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Investment Solutions

Spring 2010

The family portrait edition
Build a healthy and wealthy family tree

What's inside:

Snippets

The family portrait edition

Wealth is something an individual will generally work hard to achieve. Sharing experience and knowledge gained over the years with family members can help the whole family make sound financial decisions.

What steps can you take to ensure strong, solid foundations for your family's financial future? In this issue we present a snapshot of strategies your financial adviser can recommend to promote healthy growth and protect your wealth and your family, no matter what your life stage.

Did you know?

If your net medical expenses (expenses you've paid, less any refunds you got or could get from Medicare or your private health fund) were more than $1,500 for 2009/10 and you haven't lodged your tax return yet, you can claim a 20% tax offset for the amount you've paid out over and above the $1,500. At the time of writing, the government had proposed to increase the $1,500 threshold to $2,000 from 1 July 2010.

One last tax tip: a tax refund is always welcome and it's tempting to go out and spend it. But if you're smart, you'll put it to good use by paying off debt.

Taking charge of tax

Although another financial year has come and gone, it's never too early to start thinking about tax strategies that could help reduce your tax bill next time around.

Will you be paying an accountant or tax agent to prepare your tax return? Don't forget, you can claim this expense as a deduction in your next tax return. You can also claim certain work-related expenses (including travel), self-education expenses and donations to charity. Get into the habit of keeping all your expense receipts for the year in one place so you don't miss those expenses you might be able to claim.

Super future

Taking on board recommendations from the recent Henry Tax Review, the government announced an increase in superannuation guarantee (SG) employer contributions starting in 2013. The current 9% SG contribution will increase by 0.25% per year for the first two years and then by 0.5% per year until it reaches 12% in the 2019/2020 financial year[1].

What will this mean for future generations? From 2019, a typical working Australian aged between 15 and 24 will have contributed $150,000 more to their super by the time they reach age 65. The increase should also add $39,000 more to the super balance of 45 to 54-year old[2].

Your financial adviser can recommend smart strategies as part of your financial plan to help ensure you make the most of your options.

[1] This is a proposal only. It hasn't yet been legislated and may change depending on the outcome of the 2010 Federal election.
[2] AMP.NATSEM Income and Wealth Report: Saving Tomorrow

Wealthy and wise – Retirees

Smart financial planning throughout your working years can pave the way for a comfortable retirement. Once you have retired, it pays to review your estate plan regularly to help build a secure financial future for your family.

Wise financial choices over the years can help your plans for a stress-free retirement. As a retiree, you may be in the enviable position of owning your own home and have accumulated savings, investments and other assets over the years.

So what's next? Where does your family fit in with your own plans for the future?

It's not just about a financial plan

At this stage in your life, you want peace of mind that all your affairs are in order so that you can relax and enjoy your retirement years. It's essential to not only have a financial plan but a sound estate plan.

Your estate plan helps to ensure that ownership and control of your assets passes to your beneficiaries in the proportions you would like. An estate plan can also help reduce the tax impact on your estate. It can be structured to protect assets in the event a beneficiary encounters legal difficulties (for example, bankruptcy).

One important aspect of your estate plan is to appoint a trustworthy attorney. This needs to be someone you can rely on to make sound financial decisions on your behalf.

Under the different States and Territories laws some attorneys can also make personal and medical treatment decisions for you.

You should review your estate plan regularly, particularly when an important event occurs. For example the birth of a child, death of a relative who is a beneficiary of your estate or change in your marital status (through divorce, marriage, or death of your spouse).

Many events can trigger a change in circumstances for you and your family. At these times it pays to think about whether your estate plan still meets your needs and objectives.

In conjunction with tax and legal professionals, your financial adviser can help structure an estate plan to suit your personal circumstances.

Did you know?

Your Will is automatically revoked or becomes invalid on the day you get married or are formally divorced by a court. You'll need to make a new Will to ensure your wishes in relation to your estate are carried out, unless you have structured your Will to take a future marriage or divorce into consideration.

Once you've signed a Will, you can't alter it, either by crossing out or writing in new clauses, although you can amend it by a separate document known as a 'codicil'. In some instances it can be simpler to make an entirely new Will.

Imparting wisdom

You've grown your own wealth by making wise (and potentially some not-so-wise) decisions. The younger generation is expected to be the wealthiest generation over time; this is largely a result of their position as beneficiaries of the estates of your generation. Help the younger generations make good decisions with their impending wealth by sharing what you've learned, giving them the opportunity to benefit from your experience, your financial triumphs and mistakes.

Do your young relatives have a plan for their future and strategies to help reach their financial goals? Can you inspire them to start thinking about where they want to be and how they are going to get there?

One of the most common goals for young Australians is to own their own home. You could consider giving children or grandchildren an incentive to listen and take your advice on board. For example, you might offer to help with a deposit for a home, on condition that they also take steps towards saving the deposit themselves.

Our article on page 6 outlines some of the strategies that would-be young home-owners might consider.

Gifting

If you do decide to give money to a family member to help them out financially and you're likely to be claiming a Centrelink pension or allowance in the next five years, you'll need to consider Centrelink's 'gifting' rules.

A single person or a couple can give away $10,000 in each financial year or $30,000 in any five consecutive financial years. Any excess you give is classed as an asset of yours by Centrelink (for the next five years), so it may still affect the amount of pension or allowance you receive.

Your financial adviser can help you with your estate planning gifting decisions.

Road to retirement – pre-retirement

The closer you get to retirement, the more important it is to make the most of investment and tax strategies to boost your super savings. It's also a good idea to safeguard your assets.

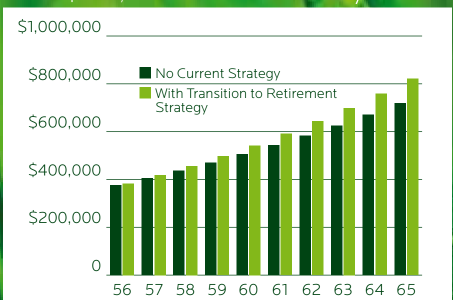
The recent global financial crisis affected different people in different ways. Investment markets have stabilised in recent months, but some people still lack confidence in the market. If you're over 55 you could benefit from a pre-retirement strategy, such as a transition to retirement strategy – even if markets fall.

Transition to retirement strategy – a case study

Neil is 55, works full-time and earns $76,000 a year. He has $350,000 in super, of which $100,000 is a tax-free component. His financial adviser recommends a 'transition to retirement' (TTR) strategy whereby Neil:

- Salary sacrifices $25,000 to super each year (which includes his employer's compulsory 9% super guarantee contributions);
- Converts his existing $350,000 super to a pre-retirement pension; and
- Draws enough pension to give him the same level of after tax-income he would have had without using the strategy.

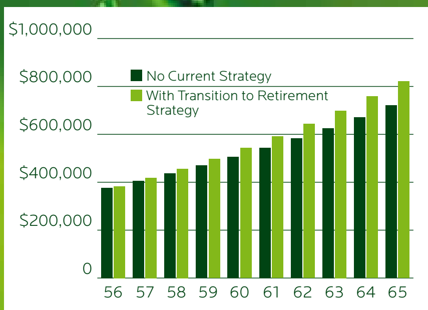
Let's assume Neil's salary increases by 4% per year and his super and pension investments grow 7% per year (before tax and excluding fees and charges). He'll see his super balance grow by around an extra $100,000 over the next 10 years.



What happens when markets fall?

Let's look at what would have happened if, instead of increasing, Neil's investments fell by an average of 3% per year over the 10-year period.

If Neil didn't use the TTR strategy, his super would be worth around $331,000 by the time he's 65. But using the strategy described earlier, Neil's super could potentially be worth around $343,000.



Why does this strategy work?

The amount you salary sacrifice is taxed at 15% instead of your marginal tax rate and pension payments are tax-free once you turn 60. This combination of tax savings on salary and pension payments has the ability to help increase your super balance, even (to some extent) in falling market conditions.

[3] This is a proposal only. It hasn't yet been legislated and may change depending on the outcome of the 2010 Federal election.

Did you know?

Under current superannuation law, if you're 50 or older, you can make concessional (pre-tax) contributions of up to $50,000 per year to your super fund. This amount will drop to $25,000 from July 2012.

In the 2010 Federal Budget, the government proposed that from 1 July 2012 the higher $50,000 cap will be a permanent measure for over-50s whose total super balance is less than $500,000[3]. If passed this measure should give a much-needed boost to the retirement savings of pre-retirees.

Preserving your wealth

While you're still working and earning a reasonable living, you may want to consider protecting that income. Your income can be used to further build your assets and your retirement savings. But if you become sick or get injured and can't work, without adequate insurance, you might have to sell some (or all) of your assets or investments to maintain your lifestyle.

Income protection insurance is designed to provide you with continued monthly income (generally up to 75% of your gross salary) if you can't work due to an injury or sickness. See our article on page 5 for more about the benefits of insurance.

Speak to your financial adviser about transition to retirement and wealth protection strategies.

Accumulate and protect – raising a family

Bringing up a family can be a costly exercise. There are a few strategies to consider if you're keen to reduce your debt and accelerate your wealth creation.

Debt recycling

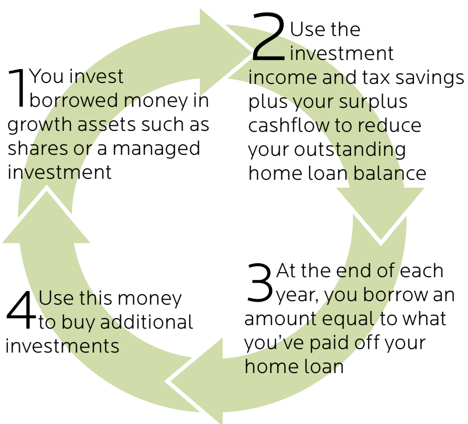
In the years when you're bringing up a family and with the financial challenge of a home loan, wealth creation plans are often put aside.

With appropriate advice, you can start investing to build wealth today whilst continuing to repay your home loan. One strategy to help reduce your home loan is to leverage equity in your home to borrow money to build an investment portfolio.

You can't claim a tax deduction for interest you pay on your home loan, but interest on an investment loan is tax-deductible.

A 'debt recycling' strategy, uses the investment income and tax savings from the investment loan to reduce your non-deductible home loan. At the end of each year, you increase the investment loan by an amount equal to the amount you've paid off your home loan. You use this money to buy more investments.

As your investments grow, the income you get from them potentially increases, as do the tax benefits. That means you're paying more and more off your home loan each year. You continue to repeat this cycle until your home loan is paid off.



It may take longer to pay off your home loan because you'll use some of the surplus cash to meet interest costs on the investment loan, but you are starting to build your investment portfolio sooner.

After paying off your home loan and assuming the after-tax returns from your investments are greater than the interest costs, you should consider reinvesting surplus cash (instead of using it to pay off the investment loan) as the interest is tax-deductible.

The key to debt recycling is budgeting and borrowing to invest over a suitable timeframe (preferably five years or longer). As with all strategies, you should only use a debt recycling strategy after considering the risks involved. Your financial adviser can discuss with you if this strategy is suitable for your circumstances.

Growth from equities

Over the past couple of years many investors have shied away from shares because of the well-publicised turmoil in share markets. But for someone looking to invest for the long term, shares have the potential to generate higher returns than fixed interest investments.

A recent report[4] found that Australian shares outperformed all other investment sectors over a twenty-year period to 31 December 2009. They delivered the highest after-tax and after-cost returns at both the lowest and highest marginal tax brackets, returning an average of 9.9% per annum and 7.8% per annum respectively.

Your investment strategy should always consider your goals, how you feel about investment risk and how soon you'll need to draw on your investment.

Protect your assets and family

Wealth creation is the part of your financial plan designed to help you build the assets to meet your financial goals. This assumes you will stay healthy and live to a certain age. Wealth preservation helps you protect your ability to create wealth. It covers those unforeseen circumstances that can impact upon your plans, helping you protect your assets.

The right insurance for you can help protect the wealth you've built.

Income protection

You can protect against loss of income due to ill health or an accident. Income protection cover generally replaces up to 75% of your income, so can give you some assurance that your family and financial future are protected.

Life cover

If you have a mortgage and a family to support, you should consider life insurance. If you or your partner were to die, those you leave behind would be under significant emotional strain. The situation could be made even more difficult if your family also had to suffer financial hardship.

Make sure you have sufficient life cover to provide for them in the event you're no longer around to support them.

Your financial adviser can recommend smart ways to build and protect your assets and provide peace of mind for your family's future.

[4] Russell Investments/ASX Long-Term Investing Report for 2010

Fast track your wealth – young and starting out

Looking to build a wealthy future from scratch? The sooner you start, the better off you're likely to be.

You enjoy the financial freedom being in the workforce affords you and you're looking to secure your long-term wellbeing. If you're serious about growing wealth, where do you start?

A disciplined approach

It's a good idea to start with a budget. Buy a cheap diary or search for an online budget tool and keep a daily record of what you're spending. By recording all your outgoings for a few weeks, you can work out where you're 'wasting' money and identify ways to cut back on unnecessary outgoings.

If you have a credit card or personal loan, use spare cash to pay off your debt. Clear debt with high interest rates first – then you can focus on saving. If you're lucky enough to receive a tax refund why not use it to pay off debt? It's money you didn't plan to receive, so you won't miss it.

Open a separate account to keep money left over at the end of each pay period or, better still, set up a regular savings plan. If you can avoid withdrawing what you've saved you'll also benefit from compound interest which will gradually work to grow your balance.

Did you know?

To encourage saving and reduce the tax burden for people who already have savings, the government is proposing a 50% tax discount on the first $1,000 of interest earned from certain savings products from 1 July 2011[5].

A normal savings account is a great start. But if you're really serious about growing wealth you could opt for a share portfolio. Shares could be a more tax-effective investment than a savings account or term deposit because of 'franking credits' for the tax already paid on share dividends you receive.

Your financial adviser can recommend savings and investment strategies to suit your circumstances.

Get super fit

It's never too early to start planning for the future. Your super fund is a good way to save for your future and can offer some tax benefits.

Using a salary sacrifice strategy, you pay tax at a lower rate on the contributions you make than you would if you received the money as part of your pay. Under current law you would also benefit from tax-free savings when you turn 60. And if the super guarantee does increase to 12% per annum over the coming years (see our snippet on page 2) you could be sitting pretty when you're ready to stop working.

Goal!

Set yourself a goal and imagine how good you'll feel when you achieve it. That's a great incentive to make the effort to work towards it. (Don't confuse 'goals' with 'dreams': a goal is something you can achieve given your circumstances, a dream is something that's always out of your reach.)

If your goal is to buy property, there are a couple of government incentives available. You could be eligible for a boost of $850 from the government every year on the first $5,000 you save through certain products. Earnings are taxed at 15% per annum and withdrawals are tax-free where they are used to purchase a first home.

The government also introduced the First Home Owners Grant (FHOG) back in 2000 to help offset the effects of GST on first home ownership. Under the scheme you could qualify for a $7,000 grant to help with your first home purchase. Some states also run their own incentive schemes in conjunction with the FHOG.

When budgeting for your first home, don't forget to include less obvious costs, such as strata levies, land tax or insurance to protect your new investment. You should also give serious consideration to protecting your most valuable asset – your ability to generate an income. See our article on page 5 for more information about the benefits of income protection insurance.

Talk to your financial adviser about the strategies available to help you build assets for a secure financial future and your potential entitlements as a first home owner.

[5]This is a proposal only and has not been legislated.

Market commentary

Provided by Advance Investment Solutions

Overall, the outlook for a meaningful recovery in the global economy over the short term continues to be mixed. Economic data highlights the fragility of the recovery, and while we do see positive aspects in the recovery, it will take time to take hold.

Economic overview — August 2010

At the time of writing the Reserve Bank of Australia (RBA) had left interest rates unchanged at 4.5% given the general concerns about the strength of the global recovery, despite a generally positive outlook for Australia.

In the US, employment growth continues to be the main issue for investors, with unemployment remaining at 9.5%. In Asia, as well as other emerging economies the flow-on impact of slower developed market global growth continues to impact financial markets. While we expect that emerging economies will move in sync with developed markets, they will remain a key engine of global growth as we continue to move through the cycle.

In Europe, markets continued to follow in line with the US. While a number of the export-orientated European economies such as Germany have defied the general economic conditions benefitting from a weaker euro, the general picture — a sluggish outlook for Europe — remains consistent with that of other developed economies.

Outlook by asset class

Australian shares

Overall, the Australian share market has lagged that of its offshore counterparts and continues to fluctuate. We do not expect this will change any time soon, although we do feel we are moving off the low point of the market.

International shares

While the outlook for global growth remains constrained, we still see a number of opportunities in the market, although many of the gains could be eroded by a move in the Australian dollar. We support some level of hedging of the Australian dollar in global equity portfolios.

Diversified Property

While aspects of the sector remain poor, we believe that the general outlook for the sector is improving. Better capital management with an improving focus on the core drivers of returns are improving an opportunity for investors not seen over the last 5 years.

International bonds

While central banks are under pressure to maintain low yields in a bid to stimulate economic activity, we believe that the risk associated with the sovereign bond market remains skewed to the downside given the extent of recent rallies.

Australian bonds

As Australian yields have fallen (in line with global markets) we believe that sovereign bonds look expensive, particularly in an Australian context given the overall relative strength of the local economy.

Alternative Assets

Given the nature of financial markets, alternative assets have had a mixed ride. Real assets (ie gold) have rallied, strongly reflecting investor concerns about global growth, while strategies linked to financial markets (ie hedge funds) have remained volatile.

While this sector provides opportunity, investors need to be targeted in their investment approach.

Commodities

We anticipate some weakness in global commodity markets in the near term because of the anticipated moderation in global economic activity, financial market volatility and investor risk aversion. However, demand from emerging economies coupled with industrial production activity resuming in the developed world should result in higher commodity prices in the medium to long term.

Real assets (ie precious metals, agriculture, etc) continue to move higher, with some prices set to remain above their fair value over the short term.

Currencies

We anticipate a strengthening in the Australian dollar although we expect it will remain soft against emerging market currencies. Our secular forecasts for the Australian dollar are 0.93 against the US Dollar, 100 against the Japanese yen, 0.7 against the Euro and 0.60 against the British Pound.

Overall, we expect the AUD will continue to benefit in the short term from both higher relative interest rates and an improving outlook for global growth over time.

More information? For further information on any issue here, or any financial matter, please contact your financial adviser.

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