

From the Editor

Welcome to the latest edition of *insight*. Our feature article this month 'The Impossible Ask' takes a look at currency forecasting and where the Australian dollar exchange rate 'should' have been at different stages since floating in 1983, according to the experts.

Adviser Rick Houden, Integralife's resident expert on life, TPD, trauma and income protection insurances, was selected to attend an exclusive Asteron Business Leaders conference on Hayman Island in October. He tells us it was mostly work and little play. Why not come in and put him to the test to get your insurances organised!

You should have received your invitation to the Christmas function with industry leader guest speaker Bryan Taylor (ASX: PLB) on 1st December at the Sanctuary Golf Resort, starting at 5.30pm. Please confirm your attendance if you have not already done so.

You may notice that Brian and Rick are sporting a moustache (or at least trying to!) this November. Their aim is to raise funds for the 'Movember' campaign (for research into prostate cancer and depression in men). They can be supported online at <http://au.movember.com/mospace/623726/> or call by calling into the office.

It is with sadness that we say farewell to Integralife's Office Administrator Christine Dowse. She will be heading off for new challenges in the mining sector. Thank you Chris, and best wishes for the future.

We end this edition with a profile of one business owners and Integralife clients Zahi and Nelly Dorkhom. If you would like your business to be profiled in future editions please contact us.

Your Integralife office will be closed from Thursday 23rd December, and re-open for 2011 on Wednesday January 5th. Thank you for your continued support by referring friends and family to us. After-hours meeting times are available for those unable to meet during office hours. You are welcome to use Integralife's off-street parking via Clifton St, if a bay is available when you visit us.

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The Impossible Ask

When it comes to currency forecasting, it's often said that there are two types of economists: Those who are wrong, and those who are wrong but just don't know it yet. It's a piece of wisdom worth pondering given recent landmark moves in the foreign exchange market.

Among those moves has been the Australian dollar's historic brush with parity with the US dollar for the first time since it was floated in 1983. Prior to then, the \$A was a managed currency, like many Asian currencies today. The float meant that its value was allowed to fluctuate depending on supply and demand in international money markets.

One consequence of the liberalisation of Australia's capital markets was the creation of an entire new industry made up of former Treasury and central bank economists employed by investment banks to make forecasts for currencies and interest rates.

The financial media, seeing the level of the currency as a sort of barometer of the country's international standing, queued up over the years to interview local and visiting experts, who opined on the true value of the currency and the madness of foreign exchange markets.

So let's start by going back to 1986. It was a little less than three years since the float and the \$A was falling sharply after the nation's then treasurer Paul Keating said Australia could become a banana republic if it failed to undertake long overdue economic reform.

A Macquarie Bank economist wrote a research note¹ at that time saying the currency was undervalued by at least 15 per cent, based on purchasing power parity – a concept used to compare currencies according to relative price levels between two countries.

Less than two years later and the problem had reversed. The Australian dollar was getting stronger again, attracting complaints from exporters about a fall in the nation's international competitiveness. An economist with one industry group predicted the local currency was headed for parity with its US counterpart within the coming year.² This was in 1988.

Well, that didn't work out. Four years later, with much of the developed world in recession, the \$A was back down again, around 69 US cents. Yet analysts were quoted as saying the local dollar was now still "undervalued" on a purchasing power parity basis.³

Another five years on and guess what? Merrill Lynch, in a report, described the \$A, by then around 73 US cents, as "one of the most undervalued currencies in the world". The \$A was "on a roll", we were told, and the only way was up as commodity prices boomed.⁴

Well, that didn't work out, because no-one saw the Asian currency crisis coming. A year or so later, most of Australia's key export markets in Asia were stung by the sudden exit of hot money flows and the \$A felt the backlash, falling all the way back to around 55 US cents.⁵

By the turn of the century, the little Aussie battler was in even worse shape. The boom now was in technology stocks and Australia, as a commodity producer, was being written off as an "old economy" too dependent on stuff that you dig out of the ground.

It was at this time that one very rich US venture capitalist, making his money out of dotcoms, wrote a condescending opinion piece for an Australian newspaper that urged Australians and New Zealanders to ditch their worthless currencies and embrace the greenback.⁶

1. 'Dollar Collapse Seen as Unjust', Sydney Morning Herald, Sept 30, 1986

2. 'Pain as we Head for Parity', Sydney Morning Herald, July 8, 1988

3. 'Rise Expected in A\$ and Rates', Sydney Morning Herald, Nov 4, 1992

4. 'Commodities are Driving the Dollar', Sydney Morning Herald, March 5, 1997

5. 'A\$ Caught in World Market Turmoil', Daily Telegraph, August 29, 1998

6. 'Let's Hear it for the Little Aussie Greenback', Robert Kunze, The Australian, March 7, 2001

Even 'The Economist' magazine rushed to the bedside of the wounded Australasian currencies, using its popular Big Mac index to declare the \$A and \$NZ as the most undervalued currencies in the world – both 40 per cent below where they should be.⁷

After reaching a nadir of just below 48 US cents in April 2001, the \$A then began to climb again, albeit slowly and with much of the improvement due more to a falling US dollar than to any improvement in sentiment toward the local unit.

Three years later, the \$A was the world's best performing currency, hitting six-year highs around 75 US cents. With China an increasingly dominant presence in the global economy, commodities were back in fashion. And so began the predictions of parity, with one prominent fund manager tipping the \$A would go one-for-one with \$US by the end of 2004.⁸

In early 2006, with the \$A now near 80 US cents, another "prominent pundit" was quoting as saying that parity was on the way, perhaps within a year.⁹ And so it continued, with the calls for parity getting more and more frequent, until by mid-2008, with the \$A around 98.5 US cents, it was seen as just a matter of time.

But then along came Lehman. With the parity party booked, the champagne on ice and every second Australian planning a cheap holiday in the US, the global financial crisis hit. True to form, having come up a long and winding stairway, the \$A went down via the elevator shaft, losing 40 cents in three months to scrape 60 US cents by October. Parity was postponed, yet again.



Source: RBA

And that brings us to the present day. The \$A finally and briefly hit parity in October 2010, more than a quarter century after this event was first predicted. Sure enough, profit takers moved in on the fact. And the press is now full of talk about whether \$1.20 is doable or whether the world's fifth most traded currency gets kicked all the way back down to the bargain basement again.

Who knows? Perhaps the most sensible thing to take away from this near 30-year rollercoaster ride is that forecasting currencies – and markets generally – is a dangerous game, particularly if you are using someone else's money.

7. 'Big Mac says Dollar will Ketchup', The Australian, April 26, 2001

8. 'Dollar Rockets into New Year', The Australian, Jan 1, 2004

9. 'Aussie May Catch \$US Next Year, Pundit Says', Sydney Morning Herald, May 13, 2006

The fact is currencies and bonds and shares and commodities will rise and fall according to any number of influences – growth, inflation, interest rates, supply, demand, trade and investment flows, global and domestic political events, company or country news, changes in technology, demographic trends, changes in spending patterns.....even the weather.

To forecast financial variables, you need to be able to forecast and anticipate all those other things correctly as well. And you need to be able to do it consistently. Not only that, but you have to get the timing right.

I don't know about you, but that sounds to me like an impossible ask.

This correspondence does not take into account the personal objectives, financial situation or needs of any person. You should consider the appropriateness of the information presented having regard to your own objectives, financial situation and needs and obtain professional financial advice prior to making any decision. If you have any questions please call (08) 9791 6111.

This article was sourced from Dimensional Fund Advisors Australia

Business Profile

Since arriving from Belgium eight years ago, Zahi and Nelly Dorkhom of Dalyellup have been busy setting up businesses.

Zahi established Dorkhom Dental Laboratories in Bunbury back in 2002. With 20 years experience he provides a range of quality prosthetics including dentures, implants and mouthguards by dentist referral. "Dentists regularly compliment me for my quality and service," he said.

Nelly has been no less busy and acquired a stake in Goodlife at the Bunbury Forum in 2008. She stocks a range of health foods and products relating to vitamin supplements, organic and gluten-free foods, hair and skin care, weight loss, homeopathics, protein and sports supplements.

Naturopathic suggestions (with a complimentary 20-minute consultation) are available in store. Goodlife Bunbury also stocks a wide range of practitioner products. "We have a special focus on nutritional health and well-being," she said. "Our customers really appreciate our well-trained and friendly staff".

So pleased were Zahi and Nelly with this shop that they invested in Goodlife Stirling, conveniently located in the Stirling Shopping Centre in the Bunbury CBD, offering the same great service and products. Zahi can be contacted on 9791 1331 to discuss dental prosthetic requirements, and Nelly can be contacted at her shop on 9721 7111.

