



With compliments from your AFG adviser

WINTER 2008 EDITION

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## economic outlook

### Outlook for Investment Markets

Further evidence of slowing growth make the outlook for domestic and global shares less positive, although the Australian sharemarket should fare better than most overseas markets. Yields on global corporate bonds are now more attractive than they have been for some time.

### Australian Equities

Despite a modest rally in March after the Federal Reserve's rescue of Bear Stearns, the S&P/ASX200 Accumulation Index was down 5.50 percent for the past three months, and down 12.90 percent for the year. With the credit crisis still in full cry, financials lost 16.90 percent for the quarter, the banks being particularly affected. Among them were the threat of Brambles losing its Wal-Mart business, and Wesfarmers' need to tap the market for a further A\$2.50 billion of equity to repay the debt taken on to buy Coles. Resources stocks fared better, the S&P/ASX300 Resources Index having recovered to not far below its previous peak last October.

Evidence of slowdown in the Australian economy is widespread. Retail sales numbers show little or no growth; consumer confidence is well down; business conditions have softened further; and jobs growth has slowed. The areas most exposed to interest rates have been weaker, and housing finance approvals have fallen much more sharply than expected. Even with this slowdown, though, the outlook for the Australian economy and sharemarket remain better than for most other places. And although the Chinese authorities may have to engineer their own slowdown, affecting the resources stocks, very large price increases appear to be in the pipeline for iron ore and coking coal which will be supportive.

### Australian Cash & Fixed Interest

Ninety-day bank bill yields peaked at 8.10 percent on 10 March, and have come down to just below 7.90 percent. Ninety-day yields rose some 0.75 percent over the quarter, principally reflecting the Reserve Bank's two interest rate rises. Commonwealth bond yields moved a little higher, to 6.20 percent for 10-year bonds. Corporate bond yields are substantially higher for the quarter, the average yield now just over nine percent, an increase of one percent for the quarter.

The Reserve Bank has now increased interest rates by one percent in four steps, so the issue is whether the Bank feels it has done enough to bring inflation back



into the two to three percent target band. Although headline annual inflation at the end of the first quarter of this year was 4.20 percent, higher than either the Bank or forecasters had anticipated, the Bank appears to be waiting to see whether the medicine will do its work. The financial futures market currently sees no further increase and a chance of the first rate cut by the end of this year. Bond yields have on average risen well clear of the cash rate, in the wake of increased investor nervousness about borrower quality. Both the running yields on offer and the potential for capital gains down the track make domestic bonds more attractive than they have been for some time.

The \$A got as high as 94.75 US cents on 28 February, and although it has edged back since, the \$A is still well up against the \$US for the quarter, with a 5.40 percent increase. This translated into a more modest 3.80 percent increase in overall trade-weighted value for the period. The outlook for the \$A remains positive on economic fundamentals, with several supportive factors (notably world commodity prices and Australia's terms of trade) still running hot, although further credit crisis-related bad news is likely to lead to sudden sharp selloffs.

### Australian Property

The listed property sector has had another tough time. The S&P/ASX300 Property Trusts Accumulation Index dropped 8.90 percent for the past quarter, and that was after a bounceback from the very lowest point in mid-March. Even after adding back dividend income, the total return was a loss of 7.30 percent for the quarter.

The sources of the listed property sector's malaise are not hard to identify. Trusts with high debt levels have come under intense scrutiny because of the higher costs of refinancing debt and the depressed market

for any fire sale of assets. The outlook is also not promising for the retail-focused trusts exposed to the risks of slower consumer spending in the developed economies. The sector is likely to continue to languish until there is greater clarity around the financial state of each trust.

### International Equities

World shares are showing modest gains over the past month and quarter. This has been contributed by a rebound which started in mid-March, the catalyst being the Federal Reserve's rescue of Bear Stearns and the signal this sent that the Fed would act to prevent the worst downside risks of the credit crisis.

Recent indicators have revealed greater downside risk from international equities than upside potential. It is now clearer that the outlook for the US is at minimum a substantial slowdown, and at worst going beyond this into recession. 67% of economists in the Wall Street Journal's latest poll believed that the US economy is already in recession. They are picking slow or no growth in the first half of this year, and a slight pickup in the second half of the year. This may be optimistic – the International Monetary Fund is more bearish still, predicting a deeper and longer recession. Soaring energy and food prices also need to be factored into global growth prospects. The ultimate evolution of the credit crisis also remains highly uncertain. A number of central banks have demonstrated their determination to unlock the more gridlocked financial markets, through either cutting interest rates or active market operations. However, the scale of actual losses continues to surprise on the downside, and requirements on banks to

replenish their equity are substantially greater than thought previously. All this adds up to increased risks for international sharemarkets in the coming months.

### International Fixed Interest

Global government bond markets have been the mirror image of sharemarkets, bond prices rising as investors worried about shares and opted for the safety of highly-rated debt. Yields on corporate debt have also continued to rise as investors have worried about the stability of the issuers, although again the Bear Stearns rescue has led to some improvement. Even so, credit remains expensive, particularly for lower-rated borrowers, and some areas of global debt markets (notably those for mortgage-backed securities and collateralised debt obligations) remain highly-illiquid.

Global government bonds remain relatively unattractive because of their low yields in the 'flight to safety' environment. The higher yields from corporate bonds are more attractive. It's possible that credit crisis anxieties may worsen again, leading to a greater widening of corporate credit spreads and temporary loss of capital value. Even so, the running yield on overseas corporate debt has risen enough to compensate for these risks.

**If you are concerned about the current market volatility or wish to discuss investment opportunities, speak with your AFG FP financial adviser.**

Article provided by Morningstar issued 29 April 2008  
[www.morningstar.com.au](http://www.morningstar.com.au)

## plan for june 30, it's not to late...

The end of financial year end is fast approaching! Plan for the current tax season with these clever year-end tips.

These easy to implement strategies help to build and protect your wealth more tax-effectively. If you want to make the most of your opportunities this financial year, you'll need to act now.

### Simple super

By putting more money into your super before 30 June, you can take advantage of tax benefits that may not be available to you otherwise. For example:

- **Salary sacrifice.** Undoubtedly you would have heard this term used a number of times, but it's not about sacrifice, rather about investing a portion of your salary, at a better tax rate, into your super fund.

The beauty of this strategy is you pay less tax because your super contribution is taxed at a maximum rate of 15%. This could be much better than your marginal rate, which may be up to 46.5%<sup>1</sup>.

You can even use this strategy for any bonuses you receive.

- If you are self-employed<sup>2</sup> or not employed, you may be able to claim your personal super contributions as a tax deduction.

The more you do this, the less taxable income you receive, which reduces the overall amount of tax you pay.

If you earn less than \$58,980 pa and make personal after-tax super contributions, the Government may contribute up to \$1,500 into your account.

A key restriction is that you earn at least 10% of your income from eligible employment or carrying on a business.

Also, once the money is invested in super, earnings are taxed at a maximum rate of 15% (not your marginal rate) and no tax is payable on super benefits received at age 60 or over<sup>4</sup>.

So when you add it all up, it's no wonder super is regarded as one of the best places to save for your retirement.

### Consider the caps

Before you decide to invest more in super, you need to be aware that caps apply to different contribution types and penalties may be payable if you exceed the relevant cap. You also need to consider that super contributions generally can't be accessed until you retire.

So if you are saving for something else, you will need to consider other options.

**Cost-effective insurances**

Buying insurance through your super can be cheaper than buying it outside super.

The same up-front tax benefits available when investing in super generally apply when you purchase life and total and permanent disability (TPD) insurance through a super fund.

Also, if money is tight, it could be possible to have the premiums deducted from your superannuation account balance, without making contributions to cover the cost.

So, if you haven't got around to protecting you and your family's lifestyle, now is a perfect time to take some action.

However, if lump sum tax is payable on the death or TPD benefit, you will generally need to increase the sum insured to take into account the potential tax liability<sup>5</sup>.

**Manage capital gains tax**

Are you set to make a capital gain from a profitable investment this financial year? Well, what about selling a poorly performing investment before 30 June and using the capital loss to offset your profit?

Alternatively, you may wish to delay any sale of profitable assets until after 30 June. This way you can defer paying tax on the capital gain for up to 12 months. And, if you expect to earn a lower taxable income next financial year, the capital gain may be taxed at a lower marginal rate.

The beauty of this strategy is you pay less tax because your super contribution is taxed at a maximum rate of 15%. This is much better than your marginal rate, which could be up to 46.5%.

If you're self-employed<sup>2</sup>, another way to save on capital gains tax is to make a personal deductible super contribution with some or all of the sale proceeds. The tax deduction you claim could reduce, or even eliminate, your capital gains tax liability.

**Bring forward deductible expenses**

To reduce your taxable income this financial year, you could bring forward expenses that are otherwise tax deductible in the following financial year.

For example, what about pre-paying 12 months interest on a fixed rate investment loan, or pre-paying 12 months income protection insurance premiums outside super before 30 June this financial year?

**Next steps**

Speak to your AFG FP financial adviser who can help you identify the strategies that best suit your needs.

Note: You should never invest solely for tax reasons. If you invest in assets that fail to produce enough income or capital growth, your loss may outweigh any reduction in your tax bill.

- 1 Includes a Medicare levy of 1.5%.
- 2 To qualify as self-employed, you must earn less than 10% of your assessable income plus reportable fringe benefits from eligible employment.
- 3 Includes assessable income plus reportable fringe benefits.
- 4 Provided the benefit is paid from a taxed super fund (not an untaxed fund such as certain Government or public sector schemes).
- 5 While increasing the sum insured will increase the premiums, the after-tax cost will generally be lower when you take into account the up-front tax concessions when making super contributions.

**Tax rates 2007-08**

Taxable income	Tax on this income
\$1 – \$6,000	Nil
\$6,001 – \$30,000	15c for each \$1 over \$6,000
\$30,001 – \$75,000	\$3,600 plus 30c for each \$1 over \$30,000
\$75,001 – \$150,000	\$17,100 plus 40c for each \$1 over \$75,000
\$150,001 and over	\$47,100 plus 45c for each \$1 over \$150,000

Article provided with the assistance of MLC

# Understanding Inflation

**What is inflation?**

Inflation is the value of money. If inflation rises, then your spending power inevitably decreases. In extreme circumstances, we hear of countries like Zimbabwe with inflation above 1000%. Australia is not nearly as bad with inflation running at 4.2% but the Reserve Bank aims to keep inflation in a 2- 3% band. To do this, it uses interest rates to control how much people spend. We've already seen over 10 straight interest rate rises and with the markets. The most frightening thing for the everyday Australia is that the question seems to be not whether interest rates will go up in the coming months but whether they will go up by 0.25% or by 0.5%.

Interest rates not only hurt our pockets because mortgage repayments go up, but they are also a negative for share prices. Companies like us are net borrowers of money and when interest rates go up, it means that they need to work harder to make a profit or otherwise face their business valuations going down and that means falls in share prices.

**Why is inflation so high at the moment?**

Oil prices recently hit over \$130US per barrel. High oil prices affect everything from petrol to transport costs to fruit and

vegetables. Couple the high oil prices with the tight labour market and you can start to see why the Reserve bank is so concerned. Recent job figures came out and they were outstanding. The unemployment rate in April 2008 was 4.2% which has now been it's lowest since 1974! What this means is that there are plenty of jobs but not as many people applying for jobs - in other words workers are in demand. In a situation like this, workers usually have the power to negotiate their pay upwards. While this sounds great for workers, it also leads to wage inflation.

Wage inflation which is above 4% at the moment means that the tight labor is starting to see wages creep up and that of course impacts on overall inflation. The RBA in its quarterly statement has issued a blunt warning that more rate hikes are expected in 2008. It increased it's inflation forecast for the current financial year to 4.25%. With this in mind, rate rises seem inevitable.

Speak with your AFG FP Financial Adviser to discuss where you should invest your money in light of inflation forecasts.

**Julia Lee,**  
Head of Fundamental Analysis at HUBB Financial  
www.hubb.com

## Shopping tips to beat inflation

### Buying in bulk

Where possible, buy in bulk. Check that a large packet is actually cheaper than several small ones. The economy size packs are sometimes more expensive. Check this with products such as cereal, milk, biscuits, ice cream and make big savings this way.

### Comparison Shopping

Compare prices of shelf items. Those at eye level are not usually the cheapest. Shops are paid a premium by the manufacturers to get their products positioned there. Look above and below to check prices of other brands. When comparing, try to convert the prices to dollars per kilo. The actual price of many items maybe surprising when converted (for example, 100g for \$1.99 works out to \$20 per kg). Take a small calculator to help you work out the comparison.

### Do Your Homework - Plan Your List

Plan your shopping list on spreadsheets, with the product name, size and price, then copy from the master list items that you'll need for that week. Autosum all items to obtain the total amount and delete the 'luxury' items (things you don't need) down to your budget figure.

### Watch the Scanner

Watch the scanner and check all dockets. You may get something for free regularly by doing this. Also, if any fresh produce does not last four days (deli meats included), ring the shop and advise them. They may provide a refund. Keeping all your dockets helps track your spending and also with returning items.

### Raincheck Items

If a particular item advertised in supermarkets are on special, but have all been sold out since your visit, you can actually get a raincheck on the product. You can go to the service desk, and fill out a ticket for how many items you want, with usually a month to use the ticket.

### Online Shopping

You can save money by doing your grocery shopping online. This way, you are not tempted to buy any little extras that catch your eyes or get distracted not always making the best brand choices. You can also keep track of your spending and can shop at whichever time is most convenient. If you go over your budget, you can delete non-essential items to keep under it. Shop fortnightly or monthly to save on delivery costs. The delivery guys can even carry your purchases right to your door step.

### When to Shop

If possible, try getting out to the shops towards the end of the day/night. You'll find that most of the mark downs occur during this time. There are often many more items reduced - juice, cakes, cheeses and fresh meats. Find out your local shopping trading hours.

### Reduced Goods

Check the use-by dates and get a mark down. When shopping, you should check the dates thoroughly. If there are only a few days left, ask an assistant for a mark down due to the time limit. More often than not you can receive a few dollars off, depending on the item. For example you can save on milk and store items in the freezer until required. It just takes a good eye.

### Impulse Shopping

The best way to save is to only buy what you need. Walking into a shop with only a vague idea is the quickest way of falling victim to impulse buying. Retailers know that most people buy from habit or on impulse, and market their goods to help you decide to buy. Do not feel weak or stupid for falling victim to impulse buying; they are very good at getting you to decide to purchase this way. Make a shopping list so all your buying decisions are made at home, away from their influence.

### Sometimes the corner shop is cheaper

You may visit your major grocery shop each fortnight to save money. However, if you went to the supermarket for bread and milk in between times, you may sometimes spend more than anticipated, because you see 'bargains on special' and return home with more than you've planned. Go to your local milk bar if you need bread or milk. It may cost a little more but may end up saving more at the end of the day (time and petrol), instead of browsing supermarket shelves for things that you don't need.

### Be Flexible

Be flexible with what you buy. If sweet biscuits are on your shopping list, choose the ones that are on sale, instead of choosing the same brand every week. If you live by yourself, how about going grocery shopping with a friend in a similar situation? Apart from saving on petrol, there may be many items that you can split 50:50 and save!

Article provided by Simple Savings.  
[www.simplesavings.com.au](http://www.simplesavings.com.au)

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