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2012 Outlook

As we welcomed in the New Year we remain concerned at the events still unfolding in Europe and the effects they might have on our personal financial situations. The purpose of this article is to provide some perspective on the current situation and offer some pointers on how to prepare for what the future might bring.

The Global Financial Crisis is now three years old. At the time we expected countries and consumers to rebuild their balance sheets by paying down their debt, a process known as 'deleveraging'. Doing this of course would leave less money for spending, which would result in slowing economic growth in those countries. This was supposed to be counteracted by zero or near zero interest rates and the printing of more money for lending. It didn't quite happen that way. There's no way of knowing exactly what effect US stimulus spending had on that country's economic growth (in other words, the recession could have been a lot worse), but what we do know is that banks haven't lent and companies haven't invested. The cash is just there on deposit and not doing much.

In China, vast foreign reserves were spent on internal infrastructure, and this helped its economy continue to grow at a strong pace and, by the way, support commodity prices and the Australian dollar.

In 2012 we don't expect the world to return to "normal" growth patterns. The issues in Europe still have to play themselves out. There are still many imbalances in the world.

We consider the following the top risks for 2012:

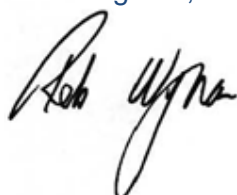
1. Breakup of the Eurozone. While this would be incredibly messy, it might not be a bad thing in the long run. At the moment all the players are positioning themselves for their best personal outcome, depending of course on what the other players are doing (or might do). The European recession will continue while this plays out. Look for the effect of a euro breakup on the US dollar. It could be a situation of looking for the cleanest dirty shirt in the closet and the US dollar could surprise on the upside.
2. Chinese growth slows due to property bust. This would be followed by the need to clean up bad debts.
3. War breaks out with Iran. We certainly hope not but if it does look forward to volatile oil prices and slower economic growth.

With all this gloom around you might expect us to be battenning down the hatches and putting all our money in cash or term deposits, but we are recommending a good neutral mix of equities, property, fixed income, credit and cash.

On current dividend yields, equities (local and international) look to be fair value (after a poor showing in 2011), as does property. Fixed interest (bonds) looks expensive at the moment. After all Australian bonds returned nearly 12% in 2011, but remains worthwhile insurance in case one (or more) of our risks eventuate. The same goes with cash.

It's been a tough few years for most investors. We're certainly not out of the woods yet, and we certainly don't expect massive rebounds from the equities markets. What we are looking for is modest improvements for all asset classes over 2012. As always, a diversified portfolio of equities, bonds and cash is the best approach to long term wealth creation.

Kind regards,



Principal/Financial Adviser