



## Another Change to Super!

Firstly, just a quick reminder to those making contributions to super - the Government has changed the rules with respect to the amount you can contribute to superannuation via Concessional Contributions. Concessional Contributions include your employer contributions under the 9% Superannuation Guarantee (SG), salary sacrifice and personal deductible contributions.

Effective from 1 July 2009, if you are 50 or over, the maximum amount you are able to contribute has been reduced from \$100,000 p.a. to \$50,000 p.a. If you are under 50, this has been reduced from \$50,000 p.a. to \$25,000 p.a. These limits are referred to as 'Concessional Contributions Caps' and penalty tax rates apply if you breach them. For those 50 and over, the \$50,000 cap will remain in place until 30 June 2012. Thereafter, it will be reduced to \$25,000 regardless of age.

Because of these changes, you will need to review and/or reduce the amount of your regular salary sacrifice and deductible contributions accordingly. If contributions have already been made for the July 2009 period, this will need to be taken into account. You will also need to take into account any 'superannuation expenses' paid directly by your employer, such as any super fund administration fees, insurance premiums, etc, as these can also be included as part of your Concessional Contributions. If you have any queries regarding these changes or would like us to assist with amending your salary sacrifice arrangements, please contact our office on Ph (02) 9939 4686.

## Bonds and Inflation

After spending last year fretting about the damage to economic growth from the global financial crisis, many investors are now worrying that policymaker's medicine may prove too effective. The fear is that all the stimulus injected by central banks via interest rate cuts and by governments via additional spending and tax reductions, will create an intractable inflationary spiral that will force interest rates sharply higher and particularly erode the value of bonds.

Inflation [i.e. rising prices] is bad for bonds in two ways. Firstly, it reduces the purchasing power of the income you receive from the bond and secondly, it undercuts the inflation-adjusted capital value of the bond. So if *stronger* growth and *rising* inflation are the next big worries on the global horizon, what should we be doing with the defensive component of your portfolio? Before answering this question, it is worth making a few observations.

Firstly, it is not clear inflation is the big concern some people say it is. Consumer prices in the 30-nation Organisation for Economic Cooperation and Development rose by 0.1 per cent in the 12 months to May—the lowest level since records began in 1971. And against that backdrop, central banks in the US, Australia and elsewhere have signaled they are in no rush to start raising interest rates.

Indeed, until quite recently, the bigger concern for policymakers was the prospect of *deflation* [i.e. fall in prices]. While there are signs the global economy is starting to recover, on balance, the weight of risks still lies on the side of deflation.

While that may sound fine on the surface, it is actually quite a grim prospect because in a deflationary spiral activity can come to a halt as people put off spending today, what they can buy more cheaply tomorrow. In this environment, the normal 'demand' instrument that central banks use — cutting official interest rates — proves ineffective. So to avoid the damage a long run bout of deflation would cause, central banks have brought out the big guns by engaging in "quantitative easing" or what is more commonly referred to as printing money.

It is the combination of this radical policy action by central banks by and the associated deficit spending of governments to fill the gap left by shrinking private demand that has inflation hawks worried. Indeed, the revival in equity markets, commodity prices and commodity-linked currencies, like the Australian and New Zealand dollars, in recent months is evidence these "reflationary" policies are having an effect.

This more positive outlook has also flowed through to the bond market with yields on longer-dated bonds rising on expectations of stronger growth and rising inflation [refer to the graph on the next page].

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## Bonds and Inflation - continued

So how do we manage this uncertainty? As many of you know, our philosophy for the **defensive** part of your portfolio is that it is designed not to take risk and is intended to be a source of liquidity. To meet these core objectives, means we only invest in high quality bonds, Term Deposits and cash for this component of your portfolio with an emphasis on diversification.

Along side this, we know that falling yields increase the price of existing bonds and conversely, that rising yields reduce the price on existing bonds. Furthermore, the longer the maturity date on the bond, the greater the price change will be.

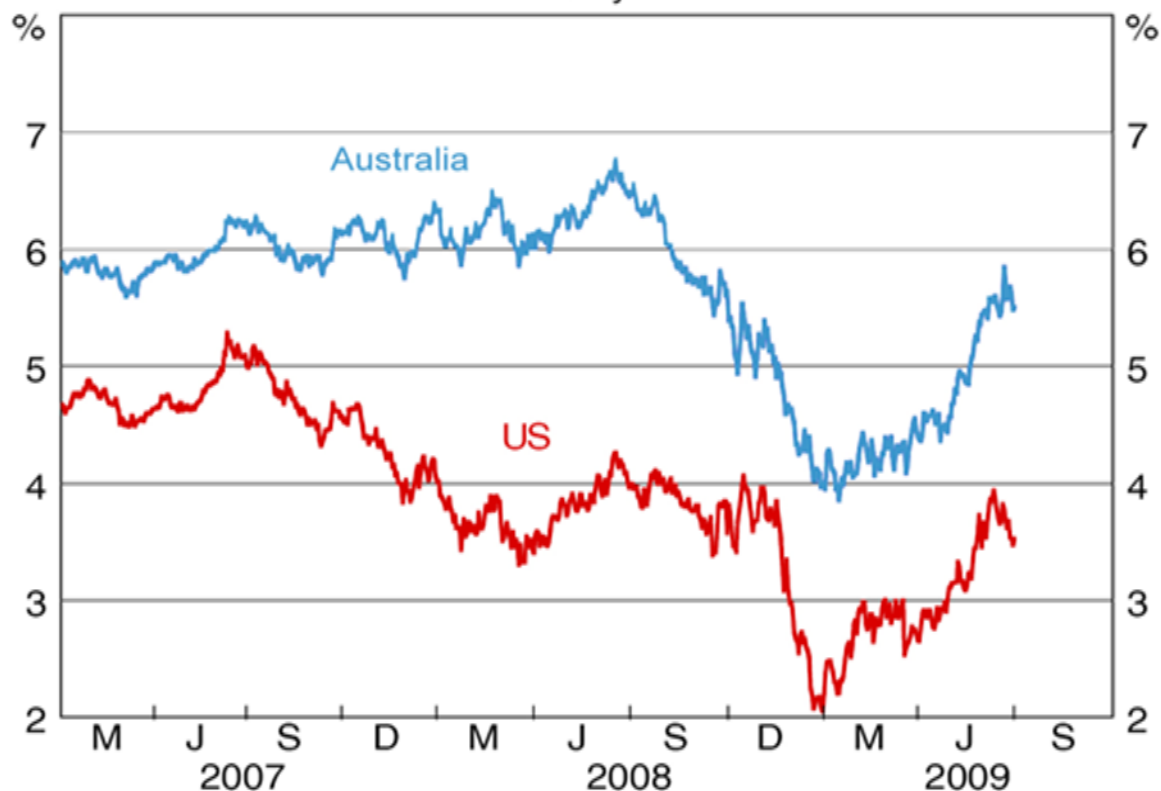
In February this year, we took the view that the probability that interest rates [and therefore bond yields] would fall further and deliver additional returns to bond holders was diminishing. The more likely probability was that market interest rates and eventually official interest rates, would start to rise. Because of this, and particularly in light of our investment philosophy, we recommended the move out of long dated bond funds into short dated bonds funds, term deposits and cash.

Ultimately, the inflation dragon may or may not be on its way back — no one knows for sure — but on a balanced view of the risks, it will take a number of years for all of the idle capacity from the global recession (labour, manufacturing etc.) to be put back to work. Until this occurs, the prospect of higher inflation [let alone rampant inflation] is, at best, some way off.

In the current environment, we believe the defensive component of your portfolio should remain in cash and short dated, high quality bonds or term deposits. When we are comfortable with the risk, we will eventually move back into longer dated, high quality bonds for diversification and additional return.

## 10-year Government Bond Yields

Daily



Sources: Bloomberg; RBA

## VIP Stocks Go MIA

One of the great myths of the investment world is you can build a successful long-term strategy around a carefully chosen small number of stocks that are perceived as generating good earnings growth year after year. Just why this myth refuses to die may be a testament to the power of hope over experience. But it's useful now and then to see the dire results of concentrated portfolios, even those chosen by supposed experts.

In mid-2007, the Australian Financial Review's Smart Investor magazine published a front cover story called 'VIP Stocks — 25 Companies that Grow Earnings Year after Year'. The 'VIP' tag in this case stood for 'Very Impressive Performers' and was accompanied by a rather nifty photograph of what looked like a backstage pass. The implication was that this was the portfolio favoured by insiders. The blue ribbon stocks were chosen after analysts "pored through consensus earnings forecasts for Australia's top 500 listed companies" to find the 25 they agreed had the best potential in terms of Earnings Per Share (EPS) growth.

This was a detailed and rigorous process, we were told. To ensure the chosen stocks were not "just a flash in the pan", the magazine's Analysts insisted on a superlative track record. The companies had to have had at least double-digit EPS growth in both the 2005 and 2006 financial years, as well as "a top earnings outlook" for either 2007 or 2008.

To ensure the companies were generating earnings efficiently, the Analysts required each stock to have a return on equity of at least 12 per cent. And to cover the risk that all the good news was priced in, they excluded any company with a price-earnings ratio "wildly above" the industry average. So given these high hurdles, it would seem reasonable to expect Australia's top analysts would create a small portfolio that would shoot the lights out, or at least outperform the market, wouldn't you think?

Unfortunately not. Of the 25 "very impressive performers" for 2008, only a mere seven (or less than a third) ended up performing better than the market, as defined by the S&P/ASX-300 Accumulation Index. They were Sonic Healthcare, Computershare, Technology One, IBA Health, Iress Market Technology, Beach Petroleum and JB Hi-Fi.

On the flipside, 18 of the 25 underperformed the market. And of those, twelve lost 60% or more of their value. In fact, the two worst performers in the magazine's list of "VIP" stocks went missing in action altogether. Investment companies Allico Finance Group and Babcock & Brown imploded over 2008 and now are no longer listed.

Overall, if you had decided to put your own money into this concentrated, "rigorously analysed" portfolio of Australian stocks last year, you would have generated an average return of a negative 58.58%, against a negative -38.90% return just by owning the market. And this is even before taking brokerage costs into account.

It should be clear from this, when you hold such a concentrated portfolio you are taking on unnecessary risk. You expose yourself to stock specific and industry factors that can blow your portfolio out of the water.

The fact is, it doesn't matter how well those individual stocks have performed up until that point. More often than not, their superlative past performance is recognised by the market and is reflected in prices.

When it comes down to it, investment is about what happens next. We don't know what happens next. And that is why we diversify.

Source—Jim Parker, Regional Director, DFA Australia Limited.  
VIP Stocks', *Financial Review Smart Investor*, June 2007

## The Strategy First Team

Patrick Anwandter  
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## Behind The Scenes

It has been busy here since the Autumn Edition of *First Light* with a lot happening behind the scenes. Some of the highlights were:

- Patrick Anwandter and his wife, Alicia, welcomed the birth of their second child, Thomas.
- Patrick also topped his year academically in the Professional Certificate in Self Managed Super Funds from the University of Adelaide
- We drafted our official submission to the Parliamentary Joint Committee on Corporations and Financial Services. As you know, we are hoping the Committees' findings will lead to genuine structural changes to the financial services industry and in particular, Financial Planning. A copy of our submission can be attained by clicking the following link.  
<http://www.strategyfirst.com.au/downloads/media/ParliamentaryInquirySubmission.pdf>
- A relentless campaign by Anneliis to rightly introduce a paperless office wore us all down in the end. So we are working towards becoming as close to officially paperless as we can by 30 September this year.