Ideas, March 2007

In this newsletter, Jo McCreery and Lisa Faddy look at opportunities for people nearing retirement and those still working and trying to reduce their tax bill.

With some careful planning, people with $1 million in assets in addition to their home may now be able to access some Age Pension benefits.

Who is this opportunity relevant to?

- If you are planning your retirement this year.
- If you are retired, but still under 65.

This opportunity only exists until September 2007, so action is needed now.

Positive investment environment continues

Despite the recent market dip, most investors have done very well over the last few years. The Australian share market is up 24% per annum over the last 3 years; listed property has delivered 26% per annum. But, will this continue? Where should our client's portfolios be positioned going forward?

Over the past month or so, we've been meeting with and listening to various economists, market analysts and investment managers. Simplistically, the view we have formed is:

- Global growth is resilient, but desynchronised.
- Australian business conditions remain favourable for company growth.
- While some sectors of the market are relatively highly valued, others offer opportunities.
- Market volatility will continue.
- Growth in China may pull back in the near term, but China is still expected to help fuel strong global growth over the medium to long term.
- Ongoing economic growth in Asia, combined with structural and cultural changes make this region attractive for long term investors.

The major risks, as summarised by Macquarie Bank's head economist, Richard Gibb, are relatively low impact as far as markets are concerned. These include a slow down in the US and Chinese economies and stock market volatility. He believes the high impact risks, such as a US recession and Chinese financial system disorder, have a low probability of occurring.

So where should portfolios be positioned?

We do not believe that there is a need to change into more conservative asset allocations, but we do believe that it is important to maintain well diversified portfolios. We continue to see opportunity offered by growing sectors such as global listed property and global infrastructure. Assets such as direct commercial property are offering very attractive yields and a stabilising component to portfolios. Select hedge funds also continue to offer diversification benefits and strong absolute returns. We also believe that the Australian share market remains a good long term, tax effective investment for clients.

More people will be able to access the Aged Pension with careful planning

With the new assets test to apply from September this year, home-owning couples with assessable asset up to $800,000 (excluding the value of their home) will be able to access some Age Pension. There will also be an opportunity for some people to invest assets in a Term Allocated Pension (TAP) prior to September 2007 to reduce assessable assets. This strategy gives couples with current assets in excess of the $800,000 threshold an opportunity to access some Age Pension benefits.

This means that many people who never expected to receive anything back from the Government for their years of labour, may now have the opportunity.

What are the benefits?

People receiving the Age Pension (even if it is just a small amount) are given a Pension Concession Card.

The card entitles you to reduced cost medicines under the Pharmaceutical Benefits Scheme (PBS).

As well as this, you may also be entitled to extra concessions from state and local Government authorities. These may include reductions in property and water rates, energy bills, fares on public transport and motor vehicle registration. It may also include a telephone allowance.

How to reduce your tax

With June 30 approaching, many of our clients will want to find ways to reduce their tax bill and each year there are a host of new products offering to do just that. There are many that will provide a tax deduction, but they are not all good investments.

Our priority is to identify the products that offer good investment opportunities. There is no point paying out money to receive a tax deduction if the investment doesn't at the very least, earn the inflation rate on your capital after tax.

So far our research has been in two areas:

1. agricultural schemes that offer large up front deductions and;
2. capital protected, geared investments.

We have talked with a number of agricultural product providers and reviewed investment opportunities in premium beef, almonds and timber. However, the Government recently announced that it would not be allowing future non-forestry schemes to offer up-front tax deductions. Consequently, the opportunity for non-forestry investments now appears limited.

The up side to forestry investments is that you do receive a large up-front tax deduction and may not have to make any further contributions. The down-side is the long investment term (10+ years) and the fact that your return doesn't get paid until the end of the term and it is typically all income as opposed to capital growth. This will have a significant impact on many people's tax liability. Another down-side is the return uncertainty. Few schemes have run to the end of their term so far.

Sector Review - 'Tax Effective Funds'

Our concern: which ones are good investments?

Outcome of our research: we believe that capital protected, geared investments generally offer a better after tax risk / return outcome than agricultural schemes that offer large up-front tax deductions.

Investors should also be aware that these investments are not all alike and some have significant advantages over others.

The other type of tax effective investments we research are the ones that provide a 100% investment loan and offer exposure to a range of growth assets eg shares, managed funds. It is the interest expense on the loan that creates the tax deduction in this case.

These products offer variable features which include:

- the term to maturity (usually 3-8 years)
- the borrowing interest rate
- the capital protection mechanism
- the income / capital growth split at maturity and during the term of the investment

Our analysis shows that how the capital protection is achieved can have a significant impact on expected returns. Various financial instruments are used to protect capital and some are more costly in certain circumstances than others.

The tax implications of the different structures also vary considerably. Some investments will deliver predominantly long term capital gains (of which only 50% is taxable), whereas others will deliver income (which is 100% taxable).

What type of fund will be appropriate for investors is a very individual consideration (depending on your personal tax rates, future work prospects, need for expenses, residency etc). Before recommending any fund, we need to review all personal circumstances and we look forward to speaking to you about this soon.

Please contact us if you would like to discuss any of these ideas:

Lisa Faddy	402 042 962	lfaddy@majellawealth.com.au
Joanna McCreery	0414 234 932	jmccreery@majellawealth.com.au
Office	02 9018 9114	

www.majellawealth.com.au