

IN
focus

Reflections on a decade

The lessons learned

Living well

Ian Baker-Finch

It's all about
rent in 2011

2011 AUTUMN EDITION



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Lessons from a lost decade

As we commence 2011, most long-term stock market investors would regard the last ten years as 'a lost decade'. ■ by Terry Dillon

One could think of it as a ten year roller coaster which began with a crash and ended with a crisis. For all the excitement of the 2003 – 2007 bull run, when viewed through a broader lens, 2001 – 2010 generated a decidedly average 4.2% return. That's less than you would have received from a bank account.

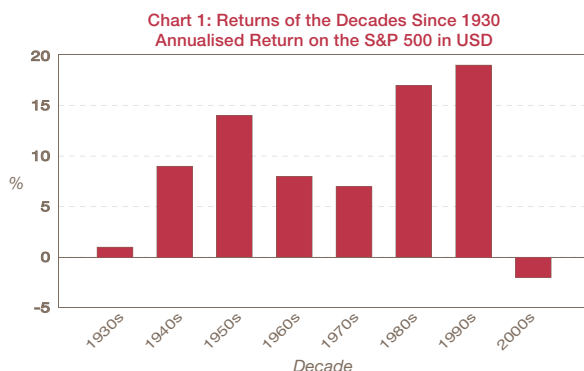
What does this mean to long-term investors - particularly the majority of Australian employees whose monthly superannuation contributions are being paid into managed fund investments?

What are the lessons to draw from 'a lost decade'?

Lesson 1: Markets are cyclical

For all the concern felt by some that the world is facing unprecedented economic problems from which it will never recover, history tells us differently. True, there are new dynamics including the shifting centre of economic gravity from West to East, and the impact of the internet on globalisation. But the challenges faced by markets today are no more intractable than the Great Depression of the 1930s or the crisis years of the 1970s. Just as in those decades, the crises facing developed world markets include Government indebtedness, high unemployment and economic stagnation.

But both the 1930s and 1970s were followed by successive decades of massive growth, a return to strong levels of employment – and for investors, robust investment returns (see chart). If history has any lesson to teach us about lost investment decades, it is that there is a cyclical nature to global economic markets. Abandoning the market may have been an understandable response in the early 40s or 80s, but what a mistake it would have been!



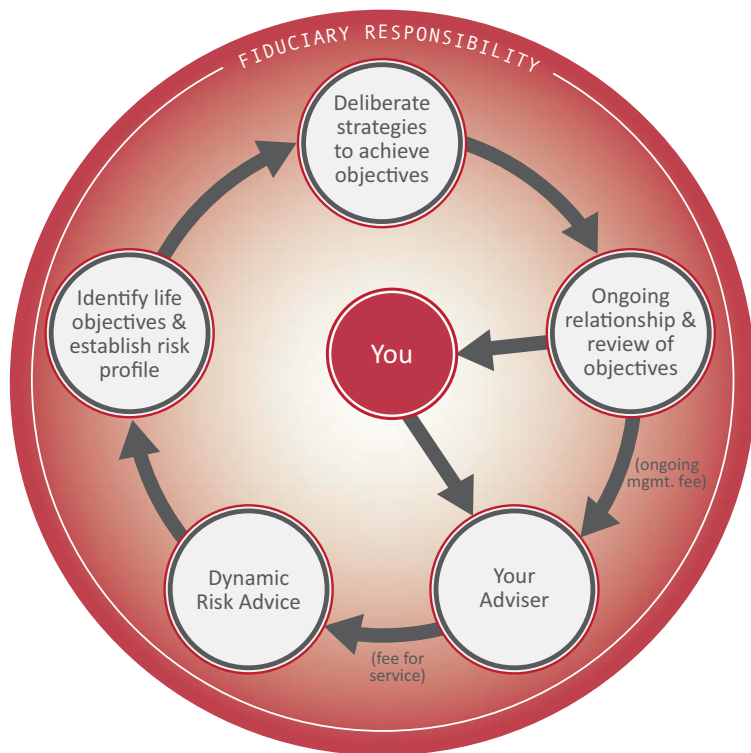
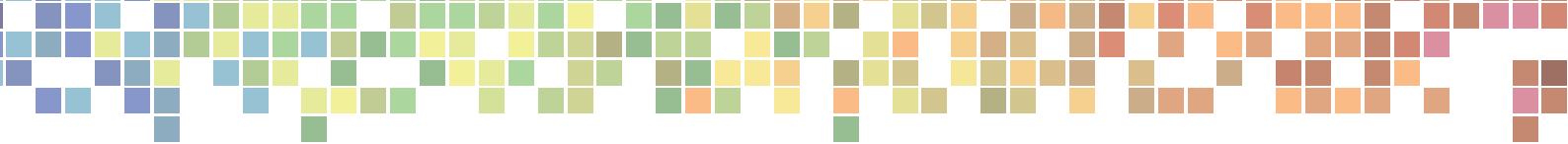
Source: Thomson One, Jan 7 2010
Past performance is not a guarantee of future results.

Lesson 2: With an appropriate level of risk

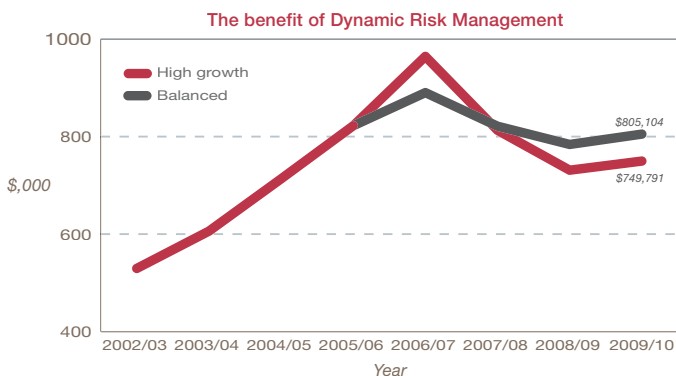
A second lesson has to do with the central purpose of wealth management in a fiduciary framework, which is to ensure an investor reaches his or her long-term financial objectives *with the appropriate level of risk*.

By 2005, most equity investors with well-diversified portfolios would have been delighted by the performance of their portfolios. It wasn't unusual for them to see returns in the high teens – two or three times the long-term equities average. 'If it ain't broke, don't fix it,' was the underlying philosophy of the era, as understandable as it was misguided. Because if investors are well ahead of where they expect to be, doesn't it make sense to reduce their risk profile and switch a portion of their portfolio into lower risk asset classes such as Government bonds? Sure, this reduces the potential upside of the portfolio if the market continues to storm to ever new heights. But it also provides a cushion for when the economic climate dramatically changes.

That's why we call this fiduciary approach Dynamic Risk Management. When financial advice is grounded in fiduciary values, determining a client's risk profile becomes a regular and dynamic cornerstone.



The accompanying chart compares two clients' portfolios - one which carried the same high growth risk profile over the whole period compared to a portfolio which had prudent Dynamic Risk Management applied. In the short term the latter would have seen lower returns than had they maintained their higher risk profile. But the much more favourable outcome, after the onset of the GFC, is clearly visible.



Of course it is human nature to want to continue enjoying bumper returns. And when the same expert forecasters who now tell us that the world is about to be swallowed up by US debt form a chorus along the lines that the world is on an unprecedented super-cycle, well, why would we switch out of our bumper asset into something as boring as bonds?

With appropriate risk is the key concept here. It is a fiduciary responsibility for professional advisers to present you with your options. It is your prerogative to act as you see fit.

Looking forward

In summary, it's way too soon to be giving up on equities. If history is to repeat itself, the next decade could be one of our best ever. But remembering the lesson of with appropriate risk and ensuring we're in an investment vehicle with proper safeguards, will help us reach our destination without repeating the mistakes of the past. ❄

A version of this article was published in The Australian, November 2010.

Living well

The Ian Baker-Finch story

Ian Baker-Finch has always been a great inspiration to me. Certainly for the heights achieved throughout his professional golf career, then for the way he fought his way through the decline in his game and then reinvented himself as one of the leading golf commentators in the world.

■ by Craig Lubich

Add his balanced lifestyle, love of his family, his philanthropy and charity work with cancer research and children's hospitals, and the fact that he is a genuinely nice guy unaffected by his success, and I consider myself blessed to call Ian a friend.

I like to think I'd put up a strong challenge against him on the course, but he'd deny that and of course he'd be right. I haven't ever taken money off him (yet) and he is still as competitive on the course as he ever was.



I recently asked 'Finchy' to share his story with some clients and staff so that others could be as inspired by him as I am. He came back with: "How many days have we got to talk?"

While obviously joking, there's some truth in there. Ian's story is a big one, indicative of having lived and continuing to live a very full life. Plus, he'll talk your ear off if given half a chance!

Ian was born the youngest of six children into a farming family in Nambour, Queensland, near the 'Big Pineapple' tourist attraction. "I had a plan for many years," said Ian, "starting from the age of 12 when I got my first set of golf clubs. My 'Plan A' was to be a golf pro, hopefully bring home some crystal vases and plenty of prize money over a long career to invest in my 'Plan B' for later in life. But it didn't quite work out like that."

Ian's upbringing was to give him the core values that would remain with him to this day – hard work and self-belief delivers success in and of itself. "On the farm, my dad instilled a hard work ethic in us kids. 'If it's not hurting, it's not worth it', he used to tell us. Needless to say, golf was a pretty distant reality from us on the farm in those days."

When Arnold Palmer and Jack Nicklaus rose to prominence in the late sixties that was all to change though. The success of first Palmer, then Nicklaus, paved the way for golf to become a national sport in Australia. Even the farmers took notice of golf.

And so did Ian. He began to play obsessively as a teenager and a string of early wins put him on track to achieving the dream he'd set for himself at the age of 12.

"I left school at the age of 15, having won a number of junior events," said Ian. "I have to admit though, I may not have actually been better, I was just a foot and a half taller than everyone. At 16, I was 6 feet 4 inches and weighed 16 stone. But I later lost the weight when I discovered girls!"

It was height that not only gave Ian his early teen success, it also gave him a life-long friend, though not in the most orthodox of ways.

"When I was 13 years old, I was so much taller than the competition," remembered Ian. "When I went onstage to accept a trophy after winning a junior event by 20 shots at the Pacific Golf Club in Queensland, Wayne Grady called out: 'Better hurry up! He's got to be back at the zoo by 9 pm!'"

"That was my first run-in with 'Grades' and we've been buddies ever since."

Ian started the Australian Tour in 1979. His first big tournament win, the WA Open in 1984, kick-started his career and he then went on to Europe and to the British Open, where he even led the Open for three days. "It had been my biggest dream to go and just play the Open," said Ian, "but to actually have the chance of winning at 23 years of age, that was just fantastic."

Needless to say, it was a fast introduction into high-intensity golf. And one where the pressure would ultimately get the better of him at that Open.

Living life on the road, golfing tournament after tournament was different back then as it is today.

“That first year playing internationally, I was invited to 13 tournaments and all up, I played 20 tournaments in a row. There isn’t a pro in the world who would consider doing that these days. Going back 25 years, you played every week you had a start. Getting £1,000 per start was a lot of money back then and you had to keep playing to earn a living. The game’s certainly changed with Tiger Woods earning upwards of \$80 million and Phil Nicholson making \$68 million.

“It had always been most important to me to play well, to play my best, enjoy the game and be a gentleman to play with. Winning wasn’t necessarily my primary motivation, but when I did win, there was no better feeling.

“Especially after having lost the championship a number of times in the years prior. It’s a great feeling of relief and accomplishment when you reach what you’ve been striving for.”

“in those days there were only five Aussies playing in the US, we weren’t always made to feel welcome back then”

By 1989 I was playing the PGA Tour in the US. In those days there were only five Aussies playing in the US: Greg Norman, Wayne Grady, Steve Elkington, David Graham and myself. We weren’t always made to feel welcome back then. Only 5% of the PGA Tour was made up of international players back then. It’s somewhere around 50% now.”

As hard as it was to perform in that kind of environment, it made the Aussies better golfers and able to stand tall amid numerous challenges.

All the hard work and self-belief culminated for Ian when he won the Open Championship in 1991.

Sadly that win was to be the pinnacle. “I kept playing for the few years up until my playing days ended in 1996,” said Ian. “During that time I’d been losing frequently. I went through 25 cuts in a row in 1995. I spent months working with coach after coach trying to bring my game back. I received thousands of letters from fans with recommendations and advice.”

It wasn’t easy for Ian. On top of the career pressure, he also had his wife and two daughters to think about.

In 1996 Ian stepped away from professional golf for what was going to be just a break for a summer. It had been a difficult decision for Ian as he’d spent his whole life in the single-minded pursuit of being a golf pro. It was this break that changed the course of his career.

the short game

- won 16 tournaments worldwide
- winner on all four Major Tours
- favourite performance is shooting 29 on the back 9 at the British Open and then 29 on the front 9 the following day
- designed courses in Western Australia, Dubai & Ireland
- current handicap is +4
- currently plays with Callaway Tour i(z) golf balls

"I was asked to commentate for the television networks while I was on my summer break," said Ian. "I wound up getting a lot of experience in a short amount of time working with the four networks: ABC, Ten, Nine and Seven. In that summer alone I think I covered 12 tournaments, worked with four different producers, four different directors, four different floor managers and 16 different announcers. I was also fulfilling different positions, such as being the analyst or providing special comments.

"I love golf because it's upstanding"

"With that kind of experience, I started getting good at it quickly. Although I look back on it now after commentating for 15 years and I now know how horrible I really was back then!"

Despite the newfound opportunity, Ian decided to give pro golf one last shot at the British Open in 1997. The experience gave Ian the confirmation that it was time to move on.

Ian soon received an offer from a television producer to commentate for ABC Sports (USA). It was with that network Ian returned to the Open in 1998. The transition was difficult for Ian as it had been the venue of his greatest victory.

That week Mark O'Meara, who'd played with Ian when he won in 1991, took out the championship. "It wound up being a fantastic time to celebrate Mark's win with him," remembers Ian. "I knew it was also the appropriate time for me to mentally move on from being a pro golf player into the next phase of my life.

"It became the perfect segue into my 'Plan B'.

"We all have these great decisions we have to focus on in our lives. For me, it was whether I'd be able to send both of my girls to Uni. I wasn't living by a manual, just by hard work and gut feel."

Other opportunities began to arise for Ian. One of these meant getting involved in the golf course design business. Ian started up ibf Designs in association with Gary Player Design. He's now designed courses all over the world, including Kennedy Bay south of Perth.

"My love for the game has stood me in good stead and I think it comes through with what I do now. I still play almost every day, off +4, and I still occasionally play tournaments.

"I love golf because it's upstanding. It's one of the only sports where players call their own fouls on themselves. There are great ambassadors in the sport who are continuing this tradition with the up-and-comers and the young kids."

Even though Ian's life didn't quite play out the way he'd planned so many years ago, he's a living testament that with the right approach and aiming to live well can still result in happiness and fulfillment. ✨





Insights for

Investors

They call this the information age. With vast amounts of information readily available via numerous communication channels and media, it has become increasingly difficult to see what is really going on.

There is more news at our fingertips at a faster rate than ever before. Despite this, it is common to have questions about how events impact us and what to do, if anything. In this Q&A we take on questions investors are frequently asking.

An over-arching theme becomes apparent: deliberate and informed decision-making is still advisable, whereas emotional and reactionary motivations still detract from what is truly important.

When markets and economies are as volatile as they have been, what would be an optimal investment strategy for an investor who is close to retirement, an investor at the height of his or her career and an investor just starting out?

The reality is that there is not all that much difference between those three scenarios. Of course each investor is facing different circumstances in each of their lives and has different sets of priorities, but there is a fundamental motivation that makes these three scenarios the same and that is they each want to actually achieve their objectives.

It was Nobel Laureate Robert Merton who said that the only real risk an investor should be concerned with is the risk they don't achieve their objectives. All other risks are either encapsulated within that risk or are a distraction.

With that in mind, each investor will have a different risk profile according to their circumstance and situation. Where each risk profile is especially unique is that it must also address how much risk each investor can handle so that they are not tempted to make emotional decisions with their investments.

An adverse decision would be for an investor to alter their strategy at the wrong time or even worse, to sell down their investments to cash. The problem with switching to cash during a volatile period is that the investor may then be stuck in cash, achieving a return that over the medium term won't achieve their objectives. They will be waiting until the market begins to recover before they invest again. This may in turn mean that the investor misses out on substantial growth by not being able to time when to invest back into the market.

It's why we broadly diversify our investment portfolios – to protect our clients.

As volatility appears to continue, is it advisable to defensively move to a lower risk investment strategy - one that favours cash or fixed interest for example?

The primary issue with this type of methodology is the risk of missing out. We've all seen portfolios go down, as well as recover. History shows us the same. It's the trying to time the recovery that may lead to missing out.

Let's face it, if an investor had sold their investments in October of 2008 and bought back into the market in March of 2009, they would have made an absolute fortune. Unfortunately no one rings a bell to tell me to buy or sell at the top or the bottom.

Most who want to switch to cash are doing it after the market has already fallen. They then come back in after it has gone back up. In hindsight, or even foresight, this strategy seems ludicrous. Inevitably during every crisis someone will succumb to their emotions and do just that.

This situation negates the heart of the matter - to achieve one's objectives. It all comes back to only being in cash if it will achieve your objective.

Cash can play a valuable role in a diversified portfolio, but investing in cash should only be done if it supports your long-term objectives. As your circumstances change over time, you may be in a position to reduce the amount of risk you are exposed to by increasing your investment in cash.

Based on your changing risk profile, an amendment to your long-term strategy is therefore made deliberately and keeps you on track to achieve your objectives.

Given high interest savings accounts and term deposits have performed arguably well compared to the market, what value do they hold to an investment strategy? Should investors focus their attention on these "safer" strategies?

We do often hear the statement "so I would have been better off if I had invested/stayed in cash." Responding to this is tough – firstly because the original question and this statement is actually wrong and secondly, because comparing cash to equities is like comparing apples and oranges. The question should be: "Why didn't we invest more in cash in the first place?"

The answer then comes back to the return you needed to achieve your objectives. It also comes back to the risk profile that showed you could withstand the adverse conditions that will always be a part of investing in growth assets and are needed to give you a high enough return over the longer term to achieve your objectives.

This question is also an unfair comparison though because, as I said, you are comparing apples with oranges.

Comparing cash performance with the performance of equities is primarily motivated by an emotional reaction to

the performance of the market, the media and what we call "the noise". Investment properties have not necessarily fared well either, but the performance of land value would never be compared with the performance of cash. So why are we tempted to compare equities and cash?

Making well-deliberated decisions when setting a strategy to achieve goals in life means committing to that strategy according to the appropriate amount of risk. As goals or circumstances change, your risk profile might change, and adjustments can be made to the strategy accordingly along the way.

Remember, broad diversification includes cash and fixed interest, as well as equities in all markets.

The media often run with headlines such as 'Top Stocks for 2011'. Is the media advising clients to time the market? What is the value of this kind of media and what kind of an effect does it have on investors?

The short answer is: the media makes a lot of money off of these headlines.

Over time this has become so overwhelmingly fundamental to how the media and the financial services industry operates, that I don't see it ending any time soon - even if there is no real value in it.

Logic alone defeats the premise of top stocks in an industry magazine. If everyone knows about a 'hot tip', the proverbial boat has already been missed.

I'm not saying that stock-picking can't be done, but it's extremely rare. Too rare to rely on, in fact.

It's best to focus on the fundamentals. Everything else is just noise.

Given the current environment, would investors be better off without financial advice?

Firstly, to address the qualifying opener - "given the current environment" - the environment now is more likely to prompt people to make the wrong decisions for the wrong reasons. More on this later.

Secondly, a preface is required with a "definition" of "financial advice". This, of course, refers to the full scope of advice which seeks to answer these key questions:

1. How much money will be enough for me to consider myself financially independent?
2. What are the right structural decisions (ie who should own what) to both minimise tax and, if necessary, provide protection; as well as provide the smoothest transition of my assets to my children?
3. How should my cash flows be directed?
4. What should my investment strategy look like to enhance the probability of reaching my objectives?
5. How should I manage and structure my debts?
6. How much should I have and/or target to have in superannuation?
7. How much insurance is enough for me?
8. What should my Wills say to ensure the smoothest transition of my assets to my children?
9. How should I invest, and in what, to improve my chances in an uncertain world of achieving my lifetime / lifestyle objectives?

All of the above questions are timeless relevant, and important to anyone who wants to ensure financial independence.



Given the current environment, would investors be better off without financial advice? (continued)

The answer is grounded in the understanding that we are not in the business of “wealth creation”. That concept belongs in the domain of entrepreneurial endeavour, the only real creation of wealth - albeit fraught with much higher risk than we take with clients’ portfolios.

Investing in “arm’s length” investments such as share, property and / or fixed interest investments (ie those over which you have no control other than buy, sell or hold; a proxy for buy, anyway) must necessarily have a different set of guidelines than those that are most effective for entrepreneurs.

Success without good quality advice has been shown by repeated research to be a very low probability event, regardless of the current environment or any other. In the investment environment, it has again been shown by many different studies over many different timeframes, that even the experts can’t beat the market’s returns and typically detract value to at least the extent of their fees.

The enduring question for DIY investors then is: “If such a massive workforce of highly educated, qualified, experienced and resourced professionals, who focus all of their attention every day on trying to beat their peers and the markets - and who get paid very handsomely if/when they occasionally manage to deliver, so have a savage lust to succeed - can’t do that with even an average level of reliability, what chance do we have?”

A number of studies indicate that self-managed investors are likely to only achieve returns of 20 - 50% of the market returns. So perhaps the question might be better couched “How much better off am I likely to be with financial advice?”

So, the answer is framed in the context of our True North probability modelling which we use to help people to make better decisions.

To not seek quality financial advice is to significantly reduce your probability of success.

What are the benefits of a fee-for-service advice model?

As the financial planning industry comes to grips with regulatory direction to use fee-for-service arrangements instead of commissions from 2012, we continue to use our time tested methods. This legislation lends support to our view that this is the best structure for client outcomes.

There are four clear reasons why. The first is that this model avoids conflicts of interest. The fee-for-service arrangement, allows for advice to be stand-alone rather than potentially product biased, as with a commission basis.

The second reason has to do with personal goals. You can have assurance that our Financial Advisers will always place your best interests before their own. Your adviser will work with you as an individual to meet your personal objectives using the appropriate investment solution for your needs.

The third benefit is that fee-for-service promotes clarity of fees. There is a clear and simple explanation of the level of fees being charged for ongoing service.

What can be done to prepare for another Global Financial Crisis, should it occur?

When discussing the GFC, it is important to focus on the fact that it was a crisis event. Sure its impact was wide-spread and colossal, but there are aspects relevant to all crises.

Because the hard-truth is that there will be other crises. That’s just part of markets going up and going down. With that in mind, can we consider the GFC as a random ‘black swan’ event? Was it a one-off?

The problem we face, as you would know, is that crises cannot be predicted by and large.

That’s why it’s important to focus on what we can control – understanding that risk and return are intrinsically linked. Fundamental to this is ensuring that your Financial Adviser has an intimate knowledge about what you want to achieve and the risk you’re willing to take on. Talking about your risk profile and goals frequently with your Financial Adviser can make all the difference.

This is because we hold to the view that the only risk that matters to you is the risk of not achieving your objectives. Establishing a financial strategy to reach your goals requires discipline. Don’t let anxiety cause you to deviate from a well-considered strategy.

The best way to mitigate risk and to set yourself up in case of a crisis is to diversify appropriately and broadly across all markets.

Additionally, we recommend outsourcing risk where possible. Ensuring you have an optimised risk management plan that fully utilises insurance options appropriate or available to you can position you in far greater stead should a crisis occur.

Lastly, it's important to not allow uncertainty or fear to motivate your actions. When we have a grip on the aspects of life we can control and position ourselves for future possible crises with deliberate and long-term strategies, we can still be on track to achieving our life goals.

In what ways is a relationship with a Financial Adviser a partnership?

Allow us to start with a fundamental concept, crucial to financial advice – your objectives.

Your objectives may be lifestyle or financially driven and are unique to you. It is common to have a general idea of when you would like to reach these objectives. Hand-in-hand with knowing what it is you want to achieve is of course knowing how you are going to achieve it.

Creating a wealth management strategy that gets you to where you want to be in life is one of the most important initiatives you can undertake. Yet for most of us, choosing and managing wealth is a complex and confusing subject.

Where the Financial Adviser fits in is to act as a financial coach to help clients achieve those objectives. This means establishing and identifying what the long-term objectives are, assist in putting strategies in place to achieve the objectives, implement the designated actions and then guide over the long-term by monitoring and reviewing the ongoing strategy according to the objectives.

Wealth management is a constantly unfolding process. As your life changes, as well as your wishes and objectives, so should the management of your wealth.

It's why we work in a partnership with you to empower you to make deliberate decisions to achieve your objectives. We believe that for a partnership to be successful, trust and communication are vital.

The regular and ongoing guidance and assessment advisers provide you, grounded in a fiduciary framework, positions you to make optimal and well-informed decisions to reach your objectives.

Do investors overemphasise the value of franking credits?

Franking credits are essentially a tax refund attached to a dividend. They are perceived to increase the after tax return on a portfolio, and many investors consider them very important. In fact, some investors even tailor their portfolio to chase shares with high levels of franking. If enough investors have the same strategy, it can create a herd mentality, and the market reacts accordingly.

It is often overlooked that the market ascribes a value to franking credits in share prices, and investors are actually paying for a significant portion of the credit. Empirical research has shown that for large cap Australian shares, the market priced in up to 86% of the franking credit value between 2006 and 2009.

While getting a franking discount is usually a good deal, it is also important to consider if there are any other discounts which investors could receive. In the case of franking credits, the cost represents the loss of potential (discounted) capital gain. When the research compared the receipt of franking credits against the potential (discounted) capital gain, net of all taxes, only tax rates less than 15% produced a benefit from the receipt of a franked dividend.

While I am not suggesting that franking credits don't provide value for an investor, this is food for thought and I would caution against structuring a portfolio to chase shares with high franking to improve after-tax returns. Given that the Australian share market already prices in a large portion of the franking credit, the perceived "free ride" that franking credits were thought to provide may not necessarily exist.

In practice, the tax benefit from franking credits varies between investors and depends on the level of franking, the level of liquidity, and the extent to which the value of the franking credit is factored in to market prices.

This is a good reminder that there is no such thing as a free lunch, and there is always an opportunity cost to consider when investing. ✨

A guide to performance

We are now in our second year 'post-GFC'. Market watchers and investors kept an eye out for convincing signs of economic recovery in markets which had struggled, such as the US and Europe.

■ by Max Young

By the end of the previous financial year investor sentiment had resumed an aversion to risk. This aversion proved to be temporary. Global and local share markets, as well as safe haven assets, such as fixed interest, produced positive results for the 2009/2010 financial year.

In this article we provide you with information about how our asset classes performed in the context of the market's performance. We will drill down into the performance since June 2010, ie the first half of the 2010/2011 financial year. We will also look into the major themes from the 2010 calendar year. Finally, we will look at the bigger picture of how asset classes have tracked over the last four decades and see that deliberate and disciplined investing, while diversifying broadly, continues to help clients achieve their long-term objectives.

How our asset classes performed

Share markets performed well in most developed countries in 2010 despite concerns of a double-dip recession in the US, rising public sector deficits in Europe and the US and competing concerns over inflation and deflation. Of the 45 developed and emerging countries tracked by index provider MSCI in their All Countries Index, 37 posted positive equity market returns in both local currency and \$US terms.

Australian shares

At the end of December, the Australian share market produced positive returns for the first half of the 2010/2011 financial year. The S&P benchmark ASX 300 Accumulation Index produced an AUD return of 13.34% for the period. Our Australian Core Equities portfolio outperformed and returned 15.52% (gross of fees) for the period.

The Australian equity market delivered only modest returns for the year, but this masked a wide divergence between marked strength in resource stocks and weakness in financials, consumer discretionary and telecommunication sectors.

In the accompanying Australian Stock Market Performance graph, the major events in the 2010 calendar are highlighted in correlation with the S&P/ASX 300 Index performance.

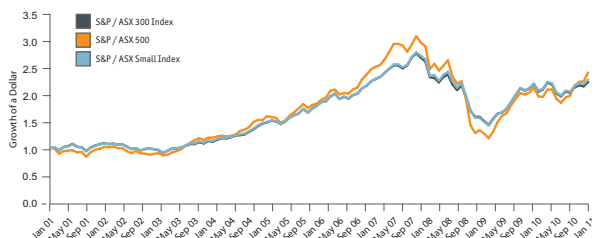
Australian Stock Market Performance
S&P/ASX-300 Index with Major Events during 2010



Source: Bloomberg

The Australian Shares Size and Style Growth of a Dollar graph depicts the context of the rise of positive returns in light of the past decade.

Australian Share Size and Style Growth of a Dollar
January 2001 - December 2010



International shares

International equities finished with a positive return despite some volatility along the way. The MSCI World ex Accumulation Index managed to produce an AUD return of 1.77%. Our International Core Equities portfolio outperformed, returning 3.40% (gross of fees) over the period, outperforming the benchmark. The hedged portfolio returned 22.86%, outperforming the MSCI World Ex Accumulation Index Hedged which returned 20.27% for the period.

Worries about the durability of the global economic recovery, particularly in the US, and the state of public finances in the developed world, were the focuses of financial markets in the September quarter.

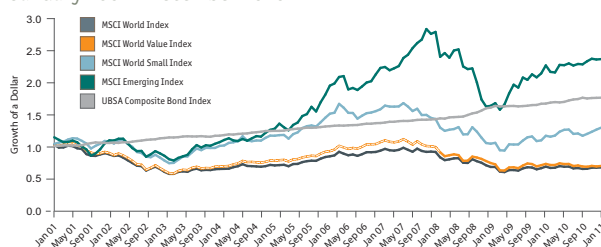
The December quarter closed with a contrast in economic performances globally. Strong growth in developing economies provided comfort when juxtaposed against the modest improvement in the US, as well as ongoing concerns over several European states.

For Australian investors, the strong gains of the AUD in 2010 against the other major currencies marred unhedged returns. As a result, there was a 15 percentage point premium in the MSCI World ex-Australia AUD hedged index over its unhedged equivalent. This means that the AUD was the second best performing currency against the \$US in 2010, reaching parity for the first time since it was floated in 1983. It also hit record highs versus the euro and 25-year highs against the pound sterling. These gains came off the back of Australia's substantial interest rate differential, the ongoing strength in commodity markets and unilateral weakness in the \$US, euro and pound.

The over-arching theme in 2010 was the wash-up from the global financial crisis. The focus, firstly, was on the progress made by the major developed economies in developing self-sustaining recoveries from a deep recession. Secondly, the concern was over the legacy of extraordinary policy stimulus on government balance sheets, particularly in Europe. Thirdly, the focus was on the continuing strong emergence of developing economies, particularly in Asia, and the consequences this would have for global growth and inflation. As always, markets took a forward-looking view of these themes, so individual investors were best served by diversifying broadly and not responding to news that was already reflected in the price.

The International Shares Size and Style Growth of a Dollar graph depicts the context of the rise of positive returns in light of the past decade.

International Share Size and Style Growth of a Dollar
January 2001 - December 2010



Cash

The Reserve Bank of Australia (RBA) raised the cash rate once in the first half of the 2010/2011 financial year from 4.50% to the current 4.75%. Australian interest rates for borrowers are around their average levels of the past decade. The Australian cash fund returned 2.66% for the first half of the year, outperforming the benchmark UBSWA 90 Day Bank Bill Index which returned 2.46%.

In its December meeting, the RBA noted “lending rates are a little above average” and that “the exchange rate has risen significantly this year, reflecting the high level of commodity prices and the respective outlooks for monetary policy in Australia and the major countries. This will assist, at the margin, in containing pressure on inflation over the period ahead. Over the next few quarters, inflation is expected to be little changed, though it is likely to increase somewhat over the medium term if the economy grows as expected.”

Fixed interest

Our strategy returned 3.21% (gross of fees) for the period, outperforming the JP Morgan Government Global Hedged benchmark by 0.67%, which returned 2.54%.

At the end of the period, the strategy had 60% of its assets allocated to the USD curve. A further 10% of assets were allocated to the AUD curve, and 23% to the GBP curve. A downward shift in the medium to long term segment of the USD curve was the primary factor for the outperformance in the September quarter. A steepening shift in the medium to long term segment of the USD curve was the primary factor for the underperformance in December quarter.

Post-GFC, investors who had become more risk averse primarily remained in fixed interest assets. In Australia, the temptation ran high for the historically unusual premium offered by bank term deposit rates over cash. This reflected intense competition among banks for retail funding amid continued tight conditions in wholesale funding markets.

Emerging markets

Emerging markets (MSCI Emerging Markets Index) outperformed developed markets (MSCI World Index) over the September quarter and underperformed in the December quarter. By the end of the period, emerging markets had returned 6.68% (gross of fees) outperforming its benchmark by 2.29%, which returned 4.39%. The best performing countries in the MSCI Emerging Markets Index for the period included first Poland and Chile, then Taiwan and Peru. The worst performing countries included first Egypt and China, then Hungary and Turkey.

Summary

The news dominating the headlines has been mixed. The major economies of the US, Europe and Japan made faltering steps out of recession. On the other hand, developing economies – particularly in East Asia continued to thrive. Australia, whose major export markets are in Asia, enjoyed the tailwind of this regional growth through buoyant commodity prices. Concerns for much of the year focused on the consequences of stimulus packages and bail-outs, particularly in Europe.

Our broadly diversified investments performed well. Emerging markets remained strong, while fixed interest and cash provided solid returns.

As we look at the remainder of the 2010/2011 financial year and the 2011 calendar year, we continue to employ a deliberate and disciplined approach to investing. We know that diversification is vital and is the only proven means of mitigating risk over the long term.

In conclusion, it is important to highlight the performance of asset classes in the context of the last four decades since 1970.

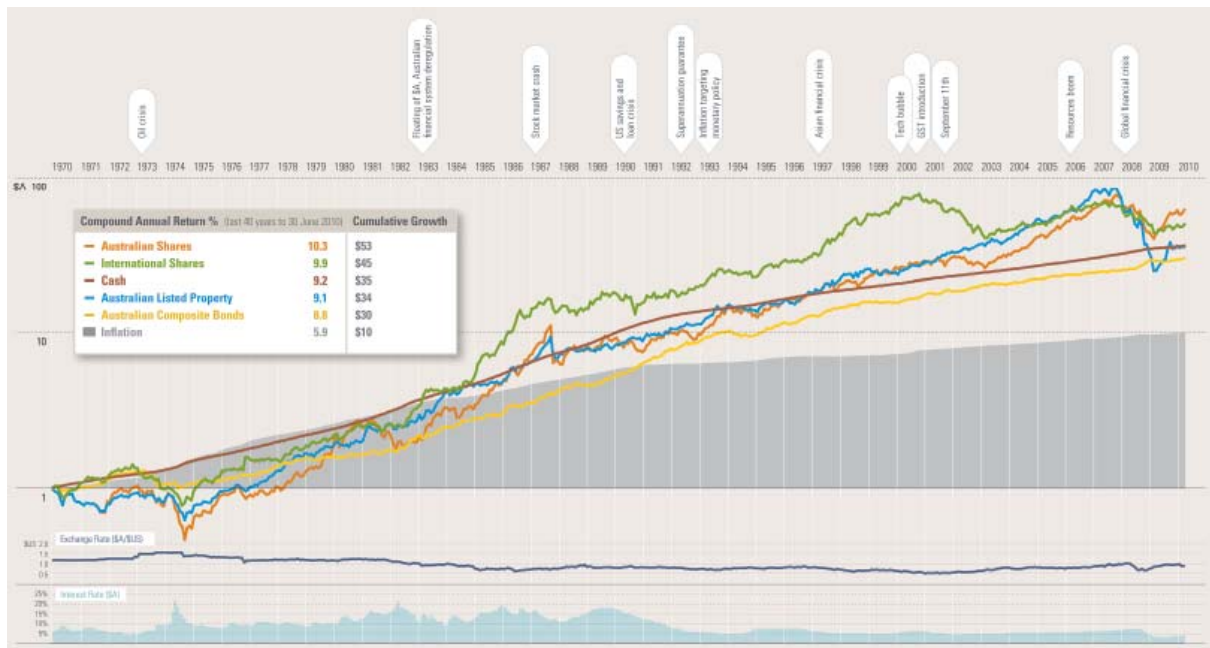
Appropriate perspective can be derived when examining 40-year market returns of various asset classes Australian investors may be invested in. This graph shows the hypothetical growth of inflation and an A\$1 investment in five asset classes from 1 January 1970 to 30 June 2010.

It is the big picture that truly exemplifies the benefits of broad diversification in order to mitigate risk appropriately over the long-term. ✨

Max Young is the Plan B Group Executive of Investments.

Asset Class Performance from 1970-2010

Source: Ibbotson



Hypothetical value of \$1 invested at the beginning of 1970. Assumes reinvestment of income and no transaction costs or taxes. This data is for illustrative purposes only and not indicative of any investment. An investment can not be made directly in an index. Past performance is no guarantee of future results.

Benefits of after-tax

With a number of financial services institutions and industry superannuation funds recently transitioning to after-tax management and reporting, it would appear this approach is finding momentum.

Given that upcoming legislation and reform address after-tax, the Federal Government has shown itself to be interested in keeping trustees accountable to the taxation consequences of investment strategies.

While super funds and investment managers have traditionally had little regard for the after-tax issue, Plan B has always had a focus on after-tax. That's quite a bit ahead of legislation.

"After-tax management is the measure of a fund's after-tax investment performance against benchmarks we delineate," says Max Young, Plan B Group Executive of Investments.

"It means that we are able to maximise the benefits to our clients amid capital gains tax rules. By keeping our focus on tax lots, we've been able to optimise our clients' taxation at the time they decide to sell shares.

"Tax management is critical for a fund, ultimately the after-tax and cost return is what a client gets to keep. There's no point in delivering a high return for the client if a large portion of that is then given back to the taxmen either by the client or the super fund.

"We've been promoting and practicing after-tax management with our portfolios for a while now and we've been surprised at how long it's taken the industry to grant it due consideration. Our hope would be that after-tax reporting eventually becomes legislated."

The value of reviewing a Will

■ by Garry Woo

It's a fact of life that circumstances change over time. Family relationships develop and can change, assets and liabilities change, even wishes may change.

If a Will is properly prepared, it remains valid until it is revoked. However, a Will is interpreted according to the applicable circumstances at the date of passing – not the circumstances at the date the Will was finalised.

As a result, Wills may need updating to reflect any of life's changes.

Do you know who holds the original signed version of your Will? Is your family aware of where it is? Without the original signed version, it becomes very difficult (if not, impossible) to administer your estate according to the instructions set out in your Will.

While it is generally expected that Wills prepared by solicitors would comply and are properly prepared, I have come across exceptions to that general rule. Get a second opinion by having it reviewed.

'Do It Yourself' Wills are possible, but it is generally best to avoid doing so. Many of the DIY Wills that come across my desk exhibit problems in the way they are written. These Wills may fail to include important provisions and may not have been signed and witnessed properly.

When was the last time you read your Will? Our lives and circumstances change over time. It is possible that your Will has become outdated due to a change in your circumstances.

If there has been a marriage or a divorce since the preparation of the Will, a review is vital. Marriage and divorce automatically revoke a Will unless the Will was made in contemplation of that marriage or divorce. However WA only recently passed laws automatically revoking a Will upon divorce, so a divorce prior to 9 February 2008 does not revoke a Will.

Superannuation might not necessarily form part of the assets dealt with under your Will. We believe it is important that a Will and the nominations on a superannuation fund are consistent with each other. Where they contradict each other, confusion and uncertainty can arise.

There are other assets that might not be covered by your Will. These include assets held in a family trust, a unit trust or company. Instead we need to look at those structures separately.

It's all too common for a Will to be thought of as a 'one off' document. Life's changes show us though that in order to protect our estates, a regular review of a Will is necessary. ✨

Garry Woo heads up the Estate Planning Team at Plan B Trustees Limited, and is a certified legal practitioner

Paid Parental Leave

by Adrian Hanrahan

If you are a working parent and expecting a child, there is something else you can expect...

If you have already seen this slogan (and the TV adverts), you would be aware that Australia's national Paid Parental Leave Scheme commenced on 1 January 2011, and applies to eligible working parents of children born or adopted on or after that date.

In a nutshell, Paid Parental Leave (PPL) will be a fully funded scheme by the government, but generally paid via the employer. It will provide eligible working parents with parental leave pay at the national minimum wage, currently \$570 per week (\$10,260 for 18 weeks) before tax.

If you are an expecting parent (or just planning ahead) there are some nuances to this scheme that you should be aware of. This article will examine the PPL scheme in detail, and how you can maximise your entitlements.

Sounds good, am I eligible?

You may be eligible for Paid Parental Leave if you:

- are the **primary carer** of a newborn child or a recently adopted child under 16 years of age
- have met the Paid Parental Leave **work test** before the birth or adoption occurs
- meet the **income test**, and
- live in Australia and meet the **residency test**.

Paid Parental Leave must be taken in one continuous 18 week period without any break, and all the pay must be received within the first 12 months after the date of the birth or adoption.

How do I meet the work test?

The work test requires that you have been engaged in work for a total period spanning at least 10 of the 13 months prior to the expected birth or adoption of your child with a break of no greater than 8 weeks between any 2 consecutive work days, and undertaken at least 330 hours of paid work during the 10 month period (ie an average of one day of paid work a week).

The work undertaken does not have to be with the same employer, includes self employed work and can be completed in Australia or overseas. You may be eligible even if you are no longer employed (ie seasonal, casual, contract). However the 330 hours must be done for financial gain or reward which means periods of unpaid leave and voluntary work do not count.

How do I meet the Income test?

To satisfy the income test, the primary carer in your family must have an adjusted taxable income less than \$150,000 in the financial year prior to the date of birth or adoption, or the date of claim (whichever is earlier).

How do I meet the residency test?

To satisfy the residency test, you must be living in Australia and be an Australian citizen, the holder of a permanent visa, a NZ citizen who arrived in Australia on a NZ passport or the holder of a specified temporary visa.

Who can be the primary carer?

The primary carer is the person who physically cares for your child on a daily basis. This can include:

- the birth mother
- an adoptive parent
- the partner of the birth mother or adoptive parent, or
- the child's other legal parent or their partner.

Keeping in touch with the workplace

Where you return to work whilst on PPL, the payments will stop unless you are deemed to be 'Keeping in touch' with the workplace. In some cases, where you return to work, the unused part of the PPL may be transferred to another carer who meets the eligibility criteria.

'Keeping in touch' with the workplace allows you to participate in activities at work for up to 10 days from the birth (or adoption) of the child until the end of the PPL period, without losing any of your entitlements. 'Keeping in touch' days cannot be taken within 14 days of birth (or adoption).

How will PPL affect my other government benefits?

If your family elects to participate in the PPL scheme, you will not receive the Baby Bonus (except in multiple birth cases) or Family Tax Benefit – Part B while you are receiving PPL. The dependent spouse, child-housekeeper and housekeeper tax offsets will also not be available.

PPL is counted as income for the purposes of Family Tax Benefit – Part A, the Commonwealth Seniors Health Card and Low Income Health Card. However, PPL is not treated as income for Centrelink income support payments (ie Parenting Payment, Newstart Allowance, and Disability Support Pension).

Should I choose the baby bonus instead of PPL?

Parental leave pay and the Baby Bonus cannot be paid for the same child, so a decision needs to be made as to which scheme would provide you with the greatest benefit.

It is estimated that more than 85% of families will be better off receiving PPL rather than the Baby Bonus. Where you are eligible for both, you should speak to your Adviser about choosing the payment scheme that yields the best overall financial position for you.

There are significant differences between the Baby Bonus and PPL scheme (for example, if you chose to receive the Baby Bonus none of the above government benefits would be affected as it is a tax free payment). We have outlined the key differences in the table on the following page.

Lodging a claim

A claim for PPL can be made online via the Family Assistance Office website at www.familyassist.gov.au/online-services

How will PPL be paid?

From 1 January 2011, the PPL scheme will be administered by the Family Assistance Office for a transitional period of 6 months, unless your employer agrees to administer the scheme for you early. After this period, it will be compulsory for your employer to administer the scheme for eligible employees.

You would be considered an eligible employee if you have been with your employer for 12 months or more, are an Australian based employee and will receive 8 weeks or more PPL. Where you are not an eligible employee, the Family Assistance Office will continue to administer the scheme for you.

Comparison of Paid Parental Leave and the Baby Bonus

	Paid Parental Leave	Baby Bonus
Entitlement	\$570 per week up to a maximum of 18 weeks (\$10,260)	13 fortnightly installments of \$407.23 (\$5,294)
Income Test	The primary carer (usually the mother) of the child must have an Adjusted Taxable Income of \$150,000 or less for the financial year prior to the date of birth (or adoption), or date of claim, whichever is earlier	Both you and your spouse must have a combined Adjusted Taxable Income less than or equal to \$75,000 for the 6 months period after the birth or adoption of the child
Work Test	The primary carer must have worked for at least 10 of the 13 months prior to the birth (or adoption) of the child, and worked at least 330 hours in that 10 months period, with no more than an 8 week gap between 2 consecutive working days	No work test required
Working while receiving the payment	Generally PPL will stop if returning to work before the end of the period (unless you satisfy the 'Keeping in Touch' requirements)	No restriction on returning to work as long as the income test is passed
Tax	Fully taxable, forms part of the recipient's assessable income	Not taxable
Payment method	Paid in installments from either the Family Assistance Office or the employer	Paid in 13 equal fortnightly installments from the Family Assistance Office

I am an employer and run a small business, what are my obligations?

The Family Assistance Office will notify you if you are required to pay an employee PPL and will ensure that the funds are received in advance (usually a day or two beforehand) enabling the PPL to be paid during your employee's normal pay cycle.

You will **not** need to:

- assess your employee's eligibility for PPL
- pay an employee PPL until after you receive the funds from the Family Assistance Office, or
- make superannuation guarantee contributions in respect of PPL payments.

Spread the joy further (and maximise your entitlements)

Claim early

When applying the income test, the Adjusted Taxable Income for the relevant financial year is the year immediately before the earlier of when the claim was made and the day the baby was born. Claims for PPL can be lodged up to three months before the birth (or adoption) of the child. This provides a planning opportunity if your adjusted taxable income exceeds \$150,000 in a financial year but your baby is not due until the following year. It may be worthwhile lodging a claim for PPL before your baby is born so that the previous financial year's adjusted taxable income will be used.

For example:

Miranda is expecting a child in August 2011 and her salary for the 2010/11 financial year is \$155,000. Her adjusted taxable income for the 2009/10 financial year was \$145,000. Miranda will not be eligible for paid parental leave if she lodges her claim when the baby is born (due to her level of income in 2010/11). Instead, she would pass the income test if she lodges a claim for PPL before 30 June 2011, and within 3 months of the birth.

Salary Sacrifice PPL to super

Assuming you are on a marginal tax rate of 30% (plus Medicare Levy) or above, and your cash flow situation permits (ie you also receive employer funded PPL at the same time), you may consider salary sacrificing some or all of the PPL to save on tax. Amounts that are salary sacrificed into super are concessional tax at 15% instead of your personal marginal tax rate.

Let's continue from the previous example:

Miranda plans to take 18 weeks leave from work following the birth of her child. Under her employment contract she will be entitled to 12 weeks maternity leave at full pay and she will use her long service leave for the remaining 6 weeks. Therefore Miranda will receive PPL of \$10,260 on top of her usual salary of \$155,000.

If Miranda has the PPL paid to her directly, she will pay tax of \$3,950 (marginal rate of 37% plus Medicare levy), whereas if she salary sacrificed the payment into super, she would save \$2,411 as contributions tax is only \$1,539.

Deferring PPL to a different financial year

You may be able to reduce tax on PPL payments by deferring the commencement of the payment to a financial year when your marginal tax would be lower. You can choose to commence the PPL any time during the period from the day the child is born ending 34 weeks from the date of birth (to ensure the full 18 weeks are paid, 52 weeks from the birth).

For example:

Dana is expecting her baby in May 2011 and she is currently on a salary of \$90,000 per annum. Dana's employer does not provide any paid maternity leave and she intends to take one year's leave from work following the birth of her child. If Dana postpones the commencement of the PPL to after 1 July 2011, her taxable income would be \$25,260 for the 2011/12 income year, assuming Dana returns to work on 1 May 2012 and her salary stays the same. What this means is that there will be a tax saving of \$2,257 on the PPL, as the PPL of \$10,260 will be taxed at her marginal tax rate of 16.5% (\$1,693) as opposed to 38.5% (\$3,950).

For more information on Paid Parental Leave, speak to your Financial Adviser, or contact the Family Assistance Office. ✨

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