



With compliments from your AFG adviser

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our investment landscape

Over the past 12 months the media has been awash with reports on the drought, global warming, nuclear power, China and our ageing population. These are real issues that will affect our lives over the next few decades.

But is the media overplaying its hand? Are we being whipped into a frenzy by politicians seeking election? What is the timeframe?

These issues will affect our investments, our investment returns and our living standards in the years ahead. So what do we do?

Every drop counts

Australia is currently in the grip of drought. It is not the first and it will not be the last. However, the reason this drought is worse than others is that it follows so soon after the last drought. Many farmers have been unable to recover after the drought of 2002-03.

Droughts hold back economic growth and bring extreme social and economic distress in rural communities. Some assistance is in place and this may tide some businesses over. But, sadly some businesses will fail.

Thirty or forty years ago, drought would have tipped Australia into recession. Exports would fall, demand from rural Australia would fall and unemployment would rise. Today the impact on the overall Australian economy is less severe. Mining and service industries have emerged to drive the economy and they are currently doing well.

According to the Reserve Bank of Australia, the long term impact on inflation is minimal while economic growth may fall by around 0.5% to 0.8%. The Government is forecasting 2.50% growth in 2006-07 and 3.75% in 2007-08 – but the latter figure does assume a return to normal seasonal conditions. We cannot take this for granted and the drought and its impact on the economy may worsen.

A weaker economy means weaker investment returns and a break in the drought would be welcomed by us all. Billions of dollars will be spent on water infrastructure over the next decade. This will present opportunities for investment.

There's a change in the air

Pollution is never welcome. Prior to the advent of unleaded petrol, many cities were choking under a blanket of smog. In earlier times the grime of London, Pittsburgh and Detroit was legendary. But Shanghai is the new Detroit and it has dozens of cousins across Asia.

From a planetary perspective it would be helpful if all countries played their part in reducing pollution. At present this is not the case. While this is unfortunate, does it mean the rest of us stop trying? Clearly not, but how far do we go?

What is the appropriate forum for global cooperation? Is it the United Nations? Is it the Kyoto Protocol? Or is it some other institution or process that has yet to be formed? And what does it mean for investors?

It has become abundantly clear that pollution comes with a cost – a cost that is not worn directly by producers or consumers. The process known as carbon trading attempts to put a price on pollution such that polluting activities are discouraged and non-



polluting or carbon absorbing activities are encouraged. Carbon trading seems likely to grow in importance in the fight against global warming.

As with 'Kyoto protocol', carbon trading is less effective if the large polluting countries do not take part.

Companies react to price signals and adjust their activities accordingly. Markets also react to price signals with the rising price of uranium one clear example. If concern about global warming leads to a reduction in the use of coal, uranium emerges as a possible alternative.

We are also likely to see energy companies lifting the level of research into alternative or cleaner energy sources such as wind, tidal and solar power.

As the global warming debate unfolds, government policy will change, taxes may change and company behaviour will have to change – as might consumer behaviour. The role of fund managers will be to understand which industries will benefit and which will face increased costs. The process has begun but it has a long way to go.

China as a superpower

China is transforming from an inward looking, tightly controlled communist state, to an increasingly modern, market driven, outward looking nation. In years to come it will be a true super power – it is already there in some respects.

In the past 20 years, China has dismantled many of the controls that prevented it from growing into a modern economy. Property rights were granted, people's freedom of movement was improved, modern transport systems were constructed, state-owned factories were privatised, its financial system was improved and the nation began the process of urbanisation. These events have unleashed immense economic energy in China.

The current resources boom and the rise in the price of petrol is one outcome of events in China. Subdued inflationary pressure is another, as is the loss of manufacturing jobs in Australia and elsewhere.

Looking ahead we need to consider the economic, environmental and political implications of a richer China. A wealthy, cooperative China will lift living standards around the world but room will have to be made 'at the table' for this emerging power.

Growth in China will not end after the Olympic Games. The transformation will continue and impact upon us for decades to come.

Our ageing population

In 1970, the average age of the population was 31 years. This rose to 37 in 2004 and by 2050 it will be around 50. In 1970, there were 8 people aged between 15 and 64 to support each person of retirement age. This has now fallen to five and is expected, by the Australia Bureau of Statistics, to be only two by 2050.

The ageing population will alter our consumption patterns, the patterns of government spending and possibly our investing behaviour. It may also affect levels of taxation. Someone needs to pay for government services!

At face value the demand for healthcare and aged care services will rise, as might demand for the leisure activities of retirees. Road trains will have to make way for increasing numbers of caravans!

But will this large body of retirees want to hold the same mix of assets as the current population? Will they dump their shares and purchase bonds? If this occurred, the mass selling of equity assets would affect markets. Share prices would fall and bond prices would rise. However, as this occurred, bond yields would fall and dividend yields would rise. Nothing stands still.

We should not take it as given that ageing of the population will create havoc in financial markets. Relative prices will change; new buyers such as the young savers of Asia may buy our assets, and retirees may in fact want to hold onto the income-producing assets that allowed them to retire in the first place.

This article has been prepared in conjunction with Colonial First State.

when just a will, just won't do

Many people choose a Will as their primary way of ensuring their wishes are carried out after they have passed away. After all, a Will is the most commonly used, legally recognised way of setting out instructions for how your assets are to be disposed of after your death. In short, it ensures that you have the opportunity to decide 'who gets what' among your loved ones.

Your Will is also your way of appointing someone as your executor. This can be a family member, a loyal friend or someone you know you can trust to make sure your wishes are carried out correctly. If you're unsure about who to appoint, you can choose an independent trustee company to act on your behalf and who is legally obliged to carry out your instructions.

The importance of a Will

A Will is so important that no one should be without one. If you die without a Will, the government can decide who gets what, which may be completely different to what you had intended. In such circumstances, your children or other loved ones may miss out entirely simply because of what the law says needs to be done in the absence of a Will.

So, a Will is vitally important. Yet, in many cases, a Will may not be enough as demonstrated in the following example where one woman who thought she was doing the right thing by leaving everything to her elderly mother when she died, ended up causing her mother to lose her pension and all its associated benefits. When the mother tried to give the estate away to charity, Centrelink penalised her for making such a gift.

The importance of estate planning

In this situation, an estate plan would have considered the affairs of both parties, if requested, and the Will could have included conditions to allow the trustee to distribute funds with the mother's specific circumstances in mind.

If you have remarried, have a family business or even run your



own self-managed superannuation fund, a simple Will may not be enough to cover your potentially more complex personal and financial needs.

In situations like these, you might actually need an estate plan involving expert advice from specialists in key fields such as financial planning, accountancy or the law. An estate plan can help you:

- minimise challenges to your Will
- assess your superannuation entitlements and help ensure your death benefits will be properly allocated
- establish an enduring power of attorney to ensure your financial affairs can continue to be carried out properly while you're alive, if for some reason you become ill or incapacitated
- review family trusts to ensure they can continue to be managed in accordance with your wishes.

Which do you need?

If you have a relatively uncomplicated personal and financial situation, a simple Will may be enough. This is especially true if you only have, say, the family home to pass on or your family structure is simple and you simply wish to divide your assets among immediate family members and this will not involve establishing any continuing trusts.

However, if any of the following circumstances apply to you then you may want to consider an estate plan over a simple Will:

- you have substantial assets beyond the family home
- you have superannuation or manage your own superannuation plan
- you operate a family trust or family business
- you have remarried or live in a de facto relationship and have children from previous relationships
- you have beneficiaries who are disabled or need some form of long term assistance or protection
- you anticipate someone could challenge your Will or you wish to place conditions or limits on your Will.

In any of these circumstances, it may be wise to consider an estate plan instead of just a simple Will – as the following two examples illustrate. A businessman left everything to his children in his Will, but on his death, his ex-wives challenged the Will, and because he had put no plans in place to keep his business going, all his employees lost their jobs. Another man, who had also left everything to his children in his Will, had neglected to assign a power of attorney to his wife. When he became incapacitated, his wife had to fight for the right to administer his affairs so that she could continue to run the household and provide for his infant son. Then, when he died, she was also forced to contest the Will.

To discuss your individual needs and help you decide whether a simple Will or an estate plan is the best option for your particular circumstances, please speak with your financial advisor.

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geared options for your investments?

There is an old saying in investment that "Money makes money". It underlines a simple investment truth – namely that you need an initial capital base in order to generate future wealth.

While the principle still rings true in today's market, investors can now boost the amount available for investment using borrowed money.

Borrowing to invest is called gearing and it could be part of a strategy to consider for long-term wealth creation. You need to be aware that gearing magnifies losses as well as gains so this strategy may not be suitable for you. But if you are looking to increase your investment base and are willing to take on greater risk, then you may want to speak to your adviser about geared investments.

Some tax benefits of gearing

There can be a number of tax benefits from borrowing to invest. If you have a fixed rate margin loan, you may be able to prepay next year's interest before 30 June and claim the interest as a tax deduction on this year's tax return, bringing forward the benefit of the deduction.

There can also be tax advantages through the reimbursement of franking credits. Any investment in Australian shares, whether direct or through a managed fund has the potential to provide franking credits. But, in a geared fund, this potential advantage could be magnified because the investor may receive additional franking credits because of the increased investment in the underlying shares.

- Borrowing to invest may not be a suitable strategy for you. While gearing has the potential to magnify gains, it will always magnify the losses.
- While a gearing strategy can have favourable tax implications, a geared investment should not be used solely to provide tax benefits. If the value of the investment falls, the losses can far outweigh any tax advantages.
- Geared share funds, and geared investments generally, involve much higher risk than non-geared investments and you should seek financial or tax specialist advice before investing or borrowing money to invest.

TIP – prepay your interest before 30 June (for the following financial year) so you can claim the interest as a tax deduction on this year's tax return

Which strategy to choose?

All geared investments present benefits and risks that you should be aware of.

	BENEFITS	RISKS
GEARED MANAGED FUND	<p>It increases the amount you have to invest.</p> <p>If your investments increase in value, gearing can magnify gains.</p> <p>Losses are limited to what you have invested in the fund.</p> <p>You won't be asked to make additional payments (margin call) or provide any security beyond your initial investment amount.</p> <p>Can be used for superannuation money without breaching the borrowing rules normally associated with gearing.</p> <p>Lower interest cost as the fund borrows at wholesale rates.</p>	<p>If your investments go down in value, gearing will magnify losses.</p> <p>No direct control over the level of gearing or where the fund invests, but you can control which asset class you invest in.</p> <p>You could lose all or a significant amount of your investment if the value of the fund falls.</p> <p>Returns must be higher than the after tax borrowing costs for gearing to be of benefit.</p> <p>You could face larger fluctuations, both up and down in the value of your investments than on a comparable ungeared portfolio.</p>
MARGIN LOAN	<p>Able to choose from a wide range of managed funds in which to invest.</p> <p>Able to control the level of gearing up to a maximum set by the lender.</p> <p>It increases the amount you have to invest.</p>	<p>As well as the risks above, if the value of your investment falls below a specified level, you will be required to make an additional contribution or sell down investments, known as a margin call, to bring your loan to value ratio (or LVR) back to the set minimum.</p> <p>There may be interest penalties if the loan is repaid sooner than agreed.</p> <p>If interest rates rise you could have to pay more interest than you anticipated.</p> <p>In the worst case you could lose all of your investment and still have an obligation to repay the loan.</p>

STRATEGY: Invest in a geared managed fund?

These are managed funds that borrow money and combine them with your investment. The extra money provides the potential for higher returns. But, if the fund's investments you choose don't perform, any losses you make will also be magnified. This creates greater volatility compared to an ungeared investment and investors will face larger fluctuations (both up and down) in the value of their investment than on a comparable ungeared investment. Geared funds are high risk and you should read the relevant Product Disclosure Statement for more information on geared funds.

STRATEGY: Take out a margin loan?

A margin loan is a way of borrowing money to increase the amount that you are able to invest, using your investment as security. For example, if you had \$10,000 to invest, a margin lender could lend you up to another \$10,000, giving you \$20,000 to invest in the fund options of your choice. You will be charged interest on the loan, and how much you can borrow (known as the loan to value ratio or LVR) will vary. A margin loan has a number of benefits but also has a number of risks which need to be carefully considered before you make any commitment.



Budget 2006 what will this mean for you?

More money in your pocket or more to invest?

You could use the extra money you get from the tax cuts to salary sacrifice or top up your super. Especially since your super benefits will be tax free when you retire (age 60+).

As Mr Costello said, "If you want to save, put money into super – you will never find a better savings vehicle."

Could your investments be more effective?

Once you reach 60, any money you take out of super will be tax free. But you will have to pay tax on any investments you have outside super. Now is a good time to look at your investments and think about whether you would be better off investing in super.

Do you need to put off retiring or semi-retiring until after 1 July 2007?

If you're over 60 and thinking of retiring within the next year you might want to reconsider. The main reason being that your super would be completely tax free after this date. If you are age 55-59 there may also be tax advantages to delay starting a pension. Talk with your financial adviser about how it would affect you if you were to retire pre and post 1 July 2007.

Do you need to delay retiring or semi-retiring until you're 60?

If you delay retirement and don't take out a pension until you turn age 60, you could save a lot of money in tax. This could mean you have more to retire on. However, if you don't want to keep working there are things you can do to reduce your tax. We suggest you discuss these options with your financial adviser.

Should I still consider splitting my super with my spouse?

The removal of RBLs and tax on the payment of super benefits after age 60 makes a super splitting strategy less relevant from a tax saving point of view. However, if you intend to retire and draw super benefits before age 60, then this strategy may still be worthwhile considering.

If you're self employed do you want to increase your contributions?

The new proposals give you similar contribution limits as employed people, as well as access to co-contributions. Putting money into your super fund is now easier and more beneficial than ever.

Could you be eligible for Centrelink benefits after 20 September 2007?

If you don't currently qualify for an age pension because you have too many assets, this may change after 20 September 2007. A proposed reduction in the Taper Rate means you could have more assets and still qualify for a part pension.

Also complying pensions purchased before 20 September 2007 will still qualify for 50% exemption from the Asset Test.

What if I have already retired and started a pension?

If you are age 60 or over, your pension will be tax free from 1 July 2007. If you are age 55-59 your pension will continue to be taxed as is until you turn 60 when it will become tax free. Also, from 1 July 2007 you may pay less tax if your pension was over the RBLs.

Want to find out more?

For more information please speak with your financial adviser.

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