Newsletter: Summer 2012

# STUART + CARLYON

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## Market update: Optimists vs Pessimists

Sometime after World War Two most economists felt we had entered a golden age of stability. Free trade and instant communication would provide all the ebb and flow required to allow free economies to find their natural balance. The future looked not only bright, but consistent.

Oh those memories! Unfortunately the world of instant information seems instead to amplify reactions to every twist and turn in every economy. We're seeing this right now while European leaders struggle to address their debt crisis.

So on balance, how should we react?

Well, the commentators have mostly gone pessimistic. Some authors are now comparing things with the fall of the Roman Empire. The wheels of the economic chariot are falling off. They predict further erosion of confidence in European banks, a return to world recession with money losing its value and physical gold being the only hope.

So what does Bill Gross of PIMCO, the world's largest bond fund manager, say? In 2008, PIMCO coined the phrase "the New Normal" to describe a world of muted western growth, high unemployment and a relatively orderly reduction in global debt levels.

Now in his January Investment Outlook letter, Gross reminds us how much paper debt was accumulated since 2001 and says that in financial markets there's still far too much paper and too little trust. It's time to redefine "New Normal" he says: and welcome in 2012's "Paranormal." Not exactly comforting words.

For PIMCO the big question is whether efforts by UK and European Central Banks and the Fed will work? It depends on what approach they take to the crisis.

- Build more, buy more. A country can grow its way out of its debt.
- Declare bankruptcy. It won't happen in the US, but may well do so in parts of Europe.
- Austerity and deflation. Governments cut spending and increase taxes causing a lower level of economic activity until debts are repaid and real growth restored.
- Mild inflation. Central banks keep interest rates low and print money so governments have cheap funds and time to implement structural reforms. Currencies tend to fall thus improving exports.

The first option, which is the best logical choice, seems to be off the table because the marketplaces are too pessimistic. We're not buying more. We're not building more. We're all sitting on our hands.

So at the moment, mild inflation is the favoured strategy, though it is leading to weaker currencies and very low interest rates are penalising savers. Commodity prices surged last year but now after a period of soaring prices, inflation is abating in Asian economies leading to – here it is - *hope* that these policies may work.

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Optimism never just vanishes completely. Author Matt Ridley in his book, "The Rational Optimist - How Prosperity Evolves" points out that over 10,000 years ago there were fewer than 10 million people on the planet. Now there are 7 billion, and we are mostly better fed, live longer and enjoy life better than our Stone Age ancestors. We can't help it. As humans we keep striving and working and making things to improve our lives regardless of any adversity encountered.

And even a pessimist still has to do something with his money.

In that light suggestions from PIMCO's Bill Gross sound more like tweaks to us: not the end of the world. So what should investors focus on?

- US sovereign bonds are favoured over European bonds.
- Corporate bonds should be A or AA and "senior" not riskier "subordinated" debt.
- Shares yield more than bonds – stick with higher dividend paying companies in utilities, pharmaceuticals and multinationals with strong brands.
- Commodity prices could go either way. So might the US dollar. For now, don't place big bets on these.

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The rational optimist points out that uncertainty has always been with us and a sensible spread of investments to suit your strategy and goals will win in the end.

## Does it pay to delay?

The filing of tax returns is not something we all look forward to. For some people the whole prospect of doing paperwork is bad enough – even though they're quite likely to discover the IRD owes them some money; what if the opposite is true? What if they find they owe the IRD money? It just seems too horrible to contemplate.

So what is the cost of delaying? If the IRD does owe you money, then you've lost the use of that cash. But let's say you owe tax and now you're late. From Day One of being overdue, the IRD will charge penalties, and these escalate the longer you hold off paying.

Why put off the inevitable? It seldom pays to delay.

Yet in the face of complex or unpleasant decisions people tend to procrastinate. Three really expensive common delays are:

- Delay over retirement plans. The later you leave it, the more expensive it gets.
- Not paying bills on time can lead to interest charges, late penalty costs and losing discounts. Time is money.
- Putting off insurance cover, or setting up an emergency fund. Inaction could leave you in a mess in case of sickness, an emergency or the loss of a loved one.

One cause for delay is the lack of information. We often make financial decisions in the face of uncertainty. Should we switch our mortgage to a fixed rate? How about making out my Will?

These decisions are not actually easy because we don't have all the information in front of us. How can anyone know how mortgage rates will go over the next 12 months?

But if markets are hard to predict there's another wildcard we need to worry about: and that's us.

One problem is that standing in the here and now, we lose perspective. It's a psychological trick that we play against ourselves – one that some economists call Hyperbolic Discounting: which means we value $50 in the hand right now rather more than we value the prospect of having $100 in the hand much later on. We lose perspective about those mounting costs of delay.

However this doesn't mean we should rush our decisions either. Psychologists have also found that we are heavily influenced by our current state of mind or body. If you're feeling down you are likely to do retail therapy. You are more vulnerable financially if your loved one has recently died.

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### Strategies to deal with procrastination

- Open your mail and email daily. Don't let your bills get buried in the avalanche.
- Get to your tax promptly. You'll feel good to have it off your plate.
- Check your bank statements regularly. Keep track of what's going out so you can avoid nasty surprises.
- Set aside time to deal with the "too hard basket." We have a client who takes a day's leave from work to get all her money affairs sorted out; the phone calls, the paperwork – all the things that were eating up her precious weekend hours.
- Set yourself deadlines. Big decisions or small, make a note about when you'll take action.
- Get outside expertise. As clients you can phone us on any matter that affects you financially. With years of experience we can provide the knowledge and clarity you need to make sound financial choices.