

Jargon Buster

A sometimes lighter view of jargon

Greece *n.*

A destination for money from the taxpayers of Northern Europe.

Resources Rent Tax *n.* aka the Resources Super Profits Tax.

A tax of Gordian complexity, designed by politicians to enhance their re-election chances.

DIY *adj.*

Do It Yourself. As in the response you get from your partner when you ask for help.

Wealthy individuals *n.*

An endangered species.

Contagion *n.*

The transmission of blame from your wealthier neighbour to you for your common fence falling down.

School fees *n.*

A series of escalating payments made in a misguided belief that your children will look after you when you are 80.

Optimise tax, to *v.*

An occurrence possible only in utero.

IMPORTANT NOTICE

Any advice contained in this newsletter is of a general nature only and has been prepared without taking into account your personal objectives, financial situation or needs. Because of that, before acting on any advice in this newsletter, you should consider whether it is appropriate for you having regard to your objectives, financial situation and needs. Further, we recommend you seek personal financial advice before acting on any advice in this newsletter.

Wealth management - more than just investing in shares

A one dimensional view of wealth management means you focus on Greece. Instead of kids/ golf/ football, etc. - Anthony Starkins*

Are you hyperventilating about Greece, the Resources Rent Tax, the budget, lawsuits against the banks, etc?

People who have properly structured their wealth management arrangements needn't be.

Faintly ridiculous

It is faintly ridiculous that an industry into which billions of dollars are poured each year, which employs tens of thousands of people and from which the government extracts vast taxes has virtually no barriers to entry.

Yes, wealth management is the ultimate Do It Yourself hobby.

It is DIY because there are few barriers to entry. You can almost do it all yourself. Almost like going to Bunnings.

And it is ultimate because it is possible, for a very few, to make a lot of money (and also to lose a lot of money).

But just because you can do something doesn't mean you should do it.

Control

Wealthy individuals like being in control. That's one of the reasons why they are wealthy.

And it is understandable, but not logical, that they take this level of control to an area where there are low barriers to entry and yet there is an array of matters over which they have little control or ability.

Proper wealth management

Simplistically, the wealth management world has evolved from two or three dimensions 40 years ago to eight today.

Eight dimensions is a lot to manage. And integrate. When it is not your full-time job.

1. Invest, don't save

The first dimension is, perhaps, the simplest, you use your savings to invest.

The difference is that saving is passive, it means setting aside cash, possibly to deposit in a bank.

Investing is putting to work that which you have set aside.

2. Protect/ manage risk

Assets are vulnerable to unforeseen events that diminish the value of that asset.

Assets can be an investment portfolio, a car or a home, an income stream or, at the most valuable, a life.

Asset need to be protected, either via diversification (investments) or insurance.

3. Deploy superannuation and other structures

You now have access to an almost uniquely Australian wealth management tool: individual superannuation.

The massive democratisation of superannuation and the development of self managed superannuation have added an extraordinary dimension to wealth management.

And complexity.

And of course there are other structures: trusts, companies, etc that can also be used.

4. Optimise tax

Your biggest expense in life is tax.

Far bigger than investment fees, school fees or accountant's fees.

Sensible and active management should mean optimal tax outcomes.

5. Use information wisely

Because we are so much more aware of economic and market events – to the point of virtual instantaneousness – we react differently than if we had more time to reflect upon new information.

Hence, whilst there has always been the madness of crowds (Dutch tulip bulb craze, South Sea Bubble, etc), now there is "contagion" where bad news in one market will adversely affect another, whether or not there is or should be a causal relationship between the two.

My colleague Dennison gives an example on page 3 of how the Greek fiscal crisis affected the share price of Patties Foods, a purely Australian domestic manufacturer of, essentially, pies. Go figure.

Continued on back page.

Use it while you can! End of year strategies

by Nikki Hill*

As we head into June it is important to take the time to ensure you maximise every opportunity to enhance your after-tax income, both for this year and for future years.

Year End Check List

- Maximise superannuation contributions, remembering the annual limits
- Contribute \$1,000 to get the government co-contribution (if eligible)
- Bring forward tax deductible expenses and defer income (where possible)
- Offset capital gains with losses
- Ensure minimal pension drawings (where appropriate)
- Consider splitting concessional contributions with your spouse

Federal budget and Henry tax review proposed changes should be considered when undertaking your stocktake.

Income tax – down (slightly) – means opportunity

The opportunities are:

- (slight) reductions to marginal tax rates from next fiscal year;
- retaining \$50,000 superannuation concessional limit for those age 50 plus with less than \$500,000 in superannuation; and
- the progressive reduction of the company tax rate to 28%.

This means possible increased value attributed to tax deductions this year rather than next, consideration of splitting contributions with your spouse and (possibly) more reasons to make trust distributions to corporate beneficiaries.

Splitting Concessional Contributions

For couples with a primary bread winner, consider splitting concessional contributions with the lower earning spouse to:

1. reduce future legislative risk associated with large superannuation account balances; and
2. take advantage of the higher earner with the potential to make higher concessional superannuation contributions (up to \$50,000) after reaching age 50 by maintaining their account below \$500,000.

Splitting is available to spouses less than age 55 or who are between age 55 and 65 and not retired. Only concessional contributions can be split. The splitting takes place in the financial year following the year the contribution is made (except for benefits being rolled over which can be split in the same year the contribution is made).

The maximum amount you can split is the lesser of 85% of the concessional contributions made or your annual concessional limit.

Concessional Superannuation Contributions

Concessional (tax deductible and pre-tax) contributions are currently subject to 15% tax in the fund (compared with

individual marginal tax rates). These contributions may be subject to future government change and it is worthwhile maximising tax effective contributions while you can.

Salaried employees may be able to direct bonuses into superannuation and self-employed (or not employed) persons may be eligible to make tax deductible superannuation contributions prior to 30 June.

Be mindful of the annual limits which apply: \$25,000 or \$50,000 until 30 June 2012 for those aged 50 (plus). Excessive contributions are subject to additional tax of 31.5% (in addition to 15%) and are counted for non-concessional limits.

Bring Forward Expenditure and Delay Income

Bringing forward payments for deductible expenditure (interest pre-payments for example) and deferral of income where possible may be more worthwhile this year in view of the slight reduction in marginal tax rates from next year.

Individuals (non-business) and small business entities can generally claim a tax deduction for eligible expenses in the year paid (provided the service period the payment relates to is not > 12 months and ends before the end of the next income year).

Henry Review changes – just sleeping

It is worth taking note of the Henry tax review recommendations which have to date been ignored by the government (only a handful of recommendations were either taken on board or ruled out).

Below we provide a summary of some of the superannuation related measures, which are likely to be considered further in a post election environment.

Possible future Henry Review superannuation changes

| Recommendation (to which the government has yet to respond) | What it may mean to you if implemented |
|--|---|
| All superannuation earnings in accumulation and pension phase taxed @ 7.5% | Superannuation would continue to be one of the most optimal structures to build wealth |
| Concessional superannuation contributions no longer tax deductible or pre-tax. All contributions subject to a flat rate tax offset | Significant disadvantage for high income earners who accumulate wealth in superannuation via concessional contributions |
| All individuals age 50 plus eligible for \$50,000 concessional cap (subject to offset) | Positive |
| People age 75 plus who meet the work test can continue to make superannuation contributions | Positive |

* Nikki Hill is Head of Strategy and a Senior Client Strategist at First Samuel

The share market is a voting machine in the short term

by *Dennison Hambling**

Had you recently arrived from a year long holiday on a secluded island you might be stunned to find that many of the lessons learnt from the events preceding the Global Financial Crisis have been quickly forgotten.

For us, the one lesson that stands head and shoulders above all others is that the market is not an all-seeing and all-knowing barometer of what is really going on in the world.

The market, in the short term, is just a bunch of people sitting in offices buying and selling shares. For any number of reasons.

Academia

However, the opposite view, i.e. that the market is an accurate barometer of economic reality, has been endorsed heavily at all levels of financial academia (less so in the real world).

It means that typically any “new” information (no matter how trivial it may be in a real sense) is quickly digested and reflected into all security prices.

In academic land it’s called the Efficient Markets Hypothesis (EMH).

It’s the training in EMH that leads our media friends to report everyday on what moved the markets – “a sharp 2% increase in oil supplies saw the price of CSL fall 4% today” etc.

Short term: a voting machine

It filters out into dinner parties, and general consciousness globally. When I think about how the world is now programmed to respond to new news I always recall the famous Benjamin Graham quote:

“In the short term the market is a voting machine.

In the long term it is a weighing machine”.

Well, after more than a decade watching day to day, and week to week market movements, I am happy to continue being in the Ben Graham club.

Nonsensical

In my observation – daily, weekly and even monthly market movements are mostly crazy, and nonsensical.

And this has been proven with the benefit of time.

A good example of this recently has been the speed and rapidity that the equity markets (including Australia) digested and “voted” on the impact of the ructions in Greece (and the implied impact that this has throughout Europe).

Greece down, Patties Foods down?

As current clients of First Samuel will know, one of our successful investments has been our holding in Patties Food Group.

Patties has no revenue (nor direct cost) exposure to anything north of Cape York (let alone Greece or Europe). Patties also has a sound balance sheet and would be expected to do well in all environments (and arguably better in tougher times).

Patties makes Four ‘N Twenty pies.

Notwithstanding this, the Greek/Europe crisis led the market to vote a 7.5% fall in Patties “value” in one week!

Uneducated market

Now clearly this is bizarre behaviour and thinking, but it does show how uneducated the educated market can be.

It’s also worth pointing out that not only is it bizarre, it is also dangerous thinking.

The EMH sits behind the theories of option pricing and modern risk management techniques, which most sane people would agree after the experience of the GFC are not just bad ideas, but dangerous too.

But what to make of this now conventional thinking?

Should we:

- a. be scared by the market,
- b. capitulate to its volatility, or
- c. simply assume that IT IS correct?

Well I would say, none of the above. But with a strong caveat.

You are investing for the right reasons and you remember the two other key lessons the market seems to have already forgotten.

1. Valuation matters

As Graham says, in the long run the market is a weighing machine. And it is.

If you are an investor it absolutely does matter what you invest in. If you buy a shonky indebted business for a large price the weighing machine will eventually weigh against you.

Of course, you may be able to presciently time your contortions into and out of these “opportunities” and make profits.

However luck only holds for so long and all “fashion” based brands (be it sexy investing names, or high street clothing) eventually die out.

If you try to pick the fashions in the share market, let me assure you, you will lose.

So don’t forget what others already have: buy cheaply (and buy durable and growing companies).

2. Time matters

Don’t misunderstand me. The voting machine does matter... in the short term.

You should be under no illusions that even the soundest and most sensible investments WILL be pushed around by any number of factors (maybe short sellers, concerns over Greece, or a large shareholder who simply has to sell out for any price to fund a pending divorce).

Therefore, if you are investing you must do so for an appropriately long period of time.

Voters get bored.

In fact, voters get bored incredibly quickly: the average equity investor (voter) holds each investment, on average, for less than a year!

Notwithstanding this, we think the appropriate time should be at least three years. Historically it is very rare not to make money in good growing companies over this period of time.

So rather than have a kneejerk reaction to all the little market tremors and motions, as we have been subliminally trained to do, we have found it is better to accept that short term market movements are outside your control.

A steely ability to see through the noise of Greece, Europe, Bird Flu, SARS, 9-11, Iraq Wars, and focus on what really does matter for the investments that you own, will see you back to your secluded island hideaway for another year!

* *Dennison Hambling is Chief Investment Officer at First Samuel*

Wealth management - more than just investing in shares continued...

6. Beware of government

Sadly, and most pervasively, the role of government is having an increasing affect on the ability to manage wealth. This includes tax, regulatory changes, economic policy, pensions and corporations' law.

My colleague Nikki provides some thoughtful matters to consider, page 2, on how to manage government impositions before that most artificial of dates, 30th June.

7. Measure and compare

You should not be content with just knowing that your SMSF was valued at \$350,000. Or that you earned \$150,000 last year and paid \$100,000 in tax.

You want to know how your portfolio performed, after fees. And after tax. Where you spent your money. What fees you paid. Where did those franking credits go?

8. Your legacy

You will not know when you are going to "shuffle off this mortal coil". So you need to plan how you wish your net assets disposed of when you do. Or before you do.

And this is much more than having a will. Your super assets, for example, are not directly covered by your will.

So, worry about Greece only as a vacation destination.

With these eight dimensions to manage and integrate, what is the best way to consider wealth management?

Surely, your time is too valuable, you really don't have the capability (go on, admit it) or you would just rather let someone else manage all of these dimensions.

It's a better world. One where you don't have to worry about Greece. Today or tomorrow. Unless, that is, your next vacation is to the Aegean.

** Anthony Starkins is the Founder and Executive Director of First Samuel*

Wry & DRY™



A better way to manage your wealth

Wry & DRY™

A weekly review of wealth management matters, through a cynical eye

If you enjoy reading our thoughts each quarter in "First Hand" then please consider reading our weekly email "Wry & Dry". Wry & Dry is a weekly review of wealth management matters, through a cynical eye.

Wry & Dry was born at the start of the Global Financial Crisis as a means of keeping our clients apprised of how the GFC was affecting them. It had a strong re-assurance emphasis and focus on long-term investment outcomes.

Over that time, and as the markets have recovered, it has evolved to reflect the sort of weekly communication on wealth management matters that our clients wish to read. As such, we feel it would be an interesting read for anyone considering becoming a First Samuel client.

All you need to do to receive "Wry & Dry" is provide your email address in one of two ways:

- visit our website www.firstsamuel.com.au and click on the gold button to subscribe or
- contact our Business Manager, Susanne Retallick on P: 03 8610 9222 or sretallick@firstsamuel.com.au

First Samuel Client Reporting

In addition to Daily Reporting on our website, our clients receive an extensive suite of Annual Reports. They are available in soft copy via individual secure login on the First Samuel Website.

We also offer a separate, secure login for our clients' accountants which allows for timely provision of data for accounting and tax planning purposes as well as a secure archive.

Our reporting schedule for the FY09/10 year is as follows:

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|--|-------------------------|
| 1. Flash After-Tax Performance Report | 2nd week of July |
| 2. June Quarter Report | 4th week of July |
| 3. Annual Investment Report | Final week of July |
| 4. Accountant's Pack & Taxation Report | Final week of September |
| 5. Independent Audit Certificate | Final week of September |

"The stock market is designed to transfer money from the active to the patient."

-Warren Buffett



2010 is the 7th year that First Samuel has been a major sponsor of Eat Street, Melbourne's premier gourmet event and charitable fundraiser.