

# Your Wealth Bulletin

September 2008

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Hi,

This month we have two articles of interest.

The first is courtesy of Jim Parker describing how the media's attention has been solely focused upon the banking sector, with little regard to the remainder of the 'real economy'.

And for those with concerns about insurance companies such as AIG, the experts from The Risk Store have answered some key questions with brief explanations of how the Australian marketplace works.

## Have you seen these headlines?

### In other news....

Have you seen the news lately? No, not the news on the carnage in the global financial markets but the headlines related to the real economy, the one where most of us live and work.

Here are just a few recent headlines from major media publications:

- 'US CEOs' Economic Outlook Rebounds in Quarter'
- 'Exports Bolster Local Economies'
- 'Germany Whistling in the Gloom'
- 'Japan's Economy: Down But Not Out'
- 'Inflation Eases as Energy Prices Decline'
- 'Australian economy taking time to cool down'

In fretting over the admittedly severe strains in the financial sector these past weeks, it's easy to lose sight of the fact that people and businesses around the world continue to work productively every day, making goods and delivering services to meet the needs of a global economy.

Most of us still go to work each day and kids still go to school. We all need to eat, clothe ourselves, house our families, look after our health and get from one place to another. Once we've covered the essentials, we may also find time to entertain ourselves, taking holidays, dining out, listening to music, reading books, watching movies and going to see our favourite sports.

Those multiple needs are met by a variety of businesses which manufacture the goods and services that meet the demands of consumers, other businesses and governments. And those businesses employ people. One of the roles of financial markets is to quickly funnel the necessary capital for these activities from lenders to borrowers.

This is not to downplay the recent momentous events in the investment banking industry and major consequences felt in financial markets. But it is wise to make a distinction between the financial economy and the real economy-between Wall Street and Main Street.

What the world has witnessed these past months is a massive unwinding of leverage and an associated repricing of risk as a lengthy era of extremely cheap credit, ever rising asset prices and bountiful liquidity came to an end.

This has had messy implications for non-deposit taking financial institutions, who invested in highly risky, highly complex and highly leveraged financial assets without sufficient capital to support their losses.

The market economy is now delivering its harsh judgement on those practices, with the pain felt most acutely by the staff and shareholders in those now failed, slimmed down or restructured institutions.

This carnage may be just the latest manifestation of what the noted Austrian economist Joseph Schumpeter called the "creative destruction" of capitalism, an evolutionary process in which the system, like an organic entity, is continually rebuilding itself from within.

In the meantime, through their interventions, policymakers are seeking to ensure that markets continue to provide their most important functions, as an efficient means of allocating capital to businesses and governments, transferring risk and financing

international trade.

By providing liquidity and easing official interest rates where necessary, central banks also are taking action to ensure the inevitable spill over of financial market events to the real economy is kept to a minimum. Regardless of what happens with Lehman Brothers in the US or HBOS in the UK or Babcock & Brown in Australia, businesses that make things and employ people still need access to capital, consumers still need to put roofs over their heads, governments still need to fund essential services and countries still need to trade with each other.

These activities are continuing, despite the ructions on Wall Street, and their comparative health is reflected in the headlines above. The ordinary investor has a role to play in this real economy by supplying the capital that underpins those day-to-day activities. And in return for taking that risk, the investor can expect to receive a reward. Over short periods, those rewards may disappear, as we are seeing at the moment.

The fact is volatility is part and parcel of investing and you should expect the occasional setback, particularly after a long period of very strong returns. But if you keep your focus on the long term and remain broadly diversified in your portfolio, short-term swings in sentiment become less significant. Speculation is one thing, but the real economy needs real investors.

#### Life Insurance Policies In Focus

##### Your Insurance Questions Answered

- **I have an existing policy - will I lose this cover if the company goes out of business?**

No. Under legislation another insurer will take over this policy and continue the cover as long as the premium continues to be paid.

- **What if i happen to be in the middle of a claim? Will I lose the ability to continue with that?**

No. The legislation will mandate that your claim in progress will be transitioned to the new insurer if necessary.

- **Why is my policy secure in this way?**

Life insurance is protected by its own special Act of Parliament. This forces insurance companies to place funds into a special account (called a statutory fund) that cannot be accessed by the company to use as operating funds or to distribute to shareholders, until all appropriate allowances have been made for a reasonable level of 'expected' claims and claim expenses.

In addition, there were amendments to these laws in the 1990's, which mean a special manager (called a judicial manager) will be allocated to the insurance company if they cannot continue to operate. This manager's key role is to arrange for other insurers to take on the existing policies and claims.

- **But this is all very well in theory - does it really work?**

Yes. This system has already saved policies of thousands of policyholders whose insurance is now held by a new insurer, when two companies in the industry were affected by fraudulent misappropriation of funds in the late 80's. The laws are even tighter now, too.

- **If another insurance company takes over my policy can they change the terms I currently have?**

No. They are bound by the terms of the existing contract, including your current acceptance terms. At present, no insurer guarantees the ongoing premium rate for any group of policies, so it is possible that premium rates across a product type can alter with any insurer. They cannot alter the individual rates however.

**Did you know?**

**USA Banking Facts**

Bank failures are not an unusual phenomenon in the USA.

Since 1934, when the records of the Federal Deposit Insurance Corporation began, there have been 3,551

bank failures accounting for \$992 billion in assets.

Between 1934 and 1942, 390 banks failed. More spectacularly, however, there were 2,849 failures between 1982 and 1993 when the savings and loan crisis was taking its toll.

As for 2008, there have been 11.

The banking system in the USA is a lot different to that in Australia. It is a fact that is not widely broadcast by media nor understood by many.

American banks commenced primarily as deposit-taking and lending institutions in their respective regions, and subsequent legislative constraints have not allowed American banks to becoming genuinely national.

Their regional orientation has limited their ability to diversify their products and revenue, which has hampered their ability to grow. Both constraints have left them commercially vulnerable.

This is in stark contrast to the banking system in Australia and the statistics about the USA system provide perspective that is well worth considering, rather than the alarmist media reports that we are fed everyday.

*Disclaimer: The statistics and figures presented in this report are based upon historical data, obtained from external sources. There is no guarantee or suggestion that markets will behave as they have in the past. Future results will be affected by political & economic events. Information is not directed to any particular persons investment financial objectives. Therefore, you must seek advice tailored to your individual circumstances before making any specific decisions.*

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