

“Investment market history tells us that over the long term – seven years plus – investing in the share market is the most likely way to create wealth...”

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Time to stick to your guns

Special Client Reference Paper – February 2008

It's easy to say 'don't panic'. But when investment markets are so volatile it can be hard to keep your resolve and hold firm. What is the most appropriate path for you – hold, sell or even buy? These pointers may help you work out the best way to navigate difficult market conditions...

Review your investment objectives

When you set up your investments, what did you want them to achieve? Were your money goals long term, such as a building towards comfortable retirement or creating a substantial investment portfolio? Or did you have a shorter time frame in mind, perhaps saving for home renovations, a new car or an overseas trip?

Investment market history tells us that over the long term – seven years plus – investing in the share market is the most likely way to create wealth, in spite of the dramatic ups and downs it experiences from time to time. The challenge is for investors to stay committed to their objectives.

There are two key points to remember here:

- the long term trend is for the share market to grow in value, and
- you may recover from a paper loss when the markets return to their long term upward trend, but you won't get the benefit of recovery if you've sold the securities. Think twice before crystallising any paper loss by selling.

What if your objectives have changed?

Think carefully about this one. Have your objectives actually changed? For example, do you now want to focus on achieving a short term goal instead of a long term goal? Or has your tolerance for market volatility changed and you're now more nervous about share market investments?

In either scenario, it's time to talk to your adviser. If your objectives have in fact changed, then it's likely you'll need to rework your investments to reflect the

different time frame. And if your risk tolerance has taken a beating, your adviser can help you work towards a more comfortable portfolio structure. In either case, having the right advice can help you minimise your losses, work out the most appropriate asset allocation for the changed circumstances and handle associated issues such as capital gains tax liability.

What if the market doesn't recover?

Students of investment market history will be able to point out several instances over the years where markets plunged and stayed low for some time. For example, by March 1982 the market was 32.4% lower than its previous high, which it had reached in May 1981. Many investors still recall the 1987-88 crash,

which at its depths in February 1988 saw the market 43.5% lower than in September 1987. The market had tumbled by 17.8% by January 1995 from its previous high point 12 months before. And in February 2003 we saw a 15.7% drop from the January 2002 high point.

In all these cases, and in all other examples of market downturns, the market eventually recovered and then went on to reach a higher point than previously.

However, recovery is not always swift. It took 16 months from the low point in March 1982 to reach the next high point in July 1983. The 1987-88 crash took substantially longer to weather, 63 months in all until

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the market climbed back out of the gloom. However it could be argued market valuations were somewhat more stretched prior to the 1987 crash than currently.

But climb back it did, and has done each time a downturn has occurred. Encouragingly for the long term investor, after each downturn the market has reached a higher point than the high point before the downturn.

Will that be the case this time? Will the market recover and reach another high point? The short answer is no one really knows, but **even though past performance is no guarantee of future performance, the market's track record appears to be consistent on this issue.**

Investment market commentators suggest that unless there's a fundamental structural change to the markets, then there's no reason to believe that what has happened in the past won't happen in the future, and we'll eventually see a recovery.

Are we seeing a fundamental structural change to the markets on this occasion? Certainly the disruption in credit markets resulting from the sub-prime mortgage problems and housing slump in the US has led to fears of a possible US recession.

But even if a recession were to occur, in spite of the preventative action taken by central banks around the world, would that constitute a 'fundamental structural change'? Probably not. After all, the markets have experienced recessions several times in the past. And have eventually recovered from them all.

How long before the markets settle down?

Even the most successful professional investment managers are unable to predict market ups and downs

with 100% accuracy. So we need to accept the unpredictable nature of investment markets and find ways to handle and work with it.

Here's where diversification comes in. Markets move in different cycles, influenced by a variety of factors. It's very rare for all markets to be up at the same time, but it is equally rare for them all to be down together. Having a diversified portfolio, invested in a number of

securities across the range of asset classes, allows you to capitalise on their cyclic nature.

Good results from investments in one sector of the market reduce the impact of poor results from another. This in stark contrast to the 'bet the farm' approach to investment, where an investor takes the risk that one security or market sector will produce the goods in all market conditions.

In summary:

1. **Don't panic. In times of market turmoil it's more productive to keep a clear head and seek sensible advice than to liquidate assets and crystallise losses.**
2. **Review your financial objectives. If they are the same now as when you set them, sit tight and hold on. If they have changed, talk to your adviser about the best way to reflect those changes.**
3. **Share market history suggests strongly that the market will recover this time, just as it has done in the past. However, the recovery time can be substantial. Talk to your adviser to make sure everything is in place for you to ride out the investment storm.**
4. **Embrace diversification. It's sound protection against the ravages of market downturns.**

Note: All market data and related information has been sourced from Counterpoint Group Pty Ltd (Market and Portfolio Commentary January 2008)

For further discussion or information about how to keep on track with a volatile investment market, speak to your Advisor.



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Western Pacific Financial Group Pty Ltd ABN 35 050 159 156
Australian Financial Services License No: 224662
Registered Office: 70-76 Yarra Street, Heidelberg VIC 3084
Email: advice@westernpacific.com.au
Website: www.westernpacific.com.au

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Minimise your tax liability

When it comes to paying tax, your responsibility is to pay as much as you are legally required to pay – certainly no less, but definitely no more! So, while *avoiding* tax is an absolute no-no, *minimising* the amount of tax assessable to you is a legal and financially prudent principle.



And you don't need to be on the rich list to implement sensible tax planning actions. Here are several ideas just sitting within your existing situation that you may not have thought about:

Married couples

Take advantage of the tax-free threshold

You can earn up to \$10,000 without paying tax on your income (combination of tax free threshold and low income offset) and the tax rate increases only gradually over the next few tax brackets. So it makes sense to transfer any substantial cash reserves into the name of the spouse with the lower earnings.

Here's an example. Mary earns \$90,000 as a company executive. Husband George has taken time out of his career to write a book and is currently not earning an income. The couple have \$100,000 in a bank term deposit in joint names paying 6.5% pa, which results in assessable income of \$6,500.

Mary's marginal tax rate is 40%. So any additional income earned, such as her half share of the bank interest (\$3,250), will also be taxed at that top rate. Simply by transferring their joint money in the bank into George's name, the couple can save \$1,300 in tax. (Medicare levy not included)

Contribution to spouse's super rewards with rebate

Here's a top way to provide more financial security for your spouse and slice a chunk off your own tax bill of up to \$540.

If your spouse earns less than \$13,800 and you make a contribution to his or her super fund, you'll be in line for a tax rebate of 18% of the contribution (up to a maximum of \$3,000). The rebate reduces by 18 cents for every \$1 the spouse's income exceeds \$10,800, cutting out at an income of \$13,800.

The full rebate of \$540 is available to you if your spouse's income is less than \$10,800 and you contribute at least \$3,000 to his or her super. Certainly well worthwhile for both reasons!

Individuals and families

Keep count of medical costs

The tax law provides for a tax offset (rebate) of 20% where net medical costs (ie the cost to you less any refund from Medicare and your private health insurer) exceed \$1,500 over the financial year.

These costs include hospital charges, fees for doctors, physios and chiro's, and a host of other therapeutic practitioners and pharmaceutical costs. There are some restrictions and limitations on what falls within the rules for this rebate, so it's well worthwhile talking to your adviser, but if you've spent the money on medical costs, you're certainly entitled to get the benefit of the tax concession.

Protect your income

You've heard it before. Your ability to earn an income is your most important asset. But are you protecting this asset like you do your home, your car or your personal possessions? If you're like most Australians the answer is 'probably not', which means you leave yourself and

your family open to potentially disastrous financial disruption if, because of accident or illness, you can't claim your regular pay packet.

Most money experts agree that having income protection insurance, which generally pays up to 75% of your usual income, is a must. And the premiums are tax deductible.

All the reasons in the world to have the protection and a tax incentive to boot!

Employees

Even little costs can add up to good tax savings

1. Home office use

Taking work home is often unavoidable, so make sure your tax return reflects the additional cost of having a home office. The Australian Tax Office (ATO) sets a guide to reasonable home office costs each year, currently 26c an hour. Might not sound much, but every little bit helps whittle down your tax bill.

2. Salary sacrifice

Here the principle is to reshuffle the way you are paid to gain longer term benefits and reduce your taxable income in the short term. Many people opt to move a bigger chunk of their salary package into super, boosting their retirement income earnings and reducing tax at the same time by moving to a lower tax bracket. Your adviser will be able to help you work out whether this is an appropriate strategy in your particular circumstances.

Positive actions in a time of uncertainty

At a time when we're bombarded with news about increasing inflation, interest rate hikes and share market dips it's tempting to retreat to the bunker of 'it's out of our control'.

So let's turn it around. In the following articles you'll find some positive actions you can take to reduce the impact of the inflation nasties and get yourself set to manage through the bumpy ride with confidence:

- Minimise your tax liability.
- Is your loan as healthy as it should be?
- Time to stick to your guns.

Here's an example of how salary sacrifice can result in a better all round financial position:

Robert, who's 40, is on \$65,000 a year. His living expenses are \$40,000 a year. His employer is paying SGC on his behalf at the statutory rate of 9% and Robert's current super account balance is \$100,000. He decides to have a go at salary sacrificing an additional \$1,000 a month into super.

Even after the first year, he sees some positive results:

After year 1	Without salary sacrifice	With salary sacrifice
Salary excluding SG	\$65,000	\$53,000
Super contribution (including SG)	\$5,850	\$17,850
Tax payable (including Medicare)	\$15,075	\$11,295
Contributions tax (15%)	\$877	\$2,677
After tax salary	\$49,925	\$41,705
Net super benefit	\$4,943	\$15,173

Robert's made tax savings of \$3,780 and has socked away an additional \$10,200 in super in the year, a total benefit of \$13,980. Yet he's only reduced his income in hand by \$8,220. A very encouraging result!

But if Robert keeps up the momentum for 10 years, he'll really reap some rewards.

After year 10	Starting super balance	Annual contributions	Value after 10 years
Without salary sacrifice	\$100,000	\$5,850	\$287,927
With salary sacrifice	\$100,000	\$17,850	\$435,690

(Assumptions: no indexation of contributions. Balanced risk profile. 8% annual growth.)

With this simple and pain-free strategy Robert has given himself the opportunity to have an additional \$147,763 in his super account after 10 years.

Talk to your adviser about some of the other items your employer may be prepared to fold into a salary sacrifice/salary packaging arrangement. A home computer, a car are some possibilities you may want to consider.

3. Employee share plans

Here's another one to discuss with your adviser. If you're entitled to participate in an employee share plan ("ESOP"), which can be a very sound way to build up your long term investment portfolio, you may be eligible for a tax concession under Section 139E of the Tax Act.

Foreign pension recipients

Make sure you're only including what you must

Australian residents receiving a pension or annuity from another country must include that income in their Australian tax return. However, the deductible amount relating to that pension is excluded from assessable income. In a nutshell, if you're getting a pension or annuity from overseas, talk to your adviser to make sure you're only being taxed on the assessable part.

Investors

Property – Dig a little deeper for all the deductions you're entitled to

It's usually well worth the cost of a quantity surveyor's report on your investment property. Not only will the cost of the report be tax deductible, but chances are it will unearth deductions which are sitting there ready to be used to reduce your taxable income.

Shares

There are a variety of reasons to choose one share over another. The payment of franked dividends is likely to be one. Where all else is equal, if company A pays fully franked dividends, which means 30% of the tax on that income is already paid, and company B doesn't, company A will provide you a better tax outcome.

Hang in there to reduce CGT

Certain assets, including investment property and shares, attract capital gains tax when you sell them. However, if you hold them for at least a year before you sell you'll be entitled to earn a 50% discount on the capital gain. Therefore if you make \$100,000 capital gain on the sale of an investment property, you will only be assessed on a net capital gain of \$50,000 this could translate into lower CGT than would have been the case if you'd sold before the year was up.

Remember to claim borrowing costs

The cost of borrowing, which may include establishment fees, stamp duty, lender's mortgage insurance, search and valuation fees and the like, to finance an investment are deductible. However, unless these expenses are less than \$100, which is pretty unlikely these days, you have to spread the total cost over the term of the loan or 5 years, whichever is the shorter. For example, if your total borrowing costs are \$2,300 and the term of the loan is 4 years, the deductible amount for each of those 4 years is \$575. However, if the term of the loan is 20 years, the borrowing costs are averaged over 5 years, resulting in a deduction for each of those 5 years of \$460.

All taxpayers

Seek professional advice to make sure you're claiming every tax benefit and concession you're entitled to. All the above mentioned strategies may not apply to your situation. The tax legislation is a complex area and it is important that you talk to a qualified tax expert.

Speak to your Advisor for a referral to a tax expert.

Is your loan as healthy as it could be?

With the current environment of interest rate rises, now's the time to go for a loan health check. As the interest rate rises most of us will have to find extra dollars from an already tight budget. This is an opportune time to review your loan and make sure you've got the best deal for you.

Talk to a specialist mortgage adviser to work through the numbers and see whether your current loan is appropriate for your situation or if there are better alternatives available for you.

Options could include:

- splitting your loan into a combination of fixed and variable interest loan
- switching to interest only payments
- fixing your repayments
- consolidating debt
- refinancing into a fixed interest loan
- or simply following a strict budget to make sure you are always in control

If your loan does need remedial treatment, your specialist adviser can help you:

- review your total financial position
- consider all the alternatives
- talk to your current lender to negotiate a better deal
- weigh up the pros and cons of conducting a 'transplant' to a healthier loan.

In any event, a complete loan health check will provide you with the peace of mind of knowing you're in the best position to ride out the interest rate storm.



Here's a handy loan health checklist to start the recovery process:

1. 'Good' debt or 'bad' debt? ('Bad' debt is not tax-deductible. Your number one priority is to pay off bad debt first).
2. Is the type of loan you have a good match for its purpose?
3. Is it affordable?
4. Is it flexible? (does it allow you to make changes without penalty?)
5. Are the 'bells and whistles' it offers useful and valuable to you?
6. Are the fees charged reasonable?
7. How does it compare with newer products?
8. What's your contingency plan to cope with interest rate rises or an unexpected inability to make the repayments?

It's important to make sure that your loan matches your particular requirements. Don't wait till the situation turns critical before getting in touch with your loan specialist.