clarity insight partnership

On The Horizon

"Only when you combine sound intellect with emotional discipline do you get rational behaviour." Warren Buffet

WINTER 2014

Welcome

Hello and welcome to the Winter 2014 issue of *On The Horizon*. It is hard to believe how quickly time goes by as the start of the 3rd quarter is already upon us.

It has been a busy first half of the year for all of us at Horizon Wealth. We continue to strive towards building the pre-eminent wealth management firm in Australia; a firm that continues to display a real sense of purpose for, and with its clients. We feel this gives you the confidence that your affairs are being managed and that your financial life is in order.

Hence the cornerstone of our value proposition: **Clarity, Insight and Partnership**. You will see this on our website, newsletters and around our office. It is our pledge to provide the support that you need from your wealth adviser.

The combination of our *vocational experience, technical competence, sense of purpose and un-conflicted value proposition* makes us unique among financial advisers and wealth management firms in Australia.

The above approach has resonated with our firm's network including our existing clients, and to this end we have been appointed as Advisers to a number of High Net Worth clients in the last 6 months. We are rigorous in our client acquisition process as we wish to ensure we retain the very high level of service for both new and existing clients.

We hope you enjoy this Winter 2014 edition of *On The Horizon*, and we invite you to contact us if there is a particular topic you would like to see covered in a future edition.

Our first article in this newsletter relates to *The Value of Great Advice*. This is a particularly topical and relevant article following the recent findings of the Senate Inquiry into the Commonwealth Bank Financial Planning activities, as well as the recent Murray Interim Report into the Australian Financial System.

Senator Mark Bishop, Chairman of the CBA inquiry used very strong language in an attempt to describe what happened: *"Systemic Theft", Systemic Fraud" and "Lying to Clients"*.

Other banks and financial services organisations were also referred to in the report.

David Murray, in his interim report referred to the vertically integrated wealth management business models used by most large institutions:

"Conflicts of interest have been a long-standing issue in financial advice. There has been a tension between providing financial advice for the benefit of consumers and the product distribution role played by advisers."

Having had extensive executive and strategic leadership roles in large organisations, we know full well how difficult it is to scale and commercialise an advice business. In fact one of the only ways large organisations can commercialize advice is through the distribution of their own manufactured financial products.

Inside This Issue

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The value of **great advice**

What is the value of great advice? What's the difference between basic, incomplete or poor advice, and comprehensive high quality advice? And does it matter anyway?

When it comes to medical advice the difference is often pretty clear, and immediate. If you have a medical problem, do you entrust your future to a newly qualified (and possibly less expensive) intern, online diagnosis; or a specialist with 20 years experience? When the prospect is one of life or death the decision is obvious. Human nature is such that unless there is a clear and present danger, remedial action is often declined, deferred or avoided.

"The only thing worse than being blind is having sight, but no vision."
Helen Keller

Herein is **the challenge when assessing the value** of great financial advice. **The impact may be deferred for years**, whilst the outcome may be the difference between comfort and poverty, security or insecurity, a legacy or a burden. In the extreme, the anxiety that financial insecurity may generate could become a life or death issue.

In the airline industry the price of first, business and economy class are differentiated by the tangible value and exclusivity associated with the first and business class lounge, the comfort and width of the seats, and the food and service received on the plane. Whilst the experience of the passengers in the different classes is distinctly different, *everyone eventually arrives at the same destination.*

Recent experience and observations reveal that the range of advice people receive extends from conflicted, poor or indifferent, to excellent. All of which provide a different experience and outcome. The greatest difficulty in the experience of the process is that it is **only after the passage of time** that one will discover whether the advice received was good or bad. And then it is **most often too late.**

We would submit that most clients are not obtaining the advice they require for 3 key reasons:

- The **quality** of the advice itself is substandard as a result of conflicts of interest, inadequate specialist skills and training, and a lack of life experience on the part of the engaged adviser,
- The client's **inability to measure the cost of advice against the benefits** which will accrue over time, and
- The **limited exposure** people have to different advisers and therefore the inability to know whether one's experience is a reflection of the industry as a whole, or merely the engaged adviser.

So how would you recognise the characteristics of great advice?

Personal Financial Advice is advice provided that is entirely appropriate to a specific individual's circumstances, requirements, goals and objectives. It is not the "general advice" (as it is known) which in reality is factual information provided by a financial institution's call centre or website.

Perhaps the greatest impediment to obtaining high quality, high impact and enduring personal advice is a function of the difficulty associated with identifying the right adviser.

Over **80% of registered advisers** are employed by, or work under licence

"First, let us pray."

for one of the big 4 Banks, AMP, Macquarie and IOOF. These advisers are **inherently conflicted** by the direct and indirect pressure associated with selling the institution's wealth products against which they are assessed. Success in this sphere drives internal recognition and reward, with the short-term interests of executives and shareholders almost always taking precedence over the best interests of the client. It's no wonder this industry is on the front page of the AFR every other week.

However, when engaging an un-aligned advisory firm, there is also no guarantee of obtaining great advice either. So **how do you choose** from amongst the approximately 16,000 registered advisers in Australia?

We would suggest you look out for the following characteristics:

- **Principals and Owners** in their own business (as opposed to those owned by, or aligned with institutions).
- **Members of a recognised Professional Association** – such as the Institute of Chartered Accountants Australia and those practices that are designated as Professional Practices of the Financial Planning Association.
- **Un-conflicted**, fee for service remuneration models with no commercial tie ups, soft dollar incentive arrangements etc.
- **Open and transparent** in all dealings.

The value of **great advice** ...cont

- **Specialists** with a strong sense of purpose, and a clear interest in developing long term relationships with their clients.
- **Recognised technical qualifications** with evidence of continuing education in order to remain current.
- **Extensive life experience**, especially in executive and leadership roles, with strong local knowledge supplemented by international experience.
- Have a demonstrated ability to consider issues on an **integrated advisory** and portfolio management basis.
- Have a strong **risk management and compliance** framework.
- Can demonstrate a strong connection between **the price charged for advice and the value received**.

Having selected a shortlist of prospective advisers, **the next step will be an assessment of the quality of the advice provided** against the following aspects:

- A clear demonstration of a **detailed understanding** of you, your current circumstances, goals and objectives.
- Identifying and understanding **potential risks**; and recommendations regarding **alternatives** to mitigate those risks.
- Sufficient life experience, insight and humility by the adviser to **"know what he/she doesn't know"** and work proactively and collaboratively with your Accounting, Legal and Tax Specialists.
- The adviser or firm **proactively reviews** your personal affairs to ensure you:
  - o **Invest in a manner consistent** with your strategic objectives and goals.
  - o Take advantage of any tax savings **prior to year end** e.g. superannuation contributions.
  - o **Timeously transition your Superannuation** from Accumulation to Pension phase.
  - o **Are advised in advance** of any problems that could be caused by for example, making excess superannuation contributions which could manifest themselves in excessive superannuation contributions and as a result tax penalties.
  - o **Have access to a structured process** of continually evaluating your insurance requirements and benchmarking these to competitive options.
  - o **Are educated regarding tax and estate planning** alternatives for consideration by your accountant or attorney.

"...do yourself a favour when seeking advice – avoid 'flying economy' – cheap advice is guaranteed to get you to an uncertain destination."

- A respectful **education orientation** in order to assist your understanding of technical concepts, in simple and easy to understand language.
- **A service culture** where time consuming administration requests are dealt with efficiently and painlessly.
- Have staff with **a strong client service ethic** who are well educated and knowledgeable and who proactively assist you with all your personal financial affairs under advice.
- Advising you of the **appropriate entities** through which to invest.
- Having a **well defined and structured investment process** which is both prudent and designed to capture the market rate of return after fees.
- Having a **structured process of communicating** your investment performance on an ongoing basis and assisting you in determining whether you are on track to achieve your goals and objectives.
- **Fees** are charged with a **clear connection to value added**, are easy to understand, transparent and benchmarked to best practice.

What is the premium paid for great advice over indifferent or poor advice?

The time and effort involved in an adviser gathering relevant information, the establishment of your and your partner's requirements (as appropriate); communicating with your accountant and attorney (where appropriate); researching products and solutions, and recording and documenting the advice provided – within the rigorous compliance and regulatory process - is significant.

At the end of the day **advice carries risk, and risk must be priced**. Advice associated with complex and material matters with potentially significant financial consequences, will be more expensive than basic advice.

Great advice consistently implemented will have an impact which should be of an order of magnitude greater than the cost of that advice.

So do yourself a favour when seeking advice – avoid 'flying economy' – cheap advice is guaranteed to get you to an uncertain destination. Rather use the framework above to maximise the probability of receiving great advice – **you owe this to yourself and your family.**

Finding a great adviser is more than just a leap of faith!

Private School Fees

We continue to update our data base of information on the cost of educating your children in Private Schools.

We have been doing this exercise across a number of Sydney based private schools for the past 10 years.

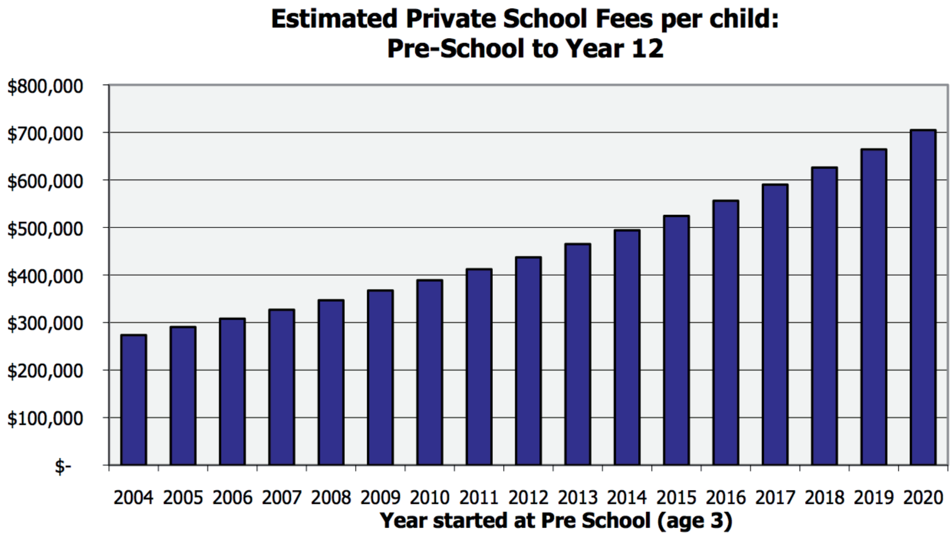
The annual increase year on year was approximately 6% before taking into account grade increases.

Essentially if your child had started pre-school in 2004 the estimated cash flow costs of completing their education in 2018 would be approximately $273,525. If the same child started pre-school in 2014 that amount increases to $494,062 and in 2020 the amount required to educate a child will be a cash flow outlay of approximately $704,753.

Multiply that amount by the number of children you have and one can see that the choice may be between taking out a mortgage and sending ones kids to Private School.

In fact, the mortgage is probably a lot less expensive!

Clearly unless one has other financial means it seems a difficult road ahead for these schools unless there is some kind of government or other community support.



This type of analysis is important as the cost of Private School education can leave a massive deficiency in the Retirement nest egg of our clients. For those of you who may be budgeting at a far lower rate, we would suggest that you re-assess your budget.

"There are nearly 60,000 personal finance books on Amazon.com. In aggregate, they contain more than 3 billion words.

This seems absurd, because 99 percent of personal finance can be summarized in nine words:

Work a lot, spend a little and invest the difference.

Master that, and the other 2.999 billion words are filler."

Morgan Housel

Investing: Residential Property or Shares?

Do you have an investing bias?

Over the past year we have been *bombarded by articles* in the press regarding the recent performance of residential property in Sydney, and shares on the Australian Stock Exchange. Some *recent headlines* from the Australian Financial Review:

Property	Shares
Residential property correction coming!	ASX attains record last reached in 2008
Home sellers cash in on record highs	Shares at record highs
House prices tipped to soar to 6 times wages	ASX at fresh 5 year highs on bets Fed won't taper
Beware of foreigners snapping up property	Plenty of length on display in latest ASX streak
Excessive behaviour by SMSF's a housing bubble risk	ASX Tipped to hit 6,000 by December 2014

We did a comparative assessment of *Sydney Residential Property* against the *ASX All Ordinaries Shares Index* for the period 1985 to 2014 and observed the following:

Performance Measures

	Sydney Detached Houses	Australian All Ordinaries Index
Annual Capital Growth Rate	11.25%	10.75%
Net Annual Income:	0.75%	5%
Gross: Rental/Dividend Yield (fully franked)	*4.25%*	*6%*
Running, Transaction and Depreciation Expenses[1]	*3.5%*	*1%*
Total Annual Return (pre-tax)	**12%**	**15.75%**

1. Running, transaction and depreciation costs referenced to RBA Housing report Dated July 2014. For consistency, it is assumed that the share portfolio is advised, attracting adviser fees and charges.

Valuation Measures

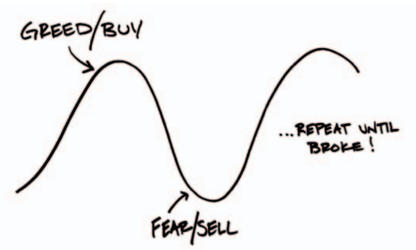
	Measurement Year	Sydney Detached Houses	Australian All Ordinaries Index
Price to Earnings Ratio	2014	7 times median income	16.4 times earnings
	1985	2.75 times median income	11.2 times earnings
Gross Yields	2014	4.25%	6%
	1985	8%	6%
Interbank Lending Rate	2014	2.5%	
	1985	1.6%	
Valuation Assessment		At historical peaks	In line with historical averages

Here's our take:

Risk and return are related!

Following a review of the above it is evident that:

- The Total Annual Return on the Australian **All Ordinaries Index has outperformed** the average Sydney Detached House Investment in the period 1985 to 2014 (15.75% vs 12%).
  - *This is as expected as Shares have greater volatility (greater risk) than domestic property.*
  - *The excess return in shares over property has largely been a function of the* ***superior income*** *attainable on shares and the* ***lower associated costs*** *relative to property.*
- **Both Property and Shares can be geared** (borrowed against), leveraging return on the capital invested.
  - *The lack of price transparency in property has lead investors to* ***borrow against property more readily than against shares*** *– which have lead to the common perception of the superiority of property over shares as an investment asset class.*
  - *It is the comfort with gearing against property that has delivered the superior return on capital invested, not the performance of property itself.*
- The high transaction costs on purchase and sale of ***property*** and the lack of price transparency, ***has resulted in investors remaining in the market*** for sufficient time to capture the market returns available.



- The low transacting costs and price transparency associated with ***shares has resulted in investors behaving inconsistently*** when investing in shares, depriving themselves of the market returns available.

Investing: Residential Property or Shares? ...cont

Looking forward, is past residential property performance an indication of future performance?

- Objectively, residential property in Australia is expensive and, at or near historical peaks on many measures:
  - o **Near Highs**
    - *Median Property Price to Income ratio*
    - *Household debt to income ratio*
    - *Residential Loans as a proportion of total bank loans*
  - o **Near Lows**
    - *Gross Rental income yields*
    - *Interest rates*
- **Most of the influences** that have lead to the run-up in property prices over the last 30 years **have run their course**:
  - o *Unbroken trend of declining interest rates,*
  - o *Improved availability of finance and declining deposit requirements,*
  - o *The breakdown of the traditional family unit and the entry of women into the workforce - generating additional demand and/or generating additional income, thereby increasing family funds available for allocation to accommodation or investment,*
  - o *Taxation Policy support – CGT exemption on primary residence and negative gearing on investment property,*
  - o *Growing, young population,*
  - o *Wages growth in excess of inflation.*
- **A number of risks are present** which may impact on continued property price inflation:
  - o A growing but ageing population,
  - o Structural shifts in the Australian economy leading to sustained at or below inflation wage increases,
  - o Pressure for taxation reform and changes to the negative gearing regime – and potentially to gearing in superfunds,
  - o Tightening availability of residential lending,
  - o Increasing interest rates,
  - o Improved supply of apartment units and / or land.
- Expected **returns** from property **may be somewhat lower** than the past.
  - o A slavish commitment to property as the only worthwhile investment in a portfolio has a high probability of disappointing and failing to deliver on personal financial goals and objectives.

That's not to say that property should not remain a component of a well constructed, diversified portfolio. But, perhaps it is time to expand one's horizons to include commercial property or international property. As billionaire Kerr Nielsen (Founder of Platinum Asset Management) recently observed:

"to be optimistic about residential property prices rising in general much faster than inflation (over the next 10 years) is a supreme act of faith".

As asset class investors we believe that a diversified portfolio across various asset classes; incorporating Cash, Fixed Interest, Equities (Global and Australian), Infrastructure and Property is the best approach that will deliver your financial objectives with **the highest probability** and with the least amount of risk.

Horizon Wealth's approach to investing is to apply a *rational, objective and un-conflicted assessment* of your financial needs, goals and objectives. We **consider** the risk of taking no risk and the risk of taking too much risk, in search of **a balance that suits your age, investor profile, appetite, requirement and capacity for risk.**

Our investment advice is consistent with Warren Buffets advice:

"To be a successful investor over a lifetime does not require a stratospheric IQ, unusual business insights or inside information. What's needed is a sound intellectual framework for making investment decisions and the ability to prevent your emotions from corroding that framework."

Our clients therefore have a far better chance of capturing the returns that are available in the market than if they pursued an unadvised approach.

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:

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