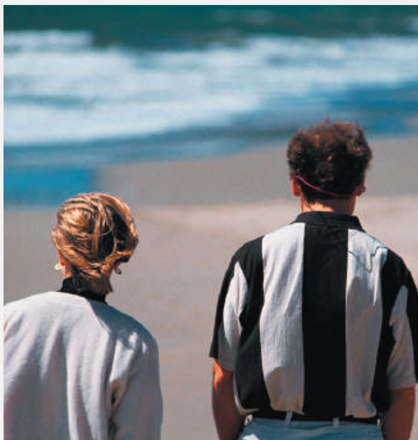
The Financial Edge

Edition Two - January 2005

Diamond Financial Solutions Pty Ltd, 65 Hume Street, Crows Nest NSW 2065, Telephone: 02 8437 3562
Email: info@diamondfinancial.com.au, Website: www.diamondfinancial.com.au. Authorised Representatives of AXA Financial Planning Limited, ABN 21 005 799 977 an Australian Financial Services Licensee Licence No: 234663.

# Reviewing your Financial Plan



**As the old adage says, "The only constant in life is change".**

In the last five years alone, over 2000 regulatory changes have been made to superannuation, social security and taxation. This is an average of a change a day!

Add to this the impact of events on international investment markets (such as the aftermath of the September 11 attack), the addition of hundreds of new investment choices, the changes to existing investment products and the bevy of proposed legislative changes.

And let's not forget any changes to your personal situation - be it a change in employment, a divorce or marriage, an addition to the family, an inheritance...
With all these changes taking place, it is critical to maintain an up-to-date financial plan.

Financial plans that are not reviewed regularly can become irrelevant. You wouldn't use an out-of-date street directory when venturing into a new town - and nor should you use an outdated financial plan to guide you towards your financial future.

A regular review of your financial plan is fundamental to your financial wellbeing. The review process addresses your financial objectives, investments and strategies. It begins with reviewing and redefining your needs and is finalised with the implementation of recommendations, which are provided in writing.

A qualified financial adviser has the expertise to recommend the most appropriate course of action and implement new strategies as required. Ensure you are still on the right path by resolving to have your financial plan reviewed in 2005.

The past year has certainly been an active one in the financial industry. Our team at Diamond Financial are monitoring financial developments on a daily basis and will keep you fully informed on any matters of concern.

To bring you up to date on what has been happening in the last quarter within Diamond Financial.

- I recently got married and had a wonderful wedding and a lovely honeymoon. Life is nearly back to normal.
- We have some exciting new additions to our team, Dale Willis is our new Client Services Manager and is available as a resource for you at any time.

We are looking forward to seeing you this year at one of the seminars that we have organised for you. For further information in regard to these seminars please do not hesitate to contact us.

We are looking forward to continuing a long & successful financial relationship and to reassure you of our commitment to ensure that you receive quality & professional advice in order to achieve your lifestyle goals.

Kind Regards,

Melissa Gilbert
Authorised Representative

Financial Planning

This information is provided by AXA Financial Planning Limited (AXAFP) ABN 21 005 799 977, an Australian Financial Services Licensee, Licence No. 234663, a wholly owned subsidiary of AXA Australia and a member of the Global AXA Group. It is believed to be correct at the time of publication, however, no representation of warranty is given as to its accuracy. No liability is accepted by any company within AXA or their respective employees or directors for any statement or opinion or any error or omission or for any loss arising from reliance on the information contained in this document. Investments may only proceed by completing the relevant application form attached to a current Product Disclosure Statement (PDS). Fund managers will receive fees for their services out of which authorised representatives of AXAFP may be paid commission. Neither the return of capital nor the investment performance of any investment is guaranteed by AXAFP. Past performance is not indicative of future performance. Any advice given in this document has not been prepared taking into account your particular investment objectives, financial situation or needs. You should assess your particular investment circumstances prior to making any financial decisions. This taxation information is based on the contribution of present laws and their interpretation and is a general statement only. Individual circumstances may vary.

From time to time we may bring to your attention products, services and other information that may be relevant to you. If at any time you no longer wish to receive information you may opt out by contacting our office.

# Growth Pensions and **Annuity Changes**

**Retirement changes, growth pensions, TAPs, Annuities.**
Retirement is a time in your life when you no longer have a regular income from employment and you have to rely on your savings, the Age Pension and/or returns from your investments to cover day-to-day living expenses. It can be confusing to navigate through the range of choices available.

In recent years, the Government has introduced legislation designed to alter the way Australians invest their retirement savings. By providing incentives such as tax concessions and social security benefits, the Government aims to make investments that offer regular long-term income streams more attractive to retirees.

These incentives have resulted in the creation of range of retirement income products, including Allocated Pensions, Guaranteed Term Annuities and Guaranteed Lifetime Annuities and Guaranteed Lifetime Annuities, which can provide you with a regular income during your retirement years. The new kid on the block is the Term Allocated Pension.

**What are TAPs?**
Term Allocated Pensions (TAPs) used to be known as growth pensions and were announced in the last Federal Budget. They're market-linked investments, which means that instead of buying a product that gives you a guaranteed income each year your income is determined by the value of your investment. In that way, they're a bit like Allocated Pensions, which are the most popular retirement income product on the market.

However, unlike Allocated Pensions, TAPs get special treatment under the Social Security assets test. If you buy a TAP, half the money invested is not counted towards the assets test in determining your Age Pension entitlement.

TAPs can also be useful for people with super in excess of the lump sum reasonable benefit limit (RBL), currently $619,223. Generally, if you invest at least half your total benefits in a TAP, your super is tested against the higher pension RBL currently $1,238,440. RBLs are important because so called 'excess benefits' above these limits don't receive tax concessions.

Unlike Allocated Pensions, TAPs can be commuted only in limited circumstances. They're generally required to be maintained until the end of the term, which is based on your life expectancy. You can, however, rollover from one complying income stream product (either a TAP or a complying pension) to another at any time during the term of your investment, subject to the approval of the product provider.

Whether this new style of pension product works for you depends on your personal circumstances and, because of the complexity of the social security and superannuation rules, come help from a financial adviser is almost certainly required.

# Why all the fuss about **Hedge Funds?**

Most fund managers purchase an investment (like a share) on the basis that it will produce an attractive level of income and capital growth over time. This sort of approach is known technically as a long-only strategy.

Long-only funds (like traditional Australian or International share funds) are heavily influenced by the direction of the broader share market and can produce poor returns over extended periods if markets are doing poorly.

Absolute return funds (or hedge funds) take a different approach. They focus on delivering positive returns across different market conditions. This means that they can make money even if markets are falling. Absolute return funds undertake a variety of strategies to achieve these objectives, with different funds offering varying levels of potential risk and return.

Most strategies fall under one of these categories listed below or, in the case of multi-strategy funds, involve a combination of these approaches. Currently, few absolute return strategies are available to Australian investors, although this is gradually changing.

**Hedge fund categories:**
1. **Directional** - seeking to anticipate the direction of securities or markets.
2. **Market neutral** - exploring inefficiencies in market pricing; and
3. **Event driven** - targeting specific market opportunities.

One aspect that most absolute return funds have in common is a focus on delivering returns that are consistently above the returns from cash.

**Essentially there are two reasons to use absolute return funds:**
1. **Diversification.** Absolute return funds perform very differently from traditional long-only investments. In technical terms, absolute return funds have a low correlation with other investments. This means they have the potential to perform well when other investments are falling in value.
2. **Returns.** Absolute return funds seek to generate positive (cash plus) returns across different market conditions. Some more aggressive strategies can produce high returns. For these riskier funds, even a small allocation

(perhaps 5 per cent of the total portfolio), can have a meaningful impact on the overall portfolio.

Note that the term 'absolute return fund' provides no information about how the fund generates returns or the level of risk involved. The term simply indicates tat the manager is targeting absolute (rather than relative) performance.

Typically, absolute return managers charge both a base management fee and a performance fee. While this makes them more expensive than their long-only counterparts, the judgement about value needs to be determined in the context of value added. Investors are usually happy to pay extra for top quality results.

When markets are falling, portfolios containing absolute return fund exposure typically perform better than traditional portfolios. Absolute return funds tend to lag long-only funds when markets are very strong. With valuations of many investment sectors still looking quite expensive relative to the historical experience, the case for inclusion of absolute return funds remains strong.

# Are you Gambling with your **Future?**

Levels of under-insurance, as revealed in the recently released AXA DEXX&R[1] report, show that although many Australians have some insurance, the levels of overall cover are dangerously inadequate. The risks many Australians are taking are alarming.

For instance, for death cover the average Australian has current insurance of 29 per cent of total insurable income is protected.

Income earning women in particular are taking significant risks by not protecting themselves should their income be interrupted by an unforeseeable event. While the average female has only 32 per cent of the death cover they require, when it comes to disability cover, on average only 14 per cent of their total insurable income is protected!

**Some levels of under-insurance c an be expected**

Some level of under-insurance can be expected as many Australians weigh up the cost of insurance and choose to take on the risk of not purchasing cover. However, the levels of under-insurance revealed by the report are extreme and suggest other issues at play.

**Miscalculating the levels of insurance needed**

Many Australians may believe they are insured merely because they have insurance; however, they may not have examined how much they need or even, in many cases, how much they have. These people may be in for a terrible shock.

**Is insurance a luxury or a necessity?**

One factor that may be contributing to the under-insurance problem in Australia is a belief that insurance is more of a luxury than a necessity. Many Australians seem genuinely shocked when the risks they are taking with their life goals, and the goals of their dependants, is held up against the cost of avoiding those risks.

Sadly, this lesson is often learned only when your income ceases due to what could have been an insured event, and the cost of self insuring is subject to the real life test of your ability to maintain your lifestyle on a dramatically reduced income.

**A false sense of security**

Many Australians are living in an increasingly modern, highly urban environment and are less exposed to the day-to-day risks that can help develop an appreciation of the benefits of insurance.

Contrast this with an attitude that tends to exist in Australian communities that are more exposed to day-to-day risks and where self-reliance is more important, such as farming communities. Because these communities tend to be more exposed to everyday risks (such as variations in seasons, bushfire, drought and reduced access to basic support services), they tend to be more self-reliant as they recognise life's risks as more common. For these communities, the benefits of managing risks through small preventative measures are often better understood.

**It's hard to get excited about insurance**

Let's face it - insurance isn't exciting! The years that go be without making a claim and the possibility that you may never need to claim at all can, for many people make insurance seems like a waste of money. Unlike investments where good decisions are usually rewarded by steady long-term growth, good decisions about insurance provide no evidence of their value unless something goes wrong. This can lead people to further discount the value of insurance.

An easy problem to solve

The problem of under-insurance can be solved relatively easily when you consider that the costs for an adequate level of insurance are not high.

For instance, the costs to close the gap and attain full insurance coverage in the event of death for the average Australian is currently $10.57 per week. For women this amount is even less, $8.20 per week. The cost to close the coverage gap in the event of disability cover is about $14.10 per week for men and, for women, is $17.23 per week[2].

Sadly, some people will only truly realise the merit of insurance when an event occurs that threatens their long-term financial goals and the need for insurance kicks in, too late for them to purchase it.

Call you adviser today, to discuss whether your insurance levels are adequate to protect you and your family from life's risks.

[1]Exposed! The risks Australians are taking with insurance, DEXX&R, July 2004

[2]Ibid

# Year in **Review?**

**Investment market review**
All major asset classes produced positive returns for the year ending 30 September 2004. Listed property returns were particularly strong with the sector moving to new highs following a spate of merger and takeover activity involving the Westfield Group among others. Australian and international shares rebounded after enduring a very tough year in 2003. The Australian market has been boosted this year by the performance of resource stocks like Rio Tinto, Newcrest and Woodside.

| Table 1 - Absolute return fund categories | | |
|---|---|---|
| Investment Sector | Market Index | Year to 30 September 2004 |
| Australian shares | S&P/ASX300 Accumulation | 20.7% |
| International shares | MSCI World Accumulation ($A) | 9.4% |
| Listed property | S&P/ASX 300 Property Trust Accum. | 29.1% |
| Australian bonds | UBS Australian Composite Bnd Index | 5.2% |
| International bonds | Lehman Bros Global Aggregate (Hedged) | 7.2% |
| Australian cash | UBS Australian Bank Bill index | 5.5% |

While many global central banks have lifted short-term interest rates, the moves so far have been modest (especially in Australia). This is good news for those with variable rate loans. Most forecasters expected that 2004 would be a bad year for bonds and so far this has not been the case. Long-term interest rates have been volatile but remain very low by historical standards.

**Key issues for the US market**
Spare a thought for US Federal Reserve Chairman, Alan Greenspan. While most men his age (Greenspan turns 79 in March) are bouncing grandchildren on their knees, he has to deal with investment markets, the upcoming US election, a surging oil price and the ongoing risk of terrorism.

The US economy is showing signs that growth may be softening. Long-term interest rates have moved sharply lower (ten-year bonds have recently touched 4 per cent) and this is often a useful indicator of a slowdown.

When the US Presidential Election campaign in full swing, this would be a worrying sign for the Bush Administration. Over the last couple of years, the US economy has been growing strongly on the back of booming consumer spending (which accounts for about two-thirds of US economic growth). Some commentators are concerned that consumer spending will fall as interest rates gradually return to normal levels (higher rates would remove the potential for mortgage re-financing and leave consumers with less money to spend on consumer items).

While business and government spending will pick up some of the slack, it is not known whether this will have a large enough impact to avert a slowdown.

Growth in the last few years has been boosted by large tax cuts and falling interest rates, but there seems little room to move on either measure. The recent share market weakness reflects these concerns, as well as unease over the soaring oil price (high oil prices take money out of consumers' pockets).

**Key issues for the Australian market**
Fortunately, the Australian equity market appears to have decoupled from the US market with Australian shares surging to new highs, as the US markets have stagnated. There are tentative signs, however, that the Australian economy is also beginning to slow, driven to some degree by an unwinding of the housing boom. While retail sales and consumer confidence remain strong, some indicators suggest that job growth may be stalling.

Australian share valuations look reasonable in a global context and this suggests that, even at current levels, Australian shares may be one of the better options for investors seeking long-term growth. The best news for investors is that the Reserve Bank of Australia (RBA) has plenty of room to move on interest rates. Should a slowdown eventuate, the RBA can lower interest rates to assist the economy. This is an option the US simply doesn't have with interest rates still at multi-decade lows.

The outlook
History may show that 2004 was in fact the tail end of a boom, with easy money, low interest rates, high property prices and booming resource stocks. Seasoned investors will not be surprised to hear the best way to manage investments market risks is to remain diversified and to ignore the hype that finds its way into the marketplace. Just eighteen months ago, few investors wanted to buy Australian shares. Fast forward to late 2004 and investors are clamouring for a piece of the action at prices some 35 per cent higher. The only major change has been sentiment.

It remains difficult to get excited about the short-term outlook for shares. Investors have seen strong gains over the past twelve months and valuations are looking a little stretched (especially in the US). For those looking somewhere to hide, the news is not great. Listed property continues to look expensive relative to the underlying assets while yields on bonds remain unexciting at around 5 per cent. One of the bright spots in a valuation sense is Asia, but volatility (risk) in this sector is exceptionally high. Asian funds are not for the faint-hearted

US consumer spending holds the key to a continued global economic recovery. While keeping an eye on developments in the US should make interesting reading, investors should also consider reviewing their own position. The returns of the past year present an excellent opportunity to review the existing investment strategy and to re-balance the portfolio as required.