History can help calm jitters

Learn from past financial crises before proclaiming the end of the world.

NOEL WHITTAKER

IT'S almost 40 years since the dismissal of the Whitlam government. In the last few days much has been written about the accomplishments and the failures of that government, yet only us older Australians who lived through it have a sense of how different the country was then.

Therefore, this column is written for those who are 55 and younger, in the hope that the lessons of that year will be of use to you in the future.

Right now, every time I make a speech there are a plethora of questions that show a fear of the future, and a belief that things are about as bad as they can get.

These feelings are not unreasonable – most developed countries are still struggling to get over the global financial crisis, while the Ebola epidemic and the strife in Iraq, Ukraine and Hong Kong are certainly cause for concern.

If you are worried now, you would have been more worried in the 1970s. The Vietnam War had ended in 1973 but the billions of American dollars spent to fund that war had created worldwide inflation. The money had been borrowed, and these borrowings had put such a strain on the American budget that in 1971 they had to suspend the convertibility of US dollars into gold.

The inflation led to wage explosions and rising industrial unrest, which led to more wage rises and more inflation. In October 1973 oil prices alone rose by a staggering 70 per cent.

The United Kingdom had its own unique problems, both with currency and debt – in America then president Gerald Ford survived two assassination attempts.

When the Whitlam government came to power in 1972 inflation was just 5 per cent, and unemployment was 2.6 per cent. By March 1975 inflation had shot up to 17.6 per cent and was accompanied by unemployment of 5 per cent. In just two years the minimum average male wage in Australia rose by 48.7 per cent.

Australian markets had been in terrible trouble. The 1960s mining boom ended with a thud in 1971 and this was followed by a property and finance crash in 1973 and 1974. I was working for a property development company at that time and I remember vividly the night all finance in Australia dried up. It was almost impossible to obtain a loan for any purpose whatsoever, and consequently almost impossible to sell a property. We thought the end of the world had come.

> The big lesson in all this is that good and bad times are always with us. It's always easy to find something to worry about, and there is always a reason to put off investing in case something goes wrong.

But markets have a habit of rebounding. By the end of 1975 Australian shares were up by 48 per cent for the year, despite inflation running at 17 per cent.

The official cash rate was around 7 per cent, with banks charging around 10.5 per cent for homebuyers. These rates do sound high today but in 1975 the average house cost just $24,000, which was less than three times the average male wage of $8600 a year.

Even though interest rates today are 5 per cent, the average house price in Brisbane has risen to $460,000 – almost six times the average income of $79,000 a year.

The big lesson in all this is that good and bad times are always with us. It's always easy to find something to worry about, and there is always a reason to put off investing in case something goes wrong. You may well have been put off investing for life at the end of 1974 – it was one of the worst market times of world history. Yet, in hindsight wouldn't it have been wonderful to have bought Westpac shares in 1975 when they were just $6.60, or a parcel of blue-chip shares when the All Ordinaries index was just 299.

Noel Whittaker is the author of *Making Money Made Simple* and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. Email: noelwhit@gmail.com.

Q I turn 65 this year and have a mortgage of $120,000. Do you think I should take this amount out of super and pay off the mortgage, or should I wait until I retire at 70?

A If you withdraw a lump sum from your super and pay it off your mortgage your effective rate of return would be the mortgage rate, which I guess is around 5 per cent. Hopefully, your superannuation can do better than that. However, if paying off the mortgage gives you extra cash which would enable you to salary sacrifice to superannuation to the maximum, paying off the mortgage with a lump sum withdrawal may be a good idea.

Q I recently inherited a blue chip share portfolio worth $50,000 and intend to reinvest the dividends where possible. How can I estimate the approximate value of the portfolio 30 years from now?

A Over the long term our stock market has averaged 9 per cent per annum. If we use that number in our projections an investment of $50,000 today should grow to $740,000 in 30 years. This assumes that all income is reinvested.

The sharemarket is driven by fear and greed, not economics

By **DAVID POTTS**

WHEN the sharemarket gets the shakes, the worst thing you can do is get them as well. Just treat it as the annual stock clearance sale, except don't go overboard because there'll be another one soon enough.

Take the other week, when it veered perilously close to a correction, generally taken to be a 10 per cent drop, only to snap back as if nothing had happened.

And that's just it. Nothing had. All that's new is the ebola scare entering the US homeland, where it's hardly a pandemic. Other viruses to rock markets, and provide unexpected share bargains, include SARS, bird flu and swine flu. Remember them? Didn't think so.

It was yet more proof that the sharemarket is driven by fear and greed; the economy isn't necessarily relevant. Even when it does count, what matters is the perception of where it's going rather than what might actually be happening, or indeed transpires.

Take the global economy. You might have a vague feeling it's slowing. That would be because both the International Monetary Fund (for the third time, no less) and the World Bank have revised down their forecasts for 2015.

But that's only half the story, or a quarter, really. The other three-quarters is that they're saying next year's growth will be stronger.

As it happens, next year's IMF forecast for Australia was even lifted a skerrick, from 2.7 to 2.9 per cent. That's less-than-expected growth of 3.8 per cent but miles above the forecasts of those we compare ourselves with. Our own Reserve Bank must think the same. The bit about local conditions in its latest board minutes had two "moderates" and one "modest" describing growth. Hmm, nothing to write home about there.

But here's the funny thing. Over the years – so I'm a slow learner – I've realised an economic statistic is not an absolute. It's what the market wants it to be on the day as seen through the prism of the central bank's likely reaction, even though nine times out 10 there won't be one.

That's why seemingly bad news, such as the impression that global growth is slowing, just as suddenly became good news.

But heaven forbid the economy might pick up. Then rates would have to rise and where would we be? A good place, surely. Official interest rates in most of the developed world are at or close to zero, or below zero in Europe where banks have to pay the central bank to take their money.

These low rates have been keeping the system going since the global financial crisis but they put the global financial system into a sort of induced coma. Nothing becomes risky any more because the alternative, super-safe bonds, earn next to nothing.

There are also mixed messages about share valuations, especially on Wall Street. Low rates boost cashflow and have undermined the US dollar, giving the big American stocks two free kicks in a row.

Since they're not investing and haven't been rehiring much, they've piled up profits which they've used to buy back their own stock, creating a virtuous circle of rising share prices.

The trouble is, while free money is being stuffed into the system by central banks markets don't have to be rational, a trait they struggle with at the best of times, I find.