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## Did You Know?

During the quarter ended 31<sup>st</sup> December 2006, the total amount invested in superannuation in Australia broke through \$1 trillion. As at 31<sup>st</sup> December 2006, superannuation assets stood at \$1,010 billion.

Source: APRA – Statistics - Quarterly Superannuation Performance – issued 29<sup>th</sup> March 2007

The editors of Timely Tips welcome feedback from readers. If you have any topics you would like to see addressed in future issues, or for that matter any other suggestions or comments, please forward your suggestions to:

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## Superannuation Contributions – Transitional Arrangements

As many readers may be aware, a superannuation fund is able to accept contributions for people under 65 years of age, irrespective of whether they are working or not. In fact, a person under age 65 may contribute to a superannuation fund even if they have never worked.

Between ages 65 and 74, contributions can only be accepted by a superannuation fund where the person for whom the contribution is made has met a “work test”. This work test requires they be employed or self-employed for gain or reward for a period of at least 40 hours worked over not more than 30 consecutive days in the financial year in which the contribution is being made.

In general terms, contributions cannot be accepted by a superannuation fund for a person once they attain age 75.

The Government recently announced a transitional arrangement that will be of particular interest to people aged either 65 or 75. This arrangement only applies to the 2006/2007 financial year.

Firstly, let's look at the situation as it applies to 65 years olds.

If aged 64 at any time during the period 10<sup>th</sup> May to 5<sup>th</sup> September 2006, a person may make non-concessional contributions (previously referred to as undeducted contributions) up until 30<sup>th</sup> June 2007, even if they have turned 65 and have not met the work test since attaining age 65.

*Example: Josephine had her 65<sup>th</sup> birthday in March 2007 and has not worked since 2003. She wishes to make a non-concessional contribution to superannuation before 30<sup>th</sup> June 2007. As she was aged 64 at some stage during the period 10<sup>th</sup> May to 5<sup>th</sup> September 2006, she is able to make a non-concessional contribution to super prior to 30<sup>th</sup> June even though she has not met the work test since turning 65.*

For those who have recently turned 75, there is still an opportunity to make

non-concessional contributions to superannuation in the current financial year. Where a person was aged 74 at any time during the period 10<sup>th</sup> May to 5<sup>th</sup> September 2006, and they met the work test in either the 2005/2006 or 2006/2007 financial year, they are able to make non-concessional contributions up until 30<sup>th</sup> June 2007 even though they have since turned 75.



These transitional arrangements only relate to non-concessional contributions. A non-concessional contribution is a personal contribution where a tax deduction is not being claimed in respect of that contribution.

Source: Peter Kelly – Professional Investment Services

## The Gear Ahead

When seeking advice to help create wealth, your adviser will consider factors such as your investment time horizon and risk profile. This information is crucial in order for your adviser to provide wise advice and ensure that you will pass the ‘sleep test’ at night.

Key decisions will also need to be made throughout your life, and these should always be discussed with your adviser to ensure that your financial plan remains relevant to your situation, needs and goals. For example, after borrowing to invest in managed funds or shares, your investment may rise or fall in value. In either case, you and your adviser will need to decide whether to rebalance to original gearing levels, or leave the loan as is. Such a decision can have a significant impact on your financial future. To help illustrate the different kinds of outcomes, let's look at the following case study.

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

## Rebalancing - A Case Study



John and Judy visited a financial adviser in June 2005 with a view to increasing their net wealth over the next five to ten years, and if possible reducing their tax payable. Taking into account that the couple had \$70,000 to invest and a growth-orientated risk profile, their adviser recommended that they borrow an extra \$70,000 with a margin loan, keeping a 50% gearing ratio to give them a large buffer against the possibility of falling markets.

With the margin loan John and Judy's investment portfolio came to \$140,000, which they invested in a variety of managed funds late in June 2005. The couple's investment performed well, in line with the positive performance of the local share market. For the purposes of this example, let's say the net return of their overall portfolio mirrored the S&P/ASX 200 Accumulation Index return of 24%, leaving them with a portfolio worth \$173,600, and an increase of \$33,600.

The rise in the value of their portfolio meant their margin loan was now only approximately 40% of their portfolio. In response to this change of circumstances, John and Judy's adviser met with them again to discuss rebalancing their margin loan. Together they decided to borrow additional monies to re-establish their original strategy of a 50% gearing ratio.

This resulted in an additional \$33,600 being borrowed and invested, which increased the value of their portfolio to \$207,200 (\$103,600 of equity, and \$103,600 of debt).

### The following year

With the rebalancing complete let's consider several scenarios for the following year to explore the impact on John and Judy's investment decision.

### A positive one

Let's assume that the return of the S&P/ASX 200 Accumulation Index is

10% and that their investment portfolio has an identical result. After reinstating their original 50% gearing ratio their portfolio would now be worth \$227,920 as at June 2007. So once they had deducted the value of their increased loan of \$103,600, they would be left with equity of \$124,320 - \$54,320 more than their initial investment. If they hadn't increased their gearing ratio from 40% to 50%, their investment portfolio would be worth \$190,960 - equity of \$120,960 or approximately \$3,500 less.

### A negative one

As we all know however, share markets don't always produce positive returns. How would John and Judy's investment have fared if the return for the financial to June 2007 on the S&P/ASX 200 Index (and their portfolio) was negative 10%? If they had reinstated their original 50% gearing ratio, then their portfolio as at June 2007 would be worth \$186,480. After deducting their increased loan of \$103,600 they would be left with equity of \$82,880, or \$12,880 more than their initial \$70,000 Investment. If they hadn't met with their adviser and rebalanced, their investment portfolio's value would be \$156,240 - a value of 86,240 after deducting the value of the loan (\$70,000).



### In for the long run

It's important to note the above case study only examines a period of two years. The appropriate timeframe for a margin loan is usually a minimum of five to seven years. If you invest over the longer-term with a margin loan, the likelihood that you will lose money tends to reduce.

As this case study demonstrates, meeting with your financial adviser on an annual basis to review your financial plan and discuss your gearing ratio is a valuable exercise. Naturally any decision will need to take into account your ability to service interest repayments and other commitments.

Source: Colonial Geared Investments

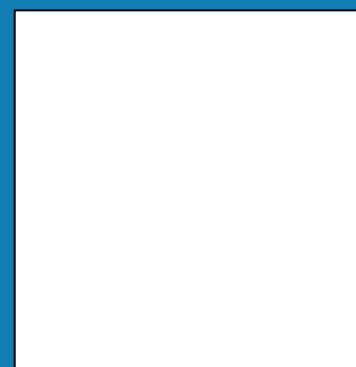
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