On The Horizon

Creating wealth requires time, patience and a plan

SUMMER 2008

Welcome

New Look For Horizon

Hello and welcome to the Summer edition of *On The Horizon*. The last few months have been particularly busy for the Horizon team. In an effort to continually improve, grow and strengthen our business, we have been working with a marketing specialist to review and enhance the Horizon Wealth Management brand and its corporate identity, so it is well positioned in the marketplace.

First things first, the Horizon logo is changing. Our new logo is a fresh take on the current version, which has been in existence since 2006. The corporate colours have been slightly enhanced and so too has the arc symbol that surrounds it. However, the name and most importantly our purpose remains the same - Horizon Wealth Management "Helping you achieve financial independence".

We are pleased to release this latest edition of *On The Horizon* which showcases our new corporate identity. As you can see, the design is now more sleek, clean and sophisticated and in keeping with the new brand. *On The Horizon* will continue to provide articles that are informative, relevant and interesting. Drop us a line to let us know if there are topics that you would like featured in future publications. We will continue to release the newsletter seasonally to ensure that you are kept abreast of developments in the fast-paced environment of financial planning and wealth management.

It's also wonderful to be able to advise you that the Horizon team has been expanding. Firstly, I would like to welcome Kevin Bettman who joined the team earlier this year. Kevin is a Financial Planner with over 10 years experience in financial services. And, all of you would have enjoyed your interactions with Vivian Wang who has been with us almost since inception.

We are also now focussing our efforts in growing our business and so welcome our new Marketing Consultant, Daniela Roberts to the team. Daniela comes to us with a strong background in profiling financial advice businesses and developing tailored programs to better service clients. She has been working closely with our team to enhance both the Horizon brand and promotional materials. We are sure you will notice the quality of her work over the coming months.

L to R: Brian May, Daniela Roberts, Vivian Wang, Kevin Bettman

And as a final word, we would like to thank you for the loyalty and support that you have shown our business during this last year.

This year has been a difficult year for everyone. Whilst we expect the coming year to be challenging, we hope to continue to provide the financial guidance you may need in your journey ahead.

On behalf of everyone at Horizon Wealth Management, I wish you and your family a safe and happy festive season and look forward to seeing you in 2009.

Kind regards,

Brian May

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HORIZON WEALTH MANAGEMENT

Helping you achieve financial independence

Observations from **Warren Buffett**

The financial world is a mess, both in the United States and abroad. Its problems, moreover, have been leaking into the general economy, and the leaks are now turning into a gusher. In the near term, unemployment will rise, business activity will falter and headlines will continue to be scary.

A simple rule dictates my buying: **Be fearful when others are greedy, and be greedy when others are fearful.** And most certainly, fear is now widespread, gripping even seasoned investors. To be sure, investors are right to be wary of highly leveraged entities or businesses in weak competitive positions. **But fears regarding the long-term prosperity of the nation's many sound companies make no sense.** These businesses will indeed suffer earnings hiccups, as they always have. But most major companies will be setting new profit records 5, 10 and 20 years from now.

Let me be clear on one point: **I can't predict the short-term movements of the stock market.** I haven't the faintest idea as to whether stocks will be higher or lower a month — or a year — from now. **What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over.**

Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. Indeed, the policies that government will follow in its efforts to alleviate the current crisis will probably prove inflationary and therefore accelerate declines in the real value of cash accounts.

Equities will almost certainly outperform cash over the next decade, probably by a substantial degree. Those investors who cling now to cash are betting they can efficiently time their move away from it later. In waiting for the comfort of good news, they are ignoring Wayne Gretzky's advice: "**I skate to where the puck is going to be, not to where it has been".**

Source: New York Times (an edited version). Warren E. Buffett is the Chief Executive of Berkshire Hathaway, a diversified holding company.

News

Employees of Horizon's corporate clients

Did you know that as employees of our corporate plans, you are able to access the details of your Company's benefits from our web site at www.horizonwealth.com.au?

It's easy! Go online and click on the button located on the top right hand corner of the home page, as shown below:

MEMBERS OF COMPANIES

The 'crises' affecting financial markets

It is important to understand that the 'crises' affecting financial markets is fundamentally a liquidity and credit crisis. Markets are not falling because they were outrageously over valued and needed to correct. The credit crisis is now clearly impacting the real economy. Recession or major slowdown in developed economies is now almost certain. However, most companies will survive and eventually prosper as we eventually regain growth. Those companies are now very cheap. Prices have been forced down by a lack of liquidity and some panic and now imply a value which has more than compensated for even a severe economic contraction. As the situation clears, people will see that businesses that have been marked down in value so savagely in recent weeks are still operating, still employing people, still making sales, still consuming raw materials and still making profits. When we reach that point we will be on the way to seeing fair value again.

Source: Mark Dutton, Chief Investment Officer – Australia and New Zealand, AXA

A unique approach to insurance

As many of you know, our business philosophy is centred on our clients and their needs – products are simply a means to an end to fulfil an objective.

It seems that most of the advisers in the life insurance industry still focus on the product and use their product knowledge as their 'point of difference'.

We thought we would share with you the main criteria to consider when structuring your insurance needs. Without following this robust framework and discipline, you may run the risk of not properly evaluating the options which could result in costly errors that are difficult or impossible to correct later.

We believe that the proper process starts in the planning phase. This comprises:

- Properly identifying the risks that you are trying to mitigate. This requires a significant investment in time and education in the various insurance options that can be procured today.
- Computing the level of cover accurately by giving reasonable thought to the accuracy of the assumptions.
- Identifying any financial constraints to the payment of premiums.

Once this is complete we are then able to build a framework which should take into account all the alternatives and options and the advantages and disadvantages of each.

At Horizon, we use the attributes and variables contained in Table 1 below as our key determinants in the design of our clients' wealth protection strategy.

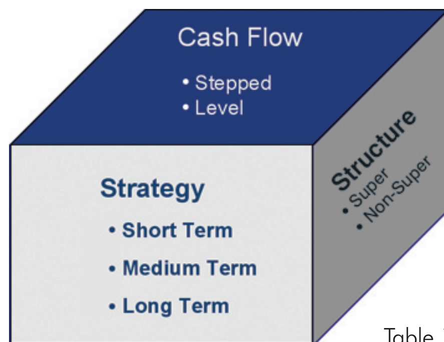


Table 1

Strategy

A key factor is the consideration of our clients' ability to fund premiums in **both** the short and long term.

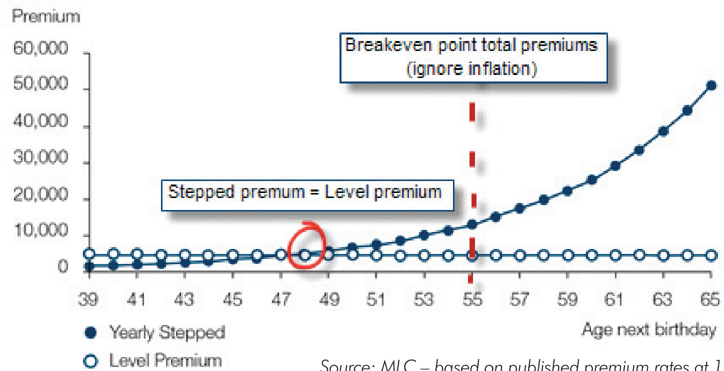


Table 2

Source: MLC – based on published premium rates at 1 May 2008.

Taking into account just our clients short term needs (without understanding the long term implications) could result in them having to fund very expensive premiums in later years. At that point in time they would have limited options as follows:

- Continue with the high costs of the premiums, or
- Reduce/cancel the existing cover which may expose them to risks which cannot be mitigated.

Structure

One of the most important considerations is the structure of ones insurances.

The two main advantages for cover inside superannuation are:

- Its tax deductibility, and
- The use of superannuation contributions to fund the premiums.

However, some clients wish to use their deductible contributions for investment purposes, and not to fund insurance premiums.

This is a complex topic as insurance definitions inside superannuation may vary to those outside superannuation. It's also not possible to house Critical Illness (or Trauma) inside superannuation.

Cash flow

Would you believe that the premiums on $1 million of Life, Critical Illness of $500,000 and TPD cover of $500,000 for someone in their mid 60's, has an annual cost of more than a staggering $50,000! This is the result of selecting all insurance cover on a stepped premium basis.

Refer to Table 2 above – which tracks the cost of cover for the case above of a male non-smoker from age 38 to age 65.

Statistics show that most claims actually occur later in life, but many policies have lapsed by this time due to the higher stepped premiums – which have become unaffordable. Selecting level premiums can make the cover more affordable in the later years and enable clients to keep the cover going at a time when they need it most.

Thus by following a structured methodology and process, we are able to make sure that our clients are properly insured, taking into account their long term requirements as well as their short and long term affordability.

It's also critical to utilise an insurance product and platform that has the flexibility to make amendments throughout our clients' lifetime with the least amount of inconvenience. The life insurance industry still has a number of product churners who move clients from one insurance company to the next, searching for the next best product feature and in so doing earning themselves commission and possibly putting their clients at risk should a claim eventuate.

Conclusion

1. Are you able to distinguish between an adviser and a product sales person?
2. Are you comfortable that you have mitigated or addressed all the risks that you may be concerned about?
3. Have you optimised the cost of your premiums in the long term?

If you have answered no to any of these questions, then you may need a second opinion on the structure of your wealth protection strategy.

The cost of **safety**

Safety first is the name of the game for many investors right now. And with wild day-to-day swings in the markets and hugely divergent performances by securities within the same asset class, who can blame them?

Tolerance for risk is at an extremely low ebb, a development reflected in the fact that yields on risk-free assets are at historic lows—in the case of US Treasury bills at levels not seen since World War II.

Yet this risk-averse behaviour masks one of the paradoxes of investment.

In good economic times, when comfort levels are high, the expected return from risk assets is less favourable. In those times, the cost of our willingness to take a risk is a lower expected return.

Correspondingly, in tough economic times, when risk aversion rises, the expected return from risk assets goes up. In these times, the cost of our reluctance to take risks is not capturing the higher expected returns on offer.

So those now harbouring the bulk of their portfolios in Treasury bills, cash-like instruments or sovereign bonds are forgoing the opportunity to get the full benefit of the bounce in risk assets when it comes.

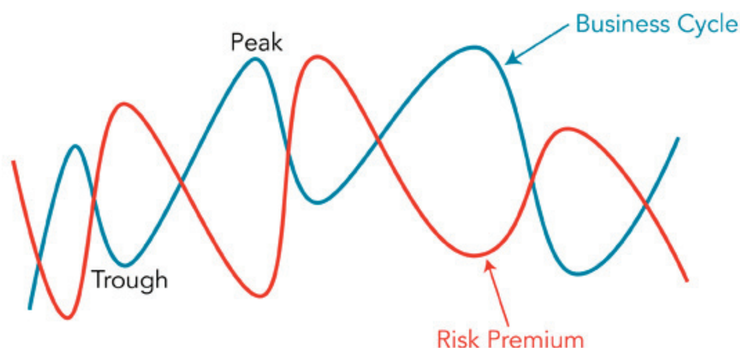
So why not wait till the economy recovers? The problem there is that the equity market tends to price in a turn in the cycle before it is evident. So by the time the news media proclaims an economic downturn to be over, the market usually has already accounted for it.

This is what financial economists mean when they say the market is a discounting mechanism. It absorbs new information very quickly. In other words, by the time you start worrying about it, it is already in the price.

The numbers back this up. For instance the average monthly risk premium of the US equity market over Treasury bills from April 1960-December 2007 is 49 basis points. That's a 6 per cent annualised return over the risk free asset.

But now look what happens around the peak and trough of the economic cycle: In the three months after the peak of an expansion, the average equity risk premium has been -1.52 per cent. But in the three months after the trough of the cycle, the average risk premium was +1.87 per cent.

What this means is that the market tends to price in turning points in the economic cycle before these are confirmed. This explains the difficulty of successfully timing the market and reinforces the benefits of staying disciplined in your chosen asset allocation. (Bear in mind that turning points in the cycle are usually only identified 6-18 months after they occur).



Source: Inmoo Lee, 'Risk Premiums Across Business Cycles', Dimensional Fund Advisors

While the market volatility we have seen this year has been hard to take, this has to be set against the unusually low volatility of the preceding years. The experts also tell us that history suggests we can expect further volatility.

The good news is that periods of high volatility have no predictive power in relation to future returns. Neither is there any predictive power in periods of "high cross-sectional dispersion", when securities in a given asset class have very dissimilar performance in a given month. We are in such a period now.

It's also worth keeping in mind that when markets are so choppy and fickle, **diversification is even more important.** That's because the sort of volatility you would experience in a portfolio with just a few stocks during settled markets will be evident in a very well diversified portfolio in wildly variable markets.

So the lessons from all this are twofold: **Firstly, diversification both across and within asset classes is always important, but even more so at times of instability. Secondly, during tough economic times, risk premiums rise to compensate investors.** While volatility can be hard to stomach, there's no evidence that this is a leading indicator of future negative returns.

Sheltering in a safe harbour to avoid the storm is understandable, but it also leaves you open to the risk of missing the change to more favourable weather when it comes. Wanting to feel safe is fine, but it comes at a price.

Source: Jim Parker, Regional Director, DFA Australia Limited

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