

# EUREKA *report*



## Fixed interest's promise

By Elizabeth Moran  
June 27, 2011

**PORTFOLIO POINT: The right fixed interest products can legitimately promise to double your money in 10 years.**

One of the most frequently repeated maxims of the Australian property investor over the past decade has been that compounded returns from property of 7% over 10 years will allow you to double your money.

With the help of the spreadsheet below, I can prove quite quickly that if your money is only compounding annually you will stop just shy of the sought-after 100% return over 10 years. If the interest is being compounded more frequently (say quarterly) then you can be reasonably comfortable that you will reach your goal.

Fig 1: Compounding over 10 years at 7%

Year	Start value	Rate of return	Interest earned	End date
1	\$ 100.00	7.00%	\$ 7.00	\$ 107.00
2	\$ 107.00	7.00%	\$ 7.49	\$ 114.49
3	\$ 114.49	7.00%	\$ 8.01	\$ 122.50
4	\$ 122.50	7.00%	\$ 8.58	\$ 131.08
5	\$ 131.08	7.00%	\$ 9.18	\$ 140.26
6	\$ 140.26	7.00%	\$ 9.82	\$ 150.07
7	\$ 150.07	7.00%	\$ 10.51	\$ 160.58
8	\$ 160.58	7.00%	\$ 11.24	\$ 171.82
9	\$ 171.82	7.00%	\$ 12.03	\$ 183.85
10	\$ 183.85	7.00%	\$ 12.87	\$ 196.72

Source: FIIG Securities

With the heat already dissipating from the property market, the idea of doubling your money in every 10 years has begun to take a back seat to more conservative investment horizons of 20 and 30 years.

The RP Data-Rismark Home Value Index has shown a national decline in average home prices of 1.5% in the year to April 2011, partially offset by a rise in rental yields over the same period with houses returning a gross 4.2% and apartments a gross 4.9%.

Average superannuation returns for 2010 were even worse, coming in around 4.1% while the benchmark for government bonds, the UBS Composite Government Bond Index, returned 5.46% over the same period.

So as you can see, asset classes of all kinds are having difficulty in achieving the much sought-after 7% compounded return.

Although asset prices will always be volatile, investors can seek out known returns for set periods from a variety of fixed interest products. Fixed interest products such as those I list below can deliver set rates of return without forcing you to commit to a multi-decade investment horizon.

Figures 2 and 3 show a range of securities available to retail investors with a minimum investment of \$50,000 that will deliver a yield as stated, provided they are held to maturity. It must also be said that each of the securities listed have different risk/reward characteristics.

The best way of achieving known returns is to invest in fixed rate bonds because the coupon you receive will not change throughout the life of the bond.

If you pay careful attention to the columns in Figure 2, you'll notice that the yield can be higher than the coupon. In this instance, the bond is trading at a discount to (less than) the face value of \$100, which inflates the yield.

The reverse is also true, where a lower yield means the bond is trading at a premium (higher than) face value.

For example, the Rural Bank bond, now 100% owned by Bendigo & Adelaide Bank, was trading at \$106.50 with accrued interest of \$3.359 to give a total price for a \$100 face value bond on June 20 of \$109.859. If an investor paid a premium to acquire this bond and held the bond until maturity, at which time they would receive \$100 face value, they would incur a capital loss.

If you take into account that the yield an investor receives comprises the capital appreciation or depreciation of the bond until maturity and the coupon paid over the life of the security you should be well on your way to doubling your investment capital over 10 years.

**Fig 2: For retail investors – \$50,000 minimum investment**

Issuer	Coupon type	Coupon/IM	Yield #
HBOS Plc	Fixed	6.75%	19.87%
AXA SA*	Fixed	7.50%	10.35%
Præco Pty Ltd	Fixed	7.13%	8.00%
Vero Insurance Ltd	Fixed	6.15%	7.77%
National Wealth Management	Fixed	6.75%	7.54%
Suncorp Metway Insurance Ltd	Fixed	6.75%	7.45%
Rural Bank	Fixed	9.50%	7.43%
Leighton Finance*	Fixed	9.50%	7.41%

\* Minimum \$100,000 parcels # To first call date

Source: FIIG Securities (yield at June 20, 2011)

There are also some floating rate notes available that deliver yields of over 7%, however, the coupon component of the return is linked to an underlying benchmark, in most cases BBSW (or the bank bill swap rate). The coupons are reset quarterly, so that ultimately the yield will be influenced by changes in economic conditions that are reflected in the RBA's setting of the cash rate.

In other words, the yield is not guaranteed to return over 7% for the life of the security but linked to the RBA's view of the economy, which may be a positive in an environment of rising inflation but less welcome in periods of low growth.

**Fig 3: For retail investors – \$50,000 minimum investment**

Issuer	Coupon type	Coupon/IM	Yield #
HBOS Plc	Floating	0.26%	19.28%
AXA SA*	Floating	1.40%	10.33%
Dalrymple Bay Coal Terminal (BBI)	Floating	0.37%	7.82%
Vero Insurance Ltd	Floating	0.70%	7.70%
Suncorp Metway Insurance Ltd	Floating	1.00%	7.58%
National Wealth Management	Floating	0.63%	7.28%
Morgan Stanley	Floating	0.47%	7.16%

\* Minimum \$100,000 parcels # To first call date

Source: FIIG Securities (yield at June 20, 2011)

The two tables above show bonds available to retail investors. Those that satisfy the "wholesale investor test" also have access to the following bonds, see Figure 4 below. (Note that these are also priced at \$50,000).

Fig 4: For wholesale investors only – \$50,000 minimum investment

Issuer	Coupon type	Coupon/IM	Yield #
Swiss Reinsurance*	Fixed	7.64%	10.39%
Suncorp Metway Insurance Ltd	Fixed	6.75%	8.16%
Rabobank Nederland	Fixed	6.42%	7.65%
Stockland Trust Management	Fixed	8.25%	7.16%
Mirvac Capital Pty Limited	Fixed	8.00%	7.09%
Swiss Reinsurance	Floating	1.17%	10.58%
Bank of Queensland	Floating	3.75%	8.42%
Rabobank Nederland*	Floating	0.67%	7.66%

\* Minimum \$100,000 parcels # To first call date

Source: FIIG Securities (yield at June 20, 2011)

Rabobank and Investec also offer term deposits with a 7% interest rate or more (see Figure 5 below). One of the downsides with term deposits is that you lock away your funds for five years and if you want to access those funds, banks usually charge a break-fee, compared to bonds that can be sold at any time on the secondary market.

Fig 5: Term deposits offering 7% or better

Issuer	Min investment	Term	Rate	Interest paid
Rabobank	\$1,000	5 years	7.00%	Annually
Investec - Retail Client	\$25,000	5 years	7.18%	Annually
Investec - Wholesale Client	\$150,000	5 years	7.33%	Annually

Source: www.termdeposit.com (prices at June 24, 2011)

To double your money in 10 years, you'll need to reinvest returns to compound the interest. The current Rabobank term deposit with a minimum investment of only a \$1000 would help an investor of any means to achieve their goal of doubling their money in 10 years.



Elizabeth Moran is director of fixed income research at **FIIG Securities**.