Time is on your side with super

Noel Whittaker

It's never too late to take advantage of the wealth-building opportunities afforded by superannuation funds.

OUTSTANDING service has become the exception rather than the norm in this fast-paced world; which is why I make a special effort to reward anybody who goes the extra mile.

Usually, I end up giving them one of my books, because a book is something that can be autographed, and the receipt of it often gives them quite a thrill because no author has ever done that for them before.

Just a fortnight ago I gave a book to a woman in one of my favourite coffee shops. She is an absolute joy to deal with, nothing is ever too much trouble for her, and she is happy to make me a cappuccino even before the shop has opened or after the closed sign is up.

Of course, next time I saw her I asked her how her reading was progressing and received an unexpected reply: "It's full of great stuff, but it's really made me depressed – I am now 39 years of age and have obviously left it too late to build some financial security for myself."

That's an understandable reaction, but it's just so wrong.

It really is never too late to start to make changes to improve your financial situation, provided you get some advice, and start to put the basic principles to work.

Yes, the hardest thing is starting, but start you must, because the quicker you begin to take some action, the easier it will be to make a difference in your life.

A great wealth-boosting strategy is to increase your income without increasing your expenses – in business this is known as boosting the bottom line. For example, if you earned $50,000 a year now and spent $49,000, the most you could save would be $1000 a year.

But imagine if you worked on improving your skills so that your take-home pay grew by $5000 a year. Then you could increase your savings to $6000 a year if you didn't fall into the trap of automatically increasing your expenses as your income grew.

Think about it – an increase in income of 10 per cent could increase your annual savings by 600 per cent.

Superannuation is still the most effective vehicle to boost wealth. Let's assume my 39-year-old friend in the coffee shop earns $40,000 a year and was prepared to work until age 65.

If she relied solely on the employer's 9 per cent compulsory superannuation she would have $386,000 in that fund if inflation averaged 3 per cent, the fund earned 9 per cent per annum, and the contributions tax stayed at 15 per cent.

But the simple act of salary sacrificing an extra $5000 a year into super would give her an extra $439,000.

Next, if she contributed an extra $1000 a year out of her take-home pay, she would also be eligible for a part government super co-contribution of $730 in the first year. If the co-contribution eligibility was adjusted in line with inflation and her income kept pace with inflation she could have an additional $178,000 from that source alone at age 65.

Add the three superannuation numbers together and you get the incredible sum of $1,003,000 at age 65. Sure, I know the sceptics are going to say $1 million in 26 years will be eroded by inflation but the examples above assume an inflation rate of 3 per cent. If that happens, our $1 million will be worth about $460,000 in today's money.

The above example is a great demonstration of how even a relatively low-income earner can achieve financial independence even if they are approaching 40 and have few assets behind them.

As always, the hardest part is starting and this is going to be harder with Christmas just around the corner.

Financial losers will get into debt to buy a whole range of unnecessary Christmas presents, while the financial winners will stick to their budget and make sure that their investment plan gets preference.

Sadly, most people will read this and say "sounds too good to be true" or "I'll start in January".

They will still be saying the same thing this time next year – and the year after.

Noel Whittaker is a director of Whittaker Macnaught Pty Ltd. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. His email is noel.whittaker@whittaker macnaught.com.au

Q I am currently putting money aside for the education of my young grandson. I started by putting $5000 on a six-month term deposit with the Commonwealth Bank and now have $15,500. It is my intention to try and increase the amount invested by $5000 each time the term deposit matures.
Would an investment bond be more appropriate in these circumstances, given that I would need to be adding to it every six months. If it is, which financial institutions sell them?
I am 70 years old and draw an allocated pension which does not attract tax.
However the interest on the term deposit is taxable so it would appear that an investment bond would be more tax effective.
Furthermore, it is my understanding that if the investment is in my grandson's name or he is specified as the beneficiary, then the investment will not be part of my estate.

A A major benefit of investment bonds is that you can choose a share-based option and thus put yourself in the position where the long-term return should be higher than what you would have if the money was left in the term deposit. Also, you have the flexibility to move between various options without capital gains tax if you take a view that the market is too high or too low. Yes, the bond will not form part of your estate and cannot be challenged when you die. An adviser will help you choose an appropriate bond.

Q My husband and I have recently sold an investment property and will have to pay approximately $40,000 capital gains tax in our tax return in 2009/10. Could we reduce this if we paid our profit into my husband's super – or how much can we put into his super to offset the CGT?

A Provided you are under 65 you could contribute to super without passing the work test but you could not claim a tax deduction if an employer is paying superannuation for you. Your financial adviser will be able to do the numbers for you and advise you if you are eligible to contribute to super and claim a tax deduction at the same time.

Q We have been running a self-managed super fund that earns only $40,000 a year. If we closed the fund down, how much can we earn as a couple with no super funds and not pay tax?
Yes, I think there is an allocated pension document out there somewhere with the "accountant", so we're not paying any tax, but it's relatively complicated and there are some costs, running the super fund. Centrelink last time weren't interested in where the money is, only how much do we have.

A The Senior Australians Tax Offset (SATO) allows a couple of pensionable age to earn $25,680 a year each without paying tax. Therefore, if your fund is only generating $40,000 a year it may be feasible for you to close down your super fund and keep the money outside the system. Just make sure you fully understand all the implications before withdrawing your money because at present you can buy and sell assets within your fund free of capital gains tax. You will not be able to do this if you take the money out of superannuation. Furthermore, depending on your total level of assets, the move could also jeopardise part of your Centrelink benefits.

Send your questions to noel.whittaker macnaught.com.au

Rapid share rally leaves investors in a quandary

By **MARTIN ROTH**

THE spectacular rise in share prices this year has left many investors perplexed, wondering whether now is the time to sell in order to lock in some profits.

That could be a mistake, according to market experts, who believe investors taking a medium-term view of the market (six months or so) can continue to find value.

But conditions apply. Some areas of the market appear fully valued, if not overvalued. In addition, future gains depend in many cases on a continuing recovery in the economy.

By mid-October the benchmark ASX/S&P 200 index had risen more than 50 per cent from its low point of early March. Even after some profit-taking, the index in early November was still up more than 45 per cent.

In addition, the market moved from a price-earnings ratio in March of less than 10 times to about 16 times in early November (based on future estimated profits), slightly higher even than the long-term average.

"In the short term, the market has run a little hard," the senior portfolio manager for Three Pillars Portfolio Managers, Otto Rieth, says. "Valuations are stretched in some areas. Though the broad view would be that the market was crazily cheap in March and April. Now we have seen a P/E re-rating, so over the next six months or so the market will be saying, 'show me the earnings'."

He says the current earnings recovery is strong enough to provide support, although he notes that not all companies are seeing profits improve.

He also worries that much depends on conditions in the US, where consumer spending and the housing market are important determinants of the economy's direction.

"Over the next year I think the big question is what happens when the stimulus here and abroad runs through," he says. "Will the economy suffer a relapse, with a double-dip, W-shaped recovery? My view is 50-50 on that at the moment. Looking further ahead I would expect a return to growth. But it will be a subdued growth environment and not at the rate of 2000 to 2007."

The chief investment officer at First Samuel, Dennison Hambling, agrees the market does not appear overvalued at present levels, despite this year's strong rally.

"Nothing in the valuation says that people should worry," he says. He notes that many professional investors are cashed up and ready to place more money into the market and believes this will help limit any share price declines.

"We would hope that the market will bubble along at around the current level for the next six to 12 months," he says. "That would be a good result. But some sectors will perform better than others. The big challenge for investors is to make sure they are in the right areas."

He points to 'defensive' stocks like AGL Energy, Origin Energy, Primary Health Care or CSL, as offering good value, relative to more cyclical market areas.

He also believes some smaller, good-quality mining stocks offer excellent value, whereas banks have become expensive, based on current growth forecasts.

But not all experts are equally sanguine about the market outlook.

Alan Hull is a technical trader, money manager, author and manager of the website alanhull.com. "Technically the market is weak," he says. "The advance we have seen this year is what we call a relief rally. It is not a renewed bull market."

"The key feature from a technical standpoint is that we are still in an overall downtrend," he says. "This started after the peak of 2007 and we are yet to break out of it.

"Although we have recently been in a rising market – and I would say make hay while the sun shines – I would be extremely cautious going forward. I would not be at all surprised if our market retests its lows of March. I am not convinced that the correction is over." SMH