On The Horizon

HORIZON
WEALTH MANAGEMENT
Helping you achieve financial independence

Edition: Autumn 2007

"Creating wealth is not about competing against someone else or a benchmark, but rather ensuring that over time, your investments outperform the value of your expenses."

IN THIS ISSUE

Should you require further information please do not hesitate to contact our office on 02 9392 8700. We will gladly provide you with further details.

To Buy or not to Buy – that is the Question!

A number of clients often ask should they purchase a home or continue to rent. This coupled with the anxiety and social pressure that is felt by not having ownership in bricks and mortar.

With housing affordability continuing to deteriorate - property prices at record levels particularly in relation to current wages – perhaps it's worthwhile to consider alternative investment opportunities or strategies.

On a continual basis we stress test alternatives for clients, so we thought we would share with you a case study of a professional couple with young children and relatively high expenses.

- The couple who are both 40 years of age, are earning a combined employment income of $360,000 pa including superannuation, i.e. primary breadwinner $300,000 pa and spouse $60,000 pa.
- The couple has cash savings of $500,000 in their bank account.
- The couple's living expenses (ex rent) are approximately $100,000 pa.
- The couple does not presently own a residential home. They pay rent of $50,000 pa.

The couple are considering whether

? **To purchase a house for $1.5 million utilising the savings of $500,000 as a deposit, or**

? **To invest their savings in the spouse's name, (although an alternative option could be to invest this as an undeducted contribution into Super which would further enhance the returns).**

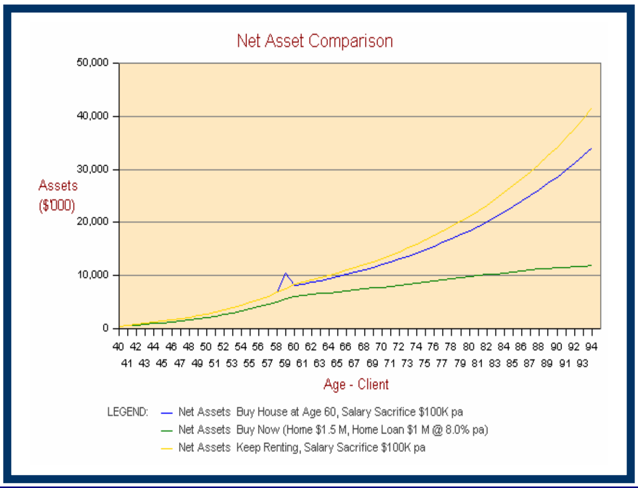
Which alternative produces the better quantitative outcome discounting all the emotion of home ownership?

Alternatives

1. Buy Now – **green** line on graph
- Contribute 9% SGC to Superannuation.
- Purchase home for $1.5m, take out home loan of $1m with deposit of $500,000.

2 a. Continue to rent for the remainder of their lives – **yellow** line on graph
- Invest $500,000 in the spouse's name.
- Salary sacrifice $100,000 pa into Superannuation ie $50,000 pa each.

We further considered a further option in 2 above and that is



2 b. Continue renting until 60 years of age and then purchase an apartment or smaller home with the current value of their $500,000 investment which has now increased in value to $2,8m, net of CGT – **blue** line on graph.

Scenarios	Age	Total Assets including residential home
Buy Home Now	60	6,107,690
SGC to Super	80	9,783,381
Continue Renting	60	8,366,118
Salary Sacrifice $100K pa per couple	80	21,182,155
Buy Home at Age 60	60	8,058,238
Salary Sacrifice $100K pa per couple	80	18,462,374

The results are quite staggering!

Although renting for the remainder of your life may financially outweigh the other 2 options, practically it makes sense to own a fully paid off property in retirement. Thus the comparison of 1 versus 2b is certainly a realistic exercise for anyone considering their options. Also note that in both 2a and 2b most of the assets are in Superannuation and will thus be in a **tax free** environment at age 60. Further, any money withdrawn will be **tax free**.

What does seem reasonably conclusive is that one should consider taking advantage of the maximum deductible superannuation contribution which from 1 July 2007 increases to $50,000 pa for all taxpayers who are less than 50 years of age.

Tax Tips for 2006-07

1. **Maximise your super contributions**

   By making a deductible contribution to superannuation, you can reduce your taxable income and therefore decrease your personal income tax liability. If you've sold an asset during the year and realised a significant capital gain, you may also be able to offset any personal income tax that would have been payable on the capital gain.

2. **Access the Govt Super Co–Contribution if you are earning less than $58,000 pa.**

   If you make a personal contribution to your super account any time before the end of the financial year, the government will match your contributions on a three-for-two basis by up to $1,500. Using this strategy you can generate a 150%, tax-free return on your investment within one year. And because the money is being invested in super it's concessionally taxed at a low rate as well.

   For those of you who took advantage of this opportunity in the 2005-06 tax year, the Government will now double its contribution as a one off payment to your superannuation account.

3. **Pre pay any qualifying expenses such as interest (if you have an investment property)**

   If you have borrowed funds to make an investment that will generate assessable income, you are entitled to claim a tax deduction for the interest payable on your loan. If you pre-pay the interest on your investment loan now – covering the next 12 months – you may be able to claim a deduction for that interest in your 2006/07 tax return.

4. **Contribute super on behalf of your spouse**

   You can receive a tax rebate for making a contribution to your spouse's super fund if their assessable income (including reportable fringe benefits) is less than $13,800. Because it's a tax offset, you will make a direct saving against your income tax liability. The maximum tax offset available is $540, implying an 18% tax rate.

5. **Salary sacrifice into Superannuation**

   If you are due for a pay rise or an end of year bonus, you may salary sacrifice this into your superannuation account.

6. $1 million super window - this Opportunity expires on the 30 June 2007

   You may make an **Undeducted Contribution** (post tax) of up to **$1 million** into your superannuation for the period starting **from 10 May 2006 to 30 June 2007**. If you are aged between 65 and 74, you would need to satisfy the work test.

   From 1 July, a new limit of $150,000 pa applies to super top-ups or $450,000 averaged over 3 years.

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Horizon Wealth Management's investment framework which is based on sound academic research

We thought we would share with you the principles that govern our investment process.

Markets Work

Capital markets are not perfect and prices are not always right, but markets are so competitive that it is unlikely an investor can systematically profit from mistakes in the market at the expense of other investors.

The Plight of Active Managers

For active managers to succeed, markets must fail. There have been (and will be) managers that outperform the market, but no more than you would expect by chance, and it is **difficult to identify them in advance.**

Market Timing Is Risky

Following decades of empirical investigation of capital markets by literally thousands of financial economists, there is no widely accepted and conclusive evidence that market timing works. **A successful timing strategy requires three correct decisions: when to get in, when to get out, and when to get back in.** When timing between stocks and cash, for example, the frequency of correct decisions must also be high enough to overcome the higher expected returns of stocks versus cash. **The success rate required to beat a buy-and-hold strategy is unattainable for most investors.**

There Is No Crystal Ball . . . and You Don't Need One!

At the root of all forms of active management is some sort of forecast, but **the future is by definition unknowable.** Although no one can predict the future, **you don't need to in order to have a successful investment experience.** With capitalism, there is a positive expected return on capital.

Risk and Return Are Related

Markets are drawn to a state of equilibrium where risk and return are related. Only non-diversifiable risks are rewarded with higher *expected* returns.

Diversification Is Key

Diversification is the closest thing there is to a free lunch. Proper diversification increases the likelihood of earning expected returns and may reduce risk by eliminating risks you are not paid for taking.

Bring Discipline to the Process

Capital markets are noisy; but in the face of that noise, **investors must maintain their discipline and stick to a long-term investment strategy in order to have a successful investment experience** that captures capital market rates of return. **Some studies conclude that individual investors under perform the market by as much as 5%, likely due to a lack of discipline that results in chasing hot stocks or hot funds or by timing markets.**

Know Thyself

Investors often exhibit behavioural biases that can lead to poor investment decisions. Overconfidence, self-attribution, mental accounting, searching for patterns, hindsight, regret, and fear are cognitive biases and emotions that an advisor can help overcome in order to promote both wealth and well-being!

Costs Matter

All investors in aggregate form the market. Therefore, it must be the case that the average investor earns the market rate of return less fees and expenses.

Managing costs (management fees, operating costs, trading costs, taxes, etc.) **allows investors to capture more of the capital market return that is there for the taking**. Keeping costs down puts the odds of success in your favour.

Horizon Wealth Management makes decisions for its clients based on the highest probability of achieving the desired outcome with the least amount of risk.

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

Does your Superannuation Fund have your Tax File Number?

One of the changes announced in the 2006 Federal Budget is that all superannuation investors need to have a valid Tax File Number (TFN) recorded with their super fund/s. You should ensure that your TFN is on all your super accounts before 1 July 2007.

The consequences of not having a TFN

Please note that from 1 July 2007, superannuation contributions made into your super account that do not include a record of your Tax File Number will be subject to additional tax.

The employer contributions and personal contributions made to new super accounts without a tax file number (TFN) will

be taxed an additional 31.5%.

- For existing accounts, the additional 31.5% will generally be payable on all contributions once the contributions for the year reach $1,000.
- For accounts created after 30 June 2007, the additional 31.5% will be payable regardless of the amount contributed.

The Government has also announced that superannuation funds will not be able to accept certain contributions which do not include an employee's TFN.

Now may be a good time to consider consolidating all your Superannuation Accounts into one to reduce your administrative burden.

If you would like any assistance with this, please do not hesitate to call us on 02 9392 8700.

What can Horizon Wealth Management do for you?

Horizon Wealth Management is in the business of assisting individuals in the efficient management of their personal wealth, helping them to **become financially independent**.

"How successfully you invest your current income and assets…. will determine your family's long term financial well being"

Should you wish us to cover other topics or wish to make an appointment, please call 02 9392 8700 or info@horizonwealth.com.au.

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