LOWE LIPPMANN

LOWE LIPPMANN FINANCIAL SERVICES

INVESTMENT OPTIONS

INTRODUCTION

An investor is faced with a myriad of investment options – both simple and complex – and not all investment options suit all investors. We recommend seeking professional advice before investing your funds. Below follows a few of the options available to an investor.

BALANCED FUNDS

Balanced funds offer investors the opportunity to pool their investment in a portfolio consisting of cash and fixed interest, property and Australian and international shares. The fund may vary the exposure amongst these sectors to reflect the manager's outlook regarding the sectors.

In relation to taxation, exposure to Australian shares provides the potential to pay fully franked dividend income which may reduce investors tax payable through the receipt of imputation credits.

Similarly, exposure to Australian listed property trusts may reduce the assessable income which the fund derives, through the presence of tax free or tax deferred distributions. This arises as the property trusts are able to pass on benefits of allowable depreciation.

Given the exposure to growth investments, balanced funds are expected to provide higher returns than interest earning investments over the long term, with greater volatility of returns over the short term. Balanced funds aim to have a maximum exposure to growth assets (Australian and international equities and listed property trusts) of approximately 60%.

CASH MANAGEMENT TRUST

A cash management trust generally offers greater interest returns than an ordinary bank account while maintaining security of capital. This is achieved by investing in short term government and bank-backed securities with duration of no longer than 12 months.

The benefits of investing into a Cash Management Trust are:

- They operate much like a bank account with no entry or exit fees.
- You centralise your cash into one account where you can monitor and manage your cashflow.
- You have access to cheque book and phone withdrawal facilities.

CASH RESERVE

A cash reserve acts as a buffer in order to meet unexpected expenses providing you with immediate access to funds. A cash reserve can also act as a temporary holding fund for planned expenditure.

DIRECT PROPERTY

Direct property ownership has been a favoured investment vehicle due to it being tangible in nature. Direct property investment can be in real estate in residential, commercial, retail, industrial and rural assets.

The main advantages of investing in direct property are:

- A larger portion of the return comes in the form of rental income, which should exhibit low volatility (although rents may increase, or even decline, over some periods).
- The value of the property will generally grow at least in line with inflation (although a capital loss is possible).
- Overall, property tends to have lower volatility of returns (mostly due to not being valued as frequently as other investments like shares).

The main disadvantages of investing in direct property are:

- Your total investment portfolio may lack sufficient diversification due to the size of your direct property investment, relative to your other investments.
- Direct property investments are illiquid because they cannot be readily converted to cash. Selling the property can take time, and to access your capital the whole investment needs to be sold (whereas you can generally access a portion of investments like shares within as little as three days).
- If the property is being financed through borrowings, an increase in interest rates may impact on your cashflow position.
- There may be periods of non-tenancy during which the property is not providing any income return.
- Tenants may damage the property, increasing the costs associated with the maintenance of the property.
- There are ongoing costs of maintaining and upgrading the property, not associated with other investments like shares.

DIRECT SHARES

Direct shares are investments where you have equity (part ownership) in a company listed on the Australian stock exchange. You have purchased rights to participate in the growth and profitability of a company and as a result receive dividends, voting and other rights. Returns on the investment are in the form of increases in the share price, known as capital growth and income in the form of dividends.

The volatility (up and down movement in the share price) of shares over the short term creates the belief that shares are risky investments. Shares can be bought and sold daily, often at differing prices. As such the value of a share can change daily. Share prices can rise as a result of improved company earnings and can fall as a result of negative investor sentiment.

For the typical investor one common danger with direct share investments is the lack of diversification. This occurs as a result of owning a small selection of companies, often within the same sector, for example bank shares. The result of which can be poor performance of the overall portfolio as a result of bad performance in one sector or one company. Such losses can be difficult to recoup.

However there are reasons why shares are a popular type of investment. Shares have historically outperformed other asset classes over the long term and can provide a growing income stream.

TERM DEPOSITS

Term Deposits are bank products where deposits are made for a fixed period of time. In return, the financial institution should receive interest payments and full return of capital upon maturity.

As Term Deposits are bank products, their investment risk is low. Interest is treated as income for taxation purposes. There is no growth in capital.

Term Deposits have an interest rate risk because the money is locked away for a period of time. When interest rates are rising, you may incur an opportunity cost. In addition, there is reinvestment risk, because you may not be able to reinvest at the same rate (upon maturity) should interest rates fall.

FIXED INTEREST FUNDS

Fixed interest funds are unit trusts where investors pool their funds and invest in a broad selection of fixed interest securities.

The portfolio of a fixed interest fund is usually well diversified with respect to the type of fixed interest securities invested in, including Australian government, state government and semi-government securities as well as corporate bonds. This ensures adequate diversification of the portfolio in the areas of security of the issuer meeting their income payments as well as future return of capital.

This type of investment is an alternative to investing in a cash management trust or term deposit. The return is primarily income in the form of an income distribution. There may be a small element of increase in the unit price, to provide some capital growth.

The key features of fixed interest funds are they:

- Provide easy access to funds at short notice.
- Provide a facsimile redemption facility.
- Distribute income quarterly.

INSURANCE BONDS

An insurance (or investment) bond is essentially a life insurance policy purchased with a single premium (although it may be possible to add further amounts at a later stage). Insurance bonds are generally structured as investment only contracts and therefore the surrender value equals the account balance (ie there is no separate life insurance cover).

You may be able to select from a wide range of underlying investments within the insurance bond (eg from capital guaranteed and cash through to international shares and growth funds). Investment returns are taxed in the hands of the company providing the insurance bond at the company tax rate (currently 30%) and earnings are therefore reported as net of tax.

If an insurance bond is withdrawn, special rules apply regarding the income tax treatment for the individual investor, as follows:

Timing of withdrawal	Income tax treatment for individual investor
Up to the 8th year	All investment profits are assessable income, but a 30% tax offset is also received
During the 9th year	Two-thirds of investment profits are assessable income, but a 30% tax offset is also received
During the 10th year	One-third of investment profits are assessable income, but a 30% tax offset is also received
After the 10th year	None of the investment profits are assessable income. The bond is considered “tax paid”

To be eligible for the above tax concessions, any contributions to the insurance bond cannot exceed 125% of the previous year’s contributions. If contributions do exceed this limit, a new 10 year period is commenced.

The benefits of investing into an Insurance Bond are:

- This may provide some tax advantages for individuals with a marginal tax rate greater than 30%. If the insurance bond is held to maturity (a period of more than 10 years), all earnings are tax paid.
- Capital gains tax will not be applicable by the individual investor when switching between investment options.
- This means there is no requirement for the owner of the bond to pay personal income tax on the income generated by the bond. This may help to reduce Medicare levy and in some cases may help retain taxable income related to rebates (such as low income rebates).

LISTED PROPERTY TRUSTS

Listed Property Trusts (LPT) allows you to purchase an interest in a professionally managed portfolio of commercial real estate. Therefore gaining exposure to both the value of the real estate and regular rental income generated from the properties.

The fund manager selects properties to buy and sell and is responsible for all maintenance, administration, rentals and improvements. Most property trust managers include properties across a diversity of geographic regions, lease lengths and tenant types.

Regular income from rentals is a common feature of an LPT, with most yielding approximately between 6-8% per annum. Part of this income is tax-free and tax-deferred. This means that the Fund does not pay tax on the tax-deferred portion until the holding in the property trust is sold.

The benefits of investing in listed property trusts are as follows:

- Provide diversified exposure to a professionally managed portfolio of real estate.
- Income payments are higher relative to shares and offer some tax advantages.
- Potential for capital gains.
- Liquidity as these are traded in the ASX.
- Generally less volatile than shares.

The risk associated with investing in listed property trusts are as follows:

- Changes in the value of the underlying properties. When property values fall, unit prices drop.
- Changes in dividend payments. Dividend payments depend on the general financial conditions of the property trust.
- Vacancy rates may increase during economic downturns and put downward pressure on the value of property trusts.
- Rising interest rates generally have an adverse effect on property trusts. When interest rates rise, there is a demand for higher yields, which lowers the market prices of the properties. Rising interest rates also increase the cost of financing, which decreases the value of the underlying property investment.

MANAGED INVESTMENTS

Managed investments allow you to pool your capital with the capital of many other investors in a unit trust. When you invest you are issued with a number of units based on the current unit price and the amount you invest. The unit price reflects the value of the managed fund's investments. The unit price can rise and fall as a result of the underlying investments.

Pooling your monies with many other investors means that the fund manager who invests the combined capital on behalf of you and the other investors has greater buying power. This buying power in turn enables you to take advantage of investment opportunities otherwise unavailable to you, specifically by increasing the number and type of assets you invest in.

The total capital of the managed investment is invested in accordance with the fund manager's research.

The benefits of this recommendation are:

- Your managed investments are invested in accordance with your personal investment risk to assist in achieving your financial goals.
- You achieve sufficient diversification across the different asset classes, and the sectors within each of the asset classes.
- Liquidity and flexibility. The proceeds from managed investments can usually be accessed within one to two weeks.
- Your investments are administered efficiently, taking advantage of the skills of professional investment managers.
- The underlying investments within the managed investments can provide some tax advantages such as franking credits.

The risks associated with this recommendation are:

- The costs associated with investing into Managed Investments are generally higher than direct investments.
- Loss of control as the underlying investments are selected by investment managers.

MORTGAGE TRUSTS

Mortgage Trusts are unit trusts where investors pool their funds and invest in a broad selection of high quality mortgages, short-term money and cash.

The portfolio of a Mortgage Trust is usually well diversified with respect to the type of property invested in, the geographic location of properties, terms to maturity and types of loans (fixed/variable) to borrowers. To ensure adequate diversification of the portfolio, Mortgage Trusts restrict the amount of funds that may be invested with any single borrower.

This type of investment is an alternative to investing in a cash management trust or term deposit. It provides competitive rates of return which generally outperforms deposit rates by approximately 2 – 3% per annum. The return is primarily income in the form of a distribution. There may be a small element of increase in the unit price, to provide some capital growth.

Mortgage Trusts aim to provide high income from investing in mortgage securities and are suitable for investors seeking a regular income stream.

The key features of mortgage trusts are they:

- Provide easy access to funds at short notice.
- Provide a telephone redemption facility.
- Can distribute income monthly or quarterly.

PROPERTY SYNDICATES

Property Syndicates are where a group of investors pool their funds to purchase and hold properties. The syndicate then purchases an interest in a professionally managed portfolio of commercial real estate. The portfolio gains exposure to both the value of the real estate the syndicate owns and regular rental income generated from the underlying properties.

The property syndicate manager selects properties to buy and is responsible for all maintenance, administration, rentals and improvements. Most property trust managers include properties across a diversity of geographic regions, lease lengths and tenant types.

Regular income from rentals is a common feature of a syndicate, with most yielding approximately 8.00 – 9.00% per annum. Part of this income is tax-free and tax-deferred. This means that the syndicate does not pay tax on the tax-deferred portion until the holding in the property is sold.

The benefits of investing in a property syndicate are as follows:

- Provides exposure to a professionally managed portfolio of commercial real estate.

- Income payments are higher relative to shares. In addition, a portion of the income is tax effective.
- Potential for capital gains. A syndicate is structured to sell its assets, with the capital (plus potential gains) distributed to the investors.
- A syndicate is closed-end. As such, it will not seek to raise additional capital over its life and will only ever hold the properties it was formed to buy.

The risks of investing in a property syndicate are as follows:

- Liquidity - Property syndicates are generally formed with an initial investment period of five years, during which you may not be able to access your capital without incurring significant penalties.
- Changes in the value of the underlying properties. When property values fall, unit prices drop, therefore, when the syndicate sells it assets, you may have to realise a capital loss.
- Changes in income distributions as it depends on the general financial conditions of the property trust.
- Property syndicates with low market values are often hard to sell. Therefore, the initial investment period of five years may be longer if it takes the syndicate longer to wind up its assets.
- Rising interest rates generally have an adverse effect on property syndicates. Rising interest rates increase the cost of financing, which decreases the value of the underlying property investment.
- The performance of a property syndicate depends on the type of property and the geographical location.

TAX EFFECTIVE INVESTMENT

We recommend client consider tax effective investments to diversify your investment portfolio and reduce your tax position for the financial year. Specifically, we recommend you consider participating in forestry investments.

A tax effective investment allows you to invest in to projects such as forestry (as approved by the ATO) to provide you with a tax deduction on the full amount invested amount as well as providing you with long term income upon maturity of the investment.

The benefits of forestry investments are:

- You can claim a tax deduction for the full amount of your upfront investment and ongoing investment expenses (provided you meet conditions set out in the ATO product ruling).
- On completion of the project you will receive a cash distribution from the Net Harvest Proceeds.
- You can diversify your portfolio. The returns from Forestry investments have a low correlation with returns from the traditional asset classes.
- You can potentially lower your Child Support obligations.

The risks associated with these investments are:

- Risks associated with establishing, growing and harvesting the product.

- Movements in the prices of the underlying product.
- The investments are usually long term, illiquid investments, meaning your initial investment is locked away.