your **money** your **future**

FINANCIAL PLANNING NEWSLETTER

Crunching the numbers on transition to retirement

Transition to retirement or TTR is now a well-accepted and financially positive way to smooth the path from the workforce into retirement. In simple terms, a TTR allows you to maintain your 'in-pocket' income but change the mix. You can use your super account to start a new income stream, while at the same time topping up your super account by increasing the amount of salary you 'sacrifice'.

However, changes in the 2012 Federal Budget raise an important question. Has the reduction from $50,000 to $25,000 in the amount that can be contributed at the concessional tax rate now reduced the benefits of a TTR strategy for some people?

How it works

Under the 'Transition to Retirement' rules, people aged 55 or over can access their super while still working. Some or all of their super is rolled into a 'non-commutable' income stream which pays them a regular income, often referred to as a pension. However, this does not allow them to withdraw a lump sum.

With this pension income stream, they then have the option to salary sacrifice more of their earnings into super while maintaining their overall income level. Because salary sacrifice uses before-tax dollars, it may be possible to contribute more to super than is actually withdrawn.

2012 Budget changes

From 1 July 2012 everyone has a maximum concessional contribution cap of $25,000, regardless of age. The move halves the cap for people 50 and over, possibly affecting the option to use salary sacrifice in the transition to retirement strategy.

But it is not just budget changes that impact on TTR. People's circumstances change all the time. Changes to the balances of people's superannuation accounts and their need for income make it necessary to regularly review your retirement strategy with a professional.

Three key benefits of a TTR[1]

Firstly, superannuation savings are moved into pension phase and tax no longer applies to the investment earnings, including realised capital gains. This boosts the effective earnings rate.

A second benefit is that money can be withdrawn from preserved benefits as pension payments, which can help increase disposable income. Using this approach may support a move to part-time work or allow an increase in home loan repayments to further reduce debt before retirement.

Finally, salary sacrificed income can be replaced with pension income. For someone aged 60 and over this can provide personal tax savings. For someone between 55 and 60, there may be some savings if less income is taken out than is sacrificed back into super.

Continued next page

1 'Is TTR still effective?', www.strategysteps.com.au

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Crunching the numbers on transition to retirement continued

The first two benefits are not impacted by the change. However, the third advantage, the ability to create personal tax savings, may be reduced.

Jane's strategy

Jane is aged 55 and earns $82,000 from her employment. Her net income is $62,480* in 2011/12 ($62,483 in 2012/13). Her employer contributes $7,380 under the Superannuation Guarantee.

Jane has $350,000 in super (all taxable component), generating taxable income in the fund of 5 per cent per annum. In 2011/12, Jane salary sacrifices into super up to her limit of $50,000 and draws enough money from a TTR pension to maintain her net income.

In 2012/13, her contribution limit comes down to $25,000 so Jane talks with her adviser to see if it is worth continuing the strategy. When they go through the figures, the calculations show there will be some significant differences between the two financial years.

For example, the amount Jane can salary sacrifice is cut by $25,000 but the amount of pension she draws from super also falls significantly. Her personal tax bill rises but her contributions tax falls by nearly as much, leaving her with about half the tax saving on income that she could achieve in 2011/12, a drop of around $700. However, the tax saving on investment earnings is unchanged from 2011/12 to 2012/13.

And the bottom line is what is important to Jane and her adviser. This shows clearly that while the strategy may be less effective after 1 July 2012, it will still generate valuable savings from the lower tax on investment earnings.[2]

Impact on the 60 and over

The story is a similar one for an employed person who is age 60 and over. The value of the strategy is significantly reduced from 1 July 2012 but some benefit remains, and the end result is usually better than doing nothing.

Creating your future

TTR strategies can help you build an effective base as you move into retirement so it is important to sit down with your adviser to work out the numbers that apply to your situation. There are a lot of factors to consider but in most cases the value of a TTR strategy depends on tax savings on the investment earnings, as well as the amount you have available to salary sacrifice.[3]

We can help you to review your strategy, to monitor it, and to make adjustments in light of changes in the rules or your own personal circumstances.

2 'Is TTR still effective?', www.strategysteps.com.au

3 ibid

The art of SMSF collectibles

Trustees of self managed superannuation funds (SMSFs) regularly step outside the investment status quo of holding shares and bonds as part of their retirement strategy by investing in collectibles of many kinds.

But you can't get behind the wheel of the vintage car or head out on the town wearing diamonds if they are owned by your SMSF. Such investments are strictly to provide retirement benefits.

Aside from correctly assessing the risks and rewards of holding collectibles in your SMSF, it is important that you know the guidelines that apply to the storage, insurance and valuation of such investments.

While the costs associated with storage, insurance and valuation are real issues for SMSF trustees, so is the potential cost of non-compliance if they get it wrong.

Professional advice could help manage the risks and keep overall costs down.

It has long been the case that artwork held by an SMSF couldn't hang on the walls in a private residence belonging to a trustee or a 'related party', but just to make sure it isn't envied by family and friends, it can no longer even be stored at such residences.

Art or similar assets can be stored at the business premises of related parties, such as a purpose-built storage facility, provided it is not displayed.

Under the rules, wherever the assets are stored, trustees must record in writing their reasons and decisions on asset storage, and keep those records for 10 years.

Similarly strict rules apply to cars. For example, a trustee is not permitted to drive a vintage car for any reason. However, a mechanic can drive it to the workshop for maintenance or restoration work. It is the same story with other SMSF assets including coins, medallions or bank notes, a collection of Grange or Scotch whisky, rare folios or books, antique pens or china dolls.

Don't forget that insurance is a 'must'. The policy must be in the name of the fund and be taken out within seven days of acquisition. A collective policy can be taken out to cover all the fund's assets but it must be separate from any existing house and contents insurance.

Any transfer of ownership to a related party for collectibles or personal assets must be done at a market price, as determined by a qualified independent valuer.

If this all feels a bit restrictive to you, remember that you still have the pleasure of collecting – and visiting rights!

Where's the big idea?

As citizens of a young nation living on the world's oldest continent, Australians have always been challenged to think big and make this thinking a reality.

Think of the Snowy River Scheme — 21 years to build at a cost of $5 billion in today's dollars[1] or the Sydney Harbour Bridge, planned as the world's longest single span bridge — 10 years to design and build at a total cost of around $143 million in today's dollars.[2] And then think where Australia would be today without the electricity generated by the Snowy Scheme? Or a road and rail bridge which allows many thousands of people to cross Sydney harbour in just minutes?

Sadly, one of the many unfortunate side effects of the global crisis and the continuing issues in Europe seems to have been the crushing of our desire to make big plans and achieve them.

What matters to Australians today?

What Matters to Australians, a research report released in May 2012, tells us how our priorities have changed under the pressures of recent global financial turmoil. The report captures our responses to the financial concerns that emerged in 2007, showing how they have cramped our style and narrowed our outlook.

In 2007, Australians named big picture issues like environmental sustainability and global security as the most important to them. Today, however, the issues that matter most to us are food and health, local crime and safety, and basic services, all quite personal concerns.[3]

It seems that our thinking is now based on day-to-day survival rather than concern for the future of the world we live in. This is not because food quality, safety and basic services for ourselves and our families were regarded as unimportant in 2007, but that five years ago we used to give priority to wider issues as well.

Financial advisers are aware that this trend also affects how investors think and make decisions. Traditionally the role of advisers has been to help clients achieve financial security and the satisfaction that can be achieved through long term planning. In other words, financial advice is about helping individuals to clearly define their goals and reach them; it is not confined to helping clients simply toward financial survival, even in a crisis.

Letting the GFC put your future on hold?

Nothing lasts forever, including the financial problems of the euro zone. In fact, taking a long-term view, this is a good time to start thinking beyond the current financial crisis to re-evaluate and redefine your broader financial goals.

One good reason for re-evaluating your investment strategy is that even after the good times return, things won't be the same as they were, and pre-2007 strategies may no longer be appropriate.

For a start, you will be at least five years older, your risk profile may have changed, your career path might have taken a new turn, and your family circumstances and personal ambitions might be quite different.

The risks of short-term thinking

One common reaction from investors has been to shift a significant proportion of their assets into cash or term deposits. While this is an understandable response, it is unlikely to be a long-term benefit for most investors. The main risk of such a defensive investment is that it fails to protect your capital against the erosion caused by inflation.

The table shows different rates of inflation and how it impacts the value of your capital over time. Fixed interest returns are limited to the extent they don't offer capital growth (only interest payments) as a natural offset against the effects of inflation.

Inflation rate* (per cent)	Value of $1000 over 10 years	Value of $1000 over 15 years	Value of $1000 over 20 years
1.6	853.22	785.10	724.27
2.6	773.62	673.57	590.44
3.6	693.06	576.97	480.33
4.6	624.43	493.43	389.91

* The annual Australian inflation rate varied between a low of 1.58 and a high of 5.99 per cent between 1992 and 2012

Thinking bigger, aiming further

Just as it is important with your money, thinking long-term and drawing on inspiration and endeavour are also important for a community and a nation. As Franklin Roosevelt said, 'To reach a port we must sail — sail, not drift.'

As we know from current debates on topics as diverse as managing climate change, building an inland rail line or faster internet, big ideas are difficult to define and often controversial in their implementation. History shows us, however, that big ideas are important for the human spirit, for setting national goals, and for leaving a valuable legacy to the generations that follow.

Whether we are a country, a family or an individual, we thrive when we have goals that extend beyond the day-to-day — and a plan which helps us bring them to reality.

1 http://www.amazingaustralia.com.au/achievements.htm

2 http://www.genesis.net.au/~ejs/sydney/index.html

3 'What matters to Australians: Our Social, Political and Economic Values', May 2012

4 http://www.rateinflation.com/inflation-rate/australia-historical-inflation-rate.php?form=ausir

Sovereign wealth funds: saving for a rainy day

Reducing debt and saving for a rainy day are back in fashion in the wake of global turmoil and it's not just households trying to shore up their finances. Governments are responding too, with a boom in sovereign wealth funds.

Sovereign wealth funds are government-owned investment funds that use the money derived from a range of investments for the benefit of the nation and its people. Like Australia's Future Fund, they can be earmarked for specific purposes such as pensions or infrastructure, or they have a more general purpose.

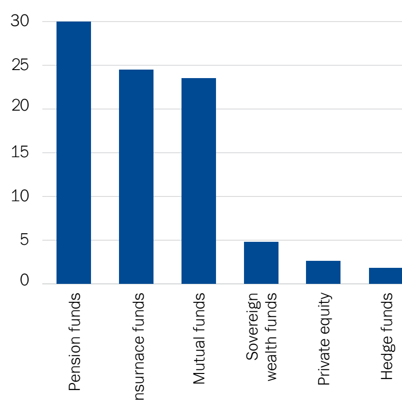
Last year alone, funds were established in Nigeria, Italy, Papua New Guinea and Mongolia. Countries planning to launch new funds include Angola, Bolivia, Canada, India, Japan, Taiwan and Thailand.[1] And Western Australia has announced a new fund in its recent state budget, to put aside royalties from the mining boom for future generations.

More than half of today's top 50 sovereign wealth funds have been launched since 2000, including our own Future Fund, which was established in 2006 to meet the federal government's unfunded superannuation liabilities by 2020.[2]

Rapid growth

While there has been growth in the number of funds, the rate of asset growth has slowed since the onset of the financial crisis, though it was still a respectable 9 per cent last year. Total assets of sovereign wealth funds grew for the third year running in 2011 to a record US$4.8 trillion, making them a real force in global financial markets.[3] The chart below shows global assets under management in relation to other types of investment funds.

Chart 2
Global assets under management ($)



The biggest and best-known funds are run by oil-rich nations to preserve some of their windfall profits for future generations. In fact, 56 per cent of global sovereign wealth fund assets were funded by commodity exports, primarily oil.[4] One stand-out is the Abu Dhabi Investment Authority, which was established in 1976 and is valued today at US$627 billion. Norway's Government Pension Fund (1990) ranks second with assets of US$611 billion.[5]

China is fast establishing a presence in the sector with four funds in the top 10 but a lack of transparency makes it difficult to ascertain their exact size. According to best estimates, China's SAFE Fund (1997) has total assets of US$568 billion and China Investment Corporation (2007) has US$410 billion[6].

Funding Australia's future

The Future Fund is a minnow by comparison. As at March 2012 it had $77 billion under management, making it the world's 13th largest sovereign wealth fund.[7] The fund was kick-started in 2006 with the proceeds of the government sale of Telstra and still has two billion Telstra shares in the kitty.

Sovereign wealth funds are designed to be the unglamorous tortoises of the investment world, steadily advancing towards their long-term financial goals with a minimum of fuss (or volatility) along the way. Future Fund general manager Mark Burgess recently reinforced the long-term nature of the fund's investment mandate.

"Maintaining a long-term perspective and ensuring adequate diversity in the portfolio is important during this period of market volatility. We continue to construct a portfolio designed to generate good returns while avoiding excessive risk," he said. The fund's portfolio, as reported in the most recent quarterly update,[8] is set out in the table below.

Future Fund asset allocation

Asset class	A$ million	Percentage of Fund
Australian equities	8,478	11.0
Global equities	17,954	23.3
Private equity	4,294	5.6
Property	4,699	6.1
Infrastructure & timber	4,311	5.6
Debt securities	14,301	18.6
Alternative assets	14,475	18.8
Cash	8,537	11.1
Total assets	**77,049**	**100**

Where to now?

The recent growth of sovereign wealth funds such as the proposed state fund in Western Australia marks an era in which the government sector has emerged as an important global investment group, with trillions of dollars in liquid assets.

These funds are playing a much longer game than many other investors do, with a different investment horizon. They are putting aside some of today's surplus, whether it be from oil or ore, to meet the challenges of a future that is beyond our own lifetime. It will be up to future generations to measure how successful they have been.

1 TheCityUK, Sovereign Wealth Funds February 2012, www.thecityuk.com/research/our-work/reports-list/sovereign-wealth-funds-2012/
2 Sovereign Wealth Fund Institute, www.swfinstitute.org/fund-rankings/
3 TheCityUK, ibid.
4 TheCityUK, ibid.
5 Sovereign Wealth Fund Institute, ibid.
6 http://www.sovereignwealthfundsnews.com/ranking.php
7 Future Fund portfolio March 2012 quarter update, May 2012. www.futurefund.gov.au
8 Future Fund, ibid.

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