

# Successful Investing

Issue 2 - 2<sup>nd</sup> Quarter 2009

Tax Effective Re-entry

Economic Update

End of Year Super Tips

The Value of Income Protection

How the Value of Investments Impact on Centrelink Benefits

Trivia and Wisdom of Great Investors

## Economic Update

As world leaders toil to turnaround the global economy and their local markets, the big question is how long will it take?

The global decline in shares and bonds halted mid-March after the new Obama Government announced more details of its rescue packages to stimulate the economy and financial markets. The US Federal Reserve joined the banks of England and Japan among others to add "quantitative easing" to their rescue packages, providing extra liquidity to purchase bad debts and buy back bonds. This printing of more money raised concerns about inflation returning.

Inflation did rise in Europe in the first quarter and unemployment in the Eurozone region rose to its highest level in more than two years.

In Japan, unemployment also rose, while consumption remained weak. However, consumer confidence showed a marginal improvement towards the end of the first quarter. Elsewhere in Asia, monetary authorities in Korea, Malaysia, Taiwan and Thailand further trimmed interest rates. In China, there were tentative signs of a recovery in consumption and industrial activity.

At home, interest rate cuts were held steady by the Reserve Bank at its March meeting as the Australian share market followed the uptick in the US. In the latest round of corporate earnings reports, Australian companies returned a reasonable set of results given the difficult economic environment. Earnings were down and dividends were cut, but were generally within expectations. While dividends may be down, so too are share prices, which can mean the yield is still comparatively good.

### So how long will it take for the markets to recover?

The truth is no one knows, but we do know there are good quality companies now available at very reasonable valuations.

*Source: Fidelity International*

FIL Investment Management (Australia) Limited (ABN 34 006 773 575, AFSL No. 237 865) ("Fidelity Australia") is a member of the FIL Limited group of companies known as Fidelity International. Fidelity Australia is not responsible for any other material within this document and the views expressed therein are not necessarily the views of Fidelity Australia.

© FIL Investment Management (Australia) Limited 2009.



# Tax Effective Re-entry

It's no secret the past 12 months have been particularly tough for anyone with an exposure to the sharemarket. With Australian shares providing an annual return of -38.92% to December 2008, it has certainly been a year to forget.

So what does 2009 have in store for investors? While it is impossible to predict where the market and economy is headed, after considering some historical facts and figures, many market participants are now allowing themselves to become more optimistic about the future. For example, the average Price/Earnings ratio of the All Ordinaries index is currently sitting at 9, the lowest reading since February 1981 when data collection began. Interest rates are also at their lowest levels in almost half a century, meaning the gap between the dividend yield on Australian shares and the cash rate stands at a record high of 3.62%. It is hoped these historically cheap valuations and high dividend yields will entice more investors back to the sharemarket over 2009.

Taking the first step to re-enter the market is often the most difficult one, and after such a tumultuous 12 months, advisers and investors can be forgiven for being a little wary. However, for those long-term investors who see a recovery taking place in 2009, whether it be rapid or drawn out, a gearing investment strategy may present the best vehicle for entering the market and amplifying future returns. Additionally, gearing can also present a tax effective means of building wealth. While gearing as an investment strategy is relatively straightforward, its related tax advantages are often overlooked. It is these tax benefits that often add significant value to the investor's overall position.

One of the key benefits of gearing is the ability to submit borrowing costs as a tax deduction, reducing the tax payable by an investor. In addition, investors can also fix their rate and pre-pay interest up to 12 months in advance, maximising tax deductions for the current financial year. An investor could potentially claim up to 24 months interest in a single financial year.

Gearing also allows investors to increase the size of their portfolio. Not only can this maximise long-term capital gains, but it can also increase regular distribution payments, many of which incorporate franking credits.

To illustrate how franking credits can reduce an investor's tax burden, consider an investor on a 31.5% marginal tax rate who receives a distribution that is 70% franked. After taking into account their franking credits, the investor will only pay an effective income tax rate of 11% on the distribution.

*Continued on page 2*

## Tax Effective Re-entry Continued.

Combined with the current gross dividend yield of 8.8% and historically low interest rates, investing for income may be an investment strategy worth considering. With the right investments, an investor could achieve a positively geared investment strategy relatively easily.

So despite the recent volatility, gearing continues to compliment and enhance long-term investment strategies. Gearing's combination of tax benefits, flexibility and its ability to increase investors' exposure to growth assets means it can play an integral part in achieving an investor's wealth accumulation goals.

*Source: Colonial Geared Investments*

For further information on how gearing can benefit you, contact your financial adviser today.

*\*Investors need to be aware that gearing does increase the level of risk associated with their investments.*

# End of Year Super Tips



**As we approach the end of another financial year we may take time to look back and reflect on the turmoil we have experienced, as have both the investment markets and world economies.**

For many of us, the value of our investments, and particularly our retirement savings, were brutally effected. For those who have recently retired, or were planning to retire in the near future, the effects have been devastating. We hear daily reports of people deciding to either re-enter the workforce, or defer retirement.

In fact, many people are re-evaluating the benefits of superannuation. They are asking if it is still relevant in the current economic environment. It is not uncommon to hear people saying that "superannuation is a bad investment" or express similar sentiments. This is being supported by media reports of a drop in the number of voluntary contributions people are making to their superannuation funds.

It is perhaps time to go back to the basics and reconsider some of the fundamentals of superannuation.

As individuals, we can hold investments in a number of different ways. We may hold cash deposits (i.e bank accounts and term deposits), we may buy shares or property, and we could purchase fixed interest investments (such as mortgages, debentures, bonds etc). We can invest directly (i.e. buy physical assets) or we may invest through managed funds. However, irrespective of the types of investment we favour, we can hold those investments in our own name, in the name of our spouse, through a family trust, or in a private company structure. Each of these structures can hold the same types of investments; the difference is generally the way in which they are taxed.

Many couples will hold their investments in the name of the lower income earning spouse to allow investment earnings that flow through such as interest, dividends, rents, and capital gains to be taxed at the lowest possible rate.

Investing through a family trust allows investment earnings to be distributed

to beneficiaries of the trust. In many cases family trusts distribute to those beneficiaries who are most tax advantaged.

Where investments are held in the name of a private company, the company pays tax at a rate of 30% on its income (i.e. income and capital gain on the investments it holds). The company may then pay dividends to its shareholders (family members) who in turn may receive the benefit of franking credits, thereby potentially optimising the tax treatment of the income they receive from their company.

There are many reasons why people use different structures for holding their investments but taxation planning is often an important consideration.

As we have seen, different structures are taxed in different ways. The most appropriate structure in any given situation will be dependent on the personal circumstances of the investor, and often the size of their investment portfolio.

In many ways, superannuation is simply just another structure in which to hold investments. Of course it has a special purpose, in that investments held through superannuation are set aside to provide for the retirement of the superannuation fund member. However, despite this, a superannuation fund is nothing more than a favourably taxed structure for holding investments.

Irrespective of the type of superannuation fund used, be it a retail or "public offer" superannuation fund, an industry fund, or a self-managed superannuation fund, most funds today offer members a wide range of investment options to select from. So, we can invest in cash, fixed interest securities, property and shares through a superannuation fund structure.

Superannuation funds in the accumulation phase (i.e. they haven't started paying a pension to members) generally pay tax on their income at a maximum rate of 15%. Capital gains arising from the sale of assets held for more than 12 months are taxed at a rate of 10%. Where a superannuation fund is paying a pension to a member, the fund pays no tax on income and capital gains that arise from assets being used to support the pension payments. Compare that to a tax payer who may be holding investments in their own name and may be taxed at a rate of up to 46.5%.

*Continued on page 3*

When holding investments through superannuation we must remember a number of important points:

- Superannuation is for retirement purposes, and
- Once money is invested through the superannuation system, it is preserved – meaning it can't be accessed until a "condition of release" is met (generally retiring after age 55, or reaching age 65).

So next time someone says superannuation is a bad investment, remind them that superannuation is not an investment in its own right, but rather a special purpose tax effective structure for holding many of the investments we may otherwise hold in our own name.

Important note: The information in this article is current at the time of writing. A Government review is currently being carried out and may result in changes to superannuation laws.

*Source: Professional Investment Services*

## The Value of Income Protection



Matt is a 35-year old self employed electrical contractor living in Melbourne's outer suburbs. He is in a business partnership with his wife, Jenny, aged 30, and they have two young children, aged six and four. Matt generates the income whilst Jenny organises Matt's work appointments and keeps the books for the business. Matt generates an income of \$110,000 after expenses. The couple have a \$300,000 home mortgage, for which they pay \$2,105 monthly, and a car lease for Matt's work van, with repayments of \$500 per month.

On the weekend, Matt plays baseball with his former schoolmates. One Saturday, whilst sliding into home base, Matt severely twisted his knee. He was taken to hospital, where it was determined that he needed a full knee reconstruction. The prognosis was good, but the doctors instructed Matt to take four months off work to recuperate. Matt's private health insurance covered most of his medical costs. However, what about the income that Matt would lose as a result of his inability to work for the four months?

Fortunately for the young family, about a year ago, Matt had taken out an income protection policy, covering 75% of his after expenses earnings, with a 30 day waiting period. This included the full \$110,000 generated through his personal exertion and amounted to a monthly income (benefit) of \$6,875. As suggested by his financial adviser, Matt also took out an accident option, which meant the insurer would pay him 1/30th of his benefit for each day that Matt was totally disabled (if he were disabled for at least three days in a row during his waiting period). Since

Matt satisfied this definition, he was able to receive the full \$6,875 after the first month of total disability, and a total of \$27,500 for the four months he was off work. The real value of this to Matt would be the ability to pay his mortgage and lease payments, and to maintain the family's lifestyle while he was disabled. Matt was also able to insure his business expenses while he was disabled.

Now consider this: If Matt were permanently disabled due to illness or injury, his lost income until the age of 65 (assuming an inflation factor of 3% p.a.) would be just under \$3.5 million. The amount of income protection that could be paid to Matt in the same period is just over \$2.5 million. This amount would be paid over and above any other insurances he had for total and permanent disability or critical illness. If Matt took a guaranteed agreed-value policy, his income protection benefit, if he were totally disabled would be payable regardless of a change in occupation, a reduction in income, a change in sporting activities or pastimes or in fact periods of

leave or unemployment. In addition, Matt's income protection premiums would be tax deductible based on his marginal tax rate.

Is it expensive? In Matt's case, his after-tax annual premium would be less than 2% of his gross income after business expenses. This premium would be at blue-collar occupation rates, and would be significantly less for a white-collar professional. In addition, Matt could save money by taking cover at level premium rates (premiums do not increase with age) rather than stepped premium rates (premiums do increase with age), which would initially be more expensive, but would provide considerable cost savings in the long-term.

*Source: CommInsure - Jeffrey Scott, Executive Manager, Business Growth Services, CommInsure*

Don't put your income to chance, contact your financial adviser today to protect your most valuable asset – your income!

## Trivia

Adding a drop of olive oil and lemon juice to an ice cube then running it over your face gives you better results than some expensive skin care products.

The national orchestra of Monaco has more individuals than its army.

Tokyo has had 24 recorded instances of people either killed or receiving serious skull fractures while bowing to each other with the traditional Japanese greeting.

The Himalayan goji berry contains, weight for weight, more iron than steak, more beta carotene than carrots, more vitamin C than oranges.

As of 2006, 200 million blogs were left without updates.

Coco Chanel started the trend for sun tans in 1923 when she accidentally got burnt on a cruise.

Up to 25% of hospital keyboards carry the MRSA infection.

Music can help reduce chronic pain by more than 20% and can alleviate depression by up to 25%.

The best value consumer purchase in terms of the price and usage is an electric kettle.

The Mona Lisa has no eyebrows. It was the fashion in Renaissance Florence to shave them off.

Honey is the only food that does not spoil. Honey found in the tombs of Egyptian pharaohs has been tasted by archaeologists and found edible.

Source: [www.berro.com](http://www.berro.com)

## How the Value of Investments Impact on Centrelink Benefits



The Australian Government provides a range of income support benefits to people who qualify. Benefits include a range of pensions and allowances.

When assessing an applicant's entitlement to income support benefits, the Government agency that administers such payments, Centrelink, applies two tests; an assets test, and an income test. The test that results in the lower benefit is the one that is applied in each individual applicant's situation.

Applicants for benefits must provide details of their assets and income at the time they make their initial claim for benefits. Once a benefit has been granted, changes in the value of assets, or in the level of income being received from other sources, must be provided to Centrelink within 14 days of the change. In addition to advising changes as they occur, benefit recipients will be asked to provide full details of their assets and income to Centrelink on a regular basis. The actual level of benefit payable may alter, either up or down, based on changes to asset values, and other income.

With the decline in the value of superannuation and investment portfolios during the course of the economic turmoil of the past year, many Australians are becoming entitled to Government income support for the first time. Furthermore, those previously receiving less than the full rate of benefit may be entitled to a higher benefit as a result of the fall in the value of investments they hold.

Where Centrelink has details of specific investments (managed funds and direct shares) held by individuals, they automatically update the value of the income recipient's assets in September and March each year. This is to ensure that the correct rate of benefit is being paid and has taken both upward and downward movements in assets into account. The automatic reviews in September 2008 and March 2009 have seen the level of benefits for many people increase.

However, some benefit recipients are excluded from this automatic adjustment due to the way in which their investment portfolios are structured. For those who hold their investments through a masterfund, wrap account, or separately managed accounts, the nature of the investment structure is such that an automatic revaluation can't be carried out by Centrelink.

Investors who hold their investments in these types of structures should review and, if necessary, advise Centrelink of the current value of their overall portfolio in order that an adjustment, if any, may be made to their income support benefit.

When considering entitlement to Government income support, the assistance of a qualified financial adviser can prove to be invaluable.

Source: Professional Investment Services

## Wisdom of Great Investors...

### Avoid Self-Destructive Investor Behaviour

Chasing the hot-performing investment category or making major tweaks to your long-term investment plan can sabotage your ability to build wealth. Instead, work closely with your financial adviser to outline your long-term goals, develop a plan to achieve them and set the expectation that you will stick with that plan when faced with difficult periods for the market.

### Be Patient

Though periods of short-term volatility for stocks are to be expected, it is crucial to bear in mind that historically stocks have rewarded patient, long-term investors.

Source: *Wisdom of great investors - Davis Advisers*

Contact our office for further information:

Rodney Gibson Financial Services Pty Ltd  
Level 2, 54 Amelia Street  
Fortitude Valley, QLD, 4006

Ph: (07) 3252 9990  
Fax: (07) 3257 7366

Email: [admin@rodneygibson.com.au](mailto:admin@rodneygibson.com.au)  
Web: [www.rodneygibson.com.au](http://www.rodneygibson.com.au)

Rodney Gibson Financial Services Pty Ltd is a corporate authorised representative of Plan 2 Pty Ltd. Australian Financial Services Licensee no. 237874

### Your Privacy

Your privacy is important to us. If you do not wish to receive information of this kind in the future, please contact your local office.

### DISCLAIMER

The information contained in this document is of a general nature only and does not take into account your particular objectives, financial situation or needs. Accordingly the information should not be used, relied upon or treated as a substitute for specific financial advice. While all care has been taken in the preparation of this material, no warranty is given in respect of the information provided and accordingly neither Associated Advisory Practices Ltd or Rodney Gibson Financial Services Pty Ltd nor its employees or agents shall be liable on any ground whatsoever with respect to decisions or actions taken as a result of you acting upon such information.