Financially Speaking

Brought to you by your Financial Planner
North West Financial Services (QLD) Pty Ltd.

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Inside this edition

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Headwinds increasing, monetary policy easing –

an outlook for the Australian economy and market 2013

In Lonsec's view, Australia is facing increased headwinds from falling iron ore and coal prices, tightening fiscal policy (at both state and federal levels) and a high Australian dollar (AUD). The economy is likely to slow rapidly as exports, investment and government spending contract. This needs to be met with lower interest rates to boost demand.

Lower interest rates should also lead to a weaker AUD, but at this stage, the currency continues to remain buoyant. This seems to be related to foreign capital flowing into the safety of the Australian bond market, together with increased foreign investment in Australian Liquefied Natural Gas projects.

The good news is that inflation is well within the Reserve Bank's (RBA's) 2-3% target range and the RBA has indeed been easing monetary policy.

The RBA has cut the cash rate by 1.5% since November 2011, with the cash rate coming down from 4.75% to 3.25%.

The banks

The banks however, have only cut loan rates by an average of 1% in response to generally higher funding costs.

The higher funding costs relate to increased competition for deposits and the higher cost of wholesale funding in a post-GFC world. What this means is that the monetary policy mechanism is not working as efficiently as in the past because Australian banks are generally holding more deposits as a percentage of total funding, which in turn leads to higher loan rates, so banks can maintain their interest margins.

Currency

There is another area where economic theory is breaking down and that is the currency. Normally, falling iron ore and coal prices and a major reduction in the cash rate would lead to weakness in the AUD. Instead the currency remains surprisingly resilient above US$1.00.

This has occurred because Europe, Japan and the US are all running large budget deficits and very loose monetary policy that devalues their own currencies, leaving the AUD the best of a 'motley crew'. The strong AUD is starting to become a concern in that it makes imports more attractive and our exports less competitive on the global stage.

Our own manufacturing base will become increasingly eroded without a major lift in productivity to offset the strong AUD.

The Australian economy faces increasing headwinds in the short term from falling bulk commodity prices, tightening fiscal policy and a high AUD. This needs to be met with easing monetary policy – which has been delivered – but not as effectively as in the past. Lonsec believes more needs to be done to support the economy against a slowing global economy and a relatively high AUD. We expect the RBA to cut rates further in the short term. This should prevent a recession and help maintain a reasonable growth rate of around 2.0% in 2013.

The Australian market

The Australian share market seems to have been stuck in a trading range of 4,000-4,500 over the past year. Small and medium sized companies have generally been outperforming the larger companies due to stronger earnings growth. The larger companies have been more hampered by patchy growth across the economy, a high AUD, government taxes and rising costs.

The recent slowdown in Asia has seen bulk commodity prices fall sharply, which is putting pressure on resource-related stocks. Banks, Industrials and Trusts (Property and Infrastructure) are generally faring better because their high dividend yields are being sought out.

We don't expect a major turnaround in earnings growth in FY13 as the economy will continue to slow until bank loan rates are cut more aggressively.

The rate cuts thus far have not been enough to spark a major rebound in consumption and construction while households are still in the frame of mind of paying down debt. If the RBA continues to cut rates, then domestic growth should rebound and we are likely to see improved earnings (for financials and industrials) in FY14. This should lead to the market breaking out of its trading range to the upside. However, the severity of the current global slowdown will also be a telling factor in local economic conditions and company earnings.

The recent rally in the share market to the 4,500 level has seen price-to-earnings ratios expand. Resources look expensive in the short term because spot prices have fallen so sharply and the market seems to be expecting a rebound in FY14.

Dividend yields are still attractive, particularly in t*he Financial and Industrial sectors*. As interest rates come down in Australia, investors will increasingly look for sustainable yield on the ASX, which should provide firm support for Industrials, Financials and Trusts.

Source: Lonsec, November 2012

What to do when you've paid off your mortgage

Once you've paid off your mortgage, you'll have some spare money. But do you know what you're going to do with it?

The first thing you want to do is to make sure you use your spare money effectively. Now that the mortgage has gone, your circumstances have changed considerably, but have you reviewed your financial goals and needs? What's going to be the most effective way to achieve those goals?

Whether you're considering creating or increasing your investment portfolio or buying an investment property, you need to be sure that you've thought about all your options.

While using your extra money to invest in another property or shares is one option, you could also consider boosting your super. If you're not already making personal contributions, you could consider using a salary sacrifice strategy to pay the equivalent of your mortgage repayments into super and take advantage of the low tax super environment. But remember that the amount of concessional contributions you can make to your super each year has been reduced to $25,000 per person. You also need to consider that any amounts you contribute to your super using a salary sacrifice strategy will now count towards your assessable income for the purposes of your eligibility for any Centrelink entitlements.

The right advice can make a difference

Everyone's financial needs and goals are different and it's worthwhile seeking professional financial advice before you make important financial decisions.

Your Financial Adviser can give you advice on tax-effective superannuation or asset protection strategies, help you make sure your retirement plans are on track or help you with your estate planning needs.

Source: IOOF, February 2012

SMSFs and property

The popularity of Self Managed Super Funds (SMSFs) has increased substantially over the past few years. In fact, SMSFs now account for about one third of total superannuation savings.

One of their major drawcards is the broad level of investment freedom they offer. This includes the ability to invest in residential and business property, an option generally not available with other super arrangements.

Potential tax benefits

So why use an SMSF to invest in property? Well, depending on your circumstances, it can sometimes be more tax-effective to purchase a property through an SMSF than to buy it outside super.

This is because rental income is taxed in super at a maximum rate of 15%. Once you retire and the fund is paying you a pension, rental income may be tax-free.

When the property is eventually sold, capital gains are taxed at 10% (if the investment has been owned for 12 months or more) and are potentially tax-free if a pension has started.

The table below compares the tax treatment of income and capital gains with other commonly used property ownership options.

Strategy tips

There's a lot to consider when investigating the property investment options with SMSFs. As well as making sure it's the right option for you, there are different strategies and rules to consider, such as:

- SMSFs can buy a business property from a fund member or a related party, such as a family member or related company or trust. It's also possible to transfer ownership of a business property into an SMSF by making what's known as an 'in specie contribution'.
- SMSFs generally can't purchase a residential property from a fund member or a related party.
- Buying a property through your SMSF needs to be consistent with the fund's investment strategy.
- You can increase your SMSF's property buying power by borrowing funds. SMSFs can only borrow to invest (using a 'limited recourse borrowing arrangement') in a 'single acquirable asset', such as a single title for land and the accompanying property, but not additional items such as furnishings.
- It's possible to have up to four members in an SMSF. By adding family members, such as adult children, you could increase the fund's balance considerably and increase your capacity to buy property assets.

Tax payable on:	Property owned by			
	Individual	**Company**	**Super fund**	**Super pension**
Rental income	Up to 45%[1]	30%	Up to 15%	Nil
Capital gains[2]	Up to 22.5%[1]	30%	Up to 10%	Nil

[1] Ignores the Medicare levy.

[2] Assumes the asset has been held for 12 months or more.

Is an SMSF right for you?

While running an SMSF can give you greater control of your super and retirement savings, it's a big commitment.

All members are generally required to be fund trustees. As a result, you are responsible for meeting a range of legal and administrative obligations and penalties apply if you don't perform your duties.

Also, to make running an SMSF a cost effective exercise, you and your fellow members will typically need upwards of $250,000 in super.

Advice and support

Given the complexities involved, a financial planner is best set to help you navigate through the complexities of an SMSF and decide whether it's right for you.

Many planners also recommend using a comprehensive administration service that can take care of the auditing, accounting and administration needed to meet compliance obligations.

To find out more about SMSFs and investing in property, speak to your Financial Adviser.

Source: MLC, November 2012

A bright future and a bold ambition need the backing of a brilliant plan

Building a free and independent lifestyle needs more than just a drive to succeed and the skill to make it happen. It takes one of two other ingredients; good luck or good planning.

We all have different definitions of success. For most of us it is the desire for financial independence, an aspiration to choose our own path in life and ultimately, a drive to achieve a sense of fulfillment and happiness.

Chances are you have already taken the right steps toward these goals:

- through education
- buying your first home
- establishing yourself in a rewarding career or business
- starting a family
- implementing an investment plan, or
- enjoying life experiences such as travel, sporting activities and entertaining friends.

It's natural to assume that we can control our progress toward these and other goals through our motivation, hard work and perseverance, and often, if we are lucky - we do. You are free to choose luck, and hope that a tragedy doesn't strike and you won't suffer from a serious illness or injury, or that unexpected death won't disturb the secure and comfortable life you want for you and your family. But fortunately, you are also free to choose a more financially secure future.

Why not take the opportunity right now to explore your options and make a conscious choice about your future, rather than leaving it to chance?

No one plans to get sick, injured or to die prematurely, but you can plan to provide a cash cushion if you or your family are ever unfortunate enough to be affected by these events. It's all about retaining control of your financial independence even if you lose the ability to earn a living through your own efforts.

Through effective planning and provision for events that threaten your life, you can safeguard the financial future for you and your family. It is within your control.

The four pillars of protection

You can effectively and economically immunise your financial future against these risks using a combination of four basic types of cover:

1. Income protection insurance to provide a replacement monthly income if you are temporarily sick or injured.
2. Critical illness insurance to provide a lump sum of cash if you are diagnosed with one of many specified medical conditions, such as cancer, multiple sclerosis and heart attack.
3. Total and permanent disability insurance to provide a lump sum of cash if you become totally disabled and are unable to work ever again.
4. Life insurance to provide a lump sum of cash upon death or terminal illness.

A combination of these insurances can give you the financial resources to maintain or adjust your lifestyle and ensure that you are able to care for yourself and your family with confidence and dignity.

Good economic sense

The advantage of owning personal insurance is that you can make relatively small payments and instantly create a huge pool of contingency capital and income. When you compare this concept to the alternatives, it represents a vastly superior economic proposition:

- saving for such contingencies yourself may take years and you will only ever receive dollar for dollar plus any investment returns
- relying on social security may only provide you with a fraction of the income you need or are accustomed to, and
- dependence on relatives or friends would cost nothing, except maybe your dignity, but is unlikely to be a secure or sufficient long term source of income.

A skilled planning partner

Putting your protection plan together is best accomplished with the help of a professional insurance adviser who specialises in risk management. Working together can be a rewarding experience as you create security and protection around the financial future of those you love. It may be the most significant step toward financial freedom that you ever take.

To find out more, contact your Financial Adviser today, and discuss your life insurance protection plan.

Source: TAL, November 2012

Holding periods and hyperbolic discounting

Investment and patience have never gone together. We might assure ourselves we are investing for the long term but all too often our emotions get in the way. A growing fascination with tracking the daily ups and down of the stock market can make investors sell too quickly or trade too much.

Behind this preference for fast gratification lies an investing bias known as hyperbolic discounting. It means that we show a marked preference for current consumption over future rewards. Hyperbolic discounting helps to explain the challenge of getting us to invest for far-off retirements. As rewards are delayed further into the future, we assign them less value.

Studies, for example, show that most people would take $100 today over $200 in two years time, but would not take $100 in six years over $200 in eight years. Rationally, there is no reason for this – we should find these trade-offs identical in relative terms.

The problem is the way that we think about time is not rational. As points in time are pushed into the future, we come to view them as simply faraway points on a fuzzy horizon. This treatment of time seriously complicates how we attach value to future rewards. The value of savings to a man aged 65 are obvious but, without a time machine, showing this to the same man in his twenties is a problem if he assigns little value to a distant reward. The issue then is that valuable years of compound investment growth can be lost to inertia.

Binding Commitments

One of the main methods of addressing this human failing is via making commitments; ideally, binding commitments. In the same way that people find it easier to train for a marathon once they have made a commitment to raise money for the effort, commitments can be useful in investing.

Superannuation is a great example of a binding commitment. It effectively bars people from using their savings before retirement and it benefits from favourable tax treatment to further promote saving over consumption.

There is no such binding commitment for a managed fund or holdings of shares. Given the patience required for investing, this poses a behavioural challenge to investors at a time when holding periods of shares have fallen to historic lows.

There is plenty of evidence to show that investing in a well-chosen portfolio of high-quality shares has been a winning strategy over time. But time is a critical part of the process. It follows then that self-control is a critical part of investing. For some investors, it might be better not to monitor the daily fluctuations in markets if these merely cause them to question the value of holding investments.

Source: Fidelity (October 2012)

Super Contributions - FAQ

Are there limits on how much I can contribute to my super?

Yes, limits do apply to the amount that can be contributed to your super each year, so it makes sense to keep tabs on how much is going into your fund. Contributions that exceed annual caps can be heavily taxed.

There are two ways to contribute to your super, and different annual limits apply depending on the type of contribution.

Before-tax/concessional contributions

'Before-tax', or 'concessional', contributions include your employer's compulsory super contributions, your own contributions made through a salary sacrifice arrangement, or contributions you make as a self-employed person. These contributions are taxed at 15% as they go into your super fund.

The total annual limit for concessional contributions is currently $25,000. Remember, this figure includes all your concessional contributions, so if you are a high income earner using salary sacrifice to boost your super you need to be careful not to exceed the annual limit. Concessional contributions above the $25,000 annual limit incur penalty tax of 31.5% over and above the standard 15% contributions tax, a total of 46.5% tax

After-tax/non-concessional contributions

The second way to add to your super is by making 'after-tax', or 'non-concessional contributions'. These are made using money out of your own pocket from say, savings or from other investments. The 15% contributions tax payable on the concessional contributions above, does not apply here because tax has already been paid on the money.

A yearly limit of $150,000 generally applies to non-concessional contributions. However, up to and including the financial year that you turn 64, you can take advantage of 'averaging' provisions. This means you can make a single payment of up to $450,000 in a single year provided no other non-concessional contributions are made in the following two years. Contributions above these limits can be taxed at 46.5%.

Source: Colonial First State Investments, November 2012

"Fast forward to the future"

What will life be like in 2050? We share some expert opinion.

It's hard to predict the future but that doesn't stop the world's top experts from trying. With close to nine billion people expected on the planet in 2050, what changes do the experts foresee? How can we meet the challenge of longer lives with more technology and less money? It all depends on having a plan.

iWorld: technology and the future

The future is already here: data is increasing exponentially and we're close to information overload. Ten years ago it was easy to laugh at the need for an internet-connected fridge. Now fridges, phones and cars are connected to the internet, and soon it's likely that all of our belongings – even our bodies – may be.

Rapid growth in internet usage and connected devices is building a new technologically-immersed world.

Tools like Google Wallet and Square Mobile are turning every iPhone into an e-commerce platform. The world's libraries will soon be rolled up into a paper-thin computing device rendering printed books cumbersome and relics of another era. Cloud computing will combine with increased miniaturisation to give us access to petabytes of data, media, music and video without the limits of local storage.

Thankfully, the future is also bringing tools to combat technology fatigue and overload. Experts predict that we'll get better at triaging information, deciding what's relevant, and using increasingly sophisticated tools to sort, store and retrieve the data we need.

Planning for a long life

Healing, in the form of technology, is also on the way. Noted artificial intelligence (AI) expert and technologist, Ray Kurzweil, predicts that by 2050 humans will transcend their biology and radically extend their lifespan using technological intervention.

If life expectancy keeps improving, we'll need to move toward longer working lives or saving more to fund our longer retirements.

For example, to receive a defined lifetime pension of 60% of our salary we need to be contributing 20 – 30% of our salary over a full career, significantly higher than our mandated 9% super contribution.[1] To make those numbers stack higher in our favour, it's time to make some small changes now, like contributing a little more to super each week.

Smaller, faster, cleaner: hi-tech cars

We'll also be moving faster. Strict environmental regulations will result in smaller, cheaper, more energy-efficient cars. Futurists predict that cars in the developed world may be computer-controlled, with traffic flow and road management issues handled by advanced networks of artificial intelligence, which may allow for greater speed of travel.[2]

And if moving quickly through the future isn't enough, we might be able to travel back to the past. In groundbreaking research, scientists have discovered that sub-atomic particles can travel faster than the speed of light. Jeff Forshaw, a professor of particle physics at Britain's Manchester University, says that if the results are confirmed it would mean that "time travel into the past would become possible."[3]

Financial advice: planning for the future, in the future

The way that financial advice is delivered, and what it means, will be impacted by all of these developments – and more – in the future. The most obvious impact is that we will all be living longer. How much longer is unclear, but if only a couple of big-ticket diseases were cured before 2050, what impact would that make to our lives?

Most people tend to think of their own parents' lives when planning their retirement, but with the right medical advances, it's possible to add 20 years, or possibly even more onto your expected longevity. It sounds like a wonderful problem to have, but only if the extra time will be spent in comfort, doing the things you want to do.

Financial advisers will be much better equipped to handle the challenges of the future. Technology has already had a huge impact on the quality and accuracy of strategies that advisers construct for clients and this trend will continue. Expect your adviser to provide you with real-time analysis of your strategies and portfolios and the ability to update them on demand.

Of course, nothing is likely to replace the comfort and power of a face-to-face meeting, but your adviser is also likely to harness industry experts and apply their knowledge to your personal situation. The requirement for signatures will be gone, with a simple thumb-print or other bio-metric device all that's required to confirm that you want an action to take place.

By 2050, managing your financial future will be absolutely critical to your future happiness. With so many more options, so much more time to enjoy life and technology that never ceases to amaze us – it's important to work with an adviser who understands your needs and is keeping abreast of the changes occurring around them.

Future shock or a future to enjoy? The answer depends on how well we plan, and how we use the technology at our fingertips.

1. Rice Warner Actuaries. Touchstone: *Surviving Longevity*. March 2010.
2. futuretimeline.net. *The World in 2050*.
3. Reuters. *Faster than light particles may be physics revolution*. 23 September 2011.

Source: Russell Investments, November 2012

All I want for Christmas… is to survive it debt free!

With the holiday season fast approaching, it's tempting to throw out the year's careful planning and budgeting to splurge in the name of Christmas. But getting into the Christmas spirit doesn't mean you have to get into debt.

Follow these tips to emerge in the New Year debt free.

Set a budget

First take some time out to review your current finances. Determine how much you can realistically afford to spend without getting into the red. Remember to include gifts and entertainment as well as all the small things that come with the season like cards, stamps, decorations, food and travel. Next make a list of everyone you plan on giving a gift to and decide how much you want to spend on each person. Finally check that the total figure you want to spend is not beyond your budget.

You may need to reduce the amount you're able to spend on each person or reassess the number of people on your list.

Start early

Before you know it, Christmas will be upon us. In fact, the department stores have already started spruiking their Christmas wares. By shopping early, you can look out for sales and great deals for later in the year. You also have time to comparison shop rather than last-minute shop; where your panic to pick up something (anything) will usually mean spending more.

Look for savings and incentives

If you choose to use your credit card, look for any rewards or discounts that may be available through your credit provider.

Also try to shop online first as you're less likely to impulse shop and can easily compare prices across various websites. There are plenty of online retailers that offer savings across a number of product categories such as fashion, skincare, make up, fragrances, books and electrical appliances. You can also find discounts through online community classifieds, auctions and daily deal sites.

Remember who you're shopping for

When you're shopping for family and friends, it's very easy to find things which will be just perfect for you. This is a very common mistake which is sure to break your budget. Christmas shopping isn't a 'one for you, one for me' deal. Don't buy it. If you really need to have it, wait until after the holidays when it's more likely to be on sale.

Stick to your budget

Remember that a deal is not a deal if you can't afford it. Once you reach your budget limit, stop.

Save early

Get off the overspending merry-go-round by saving early for next year. As soon as the holiday season is over, determine next year's Christmas budget and set up automatic direct debits into a dedicated Christmas savings account. You'll be all set by the time the department stores bring out their tinsel again.

If you'd like more advice on how to manage debt and build a savings plan, contact your Financial Adviser today.

Source: IOOF, January 2012

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