

Prosperitas

Prosperitas: Latin for prosperity & good fortune

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Spring time means horse racing and property!

When Spring time comes around, it seems that many Australians fall in love all over again with their two alluring passions – horse racing and property!

Whilst providing Spring Carnival winners is well beyond the brief and expertise of *Prosperitas*, property investment is a little closer to home and a topic that we are more than comfortable exploring. The page 2 article entitled 'Investing in Property – What are your Options' aims to lift the view of our readers from a fix on residential property to the myriad of other attractive alternatives within the sector.

As our local currency reaches new heights alongside the US equivalent, how do we continue to invest in the largest economy in the world and still reap the rewards for the investment risk being undertaken? Fortunately, many of our favoured International fund managers have developed currency hedging solutions aimed at achieving a satisfactory outcome for all. We also include a brief article on page 3 which aims to get to the bottom of the tax strategies proposed by both of the major Australian political parties over the last couple of weeks – what's in it for you!

Finally, although the Australian share market has long recovered from the correction experienced in August, we advise that the issues causing this rumbling have not yet necessarily gone away. Whilst investing over the past four years has been relatively smooth sailing, we expect that the coming 24 months will provide a few more ups and downs. At all times, prevailing cool heads will continue to benefit from a strong local economy being buffeted by global events – further, opportunities are certain to present themselves when the share price gyrates from the undue weighting of recent events.

We all hope that you enjoy this edition of *Prosperitas*, back a winner and if buying property that the hammer falls on your bid!

Martin R McIntosh
Managing Partner



WHAT ARE YOUR OPTIONS? Investing in property

Traditionally, residential property has been seen by many Australians as a safe and essential long-term wealth creation strategy.

Today however, there is increased diversity of the types of property available – supermarkets, office towers and industrial parks are all accessible to the potential property investor via various investment options. No longer does owning property simply mean buying the roof over your head.

So what are your options? And what are the advantages or disadvantages of each option?

Direct property ownership (residential)

There are many advantages to buying your own home. These include security of tenure (you are the landlord), the ability to do what you want with the property (install a new kitchen, update the bathroom or landscape the backyard) and perhaps most importantly, capital appreciation over time. Where the property is used as your Principal Residence, there is no Capital Gains Tax applicable when you sell the property.

A common strategy has been to draw down on the equity in one's own home as a deposit for a loan to purchase a second residential investment property. This has proved to be successful as residential property prices have increased consistently, particularly over the last 10 years. Just as importantly, the discipline of regular payments on an investment loan has assisted many investors to capture cashflow which may have otherwise been used for lifestyle purposes.

However, it is important to note that the dynamics of residential property as an asset class has changed considerably over time. Fifteen years ago, for example, it was possible to buy a property in any major city on a yield of 6%. This meant annual rental income was 6% of the value of the property. Certainly helpful in paying off the loan. Today, the net yield on a residential property can be below 3% (after taking into account the outgoings which the Landlord must pay including; rates, repairs and land tax.) This means that the investor is relying almost entirely on capital growth to make the investment worthwhile.

To provide a greater chance of earning the required capital growth, it is important to bear in mind that land in sought after locations is a scarce resource and will generally appreciate over extra time. On the other hand, buildings and fixtures and fittings will generally depreciate over time. All properties have some combination of land and building components. For example, a free standing house on a block of land will have a greater land component than an apartment in a high rise building. Over time, buildings decay and eventually need to be pulled down. At this point, the value of the property will revert to it's land value.

For the reasons listed above and many others, we generally recommend that clients seek advice from an experienced and independent Buyers Advocate when considering the purchase of a residential investment property.

What about other property investments?

More investors are realising that there are other property markets beyond residential. The essential features of property investment are still present: steady growth in capital values with growing and often tax-effective rental incomes. However, these increasingly sophisticated property markets come with some advantages not available to the average residential property investor.

Listed property trusts

Listed property trusts offer investors exposure to a variety of property sectors and, as the name suggests, are listed on stock exchanges. The advantages of listed property trusts include liquidity (the ability to buy and sell quickly) and access to a wide range of properties in both domestic and international markets. The sector is presently trading on an average yield of around 6.5% and has experienced outstanding total returns of an average of 19% per annum for the last 5 years.

The nature of listed property trusts has also changed considerably over the past few years as a greater proportion of earnings from the Trusts have come from fees for managing property as opposed to rent and capital growth from underlying property holdings. In addition to this, property trusts are listed on the ASX and are valued by the market daily which means that their value can fluctuate in a similar manner to shares, in the short term.

Direct Property Ownership (Commercial or Retail)

Some investors will have the capacity to purchase an office or retail shop either outright, or more frequently, with a combination of cash and borrowing. High quality commercial and retail properties generally provide consistent returns over long time frames (5 years plus) and the 'feel-good' factor of being able to see and touch your investment.

In recent times, demand for properties valued up to two million dollars has increased significantly pushing prices and reducing rental yields for prospective purchasers. This demand has been fuelled to a large extent by property hungry Self Managed Superannuation Fund investors who contributed large sums in the run-up to 30 June!

Direct property funds

Direct property funds also offer investors an exposure to different property sectors such as office, industrial and retail. But, unlike property trusts, they are not listed on stock exchanges. Instead they offer investors the opportunity to invest via a Product Disclosure Statement, with a view to selling it at a later time for a profit. In the meantime, the rental income is distributed to investors on a regular basis. These Funds allow investors to participate in returns from property assets which they could not access by themselves (eg. large office or shopping centre) which may have a super income yield and capital growth prospects.

Continued on back page

International Investments and Currency strategies

PROTECTING OR ADDING VALUE

As the Australian dollar pushes to new highs, investors are focusing on currency management as a way of protecting or enhancing investment returns.

Currency management strategies can be split into two types – value-adding or protection. In simple terms, currency hedging is about mitigating the risk or exposure an investor has to exchange rate fluctuations when they invest in foreign assets. Value-adding or active strategies use currency to enhance returns. The decision to implement passive or active currency hedging depends on the needs of the investor and can often vary between income and growth assets.

Fixed income and property

For fixed income assets, potential value can be added or lost primarily via movements in interest rates, changes in exchange rates or exposure to credit risk. For most fixed income assets, investors want the benefit of a steady income as opposed to capital gain. Changes in the exchange rate have the potential to significantly erode returns from income. Consequently it is common to fully hedge fixed income assets and exclude currency exposure as a source of returns. Similarly, if investors are investing in global property then they will want returns that are consistent with property as an asset class with property-like income and volatility. Again, to better

reflect that, it is likely that they will want to remove the currency exposure.

In addition to protecting income streams, a key advantage of currency protection strategies is the protection of capital. A foreign exchange movement can significantly impact an investor's capital. This is particularly relevant for income-focused asset classes that do not have significant capital gains of their own to offset any capital losses from foreign exchange.

Shares

With shares, most investors are prepared to accept greater volatility in return for higher capital returns and they may be willing to take on at least some currency risk to increase their potential for additional returns. In an international share investment, the value of unhedged international investments will fall as the A\$ rises. This means in a rising A\$ environment, investors would be better off maintaining a reasonable amount of hedging to help protect returns eroding due to currency movements.

Predicting currency movements is difficult, even for seasoned economists and fund managers. For example, very few people predicted the sharp rise in the \$AUD up to 90 US cents in the past few months. This currency appreciation has had a negative impact on the return of unhedged

international shares. We outline below a brief overview of the currency management techniques of two funds which are included in many client portfolios. This is sourced from our research house, Van Eyk's International Equities Review in June 2007.

Platinum International Fund

'Currency is actively managed with Platinum aiming to expose the portfolio to stronger currencies rather than automatically hedging back into Australian dollars or remaining unhedged. Currency views are derived from a combination of the specific stock and fundamental macro-economic research as well as contrarian calls.'

Axa Global Equity Value Fund

'Currency is treated as a separate asset class. The Investment Policy Group manages currency decisions. The manager develops an expected return for each foreign currency relative to the portfolio's base currency. The manager constrains all currency decisions to ensure that impacts from these are relatively modest, and that premium over time is derived primarily from stock selection.'

Should you wish to discuss the impact of currency management on your portfolio in further detail, please do not hesitate to contact our offices.

The Election is coming and Politicians are making promises

A mere two days after the election was announced, John Howard and Peter Costello announced planned income tax cuts over the next few years. The Government's tax proposal is outline below.

PROPOSED PERSONAL TAX RATES AND THRESHOLDS

Current		From 1 July 2008		From 1 July 2009		From 1 July 2010	
Taxable Income	Rate	Taxable Income	Rate	Taxable Income	Rate	Taxable Income	Rate
(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
0 – 6,000	0	0 – 6,000	0	0 – 6,000	0	0 – 6,000	0
6,001 – 30,000	15	6,001 – 34,000	15	6,001 – 35,000	15	6,001 – 37,000	15
30,001 – 75,000	30	34,001 – 80,000	30	35,001 – 80,000	30	37,001 – 80,000	30
75,001 – 150,000	40	80,001 – 180,000	40	80,001 – 180,000	38	80,001 – 180,000	37
150,001+	45	180,001+	45	180,001+	43	180,001+	42

Not to be outdone, Kevin Rudd and Wayne Swann announced their tax policy a few days after the Government. The policy was very similar, the only notable difference being that Labor will leave the marginal tax rate at 45% for people earning over \$180,000 a year. A further initiative (supported by both parties) is the increase of the Low Income Tax Offset over the next 3 years. Currently, the effect of this offset is that individuals on incomes of \$11,000 or less do not pay any tax. This 'effective tax free threshold' is proposed to increase progressively to \$16,000 from 1 July 2010. At this stage, we do not see that the proposed tax rate changes (under either party) will have a significant impact on financial planning strategies for our clients. We also are not concerned about the potential for a new Government to wind back the generous changes which were made under the 'Simple Super' system which came into effect on 1 July 2007.



Roni Mason

The person whose career I admire most is... *My boss Marty, look at how much he has achieved.*

How I relax is... *Walk on the beach with my killer dog Max, followed by a latte.*

Last movie I saw was... *The Brave One – Jodi Foster.*

My favourite TV show is... *Naruto – I know it's a Kids show but I love it!*

My favourite CD/record is... *Blackeyed Peas, Monkey Business and The Best of Cat Stevens.*

My favourite gadget is... *GPS – I would be lost without it!*

My favourite way to pass a day is... *hanging out and having drinks with family and friends.*

If I could travel anywhere it would be... *Venice, for the gondola's.*

The sports team (eg. union, league, AFL or soccer team etc.) I mostly follow is... *Rugby Union – The Red's.*

I wish I knew... *more about computers.*

I'm passionate about... *life and family.*

My favourite quote is... *If tomorrow your received all you wished for, what would you have to look forward to.*



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Choosing chocolate FOR HEALTH

By Judy Davie (The Food Coach)

Most of us love chocolate, but before indulging it's important to make the right choice. What's the point in total sacrifice at the expense of a whole lot of pleasure when you can choose carefully and benefit overall. Aside from tasting good, chocolate does have some real health benefits – it just all boils down to what kind and how much.



Health benefits

Cocoa from the cocoa bean contains plant phenols which have been proven to help prevent blood clots and keep the blood flowing freely through the arteries. It's also known to help reduce high blood pressure. The bottom line here is that chocolate is good for the heart. Also, it is a good source of antioxidants necessary to kill off scavenging free radicals that destroy healthy cells in the body. Now while we know there may be better sources of all these things with fewer kilojoules, the fact remains that there are health benefits from eating chocolate and that's good news for chocolate lovers, especially at Easter time.

But it's not all good news!

White chocolate is both high in energy and has no health attributes at all – We know that it's in the cocoa bean where the health properties are found, but to be called chocolate, a product needs to contain cocoa butter only – no cocoa! And all that cocoa butter is, is fat with a chocolaty flavour! **White chocolate is made from cocoa butter, milk solids, sugar and sometimes additional vegetable fats only.** In addition, milk added to chocolate may interfere with the absorption of antioxidants. It's more bad news for milk chocolate fans, as studies seem to show that antioxidant benefits may be negated with the added milk.

Dark chocolate holds the key to good health – Eaten three times a month, in moderate amounts you can lower blood pressure and reduce the risk of blood clots. Dark chocolate with its rich bitter sweet taste should be made from around 70% cocoa to have any real effects. The good news here is that because it is so rich you're most unlikely to eat too much.

Investing in Property

Continued from page 2

Furthermore, the holdings in direct property funds are valued independently at regular intervals and are unaffected by any short-term fluctuations of the sharemarket. Finally, these vehicles provide access to professional managers who may add value to properties over time through professional lease and capital management expertise. A disadvantage of some direct property funds is that you cannot access your money quickly, as some direct property funds may be deemed to be "illiquid" and units can only be redeemed at pre-set times.

Combination property funds

As the title suggests, these are managed funds that invest in a combination of direct property (including unlisted property funds) and listed property securities. The direct holdings are valued as they appreciate over time, independent of any fluctuations of the sharemarket. The money invested in listed property trusts provides the fund with the necessary liquidity to take advantage of investment opportunities. Also, investors have the ability to buy or sell units on a daily basis, as well as the services of a professional fund manager.

In summary

Creating long-term wealth as a property investor is all about identifying those assets with reliable and growing rental streams. With reliable rent, a steadily appreciating capital gain should follow. So whether you choose to purchase residential or invest in alternative property investments, it is crucial you understand the underlying dynamics of your chosen market.