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July 2012 | Financial food for thought

Market Update

We talk to Felix Stephen, Manager Strategy & Research at Advance, for his thoughts on recent global economic activity and what it means for investors.



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Global Economic Update

The aftermath of the 2007 global financial crisis has witnessed a significant fiscal, structural and political adjustment unfold worldwide, while a series of recurring natural and man-made events have made the previously fragile global economic recovery and healing process uncertain.

Households and corporations continue to remain risk averse, cautious and hesitant about future consumption and investment choices due to heightened levels of uncertainty in respect of employment prospects, tax changes, regulatory changes, and unstable global and domestic politics.

While a low interest rate and modest investment return environment has forced risk averse 'baby boomers' to seek less volatile, 'safe' and higher income delivering investments. This has resulted in safe assets becoming extremely expensive and 'risky' assets cheap, relative to past economic cycles.

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Financial Market Risks

- Most of the financial asset market risks are envisaged to be around the fiscal standstill resulting from the approaching Presidential election in the US in November this year, and the continued political standoff in Europe that is likely to intensify later this year and into early next year.
- The inability of policy makers to agree and implement credible strategies to arrest and resolve the prevailing ‘crisis of confidence’ has the potential to cause a fragile global economy to tip into a prolonged recession.

What this means for investors

- Geopolitical uncertainty, economic and social turbulence, and heightened levels of risk aversion have combined to generate an environment that is less conducive for accumulating growth assets, although these assets presently offer a good risk/reward trade off.
- Given that financial market and economic volatility is here to stay, investors should think about being more agile and pro-active when making investment decisions and managing associated risks around short, medium or long-term investment decisions and choices.

- In order to navigate and successfully survive high volatility periods, investors need to be mindful of both stabilising and destabilising forces that are in constant play within society, financial markets, geopolitics and economics. They need to rely on active and dynamic asset allocation strategies that are specifically designed to preserve and enhance investor capital during turbulent times.

Financial market outlook

Based on our one-year market forecasts as at the beginning of June 2012, and current prevailing market prices, our return projections for the major asset classes are as follows:

Equities

The outlook for both domestic and global equity markets is modestly positive but volatile. We estimate total returns to be around 9% for domestic equities and around 10% for global equities over the next 12 months.

Fixed interest

Bond yields are expected to rise from their historically low yields over the next year. We expect them to be supported by risk averse and institutional investors seeking investments that are specifically used for solvency and capital adequacy



needs. We anticipate domestic fixed interest to return around 3% over the next year while global bonds are expected to return around 2%.

Commodities

We expect commodity markets to remain volatile in the short term but due to significant supply restraints anticipate the commodity complex to return around 10% over the next 12 months.

Listed property

We expect diversified listed property markets to return around 9% over the next 12 months as investors seek income-producing assets.

Currencies

We expect the Australian dollar to weaken over the next 12 months, in particular against the US dollar, the euro and the British pound.

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