Your Wealth Bulletin
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Hi,

Welcome to the June issue of your wealth bulletin.

Twenty years from now you will be more disappointed by the things you didn't do than the ones you did. So throw off the bowlines, sail away from the safe harbour. Catch the trade winds in your sails. (Mark Twain)

Reflecting on your experience

A time to review

With the end of the financial year, combined with significant volatilty in markets worldwide, it is a good time to review asset allocation. After all, studies show that Asset Allocation can drive 94% of your portfolio's return.

How much money is placed into the asset classes of cash, fixed interest, property and shares is really a crucial decision. It will determine the amount of fluctuation (ie. risk) and the returns that you can expect from the portfolio.

Investors worldwide have experienced one of the greatest declines in market values over the last 18 months. Therefore it's an excellent time to sit back and reflect upon this experience during this period.

After experiencing the high market volatility, it could now be the case that your feelings have changed to what your original comfort levels were.

You may have not been bothered by the volatility and understand completely that markets are subject to significant falls and rises, but over the long term, markets will trend back to their long term historical averages upwards.

Yet if your portfolio has a high weighting of conservative assets, then it may be time to review this asset allocation and move into more growth assets.

Alternatively, if you have experienced tense concerns and worries about the portfolio, more than you originally expected, perhaps an increase in conservative assets should be considered for future investing.

The final outcome could be that while negative returns are never enjoyable, you understand market movements and remain confident that the original weightings of asset classes is suitable for you.

In summary, with investors experiencing one of the largest declines in history, it's a fine opportunity to reflect and consider that this is close to as bad as it gets.

How do I feel about the market portfolio? Should I be thinking of a different strategy for the future? Should I be more assertive, or more conservative, after reflecting upon this experience?

You're welcome to send us an email or phone in to discuss your needs more.

Competing for capital

Market risk premiums explained

Academics are higlighting that the 'risk premium' in sharemarkets are high. What does that mean exactly? The following article from Jim Parker of Dimensional explains it well:-

"One of the consequences of the global financial crisis is that equity market investors, at least in comparison to their behaviour in the recent boom, are demanding a greater premium for the risks they are adopting.

It may seem counter-intuitive, but when markets are at record highs, the expected return from equities-the premium over the risk-free rate-is lower. In other words, companies can raise capital relatively cheaply.

But now with many major markets still 30 to 50 per cent below their record highs, companies are paying a higher price to raise equity capital. Put another way, investors are demanding a higher expected return for the risks they are adopting.

This makes sense if you think of it in terms of supply and demand. A consequence of the difficult markets of the past year or so is that the supply of capital from now more risk-averse investors has tightened up. In the meantime, companies' demand for new money through the equity markets has increased. So the price of capital has gone up.

In many developed markets, there has been a glut of capital raisings in recent months as companies shore up their balance sheets or bring in new money as a buffer against the global economic downturn.

Going to the equity market becomes the only option for many firms squeezed by a combination of falling revenue and tighter lending conditions. In the UK for instance, companies have raised more money through share offerings so far this year than over the same period over the past 13 years combined, according to research firm Dealogic.1

In the US market, with volatility down and fund flows improving, Dealogic says the rate of issuance recently reached its highest level in two years.2 In Australia, too, the trend is evident. Of the 388 Asia Pacific share issues outside Japan this year, a third has been from Australian companies. This proportion has risen to more than 60 per cent in the past eight weeks.3

According to the Australian Securities Exchange, capital raisings in April alone totalled $A7.1 billion, up 65 per cent on the previous corresponding period. The vast majority of these were secondary raisings.4

The major Australian companies that have tapped the market since January include Wesfarmers, Westfield Group, Fairfax Media, OneSteel, Insurance Australia Group, Qantas, Macquarie Group and Bluescope Steel.

Due to the competitive nature of the capital markets right now, the majority of these issues have been pitched at big discounts to prevailing prices and Dimensional has participated in many of them to the benefit of unitholders.

In fact, an analysis of the Australian capital raisings in which Dimensional has participated since January shows all had delivered a positive return as of early

May and all but three had delivered a return above the market.

As an example, conglomerate Wesfarmers raised at least $A1.8 billion of new equity capital in January to reduce its debt load and help it deal with a severe slowdown in earnings growth. The debt was a legacy of its 2007 purchase of many of the retail assets of the old Coles Myer. Wesfarmers pitched a three-for- seven entitlement offer to institutions, priced at $13.50 a share, a very steep discount to its then prevailing on-market price of nearly $17 a share.

Dimensional took up an entitlement of nearly 900,000 shares in that offer, an investment that as of early May had yielded a return of 65 per cent, or 50 per cent above what would have been earned in the broad market.

These examples should not be interpreted, by the way, as a judgment on the long-term merits of these individual stocks. But they do serve to show that competitive capital markets are working and that companies' cost of capital equates to investors' expected return."

If you have any queries about this month's newsletter or would like to discuss your financial situation in more detail, please feel free to email or call our office on 1300 78 55 77. If you would like to forward this email to a friend, click on the forward email link below.

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