

DecidingFactors

Q2/06

Welcome to the first edition of the DecisionMakers newsletter...

We are extremely excited about the company's new look, feel and way of doing things. This newsletter is just the first example of better things to come. As mentioned in our previous letters informing you of the change, we decided to create a new company because:

- We wanted to embrace international Best Practice standards in order to provide the highest levels of disclosure and protection for our clients.
- We wanted to create a truly dynamic company that stands for innovation, independence and a higher level of commitment to you.
- We wanted to develop a progressive, growing organisation that utilises the most up-to-date methods and systems.

They say a change is as good as a holiday and we certainly feel refreshed and excited about the prospects of our new company. Don't forget to check out our new website at www.decisionmakers.co.nz and give us a call (or pop in and see us) if you have any questions.

Diversification ideas

The point of diversification is not simply to hold more investments, but rather to hold a more efficient range of investments, thereby reducing a portfolio's overall risk profile. This means looking for investments that are unlikely to move in the same direction at the same time. In technical terms, this means investments with a low - or preferably, negative - 'correlation'. With international shares this used to be fairly easy to achieve just by investing in a spread of good quality shares from different countries.

However, over the last decade the world's major sharemarkets (US, UK, Europe and Japan) have now converged to the point where they are more correlated than they have been for 40 years. In other words, they all tend to move up and down in sync. One major reason for this is that companies and industries are becoming more global in their operations. A second reason is that countries within a single region are increasingly integrating their economies through the likes of the European Union or Closer Economic Relations.

The more integrated the world's economies become, the harder it is to achieve efficient diversification using geographical diversification as the primary tool.

So, buying a larger number of shares today will not necessarily give you a more diversified portfolio. In fact, you could end up with a portfolio that is highly correlated, which will increase your risk profile. A number of fund managers address this issue by using a sector or industry focus rather than a country or regional one. This is because global sectors/industries are generally far less correlated than country and regional sharemarkets. For example, think of the contrasts between the 'hot' sectors, such as energy and healthcare, and others that are currently struggling, such as technology and insurance. Understanding and utilising correlation to help achieve diversification is a very good reason why investors should use professional advisers and fund managers when investing their hard-earned dollars.



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Key DecisionMaker: Kirby Taylor CFP from DecisionMakers Wellington has had 30+ years developing and managing successful businesses. He is a Member of the College of Financial Planners and a member of the Financial Planners and Insurance Advisers Association. He is also a Certified Financial Planner with eight years in the field.


The best financial decision you'll ever make

Survey provides a stark warning about underinsurance

The results of a survey released from American International Assurance New Zealand (AIA) late last year cannot be ignored. The internet poll concluded that three quarters of New Zealanders are trapped in a cycle of debt and underinsurance, leaving their families exposed to the risks of financial hardship. The survey showed the following:

- 40% of New Zealanders would not be able to cope for more than three months if anything happened to their ability to earn a living.
 - Almost half of all New Zealanders have absolutely no cover on their lives or their health (i.e. life, medical, income protection or trauma insurance).
 - Only around a quarter of those surveyed are confident their level of cover would be sufficient to look after their family in the event of death or serious illness.
 - Of those who do have insurance, just over 37% have basic life insurance, 33% have medical insurance, 13% have income protection insurance, and only 9% have critical illness (trauma) cover.
 - 20% of respondents believed they would not be able to manage for a month on their own resources (without any income).
 - The average family has \$125,000 of borrowings in mortgages, personal loans and credit cards and many of them have no idea how they will be able to pay that off if anything untoward happens.
- According to AIA, around 880 people with dependent children will die in New Zealand each year. In addition, three quarters of Kiwis worry that their families will be exposed to

financial hardship because of inadequate insurance. Despite this, survey respondents claimed they could not afford to pay the premiums, even though their expenditure, funded through borrowings, had risen by 16% over the past year.

If any of the above seems familiar to you, or you have friends and family in similar circumstances and you would like to discuss it, please contact us. We would much rather work with you to plan for a certain future than leave it until it is too late.

life's tips : money

"When I was young I used to think that money was the most important thing in life. Now that I am old, I know it is." – Oscar Wilde

CASE STUDY: Beware the timing of your gifting

If you have a family trust, make sure you read this article to ensure you do not fall into the same trap as one unlucky investor!

Firstly, a bit of technical background. If you put money or assets into a family trust you are effectively moving property out of your personal ownership. Because of this, the trust (trustees) owes a debt to you in your capacity of establishing the trust (as the settlor). In order for this property to be ring-fenced as a trust asset (and therefore no longer in individual ownership), the debt needs to be gifted away. The IRD will allow an individual to gift a maximum of \$27,000 per annum (or \$54,000 per annum in the case of a couple) without incurring any gift duty.

What this usually means is that you need to lodge a form with the IRD and pass a trustee

minute on an annual basis stating you have gifted either of these amounts, until all trust assets are fully gifted.

This is exactly what happened for Mr Wilson* until one day it all came unstuck. Mr Wilson had been lodging his form diligently every year, 366 days after the previous one was lodged. However, one year Mr Wilson was away on holiday on the usual anniversary, so he lodged the form three weeks later than normal.



The following year's gift form then reverted to the usual anniversary date.

Some years later, Mr Wilson contacted the IRD to see if he had completed the gifting programme. The IRD confirmed he had, but they looked more closely at the dates of his gifting statements. Because he had reverted to his original anniversary date in the gift he made in the year after his holiday, he had inadvertently made two \$27,000 lots of gifting in one 365 day period.

This meant Mr Wilson was liable for gift duty of around \$2,700, as well as backdated penalty interest of \$2,500. The moral of the story?

Take a lot of care with the dates of your gifting!

**Name changed*

- Talk to your adviser about protecting yourself properly with adequate insurance
- Check your gifting is managed properly and that dates are observed

Making smarter decisions about property investment

Few could deny the fact that New Zealanders have a love affair with direct residential property investment. Whether or not direct property investment is the right move for you is a complicated question, which ideally we would like to discuss with you on an individual basis. Some of the factors you would need to weigh up include:



- Your current level of debt and financial assets
 - Whether you have the time and money to put into managing a rental property
 - Your goals and objectives
 - How you would deal with a worst-case scenario
 - The current state of the market, interest rates, etc.
- If, after you have been through that process and you decide you would like to enter the market, here are some helpful tips to help you carefully manage the risks associated with direct property investment:
1. Always buy quality (look at location, tenant and lease as the three key factors)
 2. Buy for income, not capital gain (favour security over speculation)
 3. Diversify your property investment with the inclusion of other asset classes
 4. Beware of lemons, e.g. specific use properties or offices which are not functional
 5. Be patient - do your homework (good property decisions are rarely based on emotion)
 6. Work hard to secure the best lease terms possible
 7. Be aware of what point in the property cycle you are buying or selling in (don't follow the herd!)
 8. Increase value by making improvements and increasing rent
 9. Don't forget about transaction costs - for example, if you intend to sell within two to three years, it may not be worthwhile when you take transaction costs into account
 10. Remember that areas and properties change over time.

life's tips : faith

"Faith is taking the first step even when you don't see the whole staircase."

– Martin Luther King

All of these are important in their own right and we would be happy to discuss these further with you. It is important that you talk to us if you are considering direct property investment, so we can help you manage the risks and make the best possible decision for your circumstances.

Changing intergenerational attitudes to money

Are there any teenagers out there who do not spend all their income and pocket money? If there are, they are definitely the minority.

Undoubtedly financial concepts such as saving, risk management, diversification and long-term returns would hardly register when all you want is the latest cellphone or pair of shoes. This attitude to money is palpably different from a generation or two ago when working hard and saving for the future were of greater importance.

So what are the practical steps that parents can take to help their kids save more?

1. Practice what you preach - unless you too are saving, it is very difficult to encourage your kids to put money away for a rainy day.
2. Encourage them to open their own bank account or investment fund early on.
3. Promote the idea of saving towards a goal.
4. Do not let them have a credit card until they have their own income and are responsible with their budgeting (maybe never!).
5. Praise them when they have done well financially and perhaps even consider contributing \$1 for every \$2 they save.
6. Educate them (and perhaps yourself) on their various investment options including shares, mutual funds and bank deposits.

This all sounds great in theory but the reality is most teenagers still won't be interested.

However, the key is you are actually doing something positive; often the greatest barrier to savings is excuses and inertia.

The teenager who moves into the workforce with an understanding of savings and investment will be far more likely to be able to come to grips with more complicated financial decisions, such as paying off their loan, saving for a home and managing their financial affairs.

DecisionMakers has access to a limited number of plastic piggy banks which have been developed to encourage savings for younger people (and the adults!). If you would like one of these, please contact us.

Economic update: Is it New Zealand's time to feel the pain?

The media loves to accentuate the negative and if we believed everything we read, we would believe we were heading for fairly desperate times. The irony is we have just had two years of absolutely stunning investment returns from equities and unless something unforeseen occurs, we are likely to see returns which exceed bank deposits over the next two years also.

The only major difference will be where to locate those good returns. They will be there but just harder to find. It is our job however, to find you appropriate risk-adjusted returns that coincide with your risk profile. With that in mind, you are likely to see some adjustment to your portfolio in the coming months.

The New Zealand sharemarket has finished its across the board, stellar performance in terms of dividends and capital gains. We now need to be far more selective in the managed funds or individual stocks we recommend. New Zealand exporters will start to benefit from the falling dollar, while those companies who import a great proportion of their product will face increased costs.

The New Zealand dollar (NZD) has fallen sharply against the US dollar and a further decline is predicted. This not only makes petrol more expensive, but also overseas holidays, motor vehicles and all imported goods. If you were planning to make a major purchase or take an overseas holiday this year, consider purchasing it sooner rather than later.

Economists believe the Reserve Bank of New Zealand (RBNZ) will start to lower interest rates in the latter part of the year. However, rates could drop sooner if the RBNZ believes the economy is slowing too quickly. Falling interest rates create opportunities for New Zealanders. Interest rates are at the top of their cycle so now may be a good time to lock in excellent fixed rate terms from some quality, fixed interest rate providers. We stress the word 'quality' because that is the key to fixed interest investment in the current environment - the return of your money, not the return on your money.



Mortgage rates will also start to decline. Ideally try and obtain a one year rate at 7.5% or below. Be aware however, these are usually difficult to obtain. Therefore, you should select a two year rate at about the same rate, but do not go any longer than this. You may even wish to split your mortgage between the one and two year rates to give yourself "a dollar each way".

The New Zealand housing market is slowing. Prices may not be falling, but it is definitely taking longer to rent and sell properties. We expect a relatively static market over the next 12 months. If you do own rental properties, talk to us about maximising your return on capital and whether now is an appropriate time to stop paying off the mortgage and just pay interest only.

Commentators are recommending international equities as the place to be in 2006-2007. We tend to agree, especially for clients with a long-term investment horizon. Contact us now to discuss how your portfolio is positioned to provide you with the returns you require to achieve your goals.

Countering extreme salary sacrifice

We are trying to get folk to save for their long term future, are we not? Yet we see many are doing a mediocre job of managing even their day-to-day cashflow. Just look at the mountain of debt surrounding the average Kiwi, let alone the lack of any adequate, long term savings.

Superannuation schemes have declined sharply since 1989, but the few remaining were given a tiny window of opportunity a few years back to entice high earners to contribute, while saving a little tax on the way.

The top personal income tax rate was increased to 39% on 1 April 2000. The Superannuation Scheme Contribution Withholding Tax (SSCWT) rate remained at 33%. Therein lay a small opportunity for folk to 'save' 6% tax on their Super scheme contributions.

Those folk with time to think about these things then saw a further opportunity to place funds into these schemes, save a little tax, and remove them sometime later for consummation – but

the wily IRD foresaw this devilish move and introduced a Fund Withdrawal Tax (FWT) to counter this avoidance.

FWT is levied at an effective rate of 5%, and with a few exemptions most (but not all) withdrawals are levied. The plan was foiled.

Since 1 April 2004 a progressive SSCWT scale was introduced. Employees who 'sacrifice salary' at increased rates or extreme employer contributions can significantly reduce their overall tax. This has led to some employees rearranging their affairs in order to minimise tax rather than using superannuation as a retirement savings vehicle.

The IRD views this extreme use as "[creating] pressure on the integrity, fairness and efficiency of the tax system". Some sacrifice schemes allow employees to reduce their salaries to very low levels, which obviously requires another means of support to live.

It is IRD's contention that if enough folk indulge in this legitimate (although not considered so at the time) practice, there could be significant erosion of the tax revenue base.

In an example of extreme use, an employee on a salary of \$100,000 has the potential to reduce their tax paid by up to \$14,250 over the first two years of the scheme.

Currently there are four methods of calculating tax on employer contributions. Two are widely used, the other two not so. The IRD is inviting feedback on whether these methods should be modified or retained.

It is also fair to consider that what was a legitimate tool to encourage savings for some is now likely to be removed or modified due to its success – it seems you just can't win sometimes!