



Financially Speaking



Leenane Templeton
the self-managed super specialists

Edition 26 2010

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Financial markets 2010 and beyond



BT Financial Group's Chief Economist Chris Caton takes a closer look at the recent performance of financial markets.

After a tumultuous 2009, BT Chief Economist Chris Caton writes about his expectations for 2010 and beyond. The questions for 2010 are the usual ones: how much more do markets have to gain, and how strong will the world economies be? There is certainly no shortage of naysayers about the world economies; there are so many analysts who believe that the recoveries are not sustainable simply because the economic problems have not gone away completely. While the doubters are ruminating about W, L or square root shaped recoveries, the world economies are recovering as they usually do, with more upside surprises than downside. Since early in 2009, forecasters have been raising their estimates of how much

growth is likely in 2010. There is no reason to think this process is over yet.

Just one example; in May 2009, the consensus forecast for growth in the Australian economy in 2010 was 1.5%; that figure is now 2.8%, and it is almost certain to be exceeded. When forecasters are raising their sights, earnings tend to improve faster than anticipated earlier, and share markets thrive. But they won't do as well in the next twelve months as they have in the past nine. The recovery to date has been primarily because stocks have been 're rated'.

The price/earnings ratio for the Australian market has gone from a bargain basement level to close to the long run average. Re rating is the only way that you can ever get close to 50% increases in a short period of time. From now on, the market will need to be fuelled by earnings growth. That should happen, but the pace of appreciation



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of the market will almost certainly be much slower. A 10% gain over the course of 2010 would be a good result. Look for interest rates to rise by about another 1.5 percentage points over the course of 2010 also.

The long run

On a longer term note, the Treasury Secretary, Ken Henry, gave a thoughtful speech in late October, in which he looked at four long term forces facing Australia.

Population Aging: within 40 years, more than one in five Australians will be 65 and over, and one in 20 will be 85 and over.

A smaller proportion of the total population will be working, and the calls on the public purse for health spending, aged care and pension payments will expand enormously. The total population will increase by about 60% (13 million) in that time, raising questions about the future of our cities, environmental sustainability, the demand for infrastructure etc.

Climate Change: the issue is about both adaptation and mitigation. To achieve the latter, the cost of energy intensive activities has to be raised. Decisions about land use and the energy efficiency of urban infrastructure will also have to be made.

The internet revolution: we all now take for granted so many aspects of everyday life that the internet revolution has brought us. There is no reason to think it's over, but for Australia to stay at the forefront will require significant and intelligent investment.

China/India: in 2009, China surpassed Japan as our biggest export market.

Japan held number one position for 43 years. China may well be our biggest export market for the next 43. China's presence softened the blow of the GFC for Australia this year. In the long run, the continued dominance of world economic growth by the developing world means that the resource sector will loom ever larger in the Australian economy. This will require a long term transferral of resources from other sectors of the economy, notably manufacturing and (other) construction.

All of these are slow burning, but long lasting stories. They will have significant implications for many sectors of the economy, and for investment markets – something to think about.

Source: Chris Caton, BT Chief Economist, BT Financial Group

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Resources boom to boom

Australia has enjoyed five major mining booms in the past 160 years beginning with the 1850s gold rush. How different is the current boom from previous ones?

In a recent address to the Sydney Institute deputy Reserve Bank of Australia Governor Ric Battellino spoke about mining booms and the Australian economy. Mr Battellino highlights three similarities between these booms:

- global events played a significant role in their cause
- each boom strengthened the economy and coincided with increased population growth
- every mining boom placed increased inflationary pressure on the economy as the productive resources were stretched

Australia's most recent resource boom began in 2005. While the effects of the current boom were offset by the global financial crisis in 2007 and 2008, it is beginning to assert itself as a driving force behind our economy once again.

Australia produces natural resources in large quantities, making it one of the most significant single industries in our economy. Over 2008-09 gross product for the mining industry (including services provided to that industry) was A\$85,090 million, more than triple that of the rural sector (A\$28,178 million) for the same period.

Resources comprise more than two thirds of Australia's total merchandise exports. Last financial year resource exports totaled more than \$159,677 million, with Japan and China the major recipients. China's demand for our minerals has increased substantially over the last decade with the total value of mineral exports growing from A\$2,990 million in 2001-02 to A\$33,056 in 2008-09¹.

Mr Battellino said that mining investment as a share of GDP and terms of trade have been significantly higher than in previous booms. "The current level of terms of trade rivals the sharp peaks that were associated with rises in wool prices following the First World War and during the Korean War", Mr Battellino said. "The current mining boom has seen both the volume and the price of resource exports rise strongly."

One major difference between the current boom and other booms is the exchange rate. In previous booms the exchange rate was fixed or managed tightly resulting in inflationary pressures. With the current floating rate, the exchange rate has adjusted accordingly resulting in a higher Australian dollar. Mr Battellino believes increased flexibility in the exchange rate and goods and labour markets combined with more sound monetary and fiscal policy frameworks makes Australia better able to accommodate mining booms than in the past.

Commodities have always made up the majority of Australia's exports. Up until the

recent resources boom, the relative prices of Australia's exports had been declining as the prices of manufactured goods and services, of which we are a net importer, rose relative to commodities.

The emergence of China as a major consumer of Australia's resources and producer of cheaper manufactured goods and services has caused a major reversal of this trend. This has had a positive impact on Australia's living standards.

Mr Battellino is uncertain as to how long the current boom in mining activity will last. "Past booms do not seem to have lasted more than 15 years before resource

depletion, or international or domestic developments, acted to slow economic activity and bring the boom to an end. On this occasion, the growth potential of countries such as China and India suggests that the expansion in resource demand could continue for an extended period, though this will depend at least to some extent on the economic management skills of authorities in these countries, not to mention our own."

Source: Vanguard Investments, March 2010, www.vanguard.com.au

¹(Australian Bureau of Agricultural and Resource Economics: Australian commodity statistics 2009).

Lessons from the market

Every market cycle – bull or bear – provides opportunities for us to improve our investment process, and the last two years were no exception.

The best thing to do is learn from what happened and apply those lessons to your future investment strategies and circumstances. Here are five vital lessons from the recent bear market.

Lesson 1 – Keep your cool

This is the most important learning from recent times. Through market cycles, it's easy for investors to react emotionally – whether through overconfidence in rising markets or, equally, reacting with fear in falling markets.

However, we know that the best way to reach your financial goals is to remain cool and stick to your long term investment strategies. History has shown us that markets tend to recover just as quickly as they fall, just as we saw in 2009 when the Australian sharemarket enjoyed a significant recovery from March through to December.

Let's look at two investors to ask the question; "After one year, did staying the course make sense?"

The red line in chart 1 shows the growth of a \$10,000 sample 70/30¹ balanced portfolio from 1 January 2003 until the end of 2009. The chart shows what happens to the portfolio's value as the result of two different scenarios:

Investor 1: This investor kept their cool and decided to stay the course, making



no changes to their investment strategy. At the end of 2009, their balance would have been \$15,278.

Investor 2: This investor panicked and switched their investment to cash. Unfortunately for them, they chose the wrong time – when the market 'bottomed'. By switching to cash, the investor missed out on the market rebound. That's the problem with trying to 'time' the markets; you never know when the market has peaked or troughed. This investor's money was now worth only \$12,761 at the end of December 2009; a difference of nearly \$3,000.

As Chart one shows when the investor kept their cool and stuck to their long term strategy, their portfolio recovered a greater percentage

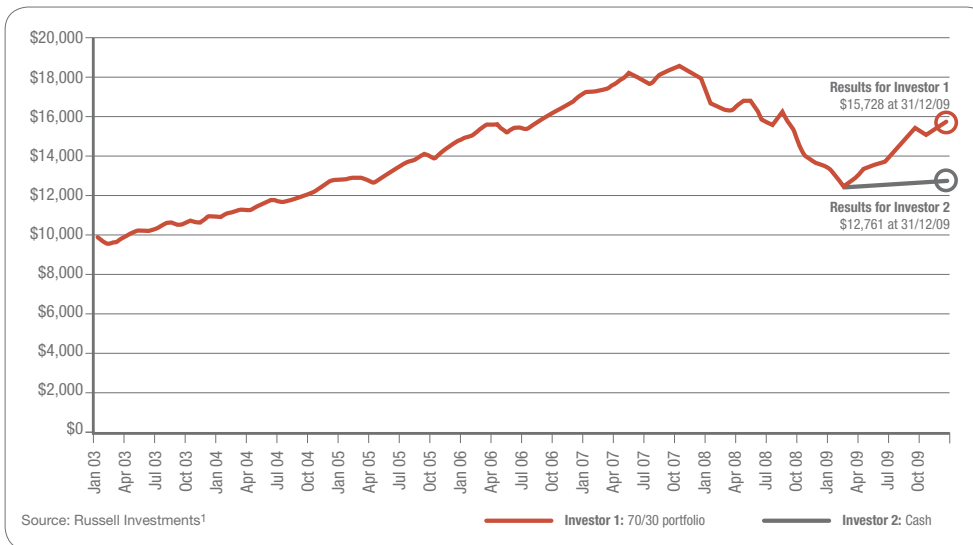
of its lost value – and at a faster rate – than when they switched to a cash investment.

Lesson 2 – Stay invested

While short term market falls are hard to ignore, it's essential to stay invested. In fact, long term investment discipline is more important than ever in a market crisis. We know that markets move in cycles, and that historically each bear market has been followed by a bull market. Therefore, if you remove your investment during a down market, you won't benefit when the market rebounds.

Chart two shows that investing \$10,000 in the Australian sharemarket in February 1980 and pursuing a 'buy and hold' strategy

Chart 1:
After one year did staying the course make sense?



As seen in chart one, a diversified investment has significantly outpaced the growth of cash.

Lesson 5 – Markets are cyclical. Whatever goes down must come back up again.

Following six years of solid growth by the Australian sharemarket, investors were reminded in 2008 that markets do in fact fall.

This we know: Markets follow cycles of ups and downs. What we don't know is their timing or duration.

As discussed in lesson 4, the Australian sharemarket experienced strong gains in 2009 following the downturn which commenced in late 2007. The point is that markets have always recovered. Over the medium to long term, despite the ups and downs, the Australian sharemarket has returned positive results.

What we've learned.

- While 2008 and 2009 were years of lows and highs for investors, they helped to demonstrate what we think are the key principles of investing:
- Diversify – it's essential to have a well diversified portfolio to help lessen the impact of market downturns.
- Stay invested – don't miss your opportunity for financial gains when the market recovers. You have to be in it to win it.
- Concentrate on the long term – the short term market returns shouldn't concern the long term investor
- Don't try to time the markets, or pick next year's winner – no one knows when markets will peak and trough, and attempting to pick which asset class will outperform is a risky behaviour.

Speak with your financial planner regarding strategies that will assist you in reaching your financial goals.

Source: Russell Investments, www.russell.com.au, March 2010

¹ Assumptions for Chart one: The diversified portfolio is hypothetical only and is calculated by a weighted average of the asset class index returns shown in accordance to the following asset allocations. 70% Growth portfolio consists of: 32% Australian Shares, 25% Australian Bonds, 5% Cash, 20% International Shares, 10% International Shares \$A Hedged, 8% REITs. Sources for the asset are Australian shares: S&P/ASX300 Accum Index; Australian Bonds: UBS Warburg Aust Comp Bond Index, Cash: UBS Warburg Bank Bill Index, International shares: MSCI World Net Div Reinvested Accumulation Index (A\$) and International shares hedged: MSCI World Net Div Reinvested Accumulation Index \$A Hedged, REITs: S&P/ASX 300 Property Accumulation Index.

² Past performance is not a reliable indicator of future performance. S&P / ASX Accumulation Index.

Chart 2:
Timing or time in?



resulted in the original investment being worth \$318,148 on January 31, 2010. The chart shows the effects on the investment of missing the best performing months and the difference is quite substantial.

It shows that an investor who incorrectly attempted to time the market and missed the single best month over a 30 year period ended up with \$270,926, almost 15% less than the investor who pursued the buy and hold strategy. Investors who sat on the sidelines and missed the best 10 months over the same period finished with just \$96,058; that is, 70% less than the patient, 'buy and hold' investor's end value.

Lesson 3 – Diversification still works

Without the knowledge of which asset classes or sectors will outperform, the key is to diversify.

Trying to pick the best performing asset class of the year is very risky, considering

that one year's best performing asset class can just as easily end up as the next year's worst performer. For example, over the last five years, Australian real estate investment trusts have been both the top performing and worst performing asset class twice.

A sound, well diversified portfolio with a long term focus will assist in reducing volatility and provide steady, consistent returns over the years.

Lesson 4 – Investing in the markets is the primary way to meet retirement and financial goals

The markets can be tough on your nerves yet, despite this, it's important to discount short term market performance when considering your longer term financial objectives. Although the Australian sharemarket fell 39% in 2008, it gained 38% in 2009². Investing is still one of the most prudent approaches to beat inflation and help realise your long term objectives.



Ease yourself into retirement

Did you know you can now access an income from your superannuation before you retire permanently? A transition to retirement strategy could help you afford a move to part time work, or boost your superannuation balance without compromising your take home pay.

- How it works
- Who is eligible?
- Things to consider

How a transition to retirement strategy works

You can access an income from your superannuation while still in the workforce through a transition to retirement pension.

There are two ways to use the income you receive from a transition to retirement pension:

1. To subsidise a move into part time work, or
2. To enable you to afford to salary sacrifice more of your income to superannuation

and boost your superannuation balance without the need to lower your take home pay

The maximum income you may draw from a transition to retirement pension in any year is 10% of the balance. In the first year, the maximum is 10% of the amount you used to open the pension and in future years the maximum is 10% of your balance on 1 July.

If you are a defined benefit member the amount you may transfer from your current account into a pension will be limited, but you may have the option to transfer out of your defined benefit plan and commence a pension with your whole balance. Speak to your financial planner about your options.

Transition to retirement strategy example

It works for Steve

Steve, 60, is still working full time, earning \$100,000 plus 9% super, and plans to retire when he is 65. With 5 years up his sleeve he wants to bolster his retirement savings. While he will be limited by his

concessional superannuation contributions cap of \$50,000 a year until 2012 and then \$25,000 (indexed) beyond, he looks into starting a transition to retirement strategy and salary sacrificing more into his super. He salary sacrifices as much as possible of his salary into his current super account and draws down an amount from his Pension Account (subject to a maximum of 10% of his Pension Account) so that he still has the same amount of money on which to live.

In one year, Steve can save over \$8,000 in tax and can contribute this to his superannuation by putting it straight into his current account. This strategy is tax effective because income payments from a Pension Account are tax free for people over 60.

If Steve was aged between 55 and 60 he could still benefit from his strategy while maintaining the same take home pay. The level of salary sacrifice contribution would be the same, but the pension income would provide a 15% tax offset rather than being tax free. In one year Steve can save up to \$1,995 in tax with this strategy.

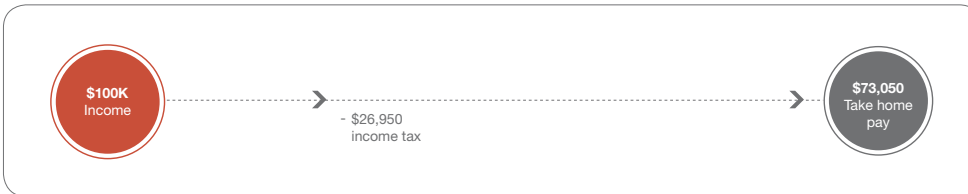
Table 1

Date of Birth	Preservation Age	Date of Birth	Preservation Age
Before 1 July 1960	55	1 July 1962 to 30 June 1963	58
1 July 1960 to 30 June 1961	56	1 July 1963 to 30 June 1964	59
1 July 1961 to 30 June 1962	57	1 July 1964 and after	60

Who is eligible?

You need to have reached your preservation age (see table 1) in order to take advantage of the transition to retirement provisions.

**Chart 1:
Without transition to retirement strategy**



**Chart 2:
With transition to retirement strategy**



Source: Russell Investments; All amounts are shown in todays dollar terms.

The illustration above is based on the Tax rates applying for the year 2009/10 (including the medicare levy). The Transitional Concessional Contribution Limit of \$50,000 per annum (up to 30 June 2012) applies. We assume no tax free component for the example of the impact between 55 and 60.

Things to consider

- Transition to retirement pensions are not commutable. This means you won't be able to withdraw more than the maximum income (10% of the balance per year) until you retire or reach age 65. You can, however, stop the pension and transfer your benefits back into your original superannuation account.
- There is no tax on investment growth in a pension
- If you are between 55 and 60 you will be liable for tax using normal marginal tax rates, less a 15% tax offset available on pension income. Remember to take into account any income you receive from other sources (such as employment) as this will affect your marginal tax rate. The tax free proportion of your payments (if any) is not taxable.
- Those aged 60 and over can withdraw their super tax free.
- Before tax super contributions (salary sacrifice) may still be made to your original superannuation account. These contributions incur a contributions tax of only 15% (compared to an income tax of up to 46.5%) and can help you to build more retirement savings.
- The income you receive from the pension can affect your taxation status and eligibility for Centrelink benefits.

Speak with your financial planner to find out more about how this strategy may assist you.

Source: Russell Investment

When is a Will not a Will?

Your Will is a legal document that sets out directions for the administration and disposal of your assets after death. It must comply with fairly strict formalities to be valid. However, even a valid Will can sometimes be totally ineffective if it does not achieve what you intend because of assets you do not actually own.

Your Sole Assets

This is because a Will can only control the sole assets that you owned in your sole name as at the date of death. Therefore, any assets held in a company, a trust (such as a family trust) or a superannuation fund will not form assets of your estate.

Put another way, your Will can only give away what you own.

This can be confusing to some who think that they own everything, even those assets that have been placed in a company, trust or superannuation fund, and that their Will can automatically control the distribution of these non estate assets. On the other hand, having assets held by other entities can also be of benefit to those seeking to protect those assets against claims after their deaths.

Non-estate Assets

For example, you do not individually own assets held as follows:



- **Jointly owned assets** are not part of your estate. These assets pass by the laws of survivorship directly to the survivor, and do not pass through your Will.
- **Company or trust assets** are not part of your estate. Company assets are governed by the company constitution, (although you may, of course, own the shares) and not your Will. The distribution of trust assets are governed by the trust deed and not by your Will.
- If assets are held in a trust such as a family trust, it will be important to confirm the effect your death will have on the

trust, and the tax implications of any family trust election you may make. It will also be important to ensure that you have complied with the land tax notification requirements for land held by the trust.

- **Investments in Superannuation Funds** do not normally form part of your estate. This is because the superannuation assets are held by the fund's trustees on your behalf. If you have a SMSF, it is prudent to ensure that your trust deed is up to date to take into account the significant number of legislative changes that have occurred over the past few years. In particular,

you may wish to have a clause allowing you to make a Binding Death Benefit Nomination if the circumstances are appropriate.

Only if assets are transferred from these other entities to your sole name prior to your death can your Will control their distribution. However, it is important to note potential stamp duty and CGT liabilities for any asset transfers.

It is important to speak with your financial planner when making decisions around your Estate. Contact your financial planner today.

Source: TopDocs

What is your most important asset?

Throughout Australia, a very high number of people have insurance for their possessions – their cars, houses, boats and even their furniture. Income protection, however, protects the most important valuables – you, your family and your ability to earn income.

Be protected and be in control.

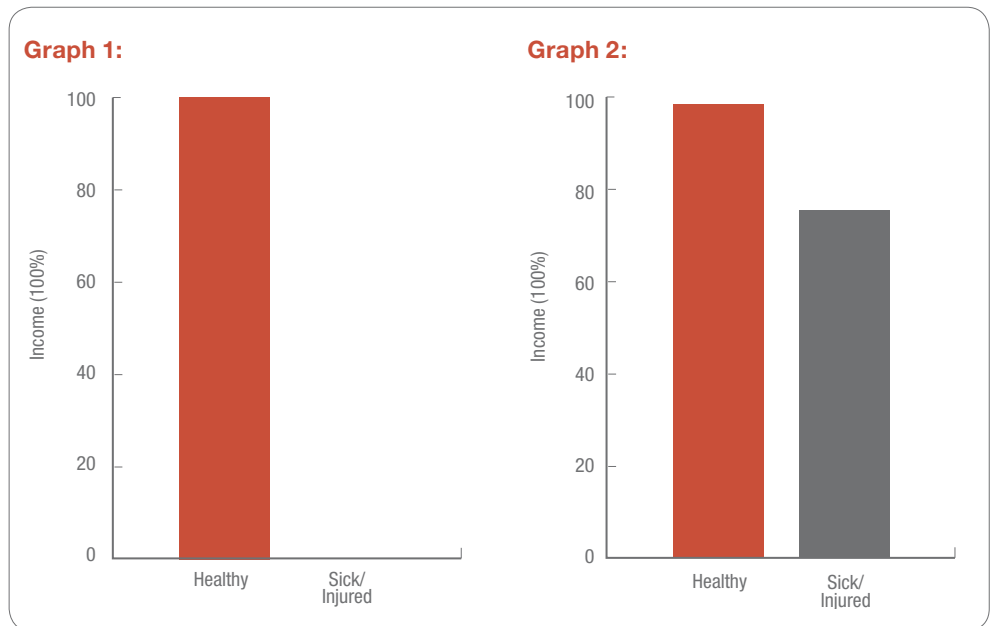
1. There are over two million people of working age in Australia with a disability potentially impacting on their ability to work. That's 13% of the population.
2. Every working Australian has a one in three chance of becoming disabled for more than three months before reaching retirement age.
3. Workers compensation will only cover you for accidents or injuries that occur during work hours or for an illness that is a direct result of your employment.

These facts are real and so is the risk.

(Source: Zurich Financial Services Australia.)

Case Study

Kathryn was 38 and was working as a marketing manager when she broke her arm while playing volleyball. Her arm was placed in a full cast for two months, and during this time she was unable to drive, meet with clients or work effectively at the office. Despite Kathryn having two weeks of holiday pay and two weeks of sick pay, she still had four weeks where she was without an income. With living expenses, medical bills,



and her mortgage, Kathryn found herself to be greatly out of pocket. Although she had insured her car, house and furniture, Kathryn had failed to insure her most important valuable – her ability to earn income.

A financial planner could have provided Kathryn with a full suite of available protection to safeguard herself and her family from the consequences of being out of income for a number of weeks.

Most people have two remuneration options:

- 1 The standard remuneration position – 100% of income is received while you are well and able to work. When you're not able to work, you get 0% of your income (see Graph 1 above).

- 2 The alternative remuneration position, including the 4 weeks covered by income protection insurance, means that you are still able to maintain a large portion of your annual income whilst you are sick/injured. (see Graph 2 above)

(Source: Zurich Financial Services Australia.)

Your financial planner can give you a full list of available protection as well as any further information you may require on premiums.

Protect yourself, your family and your future and enjoy peace of mind.

Contact your financial planner today.

Source: Lonsdale Financial Group Limited

How tax effective is super?

Below are two scenarios that illustrate how salary sacrificing towards your super can work towards your financial goals in retirement.

Names: John & Jane

Ages: 41 & 39

Current Salary: \$75,000 pa & \$95,000 pa.

What Jane and John did: Salary sacrificed an additional \$5,000 a year towards their retirement.

Let's say John and Jane both decide they each want to put away \$5,000 a year towards their retirement. They look at how much they could save by 'sacrificing' some of their salary into their super account. They also look and compare how much they could save by investing outside super. For the purposes of this example, the assumptions are the same for both super and non-super, using an investment return of 7.7% pa.

Helpful tip

If your salary puts you into the next tax bracket by just a few thousand dollars, your sacrificed contributions could reduce your taxable income and bring it down into a lower income tax bracket, further reducing your tax.

Speak to your financial planner about the tax effectiveness of your super.

Source: Colonial First State, www.colonialfirststate.com.au, March 2010

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John

John earns \$75,000 pa and pays tax at the marginal rate of 31.5%. After 20 years John's savings could be:

Inside super \$97,816

Outside super \$67,959

That's a difference of \$29,857 if John salary sacrifices into super.

Jane

Jane earns \$95,000 pa and pays tax at the marginal rate of 41.5%. After 20 years Jane's savings could be:

Inside super \$97,816

Outside super \$53,120

That's a difference of \$44,696 if Jane salary sacrifices into super.

Super can give you tax savings

	Inside super 15% tax	John Outside super 31.5% taxpayer	Jane Outside super 41.5% taxpayer
Salary sacrificed	\$5,000	\$5,000	\$5,000
After tax	\$4,250	\$3,425	\$2,925
Plus 7.7% return (year 1)	\$327	\$264	\$225
Minus tax on performance returns (year 1)*	\$49^	\$83^	\$93^
Financial position after year 1*	\$4,528	\$3,606	\$3,057
Financial position after year 20	\$97,816	\$67,959	\$53,120

This table is for illustrative purposes only and does not represent actual returns. A change in one or more of the variables and assumptions will produce different results. This is general information only and does not take into account your individual objectives, financial situation or needs.

This table illustrates the position after 20 years of taking \$5,000 pa of before-tax salary and either salary sacrificing it into super or taking it as cash salary and investing outside of super. It assumes investment earnings of 7.7% pa, after fees and before tax. Super investment earnings and contributions are taxed at 15% Non-super investment earnings are taxed at a marginal tax rate of 41.5% All figures are in today's dollars, adjusted for inflation of 3.0% pa.



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