September 2011

Market Update

August was undoubtedly one of the strangest months on record. The volatility was extreme – almost as bad as the worst of the GFC months. The difference was back then we didn't know what we were in for or when it would stop. It was death by a thousand cuts. Having lived through that period we have become inured to market volatility. Investors are aware that the world is not quite as it should be therefore market weakness is no surprise. The extreme volatility of August, however, is never welcome despite the opportunities it threw up.

Some shares traded at what seem like whacky prices: CBA at under $44 (now $48 and ex dividend of $1.88); BHP at under $36 (now $39); Worley at $22.50 (now $17); Monadelphous at $15 (now $20).

We recently attended a talk by one of the economists at a large institutional broker. Like all strategists this fellow was as optimistic as ever and believes that the market is about 1600 points (almost 40%) under-valued. His model says the market should be 5800! It's a nice thought and we'd all welcome it but we are not convinced it is going to happen any time soon!

Why not? Slow US growth, introduction of a new experimental carbon tax, mining tax, flood tax, over-zealous interest rate settings and the elephant in the room - Euro sovereign debt issues. When we mention all of these things we are not making political statements, or endorsing one party over the other. We are simply stating facts (except in the case of interest rate settings, which is an opinion). The introduction of three new taxes, as well as the government's efforts to balance the budget by 2013 is weighing on the market. Anyone of the foregoing would be serious in isolation, but put them all together and your applying the air brakes to a semi trailer that's already slowed to a crawl in peak hour traffic.

That's not to say the market cannot rise from its present levels – but we don't believe we are going to enter a raging bull market any time soon – so the focus comes back to the sustainability of profits and dividends when considering equities investments.

Our main concern is the Euro sovereign debt situation. We are not experts in this area and refer to those with more knowledge, such as Satjayit Das and Carmen Reinhart and Kenneth Rogoff. Das has a wealth of experience in credit markets and is on the record as having warned about the impending credit crisis a year before it happened. Reinhart and Rogoff are US academics who specialise in the study of historical financial crises and sovereign defaults. Their view is that after a financial crisis of the magnitude we saw in 2008, sovereign defaults are inevitable.

Das believes it is unlikely European countries will be able

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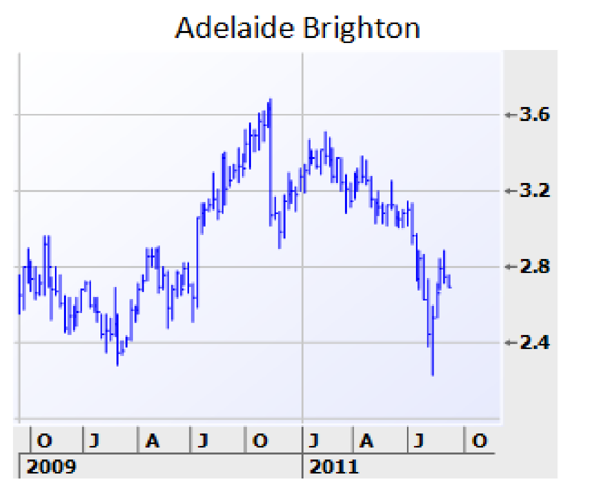
to implement the bailout package announced on July 21, 2011. Finland demanded and received 500 million euro in cash as security for its 1.4 billion euro share of the bailout package. Finland, Austria, the Netherlands and Slovakia are now demanding collateral. Greece is providing the collateral, which it will have to borrow.

The economist referred to above stated that Italy's debt to GDP ratio was 90 per cent. According to Reinhart and Rogoff once debt to GDP rises above 90%, economic growth slows. We don't know where this fellow got his figures, but every source we can find says that Italy's debt ratio was somewhere between 116% and 118% in 2010. It is likely to be above that now.

Why does it matter to us? When the GFC hit, credit markets froze. Banks would not lend to each other for fear of collapse. Local banks borrow overseas to fund their balance sheets. If there is no credit the banks have to pay more to borrow which will find its way into mortgage rates. In the post GFC world our banks are paying up to 1% more to borrow offshore. That spread will increase should there be another liquidity event, leading to higher mortgage rates and ultimately lower economic growth.

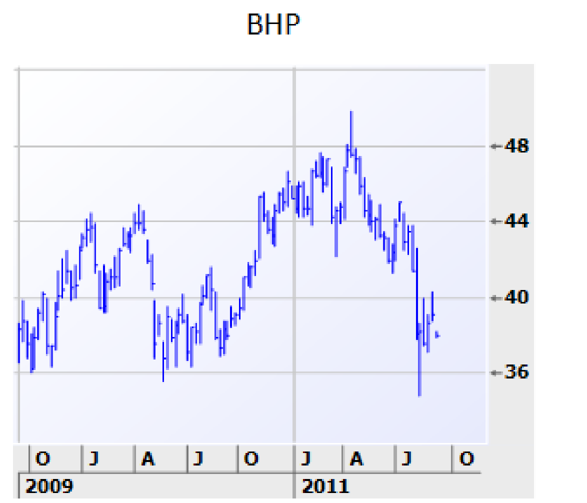
Nevertheless extreme market weakness throws up opportunities. The charts below are reflective of what happened to the broader market in early August to specific company's share prices.

Current Price: $45.71 | Dividend Yield: 7% | P/E: 11.8



Current Price: $2.70 | Dividend Yield: 6% | P/E: 11.8

Current Price: $3.00 | Dividend Yield: 9.40% | P/E: 11.5



Current Price: $38.00 | Dividend Yield: 2.7% | P/E: 9.5

Is there a death tax on Super?

How does the Draft Tax Ruling TR 2011/D3 affect you?

There has always been confusion regarding whether or not a capital gain event is triggered when a member of a super fund with a pension dies This ruling clarifies the issue but is still a *draft* ruling.

What happens on death?

According to the ruling, a superannuation income stream ceases on the day that a pension member dies, unless the pension is set up with an automatic reversionary beneficiary.

If the pension member dies and the beneficiary is decided under either a binding death benefit nomination or trustee discretion, the pension is deemed to cease and the money is effectively moved back into accumulation phase.

Taxation will then apply to the earnings on the underlying assets, including capital gains tax IF the assets are sold to pay the death benefit.

If the beneficiary selects to start an income stream the pension exemptions can restart from the date of commencement to that person, potentially the day after the death and thus negligible tax impact might occur.

TRAP - A death benefit pension can only be paid to:

- a surviving spouse
- a child under age 18 (or 18-25 who is a full-time student)
- another person (not child) who is a financial dependent or was in an interdependency relationship with the deceased.

It cannot be paid to an adult child or grandchildren unless you can prove an interdependency relationship.

What tax is payable?

If the pension is deemed to have ceased and the SMSF sells assets to pay a lump sum or restructure investments, capital gains tax (CGT) is payable on any realised capital gains. This reduces the amount of the death benefit payable.

CGT is payable at 15% although a one-third discount applies if the assets have been held for longer than 12 months.

This applies in addition to the 16.5% tax on the taxable part of the death benefit paid to a non-tax dependant generally adult children (your spouse is a tax dependant).

Although not finalised, the draft tax ruling indicates the views of the ATO in relation to how super income streams should be taxed. Should the ruling be finalised, it is proposed to be effective from 1 July 2007.

There are a number of strategies to minimise tax payable on death that can be considered and if you are not clear on what the tax impacts will be to your beneficiaries of if there are strategies you should be considering please talk to your Adviser.

Warning: If trustees sell down assets and repurchase them for the main purpose of reducing or avoiding tax, Part IVA tax penalties could apply.

Self Managed Super Fund (SMSF) Updates

Supervisory levy increased to $180

The annual SMSF supervisory levy levied by the ATO as the Regulator of SMSFs has been increased from $150 to $180, with effect from the 2010-11 financial year. It is paid when you lodge your annual tax return and as such this cost is "hidden" in that it is paid out of the refund or as part of the total tax payable for your SMSF. The ATO advise that the increase in the levy is to offset the costs of implementing the Stronger Super SMSF reforms.

New Rules on Collectibles & Personal Assets

These new rules start from 1 July 2011 for new assets, existing assets such as artworks, wine collections etc. have until 1 July 2016 to comply.

What's Happening in the Finance World?

In today's column I'll be discussing the pros and cons of fixed vs variable rates, the government's recent decision to abolish exit fees, latest offers from the big banks and some tips to reduce your mortgage quickly and significantly.

Fixed or Variable?

When we see fixed rates reducing, we have a tendency to jump in and fix our loans with little or no thought at all. It's a good exercise to stop and ask "why are fixed rates are being reduced". Generally the answer is not going to be "banks are reducing rates for our benefit". Rather, it can be an indication that variable rates are right behind them in falling. Here are some questions to consider before you make the leap into a fixed rate:

Is it right for my situation? – For example, if your only loan is a personal mortgage, your primary objective should be to find ways to reduce and eliminate your home loan. In this case a fixed loan that creates restrictions on how much extra you can repay is not gong to the best decision for you in the longer term

Will it save me, or cost me money? – Often I see clients paying a premium to have a fixed rate. What I mean is normally when the dust settles, fixed rates end up higher than variable rates, and unless you got in at the perfect time, variable rates will catch up and you will be left with a higher rate, and the only way of getting out will be to pay high exit costs

Is it right for my overall strategy? – It's not all negative. There are times when fixed rates form part of a great structure – which your Financial Adviser can help you to set. If you have a home loan and several investment loans, and the price is right, fixing can be a great way to leave you cash-flow efficient and knowing what your obligations are for years to come, whilst focusing on reducing your non-tax deductible debt

Removal of Exit Fees

Is the government's blanket decision to remove 'exit fees' a good thing? At face value, you may say a resounding *"YES"!* However as with most things, there are two sides to consider. Let's consider the facts:

Banks are rarely inclined to absorb changes in market conditions and will generally find a way to 'shift' costs

Putting non-banks lenders aside – who have enormous exit fees – exit fees or better known as deferred establishment fees, were designed to allow a client to enter with little or no upfront fees, whilst still allowing banks to maintain a reasonable return on shorter term loans. This decision by the government might bring back 'upfront fees'

Should you move? In my experience, clients generally move on service and then cost. If you feel inclined to make a shift, ensure your move is not price-driven alone and that the lender and product you choose can help you achieve the goals you have set for yourself

Latest Offers - Now, what's hot on the market?

Variable – Suncorp's Money Manager is now selling at 6.8% with no other fees apart from a $300 annual fee that includes Offset

Intro – If you're looking for a short, sharp rate, AMP has dropped their Pro-Pack 1-Yr Intro Rate to 6.57%, and with a post-intro rate of 7.07%, it's not bad value

Fixed – ING has an unbelievable 3-Yr rate currently selling at 6.39% and you can't go past Nab for your 5-Yr rate at 6.84%

Exciting – Exciting products to hit our streets recently are AMP's Master Limit ultra flexible lifestyle loan and Macquarie's Fixed Rate Line of Credit

Happy financing!

Paul DeGatesbury

Increased Macquarie CMA rates

From 1 July 2011, all clients who hold a Macquarie Cash Management account will receive an increased interest rate from 4.75% to 5.00%. This change reflects our ability to rebate the trail commission that would otherwise be paid to Life Strategies.

Life Strategies has a long standing policy of rebating trails to fee paying clients wherever it is possible to do so and the rebate is credited to you in a manner that does not erode the rebate by increased administration i.e. it's simple.

This change in Macquarie comes from their internal changes as they and other Fund Managers get ready for the removal of ongoing investment commissions from 30th June 2012.

In the last week of August Treasury confirmed that trail commissions will remain in place for all investments placed prior to 1 July 2012 however will not be allowed for new investments after this date.

Paul DeGatesbury is a Senior Consultant for Boss Outsourcing Solutions and works closely with Life Strategies. The contents of this article are Paul's opinions and do not take into consideration anyone's personal situation. Please speak with your Adviser before making or acting on any information contained. For more news and tips, go to www.twitter.com/BossAustralia

Life Insurance Myth Busters

PART II

In our June newsletter we discussed 4 common misconceptions around the various forms of life insurances such as Death cover, Total and Permanent Disability (TPD), Trauma and Income Protection insurance. Here are 3 more…

Myth 5 – Thanks, but I've got enough life insurance cover in my super fund

You probably don't have enough cover in your super fund. You may have some life insurance (death cover) through your super policy, but on average people with cover through super have less than half the level of cover they need.

Insurance through super also usually doesn't give you access to all insurance types – like critical illness or comprehensive income protection cover.

You should contact your super fund, or check your annual statement, to see what level – and types – of cover you already have. We may then be able to assist you in determining whether this is right for your needs.

Myth 6 – Life Insurance Companies don't pay claims!

The whole life insurance industry pays out almost $11.4 million every working day in claims to customers. This figure would be even higher if Australians had adequate levels of cover. (Source: www.riskstore.com.au).

However, not one of these claimants expected to claim on their insurance. If they hadn't received $2.78 billion from insurance policies, then *where else would they have got this money?*

That's a lot of people who didn't ever want to claim — *but had to*. How glad do you think they and their dependants were, to have been wise enough to take good advice and plan for the unexpected?

Myth 7 – Life Insurance is too expensive

For most Australians insurance is very affordable! For less than the price of a cup of coffee a day, you can get a substantial amount of cover to protect your family's lifestyle. And, of course, the benefits of having life insurance can far outweigh the costs!

Some of the insurance can also be held within your super fund meaning that the premiums can be paid out of your existing account balance thereby freeing up your cash flow and disposable income.

Contact us for an assessment of your needs

When it comes to life insurance, everyone has different financial needs. That's why it is vital to get the right advice for you. Should you want to discuss your individual circumstances and needs when it comes to protecting and securing your financial future, please contact our office. The initial meeting is at our expense- so no cost to you apart from your time!

Life Strategies' Ongoing Training & Development

Our Financial Adviser, Sharni Tucker attended the 2011 Portfolio Construction Conference, a professional development program on issues regarding the markets, strategies and investment portfolios.

Sharni also recently completed an FPA Accredited Estate Planning Course at the University of Technology, Sydney.

Our SMSF Administrator, Barbara Rawlingson attended the DBA Lawyers Self-Managed Super Fund Quarterly Seminar gaining an insight on the issues surrounding the control of a Self-Managed Super Fund when a trustee becomes incapacitated.

Life Strategies new website!

After 16½ years of business we are close to having our first website.

This has been a work in progress for some time and we look forward to sending you the website address and getting your feedback in October.

Would your family or friends benefit from reading our newsletter?

Please feel free to forward our newsletter to them if there are items you think would be relevant and could benefit them.

If you require extra copies please do not hesitate to contact our office.