



The costs of living

Increases – or changes in the way we live?

Australia may have the third lowest cost of living in the developed world after the US and New Zealand¹ and relatively stable CPI figures yet it seems many Australians are quite concerned about a possible leap in basic living costs. A recent capital city newspaper reader survey found that 81 per cent of those responding believed that the true cost of living was way above the recent annual consumer price index (CPI) figure of 3.3 per cent (or a still modest 2.6 per cent, adjusted for volatile items).²

For many of us, the main cause for concern seems to be recent increases in the price of water and power, the two utilities we can't live without and whose bills we receive every quarter. The most recently published Nielsen Research Global Online Consumer Survey (June 2010) reported that increasing utility bills were by far the biggest concern among Australian consumers³ and these cost concerns were certainly reflected in Australian Bureau of Statistics (ABS) data. The latest quarterly statistics report that while inflation rose 2.7 per cent in 2010, electricity rose 12.5 per cent, and water and sewerage costs by 12.8 per cent.⁴ Recent press headlines flag even higher utility prices in the pipeline.

On top of that, as these items move up in price, they have a greater impact on the CPI when the ABS recalibrates the index every five years. In the latest adjustment, food moved up 1 per cent while utilities including power took up an extra 1.8 per cent of the index.⁵

Electricity price shocks: preventable?

What can consumers do about rising electricity costs? Apart from choosing energy-smart appliances and running fewer of them, it seems that an effective answer might be to switch to solar. For the first time the cost of solar is almost at level pegging with the cost of conventional power. Thanks to government incentives, the falling cost of the technology, the rise in the Australian dollar, and increases in the costs of conventional power, those who switch to solar should be getting free electricity for a decade once the system is paid off over 7-10 years. In fact, those who generate enough solar power to sell the excess back to the supplier grid might even make a profit out of it.⁶

Thankfully, it seems that the proposed carbon tax will not impact heavily on household electricity costs if implemented. Estimates suggest that it could add up to between \$2.70 and \$4.20 a week to the bill, but that should be offset by compensation promised to low and middle-income earners.⁷

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1 www.immigration2australia.com/living_in_australia/living_cost_of_living/

2 ABS Media Release, 27 Apr. 11. Plus commentary and analysis, JB Were (Tim Toohey), 27 Apr. 11

3 Nielsen Global Online Consumer Survey for Quarter 2, 2010

4 <http://www.dailytelegraph.com.au/money/money-matters/prices-go-up-the-cost-of-living-at-a-glance/story-fn300aev-1225859344076>

5 <http://www.theaustralian.com.au/business/industry-sectors/food-power-add-weight-to-cpi/>, March 23, 2011

6 <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/6401.0Main%20Features3Dec%202010?opendocument&tabname=Summary&prodno=6401.0&issue=Dec%202010&num=&view=>

7 Abbott's beef on carbon tax doesn't add up, Lenore Taylor, SMH, April 9, 2011

Review or regret – why reviewing your wealth protection plan is a solid investment

A wealth protection strategy is an important part of any overall wealth creation plan. Of course, we're all interested in reviewing the current status of our wealth creation plan to see how our investments are performing.

But, reviewing your wealth protection plan is an often forgotten activity, as many of us adopt a 'set and forget' approach to insurance. Payment of insurance premiums is often viewed as a necessary evil, and few clients contact their adviser to facilitate a review.

When should a review occur?

A review of your risk insurance should be conducted whenever there is a change in your personal or business circumstances.

Changes in any of the following areas should prompt you to review your cover as they can impact the type and amount of insurance cover you need:

- income
- debt levels
- dependants
- relationship status (marriage, divorce, new partner)
- occupation/employment status (i.e. self employed or employee)
- health (improvements or change in health of you or your partner).

Typically, a review of your wealth protection plan is instigated by your financial adviser. They may contact you on an annual basis to determine any relevant changes to your situation and recommend a review of your insurance cover and amount.

What if nothing has really changed?

Even if nothing has changed, it's still worth reviewing your risk needs, at least on an annual basis to make sure you still have the most appropriate products to suit your needs. Intense competition in the risk insurance industry means that insurance providers are always looking for the 'edge' with their products, particularly to ensure they remain in the top quartile of rated products. This results in ongoing product improvements, in the form of additional benefits, better policy definitions and the introduction of new additional options.



While many insurers will automatically 'pass back' any improvements in policy definitions to a client, this shouldn't be assumed. A regular review will ensure that your policy provides you with the most appropriate benefits and features to meet your needs and objectives. By keeping your policies up to date with changes in the industry, you may have a better outcome should you need to claim.

The following story¹ highlights the importance of making the time to review your risk insurance.

Joanne and Michael's story

As the mother of two children, Joanne didn't need to be reminded of the importance of holding adequate risk insurance to make sure her family would be looked after in the event of suffering a serious illness or injury or premature death. Both Joanne and her husband Michael met with their financial adviser when their first child was born 8 years ago and with her assistance implemented a wealth protection plan to cover their family.

As Michael was the family's income earner he met with their adviser on an annual basis to check his income protection benefit was adequate and confirm the family's debt levels hadn't changed.

Joanne was busy looking after the family and despite the adviser's recommendations to revisit her insurance, at least on an annual basis, she kept putting a review off until she had more time.

Sadly, several months ago, Joanne was diagnosed with carcinoma in situ of the breast, an early form of breast cancer that has a good prognosis if found early and treated. Joanne underwent removal of the breast lump and a course of chemotherapy over several months. Fortunately, Joanne's doctor has given her a good prognosis.

Once Joanne's treatment had finished, Michael contacted his adviser to find out the necessary steps to lodge a trauma insurance claim for Joanne.

Joanne's insurance cover hadn't been reviewed for eight years and her policy definition of cancer did not provide a payment for the treatment she received. She was not eligible to receive any benefit from her trauma policy.

Michael had taken time off work to mind the children and support Joanne through her treatment. While he had some leave entitlements, he still needed to take unpaid leave. There were also medical expenses that were not covered by Medicare or private health insurance. These costs would now have to be borne by the family.

Had Joanne undertaken a review of her insurance cover, she may have considered upgrading her trauma insurance to a new policy that would have paid a partial benefit for her breast cancer.

¹ This is a true story. Some details have been changed for privacy reasons.

Waking up – the US economy today

American author Mark Twain once famously wrote that reports of his death were greatly exaggerated. The same could be said for his country today. The US was at the epicentre of the Global Financial Crisis (GFC), and is still grappling with its impact. But America remains a rich country, the world's biggest economy, and recovery is gradually getting underway.

Consumer sentiment is rising¹ and industrial production lifted at an annual rate of 6 per cent in the first quarter. Inflation is rising too, but for the moment that is good news in a country where interest rates have been close to zero. The US consumer price index, (their measure of inflation) rose 2.7 per cent in the year to March, a sign that the economy and prices are stirring.

Unemployment is also falling, albeit slowly, as the economic recovery soaks up some of the eight million jobs lost since the recession began in December 2007. US unemployment was 9.2 per cent in March, down from a high of 10.6 per cent in January 2010.

Bumps in the road

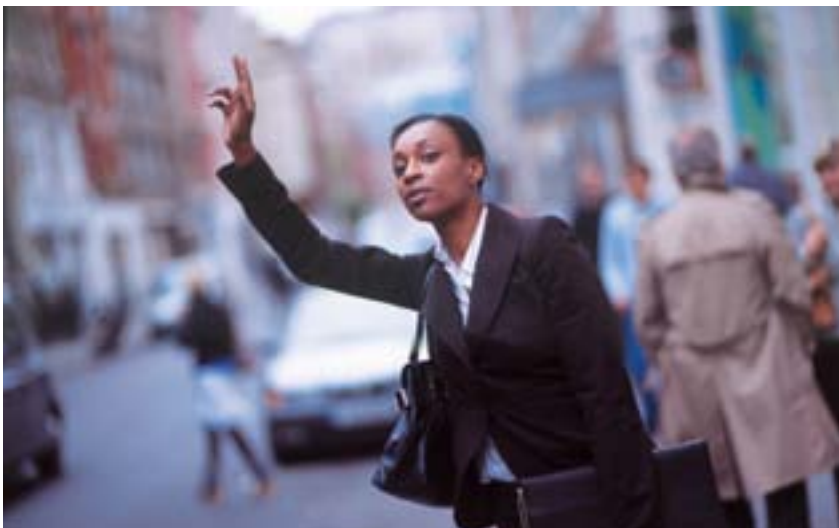
But despite the glimmer of recovery, there is still plenty to worry about apart from the sluggish jobs figures. Recovery is strong in some areas, but has missed others.²

The US housing market remains weak more than three years after providing the trigger for the GFC. Prices of existing houses are at their lowest in 9 years.³ If prices fall further, consumer confidence and the banking system will both come under pressure.

Rising oil prices on the back of political turmoil in the Middle East are a concern for people everywhere, but the US is more dependent on imported oil than most. America is the world's biggest consumer at 18.8 billion barrels of oil a day and oil prices have jumped 25 per cent over the past year to more than US\$110 a barrel. If oil prices hit US\$140 a barrel, as some commentators are suggesting, then this will feed inflation and slow down economic recovery.

US debt

Arguably the major block to a robust US recovery is political. In April, ratings agency Standard & Poor's revised its outlook on America's AAA credit rating on sovereign debt from stable to negative. S&P cited a one-in-three chance the US could lose its AAA sovereign credit rating within the next two



years, saying "US policymakers might not reach an agreement on how to address medium and long-term budgetary challenges by 2013".⁴

Within days of S&P's statement the Congress struck a deal to pass US\$38 billion in budget cuts, but the US budget deficit is likely to remain above 10 per cent this year; that is, the government will spend 10 per cent more than it earns. Gross public debt, the accumulated budget deficits, could exceed GDP next year. US government debt is already nudging 100 per cent of GDP⁵ – only Ireland, Greece, Italy and Japan among developed nations have higher levels. By comparison, Australia's public debt is just 24 per cent of GDP and China's is 17 per cent. For the US, there is still a long way to go.

While Europe and the UK introduced austerity measures last year to tackle their huge public debt, America has taken a different tack, trying to inflate its way out of its US\$14.3 trillion debt by increasing the money supply. The US Federal Reserve has been printing money to buy US government bonds, a strategy it calls quantitative easing (QE).

QE1 came to an end in March last year and QE2 was launched in November. This has resulted in higher bond prices and low bond yields (yields go down as bond prices rise). It has also devalued the US dollar against other currencies and prompted a rush into hard assets such as gold and commodities.

In May, gold pushed through the US\$1500 an ounce barrier and the Australian dollar hit US\$107 cents.

Where to now?

When QE2 ends in June it could prove to be a turning point for global asset markets, though the jury is still out on whether that will be a positive or negative turn, or simply another stage on the long journey back.

April earnings reports from US companies were more positive than previously expected,⁶ and it is clear that some major Australian companies with a strong presence in the US are confident as they are increasing their US investments.⁷ No doubt they appreciate just how massive the US economy is, with single states like California, Texas and New York ranking alongside the world's 16 largest sovereign economies. In fact, these economies are larger than the Australian economy.^{8,9}

Investors have reason to be cautious, but America's sheer size and steady recovery provide a measure of confidence that the sleeping giant is waking, at last. If you want to discuss how this might affect your investments please give us a call.

1 The Conference Board index of leading indicators, April 2011

2 <http://www.visualeconomics.com/recession-recovery-best-and-worst-american-cities/>

3 US National Association of Realtors

4 'AAA/A-1+ Rating On United States of America Affirmed; Outlook Revised To Negative' <http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245302886884>, 18 Apr 2011

5 IMF Fiscal Monitor April 2011

6 Australian Financial Review, Earnings of Ford, 3M, and Reuter's analysis quoted as examples. 27 April 2011

7 ASX100 companies Boral, Brambles, Sonic Healthcare and QBE Insurance have all announced or completed US acquisitions in Mar Qtr 2011.

8 www.visualeconomics.com/california-vs-the-world_2010-05-10/; www.esd.ny.gov/WhyNewYork/NYS_Economy.html

9 <http://data.worldbank.org/data-catalog>, GDP Ranking, PPP based.

Superannuation: what happens to it when you're gone?

Most people know they can transfer their property, money and personal effects to their dependants and others through their Will.

But can you do the same with your superannuation? Is it enough to direct it to others via your Will? And do you know the tax implications if your remaining super funds are distributed to your dependants and other beneficiaries?

In practice, it takes more than a mere mention in your Will to direct super funds to your beneficiaries, so it's important to consider superannuation within your ongoing financial and estate planning.

Here are some of the issues to think about.

The nuts and bolts

If you die before all your super assets are withdrawn, your super fund pays a death benefit to your dependants or estate. Death benefits include the balance of your super account, plus an insurance benefit if you have been paying life insurance premiums through your super fund. The total payout may also be increased by a refund of contributions tax paid during your lifetime. This refund is referred to as an anti-detriment death benefit payment.

While a spouse or dependent children pay no tax on super death benefits, adult children and other beneficiaries who are not dependants may pay tax of 16.5 per cent (including Medicare), on the taxed element of the taxable component of your super benefits and 31.5 per cent on the untaxed element. The taxed component includes any eligible termination payments you've received and salary sacrifice and personal contributions you've made.

If death benefits are paid into your estate they may be taxed up to 31.5 per cent.

Who is eligible to receive your super?

Super is one of a handful of assets that lie outside your Will and there are strict rules governing who can inherit this money. Generally speaking you can nominate your dependants or your estate, but for superannuation purposes the tax definition of dependants is quite specific. Dependants include your spouse, de facto or same sex partner, dependant children and anyone who is a financial dependant or was in an interdependent relationship with you at the time of your death.

The rules are slightly different for anti-detriment death benefits. However, not all funds pay these benefits so if you're unsure about where your fund stands on this, please contact us.



Tying things up

The nomination of your beneficiaries requires careful thought. You can make a non-binding nomination which acts as a guide to your wishes but can be overturned by the fund trustees, or a binding nomination which can't be challenged, if validly made. To be valid, it must be witnessed by two non beneficiaries, renewed every three years, and directed towards an eligible dependant or your legal representative, usually the executor of your estate.

If you want your super to pass on to your partner tax-free, it is a good idea to make a binding nomination in their favour rather than have the money go into your estate.

If you are receiving an allocated pension it is often recommended that you nominate a reversionary beneficiary for the income stream. Following your death, the reversionary beneficiary can continue to receive the pension rather than have it paid out as a lump sum. Keeping the money in the tax-free super environment can mean significant tax savings.

Even when you are over 60 and receiving a tax-free super pension, tax may still be payable from your super if you die after a divorce or if your spouse pre-deceases you, and your super then passes to non dependants such as adult children.

However, with the help of your advisor you could employ a withdrawal and re-contribution strategy at pre-retirement to minimise or completely reduce this tax.

A winning strategy

John, 64, is a retired architect and widower with one independent adult daughter, Marie. John has a superannuation policy made up of the following components:

Taxable component	\$380,000
Tax-free component	\$20,000
Total	\$400,000

John has made a binding nomination with Marie nominated to receive his total super benefit when he dies. As things stand, Marie would pay tax of \$62,700 (16.5 per cent of the taxable component), leaving her with \$337,300.

Now look what happens if John uses a withdrawal and re-contribution strategy.

As John is over 60 he can withdraw his total super benefit tax-free and re-contribute the funds as a non-concessional contribution. If John was to die immediately after putting this plan into action, Marie would receive the entire \$400,000 tax-free, giving her an additional \$62,700.¹ Note, however, if the fund makes anti-detriment payments, the overall tax saving won't be as significant.

When it comes to super, the optimal estate planning strategy depends very much on individual circumstances.

So we encourage you to call us if you want to discuss estate planning or other financial issues.

¹ Care needs to be taken that these tax savings are not outweighed by the loss of anti-detriment death benefits which can only be paid on the taxable component. Marie could potentially receive an additional \$67,059 in anti-detriment payments, boosting the total taxable payout to \$467,059. After tax she would receive \$393,294. Nevertheless, she is still better off by \$6,706 (\$400,000 - \$394,294) if John goes ahead with a withdrawal and re-contribution strategy.