

Perceptions

SPRING 08



A REASON FOR THE PAIN

These days discussion at any Australian barbie or dinner table seems to focus on two things: petrol prices and mortgage interest rates. Who would have thought 30 years ago that ordinary Aussies would be talking about economics at social gatherings, but with the drastic increases to both in recent years many people want to know the truth behind what's causing them so much pain.

MARKET MOVEMENTS

Regardless of the overall trend of the market, what is of concern to many investors is the sharp volatility that we have seen over the short term. A simple way of demonstrating this is to look at how often the market moves by at least 1% on a single day - whether that be higher or lower. After all, it is these types of results that tend to make the news headlines and thereby cause some anxiety amongst the investing public.

The table below provides an indication of recent market volatility on a quarter-by-quarter basis since the start of 2006. So, for example, in the three months from 1 January to 31 March 2006, the market rose by at least 1% on four of its trading days and fell by at least 1% five times. Despite this, it finished the quarter a massive 7.7% higher.

From these results we can clearly see the increased level of

| | Sep 06 | Dec 06 | Mar 07 | Jun 07 | Sep 07 | Dec 07 | Mar 08 | Jun 08 | Sep 08 |
|------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Days +1% or more | 8 | 4 | 7 | 10 | 13 | 14 | 12 | 8 | 14 |
| Days -1% or more | 7 | 2 | 6 | 6 | 12 | 11 | 20 | 10 | 23 |
| Total return | +1.2% | +9.5% | +5.7% | +6.1% | +4.9% | -3.4% | -15.7% | -1.5% | -13.3% |

Data Sources: ASX, RBA

Where to from here for interest rates and inflation?

These two issues are closely linked, in part because the Reserve Bank of Australia (RBA) uses its benchmark cash rate as a means of controlling growth in the economy (ie. inflation). As inflation creeps up, the RBA slides up the interest rate to compensate. Despite inflation remaining well above the target range, at its September meeting, the RBA lowered rates by 0.25%, being the first rate reduction since March 2002 when the official rate was only 4.25%.

The RBA has an inflation target range between 2% and 3%. The Australian economy remains strong, although the continuing fallout from the US credit squeeze is expected to provide further restraints throughout the remainder of 2008.

At the beginning of 2008 the Australian market started to come off its bull run, paring back some of the extraordinary gains that had been made as the market had doubled its value since five years ago when it traded at around the 2,800 level. Recent political and economic turmoil surrounding the global credit crisis has seen a significant drop in the market, with as much as 4.3%, or \$55 billion, being wiped off the value of the market in a single day, although the severity of the decline has not been sustained. The reduction of a full 1% at their October meeting shocked even the economists, but the RBA decided it was the best way to resolve economic jitters and improve consumer confidence in the Australian market.

volatility in our market, especially since the September quarter last year. At that time, it seemed that the strength of the local economy was able to shake off the initial impact of the US credit crisis. More recently, we have still had plenty of positive signs on the economic front - as evidenced by many positive daily results - but an overall downward movement had emerged.

For investors in the current environment, it can be easy to be distracted by the daily noise regarding interest rates, inflation and the share market. While it is unwise to totally ignore these issues, it is also important to remain focused on your medium-to-long term goals and financial strategy.

So the next time you're hearing a discussion about how "bad" things are, you can see that this is all just part of the bigger cycle that rolls on and on... and once it all catches up, the good days will return.



THE COSTS OF RAISING CHILDREN

Providing financial support to children will need to last until they are old enough to provide for themselves – which may be anywhere from 14 or 40, depending on your situation! The impact of this financial commitment will vary greatly from one family to the next, but for many people there are certain Government benefits that can assist.

There are basic costs such as clothing, housing and food. On top of that will be extra costs where you make a choice, for instance child-care, education and outside school activities. Education may be the biggest cost if you choose a private school. In 2005, the average cost of private education rose by 6.3%, well over the general inflation figure. Some families may face additional costs if their child requires significant medical attention.

What does it cost to raise a child?

Research by NATSEM in 2002 concluded that on average it cost about \$225,000 to raise one child to age 20. This is \$11,250 a year though costs are likely to be higher when they are babies, then level off and peak again during senior education.

In 2005 research showed the more you earn, the more you spend on your children. A family with combined income of \$70,000 could expect to spend \$240,000 to raise a child to age 18 – that is about \$13,500 a year. However, a family with combined income of \$150,000 may spend \$475,000 over the same period - \$26,500 a year.

If you earn between \$30,000 and \$75,000 a year your marginal tax rate is 31.5% (including Medicare). This means that \$19,708 of your pre-tax income is required to have the \$13,500 to spend on raising one child. If you are on the highest tax rate of 46.5%, you will need \$49,533 of your pre-tax income to have the \$26,500 to spend on child-raising.

HOW DOES THE GOVERNMENT HELP?

The Government supports families in a number of ways. This includes:

Maternity payment. A one-off lump sum payment of \$4,133 for each newborn child.

Family Tax Benefit A. An income tested ongoing payment of up to \$5,332 per child per year.

Family Tax Benefit B. An income tested ongoing payment of up to \$3,467 per child per year for families where there is one main breadwinner.

Child Care Benefit. An income tested weekly payment of up to \$148.

Family Assistance Offices provide a one-stop shop to make enquiries and claims for these payments

An example

These payments can make a significant difference. As an example consider this family. Brett is earning an annual wage of \$50,000. He pays \$10,350 in tax. His wife Mandy looks after their two children aged three and five and they receive Family Tax Benefits of \$8,103, meaning as a family they pay less than 5% in tax.

What can you do?

One option would be to not have children but most parents see raising children as a rewarding challenge and one that is worth the money. After all, when the time comes your children will be choosing your nursing home, so it pays to raise them well!

Making a financial plan might bring to the surface the real cost of a family in money terms, but regardless of this the best aspect is that it provides a level of certainty. This can guide you to better decisions in areas such as savings plans, wills and estate plans and insurance cover. This is one of the many aspects of the discussion you should have with us when the time is right.

Sources:
NATSEM National Centre for Social and Economic Modelling
University of Queensland Social Policy Unit 2005
Australian Bureau of Statistics

HELPING YOUR FAMILY INTO THEIR FIRST HOME

Recently, the Prime Minister announced that the First Home Owners Grant will be increasing from \$7,000 to \$14,000 plus an additional \$7,000 to assist with construction (effective date TBC). This should fuel demand from First Home Owners looking to enter the market and subsequently, looking for lending.

The majority of First Home Owners will be required to take out Lenders Mortgage Insurance as they are unable to come up with a minimum 15% deposit plus funds to cover associated costs such as stamp duty. The Lenders Mortgage Insurance premium can be costly and does not benefit the client; only the Bank.

A facility is now available which enables direct family members to help with the purchase at no direct cost to themselves. A "Family Guarantee Loan" enables parents, or another family member, to use their own home as security for up to 20% of the new home.

This can be an invaluable aid to younger family members buying their own home. **In particular:**

INSTALMENT WARRANTS IN SELF-MANAGED SUPER FUNDS

One of the best ways to build wealth over the long term is through gearing or borrowing to invest. Although superannuation is a long-term investment, gearing is an option not available to super funds because you are not allowed to borrow in a super fund.

However, instalment warrants provide a way for an investor to own company shares and receive dividends and franking credits without having to pay the full price up front. A high level of franking can wipe out all of a fund's tax liability or even provide a tax refund. Not surprisingly instalment warrants have become increasingly popular in Self-Managed Super Funds (SMSFs) over the last few years. They are just like buying shares on lay-by.

Additional advantages of instalment warrants are that they are lower risk (as the initial instalment is the most you can lose if the company goes broke) and will never require a margin call. At the end of the term, investors can pay the final instalment, sell the share, or rollover to a new warrant.

Warrants come with different levels of risk and not all would be suitable for SMSFs, however, those based on ASX Top 100 companies should pay regular dividends and be lower risk.

Of course, there are costs involved and interest on the loan provided by the warrant issuer. In addition, investors need to be aware that the extra leverage works both ways – there are benefits when the share price goes up but risks when it goes down.

The Australian Prudential Regulation Authority (APRA) and the Australian Taxation Office (ATO) have determined that instalment warrants are suitable investments for SMSFs. The only limitation is that they must be bought with cash not



through a Security Holder Application (ie. converting shares already held by the SMSF into instalment warrants and getting cash back).

The regulator's ruling has reiterated the need for a SMSF to have an investment strategy and to consider the appropriateness of instalment warrants and their risks.

To determine if instalment warrants provide another opportunity for effective wealth creation for you, please contact us.

What is an auditor?

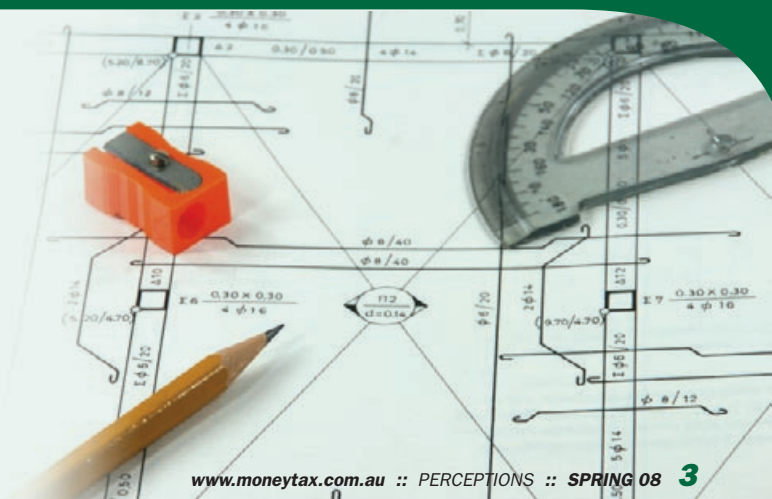
“Someone who arrives after the battle and bayonets the wounded.”

Why did the auditor cross the road?

“Because he looked in the file and that's what they did last year.”

- The buyers may be able to afford a more appropriate property for their needs.
- It may enable them to purchase at a time when they don't have a deposit available.
- It will avoid the need to pay costly mortgage insurance (usually required when borrowing greater than 80% of the purchase price).
- Your liability is limited to 20% of the purchase price and this will be reduced as the mortgage is reduced.

This is an easy and cost free way to assist your family into their first home. Please contact us if you would like further information about this facility.



IS THERE SUCH A THING AS “LUCK”?

Saying “rabbits, rabbits, rabbits” as soon as you wake on the first day of the month is “reported” to bring you good luck for that month. Crossing your fingers was supposed to repel evil spirits because the cross is the symbol of Christianity, and ‘knocking on wood’ is a call for protection from the good spirits that live in trees.

From the earliest times human beings have been superstitious. Some actions would bring good luck whilst others will have the opposite effect. For example, the number 13 is unlucky allegedly because there were 12 gods in Scandinavian folk lore and if another god joined them he would be evil and bring bad luck. In ancient times, salt was a valuable commodity and it was unlucky to spill it. However, you could limit the damage by throwing the salt over your left shoulder into the eye of the evil spirits who lurk there.

Even though many people might laugh at these superstitions nowadays, we still wear our lucky beanie to the footy and buy our lotto ticket from the same “lucky” newsagent every week. By the way, the chance of winning lotto is one in 7,059,022 so you do need lots of luck.

In fact, most good luck comes from being prepared. When a movie star or sportsman gets a big break you might say they were lucky - but they know how much hard work and preparation went into being ready for the lucky break.

As individuals we have the same choices. We can wait patiently for our lucky break – for example, the winning lottery ticket or a wealthy boy/girlfriend to solve all our problems. Or we can prepare ourselves, so when the opportunity comes along ‘luck’ will tap us on the shoulder. It all comes down to how we choose to behave.



Changing your luck

Your dream is to have your own house but you have a poorly paying job and credit card debts. You could wait for luck to come your way, meanwhile complaining about housing affordability and calling on the Government to ‘fix’ the problem.

Or you could look for a better job (or even two jobs), get a qualification to earn more, live on a budget and work to eliminate debts and save money. Of course, when you have your first home, people will call you lucky!

LIVING IN VOLATILE TIMES

When financial markets enter a time of volatility, many investors obviously worry, but what are the real effects of a “volatile market”?

If you are a long-term investor, with a timeframe of five years or more, you cannot afford to overlook the benefits of growth investments such as shares or property. As an astute investor you will be aware of the fact that the value of these assets will vary over time – both up and down. However, if you have purchased a sound asset, whether it is shares or property, the price will invariably rise over time.

When you invest in growth assets it is important to accept that you should be targeting an average rate of return.

Some years you may achieve returns well in excess of your target, while in other years the return may be lower, and sometimes negative. If your targeted average is achieved over the longer term you will meet your objectives.

It is also important to note that different asset classes will outperform in different years. This is illustrated by looking at the five major asset classes used by most investors over the 13 years to June 2008. Frequently the asset class which outperformed in one year showed a poor, or even negative, return the following year. This illustrates the importance of having a diversified investment portfolio covering all the major asset classes.

| Year End 30 June | Cash | Aus. Fixed Interest | Listed Property Trusts | Aus. Shares | International Shares |
|------------------|------|---------------------|------------------------|-------------|----------------------|
| 1996 | 7.8% | 9.5% | 3.6% | 15.8% | 6.7% |
| 1997 | 6.8% | 16.8% | 28.5% | 26.6% | 28.6% |
| 1998 | 5.1% | 10.9% | 10.0% | 1.6% | 42.2% |
| 1999 | 5.0% | 3.3% | 4.3% | 15.3% | 8.2% |
| 2000 | 5.6% | 6.2% | 12.1% | 13.7% | 23.8% |
| 2001 | 6.1% | 7.4% | 14.1% | 8.8% | -6.0% |
| 2002 | 4.7% | 6.2% | 15.5% | -4.5% | -23.5% |
| 2003 | 5.0% | 9.8% | 12.1% | -1.1% | -18.5% |
| 2004 | 5.3% | 2.3% | 17.2% | 22.4% | 19.4% |
| 2005 | 5.6% | 7.8% | 18.1% | 24.7% | 0.1% |
| 2006 | 5.8% | 3.4% | 18.0% | 24.2% | 19.9% |
| 2007 | 6.4% | 4.0% | 25.9% | 30.3% | 7.8% |
| 2008 | 7.3% | 4.3% | -35.8% | -11.9% | -21.7% |



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