

# the INVESTORSvoice

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

December 2013

## Hitchhikers guide to investing PORTFOLIOS



## SMSF Active Investing Women & MONEY



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# A Hitchhiker's GUIDE TO INVESTING

Nick Radge

There are many ways to invest in the stock market and one method becoming more widely accepted is momentum investing. There are numerous ways to measure momentum, such as Price-to-Book Ratio, Price-to-Cash flow, Earnings Growth and many others. Ultimately, however, we are judged by the difference between our purchase price and our sale price, or the current mark-to-market price if a position remains open. Therefore, the heart of a pure momentum strategy is solely price action. Indeed, the heart of any strategy, regardless of how much you want to dress it up, is price movement.

Catching price momentum is like a hitchhiker catching a ride. A hitchhiker solicits a ride by standing at the edge of the road; thumb out while facing the oncoming traffic. When looking to capture a ride, hitchhikers don't know which car will stop or how far a ride will take them should a driver offer a lift. A hitchhiker simply goes with the flow but will only join a ride that is heading in the right direction.

Likewise, a momentum investor will tend to stand aligned with oncoming price action ready to buy as prices are rising and ready to exit when prices start falling. A momentum investor does not attempt to predict which stock will offer the next ride or how far the ride will take them. A momentum investor, like a hitchhiker, simply goes with the flow of the market: fully invested as the market rises in a sustained up-trend and reverting to cash in a sustained bear trend.

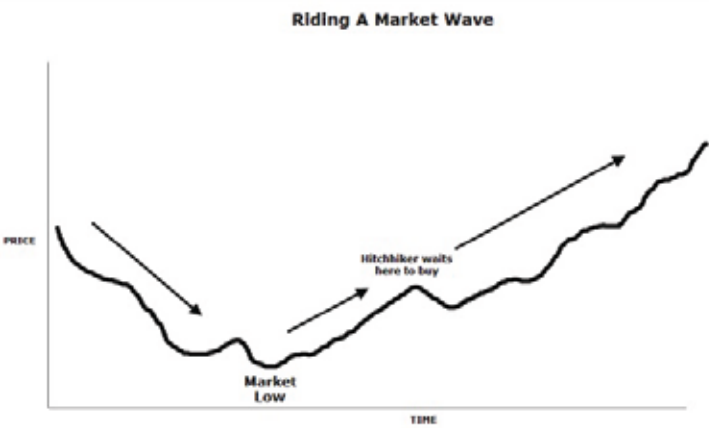


Figure 1: A hitchhiker catches a market wave only after a low is made.

A common misconception is that a momentum investing strategy 'buys high, sells low'. Sceptics suggest that momentum investors are more likely to buy when everyone else is buying and to sell when everyone else is selling, rather than follow the traditional laws that govern value investing whereby one 'buys fear and sells greed'. This is inaccurate. How, precisely, is a high defined and what exactly a low? Regardless of the type of investor you are, the reality is you can never predict the absolute high or low. An investor can try to guess (or attempt to predict) when a high or low is achieved but a momentum investor will wait for confirmation.

The following chart of Iluka Resources shows the stock in a clear range spanning several years. Is the price considered high or low?



Figure 2: Iluka Resources appears to be trading toward the top end of a range that had been in place for several years.

Over the following 12-month period the stock travelled from \$5.00 to \$19.00 in an extremely clear trend. When price moved through \$5.00 it never looked back – it just kept going. Awaiting a dip to buy in weakness would have been a very costly mistake.



Figure 3: Iluka Resources in August 2011 - is the price high or low?

Traditional logic says we need to buy into weakness usually with the intent of purchasing a quality asset at a cheap price and well below its valuation. Doing so however creates unknowns, specifically:

- Will the stock continue to travel lower?
- If so, how far lower will it go?
- How long before weakness reverses and prices start to rise?

These unknowns are associated with definitive risks, yet they remain the acceptable call to action by the herd. One need not look too far back to see damaging examples of stocks that kept travelling lower and lower.

On the other hand a momentum investor removes these unknowns by waiting for strength to return before entering. The following diagram shows how both types of investor have essentially bought in the same general region yet the momentum investor is less susceptible to the three traits above.

## A Hitchhiker's Guide to Investing continued...



Figure 4: A value investor buys into weakness. A momentum investor awaits strength before buying.

Not every stock will trend all of the time, but there are generally enough stocks trending some of the time to present opportunities. In certain market conditions these rides, or trends, can be very long and extremely rewarding. In other market conditions they may be short and less rewarding.

A momentum investor will take the good with the bad knowing that, over time, the good outweighs the bad by a significant margin due to the creation of a positive mathematical expectancy. Whilst momentum investing works reasonably well most of the time, like any strategy, investment or asset class, it will have periods where performance is lacklustre. It is important to stress that during these times the strategy is not broken and need not be discarded. This is a beginner's trap and is a topic of discussion unto itself.

The most traditional investment strategies rely on picking the right stocks, or at least the right sector in which the stocks sit. A momentum investor, on the other hand, does not pick the stock, but rather the stock picks the momentum investor. The stock must start trending higher before it becomes a buying candidate, as is shown in Figure 4. An extrapolation of this is that a momentum investor need not predict the next hot sector, because stocks in a sector that is moving will automatically rise to the top and be presented as a new trend opportunity.

A momentum investor does not mind which stocks are held, what they do as businesses, the fundamentals, the financial metrics or what the stock's future outlook is. These are simply by-products of the underlying strategy itself. An investor using a momentum strategy creates what is known as an edge, or a positive mathematical expectancy, and it's this edge that generates profits. Rather than focus on selecting the next great stock or sector, a momentum investor's sole focus is replicating their edge over the longer term.

Nick Radge is Head of Trading and Research at The Chartist with 26 years experience in the financial markets throughout the world. He has authored numerous books on trading and investing with *Unholy Grails* (2012) considered a required read on Momentum Investing. The Chartist offers bespoke advice on technical analysis and momentum strategies.

## President's Message By Bill Shirley



The end of the year is coming at a great rate. Each week seems busier than its predecessor and I believe this rush will continue to the end of the year.

I would like to thank all our volunteers for their kind efforts and time. They help us complete the many meetings and publications during the year – Thank You.

We must also not forget our office staff, managing and completing these activities, on your behalf. We, the Board, can only say a big thank you.

Now to an investment matter that may be of interest to you. This approach may be suitable for you depending on your investment profile, and SMSF pension status. The approach is to use Australian listed Hybrid's to achieve two objectives within your portfolio, these being to increase income, and reduce some of the possible risk in the event of a downturn in the equities part of your portfolio.

### How is this concept achieved?

Increase of Income – Hybrids can be used to increase your interest income by around 30% over a current traditional bank term deposit. (Assumes you are in full pension mode, as well as receiving 100% refund of the available franking credits from the Hybrid products.)

The downside is there is a degree of risk as this investment product is not government guaranteed, as term deposits are if they are below \$250,000 per bank.

(Maybe, the big bank Hybrid's could reduce this possible risk by a small amount, but you need to assess the level of risk you wish to structure within your fund.)

### Reduction of Possible Equities Risk.

The approach is a relatively simple task of using asset allocation techniques to adjust your equities holdings depending upon the perceived risk identified.

This activity is achieved by initially reducing your Ordinary holdings, and replacing them with Hybrids. (In the past this approach may have been achieved by using Term Deposits, these can still be used in the mix, but are now blended with the Hybrid's) At a suitable point in the future when the risk aspect has lessened, you may wish to enhance your equities holdings, it's a simple activity to sell via the ASX some, or all of your Hybrid holdings. The available funds could now be used to acquire identified ordinary shares to increase this section of your portfolio

In summary we would have three buckets comprising of Interest bearing assets (Cash & T.D's), the next would be the Hybrid bucket (big banks), and the last would be the Ordinary Share container. Depending upon the perceived risk you have identified you move funds between the buckets to achieve the risk formula you require.

AIA Matters – Media – Recently while reviewing the Association's strategic interim plan; a need for improvement was highlighted in the Media area.

I would like to make a request for a suitably qualified retired member to help us write one to three page press release statements from time to time, an example would be the current "Investor Sentiment Survey" we jointly issue during the year – any volunteers – please.

Finally, we would like to wish all our members a Happy & Merry Xmas, as well as an enjoyable festive season with your families, and friends.

Also may this period be a safe one for all.  
Merry Xmas - Bill Shirley.



# INVESTORS VOICE



Hopefully, members will have noticed some changes to IV. We have been progressively upgrading the publication over that last 3 or 4 issues. Our aim has been to gradually transform 'Investors Voice' from a newsletter to a magazine, and ultimately create a unique and worthwhile publication which is of benefit to members. Maybe IV can become the preferred publication for self-directed investors.

We initially moved from 12 to 20 pages, and in this and the previous edition - to 24 pages. We have upgraded the graphic design to a more modern appearance, and IV is now mailed as a magazine rather than a 3-fold newsletter. We are open to the possibility of expanding further beyond the current 24 pages, provided that we can maintain the number and quality of articles. Our mailing costs have reduced due to our registration for Print Post.

We have developed advertising revenue, and we will continue to enhance the value of our offering to our advertisers and our sponsors.

We have achieved this first part of the vision, and the second stage is now to develop the content and find a unique character for the publication.

This is likely to include:-

#### An editorial

The editor's commentary on a current investment or AIA issue.

#### Letters to the Editor

Where members may comment on investing issues.

#### Regular "special interest" or subject based sections

- eg. SMSF, managed funds, fixed interest, property, estate planning, etc., with a consistent image and presentation, so that each section is recognisable from one issue to the next. Members will seek out their favourite section and will recognise it when they find it.

I would like to receive your comments in due course. Any feedback assists us to better serve our members.

Graeme Bottrill  
Vice President

### Q: What is the difference between a fund manager and a shopping trolley?

**A: There is a limit to how much food can go into a shopping trolley!**

Or, if you prefer the alternate answer -

**A shopping trolley has a mind of its own!**

#### Dear Investor,

*Intelligent Investor Share Advisor* has been providing profitable stockmarket advice to thousands of Australians for over 15 years, and I'd like to offer you 30 days to access our research and recommendations completely free of charge. So why should you give it a try?

- **Performance:** A \$100,000 investment in our Growth Portfolio in 2008 would be worth \$198,000 today. That's \$86,000 more than if you'd invested in the All Ords Accum. Index during the same period\* (30 Jun 2008-30 Jun 2013).
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\*Past performance is not indicative of future results.

Nathan Bell,  
Research Director

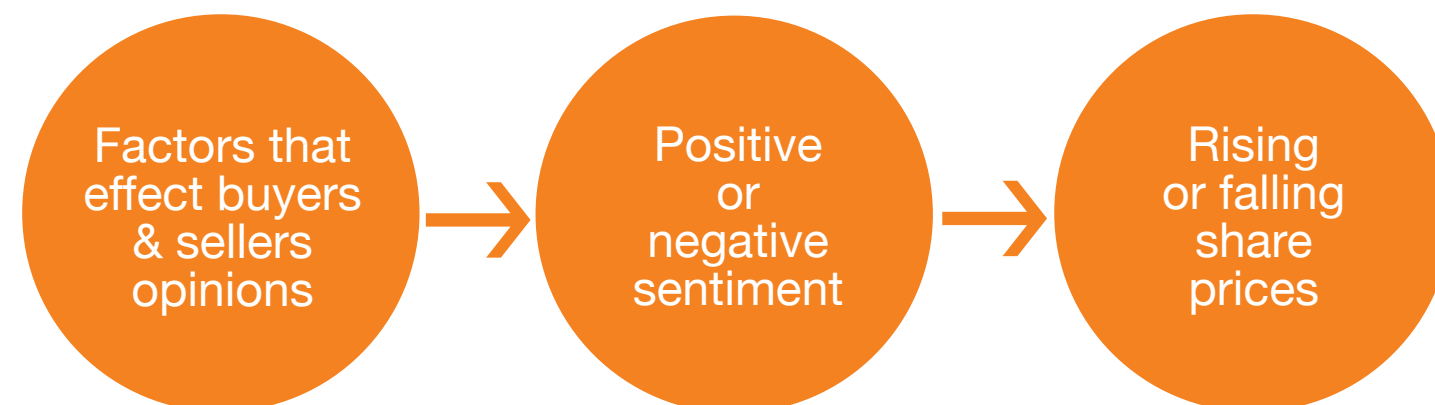
INTELLIGENT INVESTOR  
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# Introduction to Active Investing

## Alan Hull

Active investing is a market approach that fills the gap between day to day trading and passive investing. Whilst many 'mum and dad' investors are loathe to commit 1 to 2 hours per day to managing a portfolio of short term trading positions, many are also frustrated by the ineffectiveness of fundamental analysis as a stand alone market tactic. Active investing extends the conventional investment approach of buying and holding 'quality' blue chip companies by employing testing and measuring procedures which facilitate 'hands on' portfolio management.

Therefore, "Active Investing", is a combination of fundamental and technical analysis. The simple block diagram illustrates the basic dynamic that drives share prices either up or down. Factors that affect opinion generate positive or negative sentiment which in turn leads to rising or falling share prices.



Normally investors come at the market dynamic from the left hand side of the diagram by employing fundamental analysis to find listed companies that are financially sound, have solid management and good future prospects. This market approach, although reliable, carries the caveat of time and requires patience.

Traders, on the other hand, use technical analysis to observe price activity and they buy shares that are rising in price and they sell shares that are falling in price. Traders approach the market dynamic from the right hand side, largely ignoring factors that affect opinion, but are prepared to monitor price activity on a regular basis.

However, Active Investors test and measure the entire market dynamic by combining both fundamental and technical analysis. By doing so they seek out fundamentally sound shares that are currently rising in price, thus eliminating the need to have to wait for share prices to go up. By testing and measuring the 'flow on' affect of good fundamentals active investors can turbocharge their portfolio's performance.

#### The sorts of shares that Active Investors would own include;

- CSL which rose from \$5 to \$40 in 5 years, from 2003 to 2008
- Toll Holdings which rose from \$1 to nearly \$5 in 2 years, from 2000 to 2002
- Cochlear which rose from \$5 to \$50 in 4 years, from 1997 to 2001
- BHP which rose from \$10 to \$45 in 4 years, from 2003 to 2007
- Boral which rose from \$2 to \$6 in 4 years, from 2000 to 2004

#### On the other hand, Active Investors would never get caught owning shares such as;

- HIH when it fell from \$3.50 to 25 cents before delisting
- ABC Learning when it fell from \$8.50 to 60 cents before delisting
- Babcock & Brown when it fell from \$30 to 33 cents before delisting
- Centro Property Group when it fell from nearly \$10 to 16.5 cents

Active Investors wouldn't own these shares because they only buy shares with a rising share price and they sell any shares when the price begins to fall. Hence, active investing is contrary to the common advice, 'Buy low...sell high'. This advice causes the majority of market participants to own shares which are not rising in price.

Stockbrokers will often recommend buying shares when prices fall. But the folly in this was driven home for me many years ago when I received a call from my then broker when the price of Lend Lease collapsed in early 2001. My broker suggested that Lend Lease shares had been unfairly oversold by the market and I should buy now.

The share price had dropped from just over \$22 to \$17 on the back of bad news. But the question was: "Will the share price fall any lower than \$17?" Well guess what... 3 months on and the price dropped to \$15. Well surely \$15 was the low and I should then buy. My broker exclaimed, 'Lend Lease is a super bargain at just \$15!!!'.

But there is no such thing as a bargain priced share. The price of a share is always the precise value that market participants collectively place on it at any particular moment in time. What the broker was really saying, was that market sentiment was abnormally low and should improve. The problem with this approach is that there is no telling when sentiment is likely to improve.

As it turned out, the price of Lend Lease shares fell below \$10 before they started to recover, years later. If a share price is rising then market sentiment is positive and if the share price is falling then market sentiment is negative. Therefore, I recommend that you buy a rising share and sell a falling share

*Alan Hull is a leading expert on blue chip shares and the best-selling author of 'Invest My Way', by Wrightbooks. He has successfully managed millions of dollars of other people's funds, consistently beating all the major ASX market averages. He is an internationally recognised educator and technical analyst who regularly conducts seminars and workshops on trading and investing in Australian shares.*



# Extravagant Buildings mean *bad news* for shareholders

Jason Sedawie

Do you want to know when to sell a stock? There is one extreme indicator that works and that is the announcement of a new corporate headquarters. It's not the everyday corporate buildings but the extravagant ones we need to keep an eye out for. At the end of the day such structures are cost centres they don't add a cent to revenue and they divert money from shareholder pockets.

### Expensive buildings for companies

In other words, management have to be successful and extremely confident in the future to spend billions of dollars to build a structure that is a monument to their own success. Historically, these so-called trophy buildings have been one of the most consistent contrarian indicators.

### Best building ever (but not for shareholders)

One of the best examples in American corporate life was the construction of the AOL Time Warner centre (now without the AOL) in Columbus Circle, New York. At the time it was the most expensive building in US history and has some of the best views of Central Park. Construction began in 2000 coinciding with the end of the dot.com boom and accompanying the announcement of the merger between the new media, AOL and the old media, Time Warner. Since construction can take years to complete, stock prices tend to peak during that time period. Time Warner stock was no exception and is currently still down 67% from its peak. As a consequence Time Warner is now looking to move headquarters to less lavish premises elsewhere in NYC.

### Next best building but like a spaceship

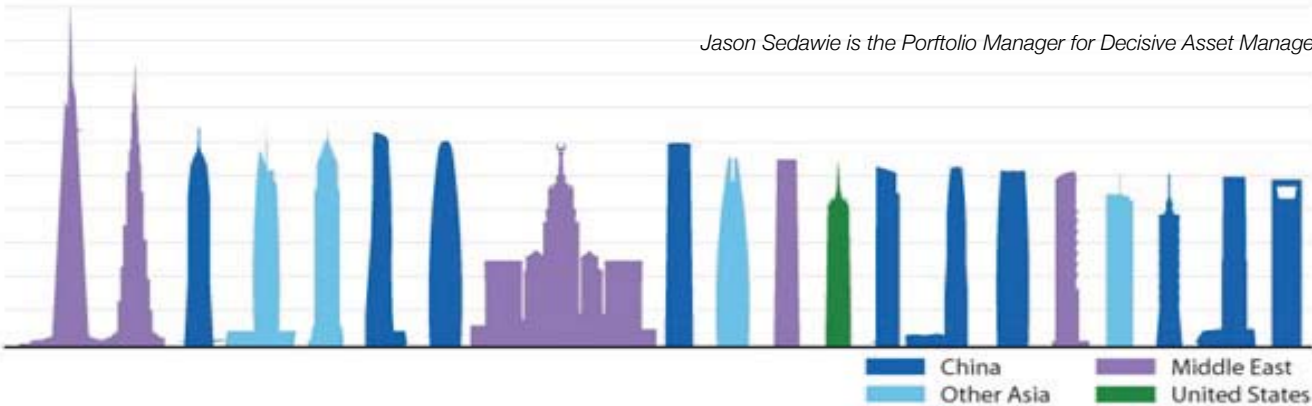
Apple is one of the all-time great companies and is currently the largest in the world. Unfortunately Apple has announced the designs of its own trophy building. It's not going to be the tallest but it is estimated to cost \$5 billion to construct. Final city council approvals are slated for November with plans for the building to be completed in 2016. Shaped like a donut it will be one of the wonders of the corporate world, about 2/3 the size of the Pentagon with 6,000 trees and a lake in the middle. Apple, being the design perfectionists that has made them famous, is constructing the building with curved edges but without corners, just like their products. The building will contain 40 foot floor to ceiling panes of concave glass. Some are calling it the UFO. Skyscrapers for economies

Is there a corresponding indicator for economies? In a similar vein the announcement of the world's tallest skyscrapers has been shown to be a great contrarian indicator for the local economy. Skyscrapers tend to be a good indicator for economies as a whole as skyscrapers require investors and bankers to be confident enough to finance the world's largest structures. Skyscraper construction also tends to be speculative with a "build it and they will come" tenant focus.

Building	Location (Completed)	Spire Height	Financial Crisis
Singer	New York (1908)	187 meters	Panic of 1907
Metropolitan Life	New York (1909)	247 meters	Panic of 1907
40 Wall Street	New York (1929)	283 meters	Great Depression
Chrysler	New York (1929)	319 meters	Great Depression
Empire State	New York (1931)	443 meters	Great Depression
World Trade Center	New York (1973)	526 meters	'70s Stagflation
Sears Tower	Chicago (1974)	527 meters	'70s Stagflation
Petronas Towers	Kuala Lumpur (1997)	452 meters	Asian Financial Crisis
Taipei 101	Taipei (2004)*	509 meters	Tech Bubble
Burj Dubai	Dubai (2008/9)**	828 meters	Global Credit Crunch

The world's tallest building the Burj Dubai is a recent example. The building is now known as the Burj Khalifa named after Sheik Khalifa of Abu Dhabi who helped bail out Dubai with the building named in his honour. Construction began in 2004 and was officially opened January 2010. The figure below is the Council on Tall buildings and Urban Habitat chart of what should be 20 of the world's tallest buildings in 2020. The Kingdom Tower in Jeddah is expected to be the tallest in the world breaking the one kilometre or 1000 metre barrier. The colour coding of the chart shows that of the twenty buildings ten will be in China, three in Korea and four in the Middle East specifically Saudi Arabia and the UAE. Just like Apple, China and the Middle East are two areas investors should keep an eye out for.

Jason Sedawie is the Portfolio Manager for Decisive Asset Management



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# Caltex: A Fuel’s Errand

Gaurav Sodhi

Everyone knows Mount Everest is the tallest mountain in the world. It’s why Edmund Hillary is a household name, why there are no books or films about Ludwig Purtscheller and why Tenzing Norgay is the world’s most famous sherpa.

In fact, Everest isn’t the world’s tallest mountain. Mauna Kea, in Hawaii, measures 10,200m from base to top compared to Everest’s 8,900m. Most of Mauna Kea, however, is underwater which doesn’t change the facts but does change the story.

Everyone knows Caltex is a lousy business, demanding vast swathes of capital deployed at unpredictable and frequently tiny rates of return. And yet the market prices the business at twice book value. Thus Caltex appears to offer a charmless combination of miserable quality and a high price.

Like Mauna Kei, however, the most significant thing about Caltex lies beneath the surface, invisible to the naked eye and beyond the ken of most investors. In the last decade, this business has doubled - yes doubled - the margin it makes on fuel.

Caltex will soon spend \$430m shutting down the Kurnell refinery and another \$250m turning it into an import terminal for refined products. Lytton, in Queensland, will remain the company’s sole operating refinery, although Caltex will limit capital expenditure on the asset.

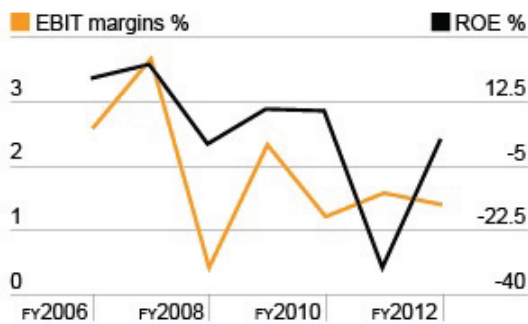
So, instead of refining crude oil, Caltex’s future profit will come from fuel retailing and convenience store sales. And that, it turns out, is a far better business.

### Separate and inspect

‘Old’ Caltex was characterised by low, volatile margins and woeful returns on capital, classic signs of chronic competition and zero pricing power (see Chart 1). The new Caltex should be a great improvement.

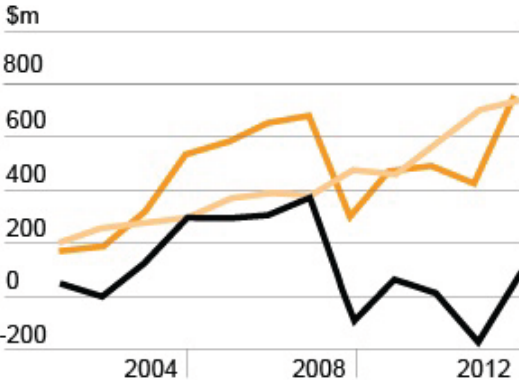
By separating the profit contribution of crude oil refining from marketing, Chart 2 shows how aggregated numbers have long misrepresented results.

Chart 1: Financial performance



Source: Capital IQ, 2013

Chart 2: Aggregated and segmented results



RCOP EBIT Marketing and distribution Refining and supply

Source: Company results, 2012

“If fuel retailing were characterised by cut-throat competition, we would expect volatile, low margins.”

The marketing business has generated consistent and rising operating profit, a fact obscured by poor performance from the refining business. Its imminent closure will leave stable and growing profits from marketing and unmask a hidden truth: as a fuel retailer, Caltex is a better quality business than most realise.

Caltex supplies about a third of all fuel consumed in Australia. It’s one of three businesses that can move fuel nationally and the distribution assets it owns – 89 fuel depots, five major pipelines, access to seven major airports and marine refuelling capacity – are almost impossible to replicate.

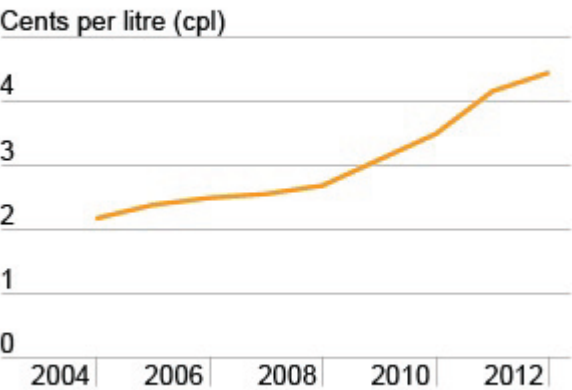
BP and Shell have similar assets but, like so many industries in Australia, fuel marketing is a cosy oligopoly with high barriers to entry; the top four fuel suppliers have a 90% market share. Caltex is number one or two in every category it competes and boasts the largest store network, supplying about 2,000 sites.

If fuel retailing were characterised by cut-throat competition, we would expect volatile, low margins. Instead, margins have increased from 2.2 cents per litre in 2004 to 4.5 cents per litre last year.

### Margins double

Why have margins doubled over the past decade? Total fuel consumption is flat: a 1-2% decline per year of unleaded fuel is offset by 4.5% p.a. growth in diesel volumes and 4% p.a. growth in jet fuel volumes. The mining boom doesn’t adequately explain higher margins either. Less than 20% of diesel sales go to the mining industry and growth has lagged the surge in retail diesel sales.

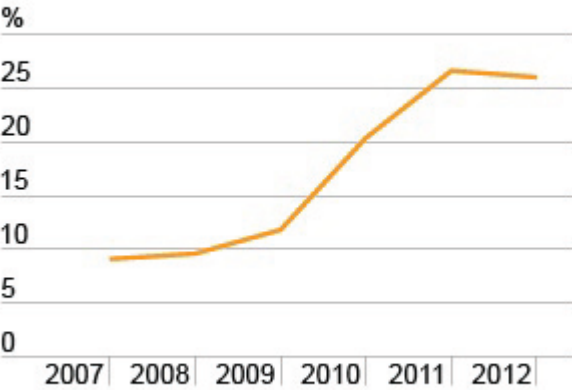
Chart 3: Marketing margin



Source: Company reports

Rising premium fuel sales are one explanation for higher margins. In 2007, premium fuels accounted for just 10% of total volumes; they now account for 25% of fuel volumes and attract higher margins. This is driven by new car sales, which increasingly demand high octane fuels to deliver better economy.

Chart 4: Premium fuels % of total



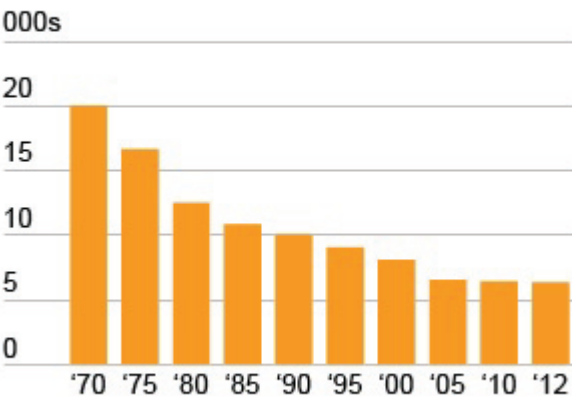
Source: Company reports

But probably the most important factor in sustained higher margins has been the diminishing number of retail outlets.

## Caltex: A Fuels’s Errand cont...

Chart 5 tells a remarkable tale. From more than 20,000 outlets in 1970, retail sites have shrunk to about 6,300, despite higher fuel demand. The decline has accelerated since the two supermarket chains have entered the fuel retailing business. Independents have all but disappeared and even the mighty Mobil, without access to supermarket deals, has exited the retailing industry. The monopolistic grip exercised in groceries by Woolworths and Coles is on show in fuel retailing. To the survivors go the spoils.

Chart 5: Retail petrol outlets in Australia



Source: Company presentation, 2012

Refining and refining marketing higher margins requires to achieve them. The cost of maintaining refineries will fall from about \$230m p.a. to \$80m and management won’t be sinking much more on growth in that business. That’s a good thing: between 2008-2012, Caltex poured \$1.2bn into its refining business to see operating profits rise from -\$99m to \$88m.

Over the same time, \$494m was spent on the marketing division to add \$265m to operating profit, an incremental return of over 50%. Such heady rates will fall but a combination of lower capital expenditure and higher returns will increase cash flow. That should lead to higher dividends from 2016 as Caltex seeks to take advantage of \$1bn in franking credits on its balance sheet.

### Priced for poor quality

Still, there are risks in the shutdown and conversion of Kurnell. Although this is a large project for Caltex, it is small by industry standards with dozens of even more complicated conversions underway around the world. Caltex has ample cash and debt facilities so, even if costs were to increase, a capital raising would be unlikely. The risk of problems may be overstated.

They also appear to be priced into the stock. Our valuation suggests that, on an EBIT (earnings before interest and tax) multiple of between 8 and 12, the new Caltex is worth between \$19 and \$30. There is hot debate about the impact of lower fuel demand within the research team but, for all the hoopla of hybrids, for now it is small new efficient petrol and diesel engines that are winning the market-place.

Like Mauna Kea, the quality of Caltex has been hidden for years. As it exits from refining, the new Caltex will emerge a much higher quality business. In a few years’ time, the company’s share price will likely reflect that fact. Right now it doesn’t. We’re upgrading to BUY for up to 5% of your portfolio.

Gaurav Sodhi from Intelligent Investor

# FEAR AND THE ART OF TRADING

Trading or investing (I use the terms interchangeably) is, at its core, an information processing profession. The job of a trader is to take information and distil it into a cohesive coherent format from which they can derive a decision. The expected end point of this decision is that the trade thus selected is ultimately profitable.

This is a somewhat optimistic view of the trading process since it assumes that the process is robotic and lacking any emotional input from the trader. Anyone who has ever been involved in markets will be able to tell that this is an overly optimistic point of view because traders are not automatons. So my original definition of trading should be revised to state that it is an information management profession, which involves the individual controlling their own fears about the financial consequences of any decision they make.

Unlike other professions, traders exist in a world of uncertainty. Other than the opening and closing times of markets and the fact that each day will be different, we really have no structure. This lack of structure creates a difficulty for us as uncertainty naturally brings anxiety. All traders would like to predict the future but, as this knowledge is denied to us, we have to make do with approximations, best guesses and plans for what to do when things go wrong.

However, this is once again an optimistic view of the trading process since the majority of traders have no plan for when things go wrong. Our natural tendency toward optimism bias means that we weight any chance for success of an action that we have undertaken as being of a higher probability than if someone else had undertaken the exact same action. This bias can best be described with a real estate analogy. Most people believe their house is worth more than their neighbours (even if they are identical) because it is their house and it has their things in it.



Chris Tate

The traders view is that BHP is worth more because they own it – both an egotistical and optimistic view of how the world works.

This dualism of uncertainty combined with often-blind optimism means that often the overwhelming emotion felt by traders is fear. As a natural consequence of this traders move to minimise their exposure to both mistakes and the fear of mistakes.

Consider the following quote from Jesse Livermore.

*"I did precisely the wrong thing. The cotton showed me a loss and I kept it. The wheat showed me a profit and I sold it out. Of all speculative blunders there are few greater than trying to average a losing game. Always sell what shows You a loss and keep what shows You a profit. That was so obviously the wise thing to do and was so well known to me that even now I marvel at myself for doing the reverse"*

What Livermore is describing is a classic failure in the trading process. Profits are taken at the first opportunity yet losses are kept. This behaviour reflects the old adages that you cannot go broke taking a profit and it's not a loss until you sell it. Whilst, these are wonderful homilies, which are done to death by those on sales side of financial product markets, they have no currency at all in the real world of trading. Undertaking either of these two strategies is precisely how most people do go broke.

There is no doubt that the uncertainty inherent within trading generates anxiety and fear in the trader. The fear of either crystallising a loss or the fear of losing open profits clouds the traders mind. However some of this fear can be neutralised if traders understand and reflect upon what is occurring between their ears.

Avoidance mechanisms seem to take two general forms and both can be equally destructive to the trader.

Consider the situation where holding an open position that gradually moves against you. The prudent thing to do would be to sell out the position and minimize any losses and preserve your capital for the next opportunity that comes alone. However, the typical or sub optimal response of the majority of traders is to delay the loss by seeking out information that justifies the original decision.

It is embarrassing to take a loss and our variety of ego preservation mechanisms will do almost anything to avoid this situation. The preservation of ego does seem to rank above the preservation of capital as a response to changes in the market.



The opposite situation sees a slightly different form of behavior creep in – the bias is still largely the same but the expression is different. As the market moves with the trader, information that presents the possibility of a pullback will be given added weight. Whenever markets have been running for sometime, crash theories abound as Chicken Little prognosticators run around yelling that the sky is falling. This fear of losing open profits is a particularly powerful stimulus among traders so these stories are given almost infinite weight and profits are taken too soon.

Fear is an almost constant companion of the nervous trader. However fear does not usually exist in the present, it is an anticipatory response. The trader creates the fear in their imagination either by thinking back to previous events or by prequalifying the present fear by thinking forward.

Fear enters into our psyche in two forms.

## 1. Chronic fear.

This is more commonly referred to as worry and is of a relatively low intensity spread out over an extended period of time. It permeates all thoughts and all actions on an everyday basis.

Chronic fear eats motivation and will stifle attempts to move forward. Some of the things we worry about are important, most are not. Many are outside the realm of a trader's influence. To combat chronic fear drag you need to drag yourself back to the present. For example if you are fearful of a pullback in the market wiping out your open profits you simply make certain that you have a well thought-out stop loss plan.

## 2. Acute fear

Acute fear can be a tremendous impediment to the trader. It is short term, intense and can lead to a failure to act. Interestingly it often manifests itself in a failure to add to positions via pyramiding. It is felt in the present, but it is still anticipatory response based upon future perceptions of what might happen if we undertake a given course of action.

Trading is an uncertain profession and we can never have perfect knowledge but this uncertainty is what generates the potential for profit. Markets are uncertain and at times they do things that take us by surprise. However being profitable should not take us by surprise since this is the outcome our trading plan has prepared us for.

Whilst we can never control the markets we can control ourselves by the implementation of the relatively simple technique of having a trading plan. Yet despite this being such a simple technique it is so rarely employed by traders.

*Chris Tate (www.tradinggame.com.au) is a trading veteran of 30 years and one of the first people to ever release a share trading book in Australia. He has had an extraordinary impact on thousands of traders. Best selling author of 'The Art of Trading' and 'The Art of Options Trading in Australia', his brutally honest approach and meticulous pursuit of excellence, ensure that exceptional traders all around the world quote his market comments.*



# Me & My Portfolio

## An AIA member explains their portfolio...

Lee M. Spano

Are you in a wealth accumulation phase or income producing one?

I find these distinctions unhelpful. I have been investing and trading the financial markets for nearly 15 years now, using both income producing and capital growth strategies. These strategies are thoroughly tested and systematised, covering different markets including Foreign Exchange (FX) and Australian stocks.

What are your investment objectives?

Each strategy or system has its own particular financial objectives. For example, in FX there is a weekly and monthly pip objective which converts to a relevant income goal and then annualised return.

What percentages of your investment assets are in the superannuation environment and what percentage are outside?

Because I manage both short and long term systems myself I tend to minimise the use of any managed fund product, including superannuation. I am also not a fan of the SMSF vehicle because of continuing regulatory changes, and the need to regularly obtain outside professional input.

Describe your current asset allocation

This is best answered in terms of asset class and then associated system. In broad terms, in the financial markets, we have two main sets of systems: first, income producing systems in the FX markets, and second, longer term investing systems in Australian stocks with appropriate hedging.

What's the reasoning here?

The FX market and Australian stocks fit quite well in this regard because I examine the global macroeconomic and investing environment on a daily basis for FX. This gives me the big picture perspective for managing Australian stocks.

Has this allocation changed much over the years?

Initially, it took quite a bit of time to evolve the current systems, but generally I always foresaw the possibility, and power of a creative income + investing approach in the financial markets. So the broad approach

and vision has not changed, just the particular systems because they are built form the ground up from empirical evidence and via a thorough testing process, which I have designed.

Let's talk now about specific assets and investments, starting with Australian shares (including managed funds). Describe your approach to shares please.

**“These tools are better used to help us to make reactive determination based on probability not prediction”**

For stocks I do not always use the traditional portfolio approach, for example, balancing risk and defensive stocks or sectors. I search for the evidence first. Remember Buffett is a Focused Investor where specific companies are researched in great detail and then held for the long term. I prefer a similar approach at both the fundamental and technical levels. Timing is also crucial in terms of the dynamics of the Australian and global markets.

What about international investments?

I get international exposure through the FX and associated global markets, such as indices and commodities. As I mentioned earlier, I minimise the use of managed products, such as international stock funds, because I design and manage my own systems.

What about property?

Over the years, we have done a fair bit in property, including property development.

Our property strategies neatly sit alongside our shorter term strategies in the financial markets as a vehicle for longer term capital growth and diversification.

Let's look to the future. Does your asset allocation and/or specific investment portfolio reflect anything about your belief about market directions in the future? Please explain.

Let me be clear, I do not believe in 'predicting' a market. I do not believe market prediction is possible with any one the tools currently available, such as Technical Analysis, Fundamental Analysis, Statistical Analysis, or the emerging Sentiment Analysis. These tools are better used to help us to a make reactive determination based probability, not prediction. From probability we can test, create rules, and then design a system.

Do you use computer software to manage your portfolio? What software and how well does it work?

I use computers extensively. I usually design my own specific digital tools, such as highly customised spreadsheets for testing. I have examined fundamental tools for stocks, and of course 'robots' for markets such as FX. I have found most of them do not provide satisfactory long term results. And we never know the assumptions behind the code. So I prefer to work with the raw data- price action and the key fundamentals, and then design my own systems.

What is the best investment advice you ever received?

None really- I have avoided advisors over the years because I have largely done things myself.

Do you have an investment hero, and if so, who is it?

I have researched at length many of the great traders and investors, particularly in the US since the early 20th Century, so a short answer is difficult. If I had to pick one, I would say Sir John Templeton because not only was he creative, but he deeply believed in community and Philanthropy. I share this philosophy and have done so for many years. It is the basis of a term I have coined- 'True Wealth', which I am currently writing about.

What has been your best investment decision so far?

Define 'best'? I do not define it as a dollar amount or even an ROI percentage. If I had to define it, I would say following by tested system and achieving the stated objective with the sound leverage of capital, time and importantly, psychology.

What has been your worst? And why was it made?

Logically, that would be the opposite of the last answer. For me, this would relate to over-trading because of my ingrained work ethic, and over-complicating things.

What do you know now that you wish you had known 5 years ago?

To me the key skill, the golden skill is learning precisely how to test, design and manage an effective trading or investing system over the long term. I believe learning how to make the vehicle, is better than buying one or simply being taught how to drive one. It takes time, but you have a lifelong skill, perhaps an inter-generational skill.

Do you have any other comments you would like to make?

Perhaps I can just provide a quote from Sir John Templeton- **"I wouldn't call it radical; I would call it enthusiasm for progress", the Philanthropist says of his approach.** - Sir John Templeton.

Lee M. Spano is a private investor and trader, and Creatness International CEO & AIA Member

## BOOK REVIEW

### Neuroinvesting

Author: Wai-Yee-Chen  
Title: Neuroinvesting  
ISBN: 9781118339213  
Publisher: Wiley  
Publication date: 2013  
Publication place: Singapore  
RRP: AU\$42.95 (paperback)  
Reviewer: Theresa Loo

Enthralled by the title of the book, I signed up to review Wai-Yee's Chen recent publication of how we make decisions when stock-trading. The book starts off with inviting the reader to heighten their awareness of themselves and their environment including one's culture and ethnicity – all things that shape our decision making.

She describes how our 'money personality' influences our perceptions about money management, a crucial ingredient to successful stock-trading. This personality is part personality and intrinsic factors that form our attitudes about money.

Beyond one's self, she hints at the external forces that compete for market share in the stock market: advanced computer programs/professional traders. To trade successfully, one needs an understanding of self. She observes that the personality traits that increase the success of investing include mental openness, plasticity, mindfulness & adaptability.

I found chapter 3 that described the physiology of impulsiveness quite insightful. Wai Yee explains how traders are hard-wired to respond to certain stimulations (e.g. rising stock price). Left unmanaged, these positive stimulations result in highs to which

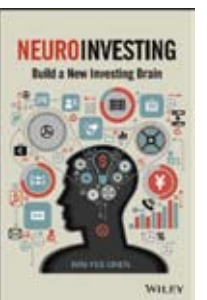
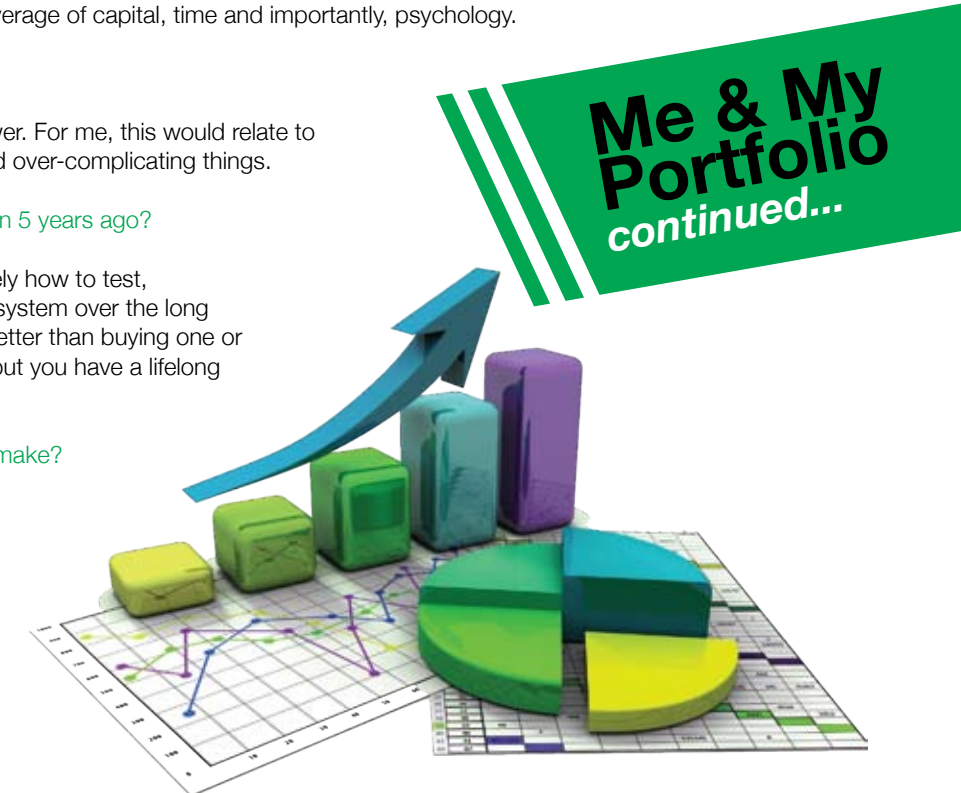
**“To trade successfully, one needs an understanding of self”**

some of us can easily become addicted. Even worse, we tend to chase these highs by taking unnecessary risks to prevent withdrawal symptoms. She observes the way we are hardwired can be rerouted: switching from “stock rising, jump in and buy” to “stock rising, hold and wait for a better price.” However, the challenge is not in changing our thought process but in being aware of who and where we are.

I was getting bogged down with the technical descriptions of the different mechanisms surrounding the brain and genetics (yes, there is a mutation on genes that can incite fear) – luckily Wai Yee warns that knowledge of one's genetic disposition should never be an excuse for the way we trade. In fact, 'we need to make adjustments so that we are not frustrated as traders or investors'

What I found most useful in the book lay in chapters 6 and beyond: they provide suggestions on how to reverse, retrain and replace unwanted automatic reactions to various situations.

I found the book a useful tool in exploring my money personality and deciphering how this influences decision-making in the share-market. Despite the jargon and lengthy descriptions of neuro-networks and how the system works, you should not let this stop you from reading this book. Simply skip the theoretical mumbo-jumbo when you need to and you will find it makes the book more bearable.







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# WOMEN & MONEY

## *It's time to get real...*



Rosemary O'Connor

A few weeks ago, I introduced Penny, who I'd met at a business networking event, to Michael who is a very experienced business consultant. Penny wanted some ideas about growing the professional services venture she and her business partner started about a year ago. The three of us chatted informally over a coffee. Peter asked her some basic questions about the business and where she and her partner wanted to take it.

Naturally, he asked her about the financial aspects of the business, its monthly cash flow, profitability, tax arrangements and so on. To our astonishment, Penny said that she left the whole financial side to her male business partner. All she knew was that the business must be profitable because it pays their salaries and it also pays tax!

While Penny is a very intelligent, capable and experienced professional, she is putting all her hard work and future financial well-being at risk by not bothering to ensure she knows exactly how the business is performing from month to month.

The more I thought about Penny, the more I realised this situation mirrors what far too many women do and don't do in their personal lives. They don't take responsibility. They don't take the time and effort to learn about financial matters, including superannuation. They leave that to their husbands or hand it over to a (usually male) accountant or financial advisor. By avoiding the effort needed to acquire basic knowledge and skills, they are putting their financial futures at risk. Here are a few reasons why that is a very bad choice.

Women are more likely than men to have breaks from employment or full-time employment. They are more likely to be in casual work. When they are in full time work, they are on average paid 16% less than men.

According to the Australian Association of Superannuation Funds, in 2011 the average superannuation balance for women was \$65,800 compared to \$105,000 for men. Women live longer than men, and are more likely to rely on the Age Pension. More women live in poverty than men.

The recent Productivity Commission report, An Ageing Australia: Preparing for the Future, suggests that access to the Age Pension be pushed up to 70, because of the large predicted increases in retiree numbers.



“  
**Education is vital, but it is up to women to take responsibility for their financial health and well-being**”

### A Challenge to Women Members of the AIA

Organisations such as the AIA play a highly valuable role in educating investors, both male and female. While it is encouraging to see the numbers of women at the excellent annual conference and the AIA events I attend in Melbourne, the proportion of women is always much lower than men.

Education is vital, but it is up to women to take responsibility for their financial health and well-being.

I challenge all female members of the AIA not only to take responsibility for themselves (presumably they already do that, otherwise they wouldn't be members) but to take on board some responsibility for the next generations – for their daughters, nieces and grand-daughters. Think of this as your most valuable legacy to them.

We need to make girls and young women more aware of the importance of taking responsibility and acquiring financial knowledge and skills. The reality is that divorce rates are high, the changing workplace means people will have numerous employers and 'careers' and/or may be self employed at various times.

The 'fairy godmother' approach to finance, where too many women abdicate responsibility to the men in their lives, or vainly hope that things will somehow be fine, is just not going to cut it in the future. Financial awareness, knowledge and skills are essential if women are to achieve financial freedom during their lives, and especially in retirement. Yes, it's time to get real.

Rosemary O'Connor  
Member AIA ~ Director, Encore Careers Australia



# Changes of trustee getting it right!

Jared Lynch & Bryce Figot

Changing the trustee of a self-managed superannuation fund ('SMSF') is critically important. SMSF deeds differ significantly in how a change of trustee is to be implemented. A failure to comply with these requirements may invalidate that change of trustee of an SMSF. We examine a case below in which a change of trustee was found to be ineffective and, as a result, the trustee office was determined to be vacant. We then outline some key considerations that arise with any change of trustee.

## MOSS SUPER

### Background

The case of Moss Super Pty Ltd v Hayne [2008] VSC 158 provides an example of why it is important to correctly draft the documentation changing the trustee of an SMSF. The case involved a dispute over the benefits of a deceased SMSF member, Mr Hayne.

Before his death, Mr Hayne was in a relationship with Ms Moss. Both Mr Hayne and Ms Moss were the sole members of an SMSF. In the period following Mr Hayne's death the corporate trustee of the SMSF had two directors (Ms Moss and Mr Hayne's lawyer) and a single member (Ms Moss). Documents were then executed to change the trustee of the SMSF to Moss Super Pty Ltd (a company of which Ms Moss was the sole director). The change of trustee consisted of documentation executed by:

- The 'old' trustee, resigning as trustee of the SMSF; and
- Ms Moss, as the sole member, appointing the Moss Super Pty Ltd as the 'new' trustee.

Mr Hayne also had children from a prior relationship and the change of trustee to Moss Super Pty Ltd was subsequently challenged.

### Decision

In determining whether or not the change of trustee was valid, Byrne J paid close attention to the terms of the SMSF's deed. The SMSF's deed referred to a party it defined as the 'founder' and required the founder to appoint any new trustees. Ms Moss was a director of the founder. Despite successfully resigning the company as trustee and signing the relevant change of trustee documentation as the sole remaining member and as director of Moss Super Pty Ltd, Ms Moss did not comply with the deed. Critically, the change of trustee documentation was not executed by the founder (even though Ms Moss signed the documentation, it was not in her capacity as director of the founder). At the risk of oversimplifying: the right signature was there (ie, Ms Moss' signature) but the wrong header appeared above it.

Byrne J found that:

If parties have, no doubt for good reason, established a complicated legal structure such as this, they must respect it. And where they have, as was the case here, multiple roles to play they must respect the conflicts which may arise.

As a result the change of trustee was not valid and Moss Super Pty Ltd was not the trustee of the SMSF but rather 'the office of Trustee remained and remains vacant'.

This decision can be disastrous for clients as well as leading to uncertainty and confusion.

### Differences in change of trustee powers

A "Trustee's most fundamental duty is to comply with the terms of the trust" (Commissioner of Taxation v Interhealth Energies Pty Ltd [2012] FCA 120 [13]). Accordingly, reference must be made to a SMSF's deed to ascertain the requirements for changing the trustee. Every deed is different and even those from the same deed supplier often change over time.

Some deeds will require a particular sequence of events; some require the consent of a founder or another party; some will not allow a change from a corporate trustee to individual trustees or vice versa; and some may require written notice to be provided in advance to the members of the SMSF to change a trustee. This means that it is critical that the specific SMSF's deed be consulted when changing the trustee of an SMSF.

### SUPERANNUATION INDUSTRY (SUPERVISION) ACT 1993 (CTH) ('SISA')

**While the above generally applies to all trusts, in the case of SMSFs the SISA must also be considered. The SISA imposes an additional regulatory framework in relation to trustees of SMSFs and the following should always be borne in mind when changing the trustee:**

#### 1. Trustee-member rules

Section 17A of the SISA provides the definition of an SMSF. The definition is extensive to cater for all the possible permutations of how a SMSF can be structured. However, broadly speaking, all the members of an SMSF must be trustees or directors of a corporate trustee of an SMSF. The reverse is also typically true.

#### 2. Correctly timing changes of trustee and admission of members

The timing of a change of trustee and any change in the membership of an SMSF is also important. Section 17A of the SISA allows an SMSF a 'grace period' of six months to make the appropriate changes to trustees or members before it ceases to be an SMSF.

However, the 'grace period' does not apply where an individual is admitted as a member without first being appointed as a trustee or director of a corporate trustee. In this case, the SMSF immediately fails to qualify as an SMSF, so the timing is critical. Therefore care should be taken to ensure that a change of trustee occurs before an individual is admitted as a member of an SMSF.

#### 3. Written consent is also required

Section 118 of the SISA provides that an individual is not eligible for appointment as a trustee or director of a corporate trustee of an SMSF unless they have consented to the appointment in writing.

# SUPER



## Changes of trustee getting it right! continued...

#### 4. Disqualified persons

Section 126K of the SISA prohibits 'disqualified persons' from being appointed as trustees or directors of corporate trustees of SMSFs. A disqualified person broadly includes anyone convicted of an offence of dishonesty and undischarged bankrupts.

The penalty for a disqualified person acting as a trustee or director of a corporate trustee of an SMSF is prescribed as two years in prison or a fine of \$10,200. Accordingly, consideration should be given to whether or not a new trustee or director of a corporate trustee might be a disqualified person. There is also a common misconception that the six month 'grace period' applies to disqualified persons. This is not the case and trustees or directors of corporate trustees facing bankruptcy should be removed in advance to ensure they do not contravene the SISA.

#### 5. Trustee declaration

Since 2007, all people becoming trustees and directors of corporate trustees of SMSFs must sign a declaration in the approved form confirming that they understand their duties. See section 104A of the SISA.

The approved form is the ATO 'Trustee Declaration' (NAT 71089). The form must be signed within 21 days of their appointment.

Further, trustees are required to retain the declaration for at least 10 years and, if requested, be able to provide the declaration for inspection by the ATO.

### CONCLUSION

The above are some of the various considerations that arise when changing the trustee of an SMSF. Advice should always be sought from an appropriately qualified professional if there is ever any doubt.

Jared Lynch - Trainee Lawyer & Bryce Figot - Director, DBA Lawyers  
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.

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# INVEST MY WAY



# Automatically Reversionary PENSIONS

## *Are they still worthwhile?*

### Introduction

The new pension rules mean that automatically reversionary pensions ('ARPs') are not necessary for everyone but do have a strategic role to play. Unless you are aware of the distinctions, you may miss out on strategic advantages!

### Issues to consider against an ARP

#### • Pension exemption continues regardless

An ARP is no longer necessarily needed to protect the tax-free status of pension assets post death. More particularly, the new income tax regulations extend the pension exemption (for non-ARPs) until it is practicable to pay out a deceased pensioner's benefits.

#### • No mixing of interests

Once a pension ceases, it typically rolls back into accumulation. This can result in the unwanted merging of the tax free and taxable components of the interests. As an ARP does not cease upon death, ARPs were used until recently as a tool to ensure a member's pension and accumulation interests remained separate upon death.

Under the new regulations, this is not necessarily required. The new tax regulations provide that a pensioner's superannuation interest will retain its tax free and taxable proportions as at the time of the pensioner's death.

There is one proviso to the above: where insurance proceeds are paid into the pension interest following the member's death (discussed further below).

#### • In kind payments

The ATO takes the view that a pension cannot be paid in kind (see SMSFR 2008/2 [73]). However, the pension exemption can now apply to a cash lump sum.

TR 2013/5 expressly states that a pension (that is not an ARP) immediately ceases upon the pensioner's death ([29]). It follows that any associated death benefit is a lump sum payment. Indeed, the new tax regulations treat the lump sum payment as a pension payment merely for the purposes of the fund claiming the pension exemption up to the time of that lump sum payment.

Accordingly, it is possible for a lump sum payment to be made following the death of a pensioner without the pension exemption ceasing (provided the lump sum is paid as soon as practicable) and therefore without giving rise to a CGT-related liability at the SMSF level (subject to the proposed \$100,000 cap on the pension exemption). In the case of an ARP, however, this is not possible since the pension continues after death and the above regulation does not apply.

#### • Eligibility for the age pension

Social Security rules may also make ARPs (or, indeed, any form of pension reversion) unattractive. Broadly, the implications are that where a member is in receipt of a reversionary pension from someone with a greater life expectancy than themselves, it could impact on that member's eligibility for the age pension.

(For completeness, note the Labor Government announced on 5 April 2013 a change to the policy that is proposed to apply the deemed rate of return test on pension assets that was to commence after 1 January 2015.)

### An issue to consider in favour of an ARP

#### • Insurance payouts

Where the SMSF is likely to receive a significant insurance payout upon a member's death (and the associated insurance premiums were paid from the member's pension interest) an ARP is likely to be worthwhile. This is especially the case where the member's interest has a high tax free component.

The reason is that a non-reversionary pension is taken to cease upon death and, under the new income tax regulations, insurance is not included when the tax free and taxable components of the death benefit are calculated. Thus, insurance proceeds will broadly

form part of the taxable component upon the death of a pensioner (in the same way as earnings are normally treated when generated in accumulation mode).

Where the member's pension automatically reverts to a beneficiary, however, the insurance proceeds will take on the existing taxable proportions of the pension interest as at the date of the pension's commencement.

While insurance within an ARP strategy that is appropriately documented can result in a sound strategic outcome, there are probably not a lot of people who would satisfy the required criteria. However, the strategic advantages discussed above may prompt members to reconsider their insurance needs especially now that insurance must be regularly considered in each SMSF's investment strategy.

So, is it necessary to rectify the situation? The release of TR 2011/D3, reflecting the ATO's earlier determination, caused an increase in the number of advisers seeking to ensure that the pensions of their respective clients automatically reverted upon death.

**The pension changes provide the perfect opportunity to review existing documentation to make sure it is appropriate**

**SMSF documentation is the key**

**Automatically Reversionary Pensions continued...**

At the time, this was typically a sensible action to take, as it prevented the merging of different interests and ensured that the pension exemption continued. However, the recent pension changes allay these concerns.

Today, an ARP may not be the best strategy in all cases and does not necessarily give rise to the most tax efficient outcome. Therefore, each pension and related strategy should be reviewed to ensure it remains appropriate.

#### 'Mid-stream' reversions

It is possible to both revert or 'un-revert' existing account style pensions (eg, transition to retirement income streams or account-based pensions) mid-stream.

Naturally, this is subject to the specific documentation. It needs to align with both the pension documents and the terms of the SMSF deed.

In March 2013 the ATO was expressly asked whether an account style pension can be made reversionary mid-stream.

The ATO confirmed this position, subject to proper documentation.

#### SMSF documentation is key

The key to getting the above strategies right is having appropriate documentation in place. Indeed, many document suppliers have not kept up to pace with the recent raft of reforms impacting on pension strategies. Many SMSF deeds, for instance, do not provide the power for the trustee's discretion to be fettered or limited. Thus, most reversionary pension nominations are at best a mere wish and may not necessarily achieve the strategy they set out to.

The recent pension changes provide the perfect opportunity to review any existing documentation to make sure it is, and remains, appropriate.

#### Conclusion

ARPs are not necessary for everyone but do have a strategic role to play. Moving forward proactive steps should be taken to ensure each pension and related strategy remains appropriate.

*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.*



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# ARE YOUR INVESTMENTS READY FOR YOU TO RETIRE?

Kylie Temple, CPA

*(Long term AIA members will know this subject, but this article is useful for newcomers, and friends and family who need educating)*

A reoccurring theme that plays on Australian's minds is "are my investments ready for me to retire?" However the timing of when they look at these investments is when they are ready to retire, travel or pursue hobbies. Don't wait until then to look at your investments and to try and make up for lost time to get some savings in the bank.

There are many reasons why your investments are not where you would like or want them to be. Maybe you made the wrong investment choices, didn't earn enough money in your younger years or suffered a financial setback that has ended in wiping out some or all of your investments.

## Where to start?

The best place to start is to take stock of your assets and liabilities and to really look at what your investments are doing. For a lot of Australians it looks a little like house, mortgage, savings, two cars, furniture and a superfund or two. So where are the investments you ask? In this case the income earning investments are hiding in your superfund. Every working Australian still struggles with this concept that they are all investors and how to place some input into how their investment can grow and ultimately support their lifestyle. Ask yourself what's the balance in my superfund and how did it get to this? For some of you, you will know the answers the majority will not. How to find out the answer requires a review of your superfund statement and to ask some questions:

- Has my employer made the contributions and the timing?
- What are the fees and are they reasonable?
- Have I got insurance and what types of cover do I have? Is it enough or too much?
- What investment strategy have I selected, conservative, moderate, balanced, growth, high growth? Is it working for me?
- What are the returns on these investments? Am I saving?
- Is there growth in the fund?
- Is this the right strategy for me? Is there a change of strategy required?
- Do I have more than one superfund and which one should I consolidate it into?

## Will I have enough money?

The amount of money you will need to retire depends on your age and your intended lifestyle. Sometimes we don't know where to start and say to ourselves but I don't want to go to a financial planner what would they know on how to improve my investments, I can do a better job than them. To get you started and put the wheels in motion take some time out and work through the retirement planner on [www.moneysmart.gov.au](http://www.moneysmart.gov.au) which can help you work out:

- What income you are likely to have from super and the age pension after you retire.
- How contributions, investment options, fees and retirement age affect your retirement income from super.
- What actions you can take to boost your super and retirement income.

Another part of [www.moneysmart.gov.au](http://www.moneysmart.gov.au) is designed for investors to learn the basics and to gain an understanding what is required to invest, budget, super when to get advice and some helpful important considerations in your overall smart money management.

## Getting advice – empower the strategy

Getting the right advice for the right investment is not only a financial planner's position but a good accountants role. The tax system is complex and can be quite overwhelming for the majority of Australians. By getting the right advice for your circumstance along the way not just in the retirement years can save you money in the later years. There are tax consequences and strategies that need to be taken into consideration to maximise your investments and minimise any unnecessary tax impacts. In some cases it's all in the timing and how best to apply the best strategy for the circumstance.

“One of the most **IMPORTANT** factors in **PLANNING** is to always **REVIEW** your **PLAN**, **REVIEW** your **STRATEGIES** **REVIEW** your **LIFESTYLE**”

**ARE YOUR INVESTMENTS  
READY FOR YOU TO RETIRE?  
continued...**

## Readjust your budget

Budgets are not a set and forget and for many of us starts at an early age. As we get older the budget becomes more complex and even overwhelming for some. A budget is either done well, barely or not at all. If you've never done a budget for your household income and expenses it's never too late to start. By really looking at your income and expenses it highlights areas of needs and wants, overspending and cutbacks or increases needed. This is where you can make informed decisions in your planning.

## Focus on saving not just the returns

If you're in your earlier years this is the time to start your planning and change your mindset of how your retirement investments or in fact any investments are going to work for you. Even if you're reaching your retirement years its best practice to develop an investment plan (available on [www.moneysmart.gov.au](http://www.moneysmart.gov.au)). The earlier you start saving or investing in any of the asset classes the better position you will be in for your retirement years.

Review, review, review.... One of the most important factors in planning is to always review your plan, review your strategies and review your lifestyle. Set down a date that you will always remember eg: June 30 and January 1. Review your savings and how best to invest them, write the plan out, talk about it with your trusted advisors and execute the plan. Execution is one of the downfalls of many Australians when it comes to saving and sticking to it. If your finding it difficult with the plan you have set, readjust it, it's not a diet!

## Manage the lifestyle change

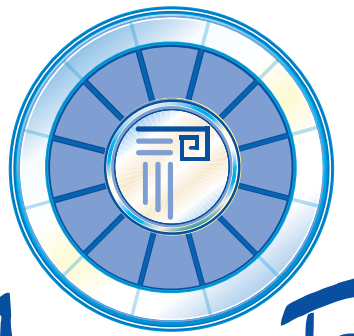
For many Australians retirement is about change; change in disposable income, change in budgeting, change in routine, change in how we look at our investments, change in health and the ever changing and complex taxation and social security system. Ease into retirement and give your superfund or savings a last boost. One strategy is to increase salary sacrifice (remember to stay within the contribution limits) into super or contribute into super from your own savings which may make you eligible for government super co-contributions (see [www.ato.gov.au](http://www.ato.gov.au) for information on super co-contributions).

Reducing or delaying your full retirement doesn't have to be a financial burden as there are strategies to transition that can be used with the right advice and can provide you with a supplement or part pension whilst allowing you the time to enjoy the change and absorb the overwhelming assessment of your financial position and strategies going forward into the retirement years.

A transition to retirement 'income stream' or pension allows you to draw on your super to supplement your employment income whilst you implement your life changes and makes for a smoother adjustment period.

Finally don't let it be too late to evaluate if your investments are ready for you to retire.

*Kylie Temple is a CPA, Registered SMSF Auditor and a Tax Agent who owns and operates MoneyFit Australia Pty Ltd and Temple and Associates Accountants and Advisers who provide a range of services including; accounting, taxation, general advice and audit of SMSF for the small to medium businesses. Her passion is in education and encouragement for her clients to empower themselves to take ownership and responsibility of their own wealth creation, knowledge and improvement on their skill sets not a reaction to historical data.*



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# Taking a pension from an SMSF

## Key issues to be aware of...

Darren Wynen

Superannuation pensions are very popular with retirees. One of the main reasons is that earnings on pension assets within the pension fund (including realised capital gains) are tax exempt.

This article discusses the time when you can commence a pension (even though you may still be working), together with a recent change that extended the pension tax exemption on the death of a member.

**STOP PRESS:** Currently, the level of tax-exempt pension income your fund can earn is uncapped. Earlier this year, Labor announced that it proposed to limit the tax-exempt earnings from pension assets to \$100,000 (unindexed) per member. However, due to complexity and compliance costs, the new Abbott government has just announced that it will scrap this measure. Therefore, pension earnings within your SMSF will continue to be tax-exempt for the foreseeable future.

### The best of both worlds - drawing a pension whilst still working

Generally, you cannot access your superannuation benefits until you reach your preservation age (currently 55) and retire, or you are at least aged 65.

However, you are able to commence a pension called a 'transition to retirement income stream' (TRIS for short) once you reach preservation age (currently 55). Importantly, there is no need to 'retire' before you commence the TRIS – you just need to be aged at least 55. This means you can start the pension even though you are still employed.

The main conditions for the TRIS are:

- you must draw down a minimum annual pension payment from your pension account;
- total annual pension payments cannot exceed 10% of the pension account balance; and
- the pension is generally non-commutable, which means that you cannot convert the balance of your pension account to a lump sum and cash it out of your fund.

**EXAMPLE** – Ally is aged 55 and still working. She wants to supplement her employment income with a pension from her SMSF. She starts a pension on 1 July 2013 with \$200,000 of her super.

Ally must:

- draw a pension payment for the 2014 income year of at least \$8,000 (4% x \$200,000); and
- not take pension payments of more than \$20,000 for the 2014 income year (i.e., 10% x \$200,000).

### Tax consequences of a TRIS payment

- If you are under age 60, then tax will generally be payable on at least some of your pension income, however any taxable income you receive from this type of pension will attract a tax offset. If you are aged at least 60, then your pension income is generally tax free.

“One of the main reasons why pensions are so popular is that earnings on pension assets are tax-exempt in the hands of your SMSF”

### Government extends the pension exemption on death

The Government has recently amended the law to allow the pension tax exemption to continue after a member's death.

As noted above, one of the main reasons why pensions are so popular is that earnings on pension assets (including realised capital gains) are tax-exempt in the hands of your SMSF. Traditionally, the pension exemption has ceased when you die, unless provision has been made to automatically continue as a reversionary pension to an eligible beneficiary (e.g. a spouse).

With pensions ceasing on death, this had meant that any income and capital gains

earned on the pension assets by your SMSF after death was taxable to the fund. This could have been a problem if pension assets needed to be liquidated prior to distribution.

The good news is that the law has now been changed with effect from 1 July 2012. Following this change, the pension exemption will extend from death until it is “as soon as practicable” to distribute the benefits to the beneficiaries.

### How does the pension exemption now apply?

From 1 July 2012, the pension earnings tax exemption will continue after death. Note, however, that rules apply to ensure that the exemption is capped to earnings on the balance of the pension account just before death. This requirement ensures the pension exemption after death is no greater than what it was prior to death.

**EXAMPLE** – Alan, a member of an SMSF, was receiving a pension at the time of his death on 1 September 2013. No provision was made to automatically continue the pension to another person, and so the pension ceased on Alan's death.

On 20 December 2013, which was as soon as practicable after Alan's death, a single lump sum of \$500,000 was paid to his adult child, Janet. Following the law change, the pension exemption continues to apply to income derived on the pension account after death (e.g. interest, dividends or capital gains on the sale of pension assets).

### Law change also affects tax split of pension account

As part of these changes to extend the pension tax exemption, the law was also amended in regards to the calculation of the taxable and tax-free components of the deceased member's pension account. By way of background, a superannuation benefit (either a pension or lump sum) paid from an SMSF is split between a 'taxable' and a 'tax free' component for tax purposes.

Normally, the split between the taxable and tax free component of a pension payment is worked out when the pension commences.



Taking a pension from an SMSF  
Key issues to be aware of continued...

This split is important for estate planning because the tax-free component will always be tax free to the recipient, whilst the taxable component is subject to tax if paid to certain beneficiaries (e.g. adult children).

However, following these changes, certain amounts (e.g. anti-detriment) added to the deceased member's pension balance will increase the taxable component of the pension account. This could increase the tax paid by particular beneficiaries (such as adult children) who are in receipt of a lump sum death benefit paid from the pension account.

Please note that this change commences from 4 June 2013.

Darren Wynen is a well-respected educator and consultant in the tax and SMSF arena. He regularly presents to the professional bodies on superannuation issues, and lectures for the University of NSW on their SMSF specialisation program. Darren is a big supporter of trustee education and he believes that it is in everyone's interest to get it right. With the Regulators increasing their oversight of trustees, and SMSFs viewed as a lucrative opportunity for many businesses to cash in on, Darren believes it is more important than ever for trustees to stay vigilant and in control of their superannuation savings. He believes the best way to do this is by empowering themselves with knowledge. If you are interested in finding out more, go to [www.smsfguy.com.au](http://www.smsfguy.com.au).



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# Calendar of Events

Date	Event	Time	Venue
DEC			
02-Dec-13	Canberra Discussion Group	7.30pm	Southern Cross Club, 92-96 Corina Street, Woden ACT
03-Dec-13	Sydney South Discussion Group	7.30pm	Miranda Community Centre, Wattle Room, 93 Karimbla Road, Miranda NSW
03-Dec-13	Perth Information Meeting	6.00pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs
03-Dec-13	Melbourne Information Meeting	7.00pm	Telstra Conference Centre, R1, L1, 242 Exhibition St, Melbourne
04-Dec-13	Blackburn Discussion Group	7.15pm	Naturalist Club of Victoria, 1 Gardenia Street, Blackburn VIC
04-Dec-13	Brisbane Information Meeting	1.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill
04-Dec-13	Franston South Discussion Group	12.30pm	Frankson VIC
11-Dec-13	Gold Coast Information Meeting	9.30am	Robina Community Centre, Robina Town Centre Drive, Robina
11-Dec-13	Sydney North Shore Information Meeting	7.30pm	The Chatswood Club, 11 Help St, Chatswood
JAN			
14-Jan-14	Geelong Discussion Group	7.00pm	St George Workers Club, 212 Pakington Street, Geelong West VIC
23-Jan-14	Bayside Discussion Group	4.00pm	Hampton Community Centre, Willis Street, Hampton VIC
FEB			
03-Feb-14	Canberra Discussion Group	7.30pm	Southern Cross Club, 92-96 Corina Street, Woden ACT
04-Feb-14	Perth Information Group	7.00pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs
04-Feb-14	Adelaide Information Group	7.00pm	German Club, 223 Flinders St, Adelaide (Wolf Blass Weinkeller Room)
04-Feb-14	Sydney South Discussion Group	7.30pm	Miranda Community Centre, Wattle Room, 93 Karimbla Road, Miranda NSW
05-Feb-14	Sydney Hills District Discussion Group	7.00pm	B Davis & Associates, Suite 17, 35 Old Northern Road, Baulkham Hills NSW
05-Feb-14	Brisbane Information Meeting	1.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill
05-Feb-14	Blackburn Discussion Group	7.15pm	Naturalist Club of Victoria, 1 Gardenia Street, Blackburn VIC
12-Feb-14	Sydney North Shore Information Meeting	7.00pm	The Chatswood Club, 11 Help St, Chatswood
18-Feb-14	Brisbane Investment Management Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
18-Feb-14	Gold Coast Information Meeting	9.30am	Robina Community Centre, Robina Town Centre Drive, Robina
18-Feb-14	Perth Equities Discussion Group	7.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs
19-Feb-14	Brisbane Share Investments Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
MARCH			
03-Mar-14	Canberra Discussion Group	7.30pm	Southern Cross Club, 92-96 Corina Street, Woden ACT
04-Mar-14	Geelong Discussion Group	7.00pm	St George Workers Club, 212 Pakington Street, Geelong West VIC
04-Mar-14	Perth Information Meeting	7.00pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs
04-Mar-14	Sydney South Discussion Group	7.30pm	Miranda Community Centre, Wattle Room, 93 Karimbla Road, Miranda NSW
05-Mar-14	Brisbane Information Meeting	1.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill
12-Mar-14	Sydney North Shore Information Meeting	7.00pm	The Chatswood Club, 11 Help St, Chatswood
18-Mar-14	Brisbane Investment Management Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
18-Mar-14	Perth Equities Discussion Group	7.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs
19-Mar-14	Brisbane Share Investments Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
27-Mar-14	Bayside Discussion Group	4.00pm	Hampton Community Centre, Willis Street, Hampton VIC

As AIA events are confirmed, details are posted to the AIA website [www.investors.asn.au](http://www.investors.asn.au). Please note topic is subject to change.



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