AFG FINANCIAL PLANNING

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STRATEGIC PROSPERITY GROUP
FINANCIAL PLANNING SPECIALISTS

With compliments from your AFG adviser

SUMMER 2008 EDITION

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hard earned worth protecting

What are your assets? When you think of the term 'assets' you most likely visualise possessions such as your home and car, or perhaps you think of jewellery, savings or investments. As valuable as these are, assets can also include intangible objects that may not immediately be considered in dollar terms.

LIFE INSURANCE PROTECTION FOR A LIFETIME'S WORTH OF ASSETS

What are your most important assets? Once you broaden the definition of asset, the priority previously given to tangible assets may change. An easy way to determine the importance of your assets is to classify them into three categories.

1. Relational Assets

These are assets based on the relationships you have with the people closest to you and are characterised by a high degree of emotional and physical dependence or interdependence.

2. Personal Assets

These are assets which have a quantifiable dollar value and which you identify as part of your personality.

3. Financial Assets

These are items which hold financial value but which generally have no personal or emotional value.

What value do you place on these assets?

One of the great ironies of financial planning and decision making is that we spend most of our time thinking, planning and worrying about financial and personal assets, and our relational assets rarely come into consideration.

What about the 'volatility' of your assets?

A characteristic of all asset types is volatility. The most common concerns regarding asset volatility are in relation to financial assets. For example, a share portfolio is generally considered to be relatively volatile due to the ongoing possibility of gains and losses. These may amount to changes in value of 10, 20 or even 30% in a year.

However, the volatility of relational assets far exceeds this. 100% of a breadwinner or homemanager's dollar value can be totally lost at any time, through major illness or injury.

What does this mean for you?

The high value and extreme potential for volatility of your relational assets makes them worthy of careful consideration. While the protection of these assets may not be something that you have considered in the past, a few minutes spent calculating their worth may be the most financially powerful thing you will ever do!

CASE STUDY TED AND JEMIMA'S STORY

Ted and Jemima's profile

- Ted is 42 and earns $75,000 pa as a leagues club manager
- Jemima is 40 and earns $35,000 pa working as a part-time sales consultant
- They have two children aged 5 and 7

Protecting their relational assets

Ted and Jemima determined that they would both prefer to continue working part time if either passed away, and so decided that they needed an insurance benefit to replace part of their income and to provide for a nanny.

- Their adviser calculated that to replace 60% of Ted's income for the next 15 years (until the children finished school) would require capital of $675,000
- To replace 60% of Jemima's income would require $315,000
- Hiring a nanny to perform basic home duties would cost approximately $30,000 pa for the next 12 years and would amount to $360,000
- They also wanted to establish an education fund of $100,000 per child if either parent were to die

Protecting their personal assets

- Ted and Jemima would like to extinguish their $220,000 mortgage in the event of either dying
- They have personal loans and credit card debts of $15,000 Financial assets
- They are saving to buy a holiday house which they estimate would cost $150,000

Their protection program

Ted's total protection needs amount to $1,620,000 and Jemima's $1,260,000. Their insurance adviser recommended they insure these amounts against death and total and permanent disablement. She also recommended that they should each have critical illness insurance to cover the cost of the mortgage plus one year's salary. This benefit would fund an extended period of leave without pay and provides a contingency fund for medical expenses, house renovations and rehabilitation.

Ted was also advised to insure his income for the maximum amount of $4,687 per month.

While Ted and Jemima describe their lifestyle as comfortable, they don't consider themselves to be rich. They apply a monthly budget to their income and consider themselves to be financially responsible.

Creating your asset protection program

The value of your relational, personal and financial assets might be enormous, so what types of insurance can you put in place to create an 'asset protection' program?

There are four main categories of insurance which are designed to work together to provide security for you and your loved ones. Income Protection Insurance, Trauma Insurance, Total and Permanent Disability Insurance and Life Insurance.

Income Protection Insurance

There are a vast number of illnesses and injuries which have varying terms of impact. These often fall outside the scope of total and permanent disability and trauma insurance. Income protection is designed to protect you from a loss of income due to such conditions by paying a replacement monthly income of up to 75% of gross income.

Trauma insurance

Trauma insurance can help you cope financially with the affect that a medical trauma, such as a stroke or a heat attack, can have on your life. Trauma insurance is normally paid as a lump sum and can be used to pay for changes to your lifestyle or for care that you may require because of the trauma.

It is vital that you and your family are financially protected against debilitating accidents, long-term sickness and, in the worst case, the death of you or your spouse.

In the past, life insurance was often the only financial product a family might have. Now, as part of a sound wealth protection strategy, it's important to consider a range of insurance products to cover for events that don't lead to death but result in time off work and partial or total loss of income.

Imagine being in an accident, or suffering from a serious illness such as cancer or a stroke – which unfortunately are all too common. Do you have enough money in the bank to cover your debt repayments if you're out of work for an extended period? Will your company keep paying your salary if you have to be off work for an extended period of time? How good is your safety net? The only way to get real peace of mind is to take steps so your are protected if the worst happens.

Total and permanent disablement insurance (TPD)

TPD insurance covers you for disabilities that permanently prevent you from ever working again. TPD is normally paid as a lump sum. Note that many TPD insurance policies require up to six months of total and permanent disability before paying a benefit.

Life Insurance

Many of us have standard life insurance embedded within our superannuation. But check how much cover you have as you may need to top it up. Not having enough means that if you were to die suddenly, the payout to your family may not be sufficient to cover outstanding debts and pay a regular income once the funds are invested. Keep in mind that at a conservative investment rate of 5% per annum, you would need to receive a payout of approximately $1 million to generate $50,000 p.a. pre-tax.

Did you know

A study conducted by the Australian Bureau of Statistics measured the economic value of typical household tasks. They calculated that such tasks would amount to approximately $580 per week if performed by paid outside resources.

Males between the age of 30 and 65 have a one in five chance of dying before age 65 and a one in six chance of suffering a serious disability (of at least six months duration) before age 65. Females aged between 30 and 65 have a one in seven chance of dying and a one in four chance of suffering a serious disability.

A child's education journey might cost anywhere between $7,653 (without childcare) and $190,895 for a full time private education including a university degree.

Hints and tips

Deciding who owns an insurance policy is an important decision. The person nominated as the owner of a life insurance policy receives benefit payments directly, without the need for distribution through a will.

Check your employer superannuation policy to see if a death and disability benefit is provided. While this may not protect all of your needs, it should be taken into consideration when formulating your protection program.

Some policies provide a cost saving by allowing you to combine multiple benefits under the one policy.

The next step

While this article provides a useful introduction to asset protection, a full analysis of your personal situation requires expert attention.

Your AFG Financial Planner can show you:

- How to accurately calculate your protection needs;
- How to build an integrated plan, combining the four types of protection; and
- How to source quality protection plans at an economical cost.

You don't have a choice about being exposed to these risks, but you do have a choice about protecting yourself and your loved ones against unforeseen financial exposure.

Article provided with the assistance of Tower Life and Aviva

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feeling bullish? consider capital protection

Recent record highs and subsequent falls on Australian equity markets have many prospective investors feeling nervous. Despite the boom times and bullish forecasts created by the emergence of China as an economic superpower, investors seem to be asking whether this is the appropriate time to invest into equities, particularly here in Australia. This behaviour is evidenced by record inflows and balances being reported by managers of leading cash trusts – money looking for a home.

One solution to this predicament is capital protection and recent years have seen growth in both choice and popularity of investment vehicles which allow investors to take the plunge secure in the knowledge that a short-term correction will not eat into their hard-earned capital. Capital-protected funds over a range of asset classes from Australian to international equities and hedge funds have proliferated. Similarly, investors in Australian shares have increasingly turned to structured products to reduce the risk of under performance which can otherwise impinge upon a portfolio of direct equities.

Similarly, margin lending has grown at a record pace, particularly in the past 18 months as growth-focused investors have switched from negative gearing into the fully-valued investment property market to the booming Australian share market. Gearing assets which are capital protected has been a key driver in the overall growth of margin lending with the protected lending industry growing to $2.003b and a major increase in the number of protected lending products launched into the market.

So why is protected lending becoming increasingly popular?

Many investors, particularly those new to the market, continue to see equities as a riskier asset class than property – the fact that valuations are dynamic and change from day-to-day keeping the potential for a fall in asset prices prominent within their subconscious. When an investors risk profile is increased through gearing, this perception of risk becomes increasingly prominent and a solution which allows leverage to the upside while reducing downside risk can become appealing.

With downside risk limited, investors can be comfortable with a larger equities portfolio at a greater level of gearing, safe in the knowledge that a margin call will not arise.

By protecting assets individually, portfolio returns can also be enhanced as losses need not be netted off against gains.

What types of investors use protected lending?

- Those entering equities for the first time, needing capital certainty as they grow comfortable with the asset class
- People with less investable assets who can grow their wealth faster with the greater leverage which protected lending affords them
- High income earners whose effective borrowing cost is reduced by the potential tax deduction it provides
- Those with, or looking to take, a large exposure to a single stock

Types of ways to gear and protect

Investors looking for capital certainty now have a wider range of choices available to them than ever before. Several providers offer a comprehensive range of protected lending products available to suit every type of investor. Whether it is for a risk adverse client just entering into the market place for the first time or a financially savvy investor, there are products that can be tailored to every individual financial objectives:

- Protected direct equities – 100% capital-protected geared investment into direct equities
- 100% Investment Loan – providing 100% finance into capital-protected investments.
- Protected Managed Funds – combining 100% protection and 100% finance into a range of managed funds.

So if you think your can benefit from capital protection, please contact your AFG Financial Planner.

Article provided with the assistance of Macquarie

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Market Outlook

economic outlook

Economic outlook Financial disruptions related to the subprime issues have added another layer of risk to global growth. Pleasingly, the US Federal Reserve and other central banks have provided ample liquidity to support the affected financial market. Recent speeches from Federal Reserve officials have acknowledged further economic uncertainties, leaving the door open for further interest rate cuts.

With an election in the US in 2008, it is inevitable that there will be political response to the sub prime debacle. For Australia, regardless who won the election; the spending promises by either party will add significant growth to the economy and undoubtedly put more pressure on already elevated inflation. One figure suggests the spending spree would add 1.0% point to growth in the next 5 years. This leaves the RBA with more work in lifting interest rates higher. While some parts of the economy would feel the impact of interest rates, the bank needs to stay ahead to ensure inflation remains under control.

International Share Market outlook Global share markets are expected to remain volatile. Market participants are waiting for fourth quarter reporting to see how much more damage the subprime issue and the related financial disruptions have caused. On the other hand, liquidity in share markets will stay as investors migrate from credit markets.

Australian Share Market outlook There are many uncertainties about the outlook for 2008; chief among them is whether the US economy can avert recession. At this stage it looks like a coin toss. The economic data continues to show the US economy muddling through, but the flow-on effects from the subprime crisis are yet to be fully reflected in the economy.

Australia has just elected a new government, but this is unlikely to have major implications for the economy or markets in 2008. The bigger issue for us is how much tightening the RBA will have to do to get on top of the inflation.

China remains crucial for the outlook for the Australian economy and, of course, for the global economy. The Chinese authorities continue to tighten policy, but the juggernaut rolls on ahead of the Olympics this year. Asset allocation positioning is currently light, reflecting the uncertainties cited above.

Listed Property outlook Assuming a soft landing for the US economy, the global listed property sector is forecasted to return around 11-12% over the next 12 months. This compares with 14.5% for global equities and 3.2% for global bonds. These estimates assume the sector delivers a 3% dividend yield with 6-7% earnings growth. With the sector trading at only a 1.0% premium to Net Asset Value and an FY08E earnings yield of 5.1%, a c100bp premium to global bonds, sector pricing is considered fair, with a soft economic landing.

Australian Dollar outlook After hitting a 23 year high of US\$0.94 in early November, the A\$ expectedly fell 5% to finish the month slumped back to slightly above US\$0.88. It was weighted down on concerns about the flow on effect of the outlook of US growth; the Chinese economy; and commodity prices. While volatilities will continue in the coming month, the case for stronger A\$ will remain due to the widening of interest rate differential against the US.

International Fixed Income outlook So far in December, credit concerns remain at the forefront with negative news continuing to be released in the US. The US Federal Reserve met on 11 December 2007 and has cut the federal funds rate by 0.25% to 4.25%.

Currently the market has factored in several rate cuts by the US Federal Reserve in the first half of 2008, whilst the Bank of Canada surprised the market by cutting their official cash rate on December 4.

From an economic perspective, investors will also remain focused on the broader economic impact of the collapse in the US housing market, particularly in relation to the impact this is having on the US labour market.

Australian Fixed Income outlook At their monthly board meeting on 5 December 2007, the RBA decided to leave the official cash rate unchanged at 6.75%.

In an effort to improve communication, the RBA has (among other things) decided to regularly release a short statement each month explaining its decision as to whether or not to change the cash rate. Explaining their December decision to leave the cash rate unchanged, the RBA noted their remaining concerns about the inflation outlook, the heightening uncertainty about the global economic outlook and the recent trends for higher local wholesale borrowing costs.

As a result of this statement, the market has moved to reduce the probability of another rate rise when they next meeting in February. Certainly the hurdle for another rate rise has increased.

The trend in Australian bonds will continue to be influenced by offshore trends, particularly the performance of the US Treasury market and the US economy. While the Australian economy remains resilient, a meaningful slowdown in the US economy will have an impact on the global economy and, in turn, on the Australian economy.

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