LIFE Strategies TODAY

December 2011

Quarterly Review

Interest Rates

The RBA lowered cash rates for the first time since April 2009 when it met in November. Most economists had been predicting further tightenings throughout 2012. They rationalised the RBA's decision by saying that the cut was adjusting the cash rate to a neutral position as inflationary pressures had diminished.

This argument proved fallacious when the RBA again lowered the cash rate this month. The RBA has never made a one off change to monetary policy. It always follows up with further rate hikes or cuts over months. Inflation is not that sensitive to small changes in interest rates. Economists have now gone the other way and have found reasons to get on the rate cut band wagon, predicting further falls from February next year. I doubt that there will be another cut as soon as February unless there is further deterioration in the Euro zone and an impact on our region. During 2008 cash was 7.25%, leaving a lot of scope to lower rates. The starting point this time was 4.75% - a much lower base to start from.

There is another important difference. Bank funding was relatively cheaper in 2008 – credit spreads had not blow out. Since then it has become more difficult, or expensive for the banks to raise funds in international markets. This was demonstrated in November 2010, the last time the RBA raised rates. In response to an increase of 0.25%, CBA raised its rates by 0.43%. The banks were imposing a de facto tightening, doing the job of the RBA.

When the RBA lowered rates November, not all of the banks passed on the rate cut, reducing the effectiveness of monetary policy. If the banks do not pass on rate cuts when the RBA lowers rates, or increases rates more when the RBA raises rates, monetary policy behaves in an unusual way. We may be faced with a situation where rate cuts have little impact, but rate hikes are magnified.

In 2008 the problems in the US had an impact on consumers and the economy here because credit markets froze. In 2011 the same thing is happening because of similar problems in Europe. The difference is that the problems in 2008 were in the private sector whilst this time around it is the public sector which is in trouble, potentially a much more serious threat. A few years ago banks borrowed about 0.25% higher than the relevant swap rate. Two months ago the spread was about 0.85% and now it's about 1.50%. Bank funding costs are rising and so the banks can protect their net interest margin, the additional cost is passed to the consumer.

The chart below shows the spread between the London interbank offer rate (LIBOR) and the three month treasury rate for the past year. Since July the spread has blow out from 0.16% to 0.53%.

To put it in perspective, the chart below is the same graph back to 2006.

Share Markets

There are two types of investment style – bottom up or top down. Bottom up means picking individual stocks. Top down means exposure to the market as a whole. When the tide rises everything goes up, and vice versa. The market we are in now is a top down market. Broader macro-economic factors are dictating where the market is heading.

Share price valuations have compressed. A stock that traded with a price earnings ratio (P/E) of 15 five years ago may now be trading at a P/E of 10. That's what happens when investors are risk averse. Regardless of the merit of the company, share prices are lower now than they were a year ago. Perversely, in the US, where so many of the world's problems emanated, has risen 10% whilst we have fallen 7%. The chart below shows the relative performance of the local market versus the US market over 2 years.

In the US, the financial sector is down about 24%, whilst ours is down about 11%. But our financial sector accounts for over 35% of the SP 200, whilst in the US the financial sector only accounts for 13% of the SP 500.

The materials sector accounts for less than 5% of the US market but almost 30% of our market. The resources sector has fallen almost 20% in our market, but a lot less in the US where it is made up more of chemicals and construction materials.

So two sectors that make up 67% of our market have performed badly and accounts for our under-performance compared to the US.

The US is home to some of the world's largest corporations, still, despite the manufacturing shift to cheap labour countries. Corporations like Boeing, GE, IBM, Apple, Microsoft, the world's largest drug companies all reside in the US. Our largest companies are miners and banks.

In the last two months the All Ordinaries Index has risen by about 6.5%, from a very oversold level. If it can break though 4400 it may rise as high as 4550. I remain of the opinion that the weight of bad news coming out of the US and Europe will cause the market to fall back towards the 4000 level. The direction of the market, as explained above, is determined by the banks and the large miners. Both sectors appear cheap but are hostage to developments overseas.

In potentially good news for the iron ore suppliers, the head of India's biggest iron ore producer says the country will stop shipping to China within 5 years. This could potentially make room for another 100 million tonnes of Australian iron ore exports to China. Exports are predicted to grow to 488.7 million tonnes in 2012/13. Iron ore prices have fallen recently from $170/tonne to as low as $125/tonne. Prices are unlikely to fall below $100/tonne because China would reduce production from some of its marginal mines. China is on track to produce 693 million tonnes of steel this year, up from 623 million last year and slightly below forecasts.

Economy

National accounts showed that the economy grew 1% in the September quarter, and 2.5% for the year due to the approval of some huge energy and mining projects. Growth in WA was an extraordinary 8.4% whilst in NSW it was 0.5% and in Victoria 0.1%. WA is home to just over 10% of the country's population, but accounted for half the growth. Demand in WA grew by an astounding 16% for the year.

Government spending, or lack of it, detracted from growth, but household consumption was stronger than expected.

Seasonally adjusted household consumption expanded 1.2 per cent in the quarter, while government spending fell 1.2 per cent.

Manufacturing rose 1.9 per cent in the September quarter, or 2.2 per cent in the year to September. Mining rose 3.7 per cent in the quarter, but was flat at 0.1 per cent in the year. Retail trade volume rose 0.6 per cent in the quarter, or 1.4 per cent in the year.

Construction and mining were the main contributors to quarterly GDP growth, adding 0.4 and 0.3 percentage points respectively. The figures are backwards looking – it is likely with a worsening of conditions in Europe and a slowdown in the US growth will not be as resilient in the current quarter.

Unemployment figures released following the national accounts painted a more sober picture – 39,400 full time jobs were lost and the unemployment rate rose to 5.3%. Employment was flat in most states but deteriorated in Victoria.

What is Key Person Insurance?

In all businesses, there is always one asset that can easily be overlooked - key staff, managers, and directors without whom the business would struggle to operate profitably or even survive. Some examples include:

- a director whose credit rating and guarantees provide loan funding to the business
- a sales manager whose ability and business contacts provide increasing sales to contribute to the profit of the business
- an administration manager whose ability and knowledge of the business's operations keep the business running smoothly and efficiently
- a key technical employee who may have developed the products the business is selling and whose knowledge and on-going product development work are essential to the viability of the business.

The Problem

Your business could suffer a substantial loss of revenue and therefore profits, in the event of death or serious disablement of a key person who is critical to its success and profitability. If there isn't a suitable replacement within the business, it may also take substantial time and financial inducement to find and train a successor.

The Solution

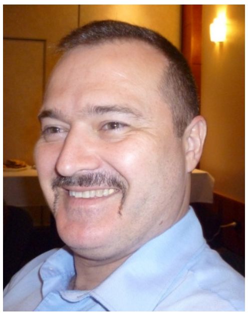
These people, like any other asset of the business, should be insured to protect the ongoing viability of the business as their skills, knowledge, experience and leadership generate significant revenue ensuring the success of the business.

Key person insurance can provide your business with enough money to compensate for the loss of revenue and associated replacement costs to replace a key employee or business owner in the event of death, serious illness or injury.

The principle is that the insurance proceeds are to go back into the business to help it survive the loss of the Key Person - the proceeds do not go directly to the business owners and so should be distinguished from Buy/Sell insurance on this basis. They should also be distinguished from "Business Expenses" insurance, which basically covers fixed on-going costs that the business is committed to (such as business overheads etc).

Contact us if you would like to know more about key person insurance and how it could benefit your business.

Life Strategies and Movember says thank you!



This year our Adviser Michael Huskic participated in Movember and with your help raised $285!

Movember aims to raise vital funds and awareness for men's health, specifically prostate cancer and depression in men.

Bob Lofgren, the founder of Life Strategies suffered from prostate cancer for 11 years and so we are very supportive of research into the cause and cure. We would like to thank all those who donated toward this worthwhile cause and towards Michael's new look!

Although Movember has come to an end, the fight against this prostate cancer continues. If you are male and over 50 or have a family history then remember to discuss testing options with your Doctor.

Also, if we can help anyone you know who needs to review or organise personal insurances such as Life, TPD, Trauma or Income Protection please note that we provide a complementary initial meeting.

Recent Changes to SMSF investments and filing fees

The number of Self-Managed Super Funds in Australia has increased by 21% over the past 3 years, with a total number of 456,472 SMSF at the end of the 2011 financial year (ATO June 2011).

The ATO has recently increased its filing fee to cover its costs in relating the funds for compliance. Trustees of SMSFs should be aware of the following recent changes to SMSF rules.

Supervisory levy increased to $180

Effective from the 2011 financial year, the annual SMSF supervisory levy has been increased from $150 to $180, to offset the costs of implementing the Stronger Super SMSF reforms. This levy is paid when you lodge your annual return.

Collectables and personal use assets

New rules have been put in place to allow SMSF trustees to continue to invest in collectables. This is however subject to tighter rules to ensure these investments are genuinely made for retirement income purposes and not for trustees' personal enjoyment.

Such assets include artwork, antiques, artefacts, motor vehicles, jewellery, memorabilia, wine or spirits, coins, just to name a few.

The tightened rules state that:

- The item must not be leased to, or part of a lease arrangement with a related party
- If the item is transferred to a related party, it must be independently valued
- The item must not be stored in the private residence of a related party
- The decision on the storage of the item must be recorded and kept for at least 10 years after the decision has been made
- The item must not be used by a related party
- The item must be insured in the fund's name.

This measure will apply to all new investments of collectables and personal use assets from 1 July 2011 and all existing holdings must comply with these regulations or be disposed of by 1 July 2016.

Losses incurred by an SMSF

Income tax laws provide that losses incurred in gaining assessable income may be deducted from a SMSF's assessable income.

However, a loss of a capital nature or outgoing of capital, is not deductible against assessable income but against capital gains only. In accordance with the capital gains tax (CGT) provisions, this includes losses arising from the disposal of assets such as shares and options. If the fund did not make a capital gain in the same income year, the capital loss can be carried forward to be offset against a future capital gain.

Previously, the CGT 'primary code rule' provided an exception for *trading stock* where capital losses could be deducted against assessable income rather than offset gains. The Government has since removed this exception so that gains or losses on specified assets (primarily shares, units in a trust and land) are subject to CGT.

Transitional rules will apply to ensure that assets held or accounted for as trading stock before 10 May 2011 are unaffected.

Is it easy to borrow in Super to purchase real estate?

Just like setting up a SMSF once you know what you need to do and the rules you have to work within setting up the structure to borrow to buy a property within your SMSF is reasonably straight forward and at Life Strategies we have the Financial Planning, Accounting and Mortgage broking capabilities to navigate you through this process.

At a recent training session the various traps that could see Trustees breaching the legislation and putting their fund's tax concessions in jeopardy were canvassed. The presenter said that they believed the ATO had made it so complex to borrow to invest in real estate within SMSFs as they didn't want anyone doing it.

As an example renovating a property can become challenging when the property is held by a SMSF. The previous guidance from the ATO being that SMSFs could not use money from any source to improve property.

However in a Draft ruling released in September the ATO has seemingly changed its position clarifying that renovations such as a new kitchen can be undertaken so long as it does not alter the character of the dwelling, such as turning a house into a block of units.

There is still a distinction between repairs which can be funded from borrowed funds and improvements which must be funded by existing monies in the fund.

If you have any queries on borrowing within SMSF please don't hesitate to contact Barbara Rawlingson or Sharni Tucker to discuss.

Superannuation Contributions Update

Super Guarantee Contributions Increase

The Superannuation Guarantee (Administration) Amendment Bill 2011 was introduced to Parliament on Wednesday, 2 November 2011. This Bill proposes to increase compulsory Superannuation Guarantee (SG) contributions from 9% to 12%.

This will be phased in over a seven-year period and put in place by 2019.

Another proposal is the removal of the age limit for compulsory contributions. The current age limit is age 70, which will be aimed to be removed by 2013.

Excess Contributions — be careful not to exceed the caps!

There are two types of super contributions – concessional (before-tax) and non-concessional (after-tax). Each type of super contribution is subject to a contributions cap for each financial year and if exceeded a penalty tax will be applied. It is therefore important to know these caps and which contributions count towards each type of cap.

The 2011-12 concessional contribution cap for individuals age under 50 is $25,000 and $50,000 for those 50 years of age or over.

Concessional contributions include:

- Employer super contributions (including SG) and any superannuation fund administration fees or insurance premiums paid by the employer on behalf of the employee's fund
- Salary sacrificed amounts and personal contributions you can claim as an income tax deduction

The 2011-12 non-concessional contribution cap is $150,000 but if you are under the age of 65, you can bring forward up to two years' worth of non-concessional contributions. Non-concessional contributions include personal contributions made from your after-tax income in which you do not claim a tax deduction.

Any contributions in excess of the concessional caps will be taxed at the normal 15% contributions tax and an additional 31.5% (including Medicare levy) – total tax of 46.5%. If you then also exceed the non-concessional cap, tax can be over 90%.

Offset Accounts

Do you want to learn the easiest way to reduce your mortgage, or do you plan to accept the lenders standard term of 30 years?

Go offset!

Many people know of an offset account yet not exactly how it works and hence do not buy into its benefits – at *their* cost. An offset is a savings/transaction account linked by an account you cannot see, to your home loan.

Having money in an offset account is like putting money in your home loan, but 100% accessible to you. To take an example of a $300,000 loan at 7% over 30 years, your repayments would be approximately $2,000 per month. If you left an additional $1,000 in your offset account per month, you would save an enormous $266,000 over the life of your loan and save a whopping 17 years.

Keep in mind, not all offsets are the same so talk to your Adviser about which suits your situation.

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

Variable – Suncorp's Money Manager is now selling at 6.55% 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 6.34%, and with a post-intro rate of 6.94%, it's not bad value

Fixed – ING has an unbelievable 3-Yr rate currently selling at 5.99% and you can't go past ING for your 5-Yr rate at 6.49%

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

2011 Christmas Drinks & Client Seminar

Life Strategies together with McEwen Investment Services held a seminar on Aged Care as well as an overall market update for clients.

Sharni provided clients with an insight on the steps involved in moving into Care and the role of your Adviser when making this transition. Rob McEwen of McEwen Investment Services brought everyone up to speed on how the International and Australian market is performing and what experts are expecting (or not expecting) in the short and medium term.

Given the success and positive feedback, Life Strategies and McEwen Investment Services plan to host more client seminars in the new year.

We appreciate any feedback and if you require further information please do not hesitate to contact our office.

Life Strategies goes live!

Our Life Strategies website has been a work in progress for some time & it's with great excitement that we unveil it.

As well as outlining the various financial planning and accounting services we offer, it provides links to financial calculators and relevant government websites. If you already have online access to a wrap account, stockbroking account or Macquarie Bank, you will find links to log into your account.

In addition, there are links to our most recent newsletters on the News & Events page, together with information on forthcoming events.

We hope you find the site informative – we would appreciate you forwarding the website link www.lifestrategies.net.au to anyone you know of who may be seeking financial advice or accounting services. We offer an initial consultation at our expense.

Christmas Break

Life Strategies will be closed from Tuesday, 20 December 2011 to Monday, 9 January 2012 for the Christmas holidays.

Please note that if you need to contact any of the staff during this time we will continue to monitor our main email yourfinancial-coach@lifestrategies.net.au and messages and will respond as soon as we can.

Life Strategies wishes you a happy and safe festive season and we look forward to working with you in the New Year.

Download the QR code application on your smartphone then scan this code and it will take you directly to our website!

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.