



Financially Speaking

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Don't get caught short in retirement



If you're over 55 and still working, taking advantage of a Transition to Retirement strategy might just be the thing to give your retirement savings a boost. Whether you're working full or part time, the strategy allows you to access your superannuation savings, while also giving you the opportunity to access some attractive tax benefits.

Most people don't realise that their investment strategy post retirement is proportionately more important than their pre-retirement plan.

In fact, accumulating wealth before your retirement is only half the story. Your focus should be equally placed on generating income for your retirement years. We should keep in mind that one of the biggest risks of investing for retirement is running out of money once you have stopped working.

On average, Australians save a constant portion of their pay through superannuation between the ages of 25 and 65, then decumulate – or draw down from their super savings – for around 25 years in retirement. But your money shouldn't stop working even when you have, and it's important that you have the right strategy in place to get the most out of your savings.

In this article Russell Investments discusses their 10/30/60 retirement rule which derives its name from the fact that every dollar decumulated consists of roughly:

- 10 cents of savings from your working years;
- 30 cents of investment return earned during the accumulation phase; and
- a whopping 60 cents of investment growth earned during the decumulation phase.



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A 'Transition to Retirement' (TtR) strategy which is closely aligned to this 10/30/60 rule focuses on maximising your ability to save for retirement, regardless of your level of employment. Whether you're employed full time or part time, a TtR strategy could be an ideal way to assist you to achieve your retirement goals.

What is a TtR strategy?

The strategy involves commencing a TtR pension from superannuation and, at the same time, salary sacrificing any surplus income back into a new superannuation fund.

The concept was originally devised to provide financial assistance to those wishing to transition to retirement by working part time for a period before finally leaving the workforce. As there are currently no requirements for those accessing a TtR pension to prove working status, this strategy has become popular with full time workers looking for an opportunity to boost their retirement savings.

The benefits of commencing a TtR pension arise for three reasons:

1. Once a pension has commenced, the tax on earnings from super reduces from up to 15% to nil.
2. Pension payments are totally tax free for those over 60, and taxable payments made to individuals under 60 are accompanied by a 15% tax rebate, whereas a salary is fully taxable.
3. Excess income from work can be salary sacrificed back into superannuation, which boosts your tax position even further, therefore helping you build even more for your retirement nest egg.

In a nutshell, a TtR strategy creates the opportunity for you to restructure the way your income is received so that, while your day to day income may remain basically the same, your superannuation balance upon retirement can be significantly increased.

What is a TtR pension?

A TtR pension is an income stream that enables you to access your superannuation without actually retiring. For people under the age of 65, the minimum amount that may be paid as income each year is 4% of the account balance. There is also a maximum income cap of 10% of the account balance, which is calculated at the start of each new financial year.

Careful planning is required to optimise a TtR pension, so consider speaking with a financial planner to ensure that it remains suitable for you both now and into the future.

Upon your retirement or reaching age 65 (whichever comes first) you may start to

Case Study

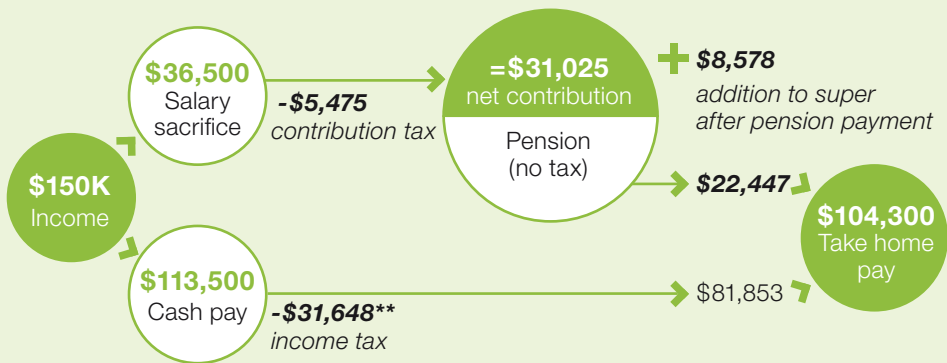
See how Bob, 60, maintains his take home pay and boosts his super balance without exceeding contribution limits.

Bob is 60 and his current salary is \$150,000. He wants to implement a transition-to-retirement strategy to maintain his take home pay and boost his super balance, without exceeding his concessional (before tax) contribution limit, which is \$50,000.

His employer contributes \$13,500 per year to his super, so he chooses to salary sacrifice \$36,500, bringing the total amount to the maximum \$50,000*. In combination with this salary sacrifice, he withdraws \$22,447 from his pension account.

Using this strategy, Bob can maintain the same take home pay and create a net addition of \$8,578 to his super, while remaining within his concessional contribution limit.

Transition to retirement strategy 2010/2011 financial year



* Assumes no additional sources of concessional contributions such as employer contributions towards insurance premiums and fees.

** Including Medicare levy

Note: This is a general example and is not specific to your personal situation. The figures in this example are based on the income rates that apply in the 2010/2011 financial year.

draw an income higher than 10% of the account balance if you wish. You may also choose to withdraw a lump sum from your pension after this time.

Who can access a TtR pension?

You can access a TtR pension if you are 55 years of age or older. Regardless of whether you are working full time and looking to reduce your hours, or working full time and loving it, you can access a TtR pension. Remember, if you do commence a TtR pension but no longer need the income, there is even the flexibility to roll back your pension to the accumulation phase.

Why adopt a TtR strategy?

The biggest investment risk you face in retirement is running out of the capital you will need to fund the rest of your life. Determining how long you need your money to last is a vital component that will impact your standard of living in retirement. Investors cannot rely on the law of averages to estimate longevity. If you find you need your income to stretch for an additional ten years to what you were expecting, you will need to squeeze an extra 2-3% each year from your investments – which can be a difficult task for any investor.

The lesson here is that longevity uncertainty becomes a greater concern than investment risk the older you get and this should be factored into investment strategies during the accumulation and decumulation phases.

Keep in mind that if you retire at 65, you may live another 20 years or more, which means you still need to be in long term planning mode. A TtR strategy is an ideal way to maximise your super savings, while reducing the tax you pay – which ultimately means more money in your pocket for your retirement.

So, if you're young at heart and want to keep working, a TtR strategy may well be the answer to helping you achieve your financial goals upon retirement.

Making a decision

The earlier you start planning, the more time you'll have to ensure that you're on track to achieve the retirement lifestyle you want.

Speak with your financial planner about your best approach to retirement.

Source: Russell Investments, October 2011



The tax-effectiveness of dividend streams

The Hawke-Keating era is renowned for its micro economic reforms. Next year will mark the 25th anniversary of one of the most significant changes for share investors – the end of the double taxation on dividends. The importance of “dividend imputation” – for that’s what the system is called – is that it changed the post tax considerations of investing in favour of Australian shares, especially over cash.

Up until 1987, company earnings paid out as dividends were largely taxed twice. The first time was when companies paid tax on their gross profits (for dividends come from net profits). The second time was when the investors who received the dividends paid tax on this income.

Dividend imputation abolished the double tax whammy on dividends by allowing shareholders to claim a tax credit for some, or all, of the tax an Australian company has paid on its earnings. These tax credits are

known as franking credits. Companies that pay all their tax in Australia often offer “fully franked” dividends.

So that low income earners could gain the full benefit of the new tax system for dividends, the Howard government made franking credits refundable in 2000. This means that low income earners can receive franking credits back in cash as part of their tax refund.

The tax law surrounding franking credits carries restrictions and exemptions that may change the tax benefits received for different people. But its mainstream application is significant because other asset classes generally don’t offer such tax effective income streams as Australian shares.

An Australian company, for instance, that offers a fully franked dividend of 5% (its expected dividend payment divided by its share price) is offering a more tax effective income stream than a bank term deposit offering a 5% return. In reality on a pre tax basis, this Australian company is offering

a 7% yield for investors on the highest marginal tax rate, versus 5% still for the term deposit.

As shares have fallen in recent times, the dividend yield on Australian shares has risen to about 5% overall, and many large stocks offer dividend yields far in excess of the average.¹ This dividend yield would carry a franking credit in excess of 90%, if the franking credit offered by the typical managed Australian share fund on their distributions is any guide. This means that the effective yield of Australian shares overall is closer to 7%. At the same time, term deposit rates are falling.

The drive behind the introduction of dividend imputation was to encourage investing in shares. It’s still working just as policy makers thought it would a quarter of a century or so ago.

Endnotes

¹ Bloomberg. As at 7 September 2011.

Based on the S&P/ASX 200 Index.

Source: FIL Investment Management (Australia) Limited, September 2011



Aged Care – The value of advice

With the ageing of the Australian population, many of us will face the prospect of requiring assistance or living out our days in assisted accommodation.

The current Australian Aged Care system is complex and options and costs can vary greatly.

Here are some of the key issues that you should consider to ensure that you have choice and peace of mind when providing for this significant lifestyle decision.

What do I do first? Government subsidised facilities and services all require an Aged Care Assessment Team (ACAT) review to establish the level of care required. Until this is known, it may be difficult to establish which facilities or services are suitable and what costs may be incurred.

Can I remain in the family home?

There are several at home care packages available that may make it possible to extend time in or remain in your home indefinitely. In general, an ACAT assessment is required to be eligible for these services.

What do I look for in a facility? One of the most important aspects to be eligible for subsidised accommodation is that the facility

is Government approved and accredited and that the provider is financially viable. The next step involves the lifestyle features of the facility:

- Ageing in place facilities – is the facility accredited to provide both low and high care thereby making the transition easier.
- Private or shared accommodation and facilities.
- Meals – variety, choice and ability to cater for specific dietary requirements.
- Medical services and facility staff – availability and qualifications.
- Location – proximity to family, friends, transport and local services.
- Type of social and recreational activities and facilities available.
- Daily routine – is there flexibility particularly in regard to visitors.
- Type of onsite extra services.
- Security of facility.

Facilities range from basic through to quite luxurious and it's about making the transition to care as seamless as possible bearing in mind the capacity to pay. It's also about balancing whether the cost of any extra

services do provide value and are of use to the resident.

What are the costs?

Entry fee

Basic daily fee

Income tested fee

Extra services fee
(if available)

As the chart indicates, there are four possible costs each of which can be influenced by many factors such as:

- Level of care required.
- Facility chosen.
- Financial situation.

Can I negotiate the costs? The costs vary widely but it may be possible to negotiate the entry fee for low care facilities and if available the extra services fee but it is important that negotiations are undertaken prior to signing any residency contracts. The basic daily and income tested fees are reviewed on a regular basis and are influenced by the investment planning strategies in place.

What if I can't afford the costs? All facilities are obliged to provide supported beds. The number of supported beds is determined on a regional basis and can vary widely throughout Australia based on the socio economic demographics of the region. Additional Government subsidies are available for supported residents.

Family Home. The decision regarding the family home is often difficult as there may be strong emotional influence and other family members to consider. The sale of the family home and the realisation of another assessable asset can have a significant effect on ongoing accommodation costs, tax outcomes and Centrelink eligibility. It is recommended that professional advice is sought to ensure that the best commercial outcome is achieved.

Getting Advice. There are many decisions to make, many of which can impact significantly on the cost and choice of care. Pre planning and the assistance of a skilled adviser, to navigate through the various steps and develop a solid investment strategy, can greatly relieve the burden of what can be a very complex and difficult decision.

Source: Lifepan Funds Management, part of the Australian Unity Group, September 2011

Why consider crisis insurance?



Most people wouldn't dream of driving without car insurance, or living in a house without home and contents insurance, so it is remarkable that the majority of Australians do not think about protecting their families through life insurance, in the event of death, accident or illness¹.

With the incidence of cancer increasing year on year² and the occurrence of cardiovascular diseases preventing many families from living a full life because of disability³, it is becoming increasingly important to consider crisis cover as part of a life insurance portfolio.

Many Australian families struggle, both emotionally and financially, when a family member is diagnosed with a life threatening or debilitating medical condition. By taking out crisis cover you can help to ease the financial burden should you suffer a traumatic event.

You might think 'it'll never happen to me', but you may think again after considering these facts.

Cancer

Cancer is a leading cause of death in Australia with more than 43,000 people expected to have died from cancer in 2010. The most common cancers in Australia are skin cancer, cancer of the digestive organs, breast cancer, lung cancer and prostate cancer⁴.

93,200 new cases of cancer will be diagnosed in Australia this year, that's 255 every day. Only 50% of these cancers are successfully treated⁵.

Prostate Cancer

- 1 in 6 men will get prostate cancer⁶.
- Almost 3,300 men die each year of prostate cancer and around 20,000 new cases are diagnosed every year⁷.
- Each day about 32 men learn news that they have prostate cancer - tragically one man every three hours will lose his battle against this insidious disease⁸.

Breast Cancer

- 1 in 9 women are at risk of being diagnosed with breast cancer by the age of 85⁹.
- 32 women were told yesterday they have breast cancer; 32 women will be told today...and tomorrow¹⁰.
- 2,707 women die from the disease in a single year – making it the leading cause of cancer-related death in females¹¹.

Skin Cancer

- Over 480,000 Australians are treated for skin cancer each year – that's over 1,000 people every day¹².
- Over 1,700 Australians die from skin cancer each year¹³.
- Australia has the highest rate of skin cancer in the world. Skin cancers account for around 80% of all new cancers diagnosed each year in Australia. Each year Australians are four times more likely to develop a common skin cancer than any other form of cancer¹⁴.

Cardiovascular disease (CVD)¹⁵

CVD is the term used for heart and blood vessel diseases and stroke.

- CVD kills 1 Australian every 10 minutes and prevents 1.4 million people from living a full life because of disability caused by the disease.
- CVD is one of Australia's largest health problems.
- CVD affects 2 out of 3 families¹⁶.

So, what is crisis cover?

Crisis cover, also known as trauma cover, pays a lump sum should you be diagnosed or suffer one of the specified trauma illnesses or events. Some of the 'illnesses' are procedures and not illnesses e.g. Coronary By-Pass, Angioplasty, Aorta Surgery, Heart Valve Surgery or Major Organ Transplant. Depending on your insurer, this lump sum payment may be up to \$2,000,000 on diagnosis.

You can take out crisis cover between the ages of 16 and 64 and it covers you 24 hours a day, 7 days a week anywhere in the world, depending on your insurer.

Each insurer differs, but most policies can cover you for a variety of crisis events such as:

- Angioplasty
- Cancer (female organs)
- Cancer (general)
- Cancer (male organs)
- Coronary by-pass surgery
- Heart attack
- Stroke
- Accidentally acquired HIV
- Aorta surgery
- Aplastic Anaemia
- Benign brain tumour
- Blindness
- Cardiomyopathy
- Kidney failure
- Chronic liver disease
- Chronic lung disease
- Coma
- Dementia & Alzheimer's disease
- Viral Encephalitis
- Heart valve surgery
- Loss of hearing
- Loss of independent existence
- Loss of limbs
- Loss of speech
- Major head trauma
- Major organ transplant
- Motor neurone disease
- Multiple sclerosis
- Muscular dystrophy
- Parkinson's disease
- Primary pulmonary hypertension
- Rheumatoid arthritis
- Severe burns



Case study *

Doug has been working as an accountant for the past eight years in Brisbane where he lives with his wife and three kids. Unfortunately for Doug and his family, he was recently diagnosed with bowel cancer. Doug's diagnosis meant that he was required to undergo extensive chemotherapy, and as a result he was unable to work for six months. As you can understand, Doug and his family were extremely devastated when the doctor diagnosed the condition. As well as dealing with the emotional stress, they also had to consider how they would pay for the mortgage, school fees and other bills without Doug's income.

Fortunately for Doug and his family, their financial adviser had recommended that both Doug and his wife take out crisis cover on top of their Term Life cover. When Doug received the news from his doctor, he called his adviser immediately who submitted a claim to his insurance company. His claim was assessed and Doug received a lump payment of \$250,000. The payment enabled Doug and his wife to pay for his medical fees, mortgage and school fees all of which his income would normally have paid for.

The lump sum payment meant not only that Doug and his family's bills were taken care of but also meant that Doug could focus all his energies on getting better instead of stressing about financial concerns.

*This is an example only to illustrate the potential benefit of taking out crisis cover, and should not be relied upon as indicative of benefits payable under any crisis cover products.

How can crisis cover benefit you?

You should speak with your financial planner about the amount and type of cover that you need. Everyone's circumstances and situations are different so discussing your needs with your adviser is a good first step when considering life insurance.

Should you be diagnosed with a life threatening or debilitating health condition, crisis cover may help you:

- to pay for any additional medical bills or necessary treatment
- to replace lost income while ill or recuperating
- to pay for home care or auxiliary services while recuperating
- to replace lost income of a family member who is caring for you
- to pay for rehabilitation
- to pay for a change in lifestyle, for example, access ramps, wheelchairs or manual car controls.

Speak to your financial planner today to find out about the most appropriate cover for you.

Endnotes:

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3. http://www.heartfoundation.org.au/Heart_Information/Statistics/Pages/default.aspx
4. <http://www.cancer.org.au/aboutcancer/FactsFigures.htm>
5. The Risk Store
6. The Risk Store
7. <http://www.prostate.org.au/articleLive/pages/Prostate-Cancer-Statistics.html>
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15. http://www.heartfoundation.org.au/Heart_Information/Statistics/Pages/default.aspx
16. The Risk Store

Source: AIA Australia Limited, September 2011



BHP is a mango

It is interesting that we don't think about shares in the same way that we think about other things that we buy or use. While it may seem strange to compare shares to mangoes, let's take a stab at it anyway.

Mangoes, just like other fruit and veg have a pricing cycle. Mangoes are cheaper at some times of the year compared to others. During the cheaper times, they are in season, they usually taste better and we happily buy more of them. When they go out of season, they become more expensive, a bit manky and we don't touch them.

While company share prices are not driven simply by supply, we seem to like them more

when they are expensive rather than when they are cheap. Many average investors seem to have this weird habit of buying shares after a few years of rising prices – when they are expensive. These same investors then tend to become fearful of shares and sell them after their price has fallen – when they are cheap.

The companies that make up the bulk of the value of the Australian share market index (the ASX 200) are essentially the same during the expensive times as they are during the cheap times. During the four months to 11 August, 2011 the price of BHP Billiton shares has been as high as \$50 and as low as \$35, but during that period the company itself was largely unchanged.

You certainly can't legitimately argue that at one point during the last four months, BHP was worth nearly 40% more than it is now. Part of the problem is that we sometimes equate 'price' to equal 'value'.

It is clear that share prices move as a result of many other things beyond intrinsic value, but if you are buying shares to hold long term then these short-term elements may lose a lot of relevance.

One way to look at investing in shares is to treat them like mangoes. Shares are real (even if you can't eat them) in that they represent a piece of a real business doing real things. Once you start to ignore all the hype, then the idea of buying them when they are cheap starts to make more sense.

Of course, individual companies can and do go broke. When that happens, the owners of the shares (owners of the company) lose all the value that they had invested in that company's shares. To reduce this risk, most superannuation funds invest in a wide range of different companies. Even if one company does go broke, the overall impact to a well diversified share portfolio should not be too dramatic.

When we see market volatility like we have seen over the recent times, we are looking at events that drive changes in the short term value of the entire market. In that same four months mentioned above, the ASX 200 went from 4,976 to 3,765 – a movement of over 30%.

The downgrading of the USA from AAA to AA+, on the face of it should not impact the underlying value of the companies that make up the Australian sharemarket. But the market sentiment – call it confidence or lack thereof – does change the price. The price changes because poor market confidence leads to people selling and when there are more sellers than buyers, the price goes down. It doesn't necessarily change the fundamental value of those companies.

The question that we should be asking is: does this new price level reflect a fundamental shift in the value of these companies, the ability of these companies to continue to operate, provide services and products, employ people and generate profits. If the answer is "No" then we have an opportunity – to make a decision on buying, holding or selling based on the reality of the value of those shares rather than market sentiment. Your financial planner can work with you to identify the most suitable investment strategy to suit your needs.

Source: Russell Investments, September 2011

How does all this volatility impact my super/investments?

Most Australians are invested in the sharemarket as part of their superannuation savings. The average super investment will comprise a mix of shares, government and corporate bonds, cash, and some 'alternative' asset classes such as property and commodities. This means any volatility in the sharemarkets will be felt to some degree in superannuation.

While it is only natural to be concerned about volatility in the markets, it is important to remember that losses on paper are not real losses until they are crystallised. That is, your super generally has a chance to recover from short-term volatility. However, if you take action and crystallise those losses by switching your investments to cash, this loss will be essentially locked in. So, trying to resist the urge to act impulsively is very important.

Super is a long-term investment and fluctuations are part of the market cycle. History shows that investors who stick to a long-term asset allocation strategy have come out ahead.

If you are just starting out or are in the middle of your working life, you have a long time to keep investing money for your future and are well-placed to take market ups and downs in your stride. In fact, sharemarket drops may present great buying opportunities.



If you are closer to retirement and plan to access your super in the next few years, there is no need to be alarmed. You still need to rely on your retirement savings for up to 30 or 40 years from when you stop working. So it's likely you'll need to keep your super invested for many years to come, giving you time for markets to recover. Keep in mind that you also continue to benefit from concessional tax treatment in the super environment and once you turn 60, any money you take out of your super is tax free.

Similarly, if you are transitioning to retirement or are in retirement, there are still many years ahead for your savings to remain invested. In addition, recent Government rules mean you can keep your savings in the super system indefinitely so you don't need to make a hasty decision. Speak with your financial planner about your best approach to retirement.

Source: Russell Investments, September 2011

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