

Investment Commentary

- Markets still tentative
- Property holding up
- Need to "retain overall perspective"
- Avoid knee-jerk reaction

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Super is long term - not short

For superannuation funds, the 2001/2002 financial year has been the worst on record with the median manager recording -4.3% (after tax and fees), for a "Balanced" Investment Option.

The main drivers of the negative outcome during 2001/2002 were poor performance by equity markets globally. In local currency terms, the US sharemarket fell by 19.6% (as measured by MSCI), Japan lost 20.0%, Germany was down 25.7% and the UK fell by 14.1%.

Relative to the major equity markets, the Australian sharemarket was one of the best performers, falling by only 4.7% for the year.

The best asset class over the year was property.

The 2001/2002 return was only the third negative financial year (ie. 30th June) return experienced by the marketplace over the past 22 years, implying a 1 in 7 year event. Statistically, this frequency is consistent with the Fund's long-term expectation for the Balanced Option recording a negative annual return of about 1 in 6-7 years.

Of particular interest is the fact that over its long history of 44 years, CSSF (which balances 31st December) has in its Balanced Option, only once declared a negative earning rate, and twice a "nil" rate ie

1974	nil
1990	nil
1994	-3%

At the time of writing (late August) results were in the negative 5%-6% range for the 7 months to end July, so it is obvious that this period has been one of the most volatile that the marketplace has experienced for many years.

In light of these statistics, some investors may be considering moving to a defensive stance in light of the current uncertain environment. However, it is generally believed that moving to a defensive stance now could expose funds to substantial risks of missed upside. Market timing is a difficult task at the best of time, and it is particularly hazardous at these uncertain times. While investment markets tend to operate in cycles, the lengths of these cycles can vary dramatically. Picking the turning points and the length of cycles is notoriously difficult. The existing climate of uncertainty is of concern to all relevant parties, not least, of course, to members approaching retirement. We have become accustomed to double digit returns for many years and general consensus seems to agree that those days are now gone. The current market seems to be one where we will have to go "one step back, before we can go two forward". There appears to be some news coming through that the worst is over and whilst we may drag along the bottom for a few months yet, there is light at the end of the tunnel.

Without a crystal-ball, one never knows – but let's hope that is the case!





A Negative Return for 2002 - Should you be worried?

For the first time in 14 years, superannuation funds generally are likely to declare negative returns for the year to 30 June.

This has largely been caused by the severe downturn in global sharemarkets.

Historically, sharemarkets have recovered fairly quickly and investment managers are generally expecting a recovery by the end of 2002.

Most superannuation funds will be reporting their investment crediting rates for the year ended 30 June 2002 during the next couple of months (once annual accounts have been prepared and audited).

Based upon the investment returns of the professionally managed investment funds which are most commonly used by superannuation trustees (Growth Funds), superannuation fund returns overall are likely to be negative.

For the year ended 30 June 2002, the best performing wholesale Growth Fund investment manager had a return of 2.1% (after tax and investment fees).

The worst performing manager's return was negative 8.9%.

The average of all managers was negative 4.3%. (Intech Survey of 35 Wholesale Growth Funds).

Why Has This Happened?

Superannuation funds typically invest around 70% of their assets in shares and property and 30% in fixed interest and cash.

Over the long term, returns from shares and property tend to outperform returns from fixed interest and cash. Accordingly, unless superannuation funds invest a reasonably high proportion of their assets in shares and property, long term results will be disappointing.

International sharemarkets have produced the best investment results of all asset classes over the last 20 years. However, a downturn in the world sharemarkets began in late 2000 and was extended by the tragic events of September 11, 2001.

Recovery has since been hampered by concerns about corporate failures and accounting practices in the USA and the ongoing conflict in the Middle East.

The recent growth in the value of our dollar has also reduced the value of investments held overseas.

Returns from the main asset classes for the year to 30 June 2002 were:

Australian Shares	-4.7%	Australian Fixed Interest	6.2%
International Shares	-23.5%	International Fixed Interest	2.9%
Listed Property	14.9%	Cash	4.7%

(Returns based on usual indices eg S&P/ASX200 Accumulation Index for Aust. Shares)

With around 50%-70% of fund assets invested in the Australian and overseas sharemarkets for the year, the positive returns from the other asset classes were not enough to balance out the negatives from the sharemarkets.

A Likely Recovery?

Many investment managers believe that a recovery in Australian and overseas sharemarkets is imminent. Clear evidence of this is their recent increases in exposure to overseas shares – typically by as much as 5% of total investments.

As further evidence of the expected recovery, the highly regarded Van Eyk Research group recommended on 5 July 2002 “that investors move to an overweight position in global shares.”

In its daily bulletin of 8 July 2002, Macquarie Research reported that it expects the Australian sharemarket “to rise by 12% over the year to June 2003.”

Investment Strategy Review

The Board decided at a recent meeting to:

- review the International Manager mandates;
- appoint a specialist Manager to an Australian “Small Companies” mandate;
- appoint a specialist Manager to an “International Hedge Fund” mandate;
- appoint an additional Manager to the Diversified Fixed Interest mandate.

An all-day Conference was held on 4th September, and eight Managers made presentations. Final consideration of the offerings is now under review, and announcements will be made in the next Newsletter.

Value of Specialist Managers

Up until 31st December 1998, CSSF used a cross-section of “Balanced Fund” Managers ... many Funds continue to do this, today.

On 1st January 1999, we switched to Specialist Managers in each investment sector, in expectation that this would lift returns to Members. Was this successful, or not?

We carried out a calculation earlier in the year (31st March 2002) and found the following:

The 3 year return to 31/3/02, after investment fees and estimated tax, was 8.03% compared with a median of 5.7% which would rank the Fund a 2nd out of 33 in the InTech Growth Funds Survey. Had the structure continued with the asset split amongst the previous managers in the same proportions, the 3 year results would have been 5.23% pa which would have been a ranking of 26 out of 33 managers.

The added-value that Members have received is undeniable. We are hopeful that other Schools which currently use “Balanced Fund” Managers will see the benefits which can accrue from accessing the “Specialist Manager” system and will consider transferring to CSSF, (or at least giving their staff the opportunity of joining CSSF) without surrendering any of their independence.

Is a Negative Return a Problem?

None of us likes to see a minus sign in front of our return. It means that, temporarily at least, our savings have gone backwards.

But – it is only temporary. The investment markets will recover and, by maintaining the current investment spread, the negative return will become positive.

The Long Term Approach

Superannuation fund returns are published regularly. For many, there are daily, weekly and monthly unit prices. Surveys of returns are widely published monthly and we all receive a benefit statement and fund report at least annually.

Such regular reporting of short term results tends to make us focus on the short term instead of looking at the longer term results for a truer picture of investment performance.

After all, superannuation is a long term investment for every one of us. Even those who are near retirement have to take a long term view for the investment of their retirement money if they want their savings to last for their retirement years.

The life expectancy of a 65 year old is 16 to 20 years.

Consider the following table which shows the average superannuation Growth fund returns for each of the last 16 year calendar years:

'86	'87	'88	'89	'90	'91	'92	'93	'94
40.6	-1.8	10.7	17.1	1.1	20.6	3.5	26.5	-5.9
'95	'96	'97	'98	'99	2000	2001	16 yr. Av.	
15.7	11.1	13.3	11.7	9.7	7.0	3.9	11.6	

(Mercer and Intech Surveys of Wholesale Growth investment funds)

During that time, there were some very good years, some pretty poor years and negative returns in 1987 and 1994.

However, the point to note is that, despite this variability in returns year on year, the average return after tax and investment fees was 11.6% for the 16 years – a very healthy result.

If you are investing your money for the short term, say, for one year with the intention of then spending it all, you will want to be careful to avoid any loss of capital. In those circumstances, most people would, understandably, go for the security of an interest bearing deposit with a bank or similar financial institution.

Your superannuation savings are very different. Contributions are paid regularly over a very long term and, even when you reach retirement age, you are unlikely to spend all of the money straight away. Most of it will remain invested for a further long term (during which time you will be drawing down regular amounts for living expenses).

Because superannuation is such a long term investment, we need to focus on the long term results rather than on short term valuations.

Another Way To Look At It

Think of it this way. If your house was revalued at 30 June every year, what would you do if it dropped in value one year by, say, 10%?

Would you be a little concerned or would you be so worried that you would want to sell the house?

Probably neither. Why? - because history has shown us that property always increases in value over the long term. People are generally comfortable with investing in real estate because of this.

Some suburbs become popular and increase in value quickly; others fall out of favour with homebuyers and don't grow as quickly (and even drop in value).

For example, whilst the price of residential real estate in Melbourne has grown faster than in any other Capital City in the last year, the median house price in some suburbs has actually fallen:

- Middle Park – down 12%
- Toorak – down 2%
- Wheelers Hill – down 0.4%

(Age Home Guide/Australian Property Monitor 7/7/02)

The Australian and international sharemarkets are like the property market. History shows us that sharemarkets always increase in value over the long term. History also shows us that the sharemarkets tend to outperform all other investment classes (property, fixed interest, etc) over the long term.

We should be comforted by that – like we are with the knowledge that property always increases in value over the long term.

The difference is that, unlike residential property, sharemarket returns are published regularly and we therefore tend to focus too heavily upon short term results rather than looking at the long term performance.

We don't see daily, monthly or, in most cases, even annual valuations of our house and, therefore, we are not aware of when and by how much its value is rising and falling.

At best, we attend an auction in our area in order to get an idea of what our place might be worth. However, that value can be moving up and down regularly.

Melbourne house prices dropped overall by almost 10% last Spring and a combination of rising interest rates and an oversupply of houses for sale could produce a similar result this Spring.

A Final Point

With most superannuation funds invested fairly heavily in the sharemarkets – as they must be in order to produce good long term returns – their year on year results will vary considerably and, from time to time, there is likely to be a negative return.

Nevertheless, investment markets generally recover quickly. The last time that superannuation funds reported a negative return for a financial year was 14 years ago ie for the year ended **30 June 1988** following the 1987 sharemarket crash (average return negative 8.2%) (Mercer Survey).

However, the markets rebounded quickly and average returns for the year ended **31 December 1988** were 10.7%.

Interestingly, the median house price in Sydney dropped by 25% in 1989 (Business Review Weekly 12 July 2002).

Average superannuation fund returns for the year ended **30 June 1994** were 8.5%. A drop in the markets led to average returns of negative 5.9% for the year ended **31 December 1994** but, for the year to **30 June 1995**, average returns were back up to 6.8%. (Intech Survey)

This article was prepared on 17 July 2002 for the members of the Geelong Grammar Superannuation Fund by CSSF. It is been prepared for general information and does not take into account any specific person's investment objectives, financial situation or needs. Accordingly, no recommendation (express or implied) or other information should be acted upon without first obtaining specific advice.



Pick the Index Competition

Our last Quarter's competition, to predict the S&P/ASX 300 Index closing figure at 31st July 2002 was won by **Gordon Cowling** from **Gippsland Grammar**. The index was 3080.3 and Gordon's entry was the closest.

Here we go again.

As at 31st July 2002 the S&P/ASX300 Index was

3080.3

Fax this page before
15 October 2002 to Combined
Schools Secretariat (03) 9640 0787.

CSS S&P/ASX 300 Index
Competition

NAME: _____

SCHOOL: _____

PHONE: _____

My estimate of the S&P/ASX300
Index as at 31 October 2002 is:

The winner will receive a voucher for an all-inclusive "Dinner for Two" at a 5 star Restaurant of their choice and a one year subscription to Personal Investment Magazine.

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Member Investment Options – Unit Prices

The following are the respective Unit Prices for each Investment Option, as at 30 June 2002.

	Unit Price		%
	30/6/2002	31/12/2001	
Australian Shares	1.46842	1.50610	(2.51)
International Shares	0.93392	1.05728	(11.66)
Fixed Interest	1.15394	1.13521	1.65
Property	1.38595	1.29710	6.85
Balanced	1.22358	1.26014	(2.90)
Capital Stable	1.18539	1.18282	0.21
Ethical	1.18515	1.28125	(7.50)
Cash	1.14549	1.13085	1.29

Your Board Members and Continuing Education

It is incumbent on all Directors to understand how Superannuation works, so that they can attend to Fund matters in the light of clear knowledge of relevant factors. All undertake a training course of the Association of Superannuation Funds of Australia (ASFA) or Australian Institute of Superannuation Trustees (AIST) when first appointed, and follow that up by attendances at Seminars; Discussion Groups; etc during the year.

At each Board Meeting (held Quarterly), an hour is set aside for a presentation from an external professional on a range of topics – e.g. investment cycles; corporate governance; the economy; followed by questions and answers.

Every Director is also appointed to one of the three Committees – Executive/Investment; Finance and Audit; or Legal; which meets a week or so prior to each Board Meeting, to go over those specific matters which need to be put to the Board, with appropriate recommendations.

Family Law Act

This piece of legislation which comes into force on 28th December 2002 required review by the Legal Committee, to see how CSSF will accommodate the requirements of the Act. Under the Act, it will be possible, for example, for a Family Court order to "split" the superannuation entitlement of a Member, with a spouse (or former spouse). We are arranging for our Trust Deed to be Amended, to allow us to comply with the requirements of this new piece of legislation.

Good Communication is Everything

Students need clear and simple instruction. English teachers have permission to use the following to assist in getting the message across:

Always avoid alliteration

Never use a long word when a diminutive one will do.

Don't use ampersands and abbreviations etc.

Don't use more words than necessary, it's highly superfluous.

capitalise every sentence and remember always end it with a full stop

Exaggeration is a billion times worse than understatement.

Take the bull by the hand and avoid mixing metaphors.

Do not put statements in the negative form.

And don't start a sentence with a conjunction. (Remember, too a preposition is a terrible word to end a sentence with).

Last but not least, don't overuse exclamation marks!!!