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INVESTORS WARNED

Get used to low rates: Reserve

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Low interest rates are the new black.

So says Reserve Bank deputy governor Philip Lowe.

Mr Lowe told a leading forecasting conference this week that after years of boom times in the 90s and noughties, investors would have to adjust their expectations to the "new normal".

"Most consumers and businesses now view it as usual, typical or expected that inflation will average two-point-something over time," Mr Lowe said.

"For most of the past 20 years we were benefiting from either the credit boom or the terms-of-trade boom.

"Under the influence of these two factors one might expect, all else constant, higher average lending rates than otherwise."

The unwinding of the credit and trade booms would mean low interest rates for longer than Australians had been used to.

Financial advisers at the *WestBusiness, Your Money* Finance Forum this week predicted this would have a big impact on investor behaviour.

They will now be seeking out the returns offered by dividend-paying stocks, which are offering post-tax yields well over double those available from bank deposits.

All the Australian deposit-taking institutions on the rates comparison site Canstar last week were offering interest rates below 5 per cent for deposits of $25,000 of four years or less, and only three had rates at 5 per cent or marginally above.

Entrust Private Wealth Management chief executive Graeme Yukich said it was likely that Australian interest rates would be low for several years but the investing public had not yet adjusted to the new reality.

Investors in the US had to seek higher growth assets such as shares because their banks had been offering deposit interest rates well below 1 per cent and closer to zero.

"Here in Australia, we have had a fantastic alternative . . . leave the money in the bank," he said. "That is last year's game, that game has now changed.

"It is going to be an interesting dynamic to see how people adjust to that."

Investment manager Sharon Hicks, of NWQ Capital Management, has warned of the dangers in the yield chase. Ms Hick said yield hunters would underpin the share market early next year before a reality check later in the year for the Australian equities market because of a tough earnings outlook.

Ms Hicks said she knew of a lot of new issues of hybrid securities as well as increased demand by investors, some of whom did not understand the nature of such instruments.

"People can get an impression that they are defensive assets that sit in a portfolio, but they tend to be highly correlated with the equities market," she said.

Morgan Stanley senior vice-president Stuart Beattie said the share market was the opposite of the situation before the global financial crisis in 2007 when bank stocks were yielding about 4.5 per cent and deposits were offering more than 7 per cent. Mr Beattie said he expected investors to initially tread carefully, but warned the yield chase could ultimately become the next bubble.

"Then the herd will run the other way," Mr Beattie said.

Mr Yukich said the process of the market becoming a bubble could take a number of years, pointing to the five-year build-up to the over-valuation of bank stocks in 2007 from a similar situation today.

Smith Coffey principal Stephen Jones said that the combination of yield and a threat of renewed inflation would see a return to growth assets, but he would not predict when this was likely to happen.

"It comes back to behavioural finance and when people feel confident," he said.