



Living in a Volatile Financial World (May 2010)

It was not long ago the world seemed to be going to hell in a hand basket, as all eyes were on the American financial markets to see if the financial system as we know it would survive. Having seemingly overcome that huge hurdle all focus has recently been on Greece and the implications on a sovereign defaulting on interest payments, and believe it or not, the potential collapse of the Euro as a currency. Whilst the jury is still out on the full implications of this, the large economies of Europe, Germany and France have stepped in to bail out their struggling neighbour(s) with the help of the international monetary fund. However, before the rescue package was announced this again sent share markets around the world tumbling as investors took flight for safer investment havens. Incidentally, as a result of this tumble I am aware of 1 international investment company that have seen this as an opportunity to increase their investment allocation in Europe from 5% to 15%. Only time will tell if this is the right move, but as Warren Buffet said 'buy when everyone is selling and sell when everyone is buying', but this is very hard to do in practice. In house during this time we have elected to take risk off the table and take a more cautious approach by down grading our outlook on international equities from out-perform to *neutral and upgraded the relative attractiveness of short term cash/fixed interest and listed commercial property*. This generally means taking a more cautious approach to overseas shares and in some cases reducing exposure.

How have Markets Performed?

Australasian Equities

Like all world share markets the **NZX 50** gave up some of its gains early in 2010, but staged a recovery in March to end up the quarter +1.17% and up **+27.59%** for the March year, and down slightly over April. At time of publication (21 May), the NZX was at a 9 month low, highlighting both volatility and opportunity.

The Australian All Ordinaries index was up +6.18% and **+53.03%** respectively (This index represents the 500 largest companies listed on the Australian stock exchange). In house our best (Australian) fund manager gained 86% (NZD terms) over the same period, albeit off a low base.

IMS clients have generally benefited from our tactical overweighting Australian shares. The weakening of the Kiwi dollar by -5.89% against the Australian dollar has further enhanced Kiwi client returns even further. An interesting point to note is that even after the stella share market rise to the end March 10, the Australian 'All Ordinary' index was still -27.8% below its October 2007 peak.

The MSCI world in NZ dollars rose +5.87% over the March quarter, and was up **+22.56%** over the March year, however markets have since fallen back around escalating debt concerns in Greece/Europe.

Whilst NZ is very well placed economically when compared to many other developed economies such as England, Japan, USA, I expect Australia will continue to outperform NZ at least whilst China continues to consume all the minerals it can dig out of the ground.

Investors have generally become more risk averse since March 10, and markets have made no further price gains whilst sovereign debt concerns in Europe remain a major concern.

What the Governments Budget Might Mean For investors

Overall changes to the tax system are positive and cleverly crafted so that most people are better off. Tax on spending will be increased (GST rises to 15%) and generally tax on savings will be reduced. Higher income earners (over \$70,000pa) will generally be the major beneficiaries receiving a 5% tax cut instead of

3% for other tax brackets. The main losers are property investors who will lose the ability to offset depreciation (an expense) against income on buildings with a life expectancy of 50 years or over. Also LAQC company tax structures will be tightened to fill loop holes.

Trust tax rates will remain at 33% whereas company tax rates will fall to 28%. PIE maximum tax rates will fall to 28% as will the tax rate on most personal investment structures.

AMP Capital have calculated that the average house hold income group will on average receive around 0.5% to 1.0% increase in their real disposable income.

This could tempt some to consider closing down their trusts in favour of a company structure. However, this should be examined very carefully as Trusts are intended firstly as 'estate protection' mechanisms not tax vehicles.

This also means that the PIE tax structure maintains its advantages by reducing the top tax rate from 33% to 28% for top income earners. And at the lower end of the income scale PIE income of up to \$48,000 could be taxed at just 10.5%. For those earning between \$14,000 and \$48,000 the marginal tax rate on PIE income is 17.5%. However you also need to take into consideration any fees charged by the PIE fund manager and compare your *net* returns (i.e. apples with apples).

To check out how the budget might effect you personally visit this government web link: www.taxguide.govt.nz (incidentally this web site was constructed by a work colleague of my son's in Hamilton).

Investment Outlook

NZ GDP is forecast to increase 3.2% in March 2011 compared to 2.4% in December. Government operating deficits will worsen but are improved on what was forecast last year and returning to surplus in 2014.

High NZ personal debt levels remain a concern, but strong take up in Kiwi Saver will help to moderate this kiwi spending binge over time.

After the strong price rises over 2009 and increased global market volatility the world has again become a more cautious place for the prudent investor. What is right today may change very quickly as markets disseminate and react to new information. However, following the budget one has to ask will capital gains as we know them be available from residential property going forward. I suspect not as the playing field has been levelled even further with the government focus steering us towards more productive investment alternatives. Also, expect global economic growth rates to be more subdued going forward as a result of very heavy debt burdens at both a Government and individual level. This will most likely translate into more subdued investment returns over the next few years.

Buying on share market dips remains a prudent long term investment strategy during the current phase of the investment market cycle, and for those seeking income include a spread of shorter term quality fixed interest in expectation of interest rates rising. Our lower company tax rate (to 28%) will be positive for business growth; the challenge meantime for growth investors is finding great buying opportunities, if so maybe I can help?

If you are seeking investments advice, and want to learn how our collective investment process may work for you, talk to your accountant or contact me direct on email selwyn@imsnz.co.nz, or phone Tauranga **07) 5767-286**.

A copy of my adviser disclosure document is available free from: www.imsnz.co.nz or from my office.

Disclaimer

This report is prepared for general information only, and as such, the specific needs, investment objectives, or financial situation of any particular investor have not been taken into consideration. Therefore, investors should seek qualified financial advice before taking any action. Those acting upon such information do so entirely at their own risk. Selwyn Parker does not accept any liability for any action you may take without first seeking his advice. This is not a recommendation to either invest or not to invest.