ROCHDALE
ACCOUNTING & FINANCIAL

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The newsletter for Capstone Financial Planning clients

In this Issue • The Future of Financial Advice • Infrastructure • Nearing Retirement?

The Future of Financial Advice

The Future of Financial Advice has been a much publicised topic in recent months. Last year, in our Winter 2010 edition, we touched on the Federal Government's review of financial advice and how it needs to be reformed in order to improve the trust and confidence Australian retail investors have in the financial planning industry. The resulting proposed reforms are a step in the right direction and we at Capstone support them. Eight million adult Australians do not have the level of knowledge and skills required to effectively manage and respond to situations involving financial decisions; it is therefore imperative that these reforms have the desired outcomes.[1]

For you, as clients of Capstone's affiliated practices, the proposed changes will have minimal impact. You already seek advice, are aware of the subsequent benefits and understand the service, costs and value being delivered. However, they are likely to affect someone you know – whether it's your children, grand children, other family members or friends and we, as advisers, need to clearly demonstrate to them and others the value that good advice can bring to many more Australians.

In recent years, the need for a more effective Superannuation System has become paramount. As life expectancies increase there needs to be peace of mind that we can all enjoy a financially secure and stable future. The Cooper Review examined Australia's Superannuation System, with two of the key outcomes that you may have already heard about being the proposed introduction of **MySuper** and **SuperStream.**

The driver for this decision was the key finding from the Review that the majority of Australians have their Superannuation benefits held in the default option of their Super funds and are completely disengaged with the investment process.[2] This finding is consistent with current research that reveals only 1 in 5 Australians receive financial advice. We at Capstone are dedicated to addressing this serious issue.

MySuper is a universal, low-cost and simple Superannuation product that will replace the existing default Super funds. Obviously, the finer details of MySuper are still being finalised. This reform is designed to ensure Australians with default Super accounts receive standardised benefits and service, whilst paying minimal fees. However, it still does not address the issue of financial education for Australian consumers nor does it encourage investors to seek advice as to other, potentially better, options.

SuperStream focuses on administration efficiency; assessing various techniques for reducing the cost of running large Superannuation funds mostly through reduced paperwork via electronic data transmissions. The overall aim here is to reduce fees and improve the service levels provided to investors, but again with MySuper there is no professional financial advice provided.

These initiatives are designed primarily to protect consumers who do not seek advice. Whether they will also actually produce a material benefit for consumers is a matter for debate. However, there are already examples where leading fund managers are ahead of the Government's reforms, having adjusted product fees and created greater product flexibility to benefit their investors. Future reforms, combined with competitor pressures, should ensure that product manufacturers continue to respond to consumers needs.

The value of financial advice is well documented and with further education and reform – we hope Australian's will take a more active approach with their financial wellbeing. We encourage you to contact your Capstone Adviser if you have any concerns over family or friends who you feel may benefit from valuable financial advice.

1 Organisation for Economic Cooperation and Development (OECD), published by the Australian Bureau of Statistics

2 Bill Shorten, Financial Services Minister 2011

Economic Highlights

Australia

Despite the disruption to normal economic activity caused by the floods, employment growth continued with 24,000 part-time jobs added in January, the unemployment rate remained at 5.0%. The Reserve Bank of Australia left official interest rates on hold at 4.75% in February and March, stating that "the currently restrictive stance of monetary policy remained appropriate in view of the general macroeconomic outlook".

Retail sales posted a smaller than expected rise of 0.2% for the key trading month of December. Interestingly, despite the festive season, food (-0.5%) was a notable area of weakness, with spending in this area declining for a second consecutive month. This weakness nevertheless proved short lived, as food sales rebounded by 2.5% in January, contributing to an increase of 0.4% in the overall measure of sales.

In a further sign of confidence within the household sector, housing finance commitments increased in value terms in each of the last four months of 2010. Data for December showed that housing finance, excluding refinancing, rose by 1.7% over the month. Investor finance (+3.0%) grew particularly strongly, outpacing a more modest gain in finance for owner-occupiers (+1.0%). It was further interesting to note that the banks' market share rose by 1.2 percentage points to 88.7%, having slipped over the preceding two months.

China

The People's Bank of China (PBOC) announced increases of 0.25% to its benchmark 1-year lending and deposit rates to 6.06% and 3.0% respectively. Subsequently, the PBOC lifted its Reserve Requirement Ratio (RRR) for the fifth time in four months, bringing the amount of reserves that the country's banks must hold against lending to between 19.5% and 20.0%. Evidently, the PBOC is aiming to address a situation where prevailing interest rates are lower than the inflation rate, and also to limit the banks' ability to fund excessive speculation in the property and commodities markets.

Data from China's National Bureau of Statistics (NBS) showed that the year-on-year rate of growth in consumer prices lifted to 4.9% in January, up from 4.6% the previous month. The NBS also announced revisions to the weightings in its price index, notably a reduction of 2.21% points in the food component. Food has been a key source of inflationary pressure over the past year, with prices having risen by 10.3% over the year to January, up from 9.6% previously.

Elsewhere within the Chinese economy, merchandise export growth surged to a year-on year growth rate of 37.8% in January, more than double the rate of 17.8% recorded in December. Exceptional strength was similarly evident in imports, which rose by 51%. A move by Chinese exporters to fill orders ahead of the Chinese New Year holiday was cited as a possible cause for the surge in exports, however the worldwide strength of recent Purchasing Managers' Index (PMI) data suggests that improving global demand is a more likely reason. With regard to China's imports, it is plausible that the result was significantly reflective of the rising trend in commodity prices.

United States

Investors in the US are emerging with differing opinions on whether monetary stimulation via quantitative easing (printing money) will give rise to a resurgence of inflationary pressure. The US Federal Reserve Chairman, Dr Ben Bernanke, recently suggested that, against a backdrop of "substantial slack" in the US economy, "inflation is still quite low and longer-term inflation expectations have remained stable". The subsequent release of the Consumer Price Index (CPI) report for January appeared to vindicate this view, with the headline measure of monthly price changes remaining unchanged at 0.4%. However, those advocating an early end to quantitative easing noted that the year-on-year measure of core inflation has risen steadily over recent months, moving from 0.6% in October to its January reading of 1.0%.

Retail sales data for January offered little in the way of further insight into the prospects for consumer demand and future inflationary trends, due to uncertainty over the impact of severe winter weather and the delayed processing of tax refunds. Winter weather conditions also impacted the month's industrial production data, which revealed particular weakness in the weather-sensitive utilities (-1.5%) and mining (-0.7%) sectors. However, there was a remarkably strong gain in the motor vehicles (+3.2%) sector, which is typically a major employer of US workers.

In a further favourable development for the US consumer sector, the December-quarter survey of the Mortgage Bankers Association (MBA) revealed a continuation of the declining trend in the percentage of housing loans that are delinquent. Specifically, the delinquency rate declined to 8.2%, from 9.1% the previous quarter, while the percentage of loans for which foreclosure actions were started edged down to 1.27%, from 1.34% previously. These figures appear broadly consistent with the Fed Chairman's observation that there are "grounds for optimism on the employment front", although it "will be several years before the unemployment rate has returned to a more normal level".

Europe

Data continued to improve across Europe, driven mainly by France and Germany. Gross Domestic Product (GDP) for the core European area rose by 0.3% over the December quarter and increased by 2.0% from the corresponding period a year earlier.

Industrial production in both the core and broader regional areas slipped by 0.1%, however the overall trend remains positive with the year-on year rate of growth posting a healthy gain of 8.0%. Moreover, given that capital goods production (+14.8%) was the major driver of this result, there is clearly cause for optimism with regard to the outlook for 2011.

United Kingdom

In the UK, the latest report on prices has seen the issue of monetary policy take centre stage, specifically higher inflation and weaker economic growth.

The Consumer Price Index (CPI) posted a year-on year gain of 4.0% at the headline level in January, while the core measure of prices rose by 3.0%.

Source: OnePath

Infrastructure – Stable and Reliable Returns

The world faced many disasters in the decade to 2010 – September 11, Hurricane Katrina, the Indian Ocean tsunami, SARS, Avian flu, the conflicts in Iraq and Afghanistan to name a few – and investment markets were no different. Investment markets were hit by the bursting of the tech bubble in the early part of the decade and the onset of the global financial crisis at the end of the decade. Not surprisingly, investment returns for listed equities through the decade were anaemic, at best.

However, the investment returns generated by listed infrastructure and utilities securities present a different story. Research shows that a hedged investment in the universe of listed infrastructure stocks domiciled in the OECD would have delivered compound annual returns of 9.0% pa for the 10 years to 31 December 2010, outperforming both global and Australian equity benchmarks whilst also exhibiting lower levels of volatility (source: Magellan research).

Analysis of investment returns over the past 10 years shows that infrastructure assets have outperformed broader equities markets when investment markets have been falling but have underperformed when investment markets have been rising (source: Magellan research). Therefore, investing in infrastructure may provide diversification benefits to a portfolio.

Outlook for Investment in Listed infrastructure

Today, the prospects for infrastructure assets reflect the underlying stability and reliability of the income streams they derive.

It is the stability and reliability of the income streams that has led to stable, real returns over the past decade. The stability and reliability reflects the definition of infrastructure.

- Infrastructure assets provide essential services needed for the functioning of a community e.g. delivery of water. Because such services are essential they face stable demand.
- Because the construction of an infrastructure asset typically requires a level of capital expenditure that is many multiples of expected earnings, infrastructure assets are natural monopolies and rarely face competition.

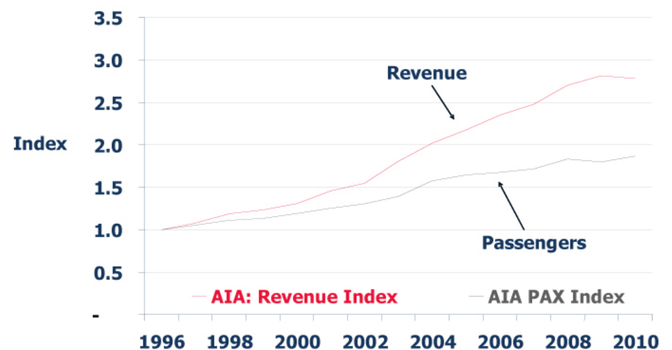
Given these characteristics, the potential for abuse of monopoly power over essential services means that infrastructure assets are regulated. Regulation is normally structured so that the infrastructure provider is able to earn a fair return, meaning earnings are stable and protected from inflation.

What are Infrastructure Assets?

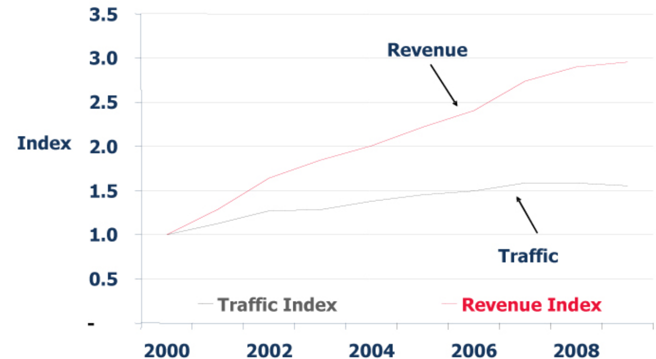
The listed infrastructure investment universe comprises two main segments:

1. **Utilities:** including energy transmission and distribution and water treatment and distribution. Regulation is normally structured so that the utility is able to earn a fair return and is protected from inflation;
2. **Infrastructure:** including airports, toll roads and ports. Revenues and earnings reflect both the volume of patronage (passengers/cars/containers) and the price paid to use the service. The price paid is regulated and is typically linked to inflation. For example; Toll Road Revenue = No. of Cars x Average Toll, with tolls linked to inflation. Hence, the earnings of infrastructure companies, such as toll roads, can be expected to generate increasing returns as patronage grows and to benefit from inflation protection. Examples of this are Auckland International Airport and the 407 toll road in Toronto, Canada whose patronage volumes and revenues over the past 10 years are shown below.

AIA – Passengers and Revenue (1996-2010)



407 - Traffic and Revenue (2000-2009)



Why Invest in Infrastructure?

- Infrastructure assets generate stable financial performance.
- Financial performance is protected from inflation.
- Investment in infrastructure provides diversification benefits to an investment portfolio.

Source: Magellan Asset Management

Nearing Retirement?

If you're nearing retirement, you're about to go through one of the biggest and most exciting changes in your life.

However, the key to making a smooth transition is to decide how you are going to spend your time as well as your money.

How will you spend your time?

Retirement is the start of a whole new chapter in your life and after decades of hard work you'll have the opportunity to take up new hobbies and pursue neglected interests.

For some people, this means spending more time with family and friends. For others, it provides an opportunity to learn a new language or do some volunteer work. There's also the potential to do more travelling, whether locally or further abroad.

Thinking about what you want to do when you retire is important for two key reasons.

Firstly, it can help you with what can be a big adjustment emotionally.

Secondly, once you know what you want to achieve from a lifestyle perspective, you'll be in a much better position to:

- determine whether you can afford to retire when you want, and
- decide how you can make the most of your money before and after you leave the workforce.

Make the most of your opportunities

Whatever your lifestyle goals might be, there are a range of strategies that could be used to maximise your financial position and give you the best chance of achieving the lifestyle you want.

For example, if you plan to keep working for a while, you could boost your retirement savings in a tax-effective manner by making 'salary sacrifice' (pre-tax) or personal deductible super contributions.

If you are aged 55 or over, you could use your existing super to start what's called a 'transition to retirement' pension and receive a tax-effective income.

This income could then be used to replace any salary sacrifice or personal deductible super contributions you make and build your nest egg without compromising your current lifestyle.

Alternatively, if you plan to scale back your working hours, the income payments could be used to maintain your lifestyle.

Also, when the time comes to retire, you could use your super to start what's called an 'account based pension'. This may enable you to:

- receive ongoing tax-effective income payments, and
- possibly qualify for (or increase your entitlement to) Age Pension payments.

Plan for success

Regardless of whether retirement is just around the corner or a few years away, it's important to think about what you want to do when the nine-to-five grind is behind you.

Once you've done that, a financial adviser can help you:

- fine-tune your lifestyle goals,
- identify how much income you'll need, and
- develop a sound financial plan to help you turn your dreams into a reality.

To find out more about planning your retirement and the strategies you could use to maximise your financial position, contact your Capstone Financial Adviser.

Source: MLC Technical Services

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