



Investment market update September 2009 *(Prepared by FSS Trustee Corporation)*

Where to from here?

After two consecutive years of disappointing investment returns, super fund members are looking hopefully at the early signs of recovery that began to emerge late in 2008–09. But are we seeing a sustainable improvement in economic conditions and will this lead to a happier experience for investors in 2009–10?

A year of losses but better times ahead... perhaps

The Australian share market fell just over 20% during the 2008-09 financial year. The average balanced super fund holds around 50% of its assets in shares, which contributed to an average loss for balanced funds of around 8% during the financial year. (By comparison, First State Super's Balanced investment option lost 4.1% for the year.)

Share markets around the world have strengthened since their March 2009 lows, prompting claims in some quarters that the worst could be over. Despite the International Monetary Fund's forecast of negative growth in the global economy for 2009, and only a slow recovery in 2010, investors still seem to be quite positive. Even if the worst is behind us, investors should be cautious. The improvement in the global financial system does not mean that risk has passed. Any meaningful recovery would have to be supported by a much better outlook for corporate earnings. However, given the short-term forecast for the global economy, any earnings recovery is unlikely to occur until well into 2010.

And in Australia...

While the recession has not hit Australia quite as hard as some other countries, it now appears that the three factors protecting the domestic economy over the past year are fading. Unemployment is increasing and people are working less hours, business investment is set to decline in line with a weaker earnings environment, and the prices for our commodities (particularly coal and iron ore) have been reduced in recent contract re-negotiations.

Many commentators, however, believe the downturn is likely to be a modest one, thanks to the scale of the fiscal stimulus and the powerful effect of lower interest rates.

The outlook

The International Monetary Fund has upgraded its forecasts for world growth as conditions appear to improve, but warns recovery will be sluggish. In its report¹ issued in early July, the IMF revised up its projections for Australia's growth to -0.5% in 2009 and 1.3% for 2010. It has also upgraded its forecasts for the world economy for 2010 to 2.5%. Its 2009 forecast remains at -1.4%.

"Despite these positive signs, the global recession is not over, and the recovery is still expected to be slow," the report said. "The main policy priority remains restoring financial sector health. Macroeconomic policies need to stay supportive, while preparing the ground for an orderly unwinding of extraordinary levels of public intervention."

1 Source: World Economic Outlook Update July 8 2009 www.imf.org

How has First State Super responded?

First State Super has responded to the challenges by keeping its portfolios very liquid, which means holding reasonably high levels of cash. This gives our investments some degree of protection from adverse market movements and avoids the possibility of having to make forced asset sales at less than satisfactory prices. It also allows us to respond to investment opportunities that might arise as part of any recovery.

Low and negative returns are, unfortunately, a natural part of the investment cycle. While a fund can take some defensive actions to protect against negative returns, it is unlikely that any action could fully protect our investments when the market falls are extremely large, as they have been over the last 18 months. What's more, the falls have been across most asset classes, including parts of the fixed interest market.





Should I switch my investment option?

Generally, over the longer term, the High Growth, Diversified and Balanced investment options tend to offer higher average returns than the Cash and Capital Guarded options, although the returns tend to be more volatile and even negative in some years. The higher returns and higher volatility reflect the higher proportion of **growth** assets such as shares and property that the High Growth, Diversified and Balanced options hold. The Cash and Capital Guarded options, on the other hand, hold mainly defensive (income) assets such as cash and fixed interest investments. Over the longer term, growth assets such as shares and property tend to outperform defensive assets such as cash and fixed interest.

However, over the short term, the returns from growth assets can fluctuate quite significantly, as we have seen over the past 18 months. As mentioned above, share markets around the world have strengthened since their March 2009 lows. However, prior to March 2009, cash and fixed interest investments had performed better than share and property investments over the short term, and some members have been asking whether they should switch to Cash or Capital Guarded.

The answer to any question about switching really depends on your personal circumstances, your age, and your attitude to investment risk.

If you have a lot of time until retirement, you may feel that you can ride out the current turbulence in investment markets and remain in an investment option that has a higher proportion of growth investments. But you also need to understand that growth investments can be very volatile in the short term and your account balance may go up and down quite often.

There is something called *dollar cost averaging* that can work in your favour when investment returns – and therefore, unit prices – fall. The value of your investment in First State Super is represented by a number of units. When earnings are positive, the unit price goes up, and when earnings are negative, the unit price goes down. These unit prices are adjusted every day, depending on what happens in the investment markets. When the unit price falls, you can buy more units for the same dollar investment. For example, if the unit price falls from \$2.00 to \$1.50, then an investment of \$100 will buy you 67 units rather than 50 units. Adding money to your super account when the unit price is lower allows you to buy more units which will potentially have greater value when markets recover.

If you have some time until retirement. Whether you are in your thirties, forties or fifties, you may have twenty years or more until retirement. Typically, this is ample time for investment markets to recover so you may feel comfortable remaining in an investment strategy with higher exposure to growth investments. But you also need to understand that if your superannuation is invested in growth investments, then there is a very good chance that your account balance will fluctuate. Of course, the longer you have till retirement, the more time markets have to recover and the more time you have to top up your account.

Conversely, the closer you get to retirement, the more cautious you should be with your investment choice because any sudden market fall could leave you without enough time for recovery.

If you have retired or planning retirement in the very near future. This is a difficult time if you have retired or you are planning retirement in the very near future. In the current environment, your superannuation account balance may be constantly fluctuating when what you really want is some degree of certainty about the amount of money you will have in retirement.

So in some respects, you have competing financial objectives. On the one hand, you want the safety and security that is generally available from more conservative investments like cash and fixed interest. But on the other hand, you want to know that your nest egg can grow enough to provide a reliable income stream for many years, which typically means investing at least some of your money in growth assets like shares and property.

Ultimately, the decision about where you invest depends on your personal circumstances and financial objectives. Each member's personal circumstances and financial objectives are different, so we recommend that you seek financial advice to ensure that your investment choices and strategies are appropriate. Members of First State Super have access to personalised financial advice through FSS Financial Planning*.





FIRST STATE SUPER

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