



Financially Speaking

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Inside this edition

- The cycle of market emotions
- Covering all bases – Insurance through a self managed super fund can be highly tax-effective
- Turning point for Aussie shares?
- What is a redundancy payment, and how much tax will I pay?
- Estate planning essentials

The cycle of market emotions

You have probably heard of the investment cycle – where markets move and investment options go up and down. But have you heard about the cycle of our emotions?

When things are great we feel that nothing can stop us. And when things go bad we look to take drastic action.

Because emotions can be such a threat to our financial health it is important that we are aware of them.

This awareness can then protect us from the negative consequences of impulsive and irrational reactions to them.

As investors, we all start with optimism. We commonly expect things to go our way, or, to be honest we tend to expect a return for the risk of investing.

As our expectations are met we get excited about the possibility of even greater returns and the excitement becomes thrilling as the returns exceed our expectations.

We are at the top of the cycle when we experience euphoria. But it is at this point that we are at the point of maximum financial risk.

When we believe everything that we touch turns to gold, we fool ourselves into believing that we can beat the market, that we cannot make mistakes, that excessive returns are common place and that we can tolerate higher levels of risk.

This euphoria was experienced by many investors in the recent property boom.

House prices were going through the roof and many investors expected this trend to continue.

The second phase of the cycle occurs when the market stops meeting our new lofty expectations and begins to turn. At first, we anxiously watch the market for any signs of direction. Our anxiety turns to denial and then quickly to fear as the value of our investments decline. We start to act defensively and may think about switching out of riskier assets to more defensive shares or other asset classes such as bonds.

In the third phase of the cycle, the realities of a bear market come to the fore and we become desperate. Many of us panic and withdraw from the market altogether – afraid of further losses. Those of us who persevere become despondent and we wonder whether the markets are ever going to recover and whether we should be there at all.

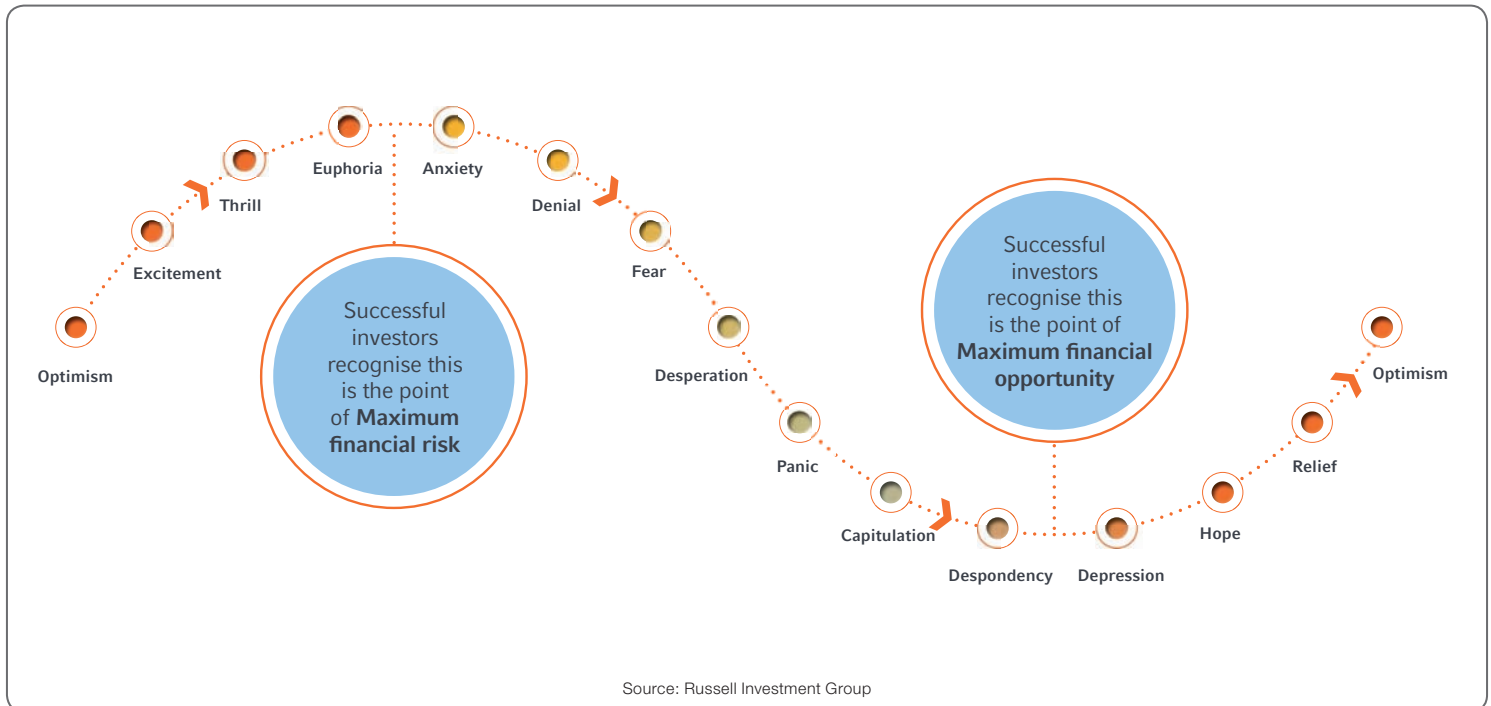
Ironically, at these times, we commonly fail to recognise that we are actually at the point of maximum financial opportunity.

What are the consequences of this emotional roller coaster?

Emotions turn rational investors into irrational investors. As investors we need to remember that markets move and our investments will always go in and out of favour.

Developed, diversified long-term financial plans are placed in jeopardy when investors are confronted by extraordinary events because we are guided by our emotions.

Chart 1: The cycle of market emotions



This is where the role of the financial adviser is of utmost importance – your adviser will help you separate your emotions from reality and endeavour to steer you on the path of rational investing.

You can also help to avoid the emotional roller coaster by being aware of the emotions you are likely to experience.

The five most common behavioural pitfalls are:

1. Overconfidence

When investors overrate their ability to select winning shares or investment managers.

2. Loss aversion

Research indicates that a loss causes about twice as much pain as a gain causes pleasure. During periods of market volatility investors experience the sense of loss more acutely.

3. Chasing past performance

We see this time and time again, but unfortunately, individual investors who are abandoning a well-diversified portfolio for bonds, or even cash, may be jeopardising their future financial security.

4. Timing the market

Research shows that no one can accurately time the market.

5. Failure to rebalance

The risk/return characteristics of an investor's portfolio should be independent

of what's happening in the market and this means selling high and buying low.

The temptation to fall into one of these traps can be resisted by developing and committing to a well defined, long-term investment policy. This is the best way to protect yourself from your emotions.

Ask your financial planner about the cycle of market emotions and the strategies you can put in place to avoid the associated risks.

Remember, this is one part to investing that is typically not considered but it can potentially have a huge effect on where we put our hard earned dollars.

Source: Russell Investment Group



Covering all bases – Insurance through a self managed super fund can be highly tax-effective

Ongoing market turbulence over the past 12 months has led to a rise in the number of self managed super funds (SMSFs) seeking expert financial advice – but many members are still not adequately covered when it comes to insurance.

Figures from the Australian Taxation Office's compliance program show the total number of SMSFs has trebled over the past decade to around \$350 billion in retirement savings, yet the total insurance cover within SMSFs is less than \$300 million.

That's despite a recent Investment Trends survey which showed 85 per cent of SMSFs were now seeking professional advice.

Graeme Colley, chairman of the SMSF Professionals' Association of Australia (SPAA), says many trustees appear more focused on lowering costs and maximising portfolio returns than ensuring their members are adequately protected.

"People who get into self managed funds do it because they like to invest in direct shares, direct property and to a degree some managed funds. But insurance doesn't seem to fit into that investment decision," he said.

"A lot of that is to do with the perceived cost of insurance and the average age of self managed fund members, which is about 57. Insurance isn't a high priority for them.

From a tax-efficiency point of view it's worrying because you've got people putting money into funds and if they're able to pay their insurance premiums out of that rather than out of their own pocket then the tax concessions are quite good."

While many people may acknowledge the importance of insurance cover, many are still not aware of the various incentives the Australian Taxation Office (ATO) now provides to hold them via a SMSF.

The ATO allows a full tax deduction for the cost of insurance held and owned by SMSFs over the life of its members. At the moment, a wide range of personal insurances are able to be held via SMSFs.

Brett Clark, the Chief Executive of Retail Life at Tower Australia, said the inclusion of life, total and permanent disability (TPD) and income protection for SMSF members provides tax concessions that in most instances are not available for insurance policies held outside of superannuation.

For example, assume the premium on your policy is \$1,000 per annum and your marginal tax rate is 31.5 per cent, including Medicare.

If your insurance policy was held outside your SMSF you would need to earn \$1,460. Tax of \$460 would also be payable, leaving you with \$1,000 to pay the insurance premium.

By holding the cover held inside a SMSF you can arrange with your employer to salary sacrifice \$1,000 of your wages into super. Your employer will not deduct tax from this amount.

The fund would normally deduct 15 per cent tax from the contribution but the fund can claim a tax deduction for the \$1,000 insurance premium so no tax is deducted. The full \$1,000 is added to your superannuation account and then deducted to pay the insurance premium.

This would provide a tax saving of around \$460 per annum, reducing the effective cost of the premium.

Recent changes in legislation have also lifted restrictions on deductibility for certain income protection policies, now making income protection attractive to hold via a SMSF.

Trustees can claim a tax deduction for the full cost of the premium providing the policy only pays a temporary disability

benefit for the period that the member is unable to perform the normal duties of their employment.

"The real message to anyone with self managed super is to consider the tax efficiencies and look at whether it's worth having insurance in their SMSF as opposed to insurance outside of it. While there are benefits from holding life insurance inside a superannuation vehicle, there are also good reasons why life cover should be held outside superannuation vehicles. The importance of advice in structuring these arrangements cannot be underestimated," Mr Clark said.

"For younger people in particular, the big attraction is that they'll have the benefit of lower premiums as well as tax benefits that stack up over time."

However, trustees of SMSFs, as with any transaction or investment, need to be conscious of the various Superannuation Industry Supervision Act and Income Tax Assessment Act requirements when holding insurance through their SMSF.

That's why it's important to talk to an experienced financial planner and to ensure that your SMSF Trust Deed allows you to hold insurance through the SMSF structure.

Source: Tower Australia Limited



Turning point for Aussie shares?

There's still value to be had from the Australian sharemarket, even in tough economic times.

The realisation that the credit crisis has spread into the main economies of the world sent equity markets into a tailspin in the second half of 2008. While belated government interventions may avert an even worse financial catastrophe, markets around the globe are now facing the sobering prospect of a severe recession. And after 17 years of economic expansion, there is growing concern that the Australian economy will suffer the same fate – a concern that has caused chaos on our own sharemarket.

Whilst local investors had been willing to shun financials from the early days of the credit crunch, there had been a long-held belief that China would be able to sustain its strong economic growth, in turn

underpinning commodity prices, business investment and the share prices of our mining companies. But China has since shown that it too is not immune to the global slowdown. And while China may be continuing to grow, it's no longer at a pace that can sustain buoyant commodity prices.

As a result, the threat of a global slowdown has resulted in a sharp sell-off in the resources sector, which fell more than 44 per cent in the December half. The sell-off certainly brought the performance of resources back to the pack after significantly outperforming in the early stages of 2008 (see Chart 1 below).

Competing forces

Since peaking in November 2007, the Australian sharemarket has suffered one of the worst bear markets on record, falling around 42 per cent in 2008 alone. What's more, ongoing volatility with large share

price movements on a daily basis would suggest that it may still be premature to call the bottom of the market. Nonetheless, valuations look compelling at these levels, with many stocks and sectors trading at long-term lows.

The key issue for investors to consider now is the additional earnings risk from the slowing domestic economy, continued weakness in commodity prices and the longer-term implications from the global financial meltdown. However, this needs to be weighed against increasingly attractive valuations for equities. According to Goldman Sachs JBWere research, the prospective price-earnings ratio (PER) multiple for industrials is at its lowest level in 13 years. Moreover, many equities are now trading at record discounts to their discounted cash flow (DCF) valuations.

The key risk to both resource and industrial earnings forecasts over the next 12 months continues to be a worse-than-expected global slowdown, combined with a failure of the US and other governments around the world to thaw capital markets.

Tough times ahead for resources

The decline in base metals prices (e.g. copper, nickel and zinc, see Chart 2 on facing page) has severely impacted the prices of some 'pure-play' stocks, including Alumina, Kagara, and copper junior Equinox. Against a backdrop of slowing growth, forecasts are still being pared back on base metals for much of 2009. Whilst production costs are falling, it is likely that lower prices will cause some cancellations of new projects and expansions. Should China resume its demand growth in the future, tighter supply may see commodity prices recover sharply, but this is unlikely in the short term.

Meanwhile, falling spot prices for bulk commodities (e.g. iron ore and coal) have tipped the scales in favour of buyers at the expense of our miners in the lead-up to annual price contract negotiations. The iron ore spot price has moved from

Chart 1

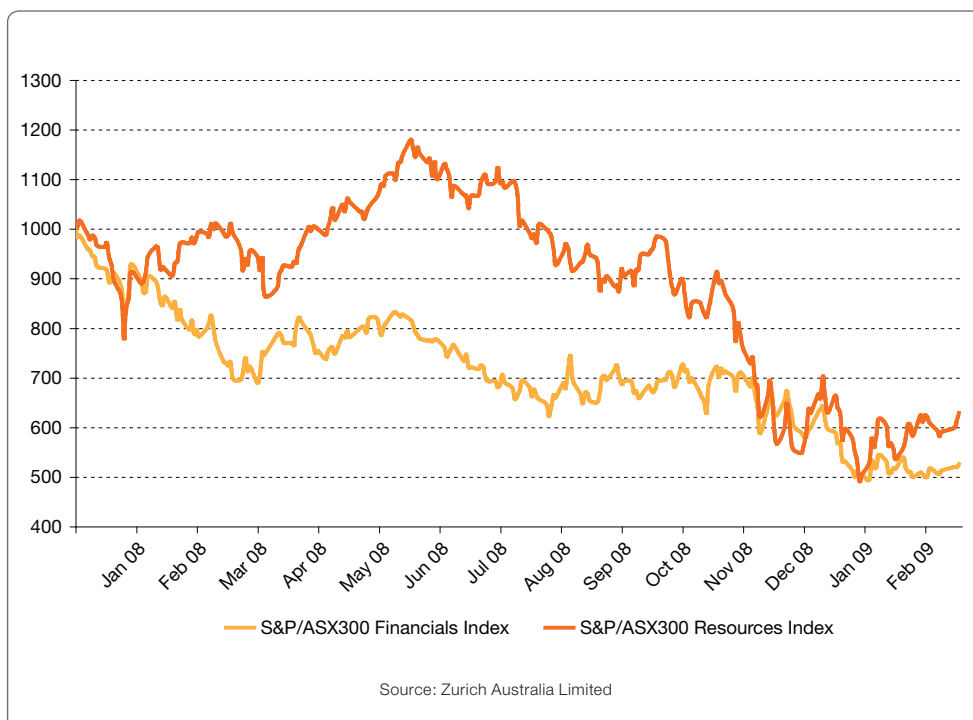
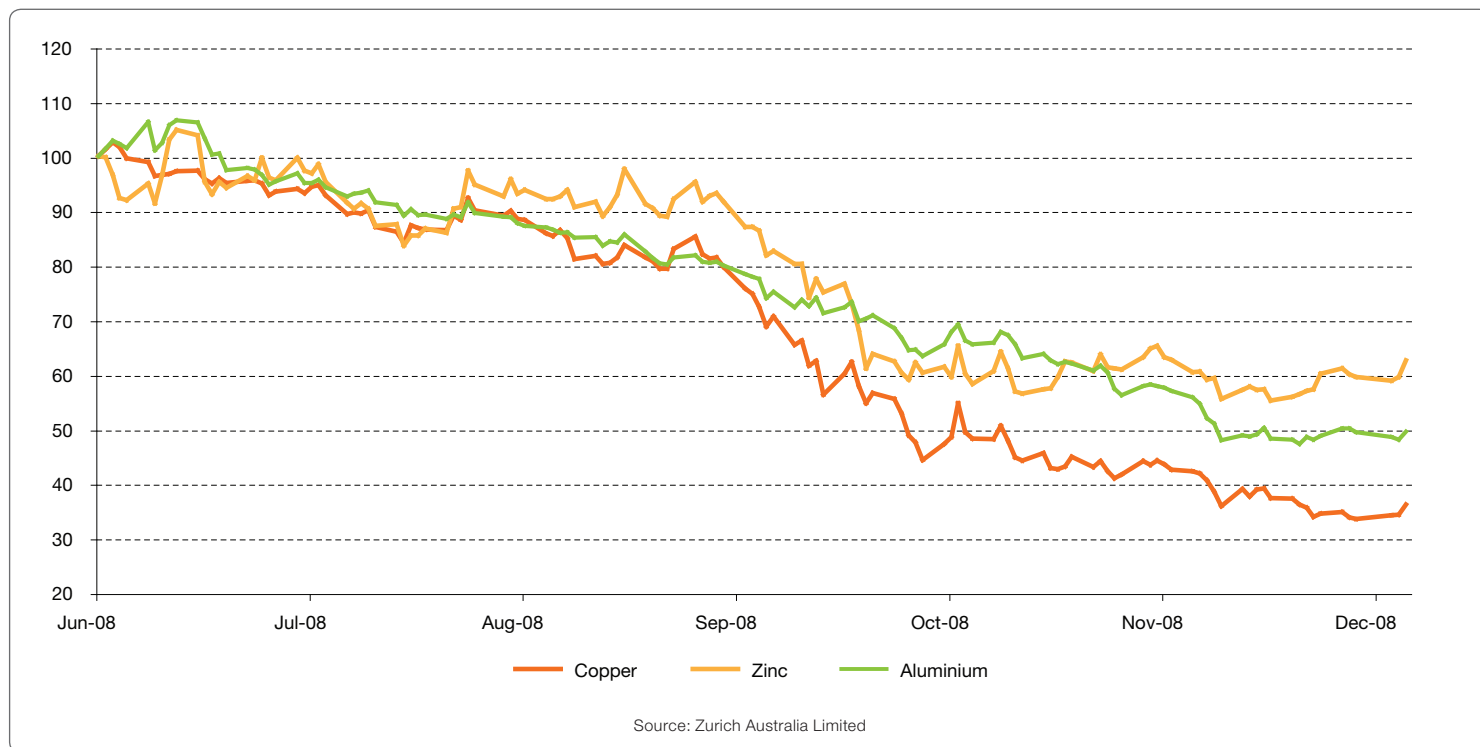


Chart 2



a large premium to a discount in a short space of time, hurting the share prices of companies like Fortescue Metals and Mt Gibson Iron, as well as the diversified majors BHP and Rio Tinto. After securing a record 85 per cent price increase in the 2008-09 negotiations, expectations are for falling prices with Chinese and Japanese steelmakers demanding a record 40 per cent cut or more in iron ore prices. Coal stocks have been similarly impacted.

Although resource stocks will benefit from the declining Australian dollar, this will not be enough to fully offset commodity price falls.

Industrials in 'fair' form

Surprisingly, industrial stocks have seen a small up-tick in earnings forecasts, primarily resulting from the sharp depreciation of the Australian dollar – a positive for companies with offshore earnings exposure. Nevertheless, downside risks still exist and may offset this currency influence.

The Federal Government's stimulus package, coupled with the Reserve Bank's slashing of interest rates is designed to provide a shot in the arm to the local economy. But whether these measures succeed in stimulating consumer spending remains to be seen given many Australians are still reeling from the widespread wealth destruction from sharemarket falls and declining house prices. Add rising unemployment to this economic mix and it

doesn't augur well for retailers, who tend to be particularly susceptible to a downturn in discretionary spending.

Bargain basement financial stocks

The banks are beginning to look cheap, even after accounting for prevailing growth and bad debt risks. Indeed, the demise of many non-bank lenders could certainly play to the banks' advantage in the future, with the lower level of competition allowing the bigger players to not only increase the size of their loan books but also their margins, which have come under pressure in earlier years.

The Commonwealth Bank has recently acquired a 30 per cent stake in Aussie Home Loans, while Westpac was able to swoop on RAMS, picking up the franchise quite cheaply after it became an early victim of the credit crunch. The merger with St George was also deemed to be a positive, giving the bank significant scale for the future.

More recently, all the majors have moved to raise equity, bolstering their already high Tier 1 capital ratios and have raised over US\$23 billion on the international wholesale markets (aided by the Federal Government's guarantee). Any future re-intermediation due to reduced wholesale lending in credit markets will also be a positive for the sector.

Has the market bottomed out?

While long-term valuations are beginning to once again look attractive, it's highly likely that the Australian sharemarket will continue to experience heightened levels of volatility in the coming months. Despite some evidence that credit markets are responding to broad-based global government initiatives, it will be some time before confidence is fully restored. Furthermore, as the prevailing economic outlook continues to deteriorate, further earnings downgrades can be expected until they meet levels more attuned to a recessionary environment.

Historically, the Australian market turns the corner when earnings stabilise, which is unlikely until the second half of 2009. This also suggests that Australian equities represent excellent value on a three-year view.

Your financial planner can assist you in planning for your future. Call your financial planner today.

Source: Zurich Australia Limited

What is a redundancy payment, and how much tax will I pay?

As we are becoming all too aware, we're going to see an increasing number of redundancies this year as the economic conditions require more and more companies to downsize. We are already seeing increased redundancies in some industries.

In this article, we are going to talk about the payments that your employer will make in the event that an employee is made redundant.

You may be familiar with the term 'ETP', however just be aware that the meaning changed when the Simpler Super rules were introduced in 2007.

In the old language, ETP stood for Eligible Termination Payment and represented any lump sum payment from an employer or a superannuation fund. Now the abbreviation stands for Employer Termination Payment and refers to lump sum payments from an employer only. An ETP is made as a consequence of termination of employment, and excludes some payments.

Excluded payments are:

- Superannuation benefits;
- Unused annual or long service leave;
- Pension or annuity payments;
- Foreign termination payments;
- Arm's length advance or loan;
- Deemed dividends;
- Compensation for personal injury;
- Payments for restraint of trade;
- Employee share scheme payments;
- Commutation of pensions; and
- Tax free amount of redundancy or early retirement scheme payments.

The ETP must generally be made within 12 months of the date of termination, and may also be paid as a result of a person's death (a death benefit termination payment),



however we are focusing on life benefit termination payments and in particular redundancy and golden handshakes.

When an employee receives a redundancy payment, they will receive a lump sum from their employer consisting of payments for any unused annual or long service leave that has accrued plus an ex-gratia amount that will often be calculated in accordance with a formula based on their years of service.

To calculate the amount that is treated as an ETP for tax purposes, the payer (the employer) will ignore the leave payments (these have their own tax treatment) and any of the above excluded payments, and calculate the tax free amount known as the Genuine Redundancy Payment.

Genuine redundancy payment (tax free) = \$7,350 + (\$3,676 x completed years of service)

What is left over is the ETP. If the employee joined the company before 1 July 1983, the ETP gets split into a tax free and a taxable component, with the pre 1983 component being the tax free amount:

Tax Free component = ETP x Days of service prior to 1 July 1983/total service days

Taxable component = ETP – tax free component.

The taxable component is taxed as shown in the table below.

Age	Below ETP cap (\$145,000 for 08/09)	Above ETP cap (\$145,000 for 08/09)
Above preservation age (55+)	Max tax 16.5%	Top marginal rate
Below preservation age (<55)	Max tax 31.5%	Top marginal rate

Here are some examples of how this works:

Example 1

Tony is 56 and has been working for a life insurance company since 24 May 1979. On 28 October 2008 he was made redundant. The payment, excluding his unused leave payments, totalled \$300,000. These figures are shown in the table below.

Example 1

Genuine Redundancy amount	$\$7,350 + (\$3,676 \times 29)$	\$113,954
ETP	$\$300,000 - \$113,954$	\$186,046
Tax free component of ETP	$\$186,046 \times (1499/10,751)^*$	\$25,940
Taxable component	$\$186,046 - \$25,940$	\$160,106
The first \$145,000	Taxed at 16.5%	\$23,925
The rest	$(\$160,106 - \$145,000) \times 46.5\%$	\$7,024
Total tax on \$300,000		\$30,949
Net payment		\$269,051

*Days of service prior to 1 July 1983/Total service days

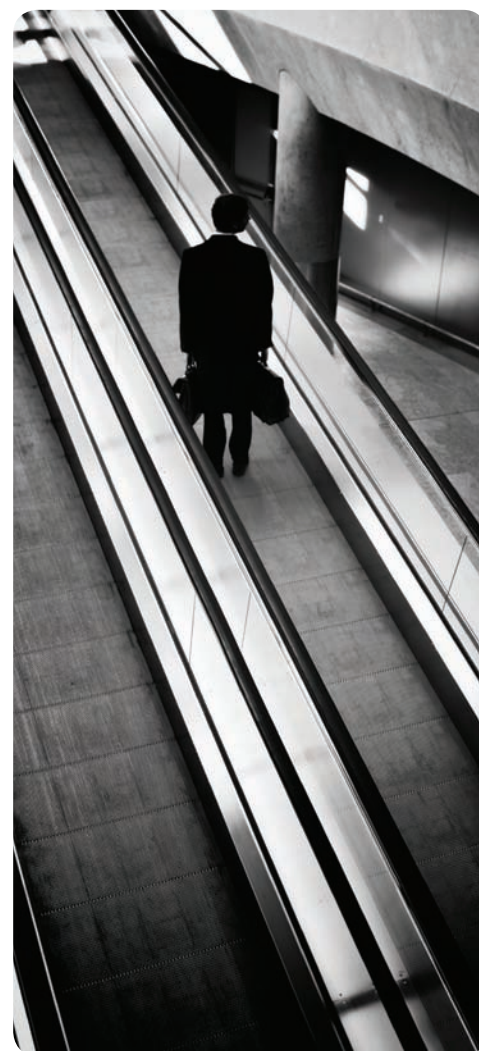
Example 2

Andy is 41 and has been working for a fund manager since 20 November 2006. He was made redundant on 28 October 2008 and also received a payment, excluding his unused leave payments, of \$300,000.

Example 2

Genuine redundancy amount	$\$7,350 + (\$3,696 \times 1)$	\$11,046
ETP (no pre 83 service)	$\$300,000 - \$11,046$	\$288,954
The first \$145,000	Taxed at 31.5%	\$45,675
The rest	$(\$288,954 - \$145,000) \times 46.5\%$	\$66,938
Total tax on \$300,000		\$112,613
Net payment		\$187,387

Andy, being younger and with much less service, pays a lot more tax than Tony on the same gross payment. Unfortunately, this payment cannot be rolled over to superannuation, so there isn't anything either one can do to reduce or manage this tax unless they fall under the transitional arrangements.



Transitional arrangements (to 30 June 2012)

Transitional arrangements apply to payments made between 1 July 2007 and 30 June 2012 if the employee was entitled, as at 9 May 2006, to such a payment specified under:

- a written contract;
- an Australian or foreign law (or an instrument under such a law); or
- a workplace agreement under the Workplace Relations Act 1996.

These documents must do this by referring to the amount of the payment or a method or formula to work it out.

Transitional termination payments may be rolled over (in full or part) to a superannuation fund or a superannuation annuity.

If you are receiving a redundancy and think you might fall under a transitional arrangement, it is very important to speak to your financial planner as there are many options available to you.

Source: Challenger

Estate planning essentials

Effective estate planning provides you with the peace of mind that the right asset will go to the right person at the right time when you're no longer around.

Do you have an up-to-date Will? Do you have a power of attorney? If you've answered yes to both these questions, then you're one step ahead of many Australians, 40 per cent of whom don't have a valid Will. But an effective estate plan goes beyond having a current and valid Will. It considers any tax and/or social security implications for beneficiaries, as well as ownership structures and other issues. That's where an experienced financial planner can add significant value.

Exclusion issues with Wills

If you are planning to leave an 'eligible person' out of your Will, it's important to seek specialist legal advice about the issues that could arise and their potential impact on your beneficiaries. Each state and territory has legislation that ensures certain individuals receive an entitlement to a deceased estate. This group of eligible individuals includes a spouse, children and certain financial dependants. If inadequate provision is made from an estate for an eligible person, there is the possibility of the estate being contested. The courts then decide how to divide up the estate to ensure all eligible beneficiaries are adequately provided for.

More estate planning options

In addition to the Will, different ownership and investment structures may be used

to complement your estate planning objectives. Some of the ways assets can be structured to bypass the estate include owning property as joint tenants, binding nominations for super, insurance policies owned by a beneficiary, inter vivos trusts and testamentary trusts.

Testamentary trusts provide the following benefits:

- capital retention within the structure for a specified period (e.g. until a beneficiary turns a certain age)
- catering for beneficiaries with special needs (e.g. minors, spendthrifts, gamblers etc.)
- protecting assets in the event of a beneficiary's marriage breakdown or bankruptcy.

Good record keeping

Capital gains tax (CGT) records should be kept for all investments to allow an accurate tax calculation. Generally, CGT is not payable when an owner dies and the asset is directed to the beneficiary. However, when the beneficiary sells the asset, a CGT event is triggered. In addition to records documenting purchase price and costs, thorough records should be kept capturing transactions such as dividend/fund income reinvestments, bonus share issues and company takeovers and mergers. Without appropriate records, a beneficiary will have considerable difficulty calculating the correct tax payable.

Super tax considerations

Superannuation law specifies who can be paid a death benefit from a super fund. Super dependants can include a spouse, child, financial dependant or someone in

Triggers for reviewing your estate plan

- Marriage
- Re-marriage
- Entering into a defacto relationship
- Divorce
- Birth/adoption of a child
- Beneficiaries have special needs (e.g. disabled child)
- Death of a beneficiary
- Acquisition and sale of assets specified in your Will
- Bankruptcy (yours or that of a beneficiary)
- Other significant changes in circumstances

an interdependent relationship with the member. Alternatively, the death benefit can be paid to the deceased member's estate. Consideration should be given to directing superannuation to death benefits dependants, who will receive the funds tax free, and non-super assets should ideally be directed to other beneficiaries.

Estate planning is a critical component of the financial planning process. If you do not have a Will and power of attorney, or your documents are out of date, or a trigger event as noted has occurred, it is wise to consult your financial planner who will review your circumstances or refer you to a professional who can identify any gaps in your estate plan.

Source: Zurich Australia Limited

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