On The Horizon

Good investment returns are one thing,
but what really matters is how much
of that you get to keep

WINTER 2009

Welcome

Hello and welcome to the Winter 2009 edition of On The Horizon. We hope that this edition keeps you up to date with the latest news at Horizon as we strive to deliver to you consistent and quality service.

Service remains a key strategic initiative as we continue to work hard for our clients. To provide you with an exceptional client experience, we are continuing to attract high quality staff to service your needs. And so we welcome aboard, Leanne Holmes, our new Paraplanner and Technical Specialist.

Leanne joins us with over five years experience in the financial services industry, with particularly strong technical knowledge in superannuation and retirement planning. Leanne will be playing an integral role in supporting the team and ensuring that clients receive a high level of tailored service and advice. I'm sure that in the months ahead you will have a chance to speak with and meet Leanne.

So although the financial services industry as a whole continues to shed resources, we strive to deliver a high quality outcome for you.

Since our last newsletter, our team has continued to work hard on showcasing the new Horizon brand, both internally and in the market place.

And so we're very excited to announce the launch of our new look website, ***www.horizonwealth.com.au***

If you haven't already seen, the site has been enhanced with new content, functionality and a refreshed visual design ensuring an even better client experience. The new online design is now in keeping with our suite of marketing and presentation materials, ensuring a consistent brand experience.

We'd like to know what you think of our new brand and website – so drop us a line to let us know.

We hope you enjoy this Winter issue and we invite you to contact us if there is a particular topic you would like to see covered in a future edition.

Kind regards,

Brian May

Leanne Holmes, our new Paraplanner and Technical Specialist

Visit our new look website, on-line now

Inside This Issue

HORIZON
WEALTH MANAGEMENT
Helping you achieve financial independence

Private school fees – at what cost?

The current environment has prompted many people to review their expenses.

After the mortgage has been paid, private school education is a significant cost for many families. At the start of the year, you most likely would have received a letter explaining the fee increase for the year.

Over the last three years, Horizon Wealth Management has built a database and model to assist our clients to more accurately budget for the future costs of private school education.

We thought we would share some of these results with you.

To educate a child at a private school from Preschool (three years) to Year 12 will cost in cash flow terms approximately $405,000 (on the assumption that your child starts Pre – school in 2009). This cost relates to 15 years of private school education and excludes the costs of Day Care. This averages out at $27,000 pa.

So, if in 2009 you had two children in Preschool and Year 2 respectively, you should expect that the cost of the school fees for both children in 2021 (when the eldest child is in Year 12) will be in the region of $87,000. This will require $144,000 in pre-tax income to fund this education bill (assuming a tax rate of 39.5% including medicare levy).

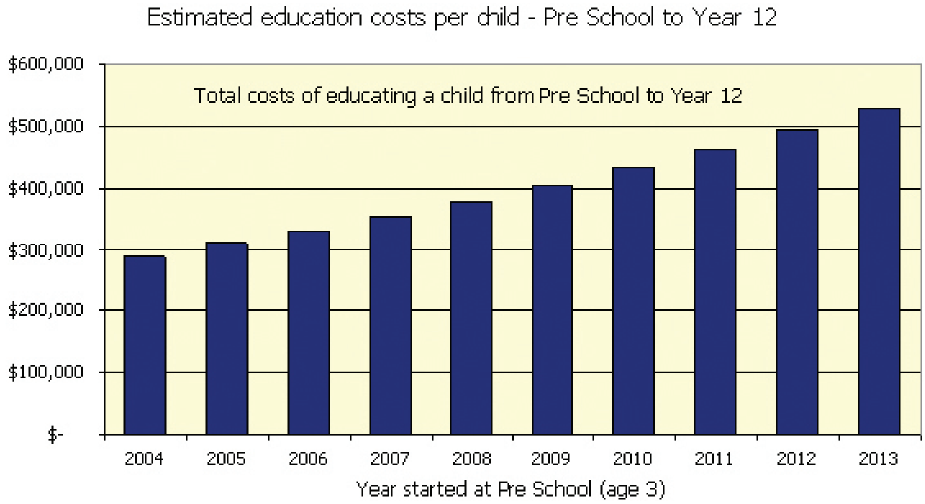
It should also be noted that certain private schools apply an age based increase to the fees: in today's costs, Year 1 equates to approximately $12,000 pa and Year 12 equates to almost $20,000, a massive 67% difference or increase!

Over and above this, is the 'inflation' adjustment of approximately 7% pa.

If you are funding these education costs yourself, then your pre-tax income needs to increase annually by at least 20% pa (assuming a tax rate of 39.5% including medicare levy).

To assist you in financially preparing and providing for your child's schooling, it is important to be aware of the quantum of the future costs of private school education.

To aid your understanding and ensure you're doing all you can to prepare for your child's education, now is a good time to seek financial advice. Horizon Wealth Management provide this as part of its service offering.

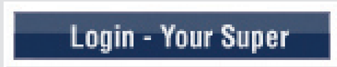


News

Employees of Horizon's corporate clients

Did you know that as employees of our corporate plans, you are able to access the details of your Company's benefits from our web site at ***www.horizonwealth.com.au***?

It's easy! Go online and click on the button located on the top right hand corner of the home page, as shown below:



Some lessons learned from the last two years

"Those who cannot remember the past are condemned to repeat it."

This oft-quoted observation from the Spanish American writer and philosopher George Satayana is used to highlight the dangers to us all of paying insufficient attention to the lessons of history.

The last two years have tested investor's emotions and tolerance for risk or stated another way, the (potential) loss of their capital or life savings. As much as we may have the tools to deal with measuring risk in normal markets, no one could have anticipated the extent of the reduction in asset values on the stock markets in October and November 2008 as well as February 2009.

The point of this article is not to restate what has received enough press lately from the collapses of Great Southern, Timbercorp, Storm Financial, Opes Prime, Babcock and Brown, Allco, ABC Learning, Bernie Madoff's business and to the freezing of a significant number of mortgage backed mutual funds and the severe reduction in asset values of listed property and infrastructure related trusts.

The point is, have we learnt any lessons from this and if so what are they?

Whilst the list below is not meant to be exhaustive, it simply highlights some of those at the forefront of the current problems and some of the processes and framework that can be used as governing principles when investing.

1. Don't invest in anything you don't understand

A classic example was infrastructure and tax driven schemes (see point 3 below). Whilst certain advisers looked at Infrastructure as a defensive asset class, we researched the sector and identified that the business model in our opinion was flawed. Paying dividends by borrowing money against the revaluation of an asset did not seem to be based on sound business principles. Perhaps the old fashioned principle of paying a dividend from free cash flow is still valid.

2. Gearing

Whist we have nothing against gearing per se, we would prefer clients who choose to gear in the equity market to be either positive or neutrally geared in order that they can withstand a reduction in the market value of their investments (with a low probability of a margin call).

3. Tax driven schemes

Our investment principles include managing costs, one of which is taxation. This enables investors to capture more of the capital market return that is there for the taking. Keeping costs down puts the odds of success in our clients favour. However, the investment merits need to take precedent over the costs. Sadly, thousands of investors lost significant amounts of capital in these tax driven schemes. Again through experience, research and common sense, we had no clients in these schemes. The article - Pulp Fiction on page 4, elaborates on the problems inherent in this sector.

4. Research

The global financial crisis was precipitated by research which was both inaccurate and poorly communicated to investors. Reliance on research by providers who are often conflicted can lead to the wrong conclusions being drawn and thus relied on by investors. A few examples locally are the mortgage backed securities funds and infrastructure, to name just a couple of sectors. The only external research that has proven to be reliable is **independent academic** research, which incidentally Horizon Wealth Management uses. We also do extensive internal research before we make a decision to recommend any product.

5. Invest with people you trust

Easier said than done – one only has to look at the disasters in the last few months such as Bernie Madoff now sentenced to 150 years and Storm Financial. The only suggestion we can give any person looking to engage a Financial Adviser is to clearly identify what one is looking for from the relationship; then interview thoroughly and identify any possible conflicts of interest. Also ensure you obtain a personal referral from a trusted adviser (such as an accountant or lawyer) whose opinion you value.

Pulp **Fiction**

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Thousands of Australian investors are learning in the most painful fashion the danger of basing an investment strategy predominantly on the desire to minimise tax.

Agricultural investment groups Great Southern and Timbercorp have collapsed in recent weeks, owing creditors billions of dollars and leaving tens of thousands of investors out of pocket.

Both of these companies operated so-called managed investment schemes that packaged forests, horticultural products and cattle as investment products and sold them to retail investors.

These schemes proved popular with many Australian investors because they provided generous tax breaks that the government allowed as a way of channelling investment capital to rural businesses.

The investments were marketed to investors through accountants and financial planners, who received incentives from the company sponsors in the form of generous commissions, sometimes of up to 18 per cent.

In fact, such was the volume of commissions, fees to scheme promoters and payments to other intermediaries that the actual proportion of every dollar invested actually going into growing trees was seen as little as 30 cents.[1]

One analysis showed that between 2000 and 2008, Great Southern paid $344 million in commissions and marketing, more than half what it spent on agricultural expenses over the same period.[2]

Like any Ponzi scheme, this all worked so long as new incoming money was sufficient to fund returns to existing investors.

In recent years, though, the federal government moved to tighten the tax rules around the agricultural schemes, which left the companies increasingly relying on borrowing to sustain their complex business models.

Then, the global financial crisis came along and the scheme's bankers became nervous about the viability of schemes that appeared to exist predominantly as a tax dodge, not as a legitimate investment.

Finally in May, Great Southern collapsed, owing up to $4 billion to more than 43,000 individual investors. This came just a month after Timbercorp was felled, with net debts of $903 million and 18,500 investors affected.

In the case of Timbercorp, the administrators called in to clean up the mess have said they were overwhelmed by the complexity of the failed group. For instance, the management company was found to have no money, no assets, no infrastructure and no employees![3]

The lessons from all this for investors are fourfold:

Firstly, when you make your priority in choosing one investment over another its success in minimising tax rather than maximising after-tax return, you are failing to see the wood for the trees, so to speak. You end up with investments that are not about the success or failure of the underlying business, but about the ability of the promoters to milk the system for tax advantage. And that tax advantage is always liable to disappear if the government changes the rules.

Secondly, the collapse of Timbercorp and Great Southern highlights the risks in taking a short-term approach to investment. In most cases, the people putting money into these schemes were focused principally on making an end-of-the-financial-year tax problem go away.

Thirdly, when you accept recommendations on investments from people motivated by the

substantial commissions they receive, you increase the risk of being put into a scheme that is inappropriate for your own particular circumstances. No matter how much these facilitators say they have their clients' best interests at heart, the fact is the conflicts of interest are so entrenched their advice cannot but fail to be compromised.

Finally, it is a good rule of thumb when making any investment to ensure you understand what it is you are committing your hard earned money to. In the case of the agricultural managed investment schemes, there were so many intertwining layers between the underlying asset and the investor that even the insolvency specialists called into wind up the businesses are having difficulty untangling it all.

So in summary, clearly understand what you are investing in, ensure the rewards you are seeking are commensurate with the risks you are adopting, maintain a long-term approach and take advice only from a professional whose interests are aligned with yours, not with those of the product provider.

It's an old story, but a true one. The rest is just pulp fiction.

1 *'Investing in Fantasy Farms', The Sydney Morning Herald, May 20, 2009*
2 *'Great Southern Used Accountants to Sell', The Australian Financial Review, May 20, 2009*
3 *'Wind-up of Collapsed Timbercorp 'Complex', The Australian, May 6, 2009*

Source: Jim Parker, Regional Director, DFA Australia Limited

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