your **money** your **future**

FINANCIAL PLANNING NEWSLETTER SPRING 2005

Make your financial plan a winner

After finding a financial adviser, and meeting to discuss your goals, how can you be sure your financial plan is a good one?

What are the rules?

The Australian Securities and Investments Commission (ASIC), the governing body of the financial planning industry, requires all financial plans to be "clear, concise and effective". ASIC's aim is to ensure that as a consumer, you understand your financial plan and the repercussions of taking the advice provided.

Your plan should be realistic, practical and all about you!

Read your plan carefully and check the following:

- your personal details – your adviser has based his/her advice on this information. Ensure nothing has been missed or overstated;
- any financial advice should be clearly linked to your objectives. For example, if you are saving to buy a house, it may be inappropriate for your adviser to recommend an investment in superannuation; and
- check that projected returns are based on realistic investment returns. It is dangerous to use recent short-term history as a guide for future performance.

Your financial plan is a map to help lead you to your goals. Make sure it provides you with clear instructions and information that helps you to understand what you need to do to realise your objectives.

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The uncertainty of secure income

A higher fixed interest return is tempting, however, it's important to remember that a higher return is usually accompanied by increased exposure to risk.

ASIC, the Australian Securities and Investments Commission warns investors of the risk associated with certain fixed interest investment.

If you don't understand it, don't invest

Fixed interest investments may have a place in some portfolios, however, the simple rule of thumb "If you don't understand it, don't invest" is important to remember. If you seek higher returns, you need to understand the associated risks before investing.

Always consult your financial adviser to investigate the suitability of any fixed interest investments you are considering.

Fixed interest investments and the associated risk levels

What they're called	Who offers them	Risk and return levels
Term deposits	Banks, building societies, credit unions and other prudentially regulated institutions.	Lower risk because the institutions are highly regulated. Lower returns.
Mortgage debentures	Companies. Offered via prospectus. By law, must be secured by first mortgage over land given to the trustee. Loan to valuation ratio may not exceed 60 per cent.	Medium risk. Trustee acts for investors. Accuracy of land valuation is a key issue. Typically medium returns.
Debentures	Companies. Offered via prospectus. By law must be secured by first mortgage over land or a 'charge' over tangible property sufficient to repay the money raised.	Medium risk. Trustee acts for investors. Accuracy of land valuation is a key issue Typically medium returns.
Unsecured notes or unsecured deposit notes	Companies. Offered via prospectus. No requirement for first mortgage over land or any 'charge' over tangible property.	Higher risk. Investors rely entirely on financial strength of company. Higher returns.

Source: ASIC

What is Capital Gains Tax?

Capital Gains Tax (CGT) is a term that is often used in conversation, particularly when we're talking about our assets. While it's easy to talk about, it's not as easy to put into practice when we're considering what to do with our assets. Here's a basic quick reference guide on CGT, and how it may affect you.

What types of assets are subject to CGT?

CGT applies to tangible assets such as land, buildings, artwork, shares in a company, units in a unit trust and intangible assets, such as goodwill, that are 'disposed of'.

Some assets that are excluded from CGT are:

- cars;
- personal-use assets acquired for $10,000 or less;
- your family home (provided it is not used for income-producing purposes); and
- any asset acquired prior to 20 September 1985.

Your accountant will be able to advise which of your assets are exempt.

What's considered to be a 'disposal'?

A disposal of an asset can occur without it being sold – the asset could be given away, destroyed or transferred to someone else; even without money changing hands.

How do I calculate a gain?

The capital gain is the difference between the cost of purchasing the asset and the disposal value of the asset. There are concessions available to reduce the taxable capital gain by 50 per cent if the asset was owned for more than one year. In addition to the concessions, some common strategies for minimising CGT are:

1. CGT is paid at the taxpayer's marginal rate of tax, so it is better to realise any capital gains in a year where your taxable income is low, taking advantage of a lower tax bracket;
2. capital losses and deductions can be used to offset a capital gain. Consideration should be given to realising any capital losses in the same financial year as any capital gains are realised; and
3. individuals (including those self-employed) who receive none or little employer superannuation support may reduce a capital gain by making a deductible superannuation contribution.

Further concessions to reduce tax on a capital gain also exist (particularly for business operators) and may apply to you.

It may seem basic in practice, but CGT can be a very complex tax issue. Before disposing of any assets, you should talk to your financial adviser or accountant about the best way to minimise your CGT liability.

Saving for a home

Owning your own home remains one of the great Australian dreams. But making the dream a reality requires dedication and a well-structured savings plan.

For first-home buyers in particular, the most difficult task in saving for a home is gathering those all-important funds to make a deposit. As a rule of thumb, potential borrowers should aim to save a deposit of at least 10 per cent of the expected value of the home, plus enough funds to cover stamp duty, legal fees and miscellaneous costs.

Savings strategies

Few people are in a position to buy a home outright. For most of us, accumulating a deposit can take years, depending on the type of home and the suburb you are aiming to buy into. The investment vehicles you may consider as part of your overall savings strategy will need to be based around your savings timeframe and estimated purchase date.

The longer-term plan

If your home savings focus is based on the longer term of five years or more, then investing in a long-term savings vehicle, that can potentially provide good annual returns, will be an option for you. Historically, shares have outperformed all other investment classes over the long term. So one option may be to invest in the sharemarket, either directly or via a professionally managed equity fund that invests in a portfolio of shares.

The medium-term plan

Perhaps your home ownership horizon is a little shorter; say three to five years. Investing over this time frame in a balanced managed fund, which has exposure to local and overseas shares, fixed interest, property and cash, is one option that can deliver good, stable growth. Having a more diversified approach than a fund investing in equities only, a balanced managed fund may offer greater security.

The short-term plan

If you are fairly close to buying a home – say, within one to three years or less – a good savings strategy may be secure products providing agreed rates of return. Cash management accounts, mortgage funds, and term deposits deliver higher returns than a standard savings account. Money in a cash management account is available at call, while money in a mortgage fund or term deposit is generally required to be invested for a defined period of time.

Your financial adviser can help you to set realistic goals for purchasing your home and can outline the investment options that may suit your savings timeframe.

What is an Allocated Pension?

We've all heard of the 'Age Pension', but what is an 'Allocated Pension'? Basically, an Allocated Pension is an investment option for your superannuation savings.

Allocated Pensions generally give you access to a range of investment choices from secure cash and fixed interest through to more aggressive options such as shares and property. More secure investment options tend to experience less volatility than higher risk investments. It's best that you seek financial advice to determine the right investment mix for you.

You can purchase an Allocated Pension with unrestricted non-preserved superannuation monies. Your lump sum is then invested into a range of investment portfolios which accumulate investment earnings. These earnings, along with your capital, are then returned to you as regular income payments.

You can choose the level of income you receive (between government-set minimum and maximum limits) and how regularly you would like to receive it. Your income must fall within these set limits, which are determined by your age and account balance. However, the range is quite broad.

You can also change your income level from one year to the next, provided that you remain within the set limits. And you can even make additional capital withdrawals in addition to your income payments at any time.

One of the best things about Allocated Pensions is that your investment earnings (as they accumulate) are tax-free. Your income will be subject to PAYG tax, which means that tax will be taken out of your income before you receive payments, much like how you receive your wage or salary now.

Another advantage of Allocated Pensions is that you may also be eligible for a tax rebate. And better still, part of your income may be tax-free.

Your income will be provided through your Allocated Pension until your funds run out or until you die. Any remaining capital may be paid to your dependants or to your estate. Alternatively, your spouse or other dependants may be able to continue receiving the income stream.

Allocated Pensions suit investors who want control over their investment and need a regular, flexible income and access to their capital.

AXA's Retirement Directions Allocated Pension Plan provides a flexible investment vehicle with a range of investment managers. The plan offers a regular income stream that can be tailored to meet your lifestyle needs in retirement.

It's important that you plan carefully for your retirement and ensure that you invest appropriately for your income and lifestyle requirements. Please contact me to help you determine the most suitable retirement investment strategy for your specific needs.

The perils of market timing

Despite repeated attempts by investors to guess the direction of markets, the evidence suggests that market timing rarely pays off in the long term.

The premise

Market timing involves buying a stock when the price is low, holding on to the investment until its market price peaks, and then selling out and moving into cash or another asset class until the stock price hits bottom. The process begins all over again as one waits for the right moment to get back in. Sounds simple enough. The problem though, is that all timing strategies are based, in part, on second-guessing the market.

However, many financial advisers all over the world have related tales of clients who felt that 'now' might not be a good time to be in the market. These investors believe that by avoiding the market during troubled times, they can reap the benefits that equities have provided over the years, while sitting out the downturns. In this way, many investors try to time their entry and exit to and from markets.

The fact that everyone seems to have a 'sure-fire' way to time the market just adds further encouragement to market timing investors. Just do a search on the internet. You will discover a myriad of web pages advertising market-timing services. A visit to your local library will yield an equal number of market timing theories. Some of these may even work – for a while.

The reality

Trying to make money by predicting short-term market moves and by attempting to pick the perfect moment to get in and out of the market doesn't work in the long term. Why? Because you cannot know which way the market is going to move in the short term. However, many investors believe differently. Here are a couple of examples:

- after the September 11 terrorist attacks, US investors pulled approximately $US29.5 billion out of US stock mutual (equity managed) funds. These investors were in for a rude surprise when the US S&P 500 Index recovered within a month;
- General Electric fell below $US30 per share after September 11, but within seven weeks, the stock had risen above $US40.

Investors in the above cases may have been sorry. The US S&P 500 Index had its second largest one-day gain in 2001, just five days after September 11. Within a month of September 11, the index had risen 3.7 per cent. This just goes to show that you can't guess market moves from one day to the next, as you don't know tomorrow's price since it will only be determined by tomorrow's events.

History has shown that the market refuses to cooperate with market timing strategies. The simple reason is that even during the worst of times, equity markets can still have many good days, and vice versa.

The best defence

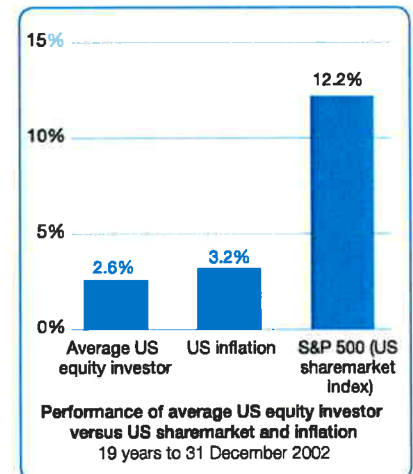
Discipline, discipline and more discipline. Investors should not let short-term volatility drive their long-term investment planning. The best defence against a fluctuating market is a well-diversified portfolio, spreading investments among asset classes and/or managers, in a strategic asset allocation that takes into account the investor's time frame, risk tolerance, need for investment income, and long-term goals. This can help their portfolio produce more consistent returns, regardless of whether markets move up or down.

Even in a managed fund era, research shows that most investors still fail. They invest in sectors and funds that are likely to be volatile, and lose patience as they withdraw their money at the worst possible time.

Astute investors know that the perils of market timing are relevant in bear markets (when fear often takes over rational investment decisions) and in the current bull markets (when over-exuberance can cloud sensible long-term investment decisions).

The graph shows that the average US share investor, who may have followed the typical fear and greed approach when investing, achieved a modest return of 2.6 per cent, over the 19 year period ended 31 December 2002. This is a very low return, even lower than inflation, which was 3.2 per cent over the same time period. The actual market return, which could have been achieved with a disciplined strategy, produced a much more pleasant 12.2 per cent return outcome.

Why most investors fail (and how not to join them)



Performance of average US equity investor versus US sharemarket and inflation
19 years to 31 December 2002

People need advice to prepare themselves for market volatility (both down and up), and to protect against making short-term decisions on long-term issues. Speak to your financial adviser about the best strategy for coping with movements in the market.