

INTEREST RATE RISES – NO PAIN, NO GAIN

Whilst many are hurting, the rise and fall of interest rates are an essential component of any investment cycle. For some, it could even be said that those very interest rate rises have put us in a better position. Why? I hear you ask.

Firstly, they deflated the property bubble in a timely and measured way. As a result, the property market has stabilized but ready to resume an upward rise if we are to believe some of the research articles. This stagnation (or even further price falls in certain areas) does provide a window of opportunity for investors who are in a financial position to take advantage of the markets.

The second consequence of rising interest rates has been a steep increase in rents. The 12 interest rate rises since 2002 has slowed down the property market as first-home buyers and investors pull out creating a shortage of rental properties and a rapid growth in what landlords can charge.

This brings us to an interesting point – one of reliance on investment income to fund a retirement life style.

Consider the two asset classes Managed Funds (indirect Shares) and Property. There are two types of returns from these investments:

- **Growth** – when the value of the underlying investment has grown over the period of investment. This usually occurs as a result of the appreciation of market-linked assets such as shares and property. Conversely, because the market value of assets can decline, the value of the underlying investment or unit can also decline.
- **Distributions or Yields** – are the payments the unit holder receives during the course of the investment. In the case of Managed Funds or Shares: income from dividends or interest. In the case of Property: rent. These typically are taxed at the unit holder's marginal tax rate.

Managed Funds have, over the last 6 months or so, dropped in value by anywhere from 10% to 30% and more depending on the asset class and risk exposure. Retirees who have all of their retirement capital tied up in managed funds or superannuation, will have had to take a considerable cut in income whilst others will be forced to draw down on a portion of their capital to sustain their lifestyle.

In contrast, those with residential property investments are benefiting from increased rental yields regardless of the value of the underlying investment.

In any event, the current market trends (both in Shares & Property), remind us of the need to (a) constantly review our investment portfolio and (b) diversify. Diversification doesn't guarantee you will not lose money but it does spread your risk across asset classes.

Accepting that interest rate rises are part and parcel of the investment market may not ease the pain for some but hopefully it will force investors to take stock and perhaps even see some opportunities.

RATE OF RETURN AND RISK

Equities, property and shares have comparable returns despite the much lower risk associated with a property investment.

This point is demonstrated by referring (see table below) to the average returns and standard deviation for Australian Shares and direct property for ten years to June 2006.

Rates of Return and Risks of Different Asset Classes, 1997 - 2006

Asset Class	Average Rate of Return	Standard Deviation
Australian Shares ¹	13.2%	11.5%
Australian Listed Properties	13.3%	4.2%
Australian Direct Property ²	11.2%	2.0%
Australian Bonds	7.4%	4.3%
Cash (Money Market)	5.5%	0.6%

The lower- risk status of property has been acknowledged by the Australian Stock Exchange in its listed property trust fact sheet. It states property has 40% less risk than that associated with a diversified share investment.³

OUR NEXT SEMINAR – SATURDAY 31ST MAY 2008

If you found the above articles interesting, then why not join us at our next Investment Seminar on Saturday 31st May 2008. Garry Lunn (Director of Independence Investments and a seasoned investor) will talk about creative investment strategies for financial independence and why these strategies are right for 2008 despite rising interest rates.

For Seminar Details click here ⇒ <http://www.i-group.com.au/Newsletter.html>

NEXT WEEK: Look out for our special article on Self Managed Super Funds (SMSFs).

SMSFs have become extremely popular over recent times. The number of SMSFs has increased from approximately 70,000 in 1994 to nearly 332,000⁴ in 2006. Find out more about this fascinating subject in next week’s article as a precursor to the seminar.

1- Based on movements in the S&P / ASX All Ordinaries Accumulation Index
2- Based on movements in the Property Trust of Australia Composite Index
3- ASX Listed Property Fact Sheet, June 2003
4- As calculated by the ATO as of 31st Dec 2006

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Would you like to know more on why investing in property is an essential component of YOUR wealth creation strategy? Now is the time to diversify and make that shift into property.

For more information on Property Investment, contact Garry Lunn on 02 4962 5800.

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Comments and contributions always welcomed.

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