

# DecidingFactors

Q3/09

## Do the 'green shoots' mean we are out of the woods?

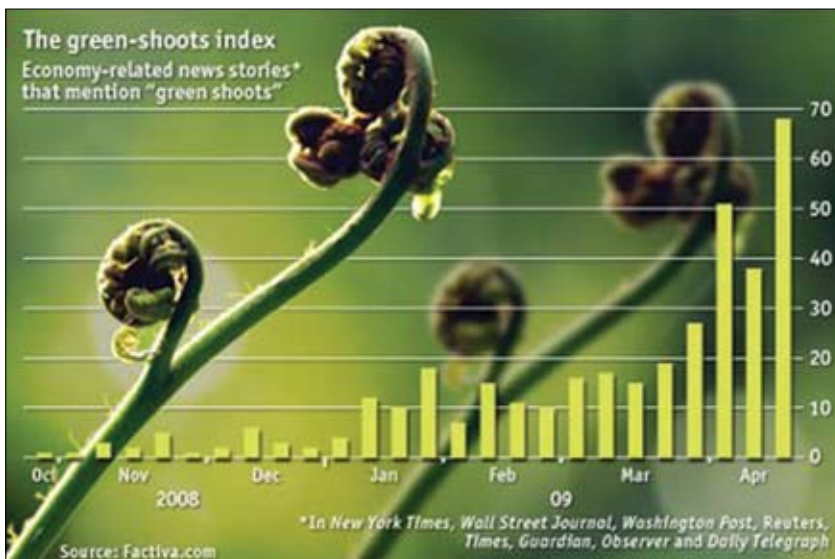
One of the more recent phrases you may have heard quoted by global media and market commentators is 'green shoots'. This term has been coined by many to describe positive economic and market indicators as some look for signs of a recovery from the global financial crisis. The focus has begun to shift away from how much worse will it get, to when is it going to get better? As you can see from the index below, international media are increasingly referring to 'green shoots' within the economic news stories they write.

It is certainly important to remain positive, and look forward to the recovery that will eventually come. After all, without the unprecedented co-ordinated efforts of the world's governments, the crisis could have been significantly worse. However, it is important to make the distinction between reported 'green shoots' and the economic fundamentals, which will ultimately drive a recovery.

The International Monetary Fund (IMF) now believes a recovery will be stronger than first forecast (Source: [www.imf.org](http://www.imf.org)). Its revised forecasts reflect differing stages of recovery across the globe, with emerging economies including China helping pull the world out of the worst recession in six decades, while Europe lags behind the US and Japan. The IMF warns the pickup is likely to be "sluggish" and called repairing the international banking system a priority.

Economist, Gary Shilling, recently explained: "Recessions are not a straight down affair. They go back and forth." He has a good case based on the eleven post-World War Two recessions, where eight have had at least one quarter of GDP growth. We may well see 'green shoots' in certain market and economic indicators over the next few months, but this does not necessarily mean the tables have turned. We should prepare ourselves for the

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### **Government Deposit Guarantee Scheme Extended**

The government has announced the Crown will extend its guarantee over the principal amount of Term Deposits with approved Banks and Finance Companies. The current scheme will continue until 12/10/2010, at which time it will be replaced by a new scheme with significantly different terms and conditions.

While some Non Bank Finance Companies are likely to promote longer term deposit rates over the coming months, we would not encourage investing in these companies beyond October 2010 just yet. Please contact your adviser to discuss what the best options are for your portfolio.



## DecisionMakers

The best financial decision you'll ever make

potential of further falls in the markets, perhaps even to the lows we saw earlier this year.

While this may be an unsettling thought, it is something we should accept as investors and remind ourselves that we are in it for the longer term, not on a month by month basis. According to Shilling: "The recession's shape will be more like an L, with slow recovery and muted growth. I see nothing steep enough to suggest anything like a V shaped recovery." If Shilling is correct (and he is one of the few who have been in the past), this means a recovery will take some time and be gradual, rather than a sudden upswing. Certainly, the fundamental economic drivers do not suggest we are through the woods just yet. In fact, this crisis has been quite different to those in more recent years (such as the tech boom and subsequent bust in 2002), where it has been the economic fundamentals themselves that have been challenged. Furthermore, the unprecedented economic action by the world's major economies has breached new territory, the long-term effects of which can at best be an educated guess at this time. What is clear though, is that this co-ordinated action has kept the financial markets and indeed global economies standing.

Warren Buffett, the world's most successful investor, recently summed up the response of governments to the global financial crisis and resulting situation well when he referred to the US economy as: "like a fellow going down in quicksand last September, and up to his shoulders, and somebody tosses a rope. We can tie it around and yank him out with a truck... You may dislocate shoulders, but it still pays to get him out."

You may well hear the phrase 'green shoots' used by more and more of the world's media as they begin to shift away from reporting negativity each day with the aim of keeping their audience captivated. However, it pays to be mindful that a recovery is likely to take time and can prove volatile. Do not pin your hopes on the latest media report suggesting the recovery is underway, yet do remain positive about the longer term. There may be further market volatility ahead and while global financial markets have not yet returned to good health, they have endured a crisis which has shaken them to their very core and a recovery will eventually come.



## The bare necessities

When it comes to reducing household expenditure, efforts of reduction tend to focus on luxury items. Where possible, purchases are often put off or avoided. However, there are some purchases that you can not avoid making each month, such as basic food stuffs, petrol and other necessities required for you to operate on a daily basis. While some form of expenditure is required on these items, there are ways to minimise this. Cutting back on luxury items is not the only way to save you money. For those willing to put a little thought into why they spend the amount they do on a particular item, there is a world of saving opportunity.

For example, petrol may be a necessary expense each month, but does it have to be as much as you pay? What are the drivers behind the dollar amount you pump into your car? Consider the following five methods to reduce the amount you spend on petrol each month, as well as inspire you to find ways to reduce the amount of money you spend on other necessities:

- 1. Keep your car tyres inflated correctly** – The flatter your tyre, the more drag your car has on the road. More drag requires more force generated from your car's engine and so more petrol is consumed.
- 2. Restrict the use of air conditioning in your car** – Turning up the air conditioning in your car on a cold morning may seem like a good idea, but this is increasing the demand on your engine and so consuming more petrol. Consider wearing an extra layer or even gloves, scarf and hat on those chilly mornings when you drive to work. It may not sound too appealing, but your wallet will thank you.
- 3. Empty the car boot regularly** – How often do you open the boot in order to load the car for a trip away, when you discover there are already items in it that you had forgotten about? All of these items add additional weight to the vehicle requiring more petrol for the engine to move the car. Take a minute or two every now and then to ensure the boot remains empty.
- 4. Service your vehicle regularly** – Spending money on servicing your vehicle regularly by ensuring oil performance is optimised, air filters are unblocked etc can be offset to a degree. A well functioning vehicle demands less of the engine and so keeps petrol consumption to a minimum.
- 5. Consider alternative transport options** – We often do not give a second thought to alternative ways to travel, if we have the luxury of a car at our disposal. However, if you have some spare time, why not walk down the road to pick up the morning paper? At the weekend, why not take the bus to your destination and enjoy the sights and sounds of your journey?

### life's tip #1

*"Forewarned, forearmed; to be prepared is half the victory." – Cervantes*

- The recovery is going to take time. Even then, there is much repair work needed on the international banking system before we can move forward
- Are your everyday expenses higher than they need to be?

# 6 reasons to reassess your life insurance needs

When was the last time you had a sparkling conversation about life insurance? To be fair, it is not something most of us want to think about too often. However, despite our reluctance to discuss them, protection policies such as life insurance are not insurances we should buy once and never think about again. The sad reality is that most of us forget to update our insurance cover when we experience life-changing events, even though this can leave you and your loved-ones in financial difficulty, should the worst subsequently happen.

You are more than likely going to experience a life-changing event at some point in your life, if not multiple events. Take note of the following life-changing events, all of which result in a change of circumstances and therefore insurance needs:

**1. You take out a joint mortgage** – When you buy your first property, it is likely your mortgage provider will impress upon you the need to purchase some form of life insurance. This is because the bank will want an assurance that, if you die, your mortgage will be repaid in full.

If you buy a home with a partner, it's even more important to ensure you have enough protection in place to cover your share of the mortgage debt.

If you don't, your other half could end up being pursued for the entire joint mortgage, should the worst happen.

## **2. You get married or enter into a civil partnership**

– When you make the commitment to spend your life with someone else, it is likely this will also mean you spend your money jointly (although not necessarily in equal amounts!). Entwining your finances with a partner's can affect the level of life insurance cover you need.

If you rely on pooling joint incomes to pay your household bills, it is important to ensure both partners' contributions to the family

finances are properly protected. Otherwise, should one of you pass away, the person left behind is likely to experience money worries, as well as heartache.

**3. You have children** – In 2009, the New Zealand government calculated that it costs an average of \$250,000 to raise a child for a middle income family and this does not include any contributions towards further education!

Even if both parents in a family work, costs like these can be difficult to cover. However, if one of the incomes you rely on was lost, the right life insurance cover could make a real difference to the surviving partner or loved ones left to bring up your family.

Also, don't forget to review your life insurance needs as your family grows. Looking after a family of three or four children will cost significantly more than meeting the needs of an only child.

## **4. You have other, non-mortgage debts**

If you have outstanding borrowing on personal loans and credit cards, it is important to understand that these will have to be repaid out of your estate (the wealth you leave behind) when you die. It is a good idea to ensure you have enough life insurance in place to cover such debts, especially if you have dependants who rely on your income to survive. If you don't, your family will have to deal with your creditors after you've gone.

**5. You get a new job** – If you are lucky enough to be offered a new job and an increased salary, you may need to increase your life insurance cover.

This sounds contrary, and it is easy to assume being better off might mean you would need less, not more, life insurance – but remember, most people become accustomed to the lifestyles they lead.

If a career move means the start of a more affluent standard of living for you and your

family, it is worth considering how they would maintain this if your income was lost.

Also, it is worth checking the terms and conditions of any new employment contract you sign. Some jobs may offer a degree of income protection as part of your package.

## **6. Your health or lifestyle changes**

– A change in health or lifestyle may enable you to remove a premium loading. For example, you may have taken out life insurance and been a smoker at the time. You may have since given up smoking and so, depending on your policy and how long ago you gave up smoking, you may be able to remove a premium loading from your policy. Another example is where you may have changed jobs from what was classed as a high risk job, to now a lower risk job.

*It is a good idea to seek independent, personal advice from an expert whenever you address or re-visit your insurance needs. Please contact us if you would like discuss your life insurance or any other key insurance policies. We will happily assist you to ensure the appropriate level of cover is in place for you and your family.*



## **Albert Einstein and the New Zealand Economist**

When Albert Einstein died, he met three New Zealanders in the queue outside the Pearly Gates. To pass the time, he asked: "What are your IQs?"

The first replied 190. "Wonderful", exclaimed Einstein. "We can discuss the contribution made by Ernest Rutherford to atomic physics and my theory of general relativity".

The second answered 150. "Good", said Einstein. "I look forward to discussing the role of New Zealand's nuclear-free legislation in the quest for world peace".

The third New Zealander mumbled 50. Einstein paused, and then asked, "So what is your forecast for the budget deficit next year?"

# Bonds 101

Demystifying some of the complicated lingo and finding a familiar concept

Essentially a bond is an IOU, an undertaking from one party to repay a loan from another party. The terms and conditions are set out in the Investment Statement and Prospectus. Many companies, local bodies and the NZ Government issue bonds from time to time. When they need funds, they issue bonds with a promise to repay at some point in the future. And those promises are called 'bonds'. The entity issuing the bonds is referred to as the 'Issuer'.

There are millions and millions of bonds issued every year. And the bond market in its entirety is staggeringly large. The total value of all outstanding bonds in the global market is approximately \$61 trillion USD, about 20% larger than the total value of shares in all global markets (about \$50 trillion).

## Learning the Lingo

There are a slew of different types of bonds available – from Government Bonds, Bank Bonds and Corporate Bonds. These are often referred to as Notes, Paper or just Debt. But no matter what you call them and no matter where you buy them, nearly all bonds share some common traits.

## Primary & Secondary Market

There is a 'primary market', which is where issuers raise funds directly from the public by issuing new bonds to be sold for the first

time. Then there is the 'secondary market', an exchange where existing bonds can be traded between investors. When an existing investor sells a bond to another investor or broker, this transaction is carried out on the Secondary Market.

## Maturity Dates

Bonds do not live forever. Each of them has an expiration date (maturity), at which time the bond issuer must return the principal to the investors. Some bonds have a very short life span, while others last for decades. As a rule of thumb, we tend toward bonds in the 5 to 10 year range. Unlike a term deposit, it is the issuer who sets the term, not the investor. The good news is the secondary market provides a very efficient exchange to sell your bonds, if the need arises. We can typically trade within a few hours and transaction costs are as low as 0.4% of the bond's market value.

## Face Value

When a bond is created or issued it is given a certain face value, sometimes called the par value or the principal of the bond. Just as with a personal loan, the principal refers to the amount of money the borrower must return to the lender at the end of a specified time period. So while a \$10,000 bond could be traded (and therefore valued on your portfolio reports) above or below par value, when the bond is repaid, it is the full \$10,000 that gets repaid by the issuer.

## Coupon Interest Rate

The word coupon harks back to the days of paper based certificates with tear-off coupons. Investors would present their certificates and exchange their coupon for the interest payment. While physical coupons are now a thing of the past, the name remains. For example, the latest Fonterra bond has a Coupon of 7.75% or \$775 per year on a \$10,000 bond.

## Yield

This is perhaps the most confusing part of investing in bonds. With a term deposit the interest rate is set at the start and fixed for the duration of the investment. However, with a Bond this can differ from the coupon when a bond is traded on the Secondary market at a price higher or lower than the \$10,000 face value. Using the Fonterra bond again as an example, it is currently trading at \$10,471 per \$10,000 bond. This results in a 'yield' of 6.95% based on the fixed amount of interest paid out by Fonterra each year.

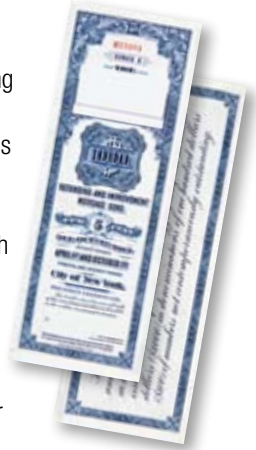
## Credit Rating

There are the very safe bonds that are called 'investment grade'. Then there are the slightly riskier bonds which are either 'below investment grade' or 'unrated bonds'. There are a few quirks around bond rating in New Zealand, as we have some very large and secure companies like Fletchers and PGG Wrightson who have simply decided not to bother getting a rating. While they are unrated, they are arguably a safer bet than many rated bonds.

## Term/Duration

The issuer sets the term or duration of the bond, prior to the issue itself and this is generally from 4 to 6 years, although some bonds (such as government bonds) can extend as far as 10 years. The duration of the latest Fonterra bond is 6 years (maturing 15 March 2010), but that doesn't mean investors necessarily need to stay invested until then. As these bonds are listed on the New Zealand Bond Exchange (much like a Stock Exchange), investors can choose to sell these at any time.

*If you would like any more information about the way we use bonds in your portfolio, or to register to hear about upcoming bond offerings, please contact us today.*



## life's tip #3

*"The only rock I know that stays steady, the only institution I know that works is the family."*  
– Lee Iacocca

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