keeping an eye on finance

focus

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Making the most of your money

If you have or need Personal Income Protection, Life, Disability or Trauma Insurance this may affect you.

Did You Know?

Including Death,Disability and Income Protection insurance in your super fund can free up your cash flow.

In addition to tax concessions already received for super contributions, you can also benefit from deductions gained by paying your insurance premiums directly from your superannuation account.

Premiums paid by your Investment Portfolio will ensure you remain covered and reduce the strain on your personal cash flow.

The savings gained can be invested for your future. To learn more about this simply call us on 1300 880 789.

Understanding subprime

What is it?

Subprime refers to the weakest credit quality segment of the US mortgage market. The subprime segment is made up of loans made to customers who probably have poor credit histories.

Heavy competition in the US mortgage market over recent years, followed by an increase in residential property prices and cheap interest rates, increased lending aggressiveness.

Subprime mortgages make up roughly 15 per cent of the US mortgage market; however this segment has experienced rapid growth since 2003 and 20 per cent of all mortgages in 2006 were subprime.

Rising interest rates, overstretched household budgets and slumping housing prices have conspired to create the 'perfect storm'. Of course, it hasn't helped that borrowers of dubious quality were extended credit.

This was made possible as borrowers that would not have normally qualified for loans were assisted with rising property values and fancy new loan structures with exotic terms.

Why the sudden interest in US subprime?

The first signs of trouble emerged in February 2007 when New Century (a US mortgage lender) filed for bankruptcy and HSBC, a major bank, announced it was setting aside 20 per cent more in reserves than expected, to cater for the weakening US mortgages market.

continued next page

in this issue

Words of Wisdom

"Someone's sitting in the shade today because someone planted a tree a long time ago"

Warren Buffet

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Understanding subprime (cont.)

Subsequently two Bear Stearns hedge funds with high exposure to the US subprime market imploded in June 2007. Problems quickly surfaced afterwards in Australia with Basis Capital and Absolute Capital suspending transactions and Macquarie's Fortress suffering a severe decline in value. More recently in August, funds in Germany (WestLB) and France (BNP Paribas) have also been suspended. At the time of writing, Basis Capital released a note advising that up to 80 per cent of the value of its Yield Fund may have been lost.

It is important to note that the US mortgage market is different from Australia's with respect to fixed versus floating interest rates. The bulk of the US market is constituted of long-term fixed rate loans, the direct opposite to Australia.

While in the past, borrowers in the US relied on the ability to refinance their home loans they are now finding it more difficult. Lenders have tightened their standards responding to regulatory and market pressure. Basically, this means that distressed borrowers can not refinance on more attractive terms and are stuck with mortgages they cannot afford – hence the distress.

The prognosis for subprime appears to be bleak, and likely to continue to be bumpy, particularly as the 2006 loans begin to mature into 2008.

The surfacing troubles have led credit ratings agencies to reconsider their earlier views and downgrade assessments on this debt.

Can Australia experience a subprime event?

The Reserve Bank of Australia has previously noted that Australia does not have a subprime market. The closest low quality paper available is the non-conforming market (e.g. lo-doc loans) making up roughly one per cent of outstanding mortgages.

At present there is no indication that Australia's credit conditions are worsening. The rising yields and widening credit spreads appear to be more a function of fear rather than deteriorating domestic fundamentals.

What to expect going forward?

Continued uncertainty in both debt and equity markets should be expected. It is unlikely that the subprime woes have worked themselves out of the system. As previously mentioned, there is still the 2006 vintage to mature.

More recently, prominent Australian companies RAMS and Centro have also been swept up in the subprime whirlwind due to their significant exposure to debt markets, particularly in the US. RAMS has since sold-off some of its business to Westpac Bank and Centro is in the midst of looking to refinance a substantial amount of debt by February 2008.

The danger is the spreading of fear and panic. The news on the economic front across the globe still remains broadly positive, so in theory continued support for asset values remains in place. However, keep in mind, this sort of information matters little when investors and markets become 'spooked'.

Get out of the red and into the black

For more than a decade, household debt (this includes mortgages, credit cards, personal loans and HECS debt) has grown at a rate well in excess of the growth in our household incomes. So for many of us, it's hard enough just paying the bills, let alone the thought of saving money. Others have a high income, but may not be sure where it all goes each week. Preparing a budget is the first step to getting control of your finances.

Work out a budget

If you are not sure where your money is going or if you want to find out what your potential to save is, you need to draw up a budget.

A budget helps you to clarify money coming in and money going out and determine if you can cut back on your spending to increase your savings.

How do you prepare a budget?

You can find budget planners on the internet or as part of personal finance software packages. You can also drop into your bank and ask for one or simply draw up your own.

First you need to list all your income

- salary
- interest on bank accounts or investments
- benefits such as child support, maintenance payments, rental assistance etc

Then list all your expenses

- accommodation expenses – mortgage or rent
- interest in debt
- bills – phone, electricity, gas, water, rates, body corporate
- insurance – health, home and contents, income protection, life, car
- transport – car costs (petrol, service costs, registration, repayments) or public transport costs
- food and groceries
- clothing and footwear
- personal items – haircuts, beauty products
- gifts and donations
- entertainment and leisure – eating out, movies, magazines, holidays, club memberships
- health – dentist, doctor, other health practitioners, medicines

Tips for spending less

- petrol prices fluctuate, buying midweek is often cheaper
- change to 15 watt compact fluorescent globes and you can not only save $11 per globe per year, but can also reduce the impact on the environment by saving tonnes of carbon dioxide being released
- dry your clothes outside rather than the clothes dryer
- eat fruit and vegetables that are in season – when not in season they may cost more
- use generic brands for grocery staples like sugar and flour – you won't notice any difference and they are usually a lot cheaper
- don't just renew your insurance – shop around each year to confirm you are still getting the best premium for what you need
- know your off peak phone times – the rates for mobile phones can vary dramatically depending on the time of a call
- find out how much you are paying in bank fees – if you make multiple ATM withdrawals or use other institution's machines then you can be up for additional monthly fees – limit your withdrawals or switch to an account with a flat fee per month

continued next page

Get out of the red and into the black (cont.)

Plastic fantastic?

Credit cards can be convenient, but they can also be a major temptation to spend what you don't have.

Below are some basic tips on card control:

- ensure you pay off the total amount each month to avoid interest. If you can't, at least aim to pay off more than just the minimum monthly payment to reduce the overall amount you end up paying
- be aware that unlike purchases, the interest free period does not apply to cash advances
- get a debit card rather than a credit card – they offer the ability to buy online or pay bills by phone, but you can't spend what you don't have
- shop around for a card with low fees and low interest (interest rates can range from 10% to 20%)
- pay for everyday items with cash eg. groceries, clothes, petrol
- if you consolidate your cards then you may be able to put all your cards into one low interest card

Start saving

The best incentive to save is to have a goal. If you have something to work towards, then the effort it takes to get there makes it all worthwhile.

Organise a direct debit from your account into a savings plan on a regular basis or with your payroll department to put an amount of money from your pay straight into a separate account – that way it will be safely tucked away before you are tempted to spend it.

If you put your savings into a separate account, look for an account with a good interest rate so that your money can benefit from compound interest (interest on your interest). Try to find an account where the interest is paid daily rather than monthly or yearly to maximise the amount you earn on your money.

Questions?

If you have any questions about budgeting, especially if you feel that your finances are controlling you rather than the other way around, then it is probably a good idea to talk to a financial adviser.

Ten ways to spend your Christmas bonus

Christmas is almost upon us and for many that means so too is the Christmas bonus.

While it may be very tempting to splash out with a big spend at the local shopping centre, it may be worth your while to take a deep breath and think of how this windfall may better prepare you for the year ahead.

Here are ten tips to make your money work a little harder and turn your minor bonus into a major benefit!

Put some on the mortgage

It's no secret that making extra, lump-sum payments can greatly reduce the life of your mortgage. If you have a re-draw facility, the money will still be available should you need it.

Pay off that 'interest free until 2010' item.

If you don't within the time frame, you can pay interest of up to 29.7 per cent on the entire amount as soon as the term expires.

Pay off that credit card debt

Boring? Maybe. But clearing those high-interest cards will give you more cash each month and remove a whole lot of stress.

Make a super contribution

By making a personal, undeducted contribution to your super you may be eligible for the Government's co-contribution scheme.

Start an investment fund

You don't need much to get started as an investor. It's always best to speak to your financial adviser for more information and to help you choose the best strategy for your situation.

Pay the school fees

You may be eligible for some sort of discount if you pay the school fees in advance.

Get the car serviced

Now is a great time to ensure your wheels remain in motion for the nest 12 months. Get new tyres and a service. Many of us do a lot of driving over the festive season, the last thing anyone needs is a breakdown.

Predict you potential needs and save

Look towards the next year and try to predict any large expenses you may encounter. An emergency fund is great to handle such surprises which you can't see coming, but if you think you'll need some funds for a specific reason it's often better to save in a separate fund for those cases.

Go to the dentist

You've been putting it off for years. Now's the time to do something about it – while you have the money to cover any problems that may come your way.

Have a holiday

It's important to have 'quality of life' for both you and your family. Why? Because you need to be rewarded for a year's worth of hard work and great performance.

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