

the **INVESTORS**voice

Newsletter of the Australian Investors Association - *Investors helping Investors*

December 2012

PORTFOLIOS **Market Timing** **BANKS** **Rentals**



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Cyclical Analysis and Market Timing

This article is an extract from Alan Hull's latest book, *Invest My Way* by Wrightbooks

We are born. Our parents shelter, clothe, feed, protect and educate us. In doing so they spend money on certain services and products. Eventually we leave home, get married, buy a house, have children of our own and the cycle of modern human life repeats itself. This pattern is inevitable and fairly predictable.

Cycle of human life



At each stage of our lives we belong to a different demographic group. Different demographic groups have different lifestyles, resulting in different needs and wants. This of course leads to quite different and distinct spending habits. Middle aged people have families and generally work whilst older people who are retired, don't work and typically consume less.

These differing circumstances will largely dictate both their consumption habits and their contribution to the economy, i.e. their productive output. Furthermore, combining this information with population data will provide powerful clues about the current and future direction of the broader economy. These financial patterns are inevitable and fairly predictable

Hence some long-term economic analysts make a career out of studying these human/economic cycles and demographic groups. Also Governments, city planners and other regulators, who have to think ahead in terms of public demands, study these cycles as well. But this is merely an obvious example of cyclical analysis with a very easily understood foundation.

The key point here is that we human beings drive economic cycles and financial markets are simply a reflection of the economic systems on which they are based. Hence, given the repetitive nature of life, cyclical analysis has a very strong and sound behavioural basis and so ignorance of this science would not only be a bit silly but a little financially foolhardy as well.

On the basis that we human beings drive markets, it is reasonable to assume that markets are a reflection of our behaviour. A couple of human traits which are often reflected in financial markets are our resistance to change and how we tend to trend. Moreover, we like to think and project on a linear basis.

So looking at just over a decade of the All Ordinaries index from the early 1990s, you can see how the market trended up the entire time. It also formed a near perfect trading channel with well defined, straight lined (linear) boundaries.

The All Ords trading in a well defined channel



The amazing thing is that no regulating authority or single powerful investor is deliberately causing this almost perfect trading channel to occur, rather it is simply the result of mass human interaction. Here's an equally compelling chart of Western Areas Mining that defines another near perfect trading channel but also demonstrates the cyclical nature of financial markets.

Western Areas forming regular cycles



Again, this is not the result of some deliberate or premeditated action but simply a reflection of human behaviour in market activity. Cyclical Analysts usually employ market lows as their key point of reference and based on this convention, Western Areas is cycling on an annual basis. Of course there are many different timeframes that markets can cycle over, ranging from several decades to just a few of days. Hence there is a variety of different perspectives that analysts can adopt. We've already covered the human life cycle and the use of demographics but there are a variety of other commonly used approaches as well:

- Macro Economics
- Fundamental/Business
- Political/election cycles

Of course, for the purpose of having a well-grounded discussion, I'm ignoring the more eccentric methods such as the study of Lunar cycles, Numerology, Astrology, etc. Rather, a commonly accepted form of cyclical analysis is the economic clock. It has been around for decades and, until fairly recently, has been widely accepted doctrine when it comes to understanding how the basic economic and business cycles work.

The Economic Clock

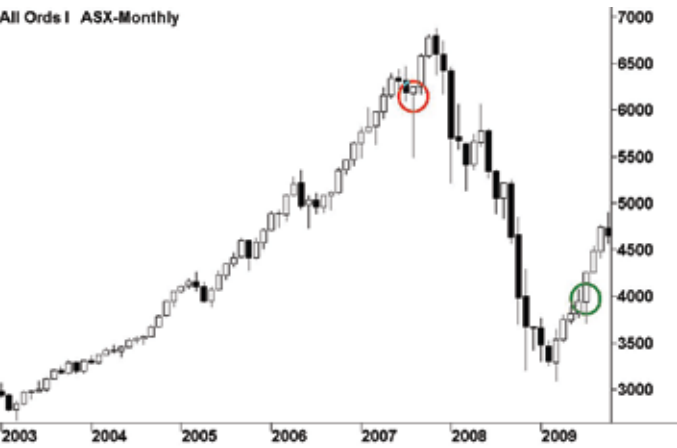


Moving around the clock in a clockwise direction indicates a set progression of key economic events and circumstances. Hence, soon after the Share Market peaks, interest rates will start to rise and then share prices will begin to fall, closely followed by falling commodity prices. Using this cycle of events as a guide, one can supposedly anticipate what's coming next and therefore what action is appropriate; buy shares, sell shares, buy property, pay down debt, etc.

It has also been conventional doctrine that the economic cycle lasts for about 10 years. But due to the introduction of stimulus by Governments and key regulators in recent times, the Economic clock has gotten a little out of whack. Alan Greenspan, recent past chairman of the U.S. Federal Reserve was another influence partially responsible for the demise of the Economic clock.

And even though cyclical analysis in some of its forms is well established, its use is far from commonplace. I was, however, able to use it to get out of the stockmarket in August 2007 and stay out until July 2009. Thus, using cyclical analysis, I managed to side-step the correction of 2008.

All Ords with circles showing my market exit & entry recommendations



My approach is based on understanding financial markets as complex adaptive systems which is a very new science. It is an extension of Chaos Theory, a branch of mathematics first explored in the 1960s but not popularised until the 1980s.

However it is important to note that Cyclical Analysis in any form is a blunt instrument and should never be seen as anything more than this. It can provide us with very broad market timing signals but most if not all attempts to refine it any further will usually end in tears.

Market timing using cyclical analysis allows us to predict future price direction and we human beings have a very powerful inclination to do this. We have this ability because of our newer brain, the neo-cortex and so we will always attempt to analyse, predict and anticipate.

Commonwealth Seniors Health Card

You may be eligible for the Commonwealth Seniors Health Care Card. The Commonwealth Seniors Health Care Card is subject to the taxable-income test (excludes superannuation pensions which are mostly non taxable) but has no assets test.

- To qualify for a Commonwealth Seniors Health Care Card you must:
- be an Australian resident and currently living in Australia and
 - not be subject to a newly arrived resident's waiting period and
 - have reached age-pension age but not qualify for a payment from Centrelink or from the Department of Veterans' Affairs and
 - provide Centrelink with your and your partner's tax file numbers, and
 - have an annual adjusted taxable income of less than: \$50 000 (singles), \$80 000 (couples, combined), or \$100 000 (couples, combined, for couples separated by illness or respite care).

Holders of the Commonwealth Seniors Health Care Card may also get a Seniors Supplement to assist with household expenses such as rates, telephone and electricity. The Seniors Supplement is paid every three months. Your Commonwealth Seniors Health Care Card entitles you to discounts on Pharmaceutical Benefits Scheme prescription medicines.

Other services may include:

- bulk-billed doctor appointments, at the discretion of the doctor
- cheaper out-of-hospital medical expenses through the Medicare Safety Net
- concessional rail travel on Great Southern Rail services, such as The Indian Pacific, The Ghan, and The Overland
- in some instances, extra health, household, transport, education, and recreation concessions that are offered by State or Territory and local governments and private providers.

Contact the Department of Human Services on 132 300 for information. www.humanservices.gov.au/seniorshhealthcard

President's Message

By Bill Shirley



An event that happened recently in Victoria has prompted me to write this outline to remind all our members of the importance of having our investments spread across various sectors of the investment market. This approach should also include a range of investment providers to increase the spread of investment platforms we use.

For example, if we use the simple term deposit as an example, you should have at least one holding in several of the big institutions, even though today the Federal Government currently guarantees deposits.

We forget that one big bank nearly went to the wall around the 1987 timeframe, so one never knows that can happened to the entities in which we hold investments.

One component of our investment tool package should be some learning, thus gaining knowledge of the various elements that comprise an Asset Allocation structure. The concepts of a suitable risk profile should also be taken into account based on the following headings – Secure, Defensive, Conservative, Balanced, Growth, as well as High Growth, each has a different investment mix, and risk outline, and you should pick the profile that is suited to your needs.

Some of the elements you may use in your selected profile are as follows – Equities Local & Overseas, Collectables, Precious Metals, Listed & Direct Property, International Interest, Australian Interest & Bonds, Hybrids, Cash CMT and savings, Term Deposits over various periods, and there are further products that can be reviewed.

The conceptual approach outlined above can go a long way in protecting a large part of our investment funds & savings, due to the spread that has been achieved. This approach should also help to make a big difference to our future life-style during the retirement period due to maybe less risk.

In conclusion I can only say please don't put all your assets one basket, in a number of baskets is the desirable approach. This is something to consider when we are planning or reviewing our asset allocation approach and the mix of elements that are used within the structure. I believe that investors need to pay close attention to this review activity.

Some AIA Happenings

Members Update – In the near future you receive a digital copy of this publication that outlines what has been happening in the AIA recently around the country. One item that will be included will be the results of the elections held at our recent AGM held in Brisbane.

Conference 2013 – This event is now in the early planning stages and a conference committee has been formed. The planning meetings have commenced and I wish the group well in their endeavours. We will advise you of further details in the New Year in reference to format, speakers and events. I can advise that the Marriott on the Gold Coast late in July has been selected as the venue. I look forward to seeing you late July 2013 on the Gold Coast.

In closing, I hope this year's results are favourable for you when compared to last year. I offer my best wishes for your investments as we run into the end of the half-year or calendar year in December. However, in your future planning, please don't forget the benefits of Asset Allocation structures and concepts briefly outlined above.

The AIA and myself offer the best of Christmas wishes to all our members and there families and we hope the season is a happy and safe one for all. As well may 2013 be a kind one for all.

Good news for Australia as China avoids hard landing

As we head towards Christmas, we have the choice of watching the test cricket on TV, another bout of hostilities in the Middle East or the fiscal cliff negotiations in the US. It is certainly not a ratings period for “free to air TV” networks although there will soon be betting that one Australian TV network is beginning to go the way of Greece!

Frankly, the next few months are unlikely to generate much positive news and so we are likely to see a new bout of volatility. There is so little growth on offer and with great challenges remaining it is clear that the share markets of the world remain the play things of hedge funds and trading houses funded by massive amounts of quantitative easing. That is probably why it was urgent that Wall Street reopened before the subways after super-storm Sandy passed through.

Despite the volatility, we will be bored pointless by the coverage of inept politicians trying to solve what they were trying to solve two and three years ago. Clime has said many times that there is no quick fix, nor a quick recovery in Europe. There are logical solutions, such as a debt forgiveness agreement, but the lack of political will and the constant covert interference by those with most to lose (the bankers, the mega wealthy and overpaid bureaucrats) will ensure that the solutions will be delayed for as long as possible. The extension of time or credit to Greece by the European Union and IMF is truly pointless except from an Irish or Portuguese perspective for they will rightfully have a claim for similar treatment.

Despite this gloomy outlook, we believe that Europe will continue to muddle along whilst the US confronts its debt/deficit cliff. In reality the fiscal cliff will be traversed by compromise with a likely delay being caused by the intransigence of the hard right of American politics who are dominated by the mega wealthy and ex bankers.

However, at this point in time and of more significance to Australia is the recovery of the Chinese economy as 2270 delegates gathered in Beijing for the Chinese Communist Party's 18th Congress. That meeting not only selected a new generation of leaders, but also endorsed the Party's new political agenda. In what may have appeared to be some sort of celebratory economic fireworks display, the Chinese Administration were able to declare that economic growth indicators had begun to accelerate again.

The Chinese economic growth is real and clearly to Australia's benefit. Noteworthy is that the price of iron ore climbed to a three month high in stark contrast to the negative commentary by many Australian experts. Indeed it was reported that for the first 10 months of 2012, Chinese iron ore imports gained 8.9% to 607 million tons from the same period a year ago. Steel product exports by China were 4.84 million tons in October or 27% higher than a year earlier. The fact remains that China continues to grow and it continues to demand more iron ore from Australia. The iron ore price has fallen from all-time highs, but this has been caused by the threat of new supply coming to the market. A material portion of this supply may be withdrawn if prices stabilise at current reduced levels.

To reiterate Clime's view of growth, we note that the growth in usage of electricity remained above 6% over the year ended June 2012.

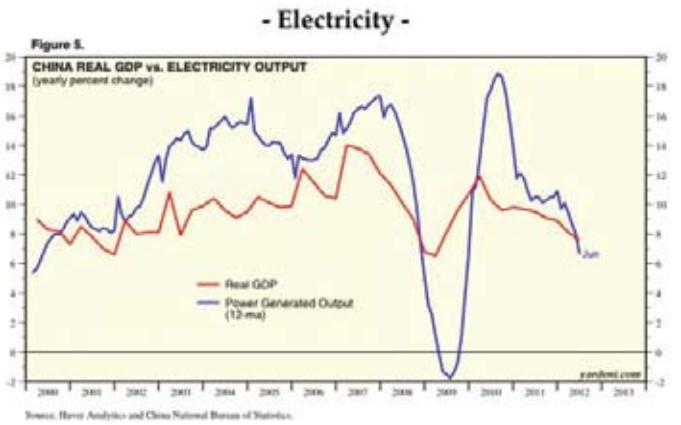


Figure 1. Electricity Source: Haver Analytics and China National Bureau of Statistics

Clime noted a couple of months back that the demise of the Australian resource sector has been greatly overstated. Whilst there is a change in the outlook for the resources sector, it is not negative on all fronts. Rather we will witness a focus on the extension or maintenance of established mines, as opposed to the development of new ones. This will negatively affect some supply and service companies, whilst maintaining a positive outlook for others.

The outlook for iron ore

The demand for iron ore is driven by the production of steel in China that supports its economic evolution. Steel production is dynamically changing from a focus upon infrastructure (necessary to support urbanisation), to one that is focused upon consumerism resulting from urbanisation. The dynamics of this change have been documented in an outlook report by the RIO economic unit. Looking at the use of steel per capita, RIO has analysed how much more intensely countries use steel as they become wealthier. Whilst some may claim that the RIO outlook is particularly bullish, it does provide some factual and historical observations which suggest that many Australian forecasters are simply naive in their questioning of the three central tenets of our resources view:

- 1. China will continue to evolve and grow for decades;
- 2. Its per capita GDP will grow at a faster rate than its overall economy;
- 3. This is a feature of industrialisation and urbanisation that leads to a growing need for steel.

RIO notes that the steel use per capita is still very low in China at about 200 kilograms per head. Historically, when countries attain wealth of \$20,000 per capita (adjusted for purchasing price parity), their consumption generally tends to settle around 600 kilograms per person. This was the case for the US and Germany, when they attained per capita wealth of \$20,000 in the 20 years after the Second World War. China's per capita wealth sits at about \$6,000 and its steel industry is in its infancy.



Figure 2. Number of years of steel production above 500kg/capita Source: Business Insider

These trends are just one part of RIO's bullish assessment of continuing strong prices for commodities. China will drive the majority of demand over the next two decades but as China's economy transforms to a more balanced one, other South Asian nations like Vietnam and Indonesia will also become major producers and manufacturers of steel. The big sleeping giant remains India, which will become the main driver of commodities growth by 2025 and whose population is not constrained by the ageing demographics of China.

Nevertheless, China currently has dozens of cities that rival the biggest cities of the US and many are still evolving and attracting inflows of people seeking a better quality of life.

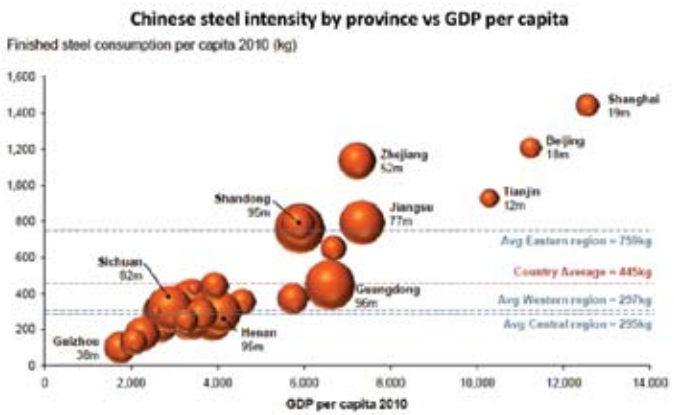


Figure 3. Chinese regional steel intensity (urban population) Source: McKinsey Global Institute, China Statistical Yearbook 2011, Rio Tinto Estimates China, which still has 650 million people living in rural areas – and rural accommodation – is expected to see 300 million of those residents shift to the cities over the next two decades. That means more residential towers, more offices and more public transport infrastructure – all of which require steel.

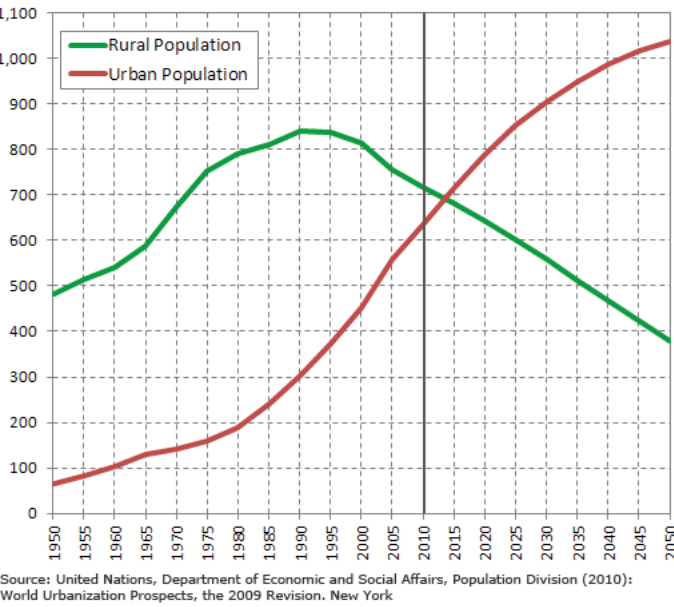


Figure 4. China urban/rural population & Chinese household steel intensity. Source: United Nations

ME AND MY PORTFOLIO By Richard Rowe

My interest in investing started around 1991 after the 1987 stock market crash and the collapse of a number of property funds about two years later. I realised that I would have what would be to me a large sum of money from superannuation to invest when I turned 60 in ten years time. Little did I know I would be investing this money sooner than I expected.

In 1994 I was made redundant from the company for which I had worked for forty years and received a lump sum payout plus my accumulated superannuation. I contacted the stock exchange for a referral to a financial advisor with experience in setting up a DIY super fund. My wife and I are both members of the fund.

We remained with this advisor for some years but eventually went solo. An accountant does the necessary tax returns etc.

In the past there have been investments both listed and unlisted in funds investing in South East Asia. These were sold shortly before the Asian collapse in late 1990's.

A decision was made some years ago to invest only in companies listed on the Australian stock market because we wanted to have more control over the investments. We did not want to keep an eye on currency movements which added more risk to overseas investments.

This decision turned out to be a good one as the US and European markets did not perform as well as the Australian market for a number of years after this decision.

Our Super fund was converted to an allocated pension in 2002. Leading up to this date the investment mix was changed to a more income orientated portfolio.

Our current investments are weighted towards the four major banks for a good dividend yield plus a number of other Blue Chip companies and three hybrids. We invest in smaller stocks via Wilson Asset Management (WAM).

About 75% of the portfolio is in shares, 20% hybrids, and 5% cash. There are no investments in listed property at present. They were sold when most of them went downhill during to the GFC. Property Trusts may be added again in the future.

Five years ago my wife and I downsized from a two hectare property to a suburban home and invested the balance in ASX listed stocks. We now have about 25% of our investments outside Super, and 75% inside Super. Our investments are conservative because of the current Global situation. It was looking as though we were past the worst of it. There had been an improvement in the US economy, Europe was looking less fragile, and China looked to have bottomed. Recent media reports seen to be indicating that Europe and the US are still far from being out of the woods.

We do not use software to manage our portfolio other than the use Spreadsheets to record income. Our on-line CommSec account gives us portfolio statements and the CommSec Research is quite good. The graphs are adequate enough for our purposes and have the indicators that I prefer to use. I like the Advanced Search Tool and use it to select some stocks to look at more closely.

A combination of fundamental and technical analysis is used when buying stocks. For our Super Fund we mainly select stocks in the ASX 200 index. We invest in stocks in the ASX300 for our investments outside Super.

The use of Technical Analysis is a more recent addition to the skills used for managing our portfolio. In the past we held on to some stocks when they should have been sold. Babcock and Brown is one that comes to mind. The stock was touted as the next Macquarie Bank but did not live up to the hype.

One of our best investments was the purchase of two amounts of ten year Northern Territory Bonds. They were purchased at an interest rate of 9.0% and 8.25%. The interest earned on the Bonds was reinvested in the Bonds at the same interest rates, even though interest rates had fallen in the mean time. It ended up a sizable amount at maturity.

Northern Territory Bonds were one of the favourite investments of Bruce Bond who gave investment advice on the radio when I started taking an interest in investing. Bruce Bond also encouraged people to educate themselves about investing. One place he recommended were the lunch time lectures at the Stock exchange. He was also instrumental in my decision to start a DIY Super Fund.

Two other people who have influenced me are Colin Nicholson who wrote “Building Wealth in the Share Market”, and Alan Hull who wrote “Blue Chip Investing”. I use the Advanced Search Tool in CommSec to run a search based on Alan Hull's book to find stocks to invest in.

I don't subscribe to any financial papers or news letters, and the only magazine I subscribe to is Smart Investor. I usually find that when there is an article in the media about a stock with an improved outlook, it has already risen in price and falls soon after the article appears. My big regret is not learning and applying technical analysis to investing decisions sooner. I am sure my wife and I would be in a better position had we done so. Even so we are in a better position than we would have been by investing through fund managers.

PORTFOLIO

By Daniel Butler (dbutler@dbalawyers.com.au), Director, DBA Lawyers
 Bryce Figot (bfigot@dbalawyers.com.au), Director, DBA Lawyers

Introduction

The Federal Government's October 2012 Mid-Year Economic and Fiscal Outlook ('MYEFO') included an important announcement that provided a great boost of confidence to the SMSF industry. Namely, with effect from 1 July 2012, a tax exemption will apply following the death of an SMSF member in receipt of a pension until that pension has been paid out of the fund. In light of this announcement, this article considers whether it is still important that pensions be made 'auto-reversionary'.

Background

In draft taxation ruling TR 2011/D3 the ATO stated:
 A superannuation pension ceases as soon as the member in receipt of the pension dies, unless a dependent beneficiary of the deceased is automatically entitled under the superannuation fund's deed, or the rules of the pension, to receive a pension on the death of the member.

This caused considerable concern. To illustrate, consider an SMSF with one member where that member has been receiving a pension for many years. Due to the pension (income tax) exemption in subdiv 295F of the Income Tax Assessment Act 1997 (Cth) ('ITAA 1997'), the SMSF probably has not paid any income tax, including capital gains tax ('CGT'), for a number of years. Now assume the member dies. The SMSF assets might be carrying a large, unrealised capital gain. The Superannuation Industry (Supervision) Regulations 1994 (Cth) require the deceased member's benefits be cashed as soon as practicable after death. Accordingly, the assets might either be transferred out of the SMSF in specie or alternatively the assets might be sold and the proceeds used to pay out the death benefit. Either way, the SMSF will have a CGT event. According to the view in TR 2011/D3, there is no longer any pension and thus there is no longer any pension exemption. Accordingly, the CGT event could result in a significant tax bill to the fund.

TR 2011/D3 acknowledged that, with the correct documentation in place, it is possible for the member's pension, upon death, to automatically continue. In this instance the pension exemption continues and no tax bill would arise to the fund. A pension structured like this is often referred to as a pension that automatically reverts, or an auto-reversionary pension ('ARP').

Change announced by the MYEFO

The MYEFO announced that:
 The Government will amend the law to allow the tax exemption for earnings on assets supporting superannuation pensions to continue following the death of a fund member in the pension phase until the deceased member's benefits have been paid out of the fund. This change will have effect from 1 July 2012. This measure is estimated to have a small but unquantifiable cost to revenue over the forward estimates period.

The superannuation law requires the benefits of a deceased member to be paid out of the fund as soon as practicable following the member's death. The continuation of the earnings tax exemption beyond the death of a member will be subject to this existing requirement.

This change will benefit the beneficiaries of deceased estates by allowing superannuation fund trustees to dispose of pension assets on a tax-free basis to fund the payment of death benefits.

As noted above, the extension of the pension exemption following death will apply from 1 July 2012. However, TR 2011/D3 applies from 1 July 2007. This means that for pensioners who died on or prior to 30 June 2012, unless they had an ARP, the ATO consider the pension exemption ceased on the person's death. We note the ATO view is reflected only in a draft ruling which is not law nor is it a binding ruling. Nevertheless it is consistent with the ATO's view reflected in ATO ID 2004/688 where the pension exemption ceased upon the member's death. Thus, if taxpayers do not follow the ATO's view they may be at risk and should seek expert advice on how to manage such risk.

How to set up an ARP

Most reversionary nominations are mere wishes and are not binding. Thus to effect an ARP a 'locked in' reversionary nomination must exist. Typically, in an SMSF this requires a special deed that facilitates a nomination that binds a trustee's discretion (ie, an effective fetter binds a trustee's discretion based on a specific power in the deed).

Our experience over many years has shown that under most SMSF deeds we have reviewed, the binding death benefit nomination ('BDBN') would prevail over a reversionary nomination. BDBNs are more specific as to death and are binding. A reversionary nomination, on the other hand, is typically discretionary and is effected at the time of commencement of a pension.

Alternatively, the ARP can also be facilitated by a BDBN that directs not only to whom the death benefit is to be paid (eg, to spouse) but also the method (eg, as a pension). Naturally, the SMSF deed should also authorise this.

Thus, an ARP typically needs to be 'locked into' the SMSF governing rules to be effective and often this is done via a specially drafted SMSF deed with a reversionary nomination and/or by a suitably drafted BDBN.

Are ARPs still required?

The next question is, once the MYEFO extended pension exemption announcement becomes law, will an ARP 'locked in' reversion still be required?

Interestingly, an ARP will, following the proposed change, not be required for the pension exemption to continue beyond a pensioner's death. However, the ATO consider that an ARP was required for pensioners who died on or before 30 June 2012 to ensure the pension exemption continues beyond death.

Therefore strictly speaking there appears to be no need for ARPs after 30 June 2012. However, considering the proportioning rule in s 307-125 of the ITAA 1997, there can be significant advantages in ensuring each pension has a 'locked in' ARP as it provides better protection against adverse tax and succession risks.

Broadly, the proportioning rule resulting in each benefit must reflect the applicable proportion of tax free and taxable components. In other words, one cannot 'cherry pick' the tax free money; a benefit paid must reflect a proportion of each (tax free and taxable) component.

In an SMSF environment, a member is generally required to have one or more separate pensions to have more than one superannuation interest. This is because a SMSF member only has one interest unless they have one or more pensions: Income Tax Assessment Regulations 1997 (Cth) regulation 307-200.05. Indeed, a lot of planning has been directed at ensuring the tax free component of each pension has been maximised in recent years and this has generally resulted in members having numerous pensions (aka superannuation interests) in the same SMSF.

In some cases, taxpayers may have certain pensions that are 100% or predominantly tax free and others that are predominantly taxable. In this situation, the death of the pensioner may, given the ATO's views in TR 2011/D3, result in a member ceasing his or her pensions unless an ARP is in place for each pension. If the pension ceases, it reverts back to accumulation mode and if there are several pensions involved, the different pension interests are merged together. This results in mixed taxable and tax free components, which cannot be separated or untangled again. Thus, ensuring ARPs exist in respect of each pension will overcome this risk. Naturally, to achieve an effective ARP requires an appropriate SMSF deed, pension documents or BDBN. These documents are generally available from SMSF lawyers.

Conclusion

The announcement in MYEFO is great news for the SMSF industry and the government should be commended for its foresight and practical approach. However, there are still reasons to ensure a pension is an ARP to protect against adverse tax consequences. Quality SMSF documentation here is a key factor in achieving an effective strategy.

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 or call Marie on 03 9092 9400.

GENERATION USELESS

By Marcus Padley

Marcus Padley article from *The Age*, *Sydney Morning Herald* and *WA News* - 6th October 2012

Since the debt boom started in 1974 we moved from "I want I save" to "I want I get" and if there was \$1000 of equity left in our house our kids had an iPad.

No being bent over in shin high water cutting cress for eight weeks in the summer holidays earning 5 pounds an hour for them. No cleaning toilets for Racial Decca in Reading and being told not to talk to any of the 'real' employees. No turning up at the Manpower offices at 6am with your brother pretending to be 18 when you're sixteen and half in the hope of snagging a job labouring on a building site with real men. No spending eight hours a day for four weeks of the holidays demolishing breezeblock warehouses breathing in breezeblock dust on a hand held jack hammer with no training and no health and safety at work Act.

No riding a 1974 Honda C50 step through moped for your first two years at university (which makes having sex just that little bit harder). No buying your first car yourself at 19, a fifth hand 2CV6 for 450 pounds and having to use the handbrake to manually slow down because it had threaded the bleed screw on the drum brake and you couldn't afford the parts.



No making your own home brew because beer was ridiculously expensive at 28p a pint. No budgeting on 11 pounds a week which meant you could only have beans with your pie and chips in the refectory 3 days a week. No camping in your car on holiday because you couldn't afford accommodation. No buying the Haynes workshop manual and lifting the engine out of your 1976 Volkswagen Golf with your Dad so you could weld the rusty chassis only to have it catch fire and destroy itself uninsured the next time out because you hadn't replaced a frayed petrol line. No catching the Magic Bus to Greece and back for your holidays because flying was for rich people. No, none of that for our kids. And we considered ourselves well off. We were lucky.

The legacy of all this is that there are people who didn't grow up in the debt boom and there are people who did and although there are obviously many people who grew up in the debt boom without sponging off the equity in their parent's house, without having their parents pay their mobile bill, without taking the cost of the internet for granted, without moving out, without paying rent, without paying for their first cars, without complaining their free car was beneath them, without having to earn their own money, without getting everything they wanted without effort, without being arrogant towards their employer, without disrespecting older people, without being arrogant, there are clearly many that did and were.

That's fine but those recent generations have created a bit of an issue when my kids go looking for a job, because courtesy of the spongers that have recently gone before them when my kids present themselves for employment to someone who cut cress for eight hours a day for eight weeks in their summer holiday instead of lying on a beach burning holes in their parents internet and mobile account, that person sees my kids as having F'wit tattooed across their forehead and as card carrying members of Generation 'Useless'.

With that sort of branding clearly my kids are going to have to work just that little bit harder to get a job and whilst I am inspired by my children's fast developing adult qualities (at times) their future cress cutting employer won't be so generous. No-one who cut cress for a living is going to give Gen 'U' the benefit of the doubt and I can't do much to change that.

But what I can do is explain to them that the debt boom is over, that we're going back to 'I want I save', that the best investment you can make is being grateful for a job, being willing to learn and replacing your financial and material impatience with realistic long term investment in your

business, the businesses of your employers and your career. You see, it's all changing again, we're going full circle and anyone who thinks iPads will continue to pop out of their parents arse indefinitely have a rude wake up call just around the corner.

This is my first car (right) and my brother's (left). They were glorious days as it happens...if only we'd known at the time.



BOOK REVIEW

Title: Find the right property, buy at the right price.
 Author: Opie, Melissa
 ISBN-13: 9781118188026
 Publisher: Wrihbooks
 Publication Date: 23/02/12
 Reviewer: Theresa Loo

Melissa Opie is known as the "Property Lady" (www.thepropertylady.com.au) and runs a Melbourne-based buyer's advocacy business. Her latest book 'Find the right property buy at the right price is targeted at seasoned as well as the new home buyer. This book targets long-term property investors, not traders.

The book is dotted with case studies and Melissa's analysis of what went wrong. More importantly, it provides readers with the opportunity to learn from the mistake of others.

Melissa favours the capital growth strategy compared to investing in cashflow positive properties as she reasons in the long term, capital growth properties increase more in value (using the example of a property with 10% capital growth p.a. vs. 5% rental growth p.a).

I find merit in both strategies and would not exclude the other as each strategy can work successfully based on the individual circumstances of the reader (e.g. investment strategy, how long the investor intends to hold the property, etc.) but I brought this up to highlight the author's philosophy.

Melissa often provides useful tips throughout the book. Notably:
 • Know your target area for at least 3 months before buying.
 • Stick to properties around the median price in the area, or slightly higher
 • So what should you do if you find yourself lumped with an underperforming property? Sell it...This may be easier said than done?

The author's gutsy and practical tips from her own stellar 25 years experience would appeal to many property investors wanting practical guidance. She addresses many of the variables associated with property buying from deciding between locations (city vs. regional), house vs. unit, old vs. new and the pros and cons of buying off the plan.

Melissa has also put together a comprehensive checklist for desirable traits to look out for when buying houses and units. The 2nd part of the book focuses on buying a property at the right price. The chapter on determining market price discusses how to build your own property data and the art of valuing the property. Chapter 9 introduces property-selling methods and discusses the rules and processes associated with auctions, including some helpful auction strategies. The chapter on negotiation skills are filled with wisdom and advice that we could all benefit from.

I like the way the book is generous with tips from lessons learnt and will find it a useful reference when the next purchasing opportunity arises.

The Three Levels of Sanity in Handling Your SMSF Estate

The Simple Case for an SMSF Will

From the desk of Shane Ellis, SMSF Law Equityprotect

It is a common belief that when you die, your superannuation entitlements will automatically be dealt with by your Will. This is simply not correct.

When you die the distribution of your superannuation entitlements is not governed by your will. (See McFadden –v- Public Trustee for Victoria [1981] 1 NSWLR 15,22) It is governed by the trustee of your superannuation fund. Your SMSF trustee decides how the distributions are to be made, subject to the terms of the superannuation trust deed and relevant legislation. Your Will only becomes relevant if the distributions are paid to your legal estate by your SMSF trustee.

Let us see what in effect can happen to your superannuation entitlements when you die. This can give you a simple understanding of why you need a SMSF Will.



Some superannuation funds allow you to make a direction, called a Non-Binding Death Benefit Nomination. The difficulty is as the name says. It is not binding on your trustee & the trustee may very well decide to ignore it. Let's have a look at how this impacted on a family in **Katz's Case**.

Katz v Grossman [2005] NSWSC 934 highlighted the shortcomings of Non-Binding Death Benefit Nominations & also the importance of choosing the trustees of a SMSF carefully.

Mr. & Mrs. Katz were members and trustees of their SMSF. They had two children, Linda and Daniel. After Mrs. Katz died, Mr. Katz appointed Linda as co-trustee of the fund. Prior to his death, Mr. Katz made a Non-Binding Death Benefit Nomination in his Will stating that his two children, Linda and Daniel, were to receive his entitlements in the SMSF in equal shares on his death. Later, when Mr. Katz died, Linda appointed her husband as co-trustee of the fund which she was legally entitled to do. Linda and her husband (as trustees of the fund) could legally decide who received Mr. Katz's superannuation entitlements. Linda and her husband resolved to pay all of Mr. Katz's superannuation (approximately \$1 million!) to Linda to the exclusion of her brother Daniel. Daniel took the matter to the Supreme Court. Unfortunately for him, the Court could not change what had occurred as it was in accordance with the law, and Daniel received no part of his father's superannuation death benefits. Quite simply if you choose to rely on Non-Binding Death Benefit Nominations it may be said that you are very insane.

Let's go up a level of sanity with your handling of your SMSF Estate.

Some superannuation funds allow you to make a legally enforceable direction, called a Binding Death Benefit Nomination. (BDBN) This is a written notice to the trustee of your super fund which sets out who will receive your superannuation entitlements upon your death, and what you want them to receive. The BDBN must comply with the rules of your super fund, as well as the law. It is arguable that it needs to be updated every three years in order to be valid and binding. It would certainly be more prudent to follow this approach.

The dangers of failing to provide a complying BDBN can be seen in the February 2009, Queensland Supreme Court case of Donovan v Donovan [2009] QSC 26.

In this case, Mr. Donovan established a superannuation fund with a corporate trustee. Mr. Donovan was a member of the SMSF. Mr. and Mrs. Donovan (his wife by a second marriage) were also the respective Director and Secretary of the corporate trustee.

The revised trust deed of Mr. Donovan's super fund required a corporate trustee to be bound by a BDBN, where it satisfied the "Statutory Requirements". Mr. Donovan signed a letter addressed to the corporate trustee, advising that, upon his death, he wished to have his superannuation entitlements distributed to his legal personal representative for inclusion in his estate assets.

On Mr. Donovan's death, his daughter by his first marriage, Lynda (who was the beneficiary under his will), brought an application to seek the court's determination that Mr. Donovan's nomination was binding on the corporate trustee, which Mrs. Donovan now controlled.

The Court found that the intent of the particular trust deed was to require Mr. Donovan's letter to be in the form described in regulation 6.17A (6) of the Superannuation Industry (Supervision) Regulations 1994 (Cmth.) to be binding on the SMSF trustees. The court held that the letter was not in the form prescribed by the act. As such Mr. Donovan's letter was not a BDBN, and the corporate trustee was accordingly not obliged to distribute Mr. Donovan's superannuation entitlements to his legal personal representative for inclusion in his legal estate. Quite simply if you choose to rely on a Binding Death Benefit Nomination it may be said that you are quite insane.

Let's go up a level of sanity with your handling of your SMSF Estate.

In accordance with the provisions of the superannuation laws, specifically section 55(1) of the Superannuation Industry (Supervision) Act 1993 (Cmth) [SIS Act], neither the trustee of a superannuation fund nor any other person, can breach any of the governing rules of the fund. Such a breach may jeopardise the fund's complying status and thus its concessional tax status. Additionally it may render the trustee liable to significant monetary penalties or being replaced by a trustee appointed by the Commissioner of Taxation.

The governing rules are defined under section 10(1) of the SIS Act to include the fund's trust deed and any other rules made by the trustee of the fund including a SMSF Will made on behalf of a member. Therefore, before a SMSF estate plan can be created, a thorough review of the trust deed must be undertaken to determine if the provisions of the Deed allow a SMSF Will to be established.

The following strategy guide on SMSF estate planning and SMSF Wills is an extract directly from the SMSF Strategies trust deed and governing rules:-

“Let's go up a LEVEL of SANITY with the handling of your SMSF ESTATE”

Shane Ellis

“SMSF Strategy Guide” – Rule 11

The opportunity of legal challenge is dramatically reduced when Death Benefits are not paid or payable to the Estate of a deceased Member by the Trustee of a Complying SMSF but directly to a beneficiary as specified by the deceased Member. The payment of superannuation Death Benefits are not subject to the provisions of the Member's Will. Accordingly, a SMSF Will can be of major strategic value to the Members of a Complying SMSF. The taxation benefits of Death Benefits paid to Dependants and the deceased Member's Legal Estate are outlined in the Product Disclosure Statement to the Simpler Super Rules.

A Member SMSF Will is an important blueprint or plan on how a Member seeks to provide Death Benefits to their Dependants or Legal Estate in the event of their death. Under the Superannuation Laws there are several possibilities:

• *The provision of a Superannuation Lump Sum – by way of cash or Assets to Dependants and/or the deceased Member's Legal Estate.*

• *The payment of a Superannuation Income Stream to Dependants (as defined for taxation purposes) of a deceased Member.*

• *The payment of a Reversionary Superannuation Income Stream to a Dependant. This is the continuation of an existing Superannuation Income Stream that was payable to a deceased Member of the Fund.*

Smart SMSF estate planners make use of a SMSF Will to steer where they wish for their SMSF estate to go upon their death. The absolute brilliance in the procedure is to ensure that the content is contained in the SMSF Will **Death Benefit Binding Directions**, namely rules of the SMSF.

A death benefit binding direction allows the member to direct the trustee as to how their death benefits are to be distributed and in what form. Additionally, it can direct the trustee as to who the deceased member's replacement trustee is to be. This is achieved by writing or embedding into the Fund's governing rules the member's death benefit binding direction so that it has the force of the trust deed and the SIS Act.

The death benefit binding direction inside a SMSF Will provides a member with the most secure option in terms of their SMSF estate planning. One may say it is the sanest way for you to proceed with your SMSF estate planning! Couple this with auto-reversionary pension documents and your SMSF death benefits are soundly protected for those that you intend to receive them.

It is advisable that for the person creating, and for the Trustee accepting, a SMSF Will to both seek expert advice from SMSF Law Equityprotect prior to finalising any SMSF Will or auto-reversionary pension documents.

“Prevention IS better than cure in the real world,
AND PREVENTION IS OFTEN VERY
MUCH CHEAPER IN THE LEGAL WORLD”.

Further thoughts on investing for income

By Graham Saunders

As a 70+ year old income investor the recent article by Jon Kalkman in the Investors Voice was enlightening in clearly explaining the thinking behind having one's savings supply the income required over a retiree's lifetime. Moreover it elucidated that judicious selection of stocks can protect this income from the ravages of inflation. Investing in this manner highlights another of those advantages of being of a more mature age. This advantage is that no longer is there a need to climb “the wall of worry” associated with growth investing where that painful decision needs to be made as to when to sell those shares that have risen so well in price. Shares now will be retained for lengthy periods, basically while ever the dividends keep rolling in. However, this is not a “set and forget” scenario. A watchful eye still needs to be maintained on the performance of each share. The dividend should be increasing each year as well as the earnings per share.

For many investors the prices of the shares in the portfolio will need to be routinely monitored. I suggest not many would be happy seeing their overall capital reducing even if the income stream is performing to expectations. Many will intend to pass on their shares to their heirs. For these reasons it is desirable not only that the shares retain their value but that these increase with inflation. Hopefully we will all live for a considerable time from the date of this article and inflation will take its toll. Thus the timing of the purchase of a company share is as critical as its evaluation for inclusion in the income portfolio. Alan Hull points out in his follow up article in a later edition of the Investors Voice “you must purchase your assets at the lowest price possible, in a market dip”. Whilst there is no need to be concerned with selling because the price of the commodity has risen, there may be a need to sell if the price drops below an acceptable level.

One of the well known maxims of share market investing is “don't lose money”. Here the commonly held 10% rule applies. If the share represents 10% of the total investment then it should be sold if its price drops 10% below its original purchase price. This will ensure that only 1% of capital is lost due to incorrect timing of the purchase. This does not mean that the company was unsatisfactory for the portfolio, merely that the timing was wrong. The 10% drop, of course, should be evaluated in conjunction with the movement of the ASX 200 Index. If the Index has dropped 10% since the share was purchased then the share price has, virtually, remained the same as when purchased. A simple way to monitor this is to record the value of the ASX 200 on the date of purchase and compare this with its value on the date at which it appears that the share price has dropped by 10%. The overall aim is to time the purchase such that the share rises in price soon after purchase thus giving insurance against the 10% rule.

With regard to which shares should be purchased for an income portfolio it is useful if a “watch list” of potential purchases is maintained. This list can then be consulted and further evaluated whenever new funds come to hand or after a share has been sold. Some of the characteristics for inclusion on this watch list may be:-

- 1. 3 to 5 years of high and increasing fully franked dividends.
- 2. 3 to 5 years of increasing earnings per share.
- 3. Low debt to equity, say, less than 40%.
- 4. High return on equity of around 20%.
- 5. Reasonable liquidity.
- 6. A capital return equal to or better than the ASX 200.

One of the great breakthroughs for the retail investor was the arrival of discount brokers in the early part of this century. While the reduction in brokerage charges was welcome, the real advantage has been the wealth of information that became available over time on their websites. Retail investors finally had the tools to truly make their own decisions on share selection. All the information suggested above for inclusion of companies on a “watch list” is readily available from these websites.

It is surprising how few companies on the ASX warrant serious consideration when these parameters are considered.

If a company share is to be purchased from this watch list other aspects need to be considered. Such things as the trend of the overall market as well as the current performance of the sector in which the company belongs, the current P/E of the company compared with its traditional P/E, any catalyst involved with the current share price and the trend of its share price. International events with their potential to affect our market also need to be taken into account.

With the present inflation rate of around 2% it should not be too difficult a task to develop a portfolio that will give a suitable capital increase as well as that desired income. But it does take significant time to develop and maintain a truly high performance “watch list”. It is not a “set and forget” investment.



How do you protect your portfolio against higher inflation?

By Elizabeth Moran

FIIG Fixed Income Specialists

Late October, the Australian Bureau of Statistics released the quarterly Consumer Price Index (CPI) figures. Market participants were surprised by the higher than expected quarterly inflation increase of 1.4%, in part attributed to the carbon tax. The biggest quarterly increases were to Housing 3.2%, Health 2.4% and Food and non-alcoholic beverages of 1.9%. However, the biggest annual increases were to Health, which increased by 7.2%, Education of 6.1% and Housing of 4.7%.

What is the Consumer Price Index?

The CPI measures quarterly changes in the price of a 'basket' of goods and services which account for a high proportion of expenditure by the CPI population group; that is metropolitan households. This 'basket' covers a wide range of goods and services, arranged in the following eleven groups:

- Food
- Alcohol and tobacco
- Clothing and footwear
- Housing
- Furnishings, household equipment and services
- Health
- Transport
- Communication
- Recreation and culture
- Education
- Insurance and financial services

Historic inflation

Underlying inflation has been contained within the annual Reserve Bank target band of between 2% to 3% in recent years. However in the past there have been inflation spikes. Beginning in 1974 through to 1977, annual inflation was over 10% and reached a peak in the March 1974 quarter of 17.6%. In the period from 1980 to 1984, inflation again hovered near or over 10% (see Figure 1). One of the major threats to purchasing power is inflation, and while the RBA may control underlying inflation, headline inflation can still be quite elevated, which damages purchasing power. The need to hedge, or insure, against inflation is particularly important for those investors at or near retirement, that are dependent on their savings to live. Importantly, the only direct hedge, or insurance against, and thus protection against inflation are inflation linked bonds.

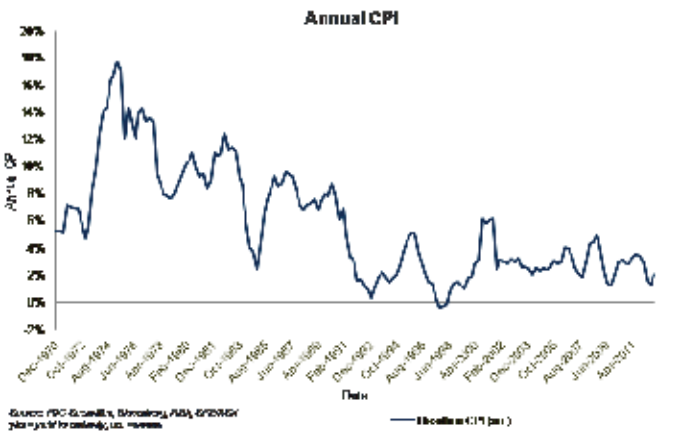


Table 1

Issuer	Sector	Maturity date	Coupon	Capital structure	YTM*	Running yield**	Capital price	Adjusted capital value***	Capital value
Ale Finance	Other Financials	20/11/2023	3.40%	Senior Debt	5.55%	3.29%	\$124.72	\$120,800.00	\$124,723.57
Envestra Ltd	Infrastructure	20/08/2025	3.04%	Senior Debt	6.60%	3.40%	\$108.98	\$121,770.00	\$108,975.93
NSW Treasury Corp	Semi-Government	20/11/2035	2.50%	Senior Debt	4.30%	2.21%	\$130.09	\$115,020.00	\$130,091.11
Sydney Airport	Infrastructure	20/11/2020	3.76%	Senior Debt	6.50%	3.82%	\$123.33	\$125,400.00	\$123,326.95
Sydney Airport	Infrastructure	20/11/2030	3.12%	Senior Debt	7.00%	3.76%	\$97.65	\$117,630.00	\$97,652.40

Two types of inflation linked bonds (ILBs)

1. Capital index bond

The most common ILB is the capital indexed bond (CIB) where variations in inflation during the life of the bond are added and subtracted to the capital price of the bond, which results in what is known as ‘the adjusted capital price’.

Based on very simple assumptions, see the following example.

If a CIB had three years until it matured and inflation was 3% per year for the three year period, the capital price would rise from \$100 to \$103 in year one, where the increase in inflation is recorded on a quarterly basis, so as to coincide with the CPI release date. Then, in year two the adjusted capital price would be \$103 + \$3.09 = \$106.09 and in year three \$106.09 + \$3.18 = \$109.27. The liability of the issuer to the investor would therefore go up, to \$109.27, so that on the maturity of the bond the issuer must pay \$109.27, not \$100. Interest payments (coupons) would be based on the new adjusted capital price, so if the coupon was 4% at the start of the three year period, the effective coupon would be 4.37% at the end as the coupon of 4% is paid on the growing capital value, assuming 3% inflation for each year. Hence, the investor receives income in two ways as illustrated in the following example:

1. If inflation rises, so does the adjusted capital price. If inflation was 3% in year one, the index factor increases the value of the bond by 3%, meaning the issuer owes you more, in the form of an increased adjusted capital price, upon maturity.
2. The coupon also rises, as the coupon is based on the adjusted capital price. Generally, coupon return varies depending on the credit quality of the issuer. Australian government ILBs will have low coupon margins whereas higher risk corporate issuers will offer higher coupon margins. There are ILBs available to satisfy a range of risk/reward appetites.

Total return, at the end of the first year, in the above example would be the sum of the increase in adjusted capital price of around 3%, assuming 3% inflation, plus the coupon margin of say 4%, multiplied by the adjusted capital price, of 1.03, to give 4.12%; providing a total return of around 7.12%.

Table 1 below shows some of the CIBs currently available. They are all senior debt, which means they sit high in the capital structure and are considered low risk. Notice how the maturity dates are all long with the NSW Treasury Corp out to 2035. The long maturity date may concern some investors but these bonds can be traded and there is no requirement to hold them to maturity. Yield to maturity (which is the expected return based on an inflation assumption of 2.5%) is high given the current market's low yields and we believe offers a very good return.

The face value of the bond is the value of the investment you are purchasing, or the adjusted capital price, which increases as inflation increases, or is the \$109.27 amount determined in the above example. For example, using an initial face value of \$100,000, the Envestra ILB adjusted capital price (or “face value” in the below table) is \$121,700, yet to purchase that value an investor needs to spend \$108,975, meaning this bond is trading at a discount. If you purchased the bond today and the company was due to repay the face value tomorrow, you would make a capital gain of \$121,700 - \$108,975 = \$12,725. The opposite is also true. For example, the NSW TCorp bond, which has been highly sought after given a “flight to quality” is trading at a premium. For an initial face value of \$100,000, the adjusted capital price (or “face value” in the below table) of the bond is \$115,020, and you would need to outlay \$130,091, meaning a potential loss of \$15,071 if the bond matured tomorrow.

If growth stays low for longer, ILBs would still earn the fixed interest (coupon) of over 3% for the corporate bonds and 2.5% for the NSW Treasury Corp bond, thus are attractive in low growth scenarios.

Table 1 (Bottom of page 9)

YTM* = Yield to maturity, which incorporates estimated interest (coupon) payments and capital gain/ loss at maturity

YTM* = Assumes inflation is 2.5% (the mid-point of the RBA 2 – 3% target band)

** Running yield = Return an investor can expect when the bond is purchased and held for a year

*** Adjusted capital value (Face value) = Value of the bond you are purchasing, which includes capital increases from inflation

Note: Most of these bonds can be bought in face value parcels of \$50,000

Source: FIIG Securities

1. Inflation indexed annuity bond

Inflation indexed annuities (IIAs) return both principal and interest at each preset payment date over the life of the bond, until the maturity date (instead of one lump sum at maturity like the CIB). This is an annuity, but the annuity is ‘indexed’ to inflation.

Just like paying a mortgage loan back to a bank, the issuer of the bond pays principal and interest to the investor. In the absence of any indexation (inflation), each payment would be equal, consisting of part principal and part interest. This amount is also referred to as the base payment or ‘base annuity’. The base payments are indexed (to inflation) over the life of the asset. Assuming that inflation is positive, there is a steady increase in the payments over the term to maturity.

IIAs offer investors a cash stream that will increase with inflation, and pays out principal over the life of the security, so are perfect for investors in retirement, or for those looking at new opportunities. One interesting aspect of the IIA is that it decreases the exposure of the investor to the issuer, over time, as the issuer pays out principal over the term of the bond.

Issuers of IIAs in Australia include: Praeco and JEM (Southbank Tafe) which both can be bought in smaller parcels.

For more information please call 1800 01 01 81 or see the website www.fiig.com.au.

All prices and yields are a guide only and subject to market availability. FIIG does not make a market in these securities.



Is your rental property prepared for storm season?

Author: Landlord Guru – Corina Bailey

With storm season upon us, running from September through March, we all need to be diligent about ensuring our homes (and our tenants) are prepared for what Mother Nature may have install for us. To best protect your property & your tenants – be sure to trim tree branches well clear of your house or power lines, check your roof is in good condition, clear all gutters and drainpipes, remove any loose objects from around the yard.

Have yourself and suggest to your tenants they have an emergency kit on stand-by with items such as a torch, mobile phone and charger, first aid kit, battery operated radio and spare batteries.

It's also a good idea to have a proper understanding (and give your tenant the heads-up) of your rental property's flood risk, contact your local Council and ask for information or a report that shows sources of flooding, including river, creek and defined overland flow paths, predicted flood levels, minimum habitable floor levels and whether you property is located within a waterway corridor.

Oh and be sure your insurance is up to date. Severe weather conditions can strike at any time, get prepared now and enjoy summer!

Australian bank stress test results are credit positive

By William Arnold

On Thursday 22nd November, the Australian Prudential Regulation Authority (APRA) released the results of its latest stress tests of Australian banks. The results were very good with none of the banks breaching the minimum Basel II capital requirements or requiring extraordinary liquidity support by the RBA – even under very severe conditions.

Background

APRA has a long history of conducting stress tests on the financial system and ADIs. Results are used to manage risk and as a base to set minimum financial requirements. It has been augured that such tests and APRA's conservative application of rules have been a driving factor in the resilience of the Australian financial system.

The scenario

During this last round of testing, APRA adopted a stricter set of macroeconomic assumptions than it did in its most recent stress test in 2010. It also included for the first time an assessment of the liquidity consequences of a freeze in the global funding markets in addition to a capital adequacy test.

- The test modeled the impact of the following on the top five banks (the ‘Big 4’ and Macquarie):
- A 5% fall in GDP
 - A more than doubling of unemployment to 12%
 - A fall in house prices of 35% and commercial property of 40%
 - A freeze in funding markets

When comparing APRA's tests to those conducted in other jurisdictions, they are very favorable. APRA's tests were broader and more severe than other nations. For example, the stress test assumption of a 5% GDP drop implies a four standard-deviation shock, compared with Europe and the US, where the regulators' macroeconomic stresses were within one to three standard deviations.

Results

- None of the five banks tested would have failed and none would have breached the current Basel II minimum Tier 1 capital requirements
- APRA estimated a 3.8 percentage point decline in the banks’ Tier 1 capital ratios which is well within their current capital cushions
- Importantly, APRA found that the housing sector, often seen as a significant source of risk for the Australian banking system, is not the main driver of aggregate losses. Although residential mortgages account for more than half of the banks’ assets, they only account for about 20% of the overall losses in the stress test
- APRA also stressed liquidity with a six month freeze in funding markets and found banks can still meet their maturing obligations without relying on central bank liquidity support beyond current repo arrangements - largely through growth in deposits and collateral inflows as a result of a drop in the Australian dollar

Conclusion

The results are obviously very good and demonstrate the strength in the Australian financial system. However the very strict scenario analysis is an indicator of the growing concerns about the possibility of future asset quality issues. The liquidity test also assumes the Australian dollar will fall in a similar fashion to previous shocks – this may not be the case and it is unclear what impact this may have.



Christmas Pudding Recipe



Christmas pudding
Serves 8
Cooking Time Prep time 40 mins,
cook 6 hrs

250 gm each raisins, sultanas and currants
100 gm candied orange, finely chopped
200 ml rum or brandy
250 gm butter, plus extra for greasing
275 gm (1¼ cups) firmly packed brown sugar
1 orange and 1 lemon, finely grated rind only
4 eggs, lightly whisked
150 gm (1 cup) plain flour
½ tsp each salt, mixed spice, nutmeg, ginger,
cinnamon and bicarbonate of soda
60 gm (½ cup) almond meal
140 gm (2 cups) fresh breadcrumbs

1 Combine dried fruit and candied orange in a bowl, scatter with rum or brandy, cover and stand overnight.

2 Using an electric mixer, beat together butter, sugar and rinds until pale and fluffy, then slowly beat in egg. Sieve together flour, salt, spices and bi-carb soda. Add to mixture in batches, alternating with soaked fruit mixture and almond meal. Stir through breadcrumbs.

3 Brush a 1.8 litre-capacity pudding bowl with butter, line the base with a circle of baking paper and dust with flour. Pour pudding mixture into bowl and top with another circle of baking paper. Cover with two layers of foil and tie with string.

4 Place pudding into a large saucepan with a wire rack or tea towel lining the base. Fill with enough water to come halfway up the side of the bowl. Cover and simmer for 6 hours, topping up water when necessary. Pudding may be made ahead and cooled in bowl. Reheat in a large saucepan of simmering water for 2½ hours. Serve with custard and ice-cream or cream or brandy butter.

This recipe is based on Margaret Fulton's rich Christmas pudding in the Margaret Fulton Cookbook. You will need to begin this recipe a day ahead. The pudding

Much tradition and folklore is attached to the Christmas pudding. Traditionally each member of the family takes a turn stirring the mixture in a clockwise direction, making a secret wish as they go. Many people also bake lucky treats into their puddings. Often they're silver coins, but in some antique shops you may come across special silver charms that were reserved for this purpose, their different shapes indicating the fortune of the finder. The pudding was usually made up to a year ahead and left to mature, and then heated up on Christmas Day and brought to the table flaming with warm brandy and decorated with holly.



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