

Investment Solutions

Spring 2011

Welcome to the Spring 2011 edition of Investment Solutions.

Following the markets' recent rollercoaster ride, Felix Stephen, Manager Strategy & Research at Advance takes us through the recent panic in the markets, the challenges that lie ahead and what investors need to be aware of.

During a time of unease it is important to ensure that you and your family have the right kind of insurance cover. In this issue we discuss the importance of protecting your most valuable asset – your income.

Find out how you can make the most of the strategies within your self managed super fund, such as acquiring an investment property.

And with Spring finally here, it's a great time to do some spring cleaning. Our article on 'Turning trash into treasure' provides some handy tips on how to clear away old junk online and get a little extra cash in the meantime.

We hope you enjoy reading this edition of Investment Solutions.

What's inside:

- Strategies for self managed superannuation funds
- Market commentary
- Turning trash into treasure online
- Is your income protected?

Strategies for self managed superannuation funds

Acquiring a residential investment property with borrowed funds.

Superannuation legislation now allow self managed superannuation funds (SMSFs) to borrow to invest, providing certain conditions are met. If you have an SMSF you are now able to use these arrangements to help you buy a residential investment property through your fund.

How does it work?

Your SMSF wants to buy a residential property but does not have enough funds for a full purchase. It does, however, have enough funds to make a partial payment. The SMSF can purchase the property under an instalment arrangement, but it must meet certain criteria.

The SMSF makes a partial payment on the property and borrows funds to pay the balance plus the other acquisition costs, using the property as security under a limited recourse loan. In the event of default, the lender only has recourse to the property and cannot claim any other SMSF assets. The property is held in trust for the SMSF which is entitled to its income. Your SMSF makes the loan repayments, paying off the loan over the agreed period.

After the loan is repaid, the legal ownership of the property can be transferred to the SMSF.

This strategy may be appropriate if you:

- are a trustee of a SMSF
- want to invest in a property within superannuation
- have a long-term investment timeframe.

The benefits of this strategy

- Your SMSF can acquire property worth more than its available funds through multiple instalments over the long-term.
- SMSF assets are secure as the lender does not have recourse to your SMSF's assets in the event of default.
- Your SMSF receives all income and capital growth even if the property has not been paid off.

- Your SMSF can use income from the property to help pay off the loan.
- Interest expense may be claimed as tax deductions by the SMSF and potentially reduce your SMSF's tax liability.
- You can walk away from the arrangement if it is not in the interest of your SMSF to continue with the arrangement. In this case the fund will receive the residual value after the loan is repaid.
- Once your SMSF acquires the property, income after expenses and any capital gain on disposal may be taxed at lower rates (i.e. 0%-15%).

Some things you should consider

- Your SMSF trust deed must allow borrowing under an instalment arrangement.
- A suitable legal or accounting professional should establish the appropriateness of the trust structure.
- Investment in residential property must be consistent with your SMSF's investment strategy. You should consider risk, return, diversification and loan interest rates.
- The instalment arrangement must meet certain requirements to ensure that the SMSF remains complying for example you must not access borrowed funds to improve the property as only maintenance and repairs are allowed.
- As trustee, you must be acting in the best interests of the SMSF beneficiaries.
- The ability of the SMSF to make the instalments over the term of the loan. Cash flow may be sourced from investment earnings or member contributions. Consider limits to contributions that are eligible for concessional tax treatment.
- Ensure that sufficient cash flow is maintained to cover any future contingencies such as interest rate increases or gaps in income.

- Any loan arrangements may be subject to the provision of personal guarantees, which may expose individual guarantors to potential personal liability.
- You must purchase the property from an unrelated party. Arrangements must be at arm's-length and transacted at market rates.
- You should weigh the benefits of the strategy against the costs of setting up and maintaining the instalment arrangement.

Case Study

Suppose your SMSF has \$150,000 in the cash account. As the SMSF trustee, you want to buy an investment property worth \$275,000. You buy the property on behalf of your SMSF under an instalment arrangement. The \$150,000 is used to make an initial payment for the property. The shortfall of \$125,000 plus \$25,000 in stamp duty and acquisition costs is funded by a limited recourse loan, using the property as security.

You then arrange for the property to be leased to an unrelated party at market rates and the rent, together with other SMSF income and/or member contributions are used to make instalment payments. Once the loan is paid off, the legal ownership of the property can be transferred to the SMSF.

The importance of financial planning

There are a number of complex rules and regulations surrounding superannuation and planning for retirement.

Your financial adviser can provide advice about borrowing strategies for SMSFs that are personalised to your situation and goals. You should also seek professional tax and legal advice, before making an investment decision.

Felix Stephen, Manager Strategy & Research at Advance, talks about the recent panic in markets, the challenges ahead and what investors need to be aware of.

Making sense of nonsense

Persistent global uncertainty and a slowdown in the non-mining sector saw the Reserve Bank leave interest rates unchanged at its August meeting. Despite the continued threat of short-term market weakness and should the global environment deteriorate further, Australia is well placed to handle this given its reasonably positive longer term fundamentals.

The US debt ceiling saga plagued the US economy in July, and despite an 11th hour agreement between political parties, Standard & Poor's downgraded the US's AAA credit rating for the first time in history.

There was concerted action on all policy fronts (foreign exchange, fiscal and monetary) in Japan last month, in an effort to support the domestic recovery.

Economic developments in the Eurozone continued to be eclipsed by sovereign debt woes. The crisis is set to plague the region for some time, and will continue to

weigh on the region's prospective economic prosperity.

China's central bank raised interest rates for the fifth time in nine months in July. The move came just days before news that inflation had accelerated to its fastest pace in three years.

What's the long-term impact?

July and early August highlighted the significance of global geopolitical events currently at play. Global equities, in particular developed market equities, underperformed emerging market equities in July, driven firstly by pessimism towards the Eurozone fiscal situation deepening, and secondly by the US debt ceiling issues and eventual credit rating downgrade.

While the sharp fall in prices of risky assets currently appears to be based upon S&P's downgrading of US sovereign debt and fault lines appearing across Europe due to concerns about the debt overhang in Italy and Spain, we believe it's due more to the

universal feeling that global policy credibility has evaporated.

The world economic recovery has been on a "stop and go" journey since the GFC, with a series of geopolitical shocks and natural disasters unsettling investor confidence and risk appetite.

While the GFC was primarily a liquidity driven crisis, the recent sell-off is driven by a lack of confidence and poor sentiment.

The issue of restoring confidence will now be at the forefront of policy makers' and regulators' agenda and coordinated central bank responses have already begun.

There is no doubt investors need clarity around these issues to have confidence to turn around. However, making decisions around moving from growth to defensive assets must be viewed in light of the panic conditions we're experiencing. Maintaining a long-term view when it comes to investing has historically proven to be the best strategy for investors.

Turning trash into treasure online

So you need a bit more space. The kids have flown the coop, your parents move into an aged care facility, or you've just had enough of all the clutter.

Whatever the reason, spring-cleaning is good for the soul, and with a bit of clever planning can be good for the wallet too. Here are some tips on how to clear-away old junk online and get a little extra cash in the meantime.

1. Know what sites to use

The most popular marketplaces in Australia are ebay and gumtree. While ebay is great for anything you are happy to send in the post, for larger items such as furniture, you may want to consider classifieds like gumtree. This means you can sell items to people in your local area, and they can come and pick it up directly from your house.

2. Do your research

Don't throw anything away without first determining its value on an online auction site like ebay. You'll be surprised what things are worth to others, especially older items and collectibles.

3. A picture tells a thousand words

When selling things online, it's essential to include at least one high quality picture of the item, and in most cases, several pictures showing different angles. Pictures should be close-up, in sharp focus and appropriately lit.

4. Write a full description

Writing an accurate description will lead to more interest, a faster sale and avoid customer dissatisfaction. Include things like specifications, an honest account of the current condition, why you're selling it and how buyers can reach you.

5. Be safe

Always be aware of internet scams and other dangers. Never give out your bank or credit card details to anyone online, and if someone is coming around to your house, don't be home alone. Also beware of what information you make public – for example it's not a good idea to advertise when you're going on holidays, or are going to be away from home for an extended period of time.

6. Consider giving things away

If you really want to get rid of things in a hurry, consider recycling sites like freecycle. This will save you the hassle of transporting large items, and will ensure your old beloved things go to a good home.

You'll be surprised how easy it is to turn trash into treasure online. But it can be more time-consuming and addictive than you expect, so do your research and start-off slow while you get the hang of things.

Is your income protected?

Did you know that your income is your greatest asset? The income that you earn today – and your potential to earn an income until you retire – is key to your family's financial future.

While most of us understand it's important to insure our home and its contents, our cars and our jewellery, we underestimate the importance of protecting our most valuable asset – our income.

Did you know that the chances of something happening to your health, leaving you unable to work or earn an income is greater than the chances of your car being stolen or your home destroyed.¹

Many people also believe that Medicare, government support payments and personal savings will be enough to cover medical bills in the event of illness or injury. But what happens if you are ill for an extended period of time or require constant specialist treatment? Do you have enough to cover regular ongoing expenses like rent, mortgage payments, personal loans, school fees and groceries?

Did you know that Centrelink only pays a maximum disability pension of \$658.40 per fortnight for singles and \$496.30 (each) for couples? Would this be enough to cover your current lifestyle?²

It won't happen to me!

Just like most of us – Robert Innes thought he was indestructible, until the day his daughter was killed in an accident.

The self-employed accountant and father of two was prepared to take on almost everything that life dealt him. He had occupied senior accounting positions and as a tennis coach, was fit and had only taken few sick days in his working life.

"I was the kind of person everyone could rely on", Roberts says. "A person who simply loved life." That was until 2007, when his 14 year old daughter, Morgan was killed when a Sydney Ferries Harbour Cat collided with the pleasure cruiser she was on. To this day, Robert is still reliving the catastrophe that befell his family. "I may be asleep two nights out of seven. I've gone from being a very driven person to someone with no goals. The only thing that keeps me going is my son, Curtis and my wife Kim," Robert says.

Robert puts part of his survival down to a fellow tennis player and long-time friend who happened to be an insurance broker. For years he insisted Robert be fully insured...just in case.

"Without income protection, our family would probably have broken up – the pressures are just enormous," Robert says. "I don't think anyone understands the depression that happens when a child is killed. When people think about trauma and accident or sickness and disability, you don't comprehend you can be sick to the point where you can't work. The thought of ever getting sick was just beyond me and while you have insurance, you never really expect to use it."

Under his income protection insurance, Robert was entitled to 75 per cent of his income until age 65.³

Facts

- 48,500 Australians suffer a heart attack in any one year⁴
- 1 in 3 men and 1 in 4 women will suffer from cancer in their lifetime⁵
- 43,000 people died from cancer in 2010⁵
- 1 in 6 men and 1 in 4 women will suffer a disability during their working life that results in taking more than six months off work.⁶

In the event of an illness or an accident where you are temporarily unable to work, income protection insurance may pay you up to 75 per cent of your income (up to the age of 65), enabling you to pay your mortgage, medical bills and other payments, helping you preserve your lifestyle.

Insurance is a crucial part of any financial plan – it's a financial safety net for you and your family when something unexpected happens. By working with your financial adviser you can tailor an insurance plan to your individual needs and circumstances so you can be protected for life.

¹Compiled using statistics and calculations from: a) National Motor Vehicle Theft Reduction Council – 12 months to March 2010 b) Insurance Statistics Australia June 2010 c) Data of individual disability income insurance sold by Australian life offices, Institute of Actuaries of Australia 2002. Report of the Disability Committee. IA Aust: Sydney.

²Centrelink website. Rates are a guide only and are effective from 20 September 2010.

³Source: Money Management - 2009

⁴Heart Foundation, Australian Facts 2008: Heart, Strokes and Vascular diseases..

⁵The Cancer Council Australia, www.cancer.org.au April 2009

⁶National Health Survey: Injuries, Australia 2001 ABS Cat No. 43840.0 – Australian Bureau of Statistics, 2003 – Based on people aged between 35 and 65.

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