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Did you know?

The amount of funds invested through superannuation in Australia grew to \$791.5* billion as at 30 September 2005. This represented an increase of just under \$50 billion over the quarter from 30 June. At this rate of growth, superannuation assets grew by just over \$500m each day of the quarter.

If we assume that 13 million Australians have superannuation, the average superannuation account balance currently stands at \$60,846. Is this adequate to provide a reasonable level of income in retirement?

* Source: Australian Prudential Regulation Authority (January 2006)



Insights into Successful Investing Diversify Your Investments

The more you spread your investments, the less chance you have of losing money.

Let's say you invest your life savings into a single company. If the share price soared, you could become very rich. On the other hand, if that company went bankrupt, you could lose your life savings. You may be better off spreading your money around.

This concept is a simple one, but often overlooked by even the most experienced investors.

Diversification is a powerful way to reduce risk. It can do this in two ways. Firstly, if you have a well-diversified investment portfolio and an individual stock (or even an entire asset class) loses ground your losses may be reduced.

Secondly, the various types of investment will perform better at different times. For instance, shares tend to perform well at the upturn in the economic cycle, whilst fixed interest investments tend to perform better in the latter parts of the cycle. So diversifying across all asset classes gives you a better chance of achieving a sound overall return.

There are three main levels of diversification – by asset class, investment security and investment manager.



1. Asset class

This refers to the type of investment – generally shares, property, fixed interest and cash.

As you can see from the table below, each asset class has its time in the sun. By investing across all the major asset classes, you will always have exposure to the best performing asset class every year.

Obviously you will also be invested in the worst performing asset class. However, this performance will at least be partially offset by the performance of other assets.

The second part of Insights into Successful Investing – “Diversify your investments” will appear in the next issue of Timely Tips.

Source: BT Financial Group – Extract from “Ten Investing Truths”

1 year returns to 31 December										
Australian %	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Cash	7.75	7.45	5.63	5.09	4.89	6.06	5.16	4.66	4.92	5.39
Fixed interest	18.63	11.87	12.23	9.54	-1.15	12.05	5.50	8.74	3.11	6.95
Property	14.28	14.24	21.76	18.37	-4.20	18.79	14.99	11.85	8.81	32.18
Shares	20.50	14.61	11.84	11.29	17.43	4.09	10.20	-10.09	15.53	27.56
International %										
Fixed Interest	24.13	-2.96	22.18	22.49	-10.26	19.63	7.48	8.63	-14.11	6.05
Shares	26.05	6.24	41.63	32.34	17.20	2.19	-9.96	-27.44	-0.76	9.94

Indices: Liquids index (Cash), UBS Fixed Interest 0+yrs index (Australian Fixed Interest), S&P/ASX Property index (Australian Listed Property), S&P/ASX 300 accumulation index (Australian shares), SSB World Government Bond index unhedged \$A (International Fixed Interest), MSCI World ex Aust Accumulation index (International shares).

getting you from **a** to **b**

What is Salary Sacrificing?

Salary sacrificing is an arrangement whereby a person enters an agreement with their employer to pay them a reduced salary in return for some other form of benefit. With the advent of fringe benefits tax, superannuation is one of the most common forms of salary sacrifice used in Australia today.

More and more people are recognising the need to build up additional savings if they are to be in a position to enjoy the type of lifestyle they would like when they get to retirement. Clearly, the current 9% compulsory superannuation contributions will not be sufficient for most people to have built an appropriate nest-egg by the time they retire.

Contributions made to a complying superannuation fund by an employer are taxed at a maximum rate of 15% while the investment income earned on those contributions within the superannuation fund is also taxed at a maximum rate of 15%.

When we receive income in our own hands, it is taxed at our personal marginal tax rate. This ranges from 0% and 47% (plus Medicare levy) depending on our total income for the financial year. The investment earnings on any savings we accumulate are also taxed at our marginal tax rate.

If we consider a person who receives a wage or salary that is taxed at the top marginal tax rate of 47%, they lose almost half of their income in tax. However, if that person were to enter a salary sacrifice agreement and their employer makes additional contributions to superannuation on their behalf, then that foregone income would be taxed as income to the superannuation fund at a rate of 15% rather than at their marginal tax rate. That represents a cut in tax on those funds of 32%. For people on lower tax rates (such as 30% and 42%) the tax savings are still worth considering.

Whilst it will be an attractive proposition for many people to consider salary sacrificing additional amounts into superannuation, it is important to remember that the funds can not be accessed until retirement on or after reaching 55 years of age. Alternatively, superannuation benefits may now be accessed between the ages of 55 and 65, even if not retired, provided the benefit is taken in the form of an income stream (rather than as a lump sum). This is allowed under the "transition to retirement" regime introduced from 1 July 2005.

Let's consider the following simple example to understand how salary sacrificing works in practice:

Larry receives a salary of \$120,000 pa. He has no other income.

	Before salary sacrificing	After salary sacrificing
Cash salary	\$120,000	\$ 95,000
Salary sacrificed contribution	\$ 0	\$ 25,000
LESS		
Tax payable	\$ 39,950	\$ 28,200
Medicare levy	\$ 1,800	\$ 1,425
Tax of super contribution	\$ 0	\$ 3,750
NET AFTER TAX BENEFIT (YR 1)	\$ 78,250	\$ 91,625

This simple example illustrates the effectiveness salary sacrificing part of a salary into superannuation for someone on the top marginal tax rate of 47%.

Whilst Larry has managed to reduce his tax payments he must remember that the \$25,000 he has salary sacrificed into super is not accessible but forms a part of his long-term savings for retirement. One further point to remember is that Larry's employer is contributing 9% of his \$120,000 cash salary to super under the compulsory superannuation guarantee system. As Larry's cash salary after salary sacrificing has reduced to \$95,000, his employer may limit future SG contributions to 9% of \$95,000. Larry needs to ask his employer how future SG contributions will be calculated before finalising his salary sacrifice arrangements.

The Australian Taxation Office has guidelines on "effective" salary sacrificing. In particular, salary sacrificing must be "prospective" – that is the agreement must be established before the remuneration to be sacrificed has been earned, there must be no access to the salary that has been sacrificed during the term of the arrangement, and a contract of employment setting out the conditions of the salary sacrificing must be established before the work is done. Salary sacrifice arrangements should ideally be fully documented.

Salary sacrificing can offer employees the opportunity to save tax and increase their savings for retirement. However, prior to entering a salary sacrifice arrangement, appropriate advice should be sought from a qualified financial planner.

Source: Peter Kelly – Professional Investment Services

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