



FINANCIAL PLANNING

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Seven things for investors to consider for the 21st century

The world has changed immeasurably in the past 30 years. The next three decades seem likely to yield even more drama as significant themes exert their influence on a more connected world.

Change is upon us. Investors must either embrace change or risk missing out on some of the biggest investment themes in a generation. But what are the investment implications? This article discusses how investors can position themselves.

Remember, though, that making predictions is fraught. It is virtual guesswork to say what level the Dow Jones Industrial Average will be in five years time. However, when it comes to the big, secular themes that are influencing economies and financial markets, there is more scope to be forthright and more reason for investors to take action.

Most of the themes that appear set to be prominent in the 21st century – the rise of the east, growing consumption and urbanisation in emerging markets, the changing demographics and ageing of the world population, the challenge of feeding and powering the world, technological and climate change, the rise of Africa – are visible and investible, or will be soon enough.

Attaching relative weights to a group of highly interconnected themes is tricky, however. Intuitively, the epochal power-shift from west to east and the emergence of China and India must surely be given most weight. It is the underlying dominant theme which recurs, or acts as a catalyst, in many of the others.

Beyond this, it becomes more difficult to attach weightings. Is finding a solution to our energy needs more important than alleviating pressure over food and water? In truth, they are related, not least because bio-fuels are reducing the amount of arable land for food.

This is where technological progress is crucial. Encouragement can be taken from the fact that every time the world has pushed up against resource limits in the past, mankind has overcome the situation. This time is different. This time we have even more brains from around the world, tackling the problems in energy, food and water, providing incremental advances and occasional step-changes that sum over time to extraordinary technological progress. It is technological progress that powers economic growth over the very long run.

Seven things to consider

Here then are seven key things long term investors might want to consider if they want to tap into the rewards on offer

from the 21st century investment themes:

- 1. Invest more in emerging markets, beware of home bias.** Investors need to ensure they have enough exposure to emerging markets but many remain under-invested for two reasons. First, although allocations have picked up from negligible levels, they still do not reflect the significant and growing share of global GDP attributable to these economies. The other is that investors tend to be over-exposed to their home markets.
- 2. Take a long term view.** Investors must step back from the occasional hyperbole that crops up about emerging market bubbles and remember that the long term outlook is compelling. There will be blips, on an upward sloping curve, but they should not stop investors. Remember that industrialising economies such as China can sustain much faster annual growth rates as they are emerging from a low base.
- 3. Include frontier markets such as those in Africa.** Incredible as the growth of China is, don't just bet on one emerging country. An allocation to emerging markets should include a range of economies at various stages of development. If you have China covered, then consider frontier markets in sub-Saharan Africa, for example, which have vast mineral wealth and huge consumption potential. Or Indonesia, Nigeria, Mexico, and Turkey. These countries have large populations and fast growing economies and are mooted as next big things.
- 4. Invest in real assets.** Some economists argue that we are entering an inflationary age. Moderate inflation is not bad for equity markets. But, some doom mongers are predicting a worse outcome due to the alleged inflationary effects of central bank asset buying programs combined with higher commodity prices (particularly food and energy). It seems sensible for investors to include inflation protection, such as inflation linked bonds, in their portfolios. However, other economists are more sanguine, given spare capacity in western economies. Meanwhile, emerging economies are in the midst of an urbanising age; one that requires infrastructure build and raw materials. An optimal strategy, therefore, may be to remain in equities but tilt the bias of investments towards real assets whose prices rise with inflation. By investing in companies that have pricing power such as miners of industrial and precious metals, investors can participate in corporate growth and generally beat inflation. Given constraints on supply, these companies tend to benefit disproportionately from higher global growth.
- 5. Remember to add food and water.** Fertiliser and agricultural companies stand to benefit from growing demand for food and changing diets in developing countries. Similarly, companies that build desalination and water management infrastructure and that can provide access to clean water should have full order books as demand for water intensifies across the world.
- 6. Consider consumption.** As emerging economies grow and become wealthier, the global middle class will expand rapidly and consumption will soar, particularly in the discretionary segment where branding is key. Beneficiaries will be based in western and emerging markets.
- 7. Do not ignore pharmaceuticals.** Pharmaceuticals have been overlooked even though their industry outlook appears bright. A massive expansion in middle class consumer populations in emerging markets, combined with people living longer, particularly in developed economies, paints a rosy picture for global healthcare spending. There is scope for the best generic and branded names to benefit.

Important information Investments in small and emerging markets can be more volatile than in more developed markets. Investments in overseas markets can be affected by currency exchange and this may affect the value of your investment.

Always speak with your financial planner when making investment decisions.

Source: Fidelity Australia, 2011

Living longer: how to make your retirement savings last the distance

Until you experience a serious injury or illness, it's very easy to think that it'll never happen to you.

It's no secret we are all living longer: female baby boomers have a 50% chance of living beyond age 90, and males a 34% chance. But before you start planning how many more overseas trips or rounds of golf you can squeeze into these extra post retirement years, there is the small matter of how to pay for it.

It is a serious issue to know about longevity risk; longer living means taking extra measures to ensure an appropriate

income to maintain your desired lifestyle for those 25-odd post retirement years. The key to managing longevity risk is to boost earnings, manage drawdowns, accelerate returns and time taxation accurately (see Figure 1).

However many Australians are not conscious enough of longevity risk and ways to mitigate this risk. For example, in the aftermath of the global financial crisis many people flooded money too heavily into term deposits which they perceived as safer.

In fact, term deposits increase longevity risk because the average term deposit interest of around 6%, as well as no capital growth, is not going to be enough to provide a decent income in retirement without having to sell assets.

Tax considerations are always important for investors but in retirement the benefits can be even greater. The money you save by being smart about tax can help combat longevity risk.

A tax deferred income fund, for example a direct property fund, normally pays distributions to investors. The tax on this income is deferred until the property trust investment is sold, at which point an investor pays tax at their marginal tax rate. The advantage for an investor in or near retirement is this rate could be much lower than their working tax rate. Also capital gains tax rules mean only 50% of the gain is taxable if an investment is held for more than 12 months – this is also relevant to tax deferred income funds.

According to a report Charter Hall recently commissioned with Strategy Steps, a leading provider of technical and investment services, investors need to construct their portfolios carefully to avoid falling into such traps. An example of how a portfolio might be structured using these principles is in Figure 2.

How to longevity-proof your savings: the investment risk/return conundrum

We have established that boosting income and not allocating too much to overly defensive assets like term deposits is important, so the question now is which investments are appropriate for those in or nearing retirement?

It can be difficult to identify income producing investments without taking on too much investment risk near retirement as any major losses can leave an investor with a big hole in their savings and little or no time to recover.

Figure 1 – The four keys to managing longevity risk

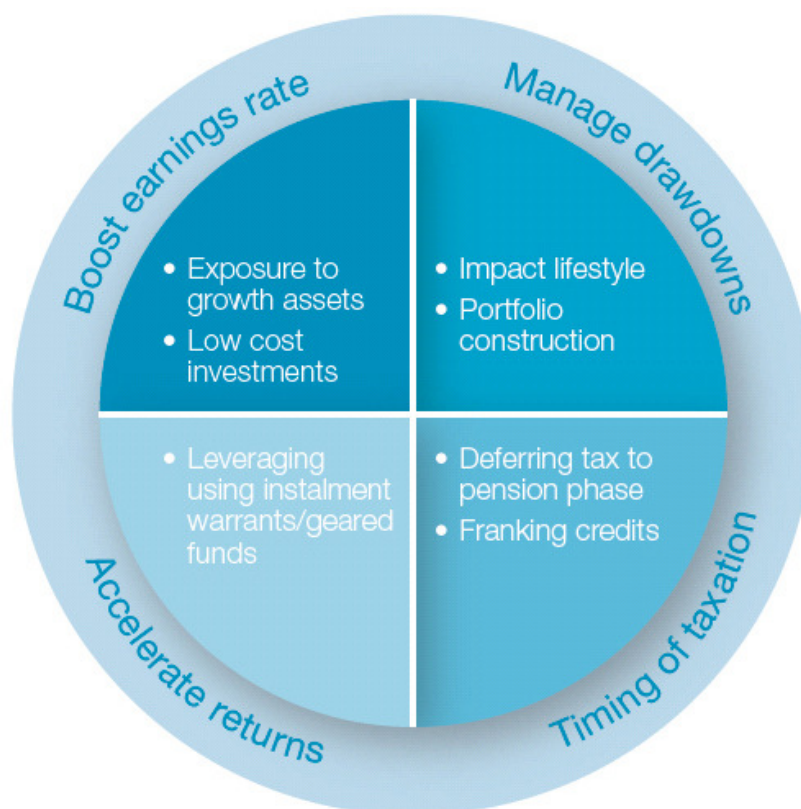


Figure 2 – Structuring the pension portfolio

Strategy 1: Draw pension from a cash bucket

Aim: Protect against market volatility in the early years by ensuring growth assets do not need to be sold to make pension payments

- Separate the portfolio into cash and growth portfolios and draw the income only from the income portfolio
- Income portfolio will hold secure investments e.g. cash. Place 2-3 years of income in the income bucket/portfolio
- Remainder of the portfolio is in growth based diversified portfolios

Strategy 2: Draw pension from balanced/growth portfolio

Aim: Select a portfolio to balance the growth potential and maintain diversification

- The portfolio is constructed based on a strategic asset allocation that fits with the client's risk profile. This often relies on the use of model portfolios for a balanced or growth risk profile
- Income drawn proportionally from all assets to maintain asset allocation

Combating longevity risk by minimising tax

Tax considerations are always important for investors but in retirement the benefits can be even greater. The money you save by being smart about tax can help combat longevity risk.

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Case study:

Adrian is two years away from retirement and invests \$20,000 in a direct property trust via his self managed superannuation fund (SMSF). The investment pays an income distribution of 8%, of which 70% is tax deferred. The tax rate of Adrian's super fund is 15%.

Adrian's super fund will receive an income return from the property trust of \$1,600 p.a. of which \$1,120 is tax deferred and \$480 is taxable in each financial year. This equates to Adrian paying \$72 in tax each financial year as the tax on the remaining income amount is deferred until the investment is sold.

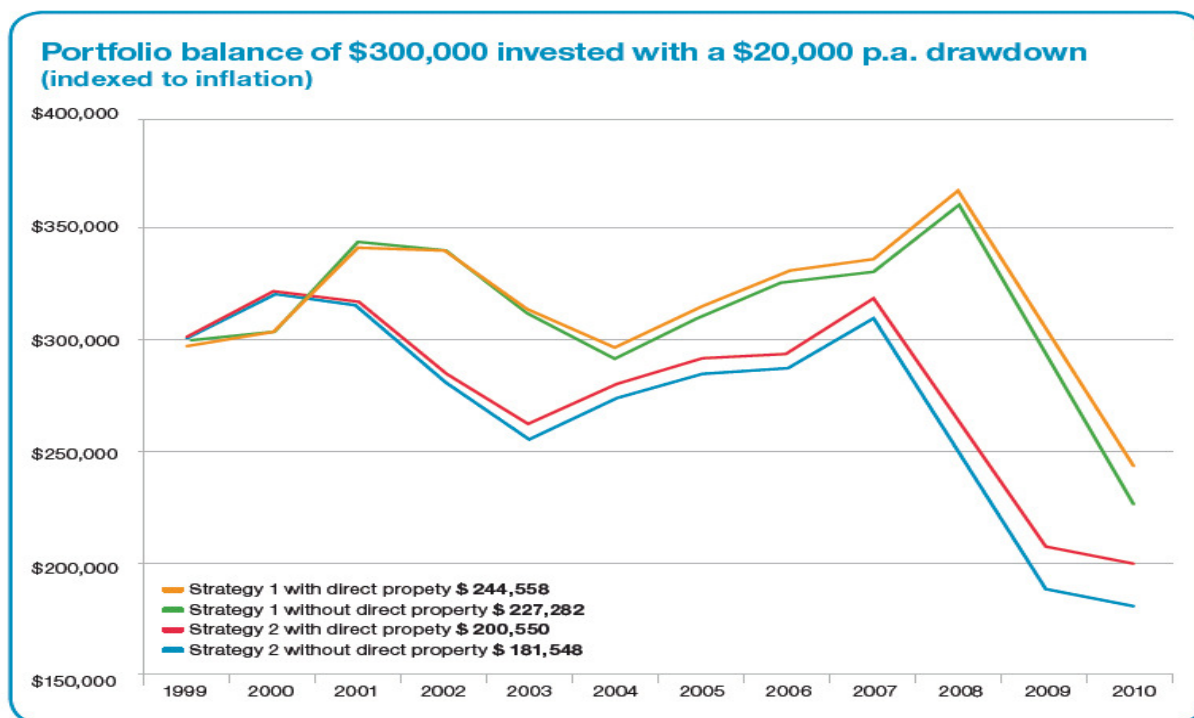
At retirement, Adrian transfers the investment from his super fund to allocated pension funds. This does not trigger an income or capital gains tax (CGT) event.

Adrian decides to redeem the direct property investment after he retires. The deferred income amounts are included in the CGT calculation. Any CGT is taxed at the pension funds marginal tax rate, which is zero. Effectively Adrian pays no tax on any capital gain made on the trust and the deferred tax income amounts are tax free.

	Income	Tax rate	Tax deferred amount	Taxable amount	Tax payable
Year 1	\$1600	15%	\$1,120	\$480	\$72
Year 2	\$1600	15%	\$1,120	\$480	\$72
Redeem investment		0%		\$2,400	\$0

Thanks to the tax deferred component and zero capital gain tax payable, Adrian's SMSF is \$336 better off (i.e. tax payable - tax paid x 2 years, or \$480 - \$72 x 2 years).

Figure 3 – Comparison of strategies



The good news is there are some solutions for those wanting high income and capital growth without the risk of volatility and investment losses that may come with higher growth assets.

For instance, direct property funds provide high, tax effective income and capital growth. Direct property is less dependent on the investment cycle, less volatile and has low correlation to the share market. See Figure 3 for a graph comparing the returns on various portfolios including direct property, which shows those that include direct property can perform better.

As outlined in Figure 3, over a ten year period, including the global financial crisis, Strategy 1 with the provision of up to 3 years cash for pension payments, provides greater preservation of capital and a higher portfolio balance. Where direct property is included in both Strategy 1 and Strategy 2, better investment results are produced.

With this in mind, investors should be aware of longevity risk and work with their adviser to help manage this risk. Speak with your financial planner about how to increase the longevity of your savings.

Source: Richard Stacker, CEO Charter Hall, Direct Property

Is self managed super right for me?

Self managed super funds are similar to other super funds as they are designed to help you build your super savings so you can have the lifestyle you want in retirement.

The key difference is that all members of SMSFs are trustees and directly control the fund. They are responsible for the fund’s assets and investments, paying the benefits and ensuring that the fund is compliant.

While SMSFs can mean more control and flexibility over your super savings, they are not for everyone as they require a much higher level of time and attention to administer and manage.

Requirements of an SMSF

- Funds can have up to four members and each member is generally a trustee of the fund.
- The fund must operate for the ‘sole purpose’ of providing benefits to its members upon their retirement.
- No member of the fund can be an employee of another member, unless they are related.
- The trustees/members do not receive any remuneration for their services as a trustee.
- Members/trustees of the SMSF are required to prepare and implement an investment strategy for their fund.

This provides a framework and direction for the investment of contributions.

- The fund has wide flexibility in investment choices. Direct property, managed investments and direct shares can all be included in an SMSF portfolio.

The key issue with SMSFs is that members/ trustees are ultimately responsible for ensuring that the SMSF remains compliant with the law. The responsibilities and obligations are numerous so it is important to discuss with your financial adviser whether an SMSF is for you.

Things to consider

Deciding to set up an SMSF is an important decision that you should consider very carefully. The following information outlines some of the advantages and disadvantages of SMSFs.

Benefits of SMSFs

Greater control

An SMSF gives you control to choose your own investment strategy. As the trustee you are responsible for managing the investment strategy and the underlying investments of the fund.

Investment choice

An SMSF gives you greater flexibility in your choice of investments under certain conditions. Your portfolio can generally include a wide range of investments such as managed funds as well as direct assets such as bonds and shares.

Cost

Trustees of SMSFs also have greater ability to manage the fees paid by the fund. By selecting and managing your investments carefully, you can keep the fees you pay at a minimum.

Tax efficiency

SMSFs are treated for tax purposes exactly the same as other superannuation funds. This means they receive the highest concessional tax rate of 15%.

Total wealth management

SMSFs may also provide you with a range of options in terms of estate planning and flexible benefit payments.

Considerations for SMSFs

Stability

SMSFs are not suited to everyone so it's important that you understand the risks as well as the benefits. Your financial adviser will be able to help you decide if an SMSF suits your circumstances.

Responsibility

As the trustee, you are ultimately responsible for the fund. You need to have a good understanding of the rules and regulations for operating an SMSF. It is also important that you keep up to date with the latest developments in investment markets and legislation. Financial professionals such as your adviser or accountant can help you manage your fund.

Administration

The administrative requirements of running an SMSF are quite time intensive so you need to ensure that the management of an SMSF will fit into your current lifestyle.

Costs

If you are considering setting up an SMSF, you will need to investigate the associated set-up costs and then the ongoing accounting, brokerage and adviser fees. You will also need a sufficient account balance to make it cost effective in the

long run.

Speak with your financial planner about whether an SMSF may be the right approach for you.

Source: Russell Investments, July 2011

Testamentary trusts – take control and gain peace of mind

By creating a testamentary trust, your long term plans for your estate can be fulfilled. The process is simple and the peace of mind is priceless.

These are just some of the many benefits of a Testamentary Trust:

- benefits of estate tax reduction strategies.
- restriction of access to the assets and income of the estate by your beneficiaries.
- ability to provide care for the mentally disabled.

Case Study

Mark and Rebecca loved travelling and often took their children Jessica and Michelle on day trips along the coast on weekends and holidays. Unfortunately, on one of the weekend holidays, the family was in a serious car crash, killing Mark and Rebecca.

Although both children survived, Jessica's back was broken and her hospital bills and ongoing care turned out to be far more costly than Michelle's.

In their Wills, both Mark and Rebecca had equally divided their money and assets left to their children. However, the executor of Mark and Rebecca's estate, Rebecca's mother, felt that with Jessica's ongoing care, her financial needs were far greater than Michelle's. Rebecca's mother feared that if she gave Jessica a greater share than what was outlined in the Wills, she may be held liable by Michelle when she was older.

If Mark and Rebecca had seen a professional financial planner, they would likely have been advised to arrange testamentary trusts for Jessica and Michelle as well as another trust to provide for unseen or unequal needs.

It is extremely important to seek professional financial advice first. This advice will assist you make the best decisions for you and your family's circumstances and establish an estate plan that fulfils your wishes.

Your financial planner can help you take control of your assets and income – while capitalising on your tax efficiency – to ensure your estate is distributed according to your wishes.

By being in control, you and your family can enjoy peace of mind. Talk to your financial planner about testamentary trusts today.

Source: Lonsdale Financial Group Limited

Just ask Geoff – a claimant's story

Many people go through enough pain and grief when dealing with their illness or injury, let alone the stress that comes along with not having an income to support their family. That's why it is important to ensure you have the appropriate risk cover in place.

Geoff and his adviser David's real names have not been used to protect their privacy.

Geoff thought the world was at his feet as he prepared himself for retirement, until he was diagnosed with a life threatening illness.

The following is an extract from a letter Geoff's insurance provider received from him...

Six weeks ago I was diagnosed with bowel cancer and secondary liver cancer.

My initial diagnosis was three to six months and I was facing the possibility of a major operation to remove the cancer in my bowel. By the afternoon, after my second visit to the specialist, my life expectancy had been reduced to between six weeks and three months.

I phoned my insurance adviser David, who I had known for 19 years and who had originally assisted in putting my insurance cover in place. Within three days of submitting a claim, I received my first payment of \$653,535 and then another payment which brought the total payment to over \$1.2 million.

Although I have not met the people who have been involved, David kept me informed of everyone's efforts to ensure that my claim was processed in the most efficient manner. I am sure this has a lot to do with the excellent relationship that he has with my insurer and the fact that the right advice was given in our situation.

I would like to express our thanks for relieving me of the financial burden and worry that I would have faced if I did not have this cover.

The payments from his insurance enabled Geoff to obtain an expensive medical treatment from Japan, only available to a few patients around the world. After taking this medication for over six months, Geoff was recently informed that his once-inoperable cancer is now operable.

This surgery will hopefully extend Geoff's life expectancy significantly, enabling him to spend more time with his family.

Speak with your financial planner today to ensure you have adequate risk cover in place.

Source: AIA Australia Limited, 2011

Michael Savy – our Qualified Financial Advisor is able to provide answers to any of your questions regarding:

Retirement Planning	<ul style="list-style-type: none"> • Income Stream Structuring • Account Based Pension • Annuities / Complying Income Streams • Centrelink / DVA • Aged Care- Nursing Home
Superannuation	<ul style="list-style-type: none"> • SMSFs • Superannuation Investment portfolio • Contribution amounts
Wealth Accumulation	<ul style="list-style-type: none"> • Investments / Portfolio Construction • Tax Effective Strategies • Gearing • Margin Lending • Child Education Bonds
Risk Management	<ul style="list-style-type: none"> • Term Life • Total and Permanent Disability • Trauma • Income Protection • Business Protection – Buy/Sell Agreement • Key man insurance
Salary Packaging	<ul style="list-style-type: none"> • Salary Sacrifice arrangements • Benevolent Institutions
Estate Planning	<ul style="list-style-type: none"> • Superannuation nomination • Review of Wills and EPAs

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