

# Your money Your future

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## Stay out of the red this Christmas

**For most people, Christmas is a time of great joy and celebration. Family get-togethers, presents and feasts all make it a fantastic time of year.**

But Christmas is also the time of year that can cause the most strain on your family budget. And, while it can be tempting to simply put a bit extra on your credit card, this will only cause problems down the track.

So if last Christmas left you with a financial hangover, what can you do to get your finances back in the black?

**Pay off your credit card debts** – holding debt on your credit card can be very expensive. Think about consolidating

this debt with other kinds of loans and perhaps use a different method of payment next time, such as direct debit or lay-by.

**Start a progressive savings plan** – putting aside just \$40 a week (or around \$6 a day) will give you more than \$2,000 over one year, ignoring earnings. A bit of savings discipline now might be just the cure for a Christmas spending splurge.

This Christmas, make sure Santa is the only person 'in the red'. Speak to your financial adviser for more information on how you can improve your budgeting skills and put in place a plan that will help deliver you a debt-free Christmas.



### Myrtle Ridge Financial Services

148 1899 7195

156 George Street  
Launceston  
TAS 7250

### Nigel Jones

### Paul von Stieglitz

Authorised Representatives

PO Box 1267  
Launceston  
TAS 7250

Phone: (03) 6334 6330

Fax: (03) 6334 6360

Email: [admin@myrtleridge.com.au](mailto:admin@myrtleridge.com.au)



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## Income insurance – agreed value or indemnity?

**Income insurance pays you a replacement income stream if you are unable to work due to sickness or injury. The income stream, usually paid monthly or fortnightly, is designed to help you pay for day-to-day expenses.**

'Agreed value' and 'indemnity' are two common types of income insurance policies which differ in the way the benefit amount is calculated at the time of claim.

### How 'agreed value' calculates your benefit amount

Agreed value income insurance calculates your benefit amount on an agreed amount (based on your income) at the time you take out the plan. Most plans increase to match inflation – this offers peace of mind as your benefit amount increases even if your income drops after you take out the plan.

### How 'indemnity' typically calculates your benefit amount

Indemnity income insurance calculates your benefit amount based on the lesser of:

- (a) the agreed amount (based on your income, less business expenses but before tax) at the time you took out the plan (plus any CPI increases); and
- (b) 75 per cent of your average monthly income (less business expenses but before tax) over the two years immediately prior to the claim.

Any drop in your income (prior to becoming totally disabled) will be reflected in your benefit amount payable. Because of this, indemnity insurance is generally cheaper than agreed value.

However, with both indemnity and agreed value plans, an income increase well above CPI will not be reflected automatically in the plan. To have a pay rise taken into account, you need to reapply for insurance based on your new income.

If your income increases steadily at about the same rate as CPI, buying indemnity income insurance will benefit you with lower premiums over your lifetime for the same level of cover.

However, if your income drops during your lifetime (for example, you become unemployed or decide to take a lower paying job), agreed value income insurance is probably better. The amount you receive will remain as you agreed when you took out the plan regardless of drops in your income.

In all cases, the most important thing to remember is to review your insurance annually with your financial adviser to ensure it reflects your situation accurately.

## High interest rates and investments

The hike in official interest rates on 2 August 2006 by the Reserve Bank of Australia (RBA), from 5.75 per cent to 6 per cent, shouldn't come as a surprise to anyone. Essentially, the RBA increased the rates to slow consumer spending, and therefore attempt to control inflation in the economy. The rise in petrol prices and easy access to money is also responsible for the RBA's move, and it should be noted, that the rate rise had little to do with the much-publicised high price of bananas.

The interest rate rise should not necessarily be considered a bad omen if you are an investor. In fact, you may now have a better opportunity to select the best-performing investment options, against the weaker ones, which may not survive in this tougher investment climate.

### Fixed interest or bonds

Bonds represent loans issued by governments, agencies and companies, promising to repay borrowed money from investors at a fixed rate of interest at a specified time (such as three or 10 years). The RBA's move highlights potential inflation

risks, which can translate to higher bond yields. When yields are rising, the return on existing bonds can actually fall since bonds which are priced at lower yields become worth less.

### Shares

Mark Dutton, Chief Investment Officer of AXA Australia and New Zealand, indicated stock markets were nervous about slower economic growth. Company profits and share prices could dip as people spend

less money. As such, intensive research of individual companies by experienced, qualified analysts and fund managers will help differentiate between quality companies and weaker ones, generating benefits for investors.

"Overall the share market is not expensive and quality stocks are well priced to offer good returns on investment in the medium and longer terms."

### Property

The current state of commercial and industrial markets is strong, reflecting low vacancy rates and rising rental yields. These markets are well placed to withstand modest changes in interest rates. But it's important to note that residential property markets are vulnerable at the moment, in most states.

For more information about how to maximise your investment returns, seek specialist financial advice to obtain a well thought out investment strategy, including diversified portfolios aimed at producing good returns even during challenging times.



## Better budgeting

**A carefully considered and realistic budget can boost your spending power, whether it's to splash out on a luxury, channel more funds into your investment portfolio, or reduce your home loan.**

We all lose track of what we spend at one time or another. Keeping on top of credit and debit card transactions, mortgage repayments, bills, as well as other expenses, can be bewildering if left unmanaged. But setting a realistic budget can quickly help you regain control of your cash flow and pave the way to achieving your financial goals.

Key to creating a successful budget is establishing your aims and regularly reviewing progress. Setting milestones will also help chart your path and keep you motivated. Whether you're saving a deposit for a property, planning an investment or just eliminating debt, working towards a target will increase your chances of success.

### **Achievable aims**

An unrealistic budget will not only limit your motivation, but you'll also risk failing to meet

your financial goals. Keep your expectations reasonable and tangible to ensure you stay on track.

### **Chart your spending**

Most of us underestimate our monthly outgoings. Obtain an accurate idea of what you spend each month by tracking every dollar. Identify regular outgoings that must be met and highlight areas with scope to trim back.

### **Keep an eye on credit**

Always pay credit debts during the interest-free period and get payments in on time. Consider consolidating multiple high-interest debts into one manageable low-interest loan to minimise repayments.

### **Review your mortgage**

Look closely at your interest rate and keep an eye out for more competitive products. Speak to your financial adviser to ensure you're getting the best deal available.

### **Stay focused**

Use your milestones to keep your motivation up. Don't be too hard on yourself – you don't

have to eliminate all the fun from your life, just find cheaper alternatives. If you have a blow-out, try to make up for it somewhere else.

### **Five steps to saving:**

- 1 Cut back on takeaways – pack your lunch and avoid fancy café coffees
- 2 Never impulse buy – stick to a shopping list so you buy what you need, rather than what you want
- 3 Minimise credit – one credit card is enough; reduce the limit to avoid temptation, or better still, consider replacing the credit card with a debit card
- 4 Earn interest – channel a proportion of your salary into a savings or investment account that earns a higher rate, or if you have a mortgage, use a 100 per cent offset account
- 5 Go wholesale – non-perishable food, beer, wine and grocery items are a lot cheaper when bought in bulk; you can also save on phone, internet, or electricity by using wholesale providers or bundling and taking advantage of 'cap' contracts.

## Interest rates – should I go with fixed or variable?

**In any discussion about interest rates, it's worth remembering that the Reserve Bank of Australia (RBA) controls only short-term interest rates, not long-term rates. Therefore while the RBA can move variable interest rates (by altering the cash rate), it is unable to control the rate applicable to fixed-rate mortgages (since these are determined by the actions of professional investors in the bond market). This is an important consideration when thinking about whether to use a fixed or variable rate mortgage.**

When the RBA lifts the official cash rate, there is a direct impact on the cost of funds in the short-term money market and these changes are quickly reflected in higher variable mortgage rates. The rates offered on fixed-rate mortgages however, change much more frequently, in line with the prevailing rates in the bond market.

The major issue for the direction of future interest rates is the extent of economic growth and the implications that this may

have for future levels of inflation. Currently, the future of interest rates appears to be slightly on the upside. Rising rates may bring about increases in mortgage repayments, causing some financial stress for many Australians.

An easy way to avoid this problem (particularly for those with large mortgages) is to lock in a proportion of the loan on a fixed rate. By locking in part of the mortgage, investors and property owners can limit their exposure to future rate increases. Importantly this would still allow additional repayments on the variable part of the loan. Finally if fixing turns out to be a poor strategy (because interest rates fall instead of rise) this may be offset by an increase in the value of the home. From this viewpoint fixing part of the mortgage is a classic hedge.



## Making school fees feasible

**A good education is a valuable start to life and one of the best investments you can make for your children. However, the cost of education is taking up an ever-increasing portion of the family budget, with school fees rising by an average of 8 per cent annually for the last 10 years.<sup>1</sup>**

While public school education is generally free, many schools ask for 'voluntary' and sometime 'compulsory' fee payments. Costs for excursions, enrolment fees, building fund contributions etc need to be taken into account. There are also school uniforms, books, stationery, sporting equipment and music lessons to consider. Parents who opt for private school education can expect to pay even more.

The earlier you start saving the better. Investing while your children are in pre-school means there are six years before the monetary demands of secondary school commence. This enables you to take advantage of earning compound interest by putting the money to work in managed funds. Even if your children have already started school, it is not too late to begin. For those with a short investment horizon,

cash management or managed funds with income objectives, may be suitable.

A few financial points to consider when selecting schools:

- What is the registration fee?
- Is there an enrolment fee? Is it refundable?
- Is there a discount if more than one child attends the school?
- Do parents have to provide an interest-free loan to the school?
- Are contributions tax deductible?
- Can arrangements be made in case of financial hardship?
- What subjects incur extra charges?
- What additional fees are associated with the school (bus services, extra curricular activities)?

Cost saving ideas for purchasing school items include:

1. Shop around for stationery. Take advantage of 'back to school sales'

and don't succumb to pressure to buy 'trendy' items.

2. School uniforms can be purchased second hand, and a little larger to accommodate growth spurts.
3. Take advantage of the rental packages for laptops.
4. Decide on acceptable amounts for spending at the canteen and on mobile phones.
5. Take advantage of discounts for up-front payments.

Speak with your financial adviser for more strategies to help you save for your children's education.

<sup>1</sup> 'Saving for education – the best investment you'll ever make', (Financial Planning Association of Australia Limited, May 2003).

## A little for a lot – seems like a good sacrifice

**Are you looking for a great way to boost your retirement savings and save on your tax bill at the same time? Salary sacrificing some of your pre-tax earnings into superannuation can be a great way to achieve both results.**

Even better, salary sacrifice can help you achieve a level of retirement savings that will mean you can enjoy your lifestyle long after you stop working. It should be noted that salary sacrifice may not be available to low income earners and those paid the award wage. Your employer also needs to approve your salary sacrifice.

### What is salary sacrifice?

Salary sacrifice involves requesting your employer to make pre-tax contributions from your salary into your superannuation fund.

The short-term result is that you will receive less take-home income because it has been sacrificed into your superannuation fund. However, the payoff is two-fold.

Firstly, provided that your marginal tax rate is more than 15 per cent, salary sacrificing

will result in an immediate reduction to the total amount of tax you pay. This is because this type of superannuation contribution is generally taxed at 15 per cent.

Secondly, because of the tax saving, you're able to inject more funds into your superannuation fund. This means your fund will be immediately boosted and, over the coming years, will provide compound benefits on the money it invests.

### Case study assumptions

The projections in this case study are based on various assumptions, including, but not limited to:

- estimated tax is calculated using marginal tax rates
- the superannuation contribution can not be accessed until you reach a condition of release, for example, reaching age 65, and
- superannuation guarantee is paid on the gross annual salary including the salary sacrifice amount.

### Case study

Sarah, aged 40, works as an IT professional in Brisbane and currently earns \$90,000 per annum. In addition to this income, she earns \$5,000 per annum from a small but growing share portfolio. While her employer already contributes the 9 per cent superannuation guarantee, Sarah decides to salary sacrifice an additional \$10,000 of her gross income into superannuation.

By sacrificing \$10,000 into superannuation, Sarah's superannuation fund is boosted by \$8,500 (after contributions tax of 15 per cent is deducted). While Sarah's take-home income is reduced by \$5,850, the overall benefit from the tax saving she receives is \$2,650.

For more information on how you can boost your retirement savings and receive a tax cut in the process, speak with your financial adviser.