

## Wealth/Super

### Self-managed super forecast

Tuesday, 2 October 2007

Last Updated: Tuesday, 2 October 2007

By Michael Laurence

Thousands of self-managed super funds – the favoured means of investment for SME owners – will borrow to invest over the next 12 months. And their investments in residential property, the premises of members' businesses, and listed investment companies will rise significantly.

The funds will become more opportunistic in their investment practices, building up stores in cash management trusts to take advantage of investment opportunities.

Yet despite the expected swing to geared investments in accordance with changes to super law last week, self-managed funds will take a more cautious approach to the sharemarket, shying away from more speculative stocks to concentrate on blue-chips.

The staggering flow of contributions into self-managed funds will continue at a remarkable rate in 2007-08, yet at a somewhat slower pace than last financial year when self-managed fund assets leapt by 30%, to \$288 billion, in the lead-up to the new super regime, according to the Australian Prudential Regulation Authority (APRA).

These forecasts for super funds over the next 12 months and beyond are based on interviewing professional advisers to self-managed super and, in part, on a new survey by specialist researcher Investment Trends of more than 2100 self-managed funds.

Here are five pointers to what's coming up for self-managed funds:

#### GEARED INVESTMENTS

**Expectations:** Many more self-managed funds will be borrowing to invest under stringent new provisions.

**Why:** Amendments to super law unambiguously allow self-managed funds to borrow to invest. The amendments permit funds to override the long-standing provision in super law barring the borrowing to buy investments.

Until now, many fund trustees were uncertain about how the borrowing ban operated in practice because of various investment and financial products, including instalment warrants, being marketed.

Under the new law, a lender cannot make a claim against any of a fund's assets in the event of default – other than against the geared asset – and the geared asset must be held in trust until the fund makes its final payment.

#### BUSINESS PREMISES

**Expectations:** SME owners will increasingly arrange for their self-managed funds to own the premises of their businesses. As required under super law, the businesses will pay a commercial rent to their funds for use of the premises – and that rent will be concessional tax within the funds.

**Why:** The recent amendments to super law that clearly allow funds to borrow to invest should boost this trend. Further, changes to the Bankruptcy Act from July mean that no assets in super – these might include business premises – are accessible to trustees in bankruptcy provided contributions were not made to defraud existing or future creditors.

#### RESIDENTIAL PROPERTY

**Expectations:** Investment Trends' latest survey of self-managed funds found a strong interest in residential property investments – higher than in past surveys.

**Why:** This seems to reflect expectations that markets in the eastern states are in recovery. The borrowing-to-invest amendments in super law will also encourage more funds to invest in residential property.

#### LISTED INVESTMENT COMPANIES

**Expectations:** Self-managed funds will increasingly use investments in listed investment companies as a foundation for their portfolios.



These companies, such as Argo and Australian Foundation, hold massive, widely diversified equity portfolios. Argo, for example, owns shares in about 180 listed companies.

**Why:** Investment Trends' survey found that self-managed funds have a fast-growing interest in listed investment companies. And self-managed fund administrator and adviser Dixon Advisory also reports that more of its clients are turning to these investments.

Mark Johnston, a director of Investment Trends, says self-managed funds have had considerable success with listed property trusts and this has given them more confidence to move into listed investment companies.

Investment Trends reports that funds surveyed had markedly increased their exposure to listed investment companies over the past 18 months – albeit from a low base. About 13% of funds surveyed had shares in listed investment companies – more than double the percentage shown in the previous survey.

Investment Trends found that more self-managed funds had early this year begun to reduce their holdings in smaller, more speculative stocks to shift more into blue-chips. And this support of blue-chip stocks will grow, according to the survey.

#### **READY CASH**

**Expectations:** Self-managed funds will continue to reduce their debenture holdings in favour of cash. Investment Trends also found that this switch was under way before the recent sharemarket correction.

**Why:** Self-managed funds have a growing policy of building up their cash to grab investment opportunities that may arise – such as in the recent sharemarket correction.

## Putting time and money to work

Lorna Thornber

Sophisticated investors with self-managed superannuation funds (SMSFs) are typically well-positioned to predict market trends, a new survey suggests.

The survey of 2,139 SMSF investors by research organisations [Investment Trends](#) and [Rabobank](#) Australia and New Zealand found that many adopted a more defensive stance prior to the recent slump in the share market, moving to blue-chip Australian shares and cash.

"While SMSFs are typically quite passive investors, last year saw a much higher than normal proportion tweaking their portfolio in order to adopt a more defensive stance," Investment Trends principal Mark Johnston said.

Johnston said SMSF investors' adoption of a more defensive stance in anticipation of the share market correction was evidenced by the following:

- \* 28 per cent changed their asset allocation in the past year, compared with just 18 per cent the previous year;
- \* of those 28 per cent, only 24 per cent had a positive outlook for Australian equities (compared with 42 per cent the previous year) and 14 per cent said they had actively adopted a more defensive stance; and
- \* many said they had 'cashed-up' in anticipation of a market correction.

At a media briefing in Sydney last week, Johnston said SMSF investors, particularly those with larger balances, had the time and/or the money to research the market in-depth and, consequently, tended to get better returns.

According to the survey results, 83 per cent of SMSF investors believed they outperformed the benchmark, with only 4 per cent believing they had underperformed.

While most SMSF investors did receive better returns this year than last (average returns were up 40 per cent to 17 per cent), the wealthier among them, including those with higher than average incomes, performed the best.

According to Johnston, the above-average returns are a result of both the share-market's record heights during the survey period (May 2006-07) and the fact that they had more cash products and better-diversified investments when the market correction eventuated.

RaboPlus head of financial services Bryan Inch said many SMSF investors are parking cash until they identify new investment opportunities.

"With the continued volatility in the markets, DIY [do-it-yourself] investors will increasingly look for less risk and more safe havens and diversify into high yielding online savings accounts, managed funds and listed property trusts."

The survey also revealed that SMSF investors contributed larger sums of money than in previous years, with a marked increase in funds with balances of more than \$1 million. As of May, SMSFs had an average balance of \$741,000. Most SMSF investors were aged 50 or over, more than two-thirds were male and one-third were business owners or self-employed.

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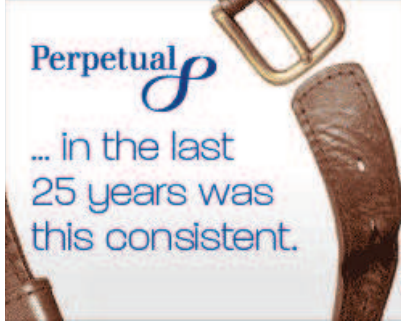
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News

## Super switchers stuck in default mode

Liam Egan

A new report from the Investment and Financial Services Association (IFSA) has found that 15 per cent of Australians switched super funds over the past two years on the advice of a financial planner.



By contrast, the report, "Super Decisions: Communicating with Customers and Effective Disclosure", found that 27 per cent of people who switched left it to their employer to put their super into a default fund.

It found a total 7 per cent of Australians switched super funds between October 2005 and October 2006, and 12 per cent considered switching.

More than half of respondents switched super as a result of leaving or changing jobs, while 15 per cent switched over performance issues, 13 per cent over an existing relationship with a fund and 11 per cent over fees.



Richard Gilbert

"The results of our research were both interesting and unexpected and highlight some short, medium and longer term challenges for the industry," according to IFSA chief executive Richard Gilbert.

"For the first time, we have viewed the superannuation decision making process from the customer's perspective and now have a clear picture of where the industry needs to lift its game.

"We look forward to engaging with ASIC [Australian Securities and Investments Commission], the Government and the broader industry to meet these challenges."

The report also contains six recommendations that would "require industry-wide effort to better support super decisions". These include further research, homing in on and testing Product Disclosure Statement composition, categorisation and presentation of information.

"We can't ignore the fact that customers are still calling for shorter documents that are presented well and written in plain English," Gilbert said.

"The research highlighted that for those engaged in making a super decision, customers are making an effort to read the documents regardless of the size and complexity of the information."

3 October 2007

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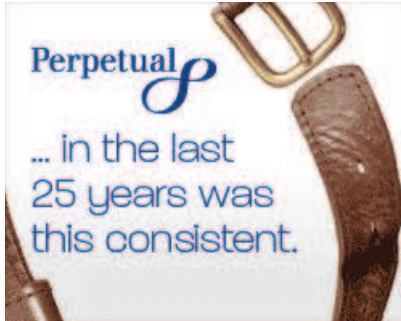
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News

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While most SMSF investors did receive better returns this year than last (average returns were up 40 per cent to 17 per cent), the wealthier among them, including those with higher than average incomes, performed the best. According to Johnston, the above-average returns are a result of both the share-market's record heights during the survey period (May 2006-07) and the fact that they had more cash products and better-diversified investments when the market correction eventuated.

RaboPlus head of financial services Bryan Inch said many SMSF investors are parking cash until they identify new investment opportunities.

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The survey also revealed that SMSF investors contributed larger sums of money than in previous years, with a marked increase in funds with balances of more than \$1 million. As of May, SMSFs had an average balance of \$741,000. Most SMSF investors were aged 50 or over, more than two-thirds were male and one third were business owners or self-employed.

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# InvestorDaily

## Super choice fails to sway savers

### **New light shed on Australia's \$1.1 trillion cash bank**

**Madeleine Collins**

**Wed 03 Oct 2007**

Heavy promotion of super choice is failing to sway Australia's \$1.15 trillion in super, with almost a quarter of people still leaving it to their employer to put their retirement savings into a default fund.

Fresh data from the Investment and Financial Services Association (IFSA) and research house Investment Trends shows 22 per cent of people who switched super funds said it was their employer's choice.

Almost half (47 per cent) of those who switched or thought about it did not shop around and half thought they did not need to do so.

Apathy still plays a role - 60 per cent of people surveyed said they knew they could get a better deal on their super elsewhere but either have no time or did not think it was worth the effort to change.

Advice from a financial planner triggered 15 per cent of switchers.

The main reasons for switchers included performance (15 per cent), an existing relationship with a fund (13 per cent) and fees (11 per cent).

Seven per cent of working Australians switched super providers between October 2005 and October 2006, while 12 per cent considered it.

Changing jobs and terminating a job accounted for more than half of the reasons why someone switched.

"For the first time, we have viewed the superannuation decision making process from the customer's perspective and now have a clear picture of where the industry needs to lift its game," IFSA chief executive Richard Gilbert said.

He said satisfaction levels are high but people want shorter documents.

"We can't ignore the fact that customers are still calling for shorter documents that are presented well and written in plain English," Gilbert said.

"We know that that information on performance, risk, investment options and fees is most important to people - all areas where we're told the documents can be improved."

Data from the Australian Prudential Regulation Authority released last week shows Australia's super assets now stand at \$1.15 trillion, a 25 per cent increase over the year to June 2007.

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## Wealth / Super

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### Creating and running your DIY super

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#### Winding up a DIY super fund: the other side of the boom

By Michael Laurence

The breathtaking popularity of self-managed super — with the number of funds opening each month surging to a long-time high of 3500 after the Federal Government announced vast improvements to the super system — truly overshadows the monthly closure of about 300 DIY funds.

More than 60,000 new DIY funds have been established since June 2004, according to estimates based on the latest-available tax office and Australian Prudential Regulation Authority (APRA) figures, against about 10,000 fund closures over the same period. These closures are the other side of the DIY super boom.

Super consultants say fund members decide to close their DIY funds for a variety of reasons, including poor investment performance or unacceptably high running costs, which is typically a reflection of a low balance. And some members begin to find the administrative and investment duties somewhat onerous given their lifestyles.

But most funds close simply because all of the members have died and the funds no longer serve a purpose. (In many cases, even the death of the founding members won't cause the shutdown of a DIY fund — their children and, later, grandchildren become members.)

Tax office statistics appear to suggest that the Government's remodelling of the super system — including the imminent removal of tax on super retirement benefits — may dramatically slow the monthly closure of DIY funds. (This legislation has just passed through Parliament.)

The majority of members who decide to close their funds usually wait until the last three months of a financial year, yet the closures shortly before the end of 2005-06 were way down on previous years. (The revamping of the super system was announced, of course, in the May 2006 budget.)

On the other hand, this apparent slowdown in the closure of DIY funds may be somewhat countered in the future by the tax office's determination to get much tougher on wayward funds that are failing to meet their obligations under super law. And as this get-tough policy bites harder, some fund members will inevitably decide they want out.

#### Alternative to closure

Members who are thinking of closing their funds because of underperformance or because of the workload should think carefully before giving up these highly effective and flexible means to save for retirement, provide retirement income, and to conduct sophisticated estate-planning strategies.

Alan Dixon, managing director of Dixon Advisory — a Canberra and Sydney financial planning group specialising in self-managed funds — says rather than closure, a solution might be for a fund to gain financial planning and investment advice and to look for ways to ease the administrative burden on members.

Within the confines of a fund's trust deed and superannuation law, Dixon says a member of a fund might be nominated to make all investment decisions, thus reducing the effort required from other members.

Again depending upon the circumstances, arrangements might be made so most members' signatures are only required on a fund's annual returns. (With a DIY fund, each member is either a trustee or a director if there is a corporate trustee.)

Dixon says a few people find that they do not have a suitable temperament to have a DIY super fund and are overwhelmed by the investment and administrative responsibilities. "The stress and pressure could upset their retirements," he says. Such individuals could be better suited by a large, public-offer super fund.



Graeme Colley, superannuation strategy manager for DIY fund administrator Super Concepts, says financial planners and other professionals can advise on whether a fund is viable or whether it should be wound up. "And a good financial planner should be able to recommend whether a client is a suitable person to be running a self-managed fund."

Colley says some members of self-managed funds can simply lose interest in them. Like Alan Dixon, Graeme Colley emphasises that some members of self-managed funds should consider relying more on the skills of professional advisers to complement their own abilities as a possible alternative to closing their funds.

### Six steps to closure

In most cases, professional advisers guide member/trustees through the various steps that should be taken to comply with superannuation and tax laws, and a fund's trust deed, when closing a fund.

The types of assets held by a DIY fund will partly dictate the ease in which it might be closed. Colley points out that a fund could find, for example, that the business premises of the members — a common DIY fund asset — takes some time to sell.

Here is quick guide to closing a DIY fund:

**Step one: Formally decide to close your fund.** The members should record their decision in writing.

**Step two: Select the best time to close your fund.** Typically, funds should not be closed soon after the start of a new financial year because the expense of preparing the final regulatory and tax returns will only cover a short time. And the target closure date should be set well ahead to give members plenty of time to make the necessary arrangements.

**Step three: Calculate the fund's assets and liabilities.** Pay liabilities and expenses such as taxes, administrative costs (including for winding up the fund) and regulatory fees.

**Step four: Distribute the fund's remaining assets to members.** This may involve paying lump sums to some retired members or rolling benefits into another super fund. "It's useful to get these instructions in writing from members just in case there's a misunderstanding in the future," suggests Colley.

He points out that some retired members may want actual assets currently held in the DIY fund — such as real estate or certain shares — transferred into their own names.

**Step five: Lodge final regulatory and tax returns to the date that the fund is being wound up.**

**Step six: Don't ditch fund records.** Superannuation law requires that most records be kept for 10 years.

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## Should you DIY your super?

*By Michael Laurence*

SME owners are responsible for much of the huge amount of money pouring into self-managed super funds. These funds hold almost a quarter of the \$920-billion-plus assets in Australian super funds – with perhaps \$145 billion flowing from successful SMEs.

No surprise why. SME owners, in their roles as trustees/members of DIY funds, can use the funds to develop highly favourable tax, estate planning, and asset protection strategies that are well within the stringent laws of superannuation.

Graeme Colley, technical manager for self-managed fund administrator and consultancy Super Concepts, says business owners established 75–80% of the 3000 funds administered by his group.

Owners of successful SMEs are often in a position to rapidly build up the assets in their funds, a move that is accelerating with the Government's proposals to make super much more tax-effective from July 1.

"Business owners have a personality that likes to be in control," Colley says, "and DIY funds give them control over their super investments."

Mark Johnston, principal of specialist researcher Investment Trends, agrees, and points out that his current annual survey on self-managed funds shows that the biggest reason why business owners establish DIY funds is to gain more control over their super. And the trigger to actually begin a fund is often the decision to go into their own businesses, according to Johnston's research.

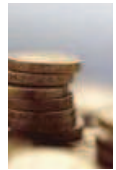
Business real estate such as a strata office or a small factory are among the few assets that funds are allowed to acquire from members.

In turn, a fund can rent the premises to a member's business for a commercial rent. And for these reasons alone, SMEs and DIY funds are often closely linked.

### Advantages of DIY super

#### Estate planning

Remarkable estate planning opportunities for members of DIY funds have emerged with the Federal Government's proposals, as part of its revamping of the super system, to abolish reasonable benefit limits (RBLs) from July 2007. (An RBL is maximum concessional amount that can be received in super upon retirement. Different dollar limits currently apply to lump sums and pensions.)



From July 2007, all superannuation lump-sum death benefits paid to dependants will be tax-free – no matter the amount. But under existing law, death benefits to dependants are only tax-free up to the deceased's unused pension RBL of \$1,356,291 for 2006-07.

Colley says a high earner could arrange for, say, a \$2 million life insurance policy through a self-managed fund. From July 2007, the full amount would be paid tax-free to dependants in the event of death.

DIY funds are appropriate for obtaining such big insurance policies, Colley says, because of their typically flexible insurance options.

Other estate planning opportunities with self-managed funds include the ability – depending upon the circumstances – for some assets to remain in the fund after the death or retirement of some members.

A prized asset such as a valuable share portfolio or business real estate can remain in a fund between generations in the case where different generations of a family are members of the same fund – provided there are sufficient fund balances to pay retirement and death benefits when required.

The *Australian Financial Planning Handbook* (published by Thomson) adds: "DIY funds can have a high degree of flexibility in terms of paying [superannuation death benefits as] lump sums or pensions. Death benefits may also be paid quickly."

#### **Tax planning**

Self-managed funds provide excellent means for managing tax on savings – particularly for business owners. These include:

- The self-employed can contribute listed shares and business property to their self-managed funds – and claim tax deductions for the contributions against other income. (Be aware that the current annual age-based limits on deductible contributions will be replaced under the Government's proposals by annual caps on concessional tax contributions from July this year.)
- Self-managed funds have the flexibility to adopt a policy – if appropriate for their investment strategy – of investing in a high proportion of fully franked shares. This will provide valuable tax refunds for excess franking credits. (Earnings of a super fund are taxed at 15% in the accumulation phase and zero when backing a pension.)
- Self-managed funds, again if appropriate for their investment strategies, can adopt a buy-and-hold approach for their investments that may minimise CGT while a member is still saving. Once investments of a fund are backing a super pension, CGT no longer applies.

David Shirlow, a division director of Macquarie Bank, says many public super funds, however, apply a nominal CGT when switching from saving phase to pension phase – even within the same fund. This is not the case with DIY funds. Shirlow says a decision by self-managed fund trustees to adopt a buy-and-hold strategy should not be driven by tax.

- Under the proposed new super system, super benefits will become tax-free for retirees over 60 from July this year.

#### **Asset protection**

Stephen Mulette, a partner of solicitors The Argyle Partnership, names superannuation as an "absolutely smart way to gain asset protection". Under current law, trustees in bankruptcy do not have immediate access to super savings up to the pension RBL of more than \$1.3 million for 2006-07. And in a significant development, the Superannuation Legislation Amendment Simplification Bill, introduced into Parliament early in February, provides for the complete removal of the RBL cap from the Bankruptcy Act from July 1, making super much more attractive for asset protection purposes. From that date, unlimited amounts of super are protected from being immediately divided among creditors of a bankrupt member.)

By contrast, the savings of bankrupts in, say, bank accounts are simply included in his or her bankrupt estate for division among creditors.

However, Mulette says trustees in bankruptcy can seek to recover money or assets contributed to super with the intention of defeating creditors. And he says other long-proposed amendments to the Bankruptcy Act intend to make this point clearer.

Mulette suggests that fund members should regularly contribute to super as part of an asset-protection strategy. A trustee in bankruptcy would have difficulty in establishing an intention to defeat creditors if a regular savings pattern through super had long existed.

#### **Disadvantages of DIY super**

##### **Low balances**

Although views differ widely, a minimum balance of, say, \$150,000 to \$200,000 is widely considered necessary in order to be cost-effective compared with large public funds – but some advisers recommend much more. So much will depend on the actual investments selected by a fund.

If a fund's balance is likely to remain low for a long time, an SME owner should carefully consider the alternative of a large public super fund with, if required, many investment options.

Low balances can also mean that a fund cannot afford adequate diversification in the investment markets as a means to increase possible returns while lowering risk.

##### **Tougher regulator**

A cashed-up tax office, in its role as DIY fund regulator, is adopting an increasing tougher stance against funds that breach superannuation laws. This is one of the tax office's core compliance thrusts.

##### **Stringent limits**

DIY funds are subject to stringent legal bans on borrowing (except in limited circumstances), making loans to members and their relatives, and buying most types of investments from members (with the main exceptions of listed securities and business real estate). Investments and leases involving related parties generally must not exceed 5% of a fund's assets. (Again, one of the exceptions is business real estate.)

#### Time-consuming

DIY funds can be extremely time-consuming in regard to tax and compliance obligations, and with looking after the investment portfolios. Would-be member/trustees of self-managed funds should satisfy themselves that they won't panic whenever the sharemarket takes a dip. Professional help is, of course, available for dealing with the administrative/compliance requirements and with the investments.

#### Untouchable

Savings in super funds cannot be accessed before retirement – apart from in cases of severe financial hardship or some limited compassionate grounds. This generally means that younger people, in particular, will want some alternative savings.

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## Super-boosting strategies for small business

By Michael Laurence

**A comprehensive new study confirms a long-held suspicion: the self-employed are dominant among the ranks of Australians with little or no super.**

There is a shortfall in the superannuation balances held by businesses at the very small end of the spectrum. The main reason is fundamental. Operators of unincorporated small businesses do not have employers who are compelled to make super contributions on their behalf.

Ross Clare – the author of the report and research director of the Association of Superannuation Funds of Australia (ASFA) – believes the super savings of the self-employed can much depend on age.

"Many younger among the self-employed, those in their 20s and 30s, have next to nothing in super, and their businesses are worth a modest amount," says Clare. Some older self-employed business owners have, of course, not only large super balances but highly valuable businesses with valuable goodwill.

But, overall, Clare says, "the balance of the self-employed would struggle even to support a modest standard of living in retirement. Often owners of personal-service businesses in particular would be misleading themselves about the value of their businesses [if put on the market to help finance their retirement]." Clare is working on a second report that looks specifically at the super of the self-employed.

It is clear that many of the self-employed are missing out on some great super opportunities. Here are just three strategies for small-business owners with growing businesses to get money into super.

#### Unincorporated small business

**Opportunity:** From the beginning of the new financial year, super contributions by the self-employed are fully-deductible for the first time. This should encourage many more of the self-employed to make pre-tax contributions. The contributions are subject only to the 15% contributions tax upon entering the fund.

"This is the most significant change in the simpler super system for the self-employed," says Sydney consulting tax adviser Leo Hollestelle. "It puts them on an equal footing with employees making salary-sacrificed contributions."

**Fine-print:** Previously, the self-employed were treated unfairly by being only allowed tax deductions for the first \$5000 of contributions plus 75% of the remainder.

**Warning points:** Under the simpler super system, the limit on tax-effective deductible contributions – now called concessional contributions – is an indexed \$50,000 a year if aged under 50, or \$100,000 a year until 2011-12 if over 50. If you overshoot these caps with pre-tax contributions, the excess is taxed at 46.5% – a real sting.

Younger business owners should be aware that super is locked away until their retirement – after reaching 60 (if you are aged under 44).

#### Lower-income business owners

**Opportunity:** From the beginning of the new financial year, the self-employed became eligible for the first time to Government co-contributions. Again, it is extraordinary that the self-employed were locked out of this great benefit for lower earners.

"There is no better way to give your super a kick-start," says Hollestelle. The Government contribution is made automatically – provided you are eligible and make an after-tax contribution.

**Fine-print:** Under the co-contribution scheme, the Government will contribute \$1.50 (to a maximum of \$1500 a year) for every after-tax \$1 you contribute to super. Couples working together in a small business could, of course, each be entitled to co-contributions.

**Warning points:** The Government's maximum co-contribution of \$1500 applies if your assessable income is less than \$28,980. And the Government's co-contribution progressively reduces, phasing out completely when your assessable income reaches \$58,980.



### Spouse working part-time in family business

**Opportunity:** Maximise salary-sacrificed super contributions for a spouse who works only part-time in your family business. (This strategy is for incorporated businesses, which are not classified in the ranks of the self-employed.)

Sydney tax and super lawyer Robert Richards says this strategy is designed for businesses in which the spouses of the owners work part-time for perhaps a few days a week. The strategy is intended for businesses that are making good money and are looking for ways to legally and simply minimise tax payable by the company, and eventually the owners.

Richards says tax law allows the value of salary-sacrificed contributions paid for part-time employees – even if related to the majority shareholder – to greatly exceed the commercial value of their part-time work.

“Any money salary-sacrificed into super is taxed at just 15% on entering the funds instead of being eventually caught by personal tax rates of perhaps double (that) or more,” he says. The businesses are entitled to a tax deduction for the contributions.

**Fine-print:** Richards says this strategy works best for couples who work together in a family business, with each maximising their contributions.

**Warning points:** Only incorporated businesses can make salary-sacrificed contributions for employees. Contributions should be within the annual concessional caps of an indexed \$50,000 if under 50 or \$100,000 if over 50.

Many small businesses whose income relies on the personal services of a single person are caught by the alienation-of-personal-income rules, with severe restrictions placed on their tax deductions including on salary-sacrificing contributions for spouses.

Richards says the strategy of making large salary-sacrificed contributions on behalf a spouse working part-time is generally only effective for trading companies where the alienation-of-personal business rules do not apply.

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The funds will become more opportunistic in their investment practices, building up stores in cash management trusts to take advantage of investment opportunities.

Yet despite the expected swing to geared investments in accordance with changes to super law last week, self-managed funds will take a more cautious approach to the sharemarket, shying away from more speculative stocks to concentrate on blue-chips.

The staggering flow of contributions into self-managed funds will continue at a remarkable rate in 2007-08, yet at a somewhat slower pace than last financial year when self-managed fund assets leapt by 30%, to \$288 billion, in the lead-up to the new super regime, according to the Australian Prudential Regulation Authority (APRA).

These forecasts for super funds over the next 12 months and beyond are based on interviewing professional advisers to self-managed super and, in part, on a new survey by specialist researcher Investment Trends of more than 2100 self-managed funds.

Here are five pointers to what's coming up for self-managed funds:

#### GEARED INVESTMENTS

**Expectations:** Many more self-managed funds will be borrowing to invest under stringent new provisions.

**Why:** Amendments to super law unambiguously allow self-managed funds to borrow to invest. The amendments permit funds to override the long-standing provision in super law barring the borrowing to buy investments.

Until now, many fund trustees were uncertain about how the borrowing ban operated in practice because of various investment and financial products, including instalment warrants, being marketed.

Under the new law, a lender cannot make a claim against any of a fund's assets in the event of default – other than against the geared asset – and the geared asset must be held in trust until the fund makes its final payment.

#### BUSINESS PREMISES

**Expectations:** SME owners will increasingly arrange for their self-managed funds to own the premises of their businesses. As required under super law, the businesses will pay a commercial rent to their funds for use of the premises – and that rent will be concessional tax within the funds.

**Why:** The recent amendments to super law that clearly allow funds to borrow to invest should boost this trend. Further, changes to the Bankruptcy Act from July mean that no assets in super – these might include business premises – are accessible to trustees in bankruptcy provided contributions were not made to defraud existing or future creditors.

#### RESIDENTIAL PROPERTY

**Expectations:** Investment Trends' latest survey of self-managed funds found a strong interest in residential property investments – higher than in past



surveys.

**Why:** This seems to reflect expectations that markets in the eastern states are in recovery. The borrowing-to-invest amendments in super law will also encourage more funds to invest in residential property.

#### LISTED INVESTMENT COMPANIES

**Expectations:** Self-managed funds will increasingly use investments in listed investment companies as a foundation for their portfolios.

These companies, such as Argo and Australian Foundation, hold massive, widely diversified equity portfolios. Argo, for example, owns shares in about 180 listed companies.

**Why:** Investment Trends' survey found that self-managed funds have a fast-growing interest in listed investment companies. And self-managed fund administrator and adviser Dixon Advisory also reports that more of its clients are turning to these investments.

Mark Johnston, a director of Investment Trends, says self-managed funds have had considerable success with listed property trusts and this has given them more confidence to move into listed investment companies.

Investment Trends reports that funds surveyed had markedly increased their exposure to listed investment companies over the past 18 months – albeit from a low base. About 13% of funds surveyed had shares in listed investment companies – more than double the percentage shown in the previous survey.

Investment Trends found that more self-managed funds had early this year begun to reduce their holdings in smaller, more speculative stocks to shift more into blue-chips. And this support of blue-chip stocks will grow, according to the survey.

#### READY CASH

**Expectations:** Self-managed funds will continue to reduce their debenture holdings in favour of cash. Investment Trends also found that this switch was under way before the recent sharemarket correction.

**Why:** Self-managed funds have a growing policy of building up their cash to grab investment opportunities that may arise – such as in the recent sharemarket correction.

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### Rescue package for ailing DIY funds

By Michael Laurence

Is your DIY super fund in good health? Could it be time to pull the plug? SmartCompany unearths four key steps to diagnosis.

Just 386 self-managed super funds were wound up in 2006-07 – against almost 42,000 that were setup, according to the latest statistics from the tax office. The low closure rate could be a signal that something is not right with thousands of Australia's DIY funds.

Most closures would be attributable to either the deaths of members or members becoming too elderly to look after their own super. In other words, there would have been no option but to close them down.

The closure numbers suggest that many members could be holding on to their DIY funds despite such factors as poor returns, excessive operating costs due to low balances, member disinterest or inertia, and lifestyle changes that leave insufficient time to properly look after a fund.

Smart fund members should treat the miniscule closure rate as a wakeup call to either ensure that their funds are competitive or to get out of DIY super – and to roll their retirement savings into large funds.

Here are four key steps to checking on the health of your DIY fund, understanding how to get an ailing fund back into shape, and knowing when (and how) to call it quits.



## 1. Check your fund's performance

This is really the starting point. Members should ask themselves "Is my fund at least matching the performance of the big super funds?"

Have a look at the website of fund rating agency [SuperRatings](#) for the latest returns of the big funds' balanced, diversified portfolios. (SuperRatings classifies balanced portfolios as those with 60% to 76% of their investments in growth assets of mainly shares and property.)

The median returns for the balanced portfolios surveyed by SuperRatings were 14.2% over the 12 months to 31 August, 11.62% annualised over five years and 9.7% annualised over 10 years. And the top quartile balanced funds recorded a breathtaking median return of 16% in the 12 months to August 31. (The returns are after investment management fees and taxes).

Of course, the asset allocation of your DIY fund – meaning its investment mix between mainly shares, property, bonds and cash – could be very different to the balanced portfolios of the big funds. You are most unlikely to be comparing apples with apples.

Research by the tax office and specialist researcher Investment Trends shows that DIY funds generally hold more cash and direct property in their portfolios than the balanced portfolios of their large counterparts. This means the returns and the levels of risk could significantly differ.

Nevertheless, a comparison with the big funds may indicate whether you are forfeiting returns by running a DIY fund.

Another useful exercise is to examine how the components of your fund's particular investment mix – in particular its shares, property, bonds and cash – have performed against the relevant market indices such as the S&P/ASX200 Accumulation Index (comprising changes in share prices and dividend payments).

## 2. Understand the reasons for poor performance – and do something about it

Various studies show that one of biggest causes for lousy performance is that a fund's investment mix is poor. Funds that are investing for the long term should have sufficient growth assets to, at the very least, counter inflation and running costs. Indeed, most funds should expect a decent margin on top.

The Australian Securities & Investments Commission's [basic tips on DIY funds](#) are worth a look.

Once fund members are confident that their funds' asset allocation or investment mix is correct and suitably diversified for their personal circumstances – including their tolerance to risk, time until retirement, investment goals and retirement needs – members can then question whether their actual investment selection is appropriate.

Investment advisers typically warn their clients about investing too much of their portfolios in a single investment and failing to diversify between investment managers with different investment styles.

More DIY funds are turning to listed investment companies, albeit still in small numbers, to provide low-cost foundations for their share portfolios. (See [Wealth/Super October 2, 2007](#).) Listed investment companies have holdings in a large number of public companies.

Wholesale managed share trusts with a range of investment styles are also used as at least foundations for many DIY funds' share portfolios.

## 3. Get professional help

A quality investment adviser with considerable experience with DIY funds is well-placed to advise you about how to rescue an ailing DIY fund – by mainly changing its asset mix and investment selection.

The Self-Managed Super Fund Professionals' Association of Australia has a valuable service that enables the public to [search online for specialist DIY fund advisers](#).

## 4. Know when to quit

If you can't get your fund back into shape or have simply lost interest, think seriously about closing it and rolling your super savings into a big fund. Closing a fund is not complicated. (See the tax office's [brief summary of what should be done](#).)

The closure of a DIY fund involves calculating the fund's assets and liabilities such as taxes, administrative costs and regulatory costs; distributing remaining assets to members (this may involve rolling the assets into other super funds or making payouts to retired members if requested); and lodging final regulatory and tax returns to the date that the fund is being wound up. (See [Wealth/Super, March 6, 2007](#) for more details about closing a DIY fund.)

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**Money:** Investing

Article from:  **THE AUSTRALIAN**

## Tools to build wealth

By **John Synott** November 13, 2007 10:00pm



- Internet has opened up options for DIY investors
- New execution tools and products on the market
- Different levels of independence and help available

DO-IT-YOURSELF investors have never had it so good as the internet keeps throwing up new sources of information and execution tools plus a plethora of new investment products.

Despite the Big Four banks' financial service arms swallowing smaller competitors, there are still plenty of new opportunities for self-directed investors to have a go.

### **Online stockbroking**

CFD (contracts for difference) trading - based on share price movements, rather than shares - is the latest front in warring between online brokers.

The Australian share market has started trading CFDs, amalgamating multiple mini-markets run by CFD providers.

Eyes are on liquidity and price spread, which are important to the success of the new market. There are two online brokers, Commsec and Morrison Securities, among the eight foundation brokers.

Commsec is offering free brokerage for the first couple of months to help the market along. E\*Trade is waiting and watching, while still offering CFDs based on the price of the underlying shares.

"CFDs have been around for a while now but are not yet a mainstream product from a DIY perspective, more a trading tool," said Commsec private client services executive general manager Edward Tate.

Westpac Broking is planning to launch CFD trading next month as well as enhance its professional trading tools. It has recently introduced stock exchange-traded options, which allow investors to protect and earn income from their share portfolios.

"This is the next level of DIY investing," says broking head Russell Karlson.

Netwealth, which is typical of the one-stop-shops growing online for the DIY investor, is still claiming to be the cheapest online broker (\$17.99 for trades to \$5000). It is pipped by OneTrade stockbroking (at \$17.95) according to infochoice.com.au.

## **Separately managed accounts**

Self-directed investors who want to retire to the Greek islands, or at least go for a three to six-month holiday, can park their shares with Direct Portfolio Services for care and maintenance as a separately managed account (SMA).

"This includes compliance action, reinvesting dividends or paying income streams to anywhere abroad," according to chief investment officer John Aldersley.

SMAs are also promoted by BlackRock (Merrill Lynch) through model portfolios similar to managed funds.

The key difference is that the investor owns the individual shares, which are managed for them by professionals. Individuals earn tax benefits such as franking credits individually - but without paying the capital gains tax that would be incurred by being pooled with other members in a managed fund.

Shaw Stockbroking says DIY investors who want to select stocks but not monitor them day to day can set up an SMA portfolio of shares with a broker, just as they would buy \$100,000 in managed funds with a financial planner.

Shaws, which has a strong reputation for resources stocks and is matching the index with its own "model" portfolios of stocks, says SMAs are commoditising a role stockbrokers traditionally played.

[Investment](#) tip sheet Fat Prophets, popular with self-directed investors, has launched two SMAs: an Australian share model portfolio and a mining and resources model portfolio, with which investors can customise their own holdings.

"It has our picks, big and small and it's a wonderful way for small investors to get a diversified resources portfolio," says CEO Angus Geddes.

## **DIY super**

Although self-directed investors like to stay in charge, financial advisers and planners are a useful tool for DIY investors to seek advice on how best to deal with all the [superannuation](#) changes.

"More self-managed super funds were using financial planners in the first half of this year because of the super changes," says Mark Johnston, director of survey company Investment Trends.

The number of DIY investors consulting advisers jumped from 33 per cent to 54 per cent in a recent survey.

Melbourne financial adviser Jamie Nemstas of Investstone Wealth Management says a lot of the recent self-managed super fund boom was not driven by investors trying to take DIY control, but accountants chasing higher fees. Some \$2000 for administration of an SMSF beats an \$80 tax return.

"But accountants do not have the capacity to invest the money, which can sit in cash," he says.

"Investors need professional advice when markets are going up and down, a proper structure and asset allocation. There's also a lot of issues around compliance for self-managed super funds. We sometimes use them but prefer wrap accounts which do not have the same compliance issues and administration."

## **Managed fund discounters**

DIY investors can get rebates on their fees on managed funds, wrap accounts, master trusts and even on trailing commissions (above \$396 per annum per family) with InvestSMART's TrailCap. It's a free tool to sign on to and nominate them as your fund broker for investments, super and pensions.

"We do not make a fuss about it because it gets up the noses of advisers but the highest refund cheque so far is \$16,000," says general manager Ron Hodge.

He argues that wrap and other administration platforms open to DIY investors who can access wholesale-priced managed funds are flavour of the month. However, investors are cautioned that by the time you add up the administration fees there can sometimes not be a lot of difference to retail managed-fund fees.

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## Investors play the risk game

November 15, 2007

Contracts for difference (CFDs) have attracted a lot of attention as tools for investors seeking alternative ways to exploit opportunities in investment markets.

The contracts allow investors to profit from movements in share prices, market indexes and other securities, without having to physically purchase those securities while outlaying only a small fraction of what it would cost to buy them.

They employ debt (that is, borrowed money, in a process known as "gearing" or "leverage") to magnify the effect of a change in the price of the underlying security.

The contracts can be used to make money from both rising prices and falling prices.

It's these two features - leverage and the ability to make money from rising or falling prices - that give the contracts their peculiar characteristics and their risk profile.

Mark Johnston, the principal of research group Investment Trends, estimates there are only 42,000 individuals actively trading contracts. In its most recent survey in April the *CFD Report* said there were 31,000 people actively trading in contracts for difference - double the number of a year earlier.

Market volatility in July and August put a dent in the rate of traders signing up but product providers said traders generally weathered the storm by carefully managing their market exposures.

Johnston says the typical contracts trader is male (85 per cent of respondents to the survey were male), aged over 40, on a higher-than-average income and already quite experienced in share trading. "CFD traders see themselves as fairly well-educated and sophisticated investors," he says.

"It's a very particular group of people - it's the frequent [share] trader market, but a more highly educated subset of the frequent trader market. There's a range of people in there but the one unifying theme is that 82 per cent of them use technical analysis.

"So this in the main tends to be about short-term trading. Most positions tend to be open for between two days and a week."

Johnston says most survey respondents trade the contracts over Australian shares, principally blue-chip shares.

A smaller number trade them over market indexes and a much smaller - but growing - number trade contracts over foreign exchange and other markets. The two biggest attractions of the contracts for difference are that they enable investors to use both leverage and short-selling strategies, which means an investor can profit from a fall in the price of a security or an index.

"The ability to sell short is a really important [attraction] and goes to current market volatility," Johnston says. "As the market becomes more volatile and we start to see markets pulling back, we expect to see some CFD traders pull back their trading, but to see others trade more frequently."

He says another feature of the contract market at the moment is "churning", or the movement of individuals between providers. This is typical of any newly developing market, he says, and is reminiscent of what the online stockbroking market looked like when it was at a similar stage of development.

"Churn tends to happen in all emergent markets, until all providers reach a certain degree of functionality," Johnston says.

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He says that not all providers of the contracts are equally good and that there's still a process of trial and error being played out as investors hunt around for the best companies.

Two firms dominate the market. CMC Markets has a market share of about 50 per cent, followed by IG Markets with about 20 per cent (CMC and IG both lay claim to being the first CFD provider in Australia).

Then there's a group of players - including MFA Derivatives, Ever the remainder.

Johnston says many users of the contracts see them as an alternative to a margin loan. A margin loan is a type of loan used to purchase investment assets. To that extent contracts for difference and margin loans share some characteristics: leverage, interest repayments and potentially higher risks. But if margin loans are generally promoted as a tool for creating medium- to long-term wealth, contracts for difference are much more often used as a short-term trading tool.

"We've begun to see a collision between the CFD landscape and the margin lending world," Johnston says.

Financial services groups are beginning to release products that meld the characteristics of the contracts, margin loans and online share broking services.

Tamas Szabo, chief operating officer for IG Markets, says the type of individual trading of the contracts has changed as the market has matured. Szabo says the early adopters were individuals already familiar with share trading and derivatives. "We've seen clients who are a little less sophisticated than the initial type," he says.

"When you launch a new product it's the people in the know who start to get attracted to it. Now we have a much broader client base.

"Initially it was quite a slow take-up. The type of client we had first was the client looking at more of a punt on the market.

"Over time, it's got a lot more coverage, a lot more players have come into the market and all the advertising and promotion that has occurred has helped raise awareness of CFDs.

"The ASX launching them has given the product more credibility and put a stamp on the product, saying that this is considered a legitimate product."

David Trew, managing director of CMC Markets, says that while there are a fair number of providers of contracts for difference in Australia, not all are created equal and the market is effectively a duopoly.

"There's approximately 20 different brands competing in the CFD space now," he says. "Most people say there's so much more competition now and they are right in one way, that yes, you have the choice of many different CFD providers, but there's only two, or perhaps three, of any substance.

"The rest are either very small operations or add-ons to existing operations."

Even so, Trew says, the sophistication of traders has begun to improve.

"From the very beginning you would have the frequent traders sign up and open accounts," he says. "Now you have people who have more of an interest in the stockmarket but it's not their whole life, if you see what I mean. They are still self-directed investors and they have an active and growing interest in the market, but they trade less often.

"It's these clients who value education more. And they are less cost-conscious, because they do not trade as often. They're more interested in: 'What can this company teach me?', and 'Can I use CFDs to limit my risks for whatever other share positions I already have?' And they are interested in international markets."

*This story was found at: <http://www.smh.com.au/articles/2007/11/14/1194766768941.html>*