

Putting 2008 in perspective



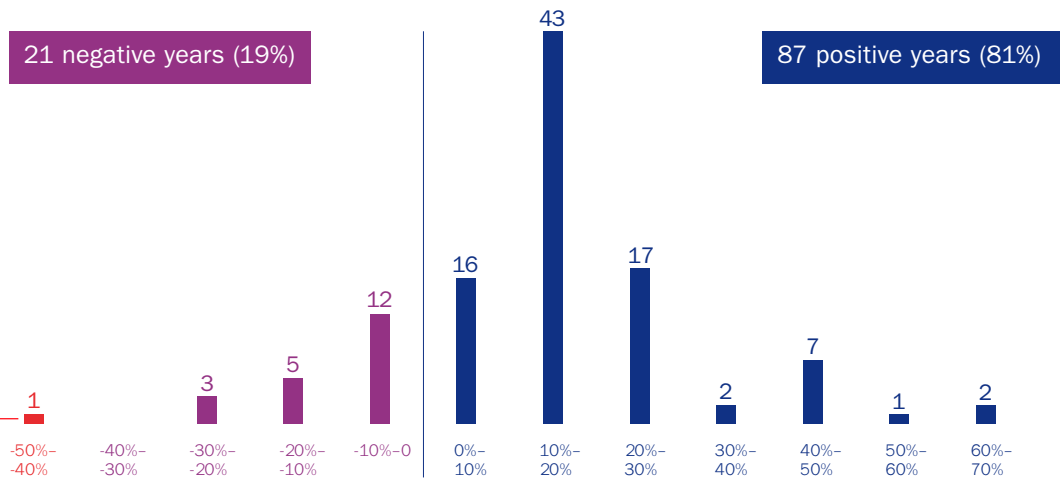
Despite drastic falls in 2008, the principles of long term investing are still relevant.

2008 was an unusually tough year for investors, as stocks around the world endured drastic falls. International shares finished the year down by 25 per cent in Australian dollars. The US sharemarket fell by 38 per cent and the Australian sharemarket experienced its worst annual result on record, with share prices dropping by 38 per cent.*

Investors are naturally feeling very anxious about the way in which markets have been behaving. As the value of hard-earned investment savings declines it's becoming increasingly difficult to resist the temptation to withdraw from market-linked investments, realise losses and head for the 'safe haven' of defensive investments such as cash.

These are uncertain times. Those investors who haven't already cashed in their losses and are still in the market are questioning their investment strategy, the value of financial advice and even the very basis of global capitalism.

Off the scale All Ordinaries Index 1900 to 2008



Source: JP Morgan

2008
Last year's results were off the scale and entirely at odds with the normal ebb and flow of market behaviour.

Over the four years from 2003 until 2007 sharemarkets generally provided investors with outstanding returns, well above the long-term average.

And, while longer term investors have more experience of market downturns, never before have we seen a calendar year produce losses of this extent.

Financial markets rise and fall over time as a matter of course. It's no exaggeration to say these are the worst market conditions that any of us have ever seen.

* ASX 200 Accumulation Index



What led to the current state of financial markets?

The credit crisis

In 2008 our global financial system came to the brink of collapse and sharemarkets around the world suffered abnormally large losses.

The credit crisis erupted when the property bubble burst in the US and borrowers who couldn't afford repayments were left with loans that were worth more than the value of their homes.

The globalisation of markets meant that problems spread very quickly. Since lenders had repackaged these loans into various forms of 'securities', often adding even more debt, and sold them to investors around the world, it wasn't clear where the debt was and who held it.

The situation escalated last September when well-known financial institutions, such as Lehman Brothers, failed, while others were bought out and in some cases nationalised. During this period trust completely broke down between counterparties and credit markets seized up.

The problems quickly spread to the broader economy, and forecasts for future global economic growth were rapidly scaled down as some of the world's major economies went into recession.

Action has been taken early

The credit crisis was the catalyst for an unwinding of excessive debt levels across the economy. While we have experienced this in previous recessions, never before have governments intervened and implemented such a wide range of global measures to stimulate economic recovery so early in the downward cycle.

While the sheer level of co-ordinated global interest rate reductions and large scale stimulus packages are history in the making, it will take time for these measures to flow through to the broader economy.

As debt continues to be unwound, we expect the global economy to slow further in the coming months and for news reports to sound very negative as companies report their declining earnings and poor outlook. This in turn is likely to cause further sharemarket volatility.

What this means for investors

At times like this it is important to remember that when there have been previous major downturns in the market, such as the 1987 stock market crash, the market has gone on to recover – even though it didn't seem likely at the time.

History shows that recovery can come without warning and occur while the economy is still in recession. This was the case for three out of four of the past US recessions, where the market turned around before recession was officially declared.

Only those who stay invested can avoid realising losses that would otherwise remain on paper and participate in the rebound. However, the extremes of recent events heighten the risk that investors will enter and exit the market at the wrong time – reinforcing the losing strategy of buying high and selling low.

Research undertaken by the US firm Dalbar which looked at investor behaviour over a 20-year period found that the average US share investor achieved a return of 4.3 per cent per annum even though the funds they invested in returned 11.8 per cent per annum. Mis-timing the market created extra risk and meant that these investors did not receive the full potential of their investment.

What we are doing

As a member of the Global AXA Group, and with \$61.6 billion of funds under management, we are well positioned to leverage our global expertise and relationships with leading investment managers around the world.

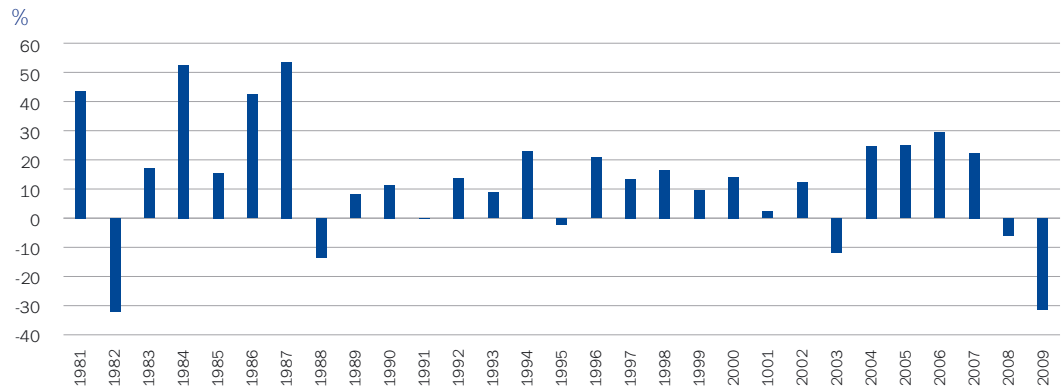
We remain dedicated and focused on:

- identifying assets most able to weather the downturn
- positioning portfolios to take advantage of new opportunities and recovery potential
- managing long-term asset allocations
- ensuring portfolios remain well diversified.

We have successfully navigated through past market downturns, and by remaining true to our investment principles we believe our portfolios are well placed to weather the storm and guide investors through to calmer times.

How should we judge 2008?

Australian sharemarket One-year returns ending March

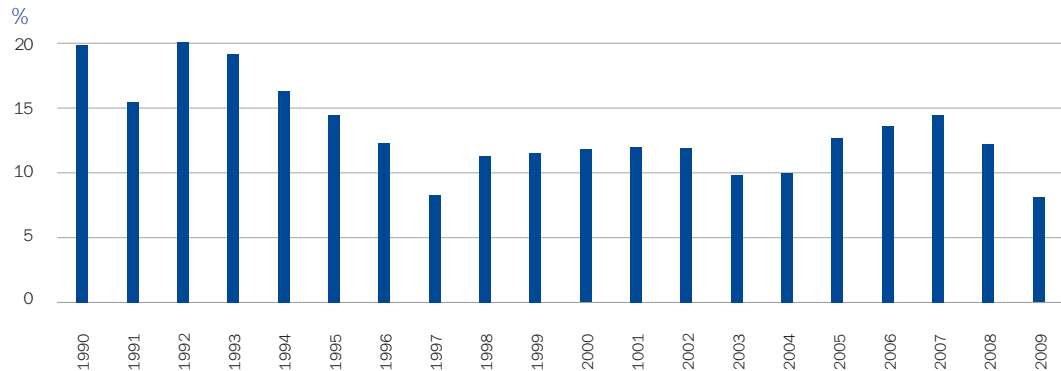


Source: IRESS

Index: S&P/ASX All Ordinaries Accumulation Index

Looking at one-year returns since 1981, there have been eight years where the Australian sharemarket lost value and 20 where it grew in value. But building wealth is a longer term exercise. Plotting average annual returns over 10-year rolling periods smooths out the extreme highs and lows and gives us a view of the market returns over a longer period.

Australian sharemarket Average annual returns ending March over 10-year periods



Source: IRESS

Index: S&P/ASX All Ordinaries Accumulation Index

This is a very different perspective and you could be forgiven for thinking the two graphs were for completely different investment situations. Given the choice of which investment journey to choose, most of us would opt for the second set of results. But that's exactly what the first set of figures gives the investor with a long-term perspective.

What does the future hold?

We cannot say with certainty what the future will bring. But years like 2008 are the exception not the rule. In all previous downturns, the markets have recovered to post new highs and there is no reason to expect a different outcome this time.

But how quick the recovery will be and how long the market will take to return to its previous high is open to debate and conjecture.

Certainly, the current crisis has exposed dysfunctional credit practices and the need for root-and-branch reform of lending standards in particular and investment banking in general. Unprecedented government intervention is likely to usher in an era of relatively highly regulated markets, more prudent risk management and conservative banking practices.

For many investors a crisis of confidence in the markets has led to a crisis of faith in the entire system of capitalism. But unless you think that capitalism itself is fundamentally flawed, global markets remain the best vehicle for recovery and long-term wealth creation, recent tremors notwithstanding.

Winners and losers

Consumers will continue to want to purchase innovative products and services. Well-run companies will continue to make money. And investors will continue to play a part in wealth creation.

The winners to emerge from the financial crisis are likely to be those investors who resist the pressure to change their investment strategy and remain committed to their long-term goals. The losers are likely to be those who retreat into a defensive bunker mentality and chop and change their portfolios in reaction to short-term volatility.

Shares or cash?

While we recognise that we are still in uncertain times, over the longer term sharemarkets appear to be well placed to recover and generate better returns than what investors can expect from defensive assets.

In the present climate defensive assets are unlikely to offer a lifeline. Cash returns, minimal at the best of times, are rapidly being eroded by falling interest rates, while even some fixed interest investments are not proving immune from the global financial crisis.

Even if it takes the Australian sharemarket as much as 10 years to recover to its high of last year, this still equates to an average annual return of 6.3 per cent. If we take dividend reinvestments and franking credits into account this return is almost double the current average return of 4 per cent that investors can get from cash.

By converting your investments into cash you may struggle to keep pace with inflation and you could also miss out on a market recovery.

Years to return to high	Annualised return (%)
3	24.3
5	14.0
7	9.7
10	6.7

Source: ipac Bloomberg, S&P/ASX 300 Price Index (excluding dividends). Index high is at 1 November 2007. Index today is at 31 March 2009. Past performance is not necessarily indicative of future performance.

The principles of long-term investing

1 Think twice before making a hasty decision

It's understandable that you might want to react to market volatility by transferring lock, stock and barrel into defensive assets and withdrawing your money from the market completely. But this short-term relief may come at a high price over the longer term. By settling for certain, but minimal, returns you can end up crystallising what is otherwise a paper loss and make achieving your long-term investment objectives much more difficult.

2 Seek quality financial advice

It's at times like this that quality financial advice becomes even more important. Your financial adviser will help you set your financial goals, help you determine your attitude to investing and how to best achieve these goals. Importantly, your financial adviser can help you along the way to make sure you remain on track, whether the markets are volatile or not.

3 Take a long-term view

Investing requires time and time rewards patient investors. It's difficult not to react when short-term volatility has eroded the value of your assets. But by reducing your exposure to growth assets you risk making a difficult situation even worse. Hard as it is, it pays to maintain a long-term perspective when considering your financial goals.

4 Diversify

Across asset classes, across investment styles, across countries. 'Don't put all your eggs in one basket' is an investment cliché for a very good reason – it is a proven way to manage risk.

The past year has seen markets fall and many funds have suffered negative returns. But the average annual returns over 10 years remain positive for all asset classes.

We believe that investors holding a portfolio diversified across growth and defensive assets remain best positioned to take advantage of market opportunities.

5 Benefit from tax-effective super

Successive Australian governments (on both sides of politics) have recognised the importance of saving for retirement and have reinforced superannuation as the preferred vehicle for Australians to save for their retirement years. Super has been granted various tax concessions to encourage investors to fund their retirement and remains a highly tax-effective vehicle, even in difficult times.

Asset class	Average compound annualised returns over five years to 31 March 2009 % per annum	One-year return to 31 March 2009
Cash	6.0	5.7
Australian fixed interest	6.4	12.8
International fixed interest	7.5	10.0
Listed property	-9.9	-57.6
Australian shares	5.5	-29.5
International shares	-1.3	-24.0
Diversified funds		
Defensive ¹	4.8	-6.1
Moderately defensive	3.7	-13.9
Balanced	2.9	-20.8
Growth	2.2	-25.8
High growth	1.6	-27.9

1 Defensive defined as 30% of investment held in growth asset classes such as shares and property with 70% of investments held in defensive asset classes such as cash and fixed interest. Balanced defined as 70% growth assets and 30% defensive assets. High growth defined as 99% growth assets and 1% defensive assets.

All figures are before any fees and taxes.
Indices used include UBS Bank Bill Index, UBS Australian Composite Bond Index, ASX 200 Accumulation Index, ASX200 Property Trust Accumulation Index, MSCI World Accumulation Index (\$A), and Lehman Brothers Global Aggregate Index.
Source: Datastream

Important information

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