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INVESTOR UPDATE

Financial Foundations Australia Pty Ltd, Australian Financial Services Licence No: 237439
ABN 56 006 829 116
49 Robinson St, Dandenong VIC 3175, Ph: (03) 9793 3722 Freecall: 1800 818 197 Fax: (03) 9793 5664
Email: info@financialfoundations.com.au Web: www.financialfoundations.com.au

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Welcome

This is the third draft of our newsletter and it was originally going to focus on the financial year just passed. Of course while overall the financial year was a positive one for investors, the market ructions which started in March with the Japanese earthquake/tsunami/nuclear disaster, were then followed by renewed debt and recession fears in Europe and the US, proved to be the beginning of a full blown market correction.

As we write, the US has just had its first trading session after Standard and Poor's reduced their credit rating to AA+. Naturally the stock market tumbled amid panic selling. Perversely virtually the only market assets to rise in value over the last week have been US Government Bonds and US dollar itself! When markets sell good company shares to buy 10 year US Bonds at a 2.5% yield, when those very Bonds have just been downgraded, proves just how irrational markets can behave in the short term.

Fortunately we don't have to participate in this stupidity. We know rational behavior will eventually return, and that over the long term, quality growth assets almost invariably outperform defensive assets such as cash and bonds. A basic human instinct is "fight or flight" and at times like these, this manifests itself in indiscriminate selling. A return to confidence from this state is going to be a drawn out process and we expect high volatility to continue for at least the next few months. In our view markets look very good value now, even after stress testing our long term projections with more conservative assumptions. Long term investors need to ride out this sort of volatility, while for those with investable funds available "great assets at cheap prices" represents a real opportunity to acquire additional growth assets.

How Markets Performed over 2010/2011

Australian shares

Australian shares returned 11.9% in another volatile year for the domestic share market, as measured by the S&P/ASX 300 Accumulation Index. Commodity prices and mining stocks rose, due to supply constraints and ongoing demand from China. The mining boom also forced up the Australian dollar which peaked at $US1.10 at the end of April 2011. At a sector level, Materials (+20.5%), Utilities (+14.6%) and Consumer Staples (+11.4%) were the best performers, while the underperforming sectors were Information Technology (-13.8%), Telecommunication Services (-0.7%) and Consumer Discretionary (-0.3%).

International shares

International shares produced returns of 22.3% in their local currencies over the year, as measured by the MSCI World ex Australia Index (net return). However, unhedged returns to Australian investors were severely reduced by the continued rise of the Australian dollar, returning only 2.7% in Australian dollar terms. Over the year the Australian dollar appreciated 26.8% against the US dollar, 18.1% against the British pound and 7.1% against the Euro. In similar fashion to the preceding financial year, international shares achieved strong gains prior to Christmas, triggered by the announcement of a second round of stimulus by the US Federal Reserve, while commodities also rallied sharply due to strong emerging market demand. Despite losing momentum over the second half of the year due to heightened risks over government debt, political instability and mixed signals on economic growth, most developed markets were still substantially higher for the year.

Five Financial Tips to get ahead

Now's the time to set a few financial goals. Nothing too complicated – just five key steps that could make the new financial year a very prosperous year indeed.

Step one is to get control of your cash.

The best way to do this is with a budget. This will show how much you earn, and how much you can afford to spend. For more information, log onto **www.financialfoundations.com.au.**

If budgets haven't worked for you in the past, adopt a 'pay yourself first' strategy. It's surprisingly simple. Just transfer part of your pay to a savings account before you have time to spend it.

Arrange an online funds transfer each pay period to shift part of your wage or salary from your everyday account to a high interest savings account. Don't wait until you've paid all your expenses to allocate part of your income to savings – chances are it will never happen.

Step two - sweat the small stuff.

A few takeaways each week or a daily latte – it all adds up. A daily cappuccino for instance may seem harmless enough. But it costs around $15 each working week or about $750 annually.

Give up the takeaway coffee and use the money to make extra repayments on your home loan. On a mortgage of $300,000 giving up the daily latte could see you save up to $30,017 in long term interest charges and be mortgage free almost two years ahead of schedule (assumes a rate of 7.0%). Use our online calculator on **www.financialfoundations.com.au** to see how much you could save by making extra repayments on your home loan.

Step three is to get serious about credit card debt.

If your budget's tight, aim to make small additional repayments each month. Or take advantage of a balance transfer deal to whittle away the card balance sooner.

If you have a small card debt, opt for a zero interest deal. Most of these last for six months, however you can find cards with a low introductory rate that extends over a longer period, up to two years. These are particularly suitable if you have a larger credit card debt to transfer. A key thing to remember though don't slacken off with your card repayments, and always try to pay back much more than the minimum monthly repayment.

Next, step four - boost your super.

There are plenty of ways to increase your retirement nest egg and you'll be glad you did when the time comes to hang up your work boots.

Talk to your adviser about salary sacrifice, namely, transferring part of your before-tax wage or salary to your super fund rather than taking the money as cash in hand.

Or, if you earn between $31,920 and under $60,920, make a personal super contribution from your own pocket. It could see the government lend a helping hand through the co-contributions scheme.

Finally, step five - don't just build wealth, protect it.

Review your insurance cover to check that it's adequate, appropriate and competitively priced.
Ask your financial adviser today!

Property

The Australian listed property sector recorded total returns of 5.9% for the financial year as measured by the S&P/ ASX 300 A-REIT Accumulation Index. There was some divergence in the performance of the sub-sectors, with office property performing strongly as leasing activity improved across capital cities. Industrial property also performed well while retail property was softer due to subdued consumer sentiment. After recapitalising following the global financial crisis, the sector as a whole now has much lower gearing levels and has refocused on its core business of owning and managing Australian properties.

Fixed income

Australian fixed income returned 5.55% over the financial year, as measured by the UBS Australian Composite Bond Index. International fixed income returned 10.51% in USD, as measured by the Barclays Capital Global Aggregate Index. Despite bouts of volatility stemming from global issues, the extra yield investors demand to hold Australian corporate bonds compared to Australian government bonds, declined over the year. This reflected improved corporate fundamentals and strong investor demand. Internationally, corporate credit spreads remained firm in response to additional stimulus by central banks and continued low cash rates. Internationally, the performance and security of government bonds diverged widely based on each country's government finances, economic strength and prospects.

Cash

Cash continued to provide protection from general market volatility but yields changed little over the financial year. Despite proclaiming a bias towards higher rates to maintain a lid on inflation the RBA only raised its cash rate once during the year, by 0.25% to 4.75% in November 2010. Cash returns over the year were 4.98%, according to the UBS Bank Bill Index.

Forget US woes, China keeps Our Economy strong

The mindset that a recession in the US means a recession in Australia is out of date.

One more time we are not part of the US economy. Every day, the US matters less and Asia matters more. The American-centric mindset that a recession in the US means a recession in Australia is hopelessly out of date. It hasn't for the past two and shouldn't for the next.

The arch folly of American politics is compressing into a few years of historic sea change that should have taken decades. The downgrading of Washington's credit rating merely reflects that reality and just helps make us look even better.

Leaving aside the disruptive impact on financial markets and concentrating on the real economy, America's impact on Australia is filtered through Asia a buffer that grows stronger every year.

Nearly 40 per cent of China's exports went to the US in 2001. Now that figure is down about 20 per cent and falling as a matter of policy. The China Daily runs stories about exporters diversifying, targeting markets in Brazil, India, Egypt, anywhere other than the US. It's an entirely obvious strategy as two-thirds of the world's growth already comes from outside the G-7, the ''old world'' major industrialised nations.

What's more, Beijing knows it has to flick the switch from exports to domestic consumption to maintain the strong economic growth it needs for social stability. That's officially spelt out in the latest five-year plan. And, unlike the US, China is actively pursuing the required economic reform instead of just talking about it.

If nothing else, America's woes provide further impetus for that necessary broadening of China's economic base, a broadening that in the immediate term sustains our commodities and capital expenditure booms and hot on their heels opens up greater opportunities for services trade if we're smart enough to grab them.

And in the very immediate future, the US and European troubles are likely to be enough to stay Beijing's hand from further attempts to slow its economy, just as they are keeping interest rates on hold here.

Our financial markets still slavishly take their lead from Wall Street which has a knock-on wealth effect on domestic consumer confidence, but the big drivers highlighted by the Reserve Bank, the factors that keep unemployment low, are to our north. As far as threats go, European sovereign debt is of more concern than the bleak decade facing the US as it still has potential to spill over into the international banking system.

Reasonable observers closer to that action put the odds at maybe one in three, but that means it is twice as likely that the current turmoil sparks the economic reform Mediterranean Europe seems incapable of achieving without a crisis.

Throw in the fact that, if stimulus is needed, Australia has plenty of monetary and fiscal ammunition (unlike the US and Europe) and you wouldn't want to have any other seat for the wild ride.

New July 2011 Measures in place

Pensioners Work Bonus

There is an improved Work Bonus for those Age Pensioners that are still working, allowing them to earn up to $250 per fortnight above the pension income threshold before their pension entitlements are affected. For pensioners who are seasonal workers, they will be able to accrue up to $6,500 in credit for any unused amount of the $250 fortnightly exemption.

Ban on Mortgage Exit Fees

Exit fees have been abolished on new home loans.

The Flood Levy

For the 2011-2012 financial year there has been a temporary Flood and Cyclone Reconstruction levy (the levy) introduced by the Government. This levy is designed to assist communities affected by declared natural disasters between 2010 and 2011 in rebuilding essential infrastructure.

How much will the levy be?

Taxable income	Flood levy on this income
$0 to $50,000	Nil
$50,001 to $100,000	Half a cent for each $1 over $50,000
Over $100,000	$250 plus 1c for each $1 over $100,000

What type of income does the levy apply to?

The levy applies to taxable income which is included in individual income tax returns. This includes salary and wages, investment income and business income. The levy may apply to employment termination payments and superannuation benefits if they are classified as income.

What type of income doesn't the levy apply to?

The levy does not apply to exempt income. This includes superannuation benefits (pension or lump sum) paid to individual who are age 60 or over.

Flood levy will not apply to a lump sum superannuation benefit received in the 2011/2012 financial year if:

- the taxable component of the payment is $50,000 or less
- the total payment is less than $200 and represents the entire account balance
- individuals receive the payment because they have a terminal medical condition
- the payment is a Departing Australia Superannuation Payment

2011/2012 Income Tax Rates:

The following rates for 2011-12 apply from 1 July 2011. These are the same rates which also applied in the 2010/2011 financial year.

Taxable income	Tax on this income
0 - $6,000	Nil
$6,001 - $37,000	15c for each $1 over $6,000
$37,001 - $80,000	$4,650 plus 30c for each $1 over $37,000
$80,001 - $180,000	$17,550 plus 37c for each $1 over $80,000
$180,001 and over	$54,550 plus 45c for each $1 over $180,000

The above rates do not include the Medicare levy of 1.5% or the Flood levy if applicable.

Proposed Carbon pollution household assistance measures announced

On Sunday 9 July the Government announced the detail of its proposal to put a price on carbon pollution. As part of those announcements the Government also announced a range of household assistance measures which are designed to help offset the price impacts of the changes. These measures include proposed tax cuts and increases in pensions, allowances and family payments.

Proposed tax cuts and tax reform

From 1 July 2012 the Government proposes to triple the tax free threshold and to increase the 15% and 30% marginal tax rates to 19% and 32.5% respectively.

From 1 July 2015 the tax free threshold and the 32.5% tax rate would be further increased to $19,401 and 33% respectively. The following table summarises the current and proposed marginal tax rates.

	Current		From 1 July 2012		From 1 July 2015	
Tax Scale	Threshold	Tax Rate	Threshold	Tax Rate	Threshold	Tax Rate
1st rate	$6,000	15%	$6,000	19%	$19,401	19%
2nd rate	$37,001	30%	$37,001	32.5%	$37,001	33%
3rd rate	$80,001	37%	$80,001	37%	$80,001	37%
4th rate	$180,001	45%	$180,001	45%	$180,001	45%

Social security / family assistance changes

As part of the household assistance measures the Government have also announced that it proposes to increase pensions, allowances and family payments. The detail of these announcements are summarised as follows:

Pensioners / allowees

A clean energy supplement is proposed from 1 July 2012. This supplement will be equivalent to 1.7% of the maximum rate of a person's pension or allowance, and will be paid as follows:

- In May/June 2012, an advance payment will be made to cover the period to 20 March 2013.
- From 20 March 2013, the clean energy supplement will then be paid as a fortnightly amount

The maximum clean energy supplement will be $338 pa for singles and $510 pa for couples combined.

Self-funded retirees

The clean energy supplement is also proposed for those eligible for the commonwealth seniors health card. As with pensioners and allowees, the maximum supplement will be $338 pa for singles and $510 pa for couples combined. The advance payment in May/June 2012 will also apply.

Family tax benefit recipients

A lump sum advance is proposed to be paid to family tax benefit recipients in May/June 2012 to cover the period to 30 June 2013. During this time, family tax benefit payment amounts will remain unchanged.