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AT A GLANCE

RESERVE BANK KEEPS RATES ON HOLD

Key Points:

- The RBA surprised the market this month by leaving the official cash rate on hold at 4.50%.
- The RBA did signal that “if economic conditions evolve as the Board currently expects, it is likely that higher interest rates will be required, at some point, to ensure that inflation remains consistent with the medium-term target.”
- It appears the RBA would like a bit more certainty in relation to domestic economic activity, particularly credit growth to move the official cash rate higher.

After leaving the cash rate unchanged for the past four months, the Reserve Bank of Australia (RBA) left interest rates on hold again at 4.50%. This was against the majority of market economists and market pricing. The expectations of a move higher came after several signals by RBA officials that higher interest rates were needed over the medium term.


In announcing the ‘on hold’ decision the RBA stated that “asset prices are not moving notably in either direction, and overall credit growth is quite subdued at this stage”. It appears the RBA would like some improvement in credit growth, particularly business credit growth before lifting interest rates. There also could be some sense of uncertainty over the global economy and global financial markets for the decision.

Some softer data over the past week (ie. August building approvals, credit growth, weaker than expected retail sales) may have influenced the decisions. But the signal that interest rates would have to move higher (November is still a possibility), at some point is consistent with expectations that nominal GDP growth will be rising sharply over the remainder of 2010 and into 2011. This jump in nominal GDP growth will be driven by the income effects from Australia’s record high terms of trade – effects which the RBA believes have only now just begun to be felt on the economy.

TOP FIVE QUESTIONS INVESTORS SHOULD ASK?

1. Is the World about to collapse due to record levels of government debt in Europe and, more particularly, the US?

The incredible reaction to the GFC by developed nation governments, in terms of massive stimulus, does come at a future cost. Governments have racked up substantial (and increasing) levels of debt, not seen since just after World War II.



The G7 countries will likely see public debt increase to over 100% of their GDP by 2015. In the absence of any fiscal control, the net debt to GDP ratio would exceed 200% by 2030 and this has many commentators worried (not so much by the Greek situation given it is such a small economy). The big anomaly is that the best way to get debt down in the longer run is to ensure you have a growing economy (which may involve even further stimulus short term).

So what do we think about this?

- Firstly, governments are not like individuals. They have the ability to collect taxes in perpetuity. This means they can sustain much higher longer term debt than individuals.
- For governments to sustain high levels of debt, there must be other entities (typically the high-saving emerging economies) willing to buy their government bonds/treasuries. This works fine, provided everyone has confidence that the government can reduce their debt burden in the long run .
- If that confidence evaporates (such as we have seen in the past with many developing nations) that's when we see massive problems with inflation and currency devaluations.
- Countries with large debt levels can not grow their economy in the future as fast as they otherwise would, as they slowly cut costs and raise taxes to repay debt.

The bottom line is a huge long term issue that, in many ways, is a necessary outcome of the GFC. The big governments have had a healthy wake up call from the PIGS (Portugal, Ireland, Greece and Spain) and we are already seeing some moves to cut public service costs and government pensions in major economies. Whilst the press can be very alarmist over this issue, these debt issues can be seen as a longer-term drain on the economic growth of these indebted nations, rather than a cause for immediate panic.

2. Why do the Chinese continue to fund the US by buying US Government securities (treasuries)?

This question gets asked a lot. People see debt issues in the US, coupled with low interest rates and logically ask why would you want to buy US treasuries?

The bottom line is that the US treasuries, despite the GFC and US issues, still remain one of the most liquid and secure places for holders of substantial funds to invest. As money pours into China from abroad to pay for their massive exports, they need a safe liquid, globally tradeable asset to invest in which rules out most other alternatives (even the physical gold market would be too small).

3. China has lots of issues and we are too dependent on them - what's going to happen if they have more problems?

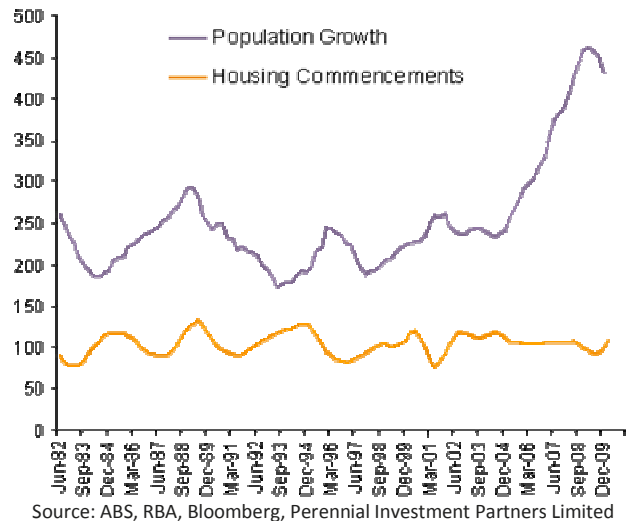
Australia's natural resources and proximity make us close to China economically. While there are big issues (pollution, maintaining growth to avoid civil unrest, property market bubble etc), we don't see Chinese growth stumbling too far in the near term. As a communist Government, China has shown a tremendous ability to control its economy and keep growth bubbling along, with the vast population gradually increasing their wealth from a low base. China's one-child policy will likely lead to a quickly ageing population. However, by the time that happens (say ten years plus), Australia may take greater advantage of Indian growth where the population is much younger. That said, much of Australia's wealth is made from exporting to China (now the World's second largest economy and Australia's biggest export market), so Australia's growth prospects are in part tied to China.

4. What's going to happen to Australian house prices - some people say they are the next bubble?

World capital flows are so large and volatile, bubbles can and will be created in the future. So, looking out for and avoiding the next bubble is a great way to think about investing. Australian residential property is more of a local market and prices are high when compared to many other markets.

The following chart gives one example that can justify why prices have risen, with housing starts being outstripped dramatically by population growth. Residential prices might cool with rising interest rates, but supply/demand factors will most likely keep prices from suffering a major short term fall.

Housing Fundamentals (rolling 4 qtrs)



5. I'm just too worried about losing money with shares, shouldn't I wait until everything settles down?

We live in a dynamic, globalised world and there will always be some form of negativity in the headlines. However: Historically, over the longer term, shares increase in value.

Various academics are of the view that the best time to invest in shares is at times of the greatest market uncertainty. Waiting for absolute certainty could be the worst time to invest, as sharemarkets tend to do well before any economic recovery is certain.

SECURITY NATIONAL NEW ESTATE PLANNING RELATIONSHIP

Security National is pleased to announce a new relationship with Featherby's Lawyers. And for the first time, we now will be able to offer you fully integrated estate planning services. We are now able to provide you with a full range of in house legal counsel services including the drafting of Trusts, Wills and Powers of Attorney, Estate Planning, Asset Protection, Estate Administration and other needs as they arise. Featherby's Lawyers are also available to advise on and assist in the administration of deceased estates to ensure your wishes are carried out in the best and most tax effective way and that the burden imposed on your family is minimised.

Security National has had a close relationship with Featherby's Lawyers for over 20 years. Security National is able to work with Featherby's to ensure that your legal matters, and particularly your estate planning decisions complement your financial planning decisions from time to time.

If you need assistance with your estate planning, we can confidently refer you to these specialists when required. For more information, please contact your adviser.

WHAT'S NEW AT SECNAT?

- It is with great pleasure that Security National would like to announce the appointment of two new staff within the Whykes/Ball practice: Karan Arya and Amila Silva. Karan holds a Masters in Accounting from Melbourne University and has been appointed as a junior para-planner. Amila holds a Bachelor of Commerce, majoring in Accounting & Management from Deakin University and works in the client support division on a permanent part-time basis. Welcome to the team!
- With Christmas almost here, it is important to remind you that our offices will be closed over the Christmas break from 5 pm on the 23rd December, 2010 and operations will resume on the 10th January, 2011.



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