IN focus

Rise of the East

Developing markets: The power base is changing

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PARADIGM STRATEGIC PLANNING

Rise of the East

Developing Markets: The power base is changing

By Bryan Taylor, Chairman and Chief Investment Officer

In the recent financial press we've seen a host of stories reporting the debt problems of Greece; a full 'currency' member state of the European Union.

Invariably, EU membership signifies a stable economy and a financial system that investors can trust, but with Greece it has recently become obvious that this is just not the case.

Spain, Portugal and Ireland are also suffering from similar problems to those seen in Greece, and fear of contagion has affected prices on European markets. At the same time, the very fabric of the euro seems close to tearing point.

As the focus concentrates on these debt-laden nations, the extent of the deficits of countries such as the UK, Japan and the US are not well reported in the press, but this does not mean their troubles have subsided. Far from it.

All of this masks some very interesting activity that has been happening in the world's emerging markets for some time, and Plan B has been monitoring the situation with great enthusiasm.

Developing markets

Before the Emerging Markets Index was created in the late '80s, there had been no real consideration of these markets by global investors. Instead, it had been common for the majority of investors to invest only in their home markets, in familiar names that gave them comfort. But when the International Monetary Fund (IMF) designated a number of economies as 'developing nations' it led some astute investors to begin to explore ways of financially exploiting the growth and development of those emerging markets.

An emerging market (or developing economy) generally experienced fast growth from the expected rapid movement of people from poverty towards the middle class. But most developing economies were also very dependent on loans from developed nations, which added to their volatility.

Volatility and higher risk paid off for some

The performance of emerging markets in the early '90s was therefore very up and down and the graph on the following page gives a strong impression of the roller coaster ride for emerging market investors. The old adage of higher risk means higher returns certainly applied, including some of Plan B's clients in our higher risk portfolios. But it was because of this volatility that we classified emerging markets as a separate asset class and did not include them in our lower risk pooled funds.

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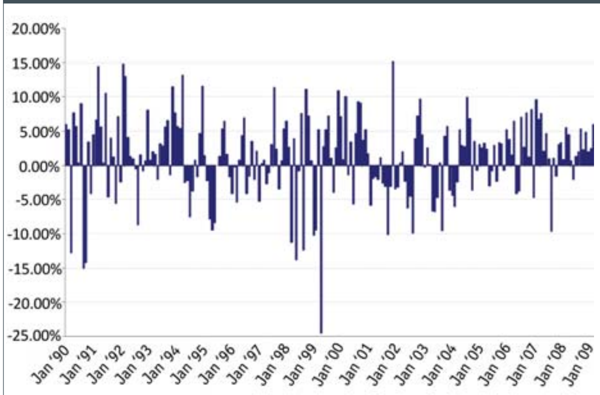
MSCI Emerging Markets Index (gross div.) 1990–2009



Source: Bloomberg

But things have changed!

In the period since 1998, the developing countries have been almost a mirror image of the major economies. They have been running surpluses compared to developed nation deficits and they have been repaying debt instead of increasing it.

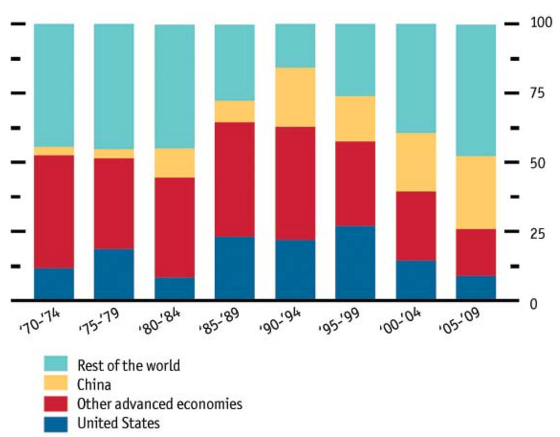
That being the case, some might consider that the developing countries could have rescued the major economies during the recent crisis. Perversely, most investors still believed that developing countries would crash almost out of existence when the global financial crisis (GFC) hit and credit became very difficult to access. Surely no one would lend money to them now!

Both of these thoughts were proven wrong. When the GFC arrived, emerging markets had not matured enough (in terms of consumption) to the point where they could save the developed western economies. The trade deficit between China and the US, for example, was the wrong way around: Chinese demand could not be relied upon because the US buys more from China than China buys from the US. Also, the artificial exchange rate regimes used by the Chinese did not help.

Developing nations saw a US$600bn surplus in 2008

And in 2008, emerging markets took another leap. These developing countries had been dependent on 'cheap' money for so long and much of it was supplied by the IMF. Yet between 1998 and 2008, developing and newly-industrialised countries—as a whole—moved from being debtor nations to having a total of US$600bn in surpluses per annum. For the three years to 2007, China's growth of reserves was running at around 10% of its gross domestic product.

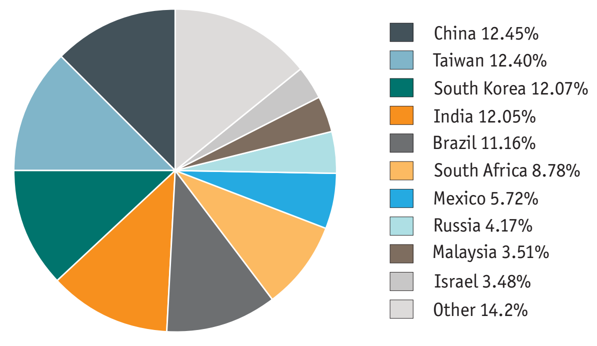
Contribution to Global GDP Growth, Purchasing Power Parity Basis (% 5-yr averages)



Source: IMF

At the same time, surpluses in developed markets were accompanied by a pickup in economic growth and imports, not a decline. In short, these last few years have been different. The surpluses have been consistent enough in recent years to actually assist the US in running large current account deficits that have grown since the early '90s and, at one stage, equated to over 90% of the world's savings. In a sense, the very strength of developing nations helped fund the problems the western world brought upon itself.

The composition of Plan B's emerging market portfolio (Feb 2010)



The power base is changing!

The past few years have revealed considerable evidence of a gradual re-alignment of global economic power and influence. Dr Mohamed El-Erian (author and ex Deputy Director of the IMF) calls this a 'hand-off' from developed countries to developing countries.

We believe that the world is witnessing a structural change and it is happening at a time that augurs well for the sustainability of some of these developing markets.

- Firstly, they have been exhibiting GDP growth well above that of the developed nations;
- Secondly, their balance sheets are very strong and well-managed compared with past efforts. In fact, some emerging economy Sovereign Wealth Funds aided privately in bailouts of US companies following the GFC; and
- Thirdly, many developing countries are beginning to supply their own consumers. The policies at this stage support producers but change is being accelerated due to the slowdown in the western world.

There is also further evidence of a 'hand-off' between the developing markets as they trade more and more amongst themselves. For instance, China is increasingly finding its growth driven by internal demand rather than external markets.

This new type of trading activity became evident as developing nations shrugged off the fall-out from the US-led GFC. Interestingly, politicians are still very vocal on subjects like protectionism and currency valuations in favour of the west, but they are potentially missing the point. The developing nations are increasingly seeking to trade with themselves and, if handled well, their internal markets may well make up for the protracted slowdown that appears likely in the developed markets.

What's the Plan B view of Emerging Markets?

1. Emerging markets should be viewed as part of the global asset class, rather than as a separate class. If the behavioural issue of home country bias did not exist, we would run one world portfolio with weightings based on the 'three-factor model' of Fama/French, using our proprietary management system.

   Therefore, in late 2010, we will integrate our holdings of emerging markets into our Global Portfolio and from then on manage all global equities within one portfolio (excluding Australia and New Zealand).

   This revised structure will enable us to compare growth in developing nations to that of developed nations. It should also ensure we do not get trapped in the current low-growth environment of the western world, the severity of which could worsen if emerging economies are able to develop their own consumer base.

2. We will re-weight our portfolios accordingly based on our findings. Remembering that because we favour 'value' over 'growth' assets, one should not jump to the conclusion that we will immediately over-weight developing markets. The allocation will need to be adaptive due to the changing dynamics – it is likely that disruptions will occur over time during the hand-off from developed to developing nations.

   One big advantage that we have is our 'market model of investing'. Under the market approach, we do not need to hurriedly sell positions when circumstances change and then rebalance. Rather, we will be able to trade-off risk within the portfolio, and seek to achieve our clients' outcomes at less expense than the compartmentalised model that is used by others.

3. Our risk management models will be under continuous improvement. The hand-off that is currently occurring has virtually no likelihood of being a smooth road. However, that will not surprise or even worry us. This volatility in our balanced market portfolio approach pays off for our clients.

At Plan B we have built our business to work on behalf of our clients and this has worked for both us and them for over 25 years.

While we pay heed to many voices in the industry and academic sectors, we are not owned either financially or in our hearts by any of them. We continue to seek out the best and most likely ways of achieving our clients' objectives with the least risk of catastrophic failure or serious under performance to world markets.

And our core belief still remains – that markets will provide the growth necessary to enable our clients to buy assets today and return improved value when they need it later in their lives.

Stress... and what you can do about it.

Most of us are all too familiar with the impact of stress.

With technology continuing to drive increases in the sheer volume and speed of information we're expected to deal with, the relentless pursuit of greater productivity, and a blurring of the line between work and home, we are all subject to increasing levels of stress. Hardly surprising, the total cost of compensation for stress-related conditions in Australia is estimated at around $200 million a year (Monash University).

According to stress management researchers, even though we live in the twenty first century, our survival response mechanism is still stuck in the stone age. We are surrounded by 'fight-flight' inducers which trigger physical changes, pumping adrenalin through our bodies to make us more alert and aggressive, and cutting the production of endorphins and other immune system mechanisms.

But unlike the days when the rare close encounter with a sabre-toothed tiger had a clear resolution, in the twenty first century most of our stresses are both pervasive and on-going. Traffic stress, difficult people at work, project deadlines and family tensions all ratchet up our stress levels. Many people have an almost permanent baseline of low level stress.

It is hardly surprising that according to the US Mind Body Institute, between 60% - 80% of visits to the doctor in the US are to deal with stress-related complaints.

The experience of stress is highly subjective - one person's frenetic afternoon may be another person's walk in the park. But recognising that we are suffering from stress and doing something about it are key to minimising its impact on our physical and mental well being. In the short term, numerous research shows the physical early warning signs may include feeling constantly tired and run down, disrupted sleeping patterns, susceptibility to every passing cold and flu bug, food intolerances and recurring headaches. Psychological symptoms encompass feelings of anxiety, tension, irritation, an inability to relax and a sense of humour failure. The longer term consequences can be much more serious, with stress being directly associated with high blood pressure, heart disease, stroke and cancer.

Even when stress has its causes in something we can do little to change, there are steps we can take to help manage our experience of it.

According to the Cleveland Clinic Heart & Vascular Institute, a leader in heart care in the US, there are two major changes we can make to our diet that will help boost a stress-depleted system. One is to enrich our diet with antioxidants and the other is to make sure we are getting enough nutrients.

Antioxidants are vitamins and minerals which remove from our blood system the harmful free radicals associated with immune deficiency. A stressed system is less resistant not only to passing viruses, but also to much bigger threats, including nearly all forms of cancer, heart disease and atherosclerosis (a condition in which plaque builds up inside the arteries). Many of us may also benefit from drinking more water on a daily basis.

Another major factor is sleep. We are far more vulnerable to stress when we don't get a proper night of sleep. Whether this means five hours or eight varies for each individual, but sleep deprivation so significantly diminishes our mental performance that according to Professor Mark Mahowald, an eminent sleep expert and Professor of Neurology at the University of Minnesota, a complete night's sleep deprivation is the equivalent of a legally intoxicating blood-alcohol reading.

An inability to sleep can itself be caused by stress - thereby creating a vicious spiral. Cortisol (a fight and flight hormone), over-thinking, anxiety and caffeine also contribute to sleep problems.

While chronic insomnia deserves medical attention, sometimes we deprive ourselves of sleep simply because we're trying to do too much. Slowing down and allowing ourselves a good night's sleep can significantly improve our ability to effectively manage stress. Australia's 'beyondblue' organisation underlines the importance of sleep to combat both stress and depression and provides helpful suggestions on how to get a good night's sleep (see **www.beyondblue.org.au** - Factsheet 7).

Regular meditation practice is another stress-buster. Numerous scientific studies such as those conducted by Dr Herbert Benson, President of the Mind Body Institute and Associate Professor of Medicine at Harvard Medical School, have established the benefits of meditation at lowering blood pressure and heart rate, improving immune function and reducing our likelihood of disease. It heightens activity in the left prefrontal cortex of the brain associated with happiness and relaxation, directly countering the effect of stress. Meditation also improves our concentration abilities and awareness of everything around us - now supported by both Western and Eastern medicine alike.

> "We are far more vulnerable to stress when we don't get a proper night of sleep"

While each of these key areas deserve further exploration, nothing can take the place of personal medical advice. As our working lives continue to get busier it's increasingly important that each one of us develops our own stress-management regime.

You should seek advice from your GP or Health Professional if you are experiencing the symptoms of stress.

West Australians given more choices, but which one is right?

By Garry Woo, Plan B Trustees Limited, Estate Planning Adviser

In February this year, new legislation in Western Australia brought about important changes relating to **Enduring Powers of Guardianship** (EPG) and **Advance Health Directives** (AHD) – also known as 'living wills'.

The legislation has given West Australians more options to deal with situations where they are unable to communicate their wishes due to major illness or accident.

At present, you may have an Enduring Power of Attorney (EPA). Under an EPA, you name a person to make decisions about your property and financial affairs, should you lose your legal capacity.

However, under the new EPG, you appoint an Enduring Guardian who can make decisions about your medical treatment decisions and lifestyle.

An EPG is different from an EPA. On the medical side, let's say you have Alzheimer's disease and require medical treatment. Someone needs to consent to that treatment on your behalf. If you don't have capacity and don't have an EPG - only a person listed in a 'default list' of decision makers could give or refuse consent to your medical treatment. Sometimes that list reflects your wishes, but other times it may not.

When it comes to lifestyle decisions, such as if you're to live at home or be admitted into a nursing home - no default list exists. Strictly speaking, an interested person (such as a family member) would have to apply to have a Guardian appointed from the State Administrative Tribunal who would then make the decision. This is not a simple process and typically occurs when conflict arises.

3 good reasons why an EPG is particularly beneficial:

1. A medical treatment decision that's made by your Enduring Guardian outranks decisions made by any other person on the default list (unless you've given directions in an AHD).
2. There's no need to apply to have a Guardian appointed.
3. You get to choose your Enduring Guardian - someone you trust and will respect your wishes.

The Advanced Health Directive goes further than the Enduring Power of Guardianship and states what medical treatment you want to receive if you lose capacity. For example, some people wish to be taken off life support if they suffer irreparable brain damage or are in the final stages of a terminal illness. Others wish to remain on life support for as long as it's possible for life to be sustained.

For many people, putting in place an EPG and telling a trusted Enduring Guardian your wishes may be a better option than having an AHD. The Enduring Guardian can make informed decisions by speaking to your doctors on your behalf.

In any case, it's vital to remember that the decisions you make in an EPA, EPG and AHD are legally binding so it's important to seek professional legal advice. With an AHD, medical advice is also essential.

"putting in place an EPG and telling a trusted Enduring Guardian your wishes may be a better option"

Generally speaking, a health professional has to follow your AHD - regardless of their own views or those of your family.

The danger with an AHD is that you could end up making an uninformed decision that's unnecessarily risky and detrimental to your health - especially if you try to 'do-it-yourself'. A poorly worded AHD can also result in legal complications and confusion... not something you want if your life or health is at stake.

My advice is to act now and speak to Plan B's Estate Planning team. We can provide you with more information and direct you to the next step.

If you deal with these matters now, you'll enjoy greater peace of mind in being better prepared for whatever may await you and your family in the future.

Garry Woo heads the Estate Planning team and is a certified legal practitioner.

Investment properties

seeing reality through the hype

By Simon Moore, Manager, Plan B Property Advisory Services

The residential property market in Perth has continued its post Global Financial Crisis rebound, with sales activity steadily regaining strength and median house prices breaking through the $500,000 mark in March 2010 for the first time in history.

In 2009 it was first home buyers leading the way, but the number of first home buyer grant approvals fell to 1,088 in February 2010 – down more than 60% from their high of 2,946 in May 2009. This year, the low interest rates, reasonable rental returns and a Western Australian economy which remains the envy of the developed world has seen trade-up buyers and investors come out in force to drive the property market.

It's no wonder there's a new sense of optimism. The media continues to heavily promote the short and long-term benefits of Western Australia, with a particular focus being on the safety and security of investing in bricks and mortar rather than the recent roller coaster share market ride.

What is extremely important to remember is that this is in no way a balanced, measured or researched outlook on our property market or investing. In fact, now is the time property investors should be making careful and deliberate choices rather than being caught up in the wave of euphoric optimism currently building in our market.

Of course, an investment property (or properties) often form an important part of an Australian investor's portfolio. But a key to successfully investing in property, much like any other asset class, is to include it as part of your overall and long-term financial strategy and critically make sure the assets you hold are likely to deliver what you hope to achieve with your portfolio.

Too many property investors are sold a property rather than making a considered and balanced decision to buy one. Never be sold a property – ensure you make a careful decision to buy one that suits your personal investment strategy.

Property asset classes and cycles

It's also important to consider property asset classes. Many investors consider residential property as one large asset class. However, there are several different classes of property, all delivering very different results and carrying varying levels of risk.

Getting the mix of property right in a portfolio is vital to ensuring your investments deliver what you need. For instance, a property portfolio overweight with growth properties (i.e. a high proportion of value in the land) at the expense of income properties (i.e. higher rental yield with value predominantly in the building) may sound attractive now. But it may leave you overexposed to risk and unable to derive an income when you need it. At the same time if you hold all income property assets, you may be unlikely to create the equity base you need in order to live comfortably in retirement.

The property market is also at the beginning of a long-term cycle of change. A rapidly expanding population mixed with two decades of a major demographic shift will change the way property markets fundamentally behave. The only way to take advantage of this is to own the right balance of assets at the right time in your investment life cycle.

Simon Moore recently joined Plan B Wealth Management to provide a specialised property advice service to clients.

Factors to consider

Right now you may be considering investing in property. Here are some simple questions you should ask yourself prior to making your final decision:

- [ ] 1. **Does it fit in with my long-term strategy?**
  Buying on a whim or because of current hype won't help you achieve your overall goals and may see you end up with an investment portfolio that's not suited to your needs.
- [ ] 2. **Will the property I'm looking at help me achieve my long-term goals? If so, in what way?**
- [ ] 3. **If I acquire the property, will my portfolio have the right mix of income, growth and balanced assets for my stage in the property investment life cycle?**
- [ ] 4. **Do I feel 'in control'? Is it really the best time for me to buy / sell?**
  Without proper research and advice, you may find yourself looking at buying because other people are, or simply because it 'feels' like the time to buy.
- [ ] 5. **Have I discussed the implications with my Financial Adviser?**
  Personal circumstances always change, so it's important to discuss your entire investment portfolio when meeting with your Adviser – including any investment properties you currently own, or are intending to own. Every asset can affect your overall wealth and the likelihood of achieving your goals.

If you answered 'no' or 'not sure' to any of the questions above, chances are you're about to become one of the many investors who make an emotional buying decision without having a clear, deliberate and well-researched approach to property investing.

Property investing should not only be an enjoyable experience, but one that integrates with your overall financial plan to help take you closer to your goals.

Did you know?

Your Paradigm Adviser will happily meet any of your family, friends or colleagues at no charge for the initial meeting.

If you have friends or loved ones who seem to be taking too much risk speculating, need some advice on a matter, or are simply intrigued by what 'deliberate wealth*' management* may mean for them, please direct them to your Adviser who will happily meet with them on a confidential basis.

* a considered, measured, scientific approach to building and managing one's wealth.

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