stonehouse
WEALTH MANAGEMENT

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Market Review and Outlook

Kevin Stewart, Senior Partner

Four months to go before I may be able to enjoy a full Scotch Finger biscuit rally.

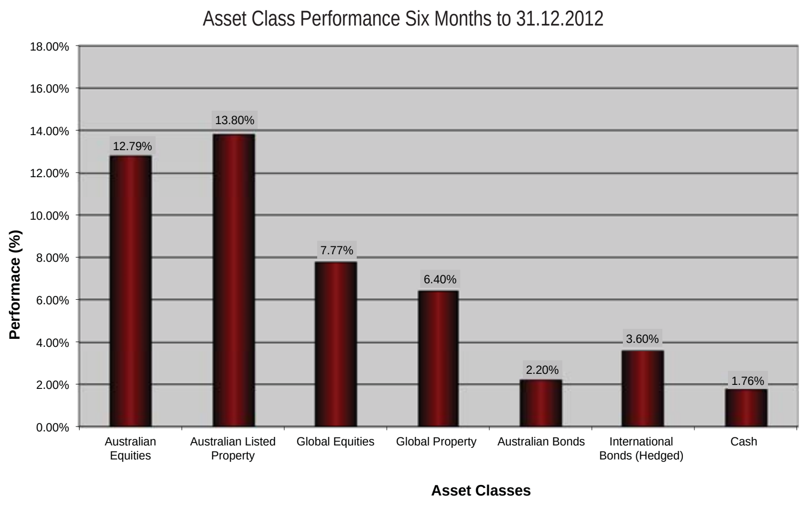
When I consider market performance over the last few years, I feel like I have been snapping the biscuit in half, dunking it in my cup of tea then watching half of my finger dissolve - the six monthly market value movements have been rising for three months and falling for three months. How very frustrating this has been but thank goodness for investment income/distributions.

Since July 2012 we have had a sustained sharp surge in equity growth.

Whilst it's fraught with danger to try to pick the bottom or top of a market, it was with some conviction I felt the market had been testing its bottom during 2011 and stuck my neck out in January last year to write the same in our newsletter at the start of 2012. I'm sure many of you may remember the prevailing pessimistic emotions of financial doom and gloom going into Christmas 2011.

Asset class performance for the six months to December 2012 (refer to the table below) shows a substantial increase in 'growth' assets, a dramatic reversal of fortune compared to the same period to December 2011.

I suggest that some of this reversal has been influenced by the appearance of the financial stabilisation of Europe, by the actions of the European Central Bank (printing as much money as needed for banks and now governments), the US continuing their substantial monetary easing, Australians believing their home prices will not implode (real estate agents have started smiling again), Australians still having a job, business still being done (all be it at reduced profits), credit being aplenty (at a lower cost) and China continuing a steady growth path. Of course there are many other factors supporting this level of growth, however one stands out in my mind the most - the low return on cash.



*Indicies = **Australian Equities** - All Ordinaries (30/06/2012 - 31/12/2012), **Australian Listed Property** - Vanguard Property Securities Index, **Global Equities** - MSCI World Acc Index with Gross Div (A$), **Global Property** - Vanguard International Property Securities Index, **Australian Bonds** - UBS Warburg Composite Bond Index, **International Bonds (Hedged)** - Vanguard International Fixed Interest Index (Hedged), **Cash** - UBS Warburg Bank Bill Index.*

The prospect of yields from equities being greater than interest rates with the potential for capital growth is overcoming the fear of drops in value. This is leading to a rotation of capital from cash to the equity markets. At this time, I believe it is primarily institutionally lead, with retail investors ('Mums and Dads') starting to emerge.

Whether this trend will continue is fodder for much discussion among economists. The majority of economists believe it will continue with a few reserving their judgement and being cautious. In fact "cautious optimism" is the catch phrase of the day.

My belief is that many external influences can derail this trajectory however the 2-3 year outlook looks pretty good. There will probably be some profit taking and dips in the shorter term that could influence people to want to stand behind the security fence again. However, the level of forward earnings at the end of 2012 was about 15% below its long term trend (refer to the Table for the MSCI equity index price to trend earnings ratio on the following page). Therefore the price to

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forward earnings (which are starting to surprise on the upside) was close to its long term average of approximately 13.5 times, the price to trend earnings ratio was much lower at 11 times. If we assume trend earnings growth of 5.5% to a dividend yield of 4% and a return of the price to trend earnings ratio to its long run average of 13.5 over a five year period, this implies an attractive five year annualised total return for the market of about 14%, hence my comment of the next three year outlook as pretty good.

David Paradice founder of Paradice Investment Management stated that "short term gyrations or pull backs in the market will be buying opportunities", as evidenced in 2011 and the early part of 2012.

The Reserve Bank of Australia has predicted slightly below trend growth of 2.5% in the next 12 months (going to 3% by 2014). Our economy is still strong and will continue to expand which should lead to benefits for all. We are yet to see a meaningful revival in home construction and real estate development, however real estate growth does traditionally tend to follow equity market growth. Evidence has emerged that interest rate cuts have started to find traction with house prices rising 2.1% in the last quarter, their first gain in more than one and a half years according to the Australian Bureau of Statistics, although it would appear that real estate may remain subdued for some time yet.

The retail sector looks to have made small gains, with Wesfarmers', (Australia's second largest retailer), Managing Director Richard Goyder stating, "the interest rate cuts by the Reserve Bank had helped boost its sales even though consumers were still wary about what they bought. The Christmas trading period was pleasing".

Our position at Stonehouse is one that mirrors the earlier comment - cautiously optimistic. We feel there is meaningful potential for clients who hold diversified managed equity portfolios over the coming years. And we are pleased for our clients who are now seeing some reward for being patient throughout the past slow period. Perhaps you too might enjoy a full scotch finger biscuit this financial year.

Five Minutes with ...

Darren Lees, Senior ParaPlanner
Stonehouse Group

What do you enjoy about working at Stonehouse?
I like being able to work autonomously, yet still in a team, as well as being constantly challenged to refine communications channels, business processes and presentations so as to improve the client's overall experience.

What does work as a ParaPlanner entail?
My main priority is to prepare statements of advice and reports which are to be presented to the client. However I also monitor market and fund performance figures, assist with alterations to client portfolios and improving our current systems, processes and the client database.

What do you love about the industry?
It is always interesting and you never know what tomorrow will bring, what strategy can be implemented to benefit the client, what the market is going to bring to the table or what new exciting product is going to be released. There is always something different and not one piece of advice is ever the same.

When did you commence your career?
I started in the industry in 2007 as a SMSF auditor in an accounting business. However I soon made the switch to financial planning and have been a ParaPlanner ever since.

Tell us about your studies?
I am PS146 compliant and also have a Certificate 2 in Business. I am aiming to finish my nearly completed Double Major in Financial Planning and Accounting at the University of the Sunshine Coast shortly.

Work aside, what are your other passions?
I am a car enthusiast and love anything and everything automotive. Whether it's working on cars, going to meets and shows or hitting the track/drag strip, I love going fast (responsibly)! and making heads turn as I drive past in a highly modified vehicle. My current ride is a HSV Maloo R8.

Investment Fundamentals

Caleb Dozzi, Partner/Senior Adviser

10 October 2008, the Australian sharemarket dropped 8.3% - the worst daily return in 15 years. The following day the market grew by 5.5%, thus representing the second best daily return in 15 years. With this level of volatility how can investors truly grow their wealth? There are a few basic investment fundamentals which can help you weather this market volatility and ensure you are better positioned to take advantage of your opportunities when they arise.

This article may guide you through some fundamentals of investing.

1. TIMING THE MARKET

If you bought and sold out of a portfolio in an attempt to avoid losses and missed just 10 of the best market trading days between October 2003 and January 2013, what would the impact be? How would the results differ if you had remained fully invested over the entire term?

CASE STUDY		
Amount Invested	Investment Start Date	Investment End Date
$ 10,000	31/10/2003	31/01/2013

MISSED TOP 10 DAYS Scenario 1: Portfolio Value on 31 January 2013		
Australian Shares	US Shares	Asia (ex Japan) Shares
$ 14,011	$ 6,385	$ 11,898

REMAINED FULLY INVESTED Scenario 2: Portfolio Value on 31 January 2013		
Australian Shares	US Shares	Asia (ex Japan) Shares
$ 22,428	$ 12,339	$ 19,889
60% higher	**93% higher**	**67% higher**

If you have a tendency to sell in periods of poor market performance you could be severely affecting the long term growth of your wealth for a short term emotional gain.

Tips:

- Stick with your strategy;
- Understand that most investments are cyclical in nature (they are supposed to have periods of poor performance) and;
- Remember it's not timing the market; it's time in the market.

2. DIVERSIFICATION

Whether you hold property, Australian shares, cash or term deposits, history has taught us that no single asset class will continuously outperform the rest. Diversification is the most efficient strategy of reducing both market volatility and risk.

Over exposure to a single asset class is the regular pitfall many investors face, whether it is excessive residential property, cash or Australian shares. Effective diversification of your wealth across numerous asset classes will assist in enhancing your long term "risk vs. return" relationship. The term of your investment should be the major contributing factor to your asset selection for example a term deposit may be an option for an 18 month investment and an aggressively diversified share and property portfolio for a long term investment.

3. DOLLAR COST AVERAGING

Market movement over any given week, month or year is impossible to predict with certainty. Managing downside risk is a fundamental component of any Stonehouse strategy and in the appropriate situation dollar cost averaging could be utilised to reduce timing risk and provide the ability for falling markets to benefit long term investors. This is achieved through staggering investments over a number of periods instead of purchasing the entire portfolio on day 1.

Option 1: Staggered Investment			
Period	Amount Invested	Share Price	Shares Purchased
1	$10,000	$ 32	313
2	$10,000	$ 24	417
3	$10,000	$ 16	625
4	$10,000	$ 18	556
5	$10,000	$ 36	278
Total	**$50,000**		**2,189**

Option 2: Investing 100% on Day 1			
Period	Amount Invested	Share Price	Shares Purchased
1	$50,000	$ 32	1,563
Total	**$50,000**		**1,563**

Results			
	Number of Shares	**Current Share Price**	**Portfolio Value**
Option 1	2,189	$36	$ 78,804
Option 2	1,563	$36	$ 56,268
Benefit of Dollar Cost Averaging: $22,536 or 40%			

Investment strategies such as dollar cost averaging have been utilised to great affect by Stonehouse advisers during the financial crisis. Do you have a strategy in place for long term wealth creation?

SMSF Notice Board

- The lodgement deadline for the 2012 tax returns is fast approaching; if we have not received all of your information yet, please send this to us as soon as possible.
- Have you changed your contact details? If so, phone or email our office and let us know.

Game, Set and Match

The highly anticipated Stonehouse Team Building Tennis Day was held this year at the University of Queensland St Lucia Tennis Centre.

Over 30 players attended, with Stonehouse employees joined by associates from affiliated groups and other industry acquaintances.

Enthusiasm, temperatures and competitive spirits were running high as four preliminary rounds across ten courts were slowly reduced to a show stopping grand finale.

The epic match eventually saw Trent McArdle (OnePath) and Mark Stewart (Stonehouse) prove victorious in Group A, over runners-up Ric Baker (Commonwealth Bank) and Brad Stewart (Stonehouse).

Lara Baker and Tash Neilson were the winners of Group B.

The game was followed by a well deserved cool down and lunch at the adjacent St Lucy caffe.

Special thanks must go to Kevin Bates and Belinda Auld for keeping the players organised and on time along with all team members who participated on the day.

Brad Stewart, Ric Baker, Mark Stewart and Trent McArdle

Ric Baker

Andrew Stewart and Yvonne Taylor

Trent McArdle and Mark Stewart

Jason Brown and Michael Stewart

Lara Baker and Tash Neilson

SMSF Trustee Obligations for Insurance – It's the Law!

Recently an amendment to the Superannuation Industry (Supervision) Regulations, section 4.09 (2)(e) was passed into law.

This regulation flowed from the Cooper Review in 2010 which included advice on improving the substantial under insurance for superannuation members.

Trustees are now required to give consideration, regularly review and give effect as to whether the Trustees should hold insurance for their members.

As this change has been introduced as an operating standard for SMSFs it is imperative that members' insurances, or lack of, are reviewed and any decisions made, documented. Trustees of SMSFs are expected to determine the type and level of insurance cover members might require whether within or outside their SMSF. In meeting this requirement, Trustees should have regard to the personal circumstances of their members.

Trustees may evidence this requirement by documenting decisions in the Fund's investment strategy or minutes of Trustee meetings that are held during the financial year. This should be done at least yearly.

Penalties may apply if this operating standard is not met.

If you are a Trustee of an SMSF and think you may not meet the standard please contact your Adviser.

- Mark Stewart, Partner