DecidingFactors
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Finance companies:

not time to throw the baby out with the bath water

You will no doubt have heard the media commentary over the financial difficulties faced by finance companies in New Zealand. This was sparked by the collapse of National Finance (2000), the receivership of Provincial Finance and Western Bay Finance ceasing its trading activities.

The media tends to love stories like this and no doubt there will be a further frenzy in the weeks and months to come, but it is important to separate fact from speculation and at all times maintain a balanced perspective.

We believe the current activity will provide a real wake-up call to the entire sector and there may be further non-bank finance company (NBFC) failures. We are reviewing all our exposures to NBFCs, however we feel it may not be appropriate to remove all NBFC exposure and 'throw the baby out with the bath water' for the following reasons:

1. The latest six-monthly NBFC Industry Report, released by FundSource, highlights the fact that the $12 billion NBFC sector, while slowing in recent times, is still in strong shape with an overall 20% growth in assets and a 16% increase in profitability for the year to 30 June 2006.

2. ANZ Bank says in its latest *Market Focus* report that while there has been a drop in investors rolling over funds in lower-quality companies, the quality end of the market is sound, prompting ANZ to add "there is little risk of systemic failure".

3. As a result of National Finance (2000) and the problems faced by Provincial Finance and Western Bay Finance, we expect greater pressure to come on finance companies to obtain a credit rating from a mainstream, independent research company such as Standard & Poor's, which will only improve transparency in the sector.

4. The Government has signalled its intention to step up regulatory efforts in the sector.

5. There are still quality companies available who pay regular income and offer rates of return over and above what can be achieved by the banks.

Our focus has always been on our clients and we take nothing more seriously than selecting robust investments that are appropriate for their risk profile. We understand the concerns of many over the state of the NBFC sector in New Zealand, but we do not believe this warrants a knee-jerk, wholesale departure from the asset class.

As always, if you have concerns or wish to discuss this in any further detail, please contact us and we will be more than happy to help you.

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Tax changes not finalised but we are on top of it

In case you haven't heard, the Government is proposing to make widespread changes to the taxation of investment income. These changes are designed to smooth out several existing anomalies, but are quite complex and we expect further modifications before coming into effect. As a brief summary:

- If a New Zealand managed fund meets the criteria of becoming a Portfolio Investment Entity (PIE) and invests into New Zealand or Australian equities, they will be exempt from capital gains tax and the tax on income produced will be deducted directly at an investor's marginal tax rate (with a cap at 33%).
- The current 'grey list' (i.e. the select list of countries, including the UK and Australia, where investments were exempt from capital gains) will effectively be disbanded.
- An individual whose direct offshore share investments are outside of Australasia, and which cost over $50,000 will be taxed on 85% of the change in value of the - investments plus dividends with a cap of 5% (based on the investments opening market value). However, if the dividends or repatriated proceeds is higher than the 5% cap, then the higher amount will be taxable.

There has been a massive amount of media attention on this 'new' capital gains tax, but in reality it already existed (in various forms) for non-grey list countries and managed funds. The proposals are not final, and the capital gains tax on overseas investments in particular will come under extreme scrutiny prior to the scheduled implementation in April 2007.

However, the removal of capital gains for PIEs that invest in New Zealand and Australia is extremely encouraging and will likely mean there will no longer be a tax advantage in investing directly.

Don't worry if you are confused – we are on top of all the changes and will keep you informed every step of the way. Please call us if you would like to discuss how the changes may affect your portfolio.

Tips for beating the winter blues

1. Drink up! It might be cold, but staying hydrated assists in flushing toxins out of your body.
2. Go bananas – bananas have a beneficial effect on physical, mental and sexual energy.
3. Smile – however badly your day is going, try to see the funny side to something – anything!
4. Write a romantic novel – penning a hot-blooded romp might dispel the chill from your life.
5. Join a dance class – you've seen what it did for Rodney Hyde!
6. Have a massage – it relieves tension, aids relaxation, and also helps the body to recover.
7. Get wet – rub all over with a sponge or loofah to get your circulation going.
8. Buy yourself a small bunch of your favourite flowers – you know you deserve a treat!
9. Indulge in a spot of retail therapy.
10. Give blood – honestly, it's not as bad as you think. One small scratch and the worst is over!

Life tip #1

"One can never consent to creep when one feels an impulse to soar." – Helen Keller

Insurance - why you need to start early

We all know you don't know what you don't know, but let me tell you what you should know. When it comes to insurance, you need to consider your potential risk exposures sooner rather than later. Why?

1. You don't want to be left exposed if the worst happens

If you suffer an injury, need expensive medical treatment or if you suffer a severe trauma or pass away, you or your surviving family could be left financially devastated without the appropriate levels of cover, if you don't have sufficient savings.

Your ability to earn income is your single greatest asset. A 45-year old earning $50,000 a year (gross) will earn nearly $1.3 million* in total by the age of 65. How would you cope right now if you lost all of your income?

2. Insurance becomes more expensive as you get older

As you would expect, the cost of insurance premiums increases as you age, because the likelihood of you claiming increases. (There are however some exceptions, such as car insurance.) For example, a 30-year old, non-smoking female could get $500,000 term life cover for around $42 per month. At 40 this becomes $45, at 50 it is $95 and at 60 it is a whopping $254 per month. The steep rate of increase in later years is even steeper for men. What you can do is pay premiums on a 'level' basis, i.e. the premiums will be more expensive to start with, but the rate of increase is gradual, rather than a stepped curve.

3. Insurance becomes harder to obtain as you get older

Insurance is not a right at the end of the day – the insurer can (and often does) refuse applicants who present too great a risk (or they will impose huge policy restrictions or premium loadings). The classic example is applying for medical insurance, when you already have a pre-existing condition. In this case, it is always best to apply sooner rather than later.

Have a think about your own risk exposures and contact us if you need any advice in the area.

**inflation adjusted*

summing up

- The proposed changes to investment tax laws provide some upsides for investors
- You are better to get insurance sooner rather than later

Be aware of trustee responsibilities

With the massive proliferation of trusts in recent years, it is timely to provide a reminder about the importance of the Prudent Person Rule contained in the 1956 Trustee Act (and more specifically in amendments to the Act in 1988).

The Prudent Person Rule means that trustees making investment decisions need to exercise "the care, diligence and skill that a person of business would exercise in managing the affairs of others". Some important things you as a trustee need to consider with regard to the trust's investment decisions are outlined below:

1. The value of the investments are protected against inflation.
2. The investments are diversified to protect capital and minimise risk.
3. The likely amount of income. Will this meet beneficiary needs?
4. The likelihood of capital gain or loss and how this fits with the risk propensity of the beneficiaries.
5. The duration of the trust.
6. Taxation liability.
7. Managing the cash flow needs of the beneficiaries in accordance with the Trust Deed.

A common mistake trustees make is placing all their investments into fixed income investments. This may seem like a sound investment strategy and the allocation could be appropriate for the beneficiaries, however:

- This will often be in conflict with modern portfolio theory, i.e. diversification among different asset classes reduces risk.
- The Act requires trustees to preserve the **real** (i.e. after inflation) value of the trust and if drawing income, the value of the trust may actually be eroding in real terms.

The importance of this is highlighted by the often quoted, but nonetheless important, Mulligan case (1998) in which the husband left a life interest in his estate to his widow. The trustees (including the widow) invested solely in fixed interest investments from 1965 to 1990.

During that time the value of the trust property assets fell from $108,000 to $102,000. If instead, the real value of the estate had been maintained, it would have been worth $1.368 million at the time of the trial in May 1996.

The court found that the trustees knew the effect inflation was having on the real value of the assets and that they should have diversified into some growth assets. It was not a balanced approach and the court held the trustees negligent.

Please contact us if you would like to discuss how we can best manage your trust's portfolio to ensure the same thing does not happen to you!

Some great websites you may not know about

www.pricespy.co.nz	Compares the price of a vast array of electronic goods
www.wotif.com	If you can hold off booking a hotel until just before you leave, you can get some fantastic deals here
www.houseoftravel.co.nz	Why not find the cheapest way to fly to that tropical location?
www.qv.co.nz	Comprehensive information about properties if looking to buy or sell
www.wises.co.nz	The complete guide to help you map your way to your destination
http://earth.google.com/	Find out what your house looks like from outer space (don't bother on a dial-up connection though!)
www.theonion.com	If you want to look at the lighter side of current affairs

life's tip #2

"The ultimate measure of a man is not where he stands in moments of comfort, but where he stands at times of challenge and controversy."

– Martin Luther King Jr

summing up

- Be aware of your legal responsibilities when making investment decisions as a trustee and always think of the best interests of beneficiaries

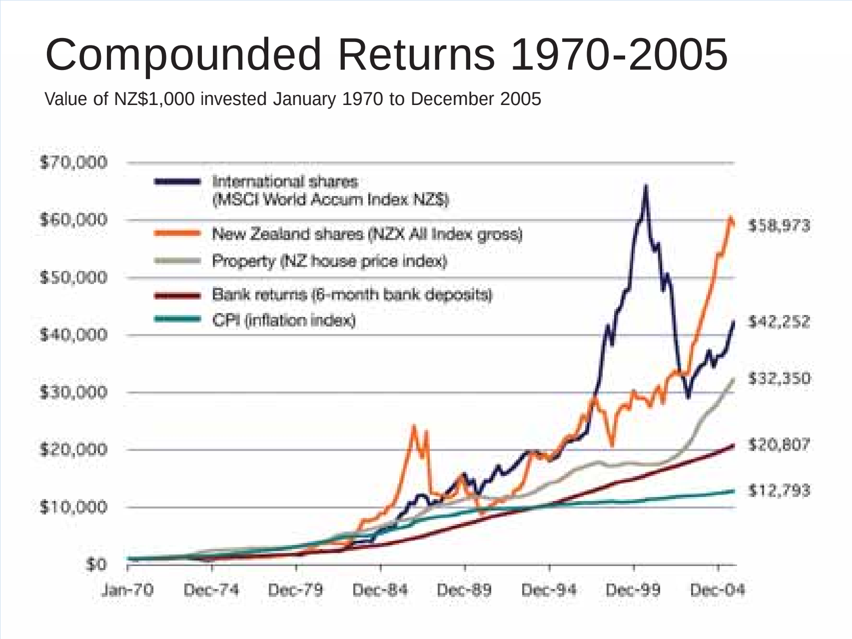
Economic update:
the more things change, the more they stay the same

Bob Dylan famously told an entire generation "the times they are a changing". And without a doubt, this applies to the current economic environment too, but in reality, economic conditions have always changed and they are probably more cyclical than you think.

For example, if you look at the current major economic concerns globally (oil prices, inflation and geo-political uncertainty); they are all issues which have reared their head previously. For each of these three events, think of the corresponding events – we have had oil crises on and off since 1970, we had inflation over 20% in the 1970s and we all know there has been war and terrorism since the year dot.

The reality is that markets have over the long-term continued to perform well (as the following graph highlights) through all kinds of events in the past.

This isn't to say that markets will always perform well or that we won't see volatility in the years to come, but it should not be forgotten that history has tended to reward those with the greatest patience and discipline (Warren Buffet, arguably the most successful investor in the world, is probably the best example of this). Please call me if you would like to discuss this in relation to your own portfolio.



Source – ABN Amro, Reserve Bank of New Zealand, Quotable Value, Bloomberg. Returns shown are in New Zealand dollars but do not take into account taxes, fees or inflation. Past performance is no guarantee of future returns and DecisionMakers Financial Services Group Ltd accepts no liability from those relying on this information to make investment decisions.

What else do I need to know about at the moment?

1. Interest rates are unlikely to fall until 2007

The consensus view among most respected commentators is that with current inflationary pressures, we are unlikely to see the Reserve Bank lower interest rates until next year. The important point is there is also widespread opinion that interest rate increases are now unlikely for the foreseeable future.

What does this mean for you?

- If you are refinancing your mortgage, look at only locking it in for one year, but no longer than two years, so that when rates do fall (perhaps at some stage next year) you are not locked in at a higher rate for too long.
- It is a good time to lock into some term investments at the current high interest rates.

2. The housing market is slowing but no alarm bells needed

We are seeing continuing signs of a slight weakening in the property sector, but as always, this depends on the sector and location you are talking about. Real estate agents will continue to tell us that everything is rosy, but we believe the market is getting slightly weaker, with properties taking longer to sell and values flattening (or falling in some cases).

Given the fundamentals of the market, we do not anticipate a huge crash, but perhaps continued 'softness' throughout the remainder of the year.

3. The currency may weaken further

The currency has continued to weaken against most trading partners, with many predicting the NZD/USD may go as low as 54 cents before the end of the year. This means imported goods will continue to become more expensive and petrol prices will increase. So, in terms of your portfolio, an allocation to offshore investments remains an excellent idea.

Please contact us if you would like to know how these economic themes can be incorporated into your portfolio.

life's tip #3

"There are only two ways to live your life. One is as though nothing is a miracle. The other is as though everything is a miracle." – Albert Einstein

next step

See us about the best investment options for you