ALTERNATIVES TO TERM DEPOSITS **Richard Nicholas**

Borrowers have seen the Reserve Bank of Australia cut rates by 1% since February 2012 from 4.25% to 3.25% on 2 October 2012. The graph below shows this phenomenon after a stable 2011. While the government want to take credit for declining rates, in practice it reflects a weakening economy amid China slowdown.

The table below shows how term deposit rates (TD) have varied in 2012 as the RBA have cut official interest rates:

Dates	**Institution**	**TD RATES 90 days**	**RBA INTEREST RATES**
Jan 24 2012	NAB	5.5%	4.25%
April 23 2012	ING	5.7%	4.25%
July 24 2012	Macquarie	5.0%	3.50%
Sept 17 2012	Bankwest	5.1%	3.50%
Oct 7 2012	Average	4.8%	3.25%

Source: Term deposits in Australia website, RBA official website, Infochoice at 7 Oct 2012 (Av 4.6% to 5% between 6 providers)

It must be stressed that all rates vary subject to size and institution, online or offline as well as longevity of deposit and can include 'honeymoon rate' attraction. There is also government guarantees on deposits up to $250,000.

You can see that while the RBA has cut rates by 1% in 2012, term deposit rates have fallen on average by 'only' 0.7%.

So what does the future direction of interest rates look like that influences term deposit rates?

Interest rate Futures	Dec-12	2.75%
(Source Goldman Sachs)	Mar-13	2.50%

The trend in rates is interesting, for while interest rate futures infer that further cuts are imminent over the next 6-9 months to maybe reach 2.5% (Source: Goldman Sachs), longer term trends infer that rates may rise beyond 2/3 years. Please note futures markets should not be relied upon and are only an indication upon a point in time.

Looking at Term Deposit rates further out, BankWest rates below infer that rates may start to rise after 3 years i.e. 2015 onwards

Longer Term Deposits

7-Oct-12	**90 days**	**6 mths**	**1 year**	**3 years**	**5 years**
Source: Bankwest	4.8%	4.7%	4.6%	4.6%	4.9%

In Term Deposit world, interest rates vary enormously between institution to reflect their different funding needs and credit standing capabilities. This has resulted in a 'rates war' as they attempt to hold/wrestle funds from domestic investors. This avoids the need for these institutions to borrow in the constrictive and uncertain overseas banking markets such as Europe. Amounts invested in term deposits have remained high in recent years to reflect the financial anxiety of retail and indeed institutional investors who have not been willing to put capital at risk into the stock market and other risk perceived assets.

But what will be the catalyst to reduce the presently high anxiety/low asset confidence levels that will see investors reduce their term deposit levels to dip their toes into risk assets?

Maybe a combination of Term Deposit rates below 4%; the stockmarket above 4,750 (it is up 14.8% for 12 months to 30 September 2012) ; house prices stabilizing and a reduction in negative global headlines? However as a portfolio manager, I would suggest to you that by that time the stockmarket is looking at 4,750, many of the high yields and good value in share prices may be a memory. Indeed as my mentor taught me "if you feel comfortable in your investment decision, it is probably too late!"

Let us look at some current alternatives to Term Deposits as at beginning of October 2012 working up the risk scale:

1. **Government Bond Yields (8 October 2012. Bloomberg)**
    a. **3 year bond yields at 2.44%** - unattractive relative to 90 day term deposits
    b. **5 year bond yields at 2.54%** - unattractive relative to 90 day term deposits
    c. **10 year bond yields at 3.08%** - unattractive relative to 90 day term deposits

2. **Australian Corporate Bond Yields at 11 October 2012 (Source: FIIG)**
    a. **8 year Inflation linked Infrastructure Company on current yield of 6.5%**

3. **Corporate Fixed Interest Hybrid Securities yields at 6.5% to 8.1% (Source: RBS Morgans)**
    a. The yield will vary per quality of company, the length and term of maturity and the rate at which interest is set – normally a margin over Bank Bill Swap rate
    b. You will need to take advice on such securities to ensure that the yield is attractive to your required level of risk
    c. ***Peak Fixed Interest Hybrid Model Portfolio***

i. Cumulative Historic Performance to 30 Sept 2012

12 months	***+7.1%***
2 years	***+13.9%***
3 years	***+23.9%***

Source: Praemium, Peak Investment Partners

4. Australian Equities

a. Lower risk defensive with high yields ***(Source: Peak Investment Partners)***

i. **Banks** with 2013 average **yields of 9.3% fully franked** across 4 majors

ii. **Property & Infrastructure Trusts** 2013 **yields of 5.5% to 8%** unfranked

iii. **Telstra** 2013 **yield of 10% fully franked**

b. Peak Income Model Portfolio of income shares and fixed interest securities

i. Cumulative Historic Performance to 30 Sept 2012

12 mths	***+22.1% (8.1% fully franked yield +14% capital growth)***
2 yrs	***+24.6%***
3 yrs	***+34.3%***
5 yrs	***+15.1%***

Source: Praemium, Peak Investment Partners

Investing has always been about matching your return requirement relative to your risk. In term deposits, there is little risk – particularly with a government guarantee. The return is now diminishing to the disadvantage of savers, but helping borrowers. After the market experiences of the last few years, 'sleep at night' remains an important part of an investment decision making process. Your ability to sleep with an increased exposure to risk assets will determine where in the above alternatives you may fit. These are frequent conversations that we have with our existing clients and prospective clients at Peak. Please note that this is general advice not personal advice and readers should seek advice from their financial adviser.

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