



**APRIL 2014**

## The April Investor Update

We wish all of our members and friends a happy and safe Easter. Plenty of chocolate and no investing hassles!! We have decided to include the results of our quarterly **Investor Sentiment Survey** in our Investor Updates, as otherwise members never see the results. Seemed a little silly really!

A reminder also about our **2014 Annual Conference**. This year's conference is focused on investment outcomes for the individual investor, and the program is one of the best that we have ever developed. The conference brochure will be arriving in your mailbox any day now.

### In this issue

- ◆ **Results of the Investor Sentiment Survey**
- ◆ **Non Arm's Length SMSF loans = huge tax bill!**  
Bryce Figot and Daniel Butler DBA Lawyers
- ◆ **Are You a Retail or Wholesale Client?**  
Elizabeth Moran, FIIG
- ◆ **The Truth about Self-Managed Super.  
The Top Myths about SMSF Super**  
David Peacock
- ◆ **How does technical analysis work and why should I use it?**  
Nick Radge

### Results of the Investor Sentiment Survey

#### Cash On Sidelines Moving Into Equities (Cautiously)

Investor attitude has changed since late last year with cash from term deposits and fixed income assets cautiously moving into equities. At the same time, investors who have benefited from rising share prices since mid-2012 have elected to take profits, moving cash back to the sidelines.

Despite these offsetting fund flows, the **Australian Investors Sentiment Survey** for March, organised by the Australian Investors' Association (AIA) and FNArena, suggests average cash allocations for investment portfolios has now fallen to 18%, down from 19% in

### Upcoming Events

**2014 AIA Annual Investors Conference**  
**Outcome Oriented  
Investment Strategies**  
**for the individual investor**

**Sunday 3<sup>rd</sup> to Wednesday 6<sup>th</sup> August**  
At the Marriott Resort, Gold Coast



This year's conference will be focused on investment **outcomes** for the individual investor.  
[More details soon](#)

**Results of the Investor Sentiment Survey (Cont'd)**

November and on equal footing with surveys in September and March last year.

According to the survey, average cash allocations have been as high as 26% in September 2011. The average allocation to equities has risen to 53.5%, the highest level in more than a year and up from 51% in November.

**Average Investment Portfolio Allocations:**

	<u>March-14</u>	<u>Nov-13</u>	<u>Sept</u>	<u>July</u>	<u>May</u>	<u>Mar</u>	<u>Sept-11</u>
<b>Equities:</b>	53.5%	51%	51%	49%	51%	53%	45%
<b>Property:</b>	17.5%	18%	19%	19%	16%	17%	17%
<b>Fixed Income:</b>	11%	12%	12%	12%	12%	12%	12%
<b>Cash:</b>	18%	19%	18%	20%	20%	18%	26%

Investors' changed attitude towards risk becomes even clearer when we consider that combined allocations to term deposits ("cash") and fixed interest peaked at 38% in September 2011. Today the corresponding number is 29%. Over that period the average allocation to equities has risen from 45% to 53.5% in March.



While indications of investor optimism continue to dominate over bearish sentiment, the results of the March survey nevertheless indicate overall investor sentiment has become more cautious. This is illustrated, for example, by a sizeable jump in respondents indicating a Neutral view on the outlook for the share market (now at 60%).

**Current Sentiment:**

	<u>March-14</u>	<u>Nov-13</u>	<u>Sept</u>	<u>July</u>	<u>May</u>	<u>Mar</u>	<u>Jan</u>
<b>Bullish</b>	27%	38%	43%	23%	32%	35%	45%
<b>Neutral</b>	60%	50%	46%	64%	57%	51%	49%
<b>Bearish</b>	13%	12%	11%	13%	11%	14%	6%

When asked whether the share market is likely to be higher in six to twelve months' time, a majority of 56.5% thinks this will be the case, against only 18.5% having a bearish view. These results still indicate a more cautious view in comparison with September last year when 65% responded positively and only 13% indicated a negative outlook.

**Markets Higher in 6-12 Months Time?**

	<u>March-14</u>	<u>Nov-13</u>	<u>Sept</u>	<u>July</u>	<u>May</u>	<u>Mar</u>	<u>Jan</u>
<b>Yes</b>	56.5%	52%	65%	54%	46%	57%	57%
<b>No</b>	18.5%	23%	13%	20%	24%	18%	16%
<b>Same</b>	25%	25%	22%	26%	30%	25%	27%

The general underlying sentiment of "cautious optimism" was reflected in comments provided with the Survey.

*"For self funded retirees who tend to be investors, rather than traders the market seems to be fully valued. Since term deposit interests rates are the lowest they have been in a long while, dividends are the main source of income."*

*"Company earnings have to improve if there is to be a significant and real improvement in share prices and dividends."*

*"Timing of markets is not accurate but I expect an upward trend to establish itself."*

But also:

*"The market has run hard, prices are high, value difficult to find, makes me nervous!"*

*"Waiting for annual pull back in April/May before increasing equities as world economy recovers (slowly) in second half of year. Expect stock picking will be important this year."*

An uptick in the FNArena/AIA Investor Confidence Index confirms overall optimism remains high, but also firmly embedded inside a cautious mindset.

Having formed a bearish low of 40.6 in May 2012, the Index proceeded to climb to 61.4 by January 2013. Since then it has maintained a level near 60 as the Australian market has gradually risen. In time this may prove to be a figure indicative of a gradually improving bull market. A value above 50% denotes investors' overall bullish sentiment towards the growth asset markets.

In March, the Index rose to 60.2%, up from a temporary dip to 56% in November.

**FNArena/AIA Investor Confidence Index**

<u>March-14</u>	<u>Nov-13</u>	<u>Sept</u>	<u>July</u>	<u>May</u>	<u>Mar</u>	<u>Jan</u>
60.2%	56%	61%	57.3%	58.4%	60.7%	61.4%

The Investor Sentiment Survey asked members at AIA and FNArena how they felt about the market and how they were invested. The Survey will be repeated in two months (May 2014).

228 respondents participated through the AIA and 204 through FNArena.



### Non-arm's length SMSF loans = huge tax bill!

By Bryce Figot ([bfigot@dbalawyers.com.au](mailto:bfigot@dbalawyers.com.au)), Director and Daniel Butler ([dbutler@dbalawyers.com.au](mailto:dbutler@dbalawyers.com.au)), Director, DBA Lawyers

#### Introduction

The ATO have released a private binding ruling suggesting that an overly favourable related party SMSF loan can give rise to significant negative tax implications.

This might come as a shock to many who incorrectly thought that the ATO previously gave a 'carte blanche' to such arrangements.

#### Facts of the private binding ruling

At the risk of oversimplifying, the related party loan was to have the following characteristics:

- nil interest
- unspecified maximum duration of the loan (but the intention seemed to be to allow a term of up to several decades)
- no personal guarantees required
- the borrower was obliged to repay the loan as a single lump sum at the end of the loan term, or earlier as agreed between the borrower and lender and
- the loan was to acquire listed ASX shares (there was to be another loan to acquire units in what appeared to be a private unit trust).

The above facts strongly suggest that the terms of the loan are not those expected in arm's length dealings.

The ATO was asked a number of questions, including whether the income derived would be non-arm's length income.

They said that it would be. Accordingly, the income would be taxed at 45%! This high rate of tax would apply regardless of whether the SMSF was in pension mode ... that is, the non-arm's length income provisions override the pension exemption.

The ATO's reasoning was as follows:

If the parties in this case were dealing with each other at arm's length, the amount of income the Fund might be expected to derive through the Custody Trust is either:

\* nil - on the basis that no lending on the proposed terms by the [related party lender] might be expected and therefore no income might be expected to be derived by the Fund through the Custody Trust; or

\* is less than under the proposed arrangement - on the basis that the Family Trust might be expected to lend on commercial terms that involve lower than 100% loan to value ratios given the nature of the assets to be acquired with the borrowed money and the limited recourse nature of the loans. Therefore, the substantially lower borrowed amounts available to be invested might be expected to generate less income to be derived by the Fund through the Custody Trust than under the proposed arrangement.

Either way, the final requirement of subsection 295-550(5) of the ITAA 1997 is satisfied.

#### Would the outcome be different if the facts were less aggressive?

As at the time of writing, there are no publicly available 2014 private binding rulings considering nil interest loans with less aggressive facts (eg, a less than 100% loan-to-value ratio).

However, extreme caution should still be used. It is vital to be able to prove that the amount of income derived would be no greater than if the parties were dealing on arm's length terms.

#### But didn't the ATO previously say it was okay?

The ATO has released private binding rulings in the past stating to the specific taxpayer applicants that their income would not be non-arm's length income (see, for example, private binding rulings 1012414213139 and 1012396819768). Naturally though private binding rulings are not public rulings and only be relied upon by the specific taxpayers who applied for them.

The ATO has made public comments regarding contributions, as well as the arm's length provisions in the *Superannuation Industry (Supervision) Act 1993* (Cth).

Originally, there was a concern that a related party loan favouring an SMSF would constitute a contribution and therefore give rise to excess contribution tax issues. The ATO in taxpayer alert [TA 2008/5](#) stated that they were concerned about such loans. They said: monies advanced by a member or related party at zero or less than a commercial rate of interest could be characterised as a contribution to the SMSF. This may result in the trustee/member having to pay excess non-concessional contributions tax under Division 292 of the *Income Tax Assessment Act 1997*...

Although taxpayer alert TA 2008/5 has never been formally withdrawn, the ATO have moved away from this position. See [item 7.4 in the June 2012 Superannuation Technical minutes of the NTLG](#). Here, the ATO said that saving an interest expense (as a result of a favourable interest rate) is not necessarily a contribution and that a nil interest rate will not prevent the arrangement from being a borrowing.

Provided the loan favours the SMSF and does not favour the related party, the ATO seem to take the view that the arm's length requirements in the SIS legislation are not contravened. See [ATO ID 2010/162](#).



#### **What to do with existing overly favourable related party limited recourse borrowing arrangements?**

Naturally, it is always wise to seek to personalised advice for a taxpayer's specific situation.

Some might wish to amend the terms of the limited recourse borrowing arrangement. To accommodate this DBA Lawyers has recently introduced a fixed fee service to amend the terms of the limited recourse borrowing arrangement.

*This article is for general information only and should not be relied upon without first seeking advice from an appropriately qualified professional.*

*Note: DBA Lawyers hold SMSF CPD training at venues all around Australia and online. For more details or to register, visit [www.dbanetwork.com.au](http://www.dbanetwork.com.au) or call Marie on 03 9092 9400.*

10 April 2014

#### **Are you a retail or a wholesale client?**

*by Elizabeth Moran*

The distinction between retail and wholesale (including professional and sophisticated) clients is important from a disclosure perspective as a result of ASIC's Information Sheet 99.

#### **ASIC's Information Sheet 99**

Information Sheet Number 99 states that a credit rating must not be disclosed in a manner that is intended to (or could reasonably be regarded as being intending to) influence a retail client in making a decision in relation to a particular financial product or class of financial products. This means that financial intermediaries (such as brokers, advisors and financial planners) are not able to disclose the credit rating of products or issuers to retail clients. But they can provide that information to wholesale clients. This anomaly has arisen because since 1 January 2010 ASIC requires credit rating agencies (such as Standard & Poor's, Moody's and Fitch) to hold an Australian Financial Services Licence and to date the ratings agencies have only obtained licences with a wholesale client authorisation.

FIIG as a fixed income broker must comply with Information Sheet 99. So, it's important that you understand if you are a retail or wholesale client because it will affect the credit rating information that we are allowed to disclose you. To assist in this regard, we have provided definitions below.

#### **Retail clients**

Essentially, everyone is a Retail Client unless they satisfy one of the requirements to be classified as a Wholesale Client under section 708(8) or (11), section 761G(5), (6), (6A) or (7) or section 761GA of the *Corporations Act 2001*.

#### **Wholesale clients**

Wholesale clients comprise sophisticated investors and professional investors under the *Corporations Act 2001*.

#### **Professional investor**

A professional investor is defined as one or more of the following:

- A financial services licensee



- A body regulated by APRA, other than a trustee of any of the following (within the meaning of the Superannuation Industry (Supervision) Act 1993):
- A superannuation fund
- An approved deposit fund
- A pooled superannuation fund
- A public sector superannuation scheme
- A body registered under the Financial Corporations Act 1974

The trustee of:

- A superannuation fund
- An approved deposit fund
- A pooled superannuation trust, or
- A public sector superannuation scheme within the meaning of the Superannuation Industry (Supervision) Act 1993

And the fund, trust or scheme has net assets of at least \$10 million

- A person or entity who controls gross assets of at least \$10 million (including any amount held by an associate or under a trust that the person manages)
- A listed entity or related body corporate of a listed entity
- An exempt public authority
- A body corporate or an unincorporated body that:
  - Carries on the business of investment in financial products, interests in land or other investments, and
  - For those purposes, invests funds received (directly or indirectly) following an offer or invitation to the public, within the meaning of section 82 of the Corporations Act 2001, the terms of which provided for the funds subscribed to be invested for those purposes
- A foreign entity that, if established or incorporated in Australia, would be covered by one of the preceding paragraphs

### Sophisticated investor

A sophisticated investor is one or more of the following:

- A person or entity that has obtained an accountant's certificate dated no more than two years ago that the client:
  - (a) Has net assets of at least \$2.5 million, or
  - (b) Has a gross income for each of the last two financial years of at least \$250,000; and
  - A person or entity that is controlled by a person or entity that meets the requirements of (a) or (b) above.
- A person or entity who invests where the purchase price of the product is at least \$500,000

### Conclusion

It's important to ascertain if you are a wholesale client and, if so, to inform FIIG so that we can ensure that you receive proper disclosure of credit ratings of products

and issuers. If you're unsure, please request assistance from our team at FIIG.



### The Truth about Self-Managed Super The Top Myths about SMSF Super

*David Peacock:*

Legendary American writer Joan Gould mused "I don't know these stories as well as they know me, I've discovered." This is probably what SMSFs would have to say were they able to speak for themselves. SMSFs have risen in popularity by significant proportions in recent years. This has however not stopped the proliferation of misinformation about them. Here are some of the most outrageous myths about SMSFs:

#### Myth 1. SMSFs are Cheaper than Public Funds

SMSFs are required to prepare an annual set of financial accounts, submit an annual income tax return, submit an audit certificate and in some cases submit actuarial certificates alongside asset valuations. Given all these requirements, SMSFs only become more economical than the alternatives with a substantial account balance; and even then, not always.

#### Myth 2. SMSF Trustees Must Have Extensive Knowledge of Investment Markets

SMSF regulations require that trustees take responsibility for all decisions made with respect to their SMSFs. They do not however require them to possess 'a substantial bank of knowledge' than all other fund members. That being said, they can always seek the input of professional advisers.

#### Myth 3. Having an SMSF is an Effective Way to Improve Your Super Performance

Whilst it might be true that the performance of the average retail super fund is largely uninspiring, active management of the composition of your super fund

assets is just as effective in the public space as with an SMSF. The amateur who expects to beat the professional is ambitious at best and delusional at worst. When all is said and done, proper professional assistance in the construction and maintenance of a super portfolio will often mean returns exceeding 'the average' by comfortable margins.

#### Myth 4. You Must Have an SMSF if You Want to Invest into Direct Shares

This is arguably the most widely held myth regarding SMSFs. Although it may have been true a couple of years back, nowadays many super funds allow members to choose from an extensive range of ASX-listed securities with others giving full ASX access. It should be said however that management of Capital Gains Tax (CGT) implications and corporate actions become problematic under these structures. Nonetheless, it is questionable whether these pros outweigh the additional costs incidental to SMSFs.

#### When a SMSF is Appropriate

SMSFs have become hugely popular in Australia, particularly since the GFC, although they're not appropriate for everyone. The main reason for establishing a SMSF is where there are certain strategies with superannuation assets that can only be adopted through a SMSF that justify establishing and maintaining one. These strategies may include selling an asset to a member, buying an asset from a member, investing in direct real estate, borrowing money and jointly owning an asset with another super fund member. If you choose to go with any of these strategies, then you must have an SMSF to do so. To be on the safe side, always seek professional advice to determine whether or not you need an SMSF to achieve your objectives.

*This article was provided by Financial Spectrum Financial Planners Sydney. [www.financialspectrum.com.au](http://www.financialspectrum.com.au)*

#### How does technical analysis work and why should I use it?

*Nick Radge:*

Technical analysis is a process of analysing historical data. It is a method that enables traders and investors to participate in the markets. It is one of the main methods – the other being fundamental analysis – participants use to determine which market or stocks they will trade.

Historical data is generally presented as a graph and is principally a representation of price. The most common methods of price representation are bar and candlestick charts which plot the open, high, low and close of the

market for any given period. Line charts plotting only the closing price are also common. The period can be anything from years to real time stock quotes where each bar represents a chosen period of minutes. Prior to computers, any stock chart would have been hand drawn, so computerisation has converted the practice of technical analysis to a vastly more efficient and powerful means of observing and utilising the price action of any particular market or instrument with stock analysis software.

Below is an example of a chart tracking a stock where each bar represents the price traded on a single day. At the base of the chart the technician is tracking the volume traded on the corresponding day.



Technicians are concerned mainly with price action. This is contrary to fundamental analysts who are more concerned with 'value'. Fundamental analysts look at a company's performance; – management, balance sheets, profit & loss etc – and are more concerned with such metrics as earnings per share, future growth, and price/earnings ratios, etc. Technical analysis assumes that price reflects all that is known about a company at any given point in time. Of course, the disciplines can be combined.

History repeats in many walks of life and price action that represents supply and demand, driven by the psychology of market participants, tends to be no different. Therefore analysis of historical data is really a search for repeatable patterns or occurrences within that data that may repeat in real time. It is a process of stacking the odds in your favour rather than one of prediction. It is a process of utilising probabilities and statistics.



One of the great misnomers of technical analysis is that it is a predictive tool. Even Wikipedia mentions it as being a “*discipline for forecasting the direction of prices*”. It is often shunned by fundamentalists for this ‘predictive’ reason. However there is no difference between a technician arriving at a buy level and profit target and a fundamentalist determining a level at which to buy (value) and one at which they will sell (overvalued). The process and ‘forecasting’ is one and the same, the only difference is the tools being used.

So choose your weapon with which to engage the markets; technical analysis, fundamental analysis or a combination. Make sure you weigh up the pros and cons of each and consider such things as; time to devote to the cause, timeliness of and ability to manage information or data, whether you want to code (computerize) trading systems, reliability of information and the ability of your trading rules to be tested and measured.



Nick Radge is Head of Trading and Research at The Chartist, [www.thechartist.com.au](http://www.thechartist.com.au). Nick uses technical analysis for both short term trading and long term investment strategies. He has 27 years’ experience in the financial markets from the trading floor of the Sydney Futures Exchange to international dealing desks in London, Singapore and Sydney and has authored several books on trading and investing including his best seller, *Unholy Grails – A New Road to Wealth*.

e

This publication has been prepared as information without consideration of any reader's specific investment objectives, personal financial situation or needs. No reader should rely upon the information and/or recommendations contained in these publications. Readers should, before acting on any information contained herein, consider the appropriateness of the information, having regard to their objectives, financial situation and needs.

The AIA believes that the material contained in these publications is based on the information from sources that are considered reliable and is accurate when issued. However, the AIA does not warrant its accuracy or reliability. All views and information expressed by the AIA, its officers, agents, representatives, and employees are for the purposes of discussion only.

Australian Investors Association Ltd  
PO Box 7439  
Gold Coast MC QLD 9726  
Tel 1300 555 061  
Fax 07 5538 8376  
Email [aia@investors.asn.au](mailto:aia@investors.asn.au)