend to occur.



The investment clock

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## History lessons - what's really changed?

With continuing global financial turmoil, it's easy to imagine that everything under the sun has changed.

We think it's timely to look back at recent Australian history to see what really changed, and what's likely to change as a result of the last few months.

### First the good news

It's a brave investor who claims to know the timing and scale of our recovery from the financial crisis. Most commentators agree that ultimately the economic cycle will turn positive, as it has always done in the past.

However, as far as economic events go, this is a big one and will no doubt leave its mark.

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### 1970s

The oil price induced recession in the early 1970s forever changed the way we viewed the cost of energy. With oil no longer as cheap as water, alternative energy sources were developed, cars got smaller and we became more conscious of energy conservation.

### 1980s

A decade later, after another severe economic trough characterised by significant wage push, inflation and industrial disputes, both sides of Australian politics concluded that we couldn't compete internationally without significant industrial relations reform.

The Hawke government's Prices and Incomes Accord revolutionised how workers, governments and employers approached wage and workplace condition agreements.

### 1990s

The most recent recession of the early 1990s, the recession "that we had to have" was characterised (but not necessarily caused by) short-term interest rates of around 18%.

The subsequent slowdown in the economy and bursting of the asset price bubble was arguably the only way in which high inflation could be rid from the economy. Policy makers agreed that interest rates were the best defence against inflation. Ensuing dedicated use of interest rates to target inflation led to at least 15 years of low inflation.

### What's likely to change now

The current financial crisis essentially began in the financial system, where it's likely the greatest permanent change will take place.

We can expect:

- A significant exit of non-bank financial institutions, particularly those built around the investment bank model.
- A far greater proportion of the global financial system will come under bank-like supervisory arrangements.
- That authorities are unlikely to again allow less regulated institutions destabilise the system.

**The return of the regulator**

The financial crisis has also shown widespread failure of banks that operated and complied within the supervisory framework. Tougher supervision is a likely permanent outcome with a heavy emphasis on the credit quality of bank assets.

No matter how stringent the supervision, the financial crisis shows how easily confidence in our banking system can be eroded. Free market economies rely on a stable financial system and the promise of financial institutions to repay. Once this confidence is lost, government intervention appears to be the only option. The financial crisis has ended any visions of a completely free or deregulated financial system.

Also at the centre of the financial crisis were the credit rating agencies, which the financial system relied on to rank and assess the risk of various financial instruments and companies. The extent to which financial institutions will rely on third parties to effectively assess the risks of their assets may also change forever.

**The smart investor learns lessons**

According to the old adage, those who forget the past are bound to re-live it. Certainly there are some lessons we should work hard to remember.

Complex financial products make it difficult for investors to assess the real risks and return opportunities. These are likely to be shunned by investors in favour of more traditional investment options.

Some investors will still seek riskier assets, as taking risk is the only way to earn returns above the risk free rate. But recent experience reinforces the importance of being able to assess this risk to determine whether there is enough premium in the prospective return to justify the risk.

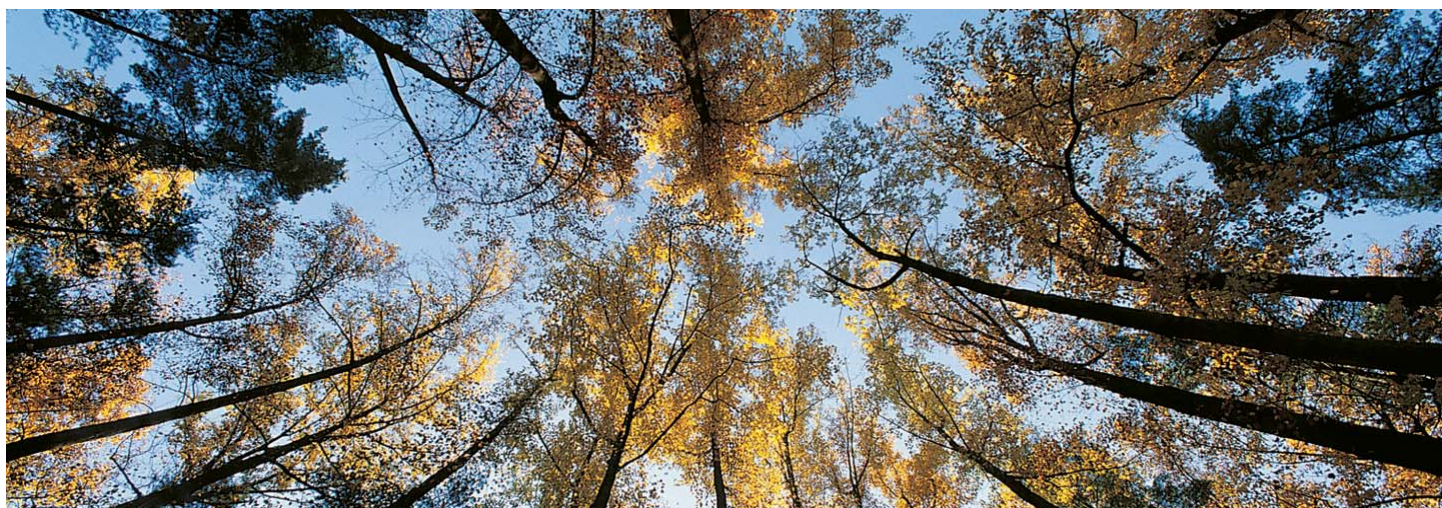
The more complex and engineered a financial product is, the more difficult this critical assessment becomes.

The financial crisis has reminded us that portfolio diversification is another way to minimise risk. Those investors who had part of their investment portfolio linked to traditional government bonds would have enjoyed double digit returns from at least part of their portfolio over the past year - helping to offset some of the losses from growth assets.

**Other lasting effects**

In addition to the lessons that financial crises has taught or re-taught, the other bright side to the crisis is the permanent improvements that it will create.

Banks will be better regulated and safer; ratings agencies will become more accountable and more accurate as a result; companies will operate with lower levels of debt leading to a more stable earnings stream; and those previously employed in investment banks building complex financial products will ultimately be redeployed to perform activities which create a sustainable contribution to economic growth.



## Accentuating the positive

In the last edition of Avenues, we looked at some of the good news about Australia in spite of the global financial downturn.

Here is an update on some of the positives that we've seen in the first quarter of 2009.

**We're saving more.** Up until recently, there was a lot of media comment over the debt burden being carried by Australian households, with high levels of borrowing to fund new homes, more cars and high tech equipment. But this trend seems to have been reversed, with household saving ratio (household savings measured against net disposable income) rose from 3.4% to an 18 year high of 8.5% in the December quarter. Interest rates are also at their lowest level in a generation.

**Australia is still doing better than most comparable economies.** GDP growth turned negative in the December quarter. But the US, UK and most of Europe fared worse, as did several major Asian economies such as Japan, Korea and Singapore. This should mean we are better placed to emerge from the downturn faster than some comparable economies.

**The global response has been strong.** Governments have intervened beyond most people's expectations, often in a coordinated manner across national boundaries.

Across the world a wave of public infrastructure projects have been announced. Here in Australia the federal government has presented an unprecedented \$42bn stimulus package.

## Talk to your financial adviser

It's important to remember that amid the gloom, there is still some positive news.

If you are concerned about market volatility or have concerns over your financial circumstances, please pick up the phone and talk to us - we can help you to determine the best strategy to make sure you are still on track to achieve your financial goals.

As Franklin D Roosevelt said amid tumultuous economic times last century, "The only thing we have to fear is fear itself".

Remember, we are partners in challenging times just the same as in times of plenty.



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