



MAY 2014

The May Investor Update

Welcome to the AIA May Investor Update. We have a great article by Marcus Padley regarding investing your own super fund assets. The usual Marcus style, funny in ways but with such underlying truth! Colin Nicholson writes about 'Bubbles', Liz Moran about Bonds capital structure, and Richard Livingstone and Liam Shorte explain the rule changes for pension entitlements.

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 have been delivered to your mailbox by now. Visit the website or phone the office 1300 555 061 to register.

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A Fool and His Super Funds are Easily Parted

Marcus Padley

This article was originally published in the Melbourne Age on 7th May

When I first joined a broker in 1982, the first thing I wanted to know about was their retirement scheme. It's what you did in those days: work your way from mail room to chairman in the same company, pick up the gold watch and retire on a pension. My dad, for instance, retired on a pension of seven-eighths of his salary. Daimler-Chrysler almost went broke trying to fund it.

These days we don't have pensions. Instead, the government in its wisdom has placed a lump sum of money under the control of the individual and made them responsible for its investment

Upcoming Events

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

Sunday 3rd to Wednesday 6th August
At the Marriott Resort, Gold Coast



This year's conference will be focused on investment **outcomes** for the individual investor.

[Full details on AIA website](#)

A Fool and His Super Funds are Easily Parted (Cont'd)

In doing so, it has also unwittingly created a massive target for financial predators. Millions of fools and their money and the barbarian hordes have descended upon them, and I don't mean the brokers, financial planners and fund managers.

Don't be insulted. Obviously, we are not all fools, but I find it staggering, the difference in government concern about the professionals compared with the amateurs.

Financial industries, such as financial planning and broking, were constipated with regulation even before the Future of Financial Advice reforms introduced by the Gillard government. I can't give my brother financial tips without sending him an eight-page statement of advice, even if I don't get paid, and every utterance comes with years of potential liability.



Yet the do-it-yourself trade-on-a-mobile-phone home fund manager who takes control of their retirement money and that of their dependants is unregulated. No exams, no hurdles to responsibility, straight into it. You don't see their spouse's advice being regulated, or the stock tips from loud-mouth dinner-party guests. No, they can say what they like. Investors can, so they do. I'm not talking about you, of course - you're smart and experienced - but the rest of them. They are a target and the fact that the average Australian simply doesn't have enough money in super suggests they are prone to throw the dice and gamble with it because the alternative is to work until they drop.

So here is a bit of simple advice for them, the stupid ones, the gamblers, the nervous and the overconfident: Their job is not to make money, but not to lose it.

Here, for your delight, is a quick checklist of things to avoid:

- Take a call from someone in Bogota with a guaranteed system for trading gold bullion.
- Buy 52 properties in 52 weeks.
- Read *How I Made \$2,000,000 in the Stock Market* and set out to do it too.
- Start with leverage, derivatives or even better, leveraged derivatives.
- Attend a free two-hour seminar and learn how to put your money into someone else's bank account and gamble with it.
- Put on trades through an iPhone app, because you're "on the move".
- Start with less than \$10,000 in your trading account, expecting to take home an average of \$100,000 to \$1 million a year trading foreign exchange.
- Trade from anywhere in the world and let the computer do all the work.

Predators are upon you and they morph from one product to the next, depending on what you will fall for. Avoiding them is easy. Just don't be stupid.

The best course is to get some objectivity: get out and about and talk to other investors. If anyone will keep you honest, it is other people and, let me tell you, they will be only too happy to tell you if you ask.

Where do you find them? There are only a few organisations in the stock market that the private investor can trust, and perhaps, unsurprisingly, they all seem to be not for profit. They include the Australian Investors Association, the Australian Shareholders Association and the Australian Technical Analysts Association. They all offer access not to a product, trading platform or leveraged derivative, but to people like you.

The motto of the Australian Investors Association sums it up as "Investors helping Investors" and, if you have ever attended its national conference, had 20 coffee breaks, nine meals and a few happy hours with the other 300 people in the same boat as you, you will know that it is true.

Of course, none of these associations have the marketing budgets or the profile they deserve, because they are not for profit and, as a result, the success of their events and the growth in their membership is not bought by slick television spots and glossy press advertisements.

It is hard won by individuals whose primary motive isn't money, but their generous interest in spreading the word for the benefit of others.

Maybe start with them

Hear **Marcus Padley** speak at the AIA National Conference “**Outcome Oriented Investment Strategies for the Individual Investor**” August 3 – 6

Also on the program are Nick Radge, Alan Hull, Roger Montgomery, Grant Abbott, Chris Caton, Colin Nicholson, Peter Thornhill plus many more sort after speakers across 44 sessions over four days.

Full details are available on our website
<http://www.investors.asn.au/events/events-schedule/aia-national-investors-conference/>

What Bubble?

Colin Nicholson

There is a constant stream of doom and gloom about the US stock market. Much of it focuses on a “bubble” in the NASDAQ stocks. Many people are pointing to bubbles all over the place now. So much so, that I seriously wonder whether the word is now so debased that it has no real meaning. This is something that happens from time to time with the language.

In stock markets we should be able to see a bubble forming on a chart of the market index. Bull markets in stocks very often unfold over many years in a trend channel. During that time, prices rise and fall within the channel, respecting the upper and lower boundaries of the channel. Some of these rises and falls will cause us to expand the width of the channel, but it should not make its slope any steeper.

The chart below is of the NASDAQ Composite index from 1970:



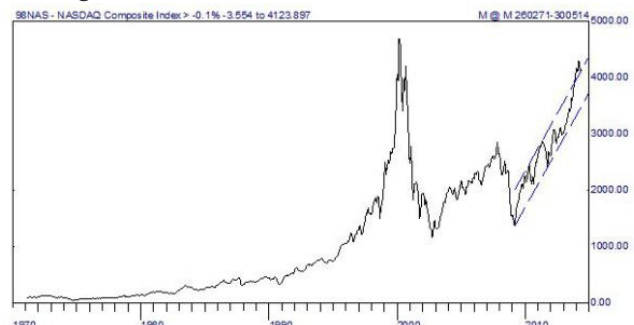
From the mid-1970s to the late 1990s the NASDAQ Composite index fluctuated within a trend channel. As the 1990s unfolded, the index began to travel towards the top of the channel. Then it broke out of the channel and began to soar upwards almost vertically. That is the bubble: when the market begins to rise at an unsustainable rate driven by wild speculation.

Now look at the present trend. Our trend channel is still somewhat tentative as far as its width is concerned. There will be some significant corrections along the way. At the moment, its slope is a bit steeper than the 1970s to 1990s period, but a correction or two is likely to dampen that slope and widen the channel. It is early days.

The important thing is that there is not yet any sign of acceleration out of the top of the channel in a true bubble.

It is important to keep in mind that all bull markets do not develop into bubbles and can end in other ways. Anything can happen, so it is always dangerous to form a fixed idea that there must be a bubble at the end and if you can't see one yet, then everything is fine.

Of course, if you want to find a bubble in almost any market, it can be done with a change to the scale. If we take the above chart of the NASDAQ Composite index and switch it to linear scale, we might have a bubble forming:



However that is simply an improper use of scaling. The first chart had a logarithmic price scale, which should be used whenever our chart has a wide dynamic range in the price. It is called a semi-log chart because the time scale is linear, as it should be, but the price scale is logarithmic. The logarithmic price scale means that every price change on the chart is represented by the same distance up the scale in percentage terms. This can be seen on the first chart: a move from 200 points to 400 points, a 100% growth, is represented as the same distance as a move from 2,000 points to 4,000 points, because it is also a 100% growth.

However, with a linear price scale, every price change is the same in units. So, on the second chart above, with the linear price scale, a move from 1,000 points to 2,000 points is the same as a move from 3,000 points to 4,000 points. But the move from 1,000 points to 2,000 points is a 100% rise, while the move from 3,000 points to 4,000 points is only a 33.3% rise.

Next time you hear someone tell you there is a bubble in a market, have a close look at the price scale on their chart. If it is a linear price scale, they are maybe manufacturing a bubble for you. Makes a good story, but the problem is that you are being misled!



Colin Nicholson BEc, SF Fin has been investing his own money in Australian shares for over 45 years. He is one of the very few teachers of investing who publishes his investment return each year. Colin has taught both technical analysis and fundamental analysis for *Finsia*, where he is a Senior Fellow. Colin has written six books on investing and written for *Shares* magazine, *Smart Investor* magazine, *The Australian Financial Review*, *BRW* and now writes extensively in his free newsletter and on his website www.bwts.com.au. Colin does not sell anything except his writing and teaching

Just like property, location matters in bonds

by Elizabeth Moran

Key points:

1. The seniority, or rank in the company's capital structure, is crucial in determining whether the return offered adequately compensates the investor for the risk involved.
2. In the event of wind-up or liquidation, funds are paid to the most senior investor in the capital structure (senior secured debt) first and these investors must be repaid in full before any funds are paid to investors on the next level.
3. Investments lower in the structure do not offer the same certainty and are thus higher risk, and should offer higher returns to investors.

Property investors know and respect the mantra; location, location, location. In bond and fixed income markets, the equivalent of location is capital structure, which determines who gets paid out first in the event of a company wind-up.

The seniority, or rank in the company's capital structure, is crucial in determining whether the return offered adequately compensates the investor for the risk involved. Every bank and company has its own capital structure and it is legally binding.

In the event of wind-up or liquidation, funds are paid to the most senior investor in the capital structure (senior secured debt) first and these investors must be repaid in full before any funds are paid to investors on the next level. In turn, each level must be repaid in full before funds are apportioned to the next level. The higher your investment sits in the capital structure, the lower the risk.



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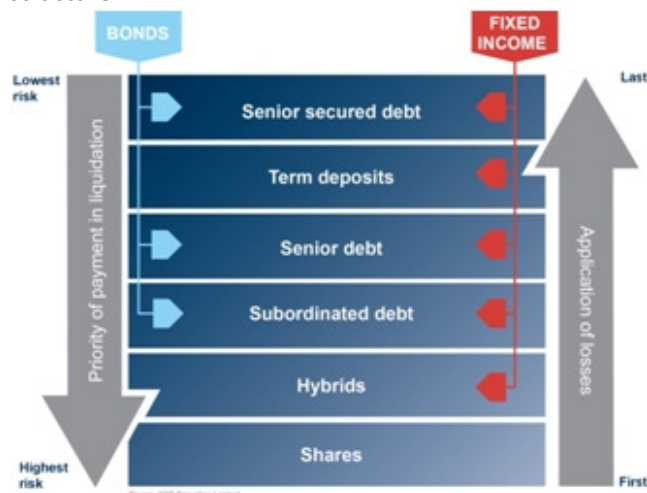
Investments at the top of the structure have known interest and maturity dates. Companies that miss paying interest or principal face serious consequences.

Moving down through the rungs, terms and conditions change and there is less certainty. Interest can be deferred or not paid at all, while maturity dates can be extended or become perpetual where there is no obligation to return principal to the investor.

Investments lower in the structure do not offer the same certainty and are thus higher risk, and should offer higher returns to investors. For example, there is no obligation for companies to pay dividends to shareholders, they can be cut without any consequences for the company and there is no repayment date. Shareholders must sell shares to recoup capital. This uncertainty needs to be adequately rewarded with higher returns.

In liquidation, losses are applied from the lowest level up, making shares the “first loss” and highest risk investment in the capital structure. Each rung from the lowest up must be “wiped out” before the next rung up on the ladder takes any loss.

However, new Basel III regulations mean bank hybrids can convert to shares on breach of a capital trigger and bank subordinated debt and hybrids can be deemed “non-viable” by APRA and also converted to shares. These conditions increase the risk of the new style investments and need to be compensated through higher returns. In essence the regulations are to ensure the bank maintains sufficient capital for its operations and they protect investors sitting higher in the capital structure.



Source: FIIG Securities

Bonds are issued at three different levels in the capital structure: senior secured, senior unsecured and

subordinated debt, whereas the fixed income asset class also includes deposits and hybrids.

Risk has a direct relationship with reward. The higher the risk of a security the greater the expected reward. Investing a high proportion of your funds in the highest risk category, shares can expose your portfolio to loss in a cyclical downturn. Investors need to diversify investments to protect income and capital. Bonds generally lower the risk of your overall portfolio and help to preserve capital.

Age pensions and super income streams: Lifting the fog - Part 1

The rules for age pension entitlements will change on 1 January. Richard Livingston and Liam Shorte explain the rules and how to get the most from them.

Key Points

- Under existing rules, account based (super) pensions generously treated
- The operation of the existing rules explained
- A strategy to maximise your age pension entitlement
- Superannuation income streams ([account based pensions](#)) are exempt from income tax and, currently, treated generously when working out your age pension eligibility.

Come 1 January 2015, the rules will change for pensions taken after that date. Let's take a look at how the rules work now (in Part 2 we'll cover the changes).

The current rules

Eligibility for the age pension and [Pensioner Concession Card](#) (and other Centrelink benefits) are based on two tests; an Assets Test and Income Test. It's a 'worst off' test, so you're entitlement is based on the test which gives you the least.

If you're single and own your own home, your assets (excluding your place of residence) must be less than \$196,750 to get the full age pension. To get anything at all, your assets must be less than \$758,750 (the amounts are \$279,000 and \$1,126,500 for home owning couples). Details of other key thresholds for the Assets Test can be found on the [Human Services website](#).

The Income Test is more complicated since financial assets are '[deemed](#)' to earn a certain amount of income

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and different rules apply to certain types of income, including account-based pensions paid by super funds. The 'cut-off' income (where no age pension is paid) for a single is currently \$1,841.60 per fortnight (\$2,817.20 for a couple). Singles can earn up to \$156 per fortnight (\$276 for couples) and get the full pension (above this level it gradually reduces). More details can again be found on the [Human Services website](#).

Let's take a look at how the Income Test works in practice.

Deeming

Under the deeming rules, financial investments (such as shares and term deposits) are regarded as earning a certain rate of return, regardless of what is actually earned. Depending on the size of the investments, Centrelink will currently deem them to have earned 2.5% or 3.5% (see Table 1).

Amount of financial assets	Deeming rate
Single	
First \$46,600	2.00%
Excess of \$46,600	3.50%
Couple (where one gets age pension)	
First \$77,400	2.00%
Excess of \$77,400	3.50%

Source: www.humanservices.gov.au

Table 1: Current deeming rates for age pension

To the 'deemed' income on financial assets, most people will have to add any superannuation pension or annuity income received (as well as net investment property rental income and any income over \$250 per fortnight from employment). But the amount added to reflect the super pension is reduced by a 'deductible amount'.

Deductible amount

The 'deductible amount' is calculated as follows:
Deductible amount = (Original purchase price - any commutations)/Relevant Number

The Relevant Number is the life expectancy when the pension is commenced (calculated from the [Australian Government life expectancy tables](#)). The shorter the life expectancy, the less income that gets included in the Income Test. Table 2 shows how the deductible amount is calculated.

Steve's starting account based pension balance	\$300,000
Relevant number (2)	18.54
Deductible amount	Calculated as \$300,000/18.54 = \$16,181
Minimum pension (3)	\$15,000

Notes:

(1) No commutations (this will typically be zero).

(2) Relevant number calculated as life expectancy for a 65 year old male, based on [life expectancy tables](#).

(3) Minimum pension calculated at 5% (for 65 year old) multiplied by \$300,000 account balance.

[See ATO website for full list of minimum withdrawal amounts.](#)

Assuming Steve has \$100,000 outside of super, in cash and shares, he'll be deemed to have earned \$2,801 (calculated in Table 3), which will be his total income for the Income Test. If he's got no significant assets apart from the super, cash, shares and his own home, he'll qualify for the full age pension.

Steve's financial assets	Deeming rate	Deemed income
First \$46,600	2.00%	\$932
Next \$53,400	3.50%	\$1,869
Total		\$2,801

Table 3: Calculation of Steve's 'deemed income'

If he had to include his account-based pension, or a substantial portion, he'd get a very different result. His age pension would fall once he exceeded \$4,067 in annual income (\$156 per week). The deductible amount shields the super pension from affecting his age pension.

Refreshing the deductible amount

As Steve ages and his portfolio returns more than the deemed return, he may want to start taking a larger super pension. But once he goes beyond the \$16,181 deductible amount, the excess will be included in the Income Test for the age pension.

One potential strategy is to refresh the deductible amount by closing the account-based pension and starting a new one. Assuming no change in purchase

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price (\$300,000), doing this at age 75 would increase his deductible amount to \$35,366 (calculation in Table 4).

Steve's starting account based pension (ABP) balance	\$300,000
Relevant number(1)	11.31
Deductible amount	Calculated as \$300,000/11.31 = \$26,525
Minimum pension (2)	\$18,000

Notes:

(1) Relevant number calculated as life expectancy for a 75 year old male, based on [life expectancy tables](#).

(2) Minimum pension calculated at 6% (for 75 year old) multiplied by \$300,000 account balance. See [ATO website for full list of minimum withdrawal amounts](#).

If he took a \$25,000 account based pension annually, he'd still be entitled to the full age pension; the higher deductible amount shelters the larger super pension. You should seek personal advice on this (and any) strategy since it may have other complications. Plus, it probably won't work after 1 January 2015, as starting the account based pension afresh would subject it to the upcoming rule changes, which we'll cover in Part 2.

Courtesy Intelligent Investor – Super Advisor

Wilson Asset Management is pleased to invite you to attend Investor Presentations about WAM Capital Limited (WAM), WAM Research Limited (WAX) and WAM Active Limited (WAA). The investment team will also provide an overview of some individual stocks held in the investment portfolios, give our broad outlook for the market and discuss current issues impacting investors and the wider market. Following this presentation, we invite you to stay for a further presentation about a new charity LIC to be launched by Wilson Asset Management Group. Please contact Mary-Ann Baldock at WAM office on (02) 9247 6755

PRESENTATION TIMES

Adelaide

**Thursday
22 May 2014**
National Wine Centre of
Australia
Cnr Botanic & Hackney Rd
Adelaide

Presentation
10.00am – 12.00pm

New charity LIC Presentation
12.15pm – 1.15pm

Brisbane

**Friday
23 May 2014**
Brisbane Convention &
Exhibition Centre
Cnr Merivale & Glenelg St
South Bank
Brisbane

Presentation
10.00am – 12.00pm

New charity LIC Presentation
12.15pm – 1.15pm

Melbourne

**Tuesday
27 May 2014**
Novotel Melbourne on Collins
270 Collins Street
Melbourne

Presentation
10.00am – 12.00pm

New charity LIC Presentation
12.15pm – 1.15pm

Sydney

**Wednesday
28 May 2014**
Wesley Conference Centre
Wesley Theatre
220 Pitt Street
Sydney

Presentation
10.00am – 12.00pm

New charity LIC Presentation
12.15pm – 1.15pm

Parking: For recommended parking, please refer to the Key Dates section on our website www.wamfunds.com.au or call the office on (02) 9247 6755.

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