Personal Wealth

Spring 2015 A Quarterly Newsletter for **Lifespan Clients**

What's inside…

- **Investment Markets**
  - **China Spooks Markets**

The event dominating global markets has been the violent pullback in the Chinese share market and subsequent falls in other equity markets.

The wildest ride has been in mainland Chinese shares with the Shanghai Composite Index down 37% in the last 3 months.

- **Mortgages, powerful but complex**
  - **Finance Solution**

A mortgage can be a powerful but complicated product.

As a result, more people are seeking the services of a mortgage broker to help them through the process.

Investment Markets

Recent History

The event dominating global markets has been the violent pullback in the Chinese share market and subsequent falls in other equity markets. The Shanghai Composite Index rose over 60% in the 4 months to mid - June when it peaked at 5,122. It subsequently fell to under 3,000 in late August, a fall of over 40%. The loss of market value in Chinese shares in the past 3 months was roughly the value of the entire Australian stock market.

The result of this was that the Australian equity market (S&P/ASX200) fell about 15% from the April peak to briefly trade around the 5,000 level. This was the first correction in Australia since June 2013 when the market fell almost 11%.

Most global markets were down by more than 10% from their highs to also be in correction territory with the US market having its first correction in 4 years. The Australian dollar was also hit hard and traded under 72 cents versus the US dollar.

Markets and Outlook

China

The wildest ride has been in mainland Chinese shares with the Shanghai Composite Index down 37% in the last 3 months. Some of the reasons for this are as follows:

Firstly, Chinese authorities encouraged the bull market in Shanghai since their plan was to raise equity prices and to float and then deleverage state-owned enterprises.

There is a lot of debt in China as a result of the massive stimulus following the GFC. That market was up by about 150% at one stage, fuelled by inexperienced retail investors and high levels of margin loan debt.

Roughly 10% of the free float of the market was on margin and about a third of that was put on with the Shanghai Composite Index above the 4,000 level. While the market was trading on a PE in the low to mid 20 times earnings, roughly 40% of shares were trading at a PE of over 80 times.

Given how quickly the market rose and the levels of margin debt, it was no surprise that it came crashing down. The fall was exacerbated by the ineptitude of the local authorities. For example, freezing certain shares led to increased selling pressure on those securities that were still liquid.

On the plus side the negative wealth effects from falling share prices are mitigated by the speed of the run up and fall. Also share investors are only about 9% of households in China versus close to 50% in the USA.

So while growth is slowing in China (Chart 1), we believe that the fall in the local stock market is mainly about excessive valuations and high margin debt rather than the real economy.

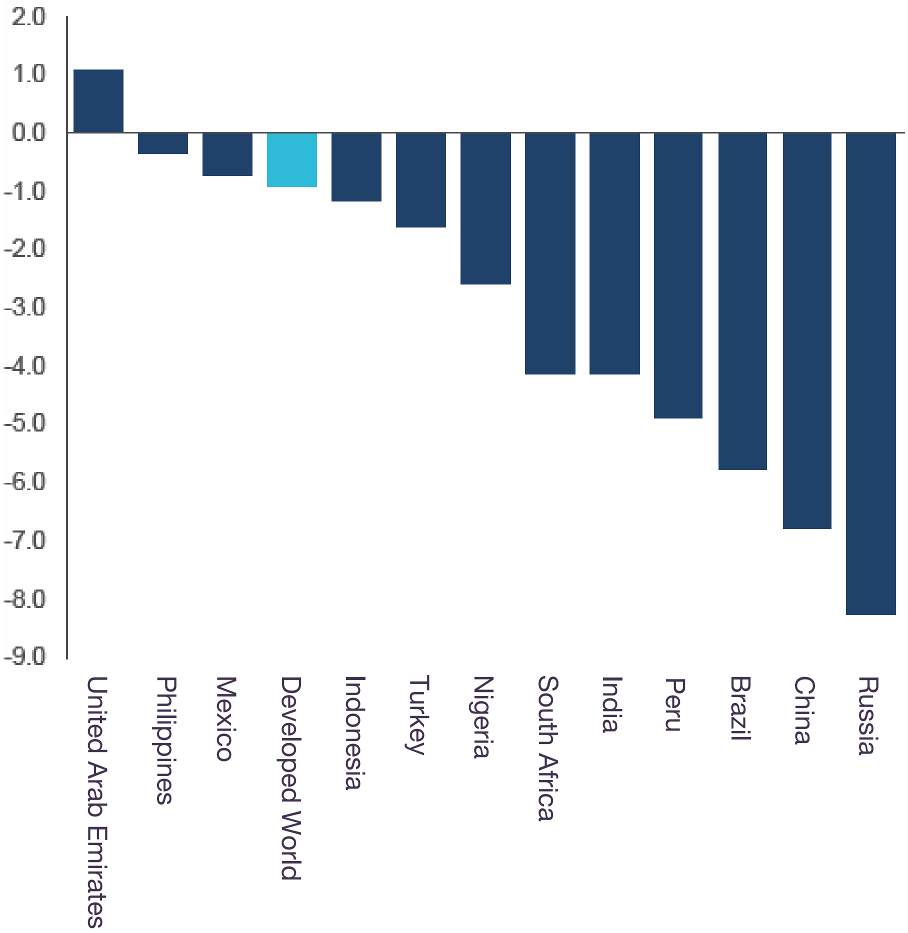
We should point out that the Shanghai market is now on a PE of around 13x which is around long term average levels. Also Chinese H - shares (which most global fund managers invest in rather than Shanghai A- Shares) are probably less than 9x now and look reasonably cheap.

Australia and Global Equities

To be honest, share prices probably needed to come back here since Australian shares were trading well above their long term average PE and estimates were for slightly negative earnings per share growth in 2015 and flat earnings in 2016. This was mostly on the back of lower commodity prices. Similarly, US shares were forecast to have no earnings growth this year due to the lower oil price and the rising US dollar.

In Australia we had an almost perfect storm with falling commodity prices and the banks were in the process of raising capital to meet higher capital requirements. This will result in the banks having less leverage and will lower the return on equity. On the face of it, this should lead to lower share prices but it does not take into account any potential re rating given the lower risk going forward.

Chart 1: GROWTH HAS SLOWED IN THE BRICS
Change in GDP Growth (%p.a.) Between 2007 and 2014



Source: T Rowe Price, Factset, MSCI

We have gone from a PE of roughly 16x in April to about 14.4x (ASX200 at 5,200) which is about the long term average for our market.

Unless you were looking closely you may not have seen the market very briefly trade under the 4,900 level. The futures market was indicating a fall of about 3.5% that day but the market actually finished up which is somewhat encouraging.

The main point is that we expect that interest rates will stay low providing valuation support to equities when the panic is over. Helping to keep rates low is the fact that there is currently over one trillion $USD in ongoing QE in Europe and Japan.

After the fall, the market here is looking much better value trading at the long term average PE with a dividend yield of about 5% (before franking) versus the Australian 10 year bond yielding about 2.7%.

While we expect the US to raise their short term interest rates at some stage, this date keeps getting pushed out. Janet Yellen (Fed Chair) is considered a Dove and has been reluctant to raise rates.

Inflation is very low and growth is sub trend in the US so there is no compelling reason to raise rates especially with the collapsing oil price lowering inflation. As we go to press, US 2nd quarter GDP growth has been revised up to a rate of 3.7% from the previous 2.3%. However this translates to an annualised growth rate of about 2.2% for the 6 months to June 30.

For the reasons above we continue to prefer equities to fixed interest especially after the recent pullback.

Within equities we would maintain our tilt towards global equities as we see higher potential growth there as well as some downside risk in the Australian dollar from falling commodity prices.

We do not believe the major risk to markets is higher interest rates but rather the scarcity of growth. The bottom line is that while we were not big fans of equities on a PE of 16 times, we think major pullbacks should be viewed as an opportunity

Chart 2: Investment Returns to 31 July 2015 (% p.a.)

Asset Class	1 month	3 months	1 Year	3 Years	5 Years
Australian Shares	4.40	-0.74	5.68	15.11	9.67
Global Shares	5.57	5.65	30.18	27.20	15.10
Listed Property	5.71	4.28	21.08	18.41	15.33
Fixed Interest	1.31	0.41	6.70	5.15	6.67

Source: Mercer

Six reasons to see Quay Finance about your home loan

A mortgage can be a powerful but complicated product. As a result, more people are seeking the services of a mortgage broker to help them through the process.

Quay Finance have been helping borrowers purchase property and ensuring they have the right loan to suit their needs for over 10 years.

Whether you're looking to purchase the family home, an investment, or looking for a better deal on your existing mortgage, here are a few reasons why we could be your best option:

Greater choice

With access to over 20 lenders including the major banks, we can place you with the lenders that are most likely to accept your application based on your personal and financial situation.

We will work one-on-one with you to assess your specific needs and find a lender that suits you personally. You will ultimately receive a customised mortgage that meets your unique requirements

Independent & unbiased

We do not work for a specific lender. We work for you, therefore all the recommendations that we make are objective and based on your needs

Access to the most competitive rates

Getting a lower interest rate can save you thousands of dollars over the life of the loan. Mortgage brokers have many lenders vying for their business and as a result you are more likely to receive a lower rate

Experts in the industry

Our specialist knowledge in the industry is derived from selling only mortgage and mortgage related products. We find that different lenders are good at different things, and offer special deals and promotions at different times. We keep up to date with all of these niches and specials to ensure you get the best deal

One stop shopping

Shopping around at several banks or trawling the internet looking for the best deals can be frustrating and time consuming.

We will not only show you every lenders product offering in one visit, but we will take care of the paperwork and loan process from the beginning through to settlement

A free service!

Our services are at no cost to you. The lender that eventually wins your business pays Quay Finance a commission for the services provided.

The commission we receive does not get passed on to you in any way, and does not impact on your interest rate, lender costs or product.

Let us help you find what you're looking for.

QUAY FINANCE

For further information, please consult your Lifespan adviser.

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