CAMELOT
PROFESSIONAL FINANCIAL ADVICE

CLIENT UPDATE

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GOVERNMENT DEBT – WHO IS PLAYING THE GAME?

Global financial markets are driven by fear, by greed, and by trust. While fear has dominated markets for most of this year, we haven't yet seen the breakdown of trust that we saw at the height of the GFC (Global Financial Crisis). Banks are being supported, and business is continuing unabated in most of the world. The biggest game in town is now Government Debt. For most of the last 10 years governments competed for the prize of "largest borrower" as a percentage of GDP (government income).

The big winners, or should we say losers, were the P.I.I.G.S. (Portugal, Italy, Ireland, Greece and Spain). The US however is not far behind. If we take the US debt position and convert the numbers into figures you and I can actually understand, then the following would apply:

- If the US government was a family, they would make $58,000 a year.
- They would spend $75,000 a year on living expenses.
- They would have a mortgage of $327,000.

The current US plan is to reduce spending to $72,000 a year (a drop of $3,000 per year) and hope the family income increases sufficiently over the next few years so as to eventually earn as much as they spend.

So, who are the players in this game?

<u>Governments</u> have a perpetual stream of tax receipts to spend (except Greece). They can borrow large amounts by selling bonds.

<u>The Eurozone</u> is a committee of 17 governments under a common currency (the Euro) however the committee has no control over individual country's spending. Being a committee of 17, decisions can be slow however there is sufficient muscle to solve this providing they all wish to play together in the sandpit.

<u>Reserve Banks</u> can print money limited only by the effects of inflation.

<u>Banks</u> provide cash and finance to enable us (consumers) to go about our business. Banks do hold reserves however they can, and do, get financially stressed when we don't pay them back, or the value of assets used as collateral (especially real estate) fall.

<u>Consumers</u> usually have fixed resources. We can't raise capital like companies, we can only borrow against certain assets like real estate, we certainly can't print money (a few have tried), and not all of us are overly productive (young children, retirees, and the sick).

When we look at the world economy in these terms we see that Governments in most nations (with the exception of Greece) are not at the crisis of confidence stage. Greece luckily is a very small player with an economy only the same size of Victoria in Australia.

WHAT IS "GENERATION Y"?

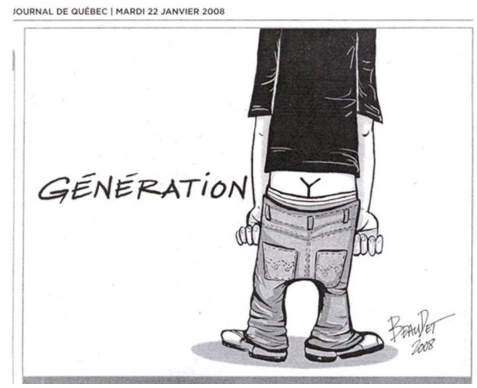
I've always wondered this myself….and now I know!

- People born before 1946 were called the Silent Generation
- The Baby Boomers were those born between 1947 and 1959 (**Steve**)
- Generation X people were born between 1960 and 1979 (**Michael**)
- Generation Y were born between 1980 and 2010 (**Jasmine**)

Why do we call the last group Generation Y?

- ♦ Y should I get a job?
- ♦ Y should I leave home and find my own place?
- ♦ Y should I get a car when I can borrow yours?
- ♦ Y should I clean my room?
- ♦ Y should I wash and iron my own clothes?
- ♦ Y should I buy any food?

A cartoonist illustrated this very eloquently ……..



FROM GREEK TRAGEDY TO ITALIAN SOAP OPERA

Recent months have certainly been big for markets, with big announcements and big movements in the price of financial assets. As many of you are aware, the 6 month period from April to September was one of the poorest on record, while the month of October saw the third single biggest gains out of the US, the world's largest sharemarket.

The European Summit overshadowed events in October with the expected and much bigger rescue plan for Greece. The package grew from €440 billion to around €1.2 trillion. Essentially the plan includes:

- Private investors holding Greek loans would have their investments halved.
- €130 billion would be given to Greece with the intention to reduce Greek government debt from around 150% of GDP (Gross Domestic Product) to 120% of GDP by 2020 (NZ debt to GDP in comparison will peak at 29% in the next year or two).

Just as we were all beginning to feel better about our investments the Greek Prime Minister stunned everyone by announcing a public referendum on the European Union rescue plan. The markets shuddered and Papandreou was forced to step down. A new coalition Greek Government then took over and the severe austerity plans were put into action.

Meanwhile, over in Italy (Europe's third biggest economy) there was more trouble brewing. The Italian Prime Minister Berlusconi was again playing the political equivalent of Russian Roulette. Italian bonds traded at record high yields reflecting the markets view that Italy was a basket case just like Greece and needed urgent and severe reform. Berlusconi was forced to resign and a new government was formed (with no elected MP's, all being appointed bankers) and the reforms passed into law.

The year is now ending with Europe again dominating the news. Have the European economies (and the elected leadership) learnt enough about pain and suffering to do what is needed to be done? With the rest of the world looking on with breath held, the next few weeks will tell us if we are there yet.

TIME IN THE MARKET?

There is an old adage that says "it is time in the market that matters, not the timing of your entry into the market". However, during volatile times, we should also add that the timing of when you first invest can make your time in the market easier to stick to.

In the last decade, global sharemarkets have experienced two major recessions – in 2000-02 and the 2008-2010 global financial crisis. It has therefore been a decade of volatility (and many sleepless nights) magnified by strong countering emotions of fear and greed.

As investors, we need to be clear about how long we are investing for. To illustrate this, consider the expected returns from a diversified portfolio of investments with 75% growth assets (shares) and 25% income assets (cash and fixed interest).

• Expected Average Return per annum	8.10%
• Range of Returns – any single year	between -11% and +30%
• Range of Returns – annual average over 10 years	between +1% and +14%

The above shows that while short term returns can vary widely, the average annual return is much less variable when looked at over a longer period of time. The longer the timeframe we have, the narrower the range of expected returns will be over time, and the actual return will be closer and closer to the expected average. This helps greatly with planning for goals such as retirement.

Therefore, time in the market does provide us with more predictable outcomes. However, when you make your investment can have a major influence on your perspective. Looking at net returns for a managed, diversified growth portfolio for periods ending October 2011 highlights this:

Start Date		Returns to Oct 2011
♦ October 2000	- *11 years*	0.5% p.a.
♦ October 2002	- *9 years*	3.5% p.a.
♦ October 2007	- *4 years*	-3.5% p.a.
♦ October 2008	- *3 years*	2.0% p.a.
♦ March 2009	- *2.5 years*	6.0% p.a.

The above shows the amazing difference between someone who invested, say, in October 2002 compared to someone who invested in 2007 – a difference of 7.0% per annum, despite holding the same assets.

So, what can we do about this?
In times of volatility, we need to step back and look at our goals, our investment timeframes, as well as our attitude to and capacity for risk. If we have a long timeframe to invest (as is the case with many KiwiSaver investors), growth assets are probably most appropriate. While growth assets will produce a higher return over time, they will also be more volatile. We need to be aware of this volatility, and be comfortable to stay the course. Regular review of your goals, timeframes and progress towards your targets is a key part of sticking to your strategy.

A key way of assessing your capacity to take on risk, and your attitude to risk, is by completing a risk profile questionnaire. This is a worthwhile exercise to complete regularly. We urge clients that are unsure about whether they hold the most appropriate investments to contact us to review their portfolio and complete a risk profile.

Another way of smoothing volatility is by dollar-cost averaging. This is simply regularly saving into growth investments so that when markets are down, you are actually buying more. This helps to reduce the average cost of your investments which you benefit from as markets rise.

Finally, when you have a clear plan for your investments, we will all know when you need access to funds. A planned gradual exit from (and entry to) markets can lessen the impact of choosing the wrong time to sell (or buy). As you get closer to needing funds, holdings in more volatile shares can be reduced and moves towards less volatile fixed interest can be planned.

As financial planners, one of our key roles is to assist in mapping out a path for you to follow to meet your goals, and helping along the way to ensure that the bumps are smoothed out and you keep on track. Please feel free to contact us to arrange a review meeting.

CHRISTMAS OFFICE HOURS

As the end of another year comes closer, we are reminded of an old Chinese proverb;

"The best time to plant a tree was 20 years ago. The second best time is now."

Our last working day for 2011 is Thursday 22 December. We will open the office again on Monday 16 January.

Should you need to contact Michael or Steve over this period you can reach them on their cell phones:

☎ Michael 021 310 241

☎ Steve 027 205 2130

Please call and leave a message as cell phone coverage can be intermittent in many holiday areas. We will get back to you as soon as possible.

We hope you have a safe and well deserved festive season, and a better, more prosperous 2012.

With our best wishes
Steve, Michael and Jasmine

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A Disclosure Statement under the Financial Advisers Act 2008 relating to Stephen Benton and Michael Shears is available on request and free of charge.
