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financiallyspeaking

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What to watch in 2014

Australian growth

The Australian economy remains in very good shape, both in the context of its own historical performance and when compared to other developed economies. Very few developed nations can match Australia's combination of vital economic statistics: low unemployment (5.6 per cent), solid credit rating (AAA rating), low government debt/GDP, low inflation (2.4 per cent), solid economic growth rate (3.1 per cent) and strong relationships with global economic powerhouses.

We expect to see reasonably strong GDP growth in the domestic economy driven by export growth and a gradual recovery in consumer demand in 2014. Interest rates remain at historically low levels and the Reserve Bank of Australia has shown little inclination towards a tightening of monetary conditions in the short to medium term.

State and federal governments are expected to take advantage of the low interest rate environment to embark on a number of infrastructure projects. This, along with productivity improvements as corporates maximise operating leverage, will support employment growth stability.

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Economy in transition

The stability of the Australian economy is dependent on a transition from mining capex led growth to an increase in domestic consumption. And while the transition is unlikely to be orderly, we believe all the necessary ingredients are in place for a gradual lift in the non-mining economy.

Australia's prosperity is not about resources alone. The services industry continues to grow in Australian sectors such as tourism and financial services. Manufacturing and agriculture continue to make a meaningful contribution to GDP as Australia embarks on niche products and value add production lines. Despite Australia having likely witnessed the peak in mining capex, bulk commodity and liquefied natural gas (LNG) exports are forecast to grow significantly in 2014, pushing the balance of payments into surplus. Retail sales are showing signs of improvement from a 50 year trend low and a very strong 2013 Christmas period.

Contributing to the improved retail outlook has been the increase in household wealth. The savings rate remains above historical averages. Combined with an average 10 per cent increase in house prices, there is a strong 'wealth effect' for Australian households with significant pent-up demand. The very high savings rate in Australia is likely to fall, funding an improvement in discretionary spending.

China is now the third largest source of inbound tourists to Australia and increasingly a significant investor in the Australian housing and commercial property market. The falling Australian dollar will see this trend strengthen and also encourage domestic travellers to holiday within Australia. A substitution of domestic for international tourism will also provide a fillip for the non-mining economy.

Australian equities for income

After a strong 2013, we are still positive on the outlook for Australian equities in 2014. We believe the market is still attractively valued given a price-to-earnings ratio of 14.7x which is around the historical average. The dividend yield of the market also remains highly attractive compared to other asset classes with a gross franked yield of 6.2 per cent, significantly better than cash (2.6 per cent) and bonds (4.3 per cent). We expect to see continued improvement in market earnings revisions and economic growth. We view the tapering of quantitative easing as confirmation of a lower macro risk environment which will see higher returns from higher beta, or more cyclical stocks, that have not been rewarded in the last few years of high uncertainty, especially in Australia. Australian equities as a global source of income will remain a very strong theme. Income, will be a large percentage of total return in 2014 with high quality companies with minimal income risk a key focus for the income portfolios.

Source: Legg Mason, February 2014

Creating new habits for 2014: how to have it all

'Serenity Now!'[1] and 'Peace, be still'[2], might be mantras we vocalise or silent pleas for help as we navigate through our busy days but over the long term are not real solutions to coping with modern life.

What we are trying to do in that moment, as we reach for a calmer train of thought, is to pause the relentless urgency that undermines our thoughtful deliberation, creativity, engagement of those around us and our ability just to get things done. And whilst possibly effective in that very moment, the ability to balance all that we have going on in our daily lives, requires long term changes in our behaviour.

The challenge of changing behaviour

Creating new positive habits can make significant differences in your life and give you the skills to turn the impossible into the possible. But how easy is it to change our behaviour? A few statistics from Tony Schwartz of the Energy Project[3], reveal change, unfortunately, is not that easy…

- Twenty five per cent of people abandon their New Years' resolution(s) after just one week
- Ninety five per cent of people who lose weight on a diet regain it
- Most alarming is that only one in seven people make any enduring life changes around eating or exercise after surviving a heart attack.

We are indeed creatures of habit. Some behaviors become so ingrained, such as smoking or biting our nails that we can't stop even if we want to. In fact, Massachusetts Institute of Technology research has identified two regions in the brain that are responsible for crystallising habits so it's no wonder we find it so hard to break them.

So how then can we break these habits? Researchers are looking at ways to treat and break habits using deep brain electrical stimulation (think of it as a pacemaker for the brain), to suppress our unwanted habits – a little extreme perhaps?

Before we line up to get rewired, there are some choices we can make to start our own patterns of change.

Making choices to embrace the best within

Chris Gardner (the man on whom the film 'The Pursuit of Happyness' was based), in his retelling of his battle to come out of poverty and homelessness, offers advice to embrace the best within us[2]:

1. Make a choice to let go of judgement and accept who you are at your best
2. Choose to break generational cycles
3. Choose to accept that you are allowed to be happy and have abundance
4. Choose to learn from the past.

Now, it isn't easy to act on this advice, apply these choices and make time for what's important when daily life stresses get in the way.

Take John for example. I'm sure we could all relate to him…

John is a small business owner married to Kate a teacher and they have two children aged 13 and 10. John is trying to: run the business, be a good husband, be a good father, keep a handle on the finances, keep fit, maintain his friendships, mentor his staff, fit in a family holiday at some point and maintain the condition of his home…..Something has got to give!

With his energy focused on so many activities, where would John find the time to make better choices and start making changes to his lifestyle?

Today we call it outsourcing, the Babylonians[4] called it '…one of the cures for a lean purse', but the message is clear – outsource the things that you are no good at or not qualified to do so that you can have more time to focus on what's important to you and what adds value to your life.

So for John it meant joining a small business peer group, hiring a trainer for his staff, seeing a financial planner and matching exercise with his friendship group. By doing this he freed up time for what was really important to him – being a good husband and father.

Six tips to create new habits

John was able to free up his time to focus on making change and you can too. But it's important to remember that change takes time and there will be some resistance along the way. Try these six tips to help you on your journey:

1:	Don't change everything at once: Focus on one or two things at a time
2:	It takes about a month to lock in a new behaviour
3:	Be precise about what you want to change
4:	Focus on a positive outcome rather than the negatives
5:	Expect resistance (especially from yourself)
6:	Enlist the support of others

Talk to a professional

Whether it's your finances in 2014 that are a priority, the estate plan, those insurances that you need but don't like talking about or even if it's the no sugar diet, you need to talk to a specialist to understand how they can help.

By enlisting the help of others you can then free up your time to make better choices and to start the journey towards creating new positive habits.

Speak to your financial planner today to see how you might benefit from the help of a professional.

1 'Seinfeld', NBC, 1989 to 1998.

2 'The Pursuit of Happyness' Chris Gardner 2006

3 'The Energy Project' www.theenergyproject.com

4 'The Richest Man in Babylon' George S. Clason 1926.

Source: Zurich, January 2014

Google: the $1 trillion question

Since February 2013, Google has significantly outperformed Apple and the S&P500 index, with Google up 46.4 per cent while Apple has risen only 13.3 per cent and the S&P500 index 18.4 per cent. Whilst Google is no doubt performing well, there is still a long way to go. Below we highlight a couple of basic assumptions regarding the secular shift to online advertising that could see Google become the world's first company to have a market capitalisation of over US$1 trillion by 2020.

Google search

Total advertising spend globally is expected to grow to around US$720 billion by 2020 (in line with World GDP growth). In the online space this growth is likely to be even faster as advertisers continue to align advertising dollars with consumer habits. The chart below shows that in spite of the explosive growth in the time spent by consumers online and on mobile platforms, advertising dollars have been relatively slow to follow.

If we assume that growth in digital advertising continues to grow in line with media consumption habits to 36 per cent of all advertising spend by 2020 (from 22 per cent today), then this would represent 13 per cent pa growth in Google's core market to US$260bn by 2020. Assuming Google can grow its market to 50 per cent from 45 per cent today, core Google search could command US$130bn pa in gross revenue.

YouTube and Android

Adding to this opportunity, Google has further growth avenues via its YouTube and Android businesses. YouTube is going after TV advertising budgets, which still remain the dominant category for advertising spend globally. YouTube is the largest online video site globally and is uniquely positioned to drag advertising dollars away from TV. It's currently estimated that YouTube has captured just 1.8 per cent of the current US$230bn plus global TV advertising budget. If this were to increase to 6 per cent by 2020, this would represent a further US$20bn revenue opportunity for Google. Adding to this success is Android, the mobile phone operating system Google gives away free to 'smart phone' manufacturers including HTC, Samsung and Sony. Google benefits from users being directed to Google Search and Google Maps, but also via users being directed to the Google Play store where Google earns a commission. Android now has over 1 billion now. Assuming continued growth in activations and US$5 in revenue per device via downloads from the Google Play store, this represents another US$12.5bn revenue opportunity by 2020.

So how do we get to $1 trillion?

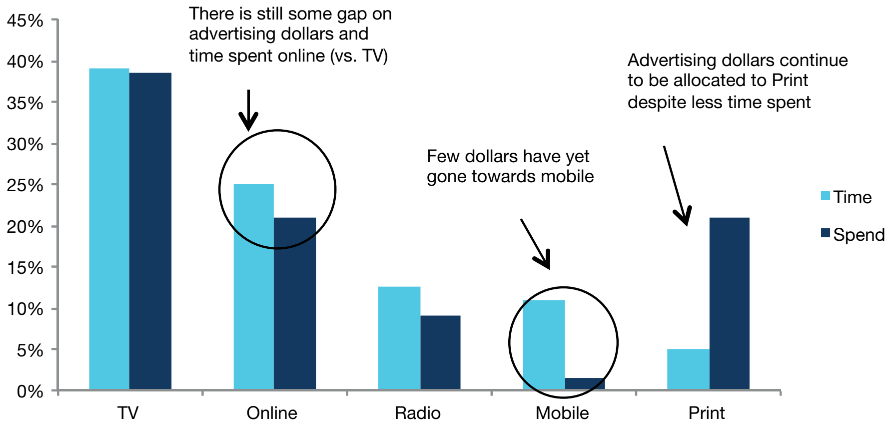
Adding these core revenue drivers together and subtracting traffic acquisition costs, we estimate that Google can achieve US$130bn pa in revenue by 2020 (a 15 per cent pa growth rate from around US$50bn net revenue today). This should equate to roughly US$65bn of EBITDA in 2020. Rolling that forward one year and applying the same 12x EV/EBITDA multiple that Google trades on today, achieves an enterprise value of US$895 billion by 2020. Add back the estimated US$120 billion in net cash that the group is expected to have accumulated by 2020, we arrive at a market capitalisation of over US$1 trillion. Google's current market capitalisation is US$343bn with US$60bn in net cash. Our estimates represent a 260 per cent rise in the share price over the next seven years.

The assumptions above used are not aggressive for a company with a dominant position in an area of strong secular growth. The bulk of Google's growth will come from consumers shifting to online media, a world which Google dominates now and is expected to extend its dominance in the future.

To determine whether these investments are suitable for your personal circumstances, speak to your financial planner today.

Source: K2 Asset Management, February 2014

Proportion of Ad Spend vs. Proportion of Time Spent on Media (US)



Source: eMarketer

Preparing for the unexpected with trauma insurance

While the first life insurance policies can be traced back hundreds of years, trauma insurance is a comparatively new entrant to the insurance market. Trauma insurance was first released in 1983 thanks to a South African surgeon, Dr Marius Barnard. The first policies were issued in Australia roughly ten years later.

Dr Barnard saw a need for financial assistance for patients who suffered a significant illness or accident. ‘When I went into private practice I could not help but notice that while many patients eventually fully recovered medically, they suffered severe financial problems. This was not because of the cost of the operation but because of the disruption to their lives and their loss of income,’ Dr Barnard said.

Trauma insurance can fill this gap. Where total and permanent disablement (TPD) requires you to be unlikely to work again, and income protection pays if you are unable to work either temporarily or permanently, trauma payments require you to meet the definition of one of a list of specified diseases and injuries. So it’s not about the level or length of the disability; rather, it’s based on the diagnosis.

You may have heard trauma insurance referred to by another name, such as living, critical illness or crisis recovery. Trauma insurance can be complicated, with different policies covering different conditions, each with specific definitions.

Initially, just a handful of conditions were covered: cancer, heart attack, stroke and coronary artery surgery. This list has expanded and some policies cover up to 40 conditions including degenerative diseases like multiple sclerosis and Parkinson’s disease, paralysis, comas, loss of speech, deafness, chronic organ failure, major organ transplants, occupationally acquired HIV and even severe rheumatoid arthritis.

Because trauma insurance provides a payment based on diagnosis, rather than the level of impairment, working out the right sum insured is complicated. Consider that for cancer, a claim may be for a melanoma or may be for stage 3 lung cancer. Trauma provides you with a one-off lump sum so income and capital requirements need to be considered. Deciding the right amount of cover for you will involve a detailed discussion with your planner around two key areas:

a What will you need at the time of your illness/injury?

b What do you want your life to look like afterwards?

Income needs

Firstly, your adviser may consider your income needs. As income protection only covers you for 75 per cent of your income, many advisers will recommend that you top this up to 100 per cent with trauma. The period you allow for is up to you, although a general rule of thumb is to allow at least two years.

You may also consider the other income in your household. If you were undergoing treatment for cancer, or diagnosed with motor neuron disease, for example, would you need and/or prefer for your partner to take some time out of the workforce to look after you and your family?

Having this option to step out of the workforce to concentrate on your recovery can make an enormous difference.

Medical costs

Secondly, you and your planner may consider the cost to have access to the best medical care available. You should consider the cost of treatment, potential travel and accommodation along with ongoing therapy. It can be difficult to quantify how much could be required. The cost of treatment and loss of productivity from cancer has been estimated at hundreds of thousands of dollars in a report for the Cancer Council of NSW.

When looking at medical costs, it isn’t just about treatment costs. Having access to quality rehabilitation services will assist your recovery. Whether this be physiotherapy, wellness services, counseling or alternative medicine, your plan needs to include an amount to fund your recovery.

Moving forward

Finally, it's important to contemplate what changes you may like to make to your life. Will you still have the same drive to return to work? Your priorities could change, and planning for this can give you the ability to reduce your hours or cease work entirely. If you're working towards retirement, you may wish to bring this date forward. Your adviser can discuss with you how these objectives can be achieved, such as through replacing income or reducing debt, so that less income is required. While trauma insurance is not well known, you are more likely to claim on this cover than life or TPD insurance. Spending time with your financial planner to talk through your personal situation and plan for your individual needs is an important step in making sure you have the appropriate level of cover in place.

Case Study

Eleanor is a 44-year-old anaesthetist. She is married to Matt, an engineer, and they have two children aged eight and six.

She discussed with her planner how difficult it was to consider what she would do if diagnosed with a serious disease or injury, but there were a number of scenarios about which she was certain. Eleanor knew that if she had to go through treatment for cancer, she wanted Matt to be able to care for her and the children. She also said if she was diagnosed with a degenerative disease like multiple sclerosis, she would want to change her priorities, step away from work and focus on her well-being.

With her planner, they put together a sum insured that would cover 25 per cent of her income for two years (her income protection policy will provide the other 75 per cent if she is off work). They also calculated a lump sum for medical care and enough to pay off their mortgage. While paying off the mortgage was not a specified need, the ability to do this would allow either Matt or Eleanor to cease working. While the future is uncertain, talking through and understanding their protection plan has given Eleanor and Matt confidence that they're prepared for the unexpected.

For more information about trauma and risk insurance, contact your financial planner.

Source: BT. Cost of Cancer in NSW by Access Economics http://www.cancercouncil.com.au/wp-content/uploads/2010/11/costofcancer_summary.pdf

Dealing with credit card crunch

The holiday season has left many people with a larger than expected credit card debt. If you are one of the people feeling the credit crunch, this article looks at ways to reduce your credit card balance.

Credit cards allow you to buy things you may not have the cash for. But with high interest rates and the difficulty to pay off balances, credit card debt can become a big problem.

Unfortunately there are no quick fixes, but implementing a budget is a great place to start.

Pay off the smallest debt first

The snow-ball method, or paying off the smallest debt first, can work if you have multiple cards and personal loans, particularly as it gives you quick wins, and keeps you motivated to do it again.

One thing to be aware of when paying off the smallest debt first is to make sure that there are no major legal downsides to not paying off one of the larger debts.

For example, if you owe the Australian Tax Office money, it might be wisest to pay them off first and then start paying off the small debts.

Pay off the most damaging debt first

If you are motivated by numbers, then you should look to pay off the debt which is doing the most financial damage. Credit cards with higher interest rates should be paid before personal loans where rates are generally lower.

Transfer your balance to a lower interest rate

There many credit cards and banks offering low interest products that are designed for balance transfers. While this can be a great way to move from those damaging, high interest rate credit cards, the low rate is often only for a period of time, before they jump up to a higher interest rate. You need to be sure you will be able to pay off the debt before the higher interest rates kick in.

To see if you can afford it, simply divide the total amount owing by the number of months for which the low interest rate is applied and this roughly becomes your monthly payment.

Once the balance is back to zero, cancel it before you start filling it up again.

Use your savings to reduce debt

You could dip into your savings to help pay off your debt. Savings accounts often have a lower interest rate than credit cards or personal loans, so it might be wise to move some of your money around so that you pay off some of your debt. But make sure to have enough savings put aside in case of emergencies.

Start saving

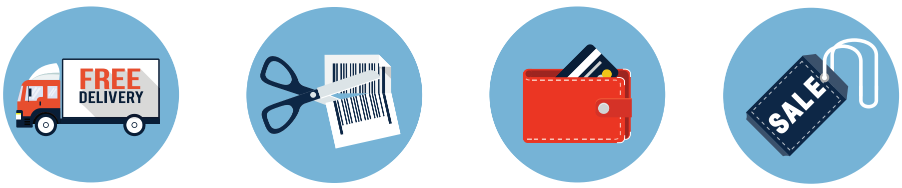
After you have paid off your debt, you can start saving. Your first priority should be to build an emergency fund which can cover up to six months of expenses. You could also look at creating a holiday or fun fund.

Top tips for dealing with credit cards

- **Shop around for a low interest rate** – If you want to transfer the balance on your old card, you can find cards with very attractive transfer rates.
- **Reduce your annual fees** – By having more than one card, you may be paying more than one annual fee. Consider consolidating to one card.
- **Try not to pay overdue or over limit fees** – You may get charged for overdue or over limit fees. Try to pay your credit card off completely every month, but if you can't do that, make sure you keep it under your limit and you pay your bill a few days before it is due.
- **Watch out for overseas transaction fees** – Try to minimise the overseas transactions you make on your card. Consider changing cards to one that does not charge overseas fees whenever you travel or make online purchases.
- **Be wary of reward cards** – These often have very high interest rates and annual fees. People get attracted by the travel offers or reward points but don't realise they are paying higher than normal rates. So do your homework and make sure you understand the fine print.

Speak to your financial planner to get more helpful hints and strategies to manage your debt.

Source: Lonsdale Financial Group, December 2013



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