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Newsletter

Spring 2010

Welcome

Welcome to Spring – to the new growth this season brings and, we hope, some fresh insights from this newsletter.

As tulips and other bulbs begin to pop up in many gardens, it's no surprise that the word "Dutch" features in this issue. What does a two-speed economy mean for Australia, and why is it known as "Dutch disease"? Our story highlights that a strong economy has the capacity to deal with the full economic cycle, not just the good times.

We also dig down into insurance to examine the cover you need. This may help you check your current insurances to make sure they really match your present circumstances.

And to complete the springtime news, we take time out to look at some research on how we can achieve happiness when we spend our money. We hope you find some valuable insights, and we welcome your comments on any issues you would like to talk about.

Kind Regards,

Scott Farmer

Latest news

Both the recent company reporting season in Australia and the latest figures coming from the United States, Europe and Asia demonstrate the same thing – recovery is definitely happening. It's just not happening as quickly as predicted.

Signs are certainly there that the Australian economy and household balance sheets are in good condition. Consumer confidence surged in August; it rose 16.5 per cent in two months and now sits well above the long-term average. Consumer spending has also been stronger than expected.

Employment data has been positive, with increases in employment and in hours worked in the June quarter. While this suggests wage pressures will not be far away as the economy grows stronger, annual wage growth is steady at 3 per cent. Interest rates remain "neutral", with some analysts suggesting increases later in the year or early 2011.

Against this backdrop, uncertainty about broader Australian economic policy has emerged, with the recent election resulting in a Gillard minority government. This uncertainty is likely to persist until the dust settles in Canberra.

Economic recovery is within reach – but our patience is being tested.

DIAGNOSIS OF THE DUTCH DISEASE

Dangers of a two-speed economy

For a country with a population about 25 per cent less than Australia's, the Netherlands sure features a lot in our language! We talk about Dutch courage, going Dutch, and double Dutch.

And in recent times "Dutch disease" has become the vogue term for economies that run at two speeds, where one part is going gangbusters while the other goes into reverse.

So how did the Dutch get the "blame" for this latest phenomenon? In the 1970s the Netherlands enjoyed a natural gas boom and the Dutch currency at the time, the guilder, skyrocketed. This had a negative impact on Dutch exports, previously a strength of the economy.

Many economists say that is exactly what Australia is experiencing with the resources sector enjoying strong growth while manufacturing takes a back seat.

And the reason for the poor performance of manufacturing is the strong Australian dollar caused by the resources boom. With foreign funds flowing into Australia to pay for commodities such as iron ore and coal, our currency is pushed higher. It may be great news for resource companies but it's not for the manufacturers and farmers who export, since their products become less competitive in global markets, causing a drop off in demand. On the domestic front, cheaper imports erode the shrinking market share of domestic manufacturers. Economists have a term for all this: "de-industrialisation".

The positive signs

But it's not all doom and gloom. For the manufacturers reliant on imported components, a higher dollar translates to cheaper production costs.

And strong demand for our resources certainly isn't harming our national economy. There's no denying the demand from China, India and Japan for our raw materials was a key reason for our escaping the global financial crisis. Plus, businesses that service the communities in the booming mining towns are also enjoying the ride.

Of course there can be a danger in too heavy a reliance on one sector of the economy.

In a way it's akin to the classic investment mantra of not putting all your eggs in one basket. If our economy were to become solely focused on resources then we might find ourselves with no "Plan B" should the demand for resources start to unravel.

Preventative health measures

So, do we have a Plan B in place?

Tim Harcourt, chief economist at the Australian Trade Commission, says the answer to the two speed economy lies in the three "i's" — innovation, investment, and international competitiveness.

"By focusing on innovation, investment and international competitiveness and taking advantage of the new opportunities offered by the free trade agreements, the rest of Australia will share in the gains from trade as well," says Harcourt.

He cites how the "second speed" Australian states have already taken up the gauntlet — Victoria has been innovating with emphasis on multimedia, biotechnology and other life sciences; South Australia through education.

Indeed international education has become such a growth industry that the sector was worth an impressive $18.6 billion to the Australian economy in 2009, according to figures released by the federal agency Australian Education International. This puts education among the top export income earners in Australia, up there with iron ore and coal.

As the Australian Chamber of Commerce and Industry says in its report *The Future for Australia's Manufacturing Sector: A Blueprint for Success,* the Australian manufacturing sector may be facing a difficult trading environment, but it does not mean de-industrialisation is having a negative effect on Australia's welfare.

"Australia does not necessarily require a large manufacturing sector relative to GDP to produce high incomes per capita," it argues.

While resources remain so strong, Australia will remain a two-speed economy. However, it is unlikely the Dutch disease is terminal. Indeed you might say what doesn't kill us makes us stronger!

TO BE SURE, TO BE SURE

… keep up to date with your insurance

Whoever put the "sure" in insurance must have had a sense of humour because as circumstances change you might not be sure what cover you're entitled to!

Added to this, insurance is rarely a set-and-forget product. As you move through life your needs change, so you should regularly check your insurance to make sure it still suits your current circumstances and lifestyle.

For instance, if you have paid off your mortgage and your children have flown the nest, then your required level of cover may be much lower than if you're in your 40s with a young family. Other trigger points might be getting a new job, buying your first home or an investment property, or getting married or divorced. Or it may simply be that your income has risen over time so your original insurance no longer matches your requirements.

But at any time of life, the unthinkable can happen. The statistics relating to Australians who are forced to take extended periods off work due to an accident or sickness or even die are staggering.

The 2008 Household, Income and Labour Dynamics in Australia (HILDA) Survey found more than 235,000 working age people living as a member of a couple with dependent children suffered a serious injury or illness in the previous 12 months and needed time off work.

And according to the Australian Bureau of Statistics, there were 12,430 deaths of married men or women of working age in 2008 — this equates to more than 34 families a day losing a member, and more than half of these involved children losing a parent.

These statistics translate to one in five families being affected by serious illness, injury, or even death.

Sufficient cover?

The most common mistake is to assume the cover you have for life, total and permanent disability, and income protection is sufficient to maintain you and your family's lifestyle should something go seriously wrong. A further misconception exists with regard to "automatic" insurance held within employee super schemes. While most working Australians have some form of life insurance in their superannuation, actuaries Rice Warner estimate 95 per cent of families still do not have adequate cover.

Using your super to hold and fund life insurance may be an effective strategy as you pay the premiums out of your super contributions, so they come from your pre-tax income. However, it's worth considering making voluntary additional contributions through your super to make up for any shortfall. Depending on your circumstances, tax may be payable on benefits paid.

Outside super you might also want to consider trauma insurance, otherwise known as critical illness cover. While income protection cover will provide you with an income should you be unable to work, trauma insurance will pay out a lump sum on diagnosis or the occurrence of a specific illness such as heart attack, cancer or stroke. Here you have to be careful of the wording of your policy as definitions will vary across insurers.

If you are running your own business in a partnership, then you need to consider how you would buy out your partner's share should they become unable to work due to death, sickness or accident. The current economic climate and the difficulties faced by small businesses seeking funds have brought this need into sharper focus.

Dangers of co-insurance

But it's not just life insurance where you can slip up and be underinsured. If you underinsure your property, usually by more than 20 per cent, then your insurance company may only pay proportionately if you make a claim. Their assumption is that by insuring for less than the full value, you are to all intents and purposes co-insuring or self-insuring. So if your $400,000 home is insured for only $200,000, you might well receive insurance cover to rebuild only half your house. If however just one room in your house was damaged, then the insurer is only obliged to fund you half the value of the room! Check if your insurance cover has a co-insurance clause.

Whether it's general or life insurance, you need to be sure you are properly covered. Life changes and so do personal circumstances; it pays to be sure your policy doesn't fall short of expectations.

Please call us if you would like to discuss your insurance cover.

$PENDING OUR WAY TO HAPPINESS

or have we found a *better* way?

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The effects of the global financial crisis are still washing through the financial system but already commentators are examining the tea leaves to see what lasting impact it has made on us, and on the way we use our money.

Retailers and governments want to know what's happening with consumers. Have our spending patterns changed? Do we want to save more, and spend less? Are we looking for an extra "something" before we'll loosen the purse strings?

Figures are showing a fall in applications for credit, an increase in personal savings, a drop in personal debt levels, and changes in consumption patterns. What's more, people are saying they actually enjoy saving their money.

But what does all this mean? Is it the "new normal" that consumers will save more and spend less — but still end up feeling happy about it?

As Stephanie Rosenbloom reported recently in the New York Times[1], the practices that consumers have adopted in response to the economic crisis ultimately could — as a raft of new research suggests — actually make them happier. Recent studies of consumption and happiness show people are happier when they spend money on experiences rather than on material objects, when they relish what they plan to buy long before they buy it, and when they stop trying to outdo their neighbours.

While the current round of belt tightening may simply be a response to the economic downturn, some analysts say consumers may also be permanently adjusting their spending based on what they've discovered about the purchases that truly make them happy or fulfilled.

"This actually is a topic that hasn't been researched very much until recently," says Elizabeth W. Dunn, an associate professor in the psychology department at the University of British Columbia, who leads research on consumption and happiness. "There's massive literature on income and happiness. It's amazing how little there is on how to spend your money."

Consumer bonding

Just where does happiness lie for consumers? While they can't say if buying a diamond ring brings more happiness than a new car, researchers have found our types of purchases, their size and frequency, and even their timing, all affect long-term happiness.

We know from our own experience that anticipation increases happiness, so if you are thinking of buying an iPad or booking a special holiday, you'll get more enjoyment out of it if you prolong the buying experience. Spending for an experience, for example — concert tickets, cooking classes, language lessons — also gives us more satisfaction than spending on ordinary "stuff".

Researchers looked at nine major categories of consumption and discovered the only one of the nine to be positively related to happiness was leisure: holidays, entertainment, sport and equipment like golf clubs.

Other research suggests unlike consumption of material goods, spending on leisure and services typically strengthens social bonds, which in turn helps amplify happiness. (Academics are already in broad agreement that there is a strong correlation between the quality of people's relationships and their happiness; hence, anything that promotes stronger social bonds has a good chance of making us feel better.)

And the creation of complex, sophisticated relationships is a rare thing in the world. As Professor Dunn and her research colleagues point out, only termites, naked mole rats and certain insects like ants and bees construct social networks as complex as those of human beings.

In that elite little club, humans are the only ones who shop!

[1] But will it make you happy? Stephanie Rosenbloom, New York Times, 9 Aug 2010.

General Advice Warning: This advice may not be suitable to you because it contains general advice that has not been tailored to your personal circumstances. Please seek personal financial advice prior to acting on this information.
Investment Performance: Past performance is not a reliable guide to future returns as future returns may differ from and be more or less volatile than past returns.

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