

the **INVESTORSvoice**

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

June 2016

BUDGET UPDATE



LIBERAL VS LABOR **US PRESIDENTIAL ELECTION YEAR** **RETIREMENT SAVINGS**



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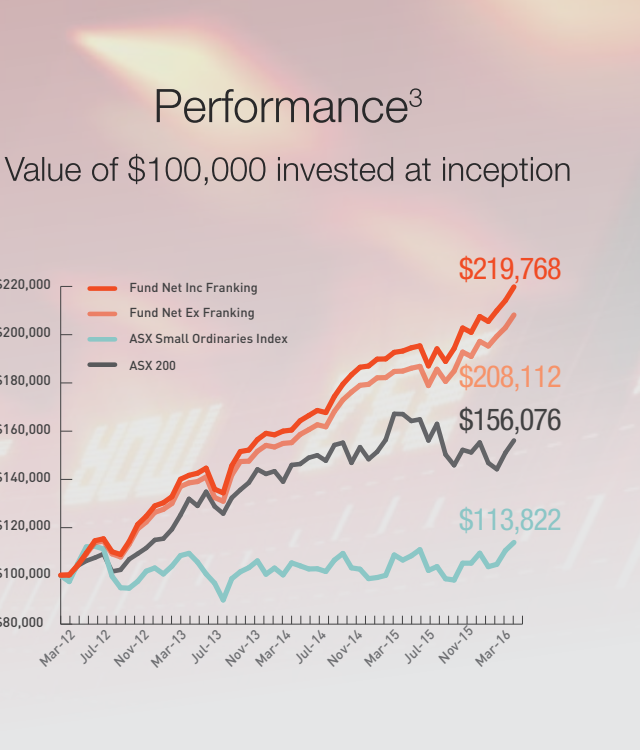
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President's Message

By Graeme Bottrill



Dear Members,

What an interesting three months since my last President's message. There is no shortage of subjects to discuss in this issue!

The board submitted a response to the Treasury's '*Object of Superannuation*' discussion paper in March. The discussion paper is quite brief, and provides background and questions for consultation on the objective of the superannuation system. It states that this consultation will help guide the final decision on the objective to be legislated.

The AIA Submission makes six recommendations (read it on our website under 'Advocacy' on the main menu). The broad thrust of our submission is that the objective of superannuation should be to provide a retirement income that is commensurate with pre-retirement income. This is a broader concept than that which seems to have been decided (see below). Thanks to our Vice President Jon Kalkman for doing most of the drafting, with input from other board members.

We at AIA have not been active recently in this advocacy role, but the board intends that this be a larger part of our focus in the future. We intend to make submissions on various issues of interest to investors. As we develop these submissions, we naturally contemplate whether the views of us as board members would align with the views of the wider membership generally. We therefore welcome correspondence from members with their thoughts and views on matters which impact their investments and investment strategy. We will be better equipped to act if we know how you think about these matters.

The Federal Budget

At the same time as the budget, we had a joint media release from the treasurer and the assistant treasurer, which said in part - "*As Australia's population ages it is becoming increasingly important to ensure that the superannuation system is based on a clearly stated objective, is providing the right incentives to save, and is flexible enough to ensure all Australians are given the opportunity to enjoy a fulfilling retirement*" (my emphasis). If only!

The release went on to say "*The Government will enshrine in law that the objective for superannuation is to provide income in retirement to substitute or supplement the Age Pension. This reflects extensive consultations following the recommendation of the Financial System Inquiry*". A rather narrow definition, I think, and certainly falls way short of the concept described in the joint press release mentioned above.

Then we had the budget itself. Most people think the budget was pretty tame, except for the Superannuation changes. Wow! Who saw that coming? Like others, I was shocked by the changes; some of which are retrospective. In the past, the various governments of the day encouraged contributions and as recently as 2014/15, the annual non-concessional limit was increased from \$150,000 to \$180,000. Now we are told, forget all that, and take savings out again.

The only thing to be said is that we should not panic just yet. Based on the last budget, most unpopular initiatives were either withdrawn due to the public outcry (the GP co-payment, etc.) or failed to pass the Senate. Who knows what may change and what form the Senate may take after a double dissolution election. I despair at these ad-hoc changes which can only cause disenchantment with the entire superannuation system.

To confuse us even further, the ALP says that if elected, it will tax the earnings of super funds in pension mode, but did not appear to have any plans to change the contribution rules. By the time you read this, we will have published a budget summary in the 'Investor Update' newsletter.

The AIA Conference

Allow me to remind you of the annual conference. We have been able to secure an incredible group of speakers for this year, and we anticipate a conference that will rate amongst the best ever. A brochure is enclosed with this IV, and the full details of all speakers and sessions is available on the AIA website.

Note that accommodation at the Marriott is filling quickly, so please don't delay your accommodation bookings. I look forward to meeting all of you at the conference.

Regards to all – Graeme Bottrill

BUDGET UPDATE

JULIE DOLAN, SMSF CONSULTING

When Scott Morrison handed down the Government's 2016–17 budget, there was a real sting in the tail in regard to SMSFs. Here is a list of the Good and Bad in relation to SMSFs.

Ouch

Reduction in concessional contribution caps

From 1st July 2017, the concessional contributions cap will be reduced to \$25,000. As it currently stands, the concessional contributions cap is \$30,000 per year for an individual under age 50 and \$35,000 for 50 years and over.

Lifetime cap for non-concessional contributions

This is the real sting... From 7.30pm (AEST) on 3 May 2016, a \$500,000 lifetime cap in relation to non-concessional contributions will be introduced. This cap is retrospective, dating back to 1 July 2007. In cases where an individual has already exceeded this cap limit prior to the commencement date, they will be taken to have used up their lifetime cap amount and will not be required to take the excess out of the superannuation system. After commencement date, any excess will need to be refunded or penalty rates will apply.

This cap is available to individuals up to the age of 75 and will be indexed in \$50,000 increments in line with average weekly ordinary times earnings (AWOTE).

This lifetime non-concessional cap will replace the existing annual cap of \$180,000 p.a. or the bring-forward provision of \$540,000 for those aged under the age of 65.

Further tax on contributions for high-income earners

From 1 July 2017, the application of the Division 293 tax will apply to individuals who make taxable contributions and their 'adjusted' taxable income exceeds \$250,000. This threshold is currently \$300,000. This in effect results in an additional 15% contribution tax on concessional contributions.

Removal of anti-detriment payments

From 1 July 2017, super funds will no longer be able to make an additional anti-detriment payment. These provisions currently allow funds to make an additional payment to a member's beneficiaries or estate on death in compensation for contribution tax deducted during the member's working life.

Transition to retirement income streams (TRIS)

From 1 July 2017, all existing and new TRISs will no longer be able to receive a tax exemption on income received on the assets backing these income streams.

The concept of these income streams will still exist in the sense of allowing access to additional cash flow while transitioning out of the workforce. However, the tax advantage will not be there. They will continue to be taxed at 15% in line with accumulation assets.

Also the recent controversy on whether you can elect to make a lump-sum payment from a TRIS, treat it towards the minimum pension requirement but claim it against the low-tax-rate cap (currently \$195,000 for the under 60s) will be closed.

Pension account Balance Transfer Cap of \$1.6 million

This is like the old RBLs revisited again. From 1st July 2017, a \$1.6 million cap will apply per person in relation to the total amount that can be transferred to commence a pension. For existing pension accounts at 1st July 2017, any account balance that exceeds \$1.6 million will need to be taken out of the fund or rolled back to accumulation mode.

For new pensions after the commencement date, only a total of \$1.6 million may be transferred to pension mode. Any other amounts must remain in accumulation mode and be taxed at 15%. Subsequent changes to the account balance due to earnings or withdrawals will not be counted.

It is proposed that this transfer cap will increase in \$100,000 increments in line with CPI.

Not so ouch

10% rule no longer applies

From 1 July 2017, all individuals up to the age of 75 will be able to claim a personal tax deduction for superannuation. This is regardless of their employment status and hence eliminates the current 10% rule.

Administration duties will not change in the sense that to claim the deduction, individuals will need to lodge a notice of intention to claim the deduction prior to lodging their personal tax return for the year in question.

Catch up for concessional contributions

From 1st July 2017, the ability to accrue unused concessional contribution cap amounts will be allowable to individuals with a super balance of less than \$500,000. Unused cap amounts can be accumulated and rolled over for a period of five years. After this period the unused amount will expire.

Extending the spouse contribution tax offset

From 1 July 2017, the income threshold will increase to \$37,000 (currently \$10,800) for the 18% tax offset of up to \$540 to apply. This offset relates to an individual contributing to a spouse's superannuation.

The tax offset will be calculated as 18% of the lesser of:

- \$3000 reduced by every dollar over \$37,000 or
- the amount of spouse contributions.

Low-income superannuation tax offset (LISTO)

From 1st July 2017, the LISTO will be introduced to replace the low-income superannuation contribution. In effect, the LISTO will provide up to a non-refundable \$500 tax offset for taxable contributions made on behalf of low-income earners. It will apply to members with adjusted taxable income of up to \$37,000.

'Work test' no longer applicable

From 1 July 2017, individuals will be able to make contributions to superannuation up to the age of 74 without the requirement of having to satisfy the current 'work test'. This will also apply to spouse contributions.

BUDGET UPDATE

CONTINUED...

“ The budget proposes significant changes. However, before any announcements can be implemented they need to go through the passage of law.”

As you can see, the budget proposes significant changes to the current superannuation system. However, it is important to note that before any of these announcements can be implemented they need to go through the passage of law. From experience, this can result in significant changes or the knocking out of many announcements.

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2016 A US PRESIDENTIAL ELECTION YEAR

JODY ELLISS, IC INVESTOR

This year started cautiously and we saw our market down in January. This does not bode well for the prospects of the Australian market – the saying goes, ‘Down in January – down for the year’.

This is measured from the options Thursday expiry on 17 December to the options Thursday on 28 January. With the December XJO value 5100 versus the January restock level of 4975, our expectation for the year is ‘passive down’. This is backed by lower interest rates, low commodity prices, higher unemployment (with the mining and support industries slowing dramatically) and real estate slowing with an expected glut of residential multi-dwellings right around Australia. This is compounded by slowing economies in both China and Japan, our two largest trading partners.

Following the US

Our market attempts to follow the US market and has a direct relationship with the US S&P 500. This is powered by dual listings for more than 20 of our top 200 (XJO) stocks in the US market. This includes BHP and RIO, which together represent more than 20% of our Top 200 Index. Thus the old adage, ‘Up in the US – up in Australia’.

This is a US presidential election year with the 58th US presidential election scheduled for Tuesday, 8 November.

“**A presidential election year has a known ‘shape’.**
If we look back at the last 10 election years we see
that all but one have a similar shape.”

A presidential election year has a known ‘shape’. If we look back at the last 10 election years we see that they all have a similar shape with the exception of the 2000 election year (George Bush). We can draw a basic diagram for the shape of the year. Going back in history, we do not get the same basic shape because presidential elections were scheduled in the first or early second quarter of the year rather than the last quarter, as they are now. However, if you adjust for the date the basic curve fits for most presidential election years in the last 100 years where we have accurate financial data.

The basic US presidential curve



History shows that the market will rise regardless of whether Republican or Democrat party wins.

The US market tends to run up into the end of the US tax year (31 December). It then runs down until Easter and so the first US quarter is negative for the S&P 500. After Easter the market picks up and continues in the ‘up’ direction for the next US quarter. It depends on the year as to what happens in the third US quarter, but the market does not find a new low in this period and is mostly ‘passive up’.

A few presidential years have seen new highs made in this period, but this is not expected this year. The market will be ‘passive down’ with uncertainty going into July with the final selection of the party nominees for both the Republicans and the Democrats. The selection date is 18 July and we can expect to see the market rally after that. This will be a Fear Uncertainty Doubt (FUD, see diagram) pattern.

The market rallies in October, the first month of the last US quarter. The market then goes into a FUD pattern and we can expect the market to retrace in fear of an uncertain outcome. Sellers will dominate the market here and the market will fall.

This is consistent for all presidential elections, regardless of the year. The market will stabilise for the election weekend. Then, after the election, regardless of who wins, the market will rally with a known outcome giving buyers the power to make an informed decision on an oversold market.



It is expected the market will recover back to its original October levels in December, prior to US tax time. In more than 50% of presidential elections, the market has gone to a higher high than the October high in December.

2016 A US PRESIDENTIAL ELECTION YEAR *continued...*

The effects on the Australian market
The Australian market will attempt to follow the US market. However, if the institutions are defensive – as they appear to be this year – then the market will move up and then retrace, move up and retrace. The jerky nature of this pattern makes medium-term investments very poor prospects with our market (XJO) expected to oscillate between 4800 and 5400 for the year.

Short-term tactical trading will give the best capital return in the Australian market, where you can pick your months and look for quick 3% to 7% returns and exit for known down periods. Long-term investments will likely see no capital gain from 2015 levels and returns will be limited to dividend yields.

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How long will my retirement savings last?

JON KALKMAN, AIA VICE PRESIDENT

The essence of retirement planning is cash flow. Just because you stop work does not mean that the bills stop. The question top-of-mind is, “How much should I save to make sure I have enough?”

However, planning this cash flow is difficult because of uncertainty about our expenditure in retirement, about investment returns and about how long we are going to live.

If we think of retirement savings as a rainwater tank, we could imagine cash flowing into the tank from investment income and the sale of assets and cash flowing out of the tank to pay a regular income stream, as well as lump sums to pay for cars, holidays or home renovations. Just like a rainwater tank, if the cash flows out faster than the cash flowing in, it is only a matter of time before the tank is empty. The critical question then is, “How long before my retirement savings are all gone?” The advice from professionals is typically, It depends... on so many uncertainties.

The result is that many retirees become extremely cautious and many will exhaust their retirement savings and depend on the age pension for all or part of their retirement income in old age.

If I spend my money faster than it is earned, I will run out of money sooner or later. Rather than simply asking people to hope for the best, the table below provides some guidance for that planning. It shows the number of years it will take for a given amount of savings to reduce to zero if the percentage drawn out is greater than the percentage earned by those savings. It is actually compound interest in reverse.

To make the spending percentages meaningful, I have included a nominal capital value of retirement savings. Please note the starting capital amount is irrelevant in determining how long it will last; what matters are the earning rate and the spending rate.

Flow rates can be calculated

Assume I have \$800,000 in savings and I need an annual income of \$64,000 p.a. (8%). Assume also these retirement savings earn 6%. Therefore I need to use some savings annually to pay for my income and

my savings balance declines over time. According to this table, by reading across the rows and down the columns, this process will take 23.79 years until those retirements savings are reduced to zero. If I could reduce my spending to 7%, my savings will last for 33.4 years. Clearly I can spend it now or later.

Retirees, concerned about outliving their money, must minimise fees and taxes. Income must also at least keep pace with inflation.

This table makes some heroic assumptions. It assumes uniform spending and earning rates over the whole time period and it assumes no fees, no taxes and no inflation. So the table is not a prediction, but it is instructive.

Implications

The table clearly shows that, ignoring inflation, if I spend no more than what my savings earn, I will always have adequate income and I need never fear outliving my savings.

To spend more than I earn is to court disaster. If I spend 8% of my savings and they earn only 3% per year – from a term deposit, for example – my savings will be exhausted in only 15.9 years. Yet term deposits remain very popular with retirees.

Of course, people do not behave like that. They typically change their annual expenditure in response to the alarming drop in their savings balance, but the principle is clear: if I pay for my retirement by selling assets, it is only a matter of time before

there are no more assets to sell. The only question is how long it takes. Yet this is the principle behind all unit-based superannuation pensions provided by retail and industry super funds.

The real world has fees, taxes & inflation

The table illustrates the effects of fees. Using the previous example, my savings are exhausted in 23.79 years if I spend 8% but my savings only earns 6%. If I need to pay an additional annual fee of 1%, I am actually spending 9% annually: 8% for me and 1% for my advisor. According to the table, my savings are now exhausted after 18.85 years. In this example, the fee of 1% has not only cost me \$8,000 per year, it also truncates my income stream by almost five years or \$320,000. That is the true cost of an annual fee of just 1%.

The table also demonstrates the effect of taxes. If I need an income of \$64,000 after tax, I need to draw out \$75,294 before tax if my tax rate is 15% (or 9.4% of savings) and I need to draw out \$91,428 before tax (or 11.4% of savings) if the tax rate is 30%. Check the table to see the effect that has on how long it will be before the money stops.

Modelling inflation is not possible because the table assumes uniform withdrawals. In an inflationary environment, withdrawals need to progressively increase to maintain the spending power of the original \$64,000. Nevertheless, if inflation is a constant 3% (which is near the Reserve Bank’s preferred rate) prices will double in 24 years. In that scenario, my example savings will be depleted long before then.

The real problem is that, without careful planning, my savings are likely to expire before I do. We know that 50% of males currently aged 65 will survive beyond age 84, but around 5% of that group will survive beyond age 97. Similarly, 50% of females currently aged 65 will survive beyond age 88, but around 5% of that group will survive beyond age 100. Some individuals will survive even longer. Therefore, if I want to plan my retirement with a 95% certainty that I will not outlive my money, I need to plan for a retirement of at least 30 years, and that means I cannot spend much more than it earns – ever!

What to do?

Your advisor’s preferred solution to any retirement savings shortfall is always:

- work longer to build a bigger nest egg and/or
- draw a smaller income stream in retirement so that it lasts longer and/or
- try to get a higher investment return within your risk appetite.
- there is always the age pension!

Apart from this obvious advice, this table contains some clear messages. Retirees, concerned about outliving their money, must minimise fees and taxes. Income must also at least keep pace with inflation. Clearly, unless I am exceedingly wealthy, my standard of living over a long retirement depends on my investment returns.

Retirees, concerned about outliving their money, must minimise fees and taxes. Income must also at least keep pace with inflation.

How long will my retirement savings last? *continued...*

We know there is a direct relationship between risk and investment return, but retirees also need to balance that market risk against the longevity risk that they will outlive their savings. In the context of a 30-year retirement, retirees who adopt conservative low-return investments may be sacrificing their long-term financial security to their short-term concerns about market volatility. Yet such a plan to deliver poverty in old age is considered normal.

Postscript

You can generate this table yourself by using the (NPER) financial function of Microsoft Excel, which calculates the number of periods for the final balance to reach zero by computing the interaction between the earning rate and the spending rate, or you can just take my word for it.

Retirement Savings			EARNING									
			1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
SPENDING	\$32,000	4%	28.91	35.00	46.90							
	\$40,000	5%	22.43	25.80	31.00	41.04						
	\$48,000	6%	18.32	20.48	23.45	28.01	36.72					
	\$56,000	7%	15.49	16.99	18.93	21.60	25.68	33.40				
	\$64,000	8%	13.42	14.53	15.90	17.67	20.10	23.79	30.73			
	\$72,000	9%	11.84	12.69	13.72	14.99	16.62	18.85	22.23	28.55		
	\$80,000	10%	10.59	11.27	12.07	13.02	14.21	15.73	17.79	20.91	26.72	
	\$88,000	11%	9.58	10.13	10.77	11.52	12.42	13.53	14.95	16.88	19.78	25.16
	\$96,000	12%	8.74	9.21	9.73	10.34	11.05	11.90	12.94	14.27	16.09	18.80
	\$104,000	13%	8.04	8.44	8.88	9.38	9.95	10.62	11.43	12.42	13.68	15.38
	\$112,000	14%	7.45	7.78	8.16	8.58	9.06	9.60	10.24	11.01	11.95	13.14
	\$120,000	15%	6.93	7.23	7.55	7.91	8.31	8.77	9.29	9.90	10.63	11.53
	\$128,000	16%	6.49	6.74	7.02	7.33	7.68	8.07	8.50	9.01	9.59	10.29
	\$136,000	17%	6.09	6.32	6.57	6.84	7.14	7.47	7.84	8.26	8.75	9.31
	\$144,000	18%	5.74	5.95	6.17	6.41	6.67	6.96	7.28	7.64	8.04	8.51
	\$152,000	19%	5.43	5.62	5.81	6.03	6.26	6.51	6.79	7.10	7.45	7.84
	\$160,000	20%	5.15	5.32	5.50	5.69	5.90	6.12	6.37	6.64	6.94	7.27

Years to zero

European low-cost carriers - no longer marginal players

JAMES SOUTTER

Across the globe, low-cost airlines have been increasingly taking share from the traditional full-service legacy carriers. Increasing costs, consumer preferences and competitive dynamics have all contributed to the rise of low-cost carriers (LCCs). In Europe, a fragmented and expanding market and lower oil prices have enabled LCCs to become a key feature of European air travel.

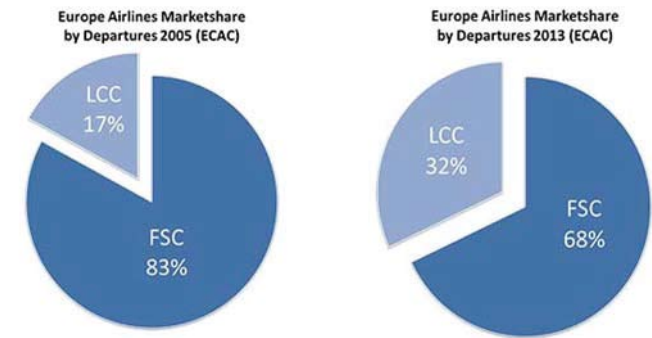
LCCs have expanded their footprint in recent years on increased passenger demand for short-haul routes at cheaper prices. Traditional legacy or full-service carriers have been slower to adjust to the changing dynamic in European aviation.

Growth market

Given the flying time from east to west across the European Union is only four hours, individuals, families and businesses have realised that paying for a premium full-service airfare is no longer necessary. Further, by signing incentive deals with smaller airports and flying thinner (cheaper) routes, LCCs have been able to offer exceptionally low fares and stimulated demand from a traveller who previously would have stayed at home or used a different method of transport.

“The market share of LCCs has approximately doubled between 2005 and 2013.”

As recognised at the European Civil Aviation Conference, the market share of LCCs has almost doubled between 2005 and 2013.

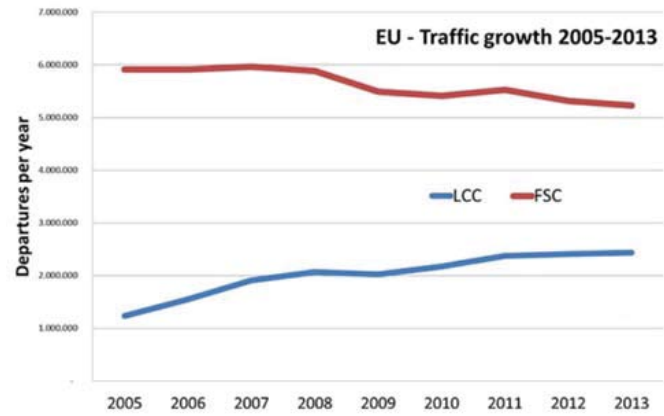


Source: Airline Profiler

Ryanair, Europe's biggest LCC, highlighted at its recent results that it now flies to more than 200 airports in 31 countries, offering its customers more than 1600 routes. Further, the airline currently operates approximately 330 Boeing 737 aircraft, with another 350 on order. Allowing for plane retirements, the airline is forecast to grow its fleet capacity 8% p.a. to 2024. The larger fleet allows it to take on more routes and add more airports that are currently in the hands of weaker legacy players.

The significant growth demonstrated by Ryanair is also replicated by its key competitor, Easyjet. A favourable IPO by Wizz Air in February 2015 and the acquisition of Vueling by International Airlines Group in 2013 demonstrate both investor and corporate interest in this fast-growing segment.

Perhaps the biggest indicator of the growth of LCCs is the graph below, which depicts a slowdown in full-service carrier (FSC) departures, and a notable increase in departures of LCCs.



Source: Airline Profiler

In addition to consistent travel growth in Western Europe, LCCs are continuing to benefit from increasing penetration into Central and Eastern Europe. This is a large and well-populated region, with increased propensity to air travel. Barclays Research estimated in 2015 that in Central and Eastern Europe there were 0.36 seats per capita, compared to 1.58 in Western Europe.

Additionally, demographics and a lower number of business travellers in Eastern Europe indicate that LCCs are likely to be preferred to full-service airlines. Despite this, Central and Eastern Europe remain relatively underserved by LCCs, with Barclays Research also estimating that LCC penetration is 20% of capacity compared to 35% in Western Europe.

Accordingly, this remains a key avenue for growth for LCCs in an area with relatively low competition, low barriers to entry and low penetration.

Low cost structure

The biggest advantage of LCCs compared to their full-service peers is their cost structure. Given LCCs often operate out of smaller and less congested airports, airport taxes and costs associated with traffic delays are minimised. Additionally, highly competitive routes (for example to and from Heathrow Airport) are more expensive for airlines due to demand and higher labour costs. In comparison, it is cheaper for a LCC to fly in and out of Gatwick, Stansted, Southend or Luton. Given the operating structure of LCCs, they have a direct advantage in terms of cost compared to their full-service competitors.

Undoubtedly the most significant cost for an airline is fuel. The recent oil price plunge from over US\$100 per barrel to under US\$40 has meant airlines have decreased their costs substantially. For LCCs, fuel is the most significant cost in the P&L, and therefore a substantial decrease in the oil price means a significant and more meaningful decrease in costs. In time, this will enable LCCs to pass on more of the benefit of decreased costs to consumers in order to capture further market share. Conversely, full-service carriers have other substantial costs such as catering, loyalty program costs, higher airport surcharges, higher route surcharges and higher maintenance costs. While a lower fuel cost also benefits full-service carriers, ultimately the extent of this benefit is more meaningful for a LCC.

European low-cost carriers
- no longer marginal players
continued...

European LCCs have seen substantial growth in recent years, and we believe this growth is set to continue based on increasing market share, European consumer preferences and highly competitive cost structures. Some funds including the K2 International Funds are able to provide investors with direct exposure to this constantly growing theme.

James Soutter is International Portfolio Manager, K2 Asset Management

Global opportunities²

Investors looking for global equities exposure should consider the K2 Global Equities Fund (KII). It offers the opportunity to invest in a diversified global fund quoted on the ASX that mirrors the existing K2 Global High Alpha Fund.

Investors can simply buy or sell units using the ASX code KII via their online broker or stockbroker.

Performance 31 March 2016 Net of all fees*	1 year % return	2 years % return per annum	3 years % return per annum	5 years % return per annum	Since Inception % return per annum
K2 Global High Alpha Fund	-2.1	11.0	17.7	14.9	20.7

Our consistent performance clearly demonstrates that vigilance rewards. Find out more at: www.k2am.com or telephone 61 3 9691 6111.

Vigilance Rewards



Past performance is not a reliable indicator of future performance and should not be the sole factor considered when selecting a financial product. Fund returns are annualised compound rates, net of all fees, exclude individual taxes, assume dividends are reinvested, and consist of income and capital return. K2 Asset Management Ltd ABN 95 085 445 094 AFSL 244 393 ("K2") is the issuer of the K2 Global High Alpha Fund ARSN 139 669 293 (inception 1/12/09). You should read K2's product disclosure statement (available from K2), and consider whether these products are appropriate for you, before deciding to acquire or continue to hold an interest in any K2 fund. K2 and its related parties do not guarantee the repayment of capital or the performance of any K2 fund. A cooling off period is available to some clients. The K2 funds' portfolios can diverge significantly from underlying market indices. KAM 31/01/16 AIA

The 7 habits for successful investing in junior goldmining companies

ROB BILLS

The first myth I will dispel is the often-touted differential in risk between blue chip and micro-cap companies. In my view, borne out by long-term investment in both, risk means different things to different people and is more about managing and mitigation strategies than generalisations. It is about understanding specific risk and constructing a portfolio at the most efficient risk-reward frontier. Part of this includes the macro view of specific commodities (supply and demand) and the commodity cycles and timing.

This article is specific to investment in gold micro-caps and assumes the macro settings and case for gold is a given. For me, it is unsurprising that the Australian-dollar-denominated gold price is rising given a number of factors: the overall global outlook, currency settings and general uncertainty around the globe. It is this uncertainty that sometimes translates into spectacular returns from many of our ASX-listed gold stocks. This has been greatly assisted by the unwinding of unsustainable costs in the mining and exploration space post the boom in iron ore and the oil and gas sectors.

The case for gold micro-caps in a portfolio has increasing relevance going forward. However, a cautionary note for those who subscribe to the old adage of 'set and forget', as often attached to blue chip investments. In the micro-cap space there is a higher propensity for things to go off the rails quickly! Risk mitigation in the micro-cap space comes down to undertaking research and, more importantly, understanding what it all means. The key success factors include the following:

1. A well-credentialed and sound management team – you might consider this factor stating the obvious and it is, unsurprisingly, touted by almost all companies. What the investor needs to establish is the track record of the board of management and the exploration team (both in the commercial and technical sense).

2. If the company is in the exploration mode, a strong preference for the role of CEO/MD to be a geologist. This is, providing point 1 is satisfied. For example, there is a group of Australian geologists who have cut their teeth in successful larger companies, many with rounded careers in all aspects of exploration, mining and commercial transactions. These geologists now fill CEO/MD roles in many of our most successful micro-cap exploration companies.

3. A micro-cap company where exploration needs to be run as a business that clearly spells out how and where shareholder money is spent, and which also takes account of the probability of discovery, technical and commercial risks, and the mitigation of them. In the exploration mode, a high percentage of shareholder funds should be spent 'in the ground' on value-accretive exploration activities such as acquiring new and high-resolution data sets, drilling, assaying and applied research to enhance discovery, not doing 'director special' drill holes to pump up the share price.

4. Demonstration that the area selection process is scientifically and commercially robust. There is no point in expending shareholder funds on exploration in non-fertile geological provinces. Similarly, there is no merit in conducting exploration where non-technical risk prevents commercialisation of a discovery. Furthermore, the size of the tenement package under exploration needs to be commensurate with the resolution of the datasets that generated that area. The probability of finding a world-class deposit within a postage-stamp-sized tenement is a punt, not an investment!

5. Long-term funding to match the likely exploration and discovery cycle. This is perhaps one of the most challenging aspects for the micro-cap explorer. Typically micro-caps are hostage to the health of the capital markets as evidenced by the, of late, increases in capital raising in this sector. Examination of many of those micro-caps that have continued exploration during the recent harsh downturn show resilience borne from seeking alternative means of funding. These are the ones that have a place in your portfolio!



6. Companies that harness the best science and technology to make new discoveries. Research shows that discovery rather than acquisition is a more direct path to increasing shareholder wealth. Hence a coherent geoscientific framework with a path to discovery, sometimes built up over many years of exploration, increases the probability for success. Similarly, new detection technologies that have increased resolution or depth penetration may discover new deposits 'blind' to previous techniques.

7. Luck is not a strategy, so every micro-cap needs a plan B should that often-elusive discovery not eventuate.

You can glean most of this from company websites, ASX announcements and investor presentations.

This perspective comes from years as a geologist focused on creating value through discovery and, more recently, as managing director of an ASX-listed junior explorer.

Are you going to invest or punt?

For further information contact the author at booth 1 during the AIA Investment Conference in August.

Rob Bills is Managing Director, Emmerson Resources

Rule one: Never lose money. Rule two: Never forget rule no.1.

Warren Buffett, Berkshire Hathaway Chairman.

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Conditional membership in an SMSF - the advantages

DANIEL BUTLER & PHILLIPPA BRIGLIA

Conditional membership
in an SMSF
- the advantages
continued...

There can be compelling reasons why one might want to share a self-managed superannuation fund (SMSF) with others. However, sharing an SMSF with a spouse (especially a second or subsequent spouse), children, siblings, in-laws, friends or business associates can involve a risk that at some stage there may be a breakdown in the relationship.

Have you ever thought what happens when this occurs?

Indeed, it's critical that SMSF members cooperate effectively and manage the fund smoothly. This is of prime concern to the member(s) who have the majority account balance(s) in the fund, and who may seek to extricate themselves from a potentially messy legal wrangle. Unfortunately, the law does not adequately provide for such situations.

A certain legal 'war story' can serve to illustrate the above problems that occurred in a mum-and-dad SMSF. In *Triway Superannuation Fund v FCT* [2011] AATA 302, the Triway Superannuation Fund was created and money was transferred to it upon advice given to its trustees by people introduced by the son. The son had a drug addiction and squandered all of his mum and dad's SMSF retirement savings. The fund was rendered non-complying. The son and his mum and dad, with assistance from their tax agent, concealed their son's contraventions for five years until they were discovered during an ATO audit.

Assuming the parents wanted to remove the son from the Triway Superannuation Fund, they did not have a clear right to do so as they would have required their son's consent.

The Triway decision is an unfortunate but good example of how conditional membership can be beneficial. Following are numerous other instances where conditional membership can be invaluable.

Removing trustees & members

So how can a member be removed from an SMSF? The starting point is that it depends on the particular SMSF deed and related documentation.

Under DBA Lawyers SMSF deed, the members with the majority account balance can appoint or remove a trustee. This weighting of votes by account balance is particularly advantageous in situations like the Triway case. This means that the member(s) with the majority account balance can remove a person or company as a trustee.

Many other SMSF deeds provide the power to the trustees or to the members by head-count. With the vast bulk of SMSFs having two members, this could easily result in a stalemate.

In addition to being removed as a trustee or director of a corporate trustee, the SMSF deed must also be examined for the provisions relating to the removal of a member. Most SMSF deeds do not provide any power for a trustee to remove a member once a falling out has occurred.

Conditional membership

Under the DBA Lawyers SMSF deed, express provision is made to admit members on a conditional basis. This deed allows a 'conditional' member to be paid out (if they have satisfied a relevant condition of release) or rolled out to another superannuation fund upon the occurrence of a specific event or upon a specified time.

For example, if a member wanted to admit their second spouse as a member but wanted the flexibility of paying or rolling their spouse's balance in the event of a relationship breakdown, then this event could be specified as one of the conditions on which the second spouse would be removed from the fund.

The 'conditional' member's consent would operate such that, upon the occurrence of one or more specific trigger events, the SMSF trustee can use the consent to remove the member and pay their benefit (if a relevant condition of release is satisfied) or transfer their benefit to another complying superannuation fund.

Conditional membership therefore operates similarly to an insurance policy – you don't want to have to use it, but if the day comes when you need to, you'll be very glad that you had the foresight to put it in place.

Conditions that may be placed on a 'conditional' member

A range of examples can be considered for giving rise to a right to remove a member, including:

- divorce or separation in the case of a de facto relationship
- a member failing to attend to their usual trustee/director duties including attending at least four trustee/director meetings
- material disagreement that is not resolved within 30 days
- where business associates share the same SMSF and their business relationship ceases or there is a triggering event under the buy-sell (or equivalent) agreement
- as the member(s) with the majority account balance determine, or
- any legal dispute between the parties.

SMSF documentation

Naturally, appropriate related documentation including disclosures and trustee resolutions should be prepared to document the member's admission and any special conditions that apply.

Under most other suppliers' SMSF deeds, however, it is difficult to remove a member without first obtaining the member's written consent. Regulations 6.28 and 6.29 of the Superannuation Industry (Supervision) Regulations 1994 (Cth) ('SISR') provide that a member's benefit in a fund must not be rolled over or transferred from the fund unless that member has given the trustee the member's written consent to the rollover.

Therefore, unless the member provides prior written consent to being paid or rolled out, as appropriate, the SMSF trustee cannot simply 'remove' the member's entitlement from the fund. As you would be well aware, consent may be impossible to obtain where there has been a falling out, especially in the case of a divorce, separation or legal dispute.

“
Having a conditional membership strategy in place should minimise the opportunity for costly and uncertain disputes that will place the SMSF and its members at significant risk.
”

The key strategy that pre-emptively addresses this issue is conditional membership. Here the existing member(s) with the larger account balance obtains the informed written consent before the new member is admitted in both their capacity as a member and trustee. Appropriate disclosure is made that the new member may be removed as both a member and trustee of the fund.

Corporate trustees

In the case of a corporate trustee, the person also needs to consent to their removal as a director. This requires the constitution to be examined to determine what is required to remove a director.

Under the DBA Lawyers' SMSF deed, the member(s) with the majority account balance can, if needed, remove a corporate trustee. However, typically the shareholders of a company can hire and fire the directors. Thus, those with the majority of voting shares already have this power. Therefore the member(s) admitting a 'conditional' member do not need to issue any shares in the company to such a new conditional member. This is the more efficient approach rather than having to replace the corporate trustee and go through all the paperwork of transferring assets etc to a new trustee company.

Moreover, there is no legislative requirement for a member to have any shares in a company that acts as an SMSF trustee.

Removing a member without a conditional membership strategy

In the event the SMSF deed does not expressly provide for conditional membership, the member(s) may need to apply to the court (typically the Supreme Court) for intervention. Courts are generally reluctant to intervene in such situations unless the member has contravened the law, e.g. the drug addict son in the Triway case above who was a trustee and had access to the fund's bank account. However the time, cost and inconvenience associated with legal action are likely to be very substantial.

Thus, unless there is some substantive breach of the trustee or director duties committed by the member who needs to be removed, the court may not provide any practical solution. In these cases, there is the prospect of the SMSF being placed in a precarious position while the parties seek to resolve their differences. Typically, during these periods, the parties do not cooperate with each other to ensure the fund is compliant and often the tax and regulatory returns and other compliance matters are not attended to in a timely manner. This can result in numerous penalties and potential non-compliance. While this can disadvantage all members, it impacts more on those with the greater account balance. Naturally, fairness dictates that the member(s) with the greater account balance should have greater say in the running of an SMSF.

Conclusion

An SMSF deed that allows for conditional membership, together with appropriate supplementary documentation including a company constitution, can provide members with greater peace of mind. Having a conditional membership strategy in place should minimise the opportunity for costly and uncertain disputes that will place the SMSF and its members at significant risk.

Daniel Butler and Philippa Briglia, DBA Lawyers



SUPERANNUATION

FUND SERVICE PROVIDERS - YOUR SAY

Last year, we said that we would like to hear from members who use a service provider for their SMSF. We would like to hear your recommendations as what service is provided and how the provider performs. We said that we will most likely publish a summary on our website as a service to other members.

Two contributions have been received to date, and we publish these below. If any other members wish to contribute, we would be pleased to receive their contributions.

SFR Advisory Group

Peter Keys, AIA member

For the past eight years I have been using SFR Advisory Group Pty Ltd in East Perth, WA as my SMSF administrator. All of my fund mail goes to its address; it maintains fund records and prepares an annual tax return and fund audit.

In addition, my complex portfolio involving Australian shares, property syndicates and overseas shares is updated regularly and available on its website. I am permitted unlimited phone and personal visits to a dedicated financial advisor.

Contribution & pension strategies

I have found the firm competent in SMSF contribution and pension strategies, but have rarely used its financial advice as I find it too conservative. I can trade Australian shares directly through its discount broker.

Audit & accounting

Audit and accounting staff are friendly, helpful and very smart, having aided me immensely during a complex ATO issue. The annual fixed fee also includes financial planning advice, and will and power of attorney preparation.

Scale of fees

It has a scale of fixed fees up to a maximum of \$11,000 p.a. including GST for a fund of \$1.5 million or above, payable in advance.

Overall I am happy with SFR Advisory Group as a SMSF admin. provider, but would like to find the same for a lesser rate.

Perpetual Private

Rex Barber, AIA Member

I have had a Small APRA Fund (SAF) with Perpetual Private for the last 25 years with two members, my wife and myself (maximum members four).

As a busy senior executive and now a busy retiree I use the administration and trustee services, which include all custody, administration, accounting and taxation (income and GST)

services carried out by the trustee as well as the arranging of audit and actuary services (during the combined pension and accumulation phase). Perpetual does offer advisory services for its clients, although I don't utilise the advisory service for my SAF as I am comfortable choosing and managing the fund's investments. However, should I pre-decease my wife the addition of the advisory service would be helpful.

Small APRA Fund versus SMSF

I chose a SAF (regulated by Australian Prudential Regulation Authority) over a SMSF (regulated by Australian Taxation Office) so that I did not have to worry about compliance, minutes, trust deed modifications etc. I continue to be happy with my decision in light of current increased obligations and penalties attached to breaches by trustees of their responsibilities.

I have a designated account manager who monitors my fund and receives instructions from me in respect to term deposits, pension payments etc.

Stockbrokers

I use my own stockbrokers directly, even though I could save on brokerage costs by using Perpetual's institutional brokers. I've had direct relationships with my full-service brokers for many years and in return for my support they provide me with access to initial public offerings and institutional placements for both my SAF and family trust. I can place a buy or sell order with my broker and it is settled by Perpetual without me having to communicate the transaction to my account manager.

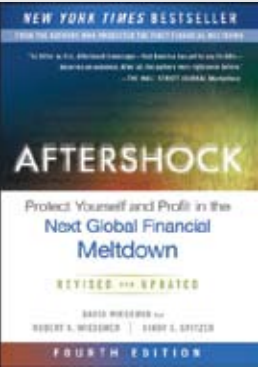
Term deposits

I make use of Perpetual Private's term deposit rates available from a range of Australian banks. I also can access my SAF securely online and download reports at any time and view my cash management account transactions and any corporate actions (e.g. rights issues and share purchase plans) that are pending, and provide online instructions in respect to actions to be taken.

Nontraditional investments

An additional benefit unique to Perpetual is the Portfolio Plus service. This allows me to access institutional investment opportunities such as alternative investments, commercial property syndicates and other nontraditional managed investments, and take up offerings that suit me and my risk profile. To date I have chosen one international and one private equity investment for the fund.

Should any AIA member wish to discuss my experiences, email rex_barber@hotmail.com or contact Mark Smith, Group Executive Perpetual Private, whom I have dealt with, on 02-9229 9686 or mark.smith@perpetual.com.au, who could explain the process for establishing a SAF or conversion of your SMSF to a SAF.



BOOK REVIEW - “Aftershock”

Afterstock: Protect yourself and profit in the next global financial meltdown - 4th edition

Author	David Wiedemer, Robert A Wiedemer and Cindy S Spitzer
ISBN	978-1-119-11850-3
Publisher	Wiley Finance
Publication date	2015 (4th Edn) in Canada
RRP	\$27.95 USD
Reviewer	Warren Toh

Aftershock claims to present the underlying reasons as to why the authors believe we have merely delayed, not avoided the big ‘aftershock’ described in prior editions that will cascade through-out the global economy as a result of seven main bubbles popping – eventually leading us to fall over the ‘cliff face’ and into meltdown. Chapter 1, ‘This Recovery is 100 Percent Fake’, introduces the notion that the aftershock has not been cancelled – merely delayed – and why. It attempts to dispel common constant counterarguments:

- inflation appearing low
- low unemployment rate
- government borrowing outpacing GDP growth.

Many of these arguments of the ‘fake recovery’ are interesting given the current unprecedented economic environment. If you are searching for a book outlying in detail specific strategies or investments to take advantage of the perceived economic meltdown to ensue, then the authors reference their book *The Aftershock Investor*, which covers this. However, two chapters are dedicated to recommended strategies and practical investments.

Most of the book focuses on the economic trouble brewing behind closed doors, the likely triggers and resulting consequences. Many arguments are repeated throughout.

Chapter 2 outlines the authors’ success in predicting the 2008 GFC, why other analysts and commentators failed to observe 2008, and what they acknowledge as having predicted wrongly.

Chapter 3 introduces us to the steps (the seven bubbles popping) leading towards the ‘aftershock’ being realised, namely:

- the real estate bubble
- the stock market bubble
- the private debt bubble
- the discretionary spending bubble
- the dollar bubble
- the government debt bubble.

According to the authors the first four have already begun to burst (leading to the well-known 2008–09 crisis), been partially reinflated (with the easy money/quantitative easing of recent years post-2008 GFC), and how the final two remaining bubbles are set to burst as we drop off the market cliff on our approach to the aftershock. The authors break down each bubble in detail, justifying the existence of the ‘bubble’, and dispelling any counter-arguments commonly published. They back up these explanations with a variety of statistical diagrams, graphs and historical information.

I related to many of the economic facts and arguments supporting the existence of the bubbles, how they have been kept artificially inflated or ‘reinflated’ post-GFC, and how they will eventually pop and deflate no matter how much the government tries to reinflate them. I found these topics interesting given the unprecedented global easy monetary policy and mixed information released publicly regarding the economy.

Chapter 4 is dedicated to the ‘market cliff’ – described as a multi-stage progressive movement towards the eventual ‘cliff’ – as the first four bubbles pop and heap pressure on the financial and economic systems of both the US and globally. It details the government’s likely natural responses, why these will fail and worsen the situation, and the structural changes required as the end draws near.

Following the market cliff post-bubbles bursting, Chapter 5 details the massive money printing response to follow, why this will result in a build-up of inflation before finally leading us to the ‘Aftershock’ event where the remaining two bubbles pop (the dollar and government debt bubbles). These two bubbles are covered in detail in Chapter 6. It concludes by detailing the six psychological stages of denial – with the final stage 6: ‘Revolutionary Action’.

The remaining few chapters cover the global meltdown that ensues (chapter 7) and the degree to which each major country is anticipated to be affected by the aftershock ripples.

Case studies of the authors’ experiences of economic denial and interactions as they travelled various locations throughout the USA fill Chapter 8. Three general rules follow for investors looking to prepare for the coming aftershock by covering assets effectively.

Specific investment opportunities and themes anticipating the upcoming market cliff and aftershock cover everything from gold to coal, to agricultural commodities, and the authors’ opinions of what will and won’t flop in the upcoming aftershock in providing ample returns.

The authors discuss the effect on future growth in jobs, what a savvy jobseeker in an aftershock environment should do, what types of jobs will experience gains and losses as a result of the calamity, as well as the effect the falling bubbles will have on the three broad economic sectors: capital goods sector, discretionary spending sector and the necessities sector.

This book's main purpose is to prompt readers to delve into economic structural issues and unsustainable post-GFC responses that will merely result in the problem being kicked down the road.

The authors conclude by reflecting on the failures to change old habits, processes and methods of thinking and cover what we must therefore seek to understand, implement and structurally change for the future in order to prevent such a calamity as the aftershock recurring.

Overall *Aftershock* presents hard-hitting counterarguments that dispel the theory that the US and the world are rosy and well on the road to recovery. It makes a good attempt at providing hard statistics and reasoning behind the ‘why’. While the book is light on specific investment themes and recommendations relative to its size, its main purpose is to prompt readers to delve into economic structural issues and unsustainable post-GFC responses that will merely result in the problem being kicked down the road. Given worldwide loose monetary policies and unprecedented levels of government borrowing, the book provides an interesting perspective into what may be in store.

While readers may not agree with the argument, I recommend the book as an alternative view. It will be interesting if the authors’ forecasts hold true over the next couple of years. Hopefully for our sakes they’re wrong! Warren Toh

UP, DOWN OR SIDEWAYS

ALAN HULL

At this year's annual conference I will be taking the 'Charting 101' class. They've called it 'Technical analysis for the not so technical', which isn't a bad title, although I think 'Charting for dummies' has a catchy ring to it. But sadly I believe it's being used as the name of a book. And while I kind of like 'Witchcraft 101' I think the powers that be at the AIA want to set a somewhat more serious tone. So I guess we're going with 'Technical analysis for the not so technical' and I promise to be serious.

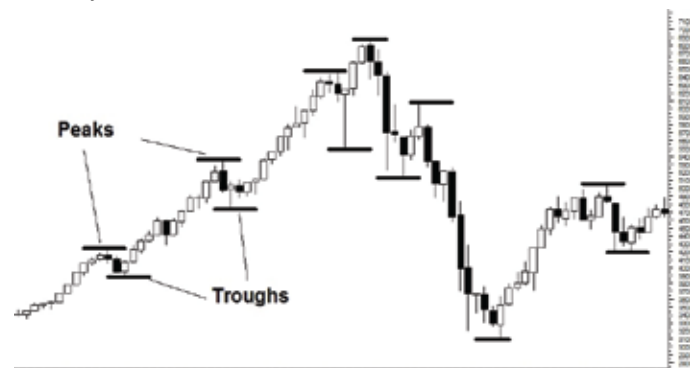
Now the first thing you need to know about charting is that it is a practical science which 99.9% of the time employs robust logic. And as an aside it was also a forerunner to the modern field of behavioural finance. Chartists were observing human behaviour centuries ago. But that's another discussion and one to be had with the guy who's doing advanced witchcraft ... and not me.

Instead I'm going to use robust logic to address the simple question that many investors ask: Is the market trending up, down or sideways? Now the first thing to do here is to look at a price chart and see if the answer is obvious. If it is, then good, but if it isn't then there are techniques we can employ to quantitatively determine a market's direction. And I favour an approach that's over 100 years old.

Peaks and troughs are the pivot points or reversal points in price movement. It is the relative position of successive peaks and troughs that helps determine if a market is rising, falling or moving sideways.

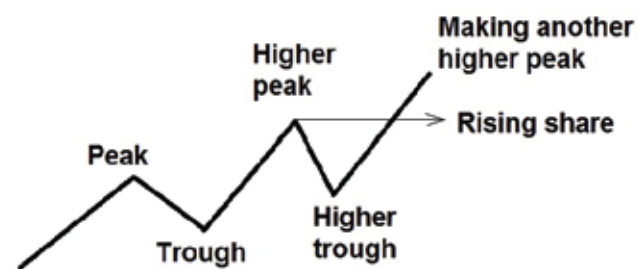
Charles Dow proposed several theories on the markets from the late 1800s to the early 1900s as part of his work as a journalist (and co-founder) of the Wall Street Journal. Most of his work centred on the relationship between business and financial markets; however, one part of his work that is of interest to chartists looks at the identification of trends using an analysis of peaks and troughs.

Peaks and troughs are the pivot points or reversal points in price movement. It is the relative position of successive peaks and troughs that helps determine if a market is rising, falling or moving sideways.

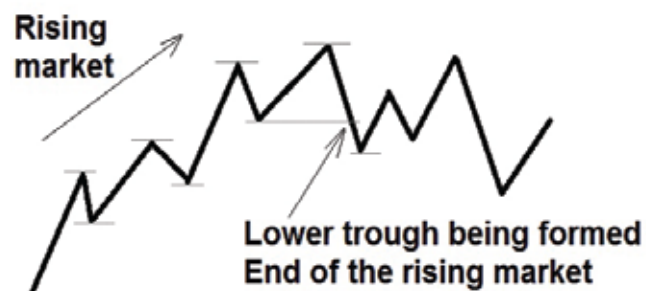


When a series of peaks and troughs are rising, the market is rising. When a series of peaks and troughs are falling, the market is falling. However it can be a little difficult to understand exactly how many peaks and troughs it takes to make a meaningful series, so consider the following diagram.

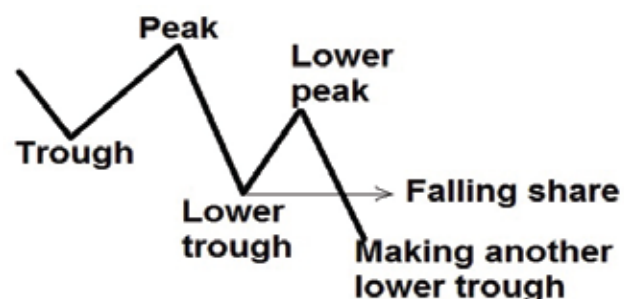
Here you can see a peak and trough followed by a higher peak and a higher trough. The market is considered to be rising after the formation of the higher trough. This is confirmed when the price rises above the higher peak, as shown in the diagram below using the thin line with the arrow to the right.



An end of a rising market is triggered when a lower peak or a lower trough is formed. This is illustrated in the following diagram. Starting at the left hand side of the diagram you can see the peaks are rising, and the troughs are rising as well. However, about halfway along, a lower trough is formed. At this point, when the market falls below the previous trough, the market is no longer rising. A chartist will often use this as a signal to exit the market. This is referred to as a Dow stop loss.



And it is important to note that the end of a rising market is not necessarily the beginning of a falling market. In a similar fashion to a rising market, a confirmed falling market requires a lower peak, a lower trough and a fall past the previous trough, as illustrated in the following diagram.



So there will be times when the market is neither rising nor falling and is classified as sideways. What's more, it should remain classified as sideways until there is a confirmed rising market or falling market.



Interestingly, there are actually two ways in which a market can be classified as sideways. A market can either be making a series of outside swings or a series of inside swings. In the following case, the All Ordinaries index was making a series of higher highs and lower lows in a widening pattern.



While this widening pattern signals that the market is becoming increasingly unstable with growing volatility, Dow Theory is only concerned with trend direction. Thus, consider the following chart of Oil Search from the same period where it's consolidating by forming lower highs and higher lows (i.e. decreasing volatility). It is also trending sideways when viewed from the perspective of Dow Theory.

UP, DOWN OR SIDEWAYS continued...



Of course, these are pristine examples and while using Dow Theory for trend analysis may seem an entirely mechanical process, there can actually be ambiguous cases. So I recommend that you find a source of price charts and have a play with Dow Theory for yourself. It is a simple and robust technique that I often use to identify trends and set trailing stop loss levels. Seriously...

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LIBERALS vs LABOR

What different election outcomes could mean for SMSF pensions

BRYCE FIGOT, DBA LAWYERS

LABOR

The policy

Labor has been consistent with their policies for superannuation (including SMSF) pensions. Its position is as follows (http://www.alp.org.au/fairer_super_plan):

... reduce the tax-free concession available to people with annual superannuation incomes from earnings of more than \$75,000. From 1 July 2017, future earnings on assets supporting income streams will be tax-free up to \$75,000 a year for each individual. Earnings above the \$75,000 threshold will attract the same concessional rate of 15 per cent that applies to earnings in the accumulation phase
... capital gains will be grandfathered ...

The drawbacks

The key drawback I feel is that the above could be very difficult to implement for those with pensions from multiple funds. For example, consider an individual who receives pensions from two superannuation funds. The earnings from the assets supporting the first pension in the first fund might total \$60,000. The earnings from the assets supporting the second pension in the second fund might also total \$60,000. Accordingly, total earnings (ie, \$60,000 + \$60,000 = \$120,000) exceed the \$75,000 threshold by \$45,000. This raises a tricky question: in which fund is the \$45,000 excess subject to tax?

I suspect that the most practical way of dealing with this problem is as follows. I stress that this is only what I suspect what would happen. Again, I have no special inside information.

- At the end of each financial year, each fund tells their pensioners what the associated pension assets earnings of the fund are by way of a document that is similar to a PAYG payment summary.
- Each pensioner has to lodge an income tax return with the total of all associated pension assets earnings from all funds. These figures would not constitute assessable income of the pensioner.
- If total associated pension assets earnings is greater than \$75,000, the ATO sends the pensioner a tax bill calculated as the excess (eg, \$45,000 in the above example) multiplied by 15%.
- The pensioner must give this bill to one or more for their superannuation funds to pay. The superannuation funds can adjust the tax bill by any deductions/losses they have in the relevant year.
- The pensioner can only pay the tax bill him or herself if there is insufficient money in any of their superannuation accounts in any superannuation funds to pay the bill.

Naturally, the above would be very paperwork heavy. Further, it would be mean that pensioners who might not otherwise have to lodge income tax returns would need to start lodging tax returns. However, I suspect the above — or some version of it — is what would be needed to make the Labor policy work.

Another drawback is the question of what happens in respect of the sale of 'lumpy' assets such as real estate. Real estate can be quite low yielding in rent meaning that in most years the \$75,000 threshold might not be used up. However, when sold, there could be a large capital gain. If this capital gain is greater than \$112,500 (ie, \$75,000 grossed up for the one-third CGT discount that superannuation funds currently get if the asset is held for more than 12 months), then the SMSF would pay tax at usual superannuation fund rates on the excess of the net capital gain over \$75,000. However, some of the harshness of this would be mitigated by the fact that 'capital gains will be grandfathered'. Also, there is no suggestion that the \$75,000 threshold will be indexed.

The pros

Firstly, 'capital gains will be grandfathered'. On one construction, this could mean that pension assets already owned in superannuation funds will remain CGT free upon sale. Alternatively, on a more charitable/optimistic reading of the sentence, this could even mean that the second drawback doesn't even occur (ie, that there's no limit on the pension exemption that applies to capital gains). Alternatively, it also mean even other things.

LIBERALS

The liberals made three noteworthy policy announcements in the Budget.

The first policy

The first policy is to:

... [f]rom 1 July 2017 ... introduce a \$1.6 million transfer balance cap on the total amount of accumulated superannuation an individual can transfer into the retirement phase. Subsequent earnings on these balances will not be restricted. This \$1.6 million cap will be indexed in increments of \$100,000 in line with the consumer price index. A fact sheet released on Budget night explains: A proportionate method which measures the percentage of the cap previously utilised will determine how much cap space an individual has available at any single point in time. - For example, if an individual has previously used up 75 per cent of their cap they will have access to 25 per cent of the current (indexed) cap

The drawbacks of the first policy

On its face, the Liberals' policy is similar to Labor's policy. Afterall, assuming that assets yield income of 4–5% pa, \$1.6 million of assets will generate approximately \$75,000 of income. However, I suspect the reality could be quite different. My reasoning is as follows. Firstly, remember that under Liberals' policy '[s]ubsequent earnings on these balances will not be restricted.' Accordingly, a taxpayer with greater than \$1.6 million of assets will have a tremendous incentive to try to do a bit of 'crystal ball gazing' in order to determine which assets will experience significant capital appreciation and use those assets to fund their pension. This can work out in two ways:

- If the crystal ball gazing is right and assets that will experience significant capital grow are allocated to the pension, then — contrary to the Liberals' motivation — high wealth individuals could still experience significant tax free income, including net capital gains.
- However, the opposite could occur (ie, the crystal ball gazing is wrong), and indeed I suspect the opposite will occur more regularly. That is, assets are allocated to commence pensions and those assets end up collapsing in

value, for example, where the next GFC comes along. Because it very much sounds like the Liberals want to implement a lifetime cap of \$1.6 million, if you pick the wrong assets (eg, if you started your pension with \$1.6 million of shares in the next Enron), then it appears to be a case of too bad: even though the original assets might collapse in value down to effectively nothing, you can never use your pension exemption again.

This means that the income tax system would not be taxing income. Rather, it would be giving a tremendous free kick to those who are good at picking investments and it would be giving a tremendous kick in the guts to those who mis-predict future investment performance.

Other draw backs of this policy include:

- It sounds like there will be a harsh penalty for exceeding one's cap. This could occur if a fund miscalculates market values and starts a pension not with \$1.6 million of assets but with what ends up being valued at, for example, \$1.7 million of assets. The penalty would a tax on not just the earnings of the excess but also on the capital of the excess. Hopefully lessons from the poorly drafted excess contributions tax regime would be learnt and a sensible discretion will be given to the ATO (or even to taxpayers themselves) in order to avoid unfair and harsh outcomes.
- It would require tracking of how much of each individual's lifetime cap — as proportionally indexed — has been used.

The pros of the first policy

This policy would be conceptually easier to administer I think than the Labor equivalent.

The second policy

The Liberals have said that they will remove 'the tax exemption on earnings of assets supporting Transition to Retirement Income Streams from 1 July 2017'.

The key point here is that to date, for those wishing to take no greater than 10% of their assets per annum, it has not made a huge difference whether they receive transition to retirement income streams or full account-based pensions. However, under this policy it would make a big difference. Accordingly, if this policy ultimately becomes law, those wishing to commence transition to retirement income streams will have an incentive to see if they can first 'trigger' a retirement event so that they can take a full account-based pension rather than a transition to retirement income stream and thus pension assets can access the pension exemption. It has been noted by many that — particular once someone reaches age 60 — 'retirement' as defined in superannuation law can occur in ways that are very unintuitive. For example, according to paragraph 22 of APRA's Prudential Practice Guide SPG 280 Payment Standard, if a 60 year old works two jobs and quits one job (eg, to work even more in the other job) this constitutes retirement under the superannuation law.

The third policy

The Liberals propose to remove the ability to make a reg 995 1.03 election that 'allows individuals to treat certain superannuation income stream payments as lump sums for tax purposes.'

LIBERALS vs LABOR

CONTINUED...

Succession planning

Both the Liberals and Labor's proposals could have a massive impact on succession planning.

Currently, the legislature has been quite explicit that if a fund member dies in pension mode, so long as their benefits are cashed as soon as practical after death, the pension exemption at the fund level will continue and there will be no 'back door' death tax by way of CGT at the fund level.

This could change a lot regardless of who wins. I won't give this full consideration in this article, however, I will note the following consideration in respect of the Liberals' policy. Namely, unlike Labor where an infinite amount can support a pension, it appears that under the Liberals' policy, someone can never receive pensions with assets that were worth more than \$1.6 million upon their commencement. This might mean in a mum and dad fund with real estate worth say \$3.2 million, if dad dies and mum already has a pension, all of dad's benefits (ie, a 50% interest in the real estate) might need to be cashed out of the fund by way of a lump sum with no scope of a death benefit pension to mum. Therefore substantially more CGT may be collected in superannuation funds in respect of death benefits especially given the Liberals' proposed removal of the anti-detriment deduction.

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NEWS

Marcus Padley appointed AIA Ambassador

The AIA board is pleased to announce that Marcus Padley has been appointed AIA Ambassador. Marcus will assist the board and staff to promote the AIA and raise the profile of the Association through his media and financial connections.

Marcus Padley (MAppFin, LLB, MSAA) is the author of the independent Marcus Today stock market newsletter aimed at helping individual investors manage their investments and trades. Marcus has been a regular speaker at the AIA National conference and at state-wide events and is a contributor to the Investors Voice on a regular basis. New Members of the AIA receive a Free trial of Marcus Today newsletter.

Marcus has a Masters in Applied Finance degree from Macquarie University, a Law degree from Southampton University in England, is a Master Stockbroking member of the SAA and a Prize winner in Applied Portfolio Management.



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Investor Centre

Calendar of Events

Please Note:

As AIA events are confirmed,
details are posted to the AIA website
www.investors.asn.au

Please note topic is subject to change.

DATE	DAY	TIME	EVENT	VENUE
NSW / ACT				
11-Jul-16	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
13-Jul-16	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street, Chatswood
17-Aug-16	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street, Chatswood
08-Aug-16	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
12-Sep-16	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
14-Sep-16	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street, Chatswood
VIC				
05-Jul-16	Tuesday	6.45pm	Geelong Discussion Group	St George Workers Club, Geelong West
06-Jul-16	Wednesday	1.00pm	Frankston Discussion Group	Private address; contact Bill Shirley for details: wshirley@hotmail.net
26-Jul-16	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough
27-Jul-16	Wednesday	7.00pm	Kew Discussion Group	Phyllis Hore Room, Kew Library
28-Jul-16	Thursday	4.00pm	Melbourne Bayside Discussion Group	Private address; contact Kevin Macdonald for detail: km.macdonald@bigpond.com
02-Aug-16	Tuesday	6.30pm	Melbourne Information Meeting	Telstra Conference Centre, Room 1, Level 1, 242 Exhibition Street, Melbourne
03-Aug-16	Wednesday	7.30pm	Blackburn Discussion Group	Naturalist Club of Victoria, 1 Gardenia Street, Blackburn
30-Aug-16	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough
06-Sep-16	Tuesday	6.45pm	Geelong Discussion Group	St George Workers Club, Geelong West
27-Sep-16	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough
28-Sep-16	Wednesday	1.00pm	Frankston Discussion Group	Private address; contact Joy Stirling for details: 03 9782 5069
28-Sep-16	Wednesday	7.00pm	Kew Discussion Group	Phyllis Hore Room, Kew Library
29-Sep-16	Thursday	4.00pm	Melbourne Bayside Discussion Group	Private address; contact Kevin Macdonald for details: km.macdonald@bigpond.com
QLD				
06-Jul-16	Wednesday	1.30pm	Brisbane Information Meeting	Cromwell Property Group, L19, 200 Mary Street, Brisbane
18-Jul-16	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road, Chermside
19-Jul-16	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
20-Jul-16	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
20-Jul-16	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
07-Aug-16	Sunday	1.00pm	Gold Coast Half Day Seminar	Marriott Resort & Spa, Surfers Paradise
07-Aug-16	Sun-Wed	5.00pm	AIA National Annual Conference	Marriott Resort & Spa Surfers Paradise
15-Aug-16	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road, Chermside
16-Aug-16	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
17-Aug-16	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
17-Aug-16	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
07-Sep-16	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street, Brisbane
19-Sep-16	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road, Chermside
20-Sep-16	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
21-Sep-16	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
21-Sep-16	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
SA				
18-Jul-16	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road, Fullarton
15-Aug-16	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road, Fullarton
12-Sep-16	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road, Fullarton
WA				
05-Jul-16	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets, Wembley Downs
19-Jul-16	Tuesday	7.30pm	Perth Equities Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets, Wembley Downs
16-Aug-16	Tuesday	7.30pm	Perth Equities Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets, Wembley Downs
06-Sep-16	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets, Wembley Downs
20-Sep-16	Tuesday	7.30pm	Perth Equities Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets, Wembley Downs

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