



CORNUCOPIA

/cor.nu.co.pi.a/ -noun -an abundant, overflowing supply

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6 May, 2010

Hello [membersalutation],

Welcome to Cornucopia May 2010

Thank you to The Hudson Institute for welcoming me to the team, I bring my experience as a retirement specialist to help our members navigate the complex waters leading up to and into retirement.

I have already presented seminars in Brisbane, Melbourne and Sydney in the last six weeks, and my intention is to visit regional centres on an increasingly regular basis to provide retirement education, and to meet with members to discuss their impending retirement, and how I might be able to help them.

For this edition of Cornucopia the first article looks back on the investment strategies of two retiree's and how they dealt with the Global Financial Crisis differently. The second article I discuss whether Capital Guaranteed Investments are really all they claim to be? And in the news... An increase in Deeming rates has been announced, how will this affect Aged Pension recipients? And if you are feeling slightly "Green" then beware – there might be a price to pay!



If you have any questions or topics you wish to know more about, please do not hesitate to drop us a line.

Until next time, take care,

Paul Jackson - Retirement Planner



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The Capital Guaranteed Product

What is it?

Capital Guaranteed products are investments that offer investors a reasonable return on their capital with the perception of little or no risk of loss. But care should be taken to understand that not all risks are avoided.

It is interesting to note that there has been an immediate re-emergence of The Capital Guaranteed product following the recent Global Financial Crisis. More significantly, it is at a time when the recovery is well under way, rather than whilst the markets were pitching themselves violently downwards.

Why a Capital Guarantee?

There are astute investment managers that realise that delivering a product that offers a better return than cash and a guarantee of capital protection, would be of interest to a good number of investors, and even more so following a severe downturn in the investment markets. It's really just clever marketing!

How does this work?

What these investment managers do is invest the client's funds into a "Statutory Fund". That is, they invest the funds into a pool that invests into all asset classes including Australian shares, international shares, property, bonds, and cash. The managers know that a balanced mix of all asset-classes will clearly outperform just cash over the longer-term. This statutory fund is not unitised in the same way as many investment trusts we understand. The investment managers employ actuaries to calculate the expected returns of the statutory fund over the longer-term, and then they declare an earning rate each year that is safely above the cash rate, but

allows the fund to retain a safe reserve for the occasions when returns are negative. Over the longer-term, a balanced strategy should return at least 2 - 3% above cash.

For example, a balanced fund might average 8 - 12% over the long-term, whilst cash funds might be offering only 5 - 6% during the same period.

What happens in negative years?

During the years there are good returns the statutory fund accumulates reserves into its "Reserve" trust. This Reserve trust then covers the shortfall in earnings to maintain paying a declared rate above the cash rate to continue to justify its existence. Remember that even during negative years many investments still have distributions that are the same or only reduced slightly, and it is their capital value that has temporarily diminished. The value of the statutory fund is not published, just the declared returns are. The client is unaware of any downturn in asset value.

What happens in a severe prolonged downturn?

This is where a Capital Guaranteed product is really challenged, and struggles to stay afloat. There is a process that occurs showing signs of trouble - For example:

1. Firstly the fund will close its doors to new investors to limit its liability during the downturn - The first warning sign.
2. Secondly - If the downturn appears prolonged, then the actuaries calculate a reduced 'Declared' earning rate until things pick up. Keep in mind that usually during a serious downturn the economy is stimulated by reducing the cash rate, so the effect of the reduction is partly hidden. I have also witnessed this happen to some Defined Benefit Super funds who adjusted their growth multiples as well as closing off the option to future employees to limit their liability further.
3. Usually shortly after reducing the 'Declared' rate, investors begin to withdraw their funds seeking better opportunities elsewhere, and that's when the fund closes or freezes any further redemptions until the markets look more stable.

Stages 2 and 3 are usually not too far apart.

I noticed that after the downturn in 2001, the majority of these Capital Guaranteed funds disappeared altogether. Perhaps their re-emergence in recent times is a sign of an optimistic outlook by some investment managers.

In my opinion, investors should understand more clearly the nature of their investments, and by doing so they will quickly realise that a Capital Guaranteed investment may not be as free of risk as they had imagined. It might be just as easy to invest their assets in the same manner as the investment manager, and benefit by retaining the additional return that is reserved in a Guaranteed Investment for themselves, and accept that volatility is a normal part of investing.

Want to know more about Investing in your Retirement? Book a consultation with Paul Jackson by calling free call **1800 804 296** or [book online](#).



In the news...



Deeming Rate Increase

Centrelink Deeming rates have been lifted from 20 March as follows:

Financial Investments Value	Situation	Deeming Rate From 20/03/2010
First \$42,000	Single	3%
First \$70,000	Pensioner Couple (combined)	3%

What does this means?

A single pensioner with \$50,000 in liquid assets will now be assessed to earn \$540 more than before March 20, and a pensioner couple with \$100,000 in liquids will be assessed to earn \$1,150 more than previously.

If your reserves have been reduced, it is important to let Centrelink know as soon as possible.

Pensioners stung for "Going Green"!

- Penalty for claiming solar panels rebate
- Government says pensions will be docked
- Family First accuses Rudd of penny-pinching

KEVIN Rudd is docking the pay of pensioners who are trying to save the environment.

Pensioners, who fix solar panels to their home and sell excess electricity back to the power company, will have any credit or rebate counted as income, and their pension payments reduced.

The Government says that is the same principle as its clawback rules for pensioners who collect rent. Family First Senator Steve Fielding blasted it as "penny pinching by a stingy government" when pensioners face rising electricity prices.

Pensioner Don Campbell, 63, said he spent \$11,000 to fit solar panels to the roof of his home on the NSW mid-north coast. "The Government preaches it wants you to cut your carbon footprint, and as soon as you do it they punish you for it," he said.

Source: Herald Sun April 26

From my point of view, and in line with the governments promotion of reducing your carbon footprint, perhaps they might consider discounting this income as it is of a special nature.

Want to know more about making the most of your retirement? Book a consultation with Paul Jackson by calling free call **1800 804 296** or [book online](#).



Portfolio Structure in Retirement – A CASE STUDY and lesson to be learned!

At a time when the light at the end of the investment tunnel is beginning to shine through, it is worthwhile to look back to see lessons learned from the recent Global Financial Crisis, and how people's reactions effected their income and investment portfolios.

Severe volatility is something we always hear a lot about, especially from financial advisers, but it is something we rarely experience. Those that survived the ravages of the recent Global Financial Crisis (GFC) intact can finally appreciate why sound advice is well worth paying for.

Let me tell you a story of two retiree's and two very different investment outcomes following the GFC:

Retiree Ron:

Ron retired in July 2007 with a sizeable final pay-cheque of \$500,000. Ron and his wife Marie established a Self Managed Super Fund (SMSF), and invested most of this capital into Australian shares, with \$40,000 in cash. They arranged to draw a pension of \$40,000 from their fund each year.

Ron purchased most of his shares on-line and believed that shares would provide the greatest return over time. He expected to top-up his cash reserves with \$25,000 of dividends every year. Ron felt very excited about his retirement.

Retiree Dave:

Dave also retired in July 2007, and had a nest egg valued around \$500,000. Needing a similar income to Ron, Dave decided to use the advice of a professional Financial Planner to plan out his retirement future.

Dave's adviser was very careful to assess the risk profile of Dave and his partner to ascertain their lump sum needs and ongoing income requirements. He carefully structured the portfolio to meet those needs, both short-term and long-term. Dave ended up with a conservative pool of cash and fixed interest investments equal to approximately 6 years of their income needs, that is - \$240,000. The remainder was then invested into a mixture of shares and property just like Ron. Dave's adviser explained that whilst the share market was providing excellent returns at the time, it was prudent for Dave to provision wisely to cover any major downturns. He went on to explain that if there was ever a major downturn, then Dave could continue to draw his income from assets that were not downturned, and would have sufficient time to await the recovery of his growth assets. Dave was pleased as he felt his portfolio captured his tolerance-to-risk accurately and provided the retirement lifestyle he planned for.

The events that unfolded shortly after in 2007 are now a fact of history. As it happened, the emotional roller coaster struck at the heart of every investor worldwide.

Retiree Ron initially accepted the volatility as it developed because he knew this was part of the deal when investing in shares. But as -10% turned to -20% and then accelerated past -30% with ease, his confidence diminished and panic set in. His nest egg had already melted to well below \$300,000, and the dreams he entertained turned black. In a panic attempt to save what was left, Ron took action, and sold all his shares.

In the meantime, **Retiree Dave** was also very concerned. He called his adviser as soon as he could. His portfolio had also diminished and he was looking at \$365,000 to live on for the next 25 years. He was hoping his adviser would tell him to sell what he could to save the situation from further deterioration. But that didn't happen. Dave's adviser understood exactly how he felt, and what was going through his head, and that he wanted to sell his investments, but that would be a huge mistake. Dave's financial planner took him through the portfolio he had constructed originally with this scenario in mind, and showed him again that he had provisioned enough to support Dave's income stream for almost 6 years so he should not rush in and make any bad decisions. Dave now understood and would wait out the recovery process whilst continuing to enjoy his income unchanged.

Stepping forward to April 2010 >>

Retiree Ron is still recovering from his experience. His super is still invested in cash, although he is starting to think about re-entering the investment markets, however his confidence is lacking. Ron has only \$305,000 remaining from his original \$500,000 and has had to take a job again to supplement his reduced drawings.

Retiree Dave too has learned from his experience. His capital has recovered a good deal and is resting just above \$410,000. He realised that the recovery is still in progress 2.5 years after the markets declined, but he reminds himself he still has quite a few years of reserves aside to cover his income stream. He knows he can continue to remain in retirement and enjoy it as originally planned.

What are the lessons we have learned?

1. Your final paycheck is too important to risk, seek professional advice!
2. Asset allocation and portfolio structure is as just as important as investor expertise
3. When things go wrong, it is especially important to have a guiding hand for reassurance and a professional financial plan!
4. Discipline is paramount

If you would like to discuss your retirement future with our Retirement Specialist Paul Jackson, please call our toll free number 1800 804 296 or book an appointment online.



GLOSSARY OF TERMS

Building you a comprehensive glossary of terms through Cornucopia.

Liquid Assets – Usually refers to assets such as cash and fixed interest investments like term deposits with short-term (less than 2 years) to maturity. Defined as such because they can be accessed in the short-term without capital fluctuation if ever needed.

SMSF – Self-Managed Super Fund, Family Super Fund, or DIY Super Fund. Restricted to maximum 4 members who must all be trustees. Might be suitable in some circumstances. Investment can be handled directly by the trustees who may be the members. Onerous responsibilities are part of the deal, and it is regulated by the Tax Office.

Volatility – Synonymous with risk from a financial perspective. The ability of investments to increase and decrease in value

according to investor sentiment.

Actuary – A qualified mathematician who undertakes calculations from a financial perspective. Often used to compile reports of a likely outcome for income and growth in investments over a defined timeframe.

Defined Benefit – Usually refers to a large superannuation fund where an actuary calculates all the variables and converts them to a formula to calculate an employee's superannuation balance at any given time. It helps smooth out the rises and falls in the markets and its effects on member's balances. In many cases the calculation involves a "Final Average Salary" times an increasing benefit multiple. The benefit multiple is calculated using contribution rates from employer and employee, and estimated average investment returns of the fund.



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