Personal Wealth

Summer 2013

A Quarterly Newsletter for **Lifespan Clients**

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Our regular feature looks at recent market changes and the major events that shaped the outcomes.

- **Securing a reliable income for your retirement:**

Retired or retiring, and wondering how you will achieve a regular income in retirement and make your savings last the rest of your life.

- **Is your super covered for death?:**

Many people die without a will or at least not a valid will. This means they die intestate and state laws decide how their estate is divided.

Investment Markets

Recent History

Global equity markets have continued their rally with the US hitting new highs and the Australian market (ASX200) trading over the 5,400 level. Australian shares returned 8.9% for the 3 months to 31 October, which was ahead of the 1.5% return for global shares.

Over one year, unhedged global equity was the best performer returning 35.0% while Australian shares returned 25.5%. Australian listed property returned 3.5% for the 3 months but was the laggard over 6 months and a year returning -2.0% and 13.3% respectively.

Fixed interest continued to underperform returning just 0.1% for 3 months and 1.8% for one year.

Equity markets are being supported by the continuation of quantitative easing (QE) in the US with no news of tapering. In fact Janet Yellen, the next US Federal Reserve chairman has said that she does not think that it is time to begin to wind back QE which has been good for equity markets.

Markets and Economy

A major positive is that the Chinese economy may have finally bottomed after a long decline in the countries growth rate.

GDP growth is now running at an annual rate of 7.8% with the quarterly numbers rising from 1.5% in Q1 to 2.2% in Q3.

Also there is an indication that 7.2% GDP growth may be the lowest acceptable number for Chinese leaders as this creates the 10 million new jobs that are required by new city dwellers.

Chart 1: China's GDP Growth Rate Stabilizing after a Long Decline?

Source: NBS, Datastream, MSWM Research

On the downside, the Reserve Bank of Australia (RBA) cut its growth forecasts for the Australian economy for next year.

It said it expects growth to remain below average throughout 2014 due to a bigger than previously expected fall in mining investment.

The Australian equity market at about 5,400 is trading at a post GFC high. A feature of the market is that small cap stocks continue to underperform while the large banks help drive the performance of the large cap ASX200 index. In fact small cap shares have underperformed large caps 3 years in a row and have underperformed by over 22% in the last year.

Also while resources shares have done better lately they have returned 33% less than industrial stocks over the last year.

Looking at valuations, the ASX200 is trading on a forward PE of about 14.8 times. This is a little above the long term average PE of 14.4 times (UBS). Also the PE of the Australian market ex resources is about 11% above its 20 year average level.

The US equity market (S&P500, 1,782) is on an end 2013 PE of ~ 16.3 times earnings, not an outrageous valuation but not cheap either. The global equity market PE is about 14.5 times which is lower than the long term average of about 16 times.

Emerging market equities at about 10 times are trading about 20% below the long term averages (T. Rowe Price).

Outlook

Equity markets have had a good rally and we believe Australian shares are probably fully priced in the short term.

We are not saying they cannot go higher but gains will be much harder to achieve from here given they are trading at slightly above long term valuation levels. The extent of these gains should depend on the level of earnings growth that is achieved rather than the PE multiple expansion which has already occurred.

We think you should have a tilt to global equities in your portfolio on the basis of relative valuation, the still high Australian dollar and for diversification reasons.

Global equities are trading at a discount to their long term valuation so represent better value than Australian shares right now.

When tapering does begin in the US we believe this should result in the Australian dollar weakening which increases the value of unhedged global shares.

Emerging markets remain cheap on a historical basis and it may be time to increase holdings if you have a long term investment horizon.

The positive factor for emerging markets is that China may have bottomed while on the negative side they do not generally do well when interest rates are rising.

We believe interest rates should rise although we think that much of the adjustment to the winding back of the US QE program has already taken place. However we would remain underweight in fixed interest as returns will be low in the short term.

Given that we think it is inevitable that interest rates will rise, we continue to prefer equities to bonds although shares are no longer cheap. In fact we believe that both Australian and US shares are probably due for a pullback.

We would not be chasing shares at these levels but rather we would look to accumulate them on pullbacks and look for bond yields to rise further before we allocated new money to that sector as well.

Chart 2. Investment Returns to 31 October 2013 (% p.a.)

Asset Class	1 month	3 months	1 Year	3 Years	5 Years
Australian Shares	3.97	8.92	25.48	10.06	11.10
Global Shares	2.71	1.52	35.00	11.63	5.56
Listed Property	2.65	3.51	13.30	13.19	7.12
Fixed Interest	-0.06	0.12	1.75	6.74	6.50

Source: Mercer

Securing a reliable income for your retirement

If you're retired, or thinking about retiring, you may be wondering how you will achieve a regular income in retirement and make your savings last the rest of your life.

A lifetime annuity is a secure investment that protects your savings and can provide an income for life. It can be used as part of your retirement investment strategy.

Challenger is a leading provider of retirement investments, offering award-winning annuities, allocated pensions and superannuation products. Challenger manages over $10 billion in assets for our 60,000 clients.

How does a lifetime annuity work?

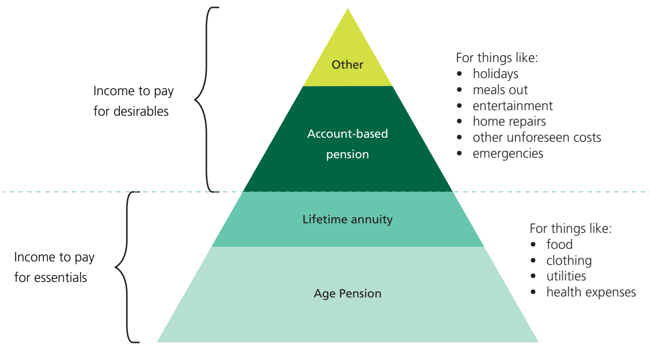
Like other investments, you buy a lifetime annuity with an initial capital amount. You choose the frequency of the regular payments and whether your payments will be indexed. Challenger then guarantees your regular payments.

How can I use a lifetime annuity?

If you are eligible for the Age Pension, a Challenger lifetime annuity can be used to supplement it, helping to secure an income for life. Because you'll generally know just how much income you will receive year-to-year from the Age Pension and annuity, you may wish to consider using this income to pay for the expenses that you can expect – your essential costs of living, like food and utilities.

Income from your remaining investments, such as account-based pensions, cash, term deposits or term annuities, can then be used to pay for the things you desire, but don't necessarily need (see below).

Income from different sources can be matched to different expenses



Your financial adviser can help you think about:

- your budget in retirement, including how to identify essential costs and desirable costs
- how to structure your investments so that you'll have a secure income to pay for the essentials
- whether you can improve your social security entitlements by using different investments.

Helping your family manage aged care fees

Aged care is a complex area and requires careful thought. The uncertainty surrounding where to move, how much it will cost and where the money will come from can be overwhelming and stressful.

The Challenger Care Annuity is designed for people who are moving into, or are already in, a residential care facility. As well as providing regular payments which last for a lifetime, it can help reduce income-tested aged care fees and increase social security entitlements.

And, if the investor dies during the first 10 years of the start of your Annuity, we will pay an amount equal to 100% of your initial capital investment to the estate.

Mistakes can be costly at this stage of the aged care process and it may not be easy to think things through properly if you, or your loved one entering care, are upset or unaware of the implications of a decision. That's why it is wise to always seek professional advice before making any commitments.

Your financial adviser can help you think about how to:

- pay for aged care costs
- minimise ongoing aged care fees
- maximise Age Pension entitlements
- receive a secure income from your investments.

Is your super covered for death?

Many people die without a will or at least not a valid will. This means they die intestate and state laws decide how their estate is divided.

You might not think this is a problem if you are young and have not accumulated much wealth or if most of your assets are jointly owned with your spouse, but what about your superannuation?

The death benefit payable from your superannuation fund may be quite large, particularly if your fund provides insurance upon your death.

It is generally the trustees of the superannuation fund who decide who gets your money and how much each beneficiary receives. This can lead to disputes particularly if you have ex-spouses or children from other relationships or if the relationships in your family are not harmonious.

Your super is likely to be your biggest asset (after your house) and an orderly distribution can save your family a lot of grief. Don't leave the outcomes to chance.

If your superannuation fund allows, you can put in place a binding death benefit nomination. This allows you to decide who is a beneficiary instead of leaving the decision to the trustee.

You can however only nominate:

- A current spouse
- Your children (including step and adopted children)
- A person who is financially dependent upon you or living in an interdependency relationship with you
- Your estate.

Nominating one or more of your dependants directly instead of your estate may allow them to get the money more quickly and with less potential for disputes.

If you nominate your estate or in case the trustees choose to pay your estate, it is also generally wise to include how to distribute your super in your will.

The nomination needs to be made in the correct format to be valid. Check the details with your superannuation fund. Also ensure it stays up to date. Many funds need you to renew the nomination at least every three years.

If you have your own self-managed fund the need to consider a binding death benefit nomination is still important to avoid family disputes.

For more details contact your adviser.

Your adviser can also assist you with determining the right amount and type of insurance cover for you.

Lifespan FINANCIAL PLANNING

ABN 23 065 921 735 Australian Financial Services Licence Number 229892
Level 1, 20 Loftus Street Sydney NSW 2000, PO Box R686 Royal Exchange Sydney NSW 1225
Tel: 02 9252 2000 Fax: 02 9252 2330 Email: info@lifespanfp.com.au Website: www.lifespanfp.com.au