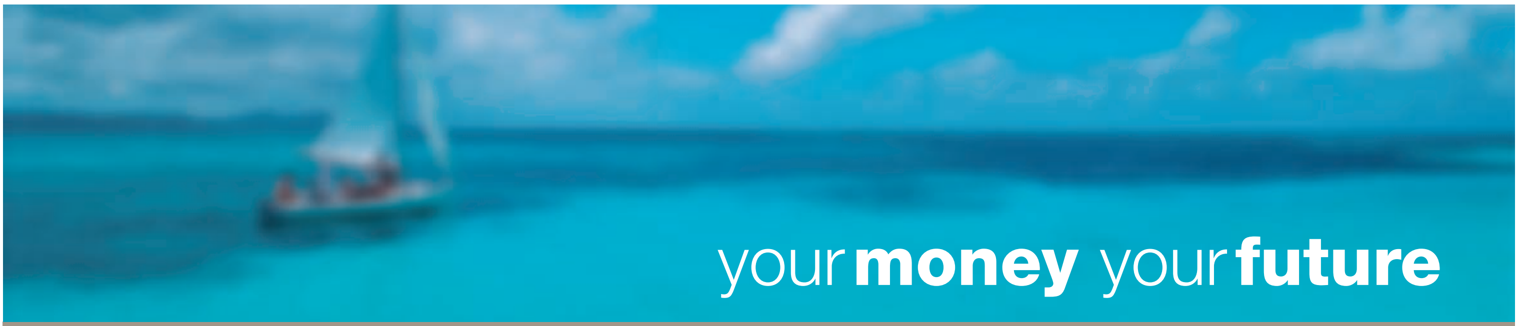

FINANCIAL PLANNING NEWSLETTER

2012 Economic Q&A

What forces will shape the performance of the Australian economy in 2012, and your small but important share of it? Nobody has a crystal ball but, judging by the major issues on the horizon at the end of last year, these are some of the questions for which we might have answers this year.

1 The big one: will there be another global financial crisis?

Tough questions about Europe, sovereign debt levels, bank stability, stalled economies, and the future of the Euro look like being the black cloud over much of the world economy in 2012. Some economists believe that Europe can't avoid another recession, but even if this happens, there is good chance that it will not spread from there to become a global one.

OECD Growth forecasts

	2011	2012	2013
Australia	1.8%	4.0%	3.2%
Euro zone	1.6%	0.2%	1.4%
Britain	0.9%	0.5%	1.8%
US	1.7%	2.0%	2.5%

Real GDP growth, year on year

Source: OECD Economic Outlook

As the table shows,[1] the December 2011 growth forecasts from the Organisation for Economic Co-operation Development (OECD) for 2012 and 2013 show Australia's prospects are much better than those of the US, Britain and especially Europe. There is every reason to be optimistic that Australia will once again be one of the world's better economic performers because key non-OECD countries such as China and India are expected to grow relatively strongly, and they are important trading partners.[2]

2 Will the euro survive?

There is a risk that the single eurozone currency, the Euro, may not survive the pressure from high national debt levels and the twin problem of Europe's major banks owning much of that debt. Billions have been written off, but more losses may force a re-alignment in Europe that ditches the weaker economies and brings an end to the common currency. When the "weaker economies" include Italy, Europe's fourth largest economy and third largest borrower, some fear this could be the straw that breaks the Euro's back.[3]

1 OECD Bulletin # 90. http://www.oecd.org/dataoecd/2/55/49112261.pdf

2 ibid

3 Financial Times Nov 29 2011 – Business and the eurozone – looking for an exit – http://www.ft.com/intl/cms/s/0/ad2d78fc-19e0-11e1-9888-00144feabdc0.html#axzz1f9V8r5Vp

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2012 Economic Q&A continued

3 How will Europe affect China?

China, so important to Australia in economic terms, has already been affected because the downturn in Europe means fewer orders for Chinese exports. While unemployment in major Chinese manufacturing regions may increase and the relentless rise of the Chinese economy will slow, affecting demand for Australian resources, it will also reduce the inflationary pressures in China.

4 How will Europe affect Australia?

The immediate impact of Europe's decline would be on international credit flows, making it more expensive for Australian banks to source funds overseas, and ultimately for business to obtain credit. On the plus side, Asian banks are in a strong position to step in and provide an alternative source of funds.

5 What is the major local challenge for the Australian economy?

Treasury's biggest headache is the predicted shortfall in revenue from taxes across the board, from personal income through to the goods and service tax and wine, because of slower growth, lower consumption and economic activity, and increased savings. The government is still committed to delivering a surplus in the 2012/13 financial year but this may require further cuts to reduce some taxpayer benefits and tighten up some concessions in allowances and superannuation.[4]

6 Is your job and your mortgage likely to be affected?

Australia's unemployment rate has stabilised at just over 5 per cent[5] and is forecast to rise to 5.05 per cent in 2012, well below the 1992 peak of 10.9 per cent. Interest rates are linked to mortgage and business lending rates; and since adjusting interest rates is the Reserve Bank's major lever to stimulate the economy, it's possible there will be more cuts beyond those in late 2011 if Europe continues to struggle.

7 What are the soft spots in the Australian economy?

Key sectors of the Australian economy lagging behind include retail, tourism, education and manufacturing. With Australian consumers in saving rather than spending mode,[6] the retail sector may remain depressed in 2012, while productivity in Australia's manufacturing sector has been patchy. The effects of our two-speed economy and gaps between the mining and non-mining states are becoming more obvious, that is unless the US economy continues to recover and takes some pressure off the Australian dollar.

8 Will 2012 be a happy new year?

The jury is still out, but it's likely not to be all doom and gloom. The introduction of the mining tax should enable Australia to meet its commitment to delivering a small budget surplus in 2012/13 and both employment and interest rates are reasonably stable. Parts of our mining industry may need to adjust if China has to deal with reduced demand from its European export markets, but Australia is still well ahead of most developed economies.

4 SMH Nov 30, 2011, "Public Servants, Students take brunt of cuts"

5 http://www.tradingeconomics.com/australia/unemployment-rate

6 Weekend Business (SMH), Sept 17 2011 – Gittens: Thrift is paying big dividends..." quoting Reserve Bank figures in the national accounts

Giving kids a hand

Parents and grandparents often wish to set aside savings for their children or grandchildren. When the children are older they can use the money for travel, higher education or a deposit on a first home. It's a great idea but there are traps for the unwary.

Not only must you decide where to invest for the best returns but whose name to invest in. You can hold the investment in the child's name or in the parent or grandparent's name, either on behalf of the child or as trustee for them.

Grandparents often choose not to invest in their own name to avoid any negative impact on their age pension entitlements. The pension will not be affected if you hold investments in trust for a child and the money is clearly earmarked for their use. But there are rules in place regarding the gifting of assets or cash which you should be aware of. If you dip into the funds for any reason the Australian Taxation Office may assume that you are the owner and tax you accordingly.

A taxing decision

Investing in a child's name may avoid confusion, but they will need their own tax file number and any investment income may be subject to punitive tax rates.

Children under 18 years of age (minors) are taxed at penalty rates of up to 66 cents in the dollar on unearned income above the tax-free threshold of $416. Unearned income refers to income from savings and investments. This contrasts to income from employment which is taxed at normal adult rates.

The impact of penalty tax rates will hit children even harder now that their investment earnings are no longer eligible for the low income tax offset (LITO). From 1 July 2011, minors are no longer able to access the LITO to reduce tax payable on their unearned income such as dividends, interest, rent, royalties and other income from property.

Insurance bonds

Insurance bonds are a popular investment vehicle for people saving for children. Investment earnings are taxed at 30 per cent inside the bond, although dividend imputation can reduce this rate. This makes them attractive for children who would otherwise pay penalty rates. Generally no

additional tax on income or capital gains is payable if you hold the bond for 10 years or more.

Not only do they sidestep many of the tax traps, but insurance bonds offer reasonable investment choice and flexibility. This is why these bonds are often considered the most tax effective savings vehicle outside superannuation.

Don't hesitate to contact us for more information, so we can advise you about the options that suit your circumstances.

All in the family

The traditional idea of a family made up of the kids with their mum and dad has shifted for many Australians, with nearly one in three children now living in a step, blended or single-parent family.[1]

We know that issues about estate planning can be complicated enough is what the Australian Bureau of Statistics calls an "intact" family, but when family dynamics change, keeping everyone informed and happy can become increasingly complex.

A modern will

Traditionally, people dealt with the distribution of their estate through the creation of a will. Usually prepared by a legal professional, a will sets out directions for the administration and disposal of property after death.

However, modern families require modern estate plans which are best prepared in discussion with your financial adviser and a specialist estate planning lawyer. As well as catering for different situations there are different assets to consider, which may not meet the definition of "property" when it comes to wills.

While the correct distribution of assets may be important, so is the protection of those assets for future generations. An inheritance received in the name of an individual can just as easily be lost as result of a divorce settlement or in the case of a business collapse.

Money and assets can just as quickly disappear where the beneficiaries are children or vulnerable people such as those with disabilities, addictions or poor money management skills.

Trusts and other assets

Testamentary and discretionary trusts can be set up as part of a will as one way to protect and distribute assets in a tax effective manner.

When a person dies the trust comes into effect and a nominated trustee then distributes the money to the named beneficiaries according to your wishes as testator.

Because the trust is a separate legal entity, assets inside the trust are generally protected from future events such as divorce proceedings or creditors.

Superannuation and insurance policies are also separate legal structures that can hold considerable sums of money, and both need to be considered in a broader estate plan.

But they may fall outside the property covered by a will, so beneficiaries may be nominated independently of the will to receive the death benefits from the superannuation fund or the proceeds of a life insurance policy upon death.

Where children or vulnerable beneficiaries are the proposed beneficiaries of a life policy you might talk with your adviser about directing the proceeds to a trust.

While family conversations about estates and death can be confronting, it is important to inform those close to you of your plans. You may want to include your financial adviser in this discussion, to make sure all the important details are included.

Case Study

John and his wife Marie have one young child, Sarah, while John also has two adult children from his previous marriage.

John's will states that Marie inherits his estate. John wants to make sure his two older children also receive something but is concerned about his older daughter's ability to manage money and his son's rocky marriage.

John sits down with his financial adviser and identifies all the assets in his estate such as his home and investments, plus $600,000 in his superannuation fund and a $1 million life insurance policy.

John's super fund allows him to make binding death benefit nominations and he requests that his death benefit be paid to his legal personal representative when he dies.

With the help of a solicitor, John's will now provides for the establishment of two testamentary trusts. Sarah is a beneficiary of one, and his two older children are the beneficiaries of the other.

He appoints his brother to act as the sole trustee of the trust for his older children, and Marie for the other trust. He nominates that on his death the proceeds of his life insurance policy be paid to the trust for Sarah. John discusses his arrangements with his wife, his brother and each of his adult children to give them as much information as possible.

When John passes away, Marie will inherit the house and other assets. His $600,000 superannuation benefit will be paid to his estate and will be included in the assets over which the trust is established. His insurance policy will be paid in the same way. His brother has the final say in the distribution of income and capital from the trust to John's older children which ensures it is not spent at once or automatically included in any future divorce proceedings.

As the trustee of the trust for Sarah, Marie controls the funds Sarah receives.

By having a well-considered estate plan, John's assets are distributed to his nominated beneficiaries at the most appropriate time and in the most tax effective manner.

1 Families then and Now, 1980–2010, by Alan Hayes, Ruth Weston, Lixia Qu and Matthew Gray, Australian Institute for Family Studies, http://www.aifs.gov.au/institute/pubs/factssheets/fs2010conf/fs2010conf.html#household
See also Australian Bureau of Statistics. (2008a). Family characteristics and transitions, Australia, 2006-07 (Cat. No. 4442.0). Canberra: ABS.

Checking you're covered

Most working Australians have some life insurance as part of their superannuation fund, yet only five per cent have enough cover to cope financially if someone in their family was in a serious accident, fell ill, or passed away.[1]

According to the Financial Services Council, Australian families with insurance received an average payout of $91,000 on the death of a spouse in 2008. Average payouts for total and permanent disablement tell a similar story, with an average $71,000 paid to people disabled and unable to work again.

However, the average family with young children has debts of $167,000, pointing to a significant gap in insurance cover for most people.

For most of us the key question is: Will my existing cover preserve my lifestyle, and that of my family, in the event of an accident, serious illness or death?

Cover for life

Your life insurance is designed to provide for your family's financial needs if you die, to cover at least any outstanding debts including the mortgage, as well as your children's education and your family's living costs and future lifestyle.

By law, trustees of superannuation funds must provide a minimum level of insurance cover for members. Premiums are normally deducted from your super contributions so they are paid from before-tax contributions.

Check with your financial adviser to make sure you have the right cover. If you do need additional cover, your adviser will assess the features of the available policies, and establish if the cover should be taken via your super fund or as a separate policy.

This is an important distinction. Some life insurance benefits paid from a super fund are tax-free only if paid to dependants, which generally includes a spouse, a de facto partner and a child under 18, while separately-owned policies may allow tax-free payments to a wider group including, for example, children over 18.

TPD insurance

Total and permanent disability (TPD) insurance may or may not be bundled with life insurance. With this insurance, you receive a lump sum if you become disabled and are unable to work again. The money you receive may be used to pay off debts, cover medical costs, and invested to generate an annual income to help maintain your lifestyle.

TPD insurance can also be bought via a superannuation fund, or outside of super. If paid for via a super fund the premiums are generally tax deductible to the fund.

Not all TPD cover is the same and you should ask your adviser to check the fine print around the conditions that have to be met before a policy is paid out, to ensure it meets your requirements.

How much?

There are no hard and fast rules about the best way to calculate how much life or TPD cover you may need, but generally it should cover your immediate expenses as well as future income needs.

You need to assess things like, your mortgage and any other loans such as for a car, everyday living expenses for a few months, children's education expenses over their lifetime, any taxes due and your funeral expenses.

Then there is the annual income your family may need after your death or long-term disablement.

Once you know how much you may need, deduct from it any existing resources including liquid assets such as cash, an estimate of what income your surviving partner may earn in the future, and any income producing assets such as property or shares, to help you arrive at a final amount.

If you think you need more insurance or you want to review your existing cover, make sure you seek specialist advice from your financial adviser so you are not left guessing.

Case study

James, 42, is married with two children aged 13 and 15.

He has an annual income of $100,000 while his wife Annie, aged 45, earns $20,000.

They have a small mortgage and are still paying private school fees. Their other main asset is an investment property.

James has a $200,000 life insurance and TPD cover via his superannuation policy. Concerned about what would happen if he was unable to work or if he died suddenly, James asks his adviser if his family will be able to remain in their home, have their children complete their education at a private school, be free of debt, and if Annie could maintain a comfortable lifestyle throughout retirement.

While James' wishes are straightforward, the calculations to arrive at the answers are not. For example, to work out the level of insurance coverage, the adviser must ensure Annie has enough assets to produce family income before and after retirement. The adviser will take account of expected returns that the insurance benefit could earn, net rental from the investment property, and any other income Annie will earn between James' death or disablement, and her retirement. That total income is then offset by forecast expenditure.

1 The Lifewise / Natsem underinsurance report, 2010