

NEXIA
COURT

FINANCIAL
SOLUTIONS
PTY LTD

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Welcome to

NEXIA COURT FINANCIAL SOLUTIONS

Investment Solutions Newsletter Autumn 2010

Just two short months into 2010 and already we are starting to see the winds of change beginning to blow a little harder.

From an economic perspective, Australia continues to gradually emerge from the global downturn of 2008/09. This is great news but we also continue to see a number of headwinds or potential risks that might still affect the pace of this recovery. All sorts of predictions have emerged about the shape of the recovery over the next few years but the two most favoured at this stage are:

- The classic “V” shaped recovery with economic activity returning to long term averages quite quickly driven by the impressive growth of China or,
- A ‘stop/start’ “W” shaped recovery with a few ups and downs before the longer term recovery emerges

Hopefully, one of these two scenarios emerges without risk of a further slide into recession. Nonetheless, significant risks remain in the US, UK and in particular, various European countries and we continue to build appropriate defensive strategies into our clients’ portfolios at this stage of the cycle (subject to their risk profile requirements). If you would like to discuss your investment requirements at any stage, please do not hesitate to let us know.

Furthermore, 2010 is also likely to be characterised by legislative change as we head into a Federal Election at the end of the year. In this first half of 2010, we expect to see delivered:

- the Henry review of the Australian taxation and retirement system and recommendations for improvements
- the Federal Budget and
- the Cooper review conducted by ASIC on the regulatory structure of the Australian superannuation system

As these important reviews are released, we will ensure that you are provided with a general analysis of each and its potential implications. Our ongoing financial advisory clients will also receive a tailored analysis of the legislative impact of those changes and any recommendations in their regular review. Of course, if at any stage you have any questions, please don’t hesitate to contact your Nexia Court adviser.

Kind Regards

Craig Wilford
Partner



A NEW DECADE OF OPPORTUNITY?

Smart investors review their investment strategy on a regular basis because circumstances can and do change.

Investment markets have been considerably less volatile recently than they were in 2008 and early 2009. This change in the market cycle should prompt you to consider if your current investment strategy is going to help you achieve the growth you need to meet your goals.

THE TRUTH ABOUT CASH

While you can be fairly confident that your capital's safe and you'll get interest on your investment, the fact is that the combined effect of tax and inflation erode the value of a cash investment over time. The risk with a strategy that relies heavily on cash is that your investment won't grow enough to help you reach your goals, and that your purchasing power is eroded due to inflationary effects.

CHANGING MARKETS

At the height of the recent financial crisis, no one could predict when the markets would reach their lowest point; but it looks like they did in March 2009. The Australian All Ordinaries index of 500 companies ended 2009 at 4882.7, a 33 per cent improvement for the year to December 2009. In hindsight, an investment in shares at the market's lowest point to December 2009 would have given you a double-digit return. You also have an added tax benefit from shares.

TAX SAVINGS ON SHARES

The imputation system for Australian shares, where you receive a 'franking credit' for the tax paid by a company on its share dividends, can potentially make shares a more tax-effective investment than, for example, a term deposit. As the table shows, \$10,000 invested in shares in XYZ Company generates a higher yield after taking franking credits into account. This example assumes both investments generate the same gross yield and the investor's marginal tax rate is 45 per cent plus Medicare levy of 1.5 per cent (total tax rate 46.5 per cent).

	675 shares @ \$16 per share in XYZ Company	Term deposit
Total investment	\$10,000	\$10,000
Gross yield	7.5%	7.5%
Fully-franked dividend income (\$1.20 X 625 shares)/ interest @ 7.5%	\$750	\$750
Franking credit	\$321.43	
Taxable income	\$1,071.43 (\$750 + \$321.43 franking credit)	\$750
Tax payable @ 46.5%	\$498.21	\$348.75
Less franking credit offset	\$321.43	
Net tax payable	\$176.78	\$348.75
Net income	\$573.22	\$401.25
After-tax yield	5.73%	4.01%

DIVERSITY IS THE KEY

It would be ideal if we could predict market movements, investing our money in the next big winners and avoiding the losers. But not even the experts can accurately predict which asset class will be the next top performer. Spreading your investments over a variety of assets means the good performers balance out the bad, so you lessen the risk of loss.

Changing markets create new opportunities for investors. Talk to your financial adviser today about strategies to help you take advantage of the opportunities in 2010.

AGED CARE AND YOUR ASSETS

In the summer issue of Investment Solutions we examined some of the options for aged care. In this issue we look at the pros and cons of selling or keeping your family home.

If you enter a hostel or nursing home, the decision to sell or keep your home can affect how much you pay for aged care and the amount of age pension you receive.

AGE PENSION

Centrelink determines your age pension entitlement by applying both an income test and an assets test. The test that results in the lower rate of pension will apply.

ASSETS TEST

If you keep your home, it's exempt from the assets test for two years after you enter an aged care facility or for an indefinite period if any of the following circumstances apply:

- Your spouse continues to live in the home
- You rent out your home within two years of entering the facility and pay some or all of aged care accommodation bond by periodic payment or you pay an accommodation charge.

If you sell your home, Centrelink may assess the proceeds depending on how you use them. Assessment will be against the higher, non-homeowner limit.

INCOME TEST

Where you pay some or all of an aged care accommodation bond by periodic payment or you pay an accommodation charge, any rental income you receive from your home is exempt for the income test indefinitely.

If you sell your home, the income test assessment depends on what you do with the proceeds.

AGED CARE COSTS AND AGE PENSION: HARRY

Harry is 80, in receipt of the maximum Centrelink age pension and is about to enter a nursing home. His only assets are family home valued at \$750,000 and \$30,000 in the bank with an interest rate of 4%.

Harry has the option to either keep and rent out his family home at \$500 per week (within two years of entering the nursing home) or, sell the home and invest the proceeds in his bank account.

The table below outlines the impact each option has on Harry's aged care fees and age pension entitlement after two years.

	Home rented	Sell home
Basic daily care fee*	\$36.94 ⁺	\$33.74 pd ⁺⁺
Income tested fee	Nil	\$5.37 pd
Accommodation charge*	\$25.05 pd	\$25.05 pd
Total fees per day	\$61.99 pd	\$64.16 pd
Total fees per annum	\$22,626.35 pa	\$23,418.40 pa
Centrelink age pension*	\$17,469.40 pa	Nil
Bank account (@ 4%)	\$1,200.00 pa	\$31,200.00 pa
Rental income (\$500 pw)	\$26,000.00 pa	N/A
Total income per annum**	\$44,669.40 pa	\$31,200.00 pa

* Ignoring indexation

** Assuming no other income

+ Standard resident consideration fee

** Phased resident consideration fee

Other assumptions:

- Expenses for home maintenance are not included
- Capital growth on home is not included
- Bank account assessable income is calculated using current deeming rates: first \$42,000 at 2% and the balance at 3%
- Age pension rates and thresholds are current as at 1 January 2010 and include pension supplement

Information taken from money management article <http://www.moneymanagement.com.au/article/The-family-home-and-age-pension/506826.aspx>.

Talk to your financial adviser about your options

Keeping your home may help to reduce your assessable assets and income. This may boost your total income and keep aged care costs lower. If you keep your home you'll need to consider home maintenance expenses and other costs. If you sell it, you'll need to consider the expected lost potential capital growth and the net returns for each of your investment options.

Your financial adviser can help you decide which option is appropriate for your particular circumstances.

WEALTH, LOVE AND SEPARATION

No one likes to think that their relationship might break down. But there's a way to protect your assets if you and your partner do decide to part ways.

While some relationships do last a lifetime, it's a sad fact that many don't. So while you (or a family member) may well enter wholeheartedly into a relationship and be willing to share everything you own with your partner, it can pay to take steps to protect your assets.

BINDING FINANCIAL AGREEMENT

A Binding Financial Agreement (BFA) is an asset protection and estate planning tool. You could compare a BFA to an insurance policy. You hope never to have a car accident, but if you do your insurance provides peace of mind. A BFA helps protect against the loss of your assets in a relationship breakdown.

A BFA can include the current and projected property ownership and super belonging to you and your partner. The BFA will determine how you divide any property and super that exists at the date you separate. So a BFA is an evolving document; it caters for the splitting of your assets at a future date.

You could also consider a 'Mini BFA'. A Mini BFA deals specifically with one asset by excluding that asset from any division if you separate; how all other assets you and your partner have accumulated are split would be negotiable if you separate.

Case study

Bob decides to sell an investment property and give \$500,000 to his son Darryl and Darryl's de-facto Claire to buy a townhouse. Bob is cautious about the money he is giving them and the fact that their relationship might not work out. Bob decides to reassure himself by entering into a mini BFA with Darryl and Claire.

Under the terms of the Mini BFA, if Darryl and Claire separate they will either have to sell the property or one of them will have to buy the other out. The 'loan' of \$500,000 will then be paid back to Bob.

STRICT REQUIREMENTS

A BFA must meet strict requirements to ensure it will, if necessary, hold up in a court at a future date. Under the Family Law Act 1975, a BFA is binding if all the following conditions have been met:

1. The agreement is signed by all parties.
2. Each party has, before signing the agreement, been provided with a certified annexure to the agreement containing independent legal advice from a legal practitioner about:
 - the effect of the agreement on the rights of that party
 - the advantages and disadvantages, at the time the advice was provided, to the party of making the agreement.
3. Each party (either before or after signing the agreement) has been provided with a certificate signed by the person providing the independent legal advice stating that they provided the advice (whether annexed to the agreement or not) and a copy of this certificate has been provided to the other party.
4. The agreement hasn't been terminated or previously set aside by a court.

Information taken from money management article <http://www.moneymanagement.com.au/Article/Will-you-marry-my-Binding-Financial-Agreement/506823.aspx>

A BFA may not be for everyone. But if you've been stung by divorce or separation in the past, it's a tool you may consider using in the future.

You should seek advice from an accredited family law specialist to draft a BFA or Mini BFA. Your financial adviser can recommend a specialist in your area to help you with your BFA needs.

DON'T RISK IT

In this issue we look at the importance of including adequate risk protection strategies as part of your financial plan.

When you have a family that relies on you to provide for them, you wouldn't like to think they would suffer hardship if something were to happen to you. The sad fact is that many Australians with dependent children don't have enough life insurance to look after their families if they were to die unexpectedly.

"IT WON'T HAPPEN TO ME"

You may be an optimist – that can be a good thing in most circumstances. But statistically there's a chance you could be one of the tens of thousands of people affected by heart disease, cancer or any number of conditions that kill or disable Australians each year.

WHAT YOU SHOULD CONSIDER

Life insurance

Life insurance generally pays a lump sum to help your dependants clear debts and cover living expenses so they don't face financial hardship if you die from an illness or accident.

You could have basic life cover through your employer-sponsored super fund, so check whether you're covered by this type of policy already. You may need to top up your cover.

If you do take out cover through your super fund, monthly insurance premiums can be deducted from your regular employer contributions. And premiums paid via super may be cheaper if your employer gets a group discount from the insurer.

Total and permanent disability

You can generally take out total and permanent disability (TPD) insurance by either linking it to your life cover, or as a stand-alone policy. TPD cover provides a lump-sum payment if you become totally and permanently disabled. "Totally disabled" can mean different things for different people, depending on your

occupation or regular daily activities. Talk to your financial adviser to determine which type of TPD cover is right for you.

Trauma

Trauma cover also known as critical illness or living insurance, is designed to provide financial relief to help you pay medical bills or other commitments (such as your mortgage) if you suffer a specific medical condition. This could cover you for a range of traumas, for example, a heart attack, stroke or cancer.

Income protection

Income protection insurance replaces up to 75% of your regular monthly income if you fall ill or are injured and you can't work. This cover is designed to help pay your mortgage and meet other living expenses when work sick leave runs out.

To calculate the level of cover that's right for you and your family, you'll need to consider the everyday costs associated with maintaining your lifestyle including paying your mortgage and other debts and providing for your partner and/or family. With the help of your financial adviser, you can select the length of time you would like the benefit to be paid. You can also choose the waiting period for your cover which is appropriate for you.

Income-protection insurance may be available through your employer-sponsored super fund as a 'salary continuance' benefit. And the good news is that premiums for income protection are tax-deductible.

Your financial adviser can help you work out if your current insurance cover is enough for your circumstances. If you think you're under-insured, talk to your financial adviser today.

INVESTMENT SOLUTIONS – JANUARY QUARTER 2010

Historically low interest rates combined with large central bank liquidity programmes and fiscal stimuli have continued to support improvement in global sentiment. Although the outlook is generally positive, inflation will be a key issue globally in 2010.

ECONOMIC OVERVIEW – JANUARY 2010 QUARTER

The pace of improvement has varied amongst the key economies. China's GDP increased at a rate of 8.9% over the year to September 2009. The US economy grew for the first time since June 2008. Positive growth was also recorded in Europe (0.4%), Australia (0.2%), and Japan (0.3%). The UK has lagged with its economy contracting by 0.2%. Inflation is likely to be an issue particularly in the emerging world and especially in China and India. Inflation is also likely to drift higher in the developed world.

OUTLOOK BY ASSET CLASS

Australian shares

We continue to hold a positive view of Australian equities and anticipate the market to return around 19% over 2010. However, the market is still likely to be volatile, with the current rally expected to falter around April/May once the headwinds to global economic growth are more pronounced. A forward-looking market will, in most cases, react well in advance by discounting the slower global (and in particular, emerging) economic and subdued earnings growth outlook and become more defensive. Once that phase is over, the market is likely to rally into year-end.

International shares

We expect international equity markets to return around 15% to 19% over 2010. However, we believe the markets will experience pronounced bouts of weakness and strength, which is typical after a strong post-recession rally.

Diversified property

We anticipate returns of around 9% from the domestic listed property market and around 16% returns from the global listed property market in 2010. We suspect the full impact of anticipated price declines that are yet to be priced into the unlisted market will eventually impact the listed property market in Australia, although this is not a major issue in other markets. We believe listed property will be a good investment later this year or early next year.

International bonds

We anticipate global sovereign bond yields moving higher during the early part of 2010 due to significant supply/demand imbalances as global monetary authorities roll back their quantitative easing and investor preference for growth assets increases. We anticipate returns for hedged global bonds for 2010 will be around 8.5%.

Australian bonds

We anticipate Australian bonds returning around 4% over 2010 with an estimated year-end Australian 10-year bond yield at around 5.80%, 5-year at around 5.25% and 3-year at around 5.00%. We expect government bond yields to move higher for the same reasons as international bonds.

Alternative assets

We anticipate returns of around 15% to 20% through nimble tactical and active strategy implementations. Given our anticipated profile of market movements where risky assets do well at the start of the year, retreat around mid-year and then rally into year-end, investors should consider using both directional and relative value strategies throughout the year.

Commodities

We believe that the broad structural/macro positive outlook for commodities is still valid. We anticipate commodities returning around 14% during 2010. Commodity prices are expected to move higher in the first half of 2010, led by a sharp rise in base and precious metal prices. Many 'alpha' generating opportunities are likely during 2010. As for most asset classes, a tactical, active and nimble approach should be considered when investing in commodities during 2010.

Currencies

We expect the Australian dollar to move into the 0.98 to 0.99 ranges during early part of this year and then move lower towards the 0.77 to 0.82 range during US dollar strength, ending the year around the 0.88 level. Significant investor risk-aversion will have a material negative impact on the prospects for the Australian dollar because of the high levels of speculative activity associated with it.

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If there is any aspect of this newsletter or your other financial affairs that you would like to discuss in more detail, please contact one of our financial planning representatives.

Robert McGuinness, Craig Wilford, Sylvia Liang on (02) 9251 4600