

iq

May 2011

Return of the US

Is the US economy bouncing back?

Investing for children

What you need to consider

Life stage strategies

Are your finances healthy?

FirstRate Investment Deposits

A new addition to the FirstRate suite

Mind vs. Emotion

What to do when your investment
decisions are pulled in two directions



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Monday to Friday,
8am to 7pm Sydney time

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Access **FirstNet**, our personalised
internet service, by visiting
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On the rise

Dear investor,

Welcome to the May 2011 edition of iQ.

Since our November edition, the Australian dollar has continued to rise, reaching record highs against many of the major currencies. Although this is fantastic news for people looking to travel overseas, it's not good news for parts of the Australian economy, particularly our tourism industry. On page 12 we look at the main drivers of the Australian dollar and the impact that a high Australian dollar has on our economy.

Return of the US

The US economy is emerging from the depths of the GFC and is on track to record economic growth in 2011. We look at the reasons behind the recovery of the US economy and whether it's sustainable. See page 4 for more.

Emotional investing

It's hard not to react to large or unexpected moves in investment markets – particularly when markets fall. It's important to remember your investment strategy before making any quick decisions and not let your emotions interfere with your investment strategy. On page 8 we share some tips on how you can avoid what's referred to as 'emotional investing'.

Wealth health check

Are you on track to achieve your financial goals? We've provided some life stage strategies on page 10 to help you get on track and stay on track.

Brian Bissaker
Chief Executive Officer
Colonial First State



Tax time tips

With the end of the financial year around the corner, here are some tips to remember:

TIP #1

Top up your super

Superannuation is a tax-effective area for your money as earnings are taxed at a maximum rate of 15%. Earnings outside super are subject to individual tax rates of up to 46.5%. There are good reasons to consider making additional pre and post tax contributions before the end of the financial year.

TIP #2

Government co-contribution

The Government will match your after-tax contributions on a dollar-for-dollar basis up to \$1,000. If you are eligible, this is an easy way to boost your retirement income on a yearly basis. To find out if you are eligible, speak to your financial adviser or visit our website.

TIP #3

Salary sacrifice

Talk to your employer about contributing part of your salary to superannuation directly instead of taking it as cash in hand. The amount you salary sacrifice is taxed at the super fund rate of 15% instead of your marginal tax rate, which could be as high as 46.5%. This may reduce your marginal tax rate and boost your super balance.

TIP #4

Split super contributions with your spouse

Contributions-splitting allows you to split certain superannuation contributions made during a financial year into your spouse's superannuation account. There are a variety of benefits, depending on your circumstances and subject to certain requirements.

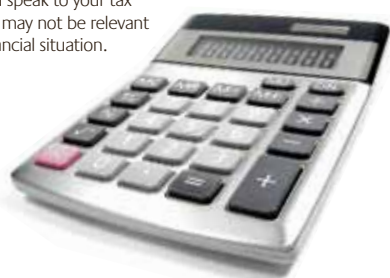
TIP #5

Spouse contributions

Making after-tax contributions to your spouse's super fund may make you eligible for a spouse contribution tax rebate.

Visit colonialfirststate.com.au/superstrategies for more information.

This article is not intended to be taken as taxation advice. We recommend you speak to your tax adviser as these tips may not be relevant to your personal financial situation.



Why pay more than you have to?

If you have multiple super funds, why don't you consolidate them? You'll only pay one set of fees, it will be easier to manage and will help you keep on top of your investment strategy.

If you would like to consolidate super to Colonial First State, simply call 13 13 36 and we can send you a consolidation kit and help you get sorted.



New Colonial First State TV commercial

Our new television commercial has hit your television screen. Keep an eye out for it!

Did you know?

There is approximately \$18 billion in lost super in Australia. To help find your lost super, visit the Australian Taxation Office Super Seeker website at www.ato.gov.au/superseeker.

New options for FirstChoice

We have recently added the following new options to the FirstChoice platform:

Investment option name	Asset class
Magellan Global	Global specialist
Realindex Emerging Markets	Global specialist
Colonial First State Global Soft Commodity	Global specialist
Zurich Investments Global Thematic Share	Global share
BlackRock Asset Allocation Alpha	Alternatives
AMP Capital Global Property Securities	Global property and infrastructure securities



Bouncing back



The United States economic outlook has brightened since the depths of the GFC and is on track for stronger economic growth in 2011. We look at what's driving this recovery, and whether it's sustainable.

It wasn't long after the full impact of the GFC hit home, that headlines such as 'The end of an empire' and 'Death of a superpower' were being bandied around by media all around the world.

But the naysayers may have spoken too soon, because the US economy is showing signs of growth. Now bold statements about the decline of America have been replaced with a question: 'Is this a respite, or a genuine resurgence?'

The key driver of the recovery to date has been the darling of the US economy through the 1960s and 1970s – manufacturing – a sector that fell from favour in recent decades as consumers borrowed more, withdrew equity from their homes and drove the US economy higher by perpetual spending.

With consumers on the sidelines, manufacturing’s contribution to GDP has started to bounce back. Businesses are lifting spending and increasing investment to rebuild inventories slashed during the GFC. This has been aided by stronger company profits and rising cash balances. The result? Manufacturing production has risen 12% since the low in June 2009.

Exports back in demand

Both domestic demand and international orders have helped the manufacturing sector. Exports make up around 10% of the US economy and have risen around 50% since the lows during the GFC, driven in part by a weaker US dollar.

Meanwhile, exports to China from the US have doubled since June 2009, once again showing the growing importance of China to the world economy and how it has aided the US recovery process. Exports have also recovered due to the important role US companies such as Apple, Microsoft, Coca-Cola and Google play in the global economy.

Consumer spending on the rise

Equally encouraging is the fact that, after being on strike in 2008 and 2009, the consumer has begun to spend again. Retail sales have now reached the level recorded prior to the GFC as consumers have become more confident about a sustained US economic recovery. Helping spur consumer spending has been signs of employment growth and the reduction of household debt levels. For the first time in three Christmases, surveyed consumers said they were confident enough to spend money on themselves.

The return of the consumer is key for the US economy given consumption makes up 70% of GDP. A large proportion of consumer sales were driven by debt and home equity withdrawal. With US house prices significantly lower than the peak and a growing aversion to debt, a sustainable consumer spending recovery is needed in the US and there are some signs this may be occurring.

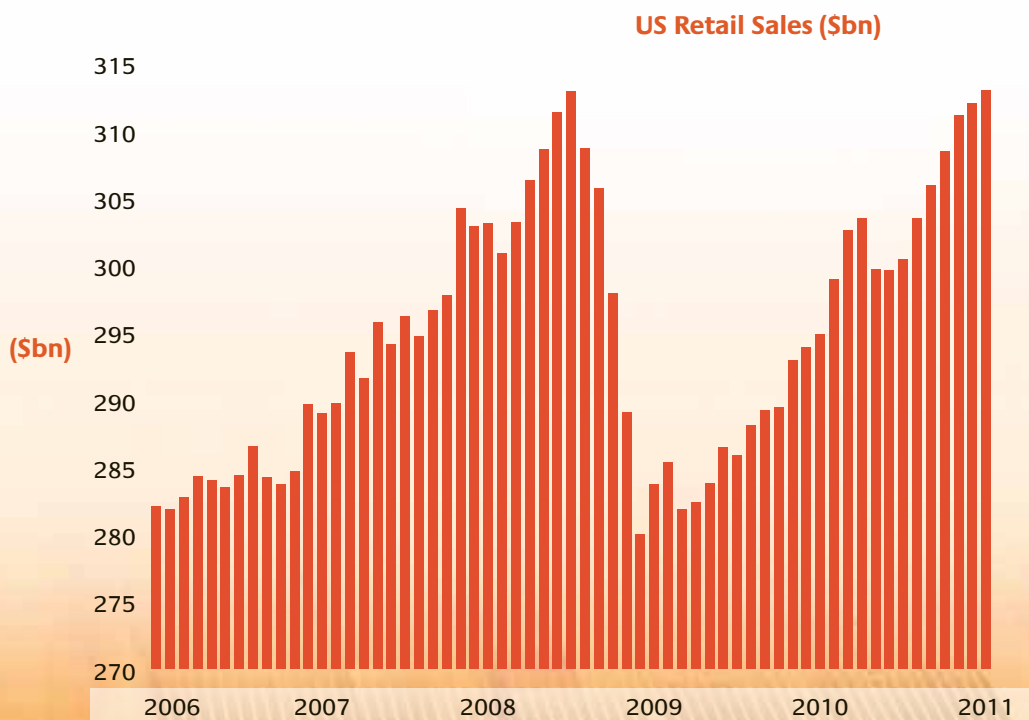
Encouragingly, despite the strength of retail sales, household savings remain at relatively high levels. What is welcome is consumer spending rising without eating into savings, a trend not seen since the early 1990s.

So far, so good

While there is no doubt the US economy is looking healthier, more progress is needed. One major issue for the US economy is debt. Federal, state and local government debt levels continue to rise. Much of this debt is due to inflated social security payments, unemployment benefits and a problematic health care system. A credible plan to reduce government debt is needed and this is likely, at some point, to crimp economic activity as spending is reduced. Over the next decade, President Obama is planning to reduce the deficit by cutting spending by US\$1.1 trillion, but it is likely more is needed and it will be a challenge politically to implement these savings.

Economic activity is at a new record level, jobs are being created, profits are rising and confidence is improving. While large manufacturing companies have done the hard yards to kickstart the recovery, it will now be up to the services sector and the many small businesses throughout the US which employ 70% of the workforce to continue the expansion.

Time will tell, but what we’ve learnt from recent years is that the US economy remains a powerful force.



Source: Bloomberg 2011

I N V E S T I N G

for children

Finding the best way to put money aside for children needs careful thought. The bottom line is the basics of good investment should always apply.

Providing a good start in life for your family is essential to many people. Whether you're interested in starting a nest egg for a newborn or helping a grandchild save for a house, it's important to understand what investments are suitable.

"When it comes to investing for children, people sometimes are too overly focused on tax issues and forget the general investment principles," says Colonial First State's Head of Technical Services Deborah Wixted.

That's why she recommends thinking about the investment timeframe – how long before the funds will be needed – and then looking at the types of products and assets that will suit.

Short-term vs. long-term

So what are the options? For short-term savings goals, say three to five years, lower risk investments such as cash and term deposits may be more suitable. A first home saver account is one option that provides a tax-effective way for people to save for their first home.

But if your sights are set on the longer term, such as an education fund for a very young child, then higher growth investments could be considered. Your financial adviser can help you to assess the child's needs and recommend the options that suit, including shares and property. These could be held directly or in managed funds, investment bonds, such as Commlnsure's Investment Growth Bond, or family trusts.

Managed funds can be a good way of providing diversity with a single account because funds typically invest across a range of assets. However, be aware that most managed funds don't accept investments in the name of a minor (under 18 years of age) but will generally have processes to allow the investment to be set up by an adult on behalf of the child. There's also an opportunity to set up a regular investment plan to take advantage of compounding investment returns.

Thinking about tax

After you have established the goals for your investment, tax is the next consideration. Tax rules will also play a part in the decision to place the investment in your name or the child's.

"Passive investments held directly by children are taxed at very high rates," says Wixted. "There's a reason for that. It's so that parents don't try to effectively split their income by holding investments in their child's name."

Various tax rules apply to different investments so you should check with your tax adviser for information about your own circumstances.

A Commlnsure Investment Growth Bond combines the benefits of a managed fund with the tax benefits of a life insurance policy. It's a simple tax-effective package because investment earnings do not have to be declared in your tax return unless money is withdrawn in the first 10 years.

Special tax rates apply to children under 18 who receive investment income but, in general, children do not need to lodge a tax return if their only source of income is less than \$3,001.

If the investment is in the child's name and the child has the benefit of the investment income and any sale proceeds, then the child pays the tax. If you use the income or benefit from any sales, you are liable for any tax. This may include capital gains tax when you want to transfer the investment into the child's name.

"Deciding whether or not to place the investment in the child's name or your own essentially comes down to three factors," says Wixted.

"Firstly, you may want to have control over it while they're young and not able to manage their money," she says.

"Secondly, the type of investment may determine the ownership. For example, super or first home saver accounts must be held in the individual's name but children may not be able to hold other investments, such as managed funds, in their own name. And thirdly, the various tax issues will also play a part in your decision."

Things to consider before you invest for a child

- How long before the investment will be required?
- What's the best type of product that will suit the time available?
- Should the investment be in the child's name or not?
- How will income tax affect the returns?
- What are the capital gains tax implications?

Plan + protect = peace of mind

It's important to plan for what will happen if your investments and super outlive you. We've detailed some important considerations for estate planning to help you achieve peace of mind.

Have a valid and up-to-date Will

A Will is a formal document that instructs how your estate is to be distributed if you die and who should administer this distribution. A Will can also be used to determine your wishes in relation to the future care of children.

It is important that your Will is kept up to date as your personal and financial circumstances change over time. If you die with an outdated Will, assets could be directed to the wrong beneficiary and your estate may have to pay more tax. Alternatively, if your Will is no longer valid (or you don't have a Will), part or all of your estate may instead be distributed under the laws of intestacy, which do not take your wishes into account.

Are all assets distributed by a Will?

While most assets that you own personally will form part of your estate (and therefore be distributed according to your Will), there are a number of exceptions. It is important to understand which assets will bypass your estate and be paid directly to your beneficiaries, because these assets may be protected in the event that someone challenges your Will.

Assets held as joint tenants

A couple commonly holds their property in a joint tenant arrangement. If one dies, the remaining joint owner will inherit full ownership of the asset. This type of ownership is a good way of ensuring the smooth transition of an asset to your spouse (or other beneficiaries) if you die.

Life insurance policies

When taking out a life insurance policy, it is possible to directly nominate a beneficiary who will receive the insurance proceeds in the event of your death.

Superannuation

If you die, your super balance may be paid either to one or more of your dependants¹, or your estate. This choice will often be made by the trustee of your super fund based on the fund's rules and the needs of your beneficiaries.

Colonial First State's super funds allow their members to put in place a Non-Lapsing Death Benefit Nomination, which allows you to nominate one or more beneficiaries with certainty.

Enduring power of attorney/ enduring guardian

It's important to also prepare for what will happen in the event that you don't die, but become mentally incapacitated and are unable to make your own financial and lifestyle decisions. Putting in place an enduring power of attorney and enduring guardian² allows you to decide who will make these decisions if you are no longer able to.

An enduring power of attorney generally allows a person nominated by you to make financial decisions on your behalf, while an enduring guardian allows for medical and lifestyle decisions to be made.

Taking action

The first step is to determine your estate planning goals – a process that should ideally involve discussions with your family members and other potential beneficiaries. These goals may include:

- Who you wish to benefit from your estate, and also from assets that will not be part of your estate.
- Whether any beneficiaries need additional funding in the event of your death.
- Whether any beneficiaries require special arrangements (eg children).
- Who you want to look after your affairs if you were no longer able to do so.

Once your estate planning needs are determined, it's important to talk to a financial adviser, who can recommend a strategy to meet your goals in an efficient and tax-effective way. Finally, a solicitor can assist you in setting up a Will, enduring power of attorney and enduring guardian to ensure that your estate planning goals can be realised with certainty.



¹ Dependant includes spouse, child, financial dependant or interdependent relation.

² Document name may vary depending on the state in which you reside.



Mind vs. Emotion

Why letting your emotions rule your head when it comes to money can lead you down the wrong investment road.

It takes a crisis like the GFC to really see how emotion can overrule logic when it comes to our investment decisions.

Constant media coverage about falling share prices and declining fund performance helped to create enough panic among investors to cause them to sell up and invest in cash. The move may come at a cost in the longer term.

The problem is that while cash doesn't suffer from the same ups and downs as shares and other investments, there's a price for that peace of mind. You lose the advantage of already being in the market when confidence and prices recover. It means that you may have sold when prices were low and, to get back into the market, you may be buying at levels higher than you'd like – far removed from the adage 'buy low, sell high'.

Cashed up

At the height of the GFC, John Dunbar¹ was so worried about the direction of share markets that he called his financial adviser and asked that his small investment – a fund put aside for holidays and emergencies – be converted to cash.

That was a major concern to financial adviser Michael MacQuillan from Priority Planners. “John was afraid the markets would keep falling and wipe him out,” he says.

While the market activity appeared frightening at the time, MacQuillan explained that the investment strategy he and John had worked on was sound.

“We had established his objectives, and most of the portfolio was not affected by the crisis, such as his home, an annuity, and a small Centrelink pension,” says MacQuillan.

Nonetheless, John was adamant about converting his holiday fund to cash.

“It meant that he realised his losses and locked into cash, thinking: ‘Well, I can’t lose any more’. But as I explained to him, if you opt out of the market you can’t take advantage of the recovery that will eventually come,” says MacQuillan.

“The holiday fund was a small part of his total financial assets when you take into account his house, the bank savings and the annuity. So his decision was definitely based on emotion rather than logic.”

Of course John wasn’t alone. Investors flee the markets in droves when prices are at their lowest. It’s partly fear, as they watch the value of their portfolios drop, and partly the strong desire to follow the crowd, a sort of reverse gold fever.

Then, when markets trend higher, more investors than ever are attracted to the activity. This is fed by the views of friends and family as they share their views about buying and selling at that particular time and by increasing media and internet coverage.

When markets are rising, the term ‘irrational exuberance’ is often applied to the frenzy of buying, after the former US Federal Reserve chairman, Alan Greenspan, used it in a speech in 1996 causing a strong reaction in global share markets.

“On the downside, during the crisis, we saw ‘irrational pessimism’ when it came to the values of some assets,” says MacQuillan.

But history shows that those who are able to withstand short-term fluctuations in their portfolios can look forward to improved growth over the long term.

We are our own worst enemy, writes finance guru and economist James Montier in his book *The Little Book of Behavioural Investing* (John Wiley, 2010).

We are all prone to stumble into “mental pitfalls”, according to Montier. “This is true in investing as it is in every other walk of life.”

One example of these mental pitfalls is the attempt by many investors to try to time their entry into the markets as well as their exit, aiming to sell at the top and buy at the bottom.

Few succeed, notes Montier, citing an annual US study that compares the performance of the S&P 500 over the past 20 years with investors’ actual returns.

While the index increased an average 8% per year, investors in equity funds reduced this performance to just 1.9% as a result of “buying and selling at just about the worst possible point in time”.

Taking out the emotion

It’s not always easy to find the courage to go against the crowd or to hold out while markets are falling, even if it might be the rational thing to do.

But MacQuillan has some tips to help stop the emotional rollercoaster.

Setting your investment goals with your financial adviser is a good place to start. Then you’re able to put in place a plan for your portfolio that will see it through times of market volatility. That’s because it takes account of the level of risk you’re prepared to take and match investments accordingly. You can calculate your risk profile using our risk profile calculator at colonialfirststate.com.au.

Your planning should also include ensuring that your investments are diverse; covering a range of markets, products and sectors. In that way, when some investments are down, others may be up. Diversification

helps to keep your portfolio (and perhaps your emotions) in balance.

What you can do

While emotion governs the majority of human decision making, being aware of behavioural biases can help you avoid them.

Question your decisions.

Are you making a choice based on emotion or informed financial analysis? You should always be able to provide a sound justification for your decision.

Keep informed.

Read a range of balanced economic analysis, such as that produced by reputable research houses (eg Standard & Poor’s) or organisations such as the Reserve Bank of Australia. Learn to sort fact from sensationalist media articles. Your financial adviser is a good source of high-quality financial information.

Maintain a well-diversified portfolio.

Diversification can assist in avoiding investment biases by helping you to see your portfolio as a whole, and part of a long-term strategy. Investing through a managed fund can also help you avoid becoming attached to certain stocks and can be an effective way to diversify if you don’t have a huge amount to invest.

Seek advice.

Professional financial advice is critical to investment success. Financial advisers have access to a range of material not available to individual investors. When you are making investment decisions, your financial adviser can help by offering guidance and a balanced viewpoint.



¹ Real names not used.

Wealth health check

Are you keeping your finances healthy by doing the right thing at the right time? Taking the best action at the optimum time can be crucial to your financial future.

Accumulators (aged 25–45)



Start a monthly investment plan

- 'Pay yourself first' rather than create unrealistic budgets.
- Salary sacrifice into super while other financial obligations are low, and stop when current needs are more important.
- Use any pay rises to fund your regular savings.
- Be clear about what you're saving for and the best structure and investment options for that.

Control debt

- Reduce unnecessary spending.
- Pay off the credit card, it's probably costing you more than 15% pa interest.
- Consider consolidating credit card debt into a personal loan, and potentially paying less interest. If you do this, resist the temptation to accumulate more debt into your credit card.

Check out the government co-contribution

- If eligible you could get up to \$1,000 added to your super for free, every year.

Consider using a mortgage offset account

- This could reduce your loan interest while giving you access to the cash if you need it.
- Make sure you have sufficient death, disability and income protection insurance.

Builders/ Pre-retirees (aged 45–65)



Stay cash flow positive

- Live within your means.
- Reduce the mortgage and other non-deductible debt such as credit cards and personal loans. This may free up cash flow for other investment opportunities.
- Consider part-time work for a non working spouse.

Increase contributions to super

- At age 50, the concessional (pre-tax) contribution cap increases from \$25,000 to \$50,000.¹
- Consider transferring non-super assets to super. You'll need to take into account any capital gains tax on the transfer and the super rules covering what assets you can transfer.

Split income where possible to save tax

- Consider investing money in the name of the spouse who pays the lowest tax.
- Consider splitting super contributions between spouses. Up to 85% of concessional contributions within the contribution cap, including Super Guarantee and salary sacrifice contributions, can be split.

Look into a pre-retirement pension if you're age 55 or more

- Consider salary sacrificing, and drawing down regular income from your super to replace the lost income – saves tax and builds your super without affecting your cash flow.
- Make sure you have sufficient death, disability and income protection insurance. Also consider taking out trauma insurance.

Retirees (aged 65+)



Ensure you don't run out of money

- Understand your plan for spending in retirement – set a budget for essential expenses and additional lifestyle expenses and how you'll fund each.
- Ask yourself if you've invested your assets too conservatively – maintaining and growing your capital today can help you provide the income you'll need in the future.
- Consider whether you need to downsize your home.
- Investigate how your income and assets affect your Centrelink benefits. Simple changes can help ensure that you maximise your total income.
- Consider setting up investments to help grandchildren with education costs, a deposit on their first home or an investment nest egg. You'll need to include this in your retirement spending or estate plan.
- Think about aged care now. When the time comes, decisions often have to be made very quickly, so plan ahead for which care options you'd like to use and how they'll be paid for.

Review your estate plan

- Consider a Non-Lapsing Death Benefit Nomination for your super or a reversionary pension for your pension.
- Ensure your Wills and enduring power are in order.

¹ The increased concessional contribution cap applies until 30 June 2012. However, the Government has indicated that it plans to permanently increase the concessional contribution cap to \$50,000 for individuals who have total super balances below \$500,000 and are 50 years old or over.

Cash security or a great interest rate? Now you can have both

If you're interested in a high interest, low-risk way to invest your money, FirstRate Investment Deposits could be for you.

What are FirstRate Investment Deposits?

FirstRate Investment Deposits are, longer-term cash deposit options and are a new addition to the FirstRate suite.

FirstRate Investment Deposits offer a guaranteed rate of 0.75% above the RBA cash rate and have been designed for investors who intend to hold the investment until 28 April 2017.¹

As with FirstRate Saver and FirstRate Term Deposits, you have the added reassurance that your money is on deposit with one of Australia's leading financial institutions, the Commonwealth Bank.

Things to know

FirstRate Investment Deposits are currently available in FirstChoice Personal Super and FirstChoice Pension.



FirstRate Investment Deposits offer you:

- a longer-term deposit option
- reassurance that your money is on deposit with the Commonwealth Bank
- a guaranteed interest rate of 0.75% above the RBA cash rate
- no ongoing fees
- monthly interest payments
- the ability to withdraw funds early if necessary, subject to an early withdrawal adjustment.

FirstRate at a glance	FirstRate Saver	FirstRate Term Deposits	FirstRate Investment Deposits
Minimum suggested timeframe	No minimum	3, 6, 9 or 12 months	Until 28 April 2017
Interest rate	Variable	Fixed	Matches RBA cash rate + 0.75%
Interest payment	Calculated daily, paid monthly	Calculated daily, paid at maturity	Calculated daily, paid monthly
Management costs	No ongoing fees or transaction costs	No ongoing fees	No ongoing fees
Early withdrawals	n/a	Early withdrawal interest adjustments apply	Early withdrawal adjustments may apply

For more information, please speak to your financial adviser and read the FirstChoice Personal Super or Pension Product Disclosure Statement available at colonialfirststate.com.au.

¹ If you switch or withdraw the full amount of your FirstRate Investment Deposit prior to the end of the term, an early withdrawal adjustment will apply. You should refer to the Product Disclosure Statement for details.

Hot dollar



Interest rates

Historically, one of the big drivers of currency moves has been interest rates. The Australian economy has been a clear outperformer since the GFC and with this has come relatively higher interest rates to counteract an upbeat medium-term outlook for the economy and expectations of higher inflation. Conversely, US, UK, Japanese and European interest rates have remained at or near zero percent since the GFC. Given the interest rate differential, investments in Australian fixed interest securities such as Commonwealth Government bonds become more attractive and this has encouraged foreign money inflow into Australia.

Commodity prices

With the re-emergence of China and India, commodity prices globally have risen substantially since the end of 2003. The Reserve Bank of Australia Commodity Price Index, which measures price gains for Australia's key commodity exports, has risen 148% in Australian dollar terms and 243% in US dollar terms over this period. Prices for Australia's key commodities, particularly iron ore, coal, copper and gold have risen significantly due to strong demand and relatively short supply.

Confidence

The Australian dollar is generally regarded as a barometer of economic confidence, especially in the Asian region. If global and local investors are feeling more confident about the outlook, the Australian dollar is in demand and this pushes the price up. The opposite is also true. Over the past 12 months, the outlook for the global economy has improved, largely driven by a US economic recovery and the continued growth from emerging economies.

Investment flows

The Australian dollar is the fifth most traded currency in global financial markets. This is an impressive statistic given the Australian economy is the 17th largest economy globally. Internationally, there is a rising demand for Australian dollar investment (given higher interest rates) and much of this is being driven by large investment funds, including sovereign wealth funds which are increasing their allocation to Australian assets. The view is that Australia is an attractive investment destination given our strong links to Asia (70% of our exports are now to Asia) and a high, relatively safe rate of return is expected.

Also, large investment funds have been lifting holdings of Australian government debt, with 69% of all Australian government bonds owned offshore. With the mining investment boom in full swing, further investment in the Australian economy is needed and could see demand for Australian dollar investments continue to rise.

Australian dollar at a glance

- Fifth most traded currency in global financial markets.
- Australia is the 17th largest economy.
- Internationally, there is a rising demand for Australian dollar investment.
- 69% of all Australian government bonds are owned offshore.
- Since 2009, the Australian dollar has risen 44% against the US dollar, 46% against the euro and 30% against the pound and Japanese yen.

Since the GFC, the Australian dollar has gone from strength to strength, surpassing parity with the US dollar. We explore why and what it means for the Australian economy.



The impact of a high Australian dollar

The positives of a strong Australian dollar are relatively well known especially if you're planning on travelling overseas. In 2010, there were 7.1 million Australians visiting an overseas destination for a short stay, this compares to 6.3 million in 2009 and 5.8 million in 2008, an increase of 22% over two years. The number of Australians visiting the US rose by 39% over two years, showing the strength of a strong currency on holiday choice.

In contrast, the strong Australian dollar has been hurting our tourism industry. Fewer Australians are holidaying domestically and overseas tourists are visiting less. In 2010, we had 5.9 million visitors for short stays, this compares to 5.6 million in 2009 and the same in 2008, an increase of only 5%. Over 2010, the number of visitors from the US actually fell by 1.5%. Tourism Australia is looking at ways to drive more visitors to the country including the recent visit by US talk show queen, Oprah Winfrey.

The strong Australian dollar also hurts other traditional sectors of the Australian economy, including those which export and those that compete with cheap imports. Manufacturers, education providers to overseas students and car producers are just some examples of industries that have been struggling because of a strong Australian dollar.

On the surface, consumers appreciate paying less for goods and the Australian dollar has assisted with this. We now have more money left in our pockets for other items, particularly as food and energy prices are rising. It is the other benefits that stem from cheaper imports that are less apparent.

With lower amounts spent on household goods, more money is being saved, used to pay down debt and also used to buy services. In fact the services sector of the Australian economy, which makes up 60% of the economy, should be a clear beneficiary of a strong Australian dollar. More money will be able to be spent at the local hairdresser, dentist, dry cleaner, gym or café. This helps create jobs for the 3 million small businesses in Australia.

While there are winners and losers, what we do know is that there are fundamental reasons why the Australian dollar has reached these high levels and it could be some time before we see the Australian dollar adjust lower.

Big spenders

With the lack of any official data from the Australian Bureau of Statistics, the RBA has recently done some analysis on the switch to online. The RBA estimates that since 2005, the value of credit card online spending has grown at an average annual rate of more than 15%. This compares to traditional credit card spending of 9%; however, online payments account for only 10% of all purchases made by credit card.

What the RBA also found was the increase in international purchases on credit cards has largely risen in line with the number of Australians travelling overseas. It is hard to determine if more people are holidaying overseas to take advantage of the strong Australian dollar and spending up big or if there is a genuine switch to purchasing goods online.

With the strong Australian dollar continuing, the switch to online spending also appears set to continue.

In the spotlight

Find out why Oil Search is part of our portfolio and how it could help you



Oil Search is an Australian listed company and is Papua New Guinea's largest oil and gas producer, operating all oil fields in the country. These activities provide Oil Search with a strong earnings stream. It is the company's stake in the 'PNG LNG' project, however, which offers the real opportunity for growth.

Oil Search owns a 29% share in the project, which is a large-scale LNG (liquefied natural gas) development. Upon completion, it will be operated by global energy giant and LNG specialist ExxonMobil. The construction of this project began in March 2010 and is expected to be completed in 2014, costing \$15 billion. The development will unlock an energy reserve which is the equivalent of more than 500 million barrels of oil.

The production of LNG involves drilling gas from the ground and transporting it in pipelines to a processing plant, where it is converted into a liquid form. The liquefied gas is then transported in specially-designed tankers. When it reaches its destination, the liquid is transferred back into a gaseous form for use in power generation. In the case of the PNG LNG project, the gas is drilled from the Southern Highlands region of Papua New Guinea and piped to a processing plant and export terminal near Port Moresby.

The construction of this project is based on well-established and proven infrastructure and the design of the processing plant is the same as others already operating in other countries.

Sale of the LNG is already fully contracted to four key buyers from Japan, Taiwan and China. This provides assurance that the project will immediately deliver cash flows on the delivery of LNG to customers. The price obtained for the LNG is linked to the oil price.

Oil Search shares are held in a number of Colonial First State funds, including the Global Resources and Geared Share Fund.



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