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SECURITIES PTY LTD

WEALTH – LIFESTYLE – SECURITY

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Welcome to our May 2008 Client Newsletter. With the end of financial year only a matter of weeks away, we would encourage you to contact your Newell Palmer Financial Adviser if you require additional information on these articles or assistance with year-end financial planning strategies or implementation. In addition to this newsletter, we have posted a "Federal Budget 2008 Update" on our website www.newellpalmer.com.au which outlines the key budget initiatives. We wish you, your family and friends all the best for a rewarding 2008/9 financial year.

Investment Outlook

Economic Overview

United States - The US-based Institute of Supply Management's non-manufacturing index came in at 49.3 for February, above the record-low 44.6 in January but still slightly below the level of 50 that separates expansion from contraction. The index has been below 50 for two consecutive months, the first such slump since January 2002. "Regardless of what you call it, it's a period of growth that's much too slow relative to what we'd like to see," Boston Fed President Eric Rosengren said.

Europe - Consumer prices in the Euro area increased 3.3 percent in February with labour-cost growth accelerating in the fourth quarter to the highest since 2006. As such, economists have pushed back their forecasts for possible interest-rate cuts this year.

Japan - Japan's consumer prices rose at the fastest pace in a decade with core prices climbing 1 percent in February from a year earlier. Export growth to Asia quickened to 13.9 per cent in February from 8.1 per cent a month earlier. Exports to the U.S. slid 6 per cent from a year earlier, the sixth monthly decline. The growth has reduced the importance of the U.S., which accounted for only 20 per cent of total exports last year, compared with about 30 per cent in 2000.

China - China's Premier Wen Jiabao pledged to take "forceful" steps to dampen inflation which is at an 11-year high. He added that the government's 4.8 percent inflation target for 2008 would be "difficult" to achieve. Consumer prices in China jumped 8.7 percent in February from a year earlier on food costs and supply disruptions caused by the worst snowstorms in half a century.

Australian Shares - At the end of the July 2007 reporting season, Macquarie had forecast market earnings per share growth for 2008 of 9.6%. This has been slashed to 1.3% due to disappointing results for the six months to 31 December 2007, and there is a risk of falling further to between -5% and -10%. With a few high-profile exceptions the state of balance sheets remains robust. Gearing levels were just over 40%, compared with about 45% in 2006. Corporate earnings growth will face pressure from higher cost and slowing sales growth. This is leading to a PE contraction.

International Shares - International share markets have been focused on the weakening state of the US economy and the ongoing debt crisis. Investors have so far not placed much weight on the upbeat developments, such as the aggressive easing by the Federal Reserve, or the strong growth in developing economies.

Property - Many listed property trusts are trading at significant discounts to their last reported Net Tangible Assets (NTA) with little or no value being attributed to the funds management and development businesses. Besides capitalization rates increasing as investors now require a higher rate of return on assets, other factors such as refinancing risk or high gearing have also played a part. Collectively the sector now trades at a 12% premium to last reported NTA, compared to the 90% premium at which the sector was trading on little over a year ago.

Sector View

Cash	–	Positive
A$ Bonds	–	Negative
A$ Hybrid Securities	–	Cautious - stay with investment grade
International Bonds	–	Neutral
Australian Equities	–	Neutral - accumulate the All Ords index below 5,500 points
International Equities	–	Increase exposure
Listed Property	–	Neutral - remain selective or buy the index
Residential Property	–	Positive

New Borrowing Rules for Self-Managed Superannuation Funds

Some recent legislative amendments have led to significant changes to a Self-Managed Superannuation Fund's (SMSF) ability to borrow money in order to purchase assets. These changes allow SMSF's to purchase assets, such as property, that it may not have been able to if it was not able to borrow.

The law does not require SMSF's use outside parties in order to setup this arrangement. The following steps need to be adhered to in this process:

1. A separate trust is created with the SMSF owning all the units in the new trust.

2. The new trust will then arrange to purchase and hold an asset on behalf of the SMSF. The SMSF will be the beneficial owner of the asset and it will be able to instruct the fixed trust in relation to the asset.

3. The SMSF borrows from a lender that will offer a non-recourse loan. A non-recourse loan is where the lender only has rights over the asset that money was borrowed for and will not be able to recover the loan from any other assets of the SMSF. In most cases this can only be achieved if the SMSF provides a significant deposit. However, you can achieve something similar to this if you are in the position to lend funds (even if you borrow them yourself) to your SMSF on a non-recourse basis.

4. The SMSF via the trust buys the asset.

5. The SMSF collects the rent, pays the interest and debt to the lender as well as paying for the maintenance of the property.

6. The SMSF can later sell the asset or pay off the debt and take legal ownership of the asset.

These steps aren't exhaustive and there are a number of other legislative issues to consider as well. An example is that the SMSF is unable to purchase an asset from a member if that asset represents more than 5% of the total value of the SMSF.

It's also important to note that a member of the SMSF is not allowed to occupy the property. However, once the member is retired it is possible under current legislation to transfer the property to the member. Depending on the circumstances, it may be possible to do so without incurring any additional taxation liability.

There are now a number of "off the shelf" products being introduced that simplify the process for trustees, however, it's important to assess the ongoing fees being charged for these services.

The changes to the legislation offer new opportunities for a SMSF to purchase assets that it may not have been able to do before and potentially increase retirement funding for members. It is now possible to purchase assets, such as residential property, within a tax-advantaged environment and for the member to salary sacrifice the loan repayments.

As this legislation is relatively new and is currently under review by the ATO, we recommend you seek advice from your Newell Palmer Financial Adviser as to whether this is a viable strategy for your SMSF and to assist you with implementation.

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Market Volatility - Sub-prime Impact on the Economy and our Balance Sheet

What is Sub-prime?

In simple terms, the US Sub-prime refers to financial institutions lending money to borrowers, to buy residential property, who may not have the ability to sustain loan repayments. It originated back in early 2000 by loose lending practices (including Mortgage Brokers) who were remunerated on the basis of selling loans. With minimal or no deposits and interest rates rising, borrowers had no incentive to hold onto properties when real estate prices began to fall. In addition, their employment income in some cases was insufficient to sustain the loan.

Home foreclosures in the US were nearly 1 million in 2007 and are expected to rise further, close to 2 million in the next 12 to 18 months. Although the housing sector represents only 5% of national output, the significant impact was felt by home lenders in general who saw property prices falling and as a follow-on, consumers tightened their belts. 70% of GDP growth is funded by consumer spending and consumer spending funded by withdrawal of funds from “equity release” has dried up. This has resulted in a slowing of spending and why recession in the US is a likely outcome.

These Sub-prime loans were in many cases “dressed-up”, repackaged as high yield, low risk securities and on-sold to other financial institutions where they now sit at significant discounts to their original value or in many cases written off, causing the fallout to financial markets detailed below.

Impact of the Fallout

It is anticipated the total write-down of the US banks will top $300 billion, with a significant write-down in equity prices, starting with the US banks. The US Federal Reserve took proactive actions including reduction of interest rates, allowing the convertibility of illiquid loans with treasury notes and other measures to free up liquidity with the aim of instilling stability in the banking system.

The fallout of the Sub-prime impacted the Australian equity market. Stocks that were significantly punished such as Centro, MFS and Allco Finance were caused by highly leveraged balance sheets. Other well-run institutions such as the 4 major banks (NAB, CBA, WBC and ANZ) have been sold down as much as 30-35%. This appears to be overdone, but margin compression and concerns over loans to companies that may prove to be bad caused the market to sell off banks. Other sectors such as property companies and investment banks have also been sold off.

Though there has been a flow on effect from the US to other markets including Australia, robust growth in China has tempered the economic slowdown. It has been recently reported that China has overtaken Japan as Australia's largest trading partner. Although China will be impacted by a US slowdown, China's GDP is expected to still grow by 8%+ in the next 12 months (down from 10%).

Outlook and Opportunity

All growth investors have suffered paper losses in the last 4 to 5 months. For those investors with a long term time horizon, the impact of these falls will subside over time.

The key issue is ensuring that portfolios are structured consistent with the risk appetite of the investor and assets are quality assets, as these will recover the quickest and continue to deliver sustainable longer term returns.

For those investors who still hold dubious high growth speculative assets, this is the time, if it has not already been done, to restructure.

For those investors holding cash, this is a real opportunity to build positions and we would argue that allocating funds over the next 3 to 6 months should prove to be profitable with a 3 to 5 year plus time horizon.

We favour selected Australian companies which demonstrate sustainable earnings, low debt and well managed businesses. In addition, we see good value investing in International equities with a bias towards the high growth regions of Asia.

Lending Rates and Mortgage Review

As the Reserve Bank of Australia has been increasing the official cash rate over the last 2 to 3 quarters and banks have increased rates over and above official rates, we see it as prudent for clients to review their lending arrangements. With a home loan and/or investment loan of $500,000, a 0.25% p.a. reduction will account for a $1,250 p.a. saving. In addition, due to a shortage of credit to finance loans, many second-tier lenders (non-bank lenders) are “pulling in the reins” and increasing interest rates as well as restricting additional lending.

This is an excellent opportunity for clients (and their family and friends) to contact their Newell Palmer Financial Adviser to arrange a review of their lending facilities with our Westpac Home Loan Partnership Manager to ensure they have the most appropriate lending package at the most competitive rate.

Transition to Retirement

Who qualifies for early access?

To be eligible for this strategy, you must:

- Have reached age 55; and
- Be eligible to salary sacrifice into superannuation.

Currently, salary sacrifice is allowed for those under age 70, however it is voluntary for employers to offer.

If this is you, please read on!

If you are 55 and over, you now have the option of easing into retirement. You can also reduce your working hours without reducing your income. On top of this, you can top up reduced income with a regular income stream from your superannuation savings.

This is a transition to retirement measure.

Let's consider a case study. Nick recently turned 55 years old, and has made few retirement plans. His superannuation balance is only fairly small for his future needs. Nick visits a Newell Palmer Securities Financial Adviser, who considers his particular situation, goals and future needs. His adviser suggests that even though Nick will need to keep working full time past age 55, he can use a transition to retirement strategy to maximise his savings.

The adviser prepares a plan that uses a transition to retirement pension (see table). Under the plan, Nick reduces his salary to $36,325 and salary sacrifices $63,675 ($54,123 after 15% contributions tax) to super. To supplement his salary, Nick commences a transition to retirement pension with $500,000 of his super and takes $50,000 per annum as a super pension. Both Nick's salary and super pension are taxed at his marginal rate however; he receives a 15 per cent tax offset on the pension income. Under the transition to retirement arrangement, Nick's after tax cash income remains about the same, at $71,400.

Case study:

	No strategy	With strategy
Pension income:	$0	$50,000
Salary:	$100,000	$36,325
Before tax income	**$100,000**	**$86,325**
Tax on taxable income	$27,100	$13,630
Plus Medicare levy	$1,500	$1,295
Net tax payable	*$28,600*	*$14,925*
After tax income	**$71,400**	**$71,400**

However, while the plan involves drawing down on Nick's super savings via a transition to retirement pension, the strategy is also effective at increasing his super. This is because of two factors. Firstly, Nick is salary sacrificing more to super than he is receiving via the transition to retirement pension - a net benefit of $4,123. Secondly, using a transition to retirement pension means Nick pays no tax on the earnings on the assets that back his pension. Assuming his $500,000 pension balance grows 7.5 per cent ($37,500 in the first year) he'll realise a further tax saving of $5,625. (Further tax savings could occur if Nick required less income to live on.)

That's a total benefit of $9,748 in the first year, which over ten years may make a big difference to Nick's retirement - especially if he maintains this strategy after age 60 when his pension income becomes tax free.

Nick's overall benefits

Net super position (Salary sacrifice less transition to retirement income)	$4,123
Tax savings on super earnings	$5,625
Total annual benefit	**$9,748**

So, what do you actually do?

- You salary sacrifice (arrange to have deducted from your pre-tax salary) some of your salary into your existing superannuation fund, paying only 15% tax on your contribution rather than being taxed at your marginal rate.
- The exact amount you salary sacrifice will depend on how much you're earning, because through salary sacrificing, you're effectively reducing your income.
- Then, to make up your income, you draw down a pension from your superannuation fund. From July 2007, some of the income drawn under age 60 may be tax free, or subject to a tax offset. Any income you draw after age 60 is tax-free.
- The exact amount of income you draw from your superannuation will depend on your lifestyle and financial commitments, what you currently have in superannuation and whether you want to work part-time or full-time. Differing transition to retirement strategies can be built for you according to whether you need to keep your income the same, boost your income or whether you can afford to reduce your income slightly to increase your super savings.

However, you need to be aware what impact this measure can have on you and your personal circumstances. Some parts of this measure are complex, and equally complex to set up and maintain. Your Financial Adviser at Newell Palmer Securities can help you set up an appropriate strategy and help you decide if this measure is right for you.