

## Australia vs the world

As the global economy is on the brink of recession, many investors may be questioning the merits of maintaining an international equity exposure.

### 2008 - the year investors would rather forget

The financial crisis that swept across the world has had lasting impacts on the global economy, with some countries faring worse than others. The fallout from the crisis wiped trillions of dollars off world sharemarkets last year.

The table below indicates how some of the world's major sharemarkets closed in 2008.

Index	Year ending 31/12/2008
Australia (S&P/ASX 300 Index)	-41.7%
US (S&P 500 Index)	-38.5%
Europe (Eurostoxx 50 Index)	-44.3%
UK (FTSE 100 Index)	-28.7%
Japan (Nikkei 225 Index)	-42.0%

Source: Stock Doctor

### The R word hits home

While the Australian economy proved itself more resilient to the global credit crisis than most developed economies during 2008, it too faces the prospect of a recession this year. The question has changed from will Australia go into recession to how long will it last? Technically, a recession is defined as two consecutive quarters of negative GDP growth.

In its latest world economic update the International Monetary Fund (IMF) has revised 2009 world growth down to just 0.5 per cent<sup>1</sup>, its lowest level in sixty years. The United States, UK, Germany, France, Italy, Japan, Singapore and Hong Kong are already in recession.

While Australia is expected to slip into recession during the first half of the year, our downturn is not expected to be as severe as other developed countries. The Australian economy grew by just 0.1 per cent (seasonally adjusted) in the September quarter. December data due out at the beginning of March will confirm whether Australia has slipped into negative growth territory.

Australia's stronger balance sheet augurs well for a speedier recovery than many other developed economies. On the plus side:

- Consumer spending remains strong with retail sales jumping 3.8 per cent in the December quarter – the highest rise in eight years. At the same time, the housing market downturn has not had the devastating household wealth impact it has had in the US.
- Australia's banking system remains relatively healthy compared to the US and Europe. The IMF estimates writedowns on US originated assets at more than US\$2.2 trillion.
- The Federal Government has released two stimulus packages to build infrastructure, extend credit to struggling industries, save jobs and encourage consumer spending. Since October the Rudd Government has announced it will inject \$52 billion into the Australian economy over the next four years.
- The Reserve Bank of Australia (RBA) is aggressively cutting interest rates – reducing official interest rates by 4 per cent since March last year. With the official cash rate at 3.25 per cent the RBA still has some room to move on monetary policy if needed. In the US interest rates have fallen to zero effectively forcing the Federal Reserve to print money to inject liquidity into the economy.
- The Australian dollar fell by 40 per cent last year making Australian exports more attractive to our trading partners.

On a more negative note:

- Treasury has revised Australian growth forecasts down. Expectations are for economic growth of 1 per cent this financial year and 0.75 per cent in 2009-10.
- The Federal Government's stimulus packages will be paid for in years to come. Treasury is forecasting a budget deficit of \$35.5 billion next financial year, Australia's first budget deficit since 2001-02, with large deficits projected until 2011-12. While at face value next year's deficit figure appears large, at 2.9 per cent of GDP it is smaller than previous deficits.
- Australia's two major trading partners, China and Japan are also experiencing economic downturns. Chinese growth is slowing rapidly down to 6.8 per cent in the year to December 2008 (2.2 per cent below the previous quarter). The Chinese downturn is expected to reduce demand for Australian resources, which has been the driving force behind Australia's economy over the last decade.
- We are expecting more downward revisions to earnings forecasts in the current reporting season as companies factor in slowing economic growth and lower commodity prices. Global commodity prices have fallen 54 per cent since reaching a peak mid last year<sup>2</sup>.

Time will tell how successful local and overseas government rescue packages have been at stimulating the world economy and credit flows. While it will take some time for liquidity to flow through to the real economy, analysts are predicting a pick up in domestic growth later this year.

Lincoln's Senior Portfolio Manager Stephen Cleugh says: "While we expect the next 12 months to remain volatile, economic conditions should improve towards the end of 2009. The impact of lower interest rates around the world and other stimulatory packages should start to positively impact company profits reported in 2010."

## Implications for asset allocation

While including international exposure can improve diversification benefits, it is not without its risks – something that the world financial crisis has highlighted all too clearly.

Stephen says: “While we advocate investors should hold a diversified group of quality investments to give them the best chance of outperforming over the long term, we advise against simply exposing yourself to sectors without reason.”

## Don't forget currency and tax

Currency volatility can play havoc with investment returns. Unhedged international portfolios get their returns from two sources - the change in the value of the investment and currency returns. While a falling Australian dollar is positive for local investors, a rising local currency can negatively impact overseas returns. This is why the hedging practices of different fund managers can be an important consideration in the investment equation.

Another important factor that investors often overlook when investing overseas is to compare the after-tax returns. Australia's dividend imputation system provides significant tax breaks for local share investors which can help to improve overall net returns. Unfortunately, these benefits do not extend to international shares.

## Spend or invest?

With lower interest rates, government handouts and falling oil prices most consumers will soon have more money in their pockets. Many may be asking whether now is the time to spend or invest?

Of course, the answer to that question will depend on your personal circumstances and objectives. All we can say is there are high quality, financially healthy companies out there representing excellent long-term value. These are the companies we target for the Lincoln Australian Share Fund (the 'Fund')<sup>3</sup>.

Lincoln's investment approach has delivered consistent top quartile performance relative to its peers. The Fund continues to retain its 5 star Morningstar Rating<sup>TM</sup> with a total return of -0.56% p.a. for the three years to 31 January 2009. This represents outperformance of 6.14% p.a. over the S&P/ASX 300 Accumulation Index. Our outstanding three year performance also ranks our Fund third out of 136 funds in the Australian Large Growth sector according to Morningstar.

## Like to know more?

To find out more about the Lincoln Australian Share Fund and our long-term approach to investing please call Ben McGrath, Managed Investments Team on **1300 676 332**.

## Archive

To view previous articles in the FUNDamentals series click here.



- <sup>1</sup> <http://www.imf.org/external/pubs/ft/survey/so/2009/RES012809A.htm>
- <sup>2</sup> [www.anz.com.au](http://www.anz.com.au), ANZ economic outlook
- <sup>3</sup> The underlying investment portfolio for the Lincoln Wholesale and Retail Australian Share Funds

Important information. This information is issued by Lincoln Indicators Pty Ltd.

Investment Manager: Lincoln Indicators Pty Ltd (Lincoln) ACN 006 715 573, AFSL 237740. Responsible Entity of the Fund: Equity Trustees Limited ABN 46 004 031 298, AFSL 240975. All figures, information and illustrations are as at 16 February 2009 unless stated otherwise. Portfolio holdings and sector allocations are subject to change without notice. This communication contains general information only. It has been prepared without taking into account the objectives, financial situation or needs of any individual investor. As a result, you should consider its appropriateness in regard to your particular objectives, financial situation and needs. You should also consider obtaining your own independent advice before making any financial decisions. It should be read in conjunction with the Product Disclosure Statement (PDS) of the Lincoln Australian Share Fund; which can be obtained by contacting Lincoln on 1300 676 332, or via our website [www.lincolnindicators.com.au](http://www.lincolnindicators.com.au). You should read and consider the PDS before making any decision about whether to acquire or continue to hold the product. Applications to acquire units can only be made on an Application Form attached to a current PDS. Lincoln, its employees and/or associates may hold interests in companies listed in this communication. This position may change at any time without notice.

Investments go up and down. Past performance is not a reliable indicator of future performance. Lincoln, as Investment Manager, will be remunerated based on funds invested. You should read and consider our Financial Services Guide, available by contacting Lincoln on 1300 676 332 or via our website [www.lincolnindicators.com.au](http://www.lincolnindicators.com.au), which sets out key information about the services we provide. Neither Lincoln, Equity Trustees Limited, or their directors, employees or agents provide any guarantee, representation or warranty as to the reliability, accuracy or completeness of the information in this document; and do not accept any responsibility or liability arising in any way (including by reason of negligence) for errors in, or omissions from, this document. This disclaimer does not purport to exclude any warranties implied by law which may not be lawfully excluded. Neither Lincoln, Equity Trustees Limited, or their directors, employees or agents guarantees the performance of, or the repayment of capital or income invested in the Fund. © Morningstar Research Pty Ltd ABN 83 062 096 342, AFSL 243161. All rights reserved. To the extent that any of the content above constitutes advice, it is general advice that has been prepared by Morningstar, without reference to your objectives, financial situation or needs. Before acting on any advice, you should consider the appropriateness of the advice and we recommend you obtain financial, legal and taxation advice before making any financial investment decision. If applicable, investors should obtain the relevant product disclosure statement and consider it before making any decision to invest. Please refer to our Financial Services Guide (FSG) for more information at [www.morningstar.com.au/fsg.asp](http://www.morningstar.com.au/fsg.asp).