Successful Ageing in Australia
“getting financially fit”

Bill Watson
Statewide Superannuation
Agenda

• The Carnival is over
• The Great Moderation
• The Challenges Ahead
• Australia is the “lucky” country
• Lean Returns
• What does this mean for investing
The Great Moderation era is over.....

• As Frank sang, it was a very good (20) year...
• 20 years of good investment returns
• 20 years of “benign” economic environment
• Unfortunately 20 years of debt and unsustainable global consumption binge
The “Great Moderation in the US” is over

Volatility of the Business Cycle: IP and Claims, Annual Volatility of YoY Changes

Volatility of these 2 indicators has very quickly returned to levels last seen in the 1970s. The ‘Great Moderation’ is over.
20 Great Years of Investment Returns

Investment Returns for the Twenty Years to December 2009

<table>
<thead>
<tr>
<th>Investment Category</th>
<th>Returns (%) p.a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australian Shares</td>
<td>9.7%</td>
</tr>
<tr>
<td>Residential investment property</td>
<td>9.8%</td>
</tr>
<tr>
<td>Australian REITs</td>
<td>7.5%</td>
</tr>
<tr>
<td>Australian bonds</td>
<td>8.9%</td>
</tr>
<tr>
<td>Cash</td>
<td>4.8%</td>
</tr>
<tr>
<td>International shares (unhedged)</td>
<td>4.8%</td>
</tr>
<tr>
<td>Global REITs (unhedged)</td>
<td>5.9%</td>
</tr>
</tbody>
</table>

2.7%pa CPI
The Challenges ahead.....

- High Personal Debt in US, UK and Australia
- Sovereign Debt in Europe, UK, USA and Japan
- Property Prices in Australia
- Ageing Demographics
- Sustainable Development of Non-Renewable Resources
- Lower investment asset class returns
Too Much Australian Debt…who will pay the ferryman?

Credit*
Ratio to nominal GDP

* Not adjusted for breaks
Sources: ABS; RBA
The Debt is mostly household...this 'ole house
Credit Fuelled Economic Growth in Australia is History

Credit and GDP
Year-ended percentage change

Credit (six-month-ended annualised)

Credit
Nominal GDP

Sources: ABS; RBA
Australian residential property is just too darn hot....
Looks like an unsustainable bubble

Prices need to fall 31% to reach average or 55% to reach 3.5 multiple of earnings.
Australian Demographics

Chart 1: An ageing and growing population

Chart 1.1: Population growth and combined dependency ratio
- Population growth rate (LHS)
- Combined dependency ratio (RHS)

Chart 1.2: Proportion of the Australian population aged 65+

Source: ABS cat. no. 3105.0.65.001 (2008) and Treasury projections.
Chart 1.6: Proportion of the Australian population in different age groups

Source: ABS cat. no. 3105.0.65.001 (2008) and Treasury projections.
Changing Spending Patterns

Chart 6: Projections of Australian government modelled spending by category

Per cent of GDP

- Health
- Age-related pensions
- Aged care
- Other income support
- Education
- Defence
- Superannuation

Source: Treasury projections.
Ageing will cause some Fiscal Pressures

Chart 3: Projected fiscal gap

Note: The fiscal gap is total Australian government receipts minus total Australian government payments (excluding interest).
Source: Treasury projections.
We must leave something to our grandchildren

Chart 6.1: Wellbeing and sustainability

- Inherited stock of capital
  - Economic, social, human and environmental capital

- Capabilities and choices of current generation

- Future generation’s stock of capital
  - Economic, social, human and environmental capital

- Capabilities and choices of future generation

Wellbeing of current generation

Sustainability ≤

Wellbeing of future generation

Source: Statewide Superannuation, The industry fund for South Australians
The most important advice to any Grandchild

Chart 6.10: The correlation of education with employment and wage outcomes

Note: 2005 average full-time weekly earnings, all persons.
Source: ABS cat. no. 6278.0, 2006.
Despite the Challenges, Australia is well placed…..

- Property Prices and Personal Debt aside, our Government finances are fine
- We still have good economic prospects
- We have exports our regional partners want
- We are positioned in the “growth” part of the world
- We’ve had a “good” GFC
Australia is better off than most

Chart 2.6: Population ageing in Japan, Italy and Australia

Next 40 Years not as good but still ok

Chart 2: Real GDP and real GDP per person
Average annual growth

Source: ABS cat. no. 5206.0 and cat. no. 3105.0.65.001, and Treasury projections.
Changing Mix of Retirement Income

Chart C.15: Projections of superannuation assets and age-related pension coverage and type

Source: Treasury projections.
This kind of tells you who’s winning and who’s not…

Figure 2.1. Average Real GDP Growth during 2010–11
(Percent)

Source: IMF staff estimates.
And Guess who’s best placed……

Figure 2.4. Asia: Average Real GDP Growth during 2010–11
(Percent)

Source: IMF staff estimates.
The Emerging World is the Paragon of Thrift
Investing in a lower growth more uncertain environment

- Emphasize Quality Stocks: i.e. no excess debt, sustainable profitability
- Take income over capital growth
- Focus on taking costs
- Opportunistic: e.g. wholesale term deposits
- Dynamic Asset Allocation
Opportunities: Income from Investment Grade Credit

Wholesale Global Credit Income Fund credit spread vs. benchmark

4 June 2010
478 bps
Opportunities: a return to blue chips…..

Top-down valuation of MEGA cap quality companies since 1965

Note: GMO defines quality companies as those with high profitability, low profit volatility, and minimal use of leverage. The historical valuation is determined by our proprietary intrinsic valuation measure.

Source: GMO. As of 4/30/10
Shares are fair value at best
Opportunities: Dividend Yield over Capital Growth
Statewide’s Forecasts back in January 2010

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>2010</th>
<th>7 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Government Bonds</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Residential Property</td>
<td>-10</td>
<td>0</td>
</tr>
<tr>
<td>Commercial Property</td>
<td>-10</td>
<td>6</td>
</tr>
<tr>
<td>Australian Shares</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Global Shares</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Australian/USA Dollar</td>
<td>0.85</td>
<td>0.85</td>
</tr>
<tr>
<td>Oil</td>
<td>$70</td>
<td>$150</td>
</tr>
</tbody>
</table>
Summary, so far

- Terrific past 20 years
- Next 7-10 will be leaner
- Capital (credit) will be scarce
- Lean investment returns
- It's all about getting income and return of capital as opposed to return on capital!
My dad........surfing the longevity wave
• Who or what is the biggest threat to your retirement savings?

• Behavioural finance tells us some unpleasant truths

• We are human – we are not rational investors
Investing wisely…………..Remember Jonesy!

• We buy high and sell low

• We are influenced easily

• We naively diversify

• We are risk averse in the domain of gains and seek risk in the domain of losses
• What does research tell us?
  – United States
  – Japan
  – Sweden

• Don’t feel too bad - professional investors are equally irrational
Investing wisely

• Investing is for the long term
• If you want to punt, set aside a pot of money
• Be aware and beware of your hardware
• Increasing longevity means different strategies – think long term

• And finally (and unfortunately) no more free lunches – time to get financially fit!
Investing wisely

• Questions