

Tackling market cycles with Australia's largest fund manager



With market cycles it is important to remember that **every action has an equal and opposite reaction.**

Avoiding the doom and gloom reported in mainstream media, let's look at the facts, learn from the past and gain perspective in order to rationally establish a strategy to cope with the current bear market.

While it is important to recognise the global and Australian economy is slowing dramatically, it is equally important to examine the large number of positive initiatives being undertaken to ensure the economy comes through this cycle and to repair any damage.

Factors and initiatives helping to kick-start the Australian economy

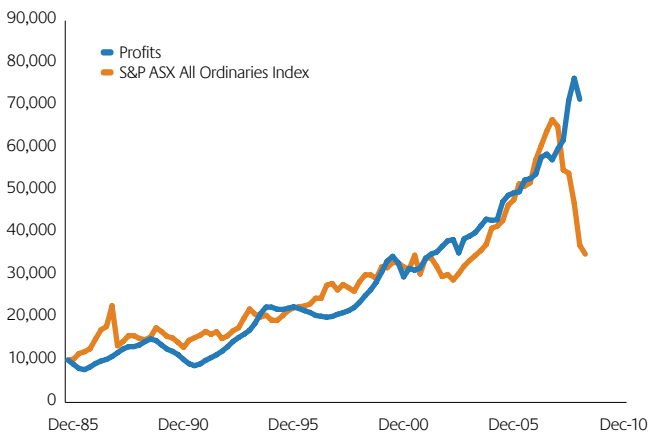
- The reduction of the official interest rates by the Reserve Bank of Australia (RBA) – from 7.25% to 3.25% since September. Reducing repayments on a \$200,000 mortgage by approximately \$500 a month.
- The Federal Government's \$42 billion spending package. To be spent over four years with more than \$12.0 billion in cash grants and \$28.8 billion on infrastructure. The cash grants aim to give an immediate kick-start to our economy, while the infrastructure spending helps build our nation's future. These projects create jobs, keep businesses profitable and add to economic growth.
- Standard & Poors (the Ratings Agency) affirmed Australia's credit rating at AAA – the highest rating possible. They were also positive toward the government's finances, resilient yet slowing economy, transparent policies and strong institutions.
- An increase in demand for housing and construction – with affordability going back to levels seen in the early 2000s and the increase in the First Home Buyers Grant. This is good news as it is an important sector in our economy, keeping people and businesses employed.
- The rural sector, after several drought years, is contributing to economic growth with a larger wheat crop.
- The 30% fall in the Australian dollar will help our exporters compete in overseas markets as well as supporting local producers to compete against imports. Recently the Australian dollar has rallied as the US announced further credit easing policies to encourage lower interest rates.

Companies are still making profits

While some companies have reported a fall in profits, they are still making money. There are also those that have managed to increase profits such as JB Hi-Fi, Cochlear, CSL, Coca Cola Amatil and Wesfarmers.

This chart shows that sharemarkets and profits move together, if profits hold up better than expected, this provides an opportunity for sharemarkets to rise. The wider the gap between corporate profits and share prices, the more share prices appear undervalued, offering new opportunities for fund managers particularly with blue chip stocks.

Corporate profits and share prices



Past performance is no indicator of future performance. This graph uses an index starting at 10,000. The index compares Australian share prices (using the S&P/ASX All Ordinaries Index) to compare profits (data source used from the Australian Bureau of Statistics - indexed constructed primarily from Company Gross Operating Profits, an Australia wide measure of profit). Corporate profit data to 31 December 2008 and All Ordinaries Index to 2 March 2009.

The Australian sharemarket has factored in a fall in company profits of around 50%. A profit fall of this scale hasn't been seen since the early 1990s recession. While the slowing in Australia may feel as hard and sharp as the early 1990s, the local economy is set to outperform its international counterparts due to the speed and scale of Australia's response to the financial and economic crisis. In addition, Australia's starting position is much healthier than international markets, shown by a slower decline in GDP growth. For the December 2008 quarter, Australia was -0.5% and the United States -1.6%, over three times greater. As such if profits hold up better than expected, sharemarkets could respond positively.

Don't miss the bounce

History has shown, that when a sharemarket bounces back it can do so very sharply. If you wait for the good news you could miss this bounce back that may occur.

Sharemarket downturns can last for some time but when they bounce back, they can do so very dramatically. No one can predict when a downturn will end, and it can be when you least expect it. Likewise, no one can predict the pace or extent of any upturn.

Recent downturns and recoveries

Market downturn starts	Market downturn ends	How long did it fall from peak to trough (months)?	How far did it fall from peak to trough?	Subsequent 12-month performance
Nov 80	Mar 82	16	-37.0%	11.0%
Sep 87	Feb 88	5	-44.4%	18.8%
Aug 89	Dec 90	16	-27.4%	29.0%
Jan 94	Jan 95	12	-20.8%	25.0%
Jun 01	Mar 03	21	-18.9%	21.4%

Source: Datastream, Colonial First State. S&P/ASX All Ordinaries Index. Peak to trough and subsequent 12 month performance calculated using end of month values.

Plan for the long term; don't react to the short term

Markets move in cycles; by moving in and out, you could miss out on a major gain. By taking a long-term view of investing, you can ride out any short-term fluctuations in the market and take advantage of the potential growth over the long term.

It's important that before you make an investment you understand all the implications, risks and costs involved. Any decisions you make should be based on good advice, not an emotional reaction to market fluctuations.

Stay calm and steadfast

Markets will fluctuate, sometimes more dramatically than others, but a long-term approach is necessary if you are aiming to achieve higher returns. It's important to not panic and react at the wrong time.

“Those with market experience know this is the right time to be looking for opportunities. It is the time to regenerate and move forward with confidence.”

Rupert Murdoch, Global Media Mogul
New York, October 2008.

How long will you have to wait?

No-one knows for sure how long markets will take to recover, but these statistics may help. As at March 2009 the Australian sharemarket is 50% down from its high in November 2007. Even if the sharemarket takes 10 years to recover the ASX All Ordinaries Index high of 6,853, the average annual return from the sharemarket over the next 10 years will still be more than 7% each year.

Points to remember

Markets move in cycles

After every downturn the market has always recovered. Some recoveries have been faster than others but in every case a recovery has always followed a fall.

Banking on growth

Shares and property are generally part of most people's investment strategy as they deliver the potential for long-term capital growth and tax effective income. Investing all your money in cash deposits and fixed interest may be more secure, but the returns over the longer-term are unlikely to match those of growth assets.

Keep informed

Our fund managers, have the tools to identify quality stocks and access to the latest market insights. Getting hold of the latest information is a valuable tool in making the right decisions, so stay informed and visit our Market Awareness mini-site providing the latest updates on the economy and sharemarket and helping to answer your big questions. Go to colonialfirststate.com.au/marketawareness.

Want more information?

Contact your financial adviser, for more updates go to colonialfirststate.com.au/marketawareness or call us on 13 13 36, Monday to Friday, 8am to 7pm, Sydney time.

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