Profile's Corner

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"*Tree of Life*" by Debbie Fowler

(Aerial shot over the Cambridge Gulf near Wyndham, WA)

PROFILE UPDATE

Welcome to Volume 18 of our quarterly client newsletter. In this section I provide an update on what's happening at Profile.

By Sarah Abood, CEO

I am very happy to announce that our Direct Shares Service is now available to clients. This project has taken longer than anticipated to complete, largely because we found it more difficult than expected to source the right structures and providers at competitive prices.

Back at the start of this project, we held client focus groups to clarify what was most important to offer. The subsequent brief was clear. Our clients wanted:

- Pro-active, timely, succinct and high quality advice on their direct share holdings
- The ability to say 'no' to suggested trades
- Minimum paperwork and hassle
- Easy access online to reports and summaries
- Timely and efficient tax reporting
- An aligned fee structure offering good value for money

After reviewing the market, we have now finalised our direct shares solution that offers a full service and a low level of hassle, while still putting our clients in the driver's seat. If you would like to find out more about Profile's new Direct Shares service, please contact your Profile financial planner.

We have just held our annual general education seminar for clients; this year on the topic of "Philanthropy" - a theme that is clearly of very great interest to many of our clients. Later in this newsletter we are pleased to include an article from our guest speaker, Louise Walsh (CEO of Philanthropy Australia), which covers some of the material she spoke on at the session. In case you missed the session and would like more information, please contact your planner who can provide more detailed information on charitable giving.

Regular readers will be aware we have been planning a relocation of our current Parramatta office from 63 Sorrell St. to a location closer to the Parramatta CBD. The right location has been hard to find - we were gazumped twice by existing tenants taking whole floors! But I am very happy to announce that at time of press we have just received the lease documents for our new premises - we will be moving to 100 George Street Parramatta, sometime in the early part of 2015. This is a modern office building with excellent communications infrastructure, that's walking distance from the train, bus and ferry stations, and close to shopping and amenities. Free parking will be available onsite for our clients coming in for appointments. We will keep you posted on timings, and until our relocation we will be operating as normal from Creagh Cottage at 63 Sorrell St in Parramatta. Our Sydney city office will keep operating as normal.

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**Asset class returns referred to in this publication are based on the following indices: Australian shares: S&P/ASX 300 Accumulation Index. International shares: MSCI World (AUD) TR Index. Fixed interest: UBS Warburg Composite All Maturities Index. Cash: UBS Warburg bank bill Index. Gold: Spot Gold Bullion (USD).*

INVESTMENT UPDATE – BETTER SIX MONTHS EARLY THAN SIX MINUTES LATE!

By Jai Parrab, Portfolio Manager

Period returns to 31 October 2014 (%)

ASSET CLASS*	1 MTH	3 MTHS	1 YR
Australian shares	4.2	-0.7	6.0
International shares ($A)	-0.2	5.8	18.2
Fixed interest	0.9	1.6	7.1
Cash	0.2	0.7	2.7
Gold ($US)	-2.9	-8.5	-11.3

Blink once. Markets are down 10%. Blink again. They're making new highs. Sound improbable? This is precisely what has happened over September and October 2014.

From their peak in early September, through to their calendar year low in mid-October, global stock markets fell 9.1% in US dollar terms - including a 4.8% fall in just five days. By the end of October they had recovered their intra-month losses, and in the US specifically, were making new record highs.

If you're confused, you're not alone. For the majority of retail and professional investors alike, October 2014 was a very perplexing month.

We are investors with a focus on preserving capital ahead of chasing risk. That means that we would prefer to be six months too early instead of six minutes too late. October initially looked like the party had finally come to an end, much as we had expected, but the bifurcation between economics and markets continued.

How long can it last?

Economies are said to have one full cycle every seven years. Stock markets, to a certain amount in sync with economies, tend to correct, or mean-revert, every five to seven years.

The last two major corrections found their beginnings in 2000 (tech bubble) and 2007 (sub-prime). Both instances were preceded by periods of excess and irrational exuberance. In other words, too much credit chasing expensive assets on both Main Street and Wall Street.

So is today any different? You don't have to look too far to see signs of credit-fuelled high prices emerging. The London and Sydney housing markets, select stock markets, even institutional-grade infrastructure, are running on prices difficult to justify from any historical or other perspective. But we cannot be the ostrich with the proverbial head in the sand – these prices are here and are being paid by rational, intelligent people right now – so we should consider what is really occurring.

The bulls say the global economy is on the mend and conditions are improving. The financial rationale, or more plausible explanation in my view, is that interest rates are at record lows, which has tilted the board in favour of borrowers and risk-takers over savers.

Fair enough. But this cannot go on indefinitely. And market participants, from leveraged hedge funds to pension funds and insurance companies, are looking for the signposts that will tell them the party is about to end.

Since much of the credit that finds its way into the economy and financial markets is priced based on central bank interest rates, this has been a key signal for investors to date. A plausible strategy for many players has been to wait for central banks to start raising interest rates, thereby tightening credit conditions, give it six to nine months, then start selling.

But what happens when they all start doing it at the same time? The obvious solution to beat the market is to start selling ten months ahead instead of six. Then eleven months ahead. And so on. The result can be both (a) highly irrational, and (b) extremely limiting for your returns.

In our strategy there is primarily one signpost we like to use. We don't look at prices, as they can be the victim of irrational exuberance, but rather we look at *value*.

Value is a great signpost because in its analysis you can allow for many other factors. They might include earnings for equity, defaults for corporate debt markets, and inflation-adjusted yields for government bonds. The less value you are getting, the lower your margin of safety. Margin of safety is important because there are some things we just don't know.

Right now, there are several things we don't know. We don't know when geopolitical disruptions will ease in the Middle East, Eastern Europe, the South and East China Seas, and more recently, in Hong Kong city.

We also don't know when the next earthquake will strike a major capital, or how far the Ebola outbreak will reach. We don't know if current central bank policy will lead to an inflationary catastrophe, whether China can effectively manage its transition from investment to consumption-led growth, or whether Europe will be forced to send their southern counterparts packing. And these are just the things we **know** we don't know! There are even more that we don't know that we don't know (to paraphrase Rumsfeld).

When stock and bond markets offer investors compelling value, we are usually being compensated to take on these unknown outcomes. In other words, the risk premium on offer has already moved ahead to factor in these risks. Today however, those risk premiums are barely there, and yet the risks clearly are.

It is our view then, that recent market action is not a reason to get excited about buying yet. And in fact, even though central banks have yet to start raising interest

rates, the mere chatter and rhetoric that has surfaced so far may have already started the unwinding process that everyone is trying to second-guess.

While risk premiums have increased modestly over the past few weeks, and in specific cases have increased significantly, we still believe they are not priced to a point where investors are being adequately compensated to take on these unknown risks. In addition, we believe some sectors like high-yield bonds are at an even greater risk due to technical factors in those specific markets.

The portfolios are positioned to cushion more downside should it manifest, but at the same time participate in any short-term rebound or upside from these technically oversold levels.

We remain invested, but with higher levels of cash. On a longer-term view we are starting to see value emerging in the Energy and Mining sectors, and regionally in Japan, while China also remains a key position due to its attractive pricing.

We can't say for sure whether this pullback will be quickly recovered, but by our analysis, we believe the attractive value we always look for has not yet appeared across the broader market. It just may take a central bank rate hike or two to get us there.

PHILANTHROPY

By Louise Walsh, CEO, Philanthropy Australia

2014 was a bumper year for large-scale gifts in Australia! From the Packer Family Foundation/Crown Resorts Foundation's establishment of a $200m philanthropic fund, to Paul Ramsay, who made Australia's largest-ever charitable bequest of a reported $3 billion on his death in May, it seems wealthy Australians have well and truly got the message about the importance of giving, and I think this trend will continue.

Of course wealthy Australians have donated large amounts before, however before 2012 it has been rare for these to be announced publicly. I think the trend to announce is a positive one – this is not just about PR for the family involved, it also creates awareness for the cause supported and, I hope, offers a model for others to follow. In a recent example, a few months after the Tuckwells gave $50m for a scholarship program at the ANU, Andrew and Nicola Forrest were inspired to create a similar gift, a donation of $65m for scholarships across universities in Western Australia and establishing a residential college. If such announcements create and support a culture of giving, that has to be a positive step for our country.

However there is still room for us to improve! Australian Taxation Office figures from 2011/12 show that 38 per cent of taxpayers with a taxable income above $1 million didn't claim a single tax deductible donation. It could be, of course, that more are donating but not claiming a deduction – although I doubt that this is the prime explanation!

Only 36% of Australians claimed a deduction for donations in that year. The average amount was just under $500.

Giving makes a real difference. Australians can, and should, do more.

Choosing a cause

The best place to start is with what matters to you. Is there a change you would like to see in the world? Health, education, culture, religion, the environment, animals – the list of causes is almost endless.

The process of discussing and researching worthy causes can be a great way of bringing the family together, with parents and children engaging with each other about how their family's wealth could make an impact in the community.

Once you have chosen a cause or number of causes, the next step is to identify not-for-profits which are doing good work in this area. You may already be aware of some, or you may need to do some searching and asking around. The Australian Charities and Not-for-profits Commission (ACNC) website lets you search online for registered charities.

One thing I would counsel you **not** to do is to set up your own charity. There are already over 60,000 registered charities in Australia and the chances are good that no matter what your cause, there is an organisation already working in the area. Even if you have quite large amounts to donate, you will generally find that it is more effective to work with an organisation that already has staff, procedures and programs in place.

How is your money spent?

I believe it is very important to understand how your money will be used. Giving is not about the dollars, it's about the impact of the dollars. Don't make the mistake of relying on a single factor like administration or overhead costs – these may be relevant to working out how much it costs the charity to do its work, but they're not a good indicator of its impact.

Other relevant information is the funding of individual programs. For example, if you are giving for disaster relief, you need to ensure your money is specifically going to that issue, rather than to the general programs of the organisation.

There can also be different funding models for individual initiatives the charity undertakes. For example, some charities might have a large corporate sponsor or their own commercial activities underwriting their administrative costs, so that donations from the public go directly to programs.

Unfortunately this information is not always easy to find. A good place to start is with the charity's annual report and financial statements. This document will disclose key financial information and give you an overall picture of

what the organisation does and how it does it. However these documents can sometimes not be that user-friendly and the information disclosed can vary a lot. Check out the websites of charities, make use of the ACNC Register, but also speak to people!

Donation structures and options

Many of us who do donate do so in an ad-hoc and relatively unplanned way. I want to put the case for giving in a structured and consistent way – with larger amounts going to fewer charities. The charity can undertake more major and impactful work, and the donor has the satisfaction of knowing that they have made a real and lasting difference in an area they really care about.

Some ways to get more 'bang' for your charity buck include:

Regular giving – this can be as simple as setting up a direct debit with the charity or charities you are supporting – the basis of the many 'child sponsorship' models in the industry. Workplace giving is another great, and simple way, to make donations from your pre-tax income.

Giving circles – these are groups of friends, family members, or simply people with philanthropic interests in common. Each member gives a nominated amount, which across the whole group can have a high level of involvement in how the money is used.

An example is the Melbourne giving circle Impact100, where 100 donations of $1,000 each are pooled to make a gift of $100,000 – a significant amount which is donated to a cause voted on by each donor.

Private Ancillary Funds (PAFs) – these typically need $400-500,000 of start-up capital to be viable. Very similar in concept to SMSFs, these structures allow you to make one, or several tax-deductible donations to set them up. They must be registered with the ACNC and endorsed by the ATO, with a requirement to give at least 5% of their funds away each year to charities with Deductible Gift Recipient (DGR) status. There are now over 1,200 PAFs in Australia with total funds of around $4 billion. They have distributed over $1.5 billion to a broad variety of important causes since 2001.

Named Sub-fund – If you're not in a position to set up a PAF, why not think about a 'named sub-fund' – these can be set up with organisations such as Community Foundations, with an initial balance as low as $20,000. You choose a name for your sub-fund, and recommend where its annual distributions are directed.

This is just a taste of some of the many options available for structured giving.

Philanthropy is one of those areas that truly has the power to change our world for the better, and the rewards of effective giving can be great for individuals, families and businesses. I encourage you to discuss with your financial planner where philanthropy could fit into your financial plans.

TAX AND MANAGED FUNDS

By Sarah Abood, CEO

Tax! Everyone's favourite topic…

In all seriousness, tax might not be something you'd choose to devote much precious leisure time to reading about. However it can definitely pay to have an understanding of the basics. And I admit that ways to possibly pay less tax are always interesting to me – and I hope to you too!

In this article, I'm going to look specifically at how managed funds are taxed. Many of our clients invest in these products, as indeed do I, and there are definitely some tax-related tips and traps that it helps to be aware of when using them.

Managed funds – the basics

Managed funds are 'pooled' investments, meaning that rather than each investor owning the investments individually, each investor owns a number of units in an overall trust (or "fund", which I'll call them in this article). The fund is the entity which owns the underlying investments.

The fund itself does not pay any tax. Instead, it must distribute its income and any realised net capital gains every year to its unitholders, who then pay tax on that income based on their own tax rate.

Tax issues when buying units

Funds are required by law to treat all unitholders fairly. So when you buy units, the price you pay must be a true reflection of the current value of the fund, which includes the latest available valuation for the underlying investments, unpaid income, estimates of any fees owing, tax gains/ losses and so on.

Trap 1

This brings us to the first trap. The unit price, when you invest, includes the value of any unpaid distributions. So if you

invest just before a distribution is paid you could potentially be getting some of your capital paid back to you, as income – taxed - shortly afterwards. Similarly to investing in shares just before a dividend is paid, even if you reinvest that distribution you will still be taxed on it.

Depending on your personal situation, the impact might well be immaterial, but it's still important to be aware of the potential issue and discuss it with your planner if you have any concerns. The easiest way to avoid this trap is to wait to invest until just after a distribution, if you're close to a distribution date.

In Profile's managed funds (the Profile Portfolio Solutions or "PPS"), we try to minimise this risk for investors by paying out interim distributions when there is a significant amount of income in the fund to distribute.

Trap 2

The next potential unit price trap is that the price you pay takes into account the tax position of the fund when you join it. There may be unrealised capital gains, or losses, embedded in that price – so you are effectively taking on the current tax position of the fund when you buy units.

It can be hard to find out the current tax position of a managed fund when you are considering investing; even the investment manager themselves may not know it accurately during the year as the tax consequences of some underlying investments might not be fully known until financial year end.

As with Trap 1, depending on your personal situation this may be immaterial, or it might even be a benefit to you. We find it is very rare to come across someone where this disadvantage is material; for most people the benefits of using the managed fund structure will outweigh a potential small tax disadvantage on joining.

However if you are materially disadvantaged, the only real solution is to invest directly rather than using a managed fund structure.

Tax while you're holding a fund

While you remain an investor in a fund, you will receive a tax statement every year as at 30 June showing the actual amounts you need to put in the various boxes on your tax return. So you can see not just the gross taxable return, but also any foreign income credits, franked dividends, CGT concessional amounts and so on.

The taxable component of your returns from the fund will depend partly on the types of assets in which the fund invests (for example, Australian shares may deliver franking credits). It will also depend on how actively the assets are traded in the funds – known as 'turnover'. Turnover is calculated as the lower of sales or purchases, divided by the average funds under management (FUM). So a turnover figure of say 50% means that half the assets of the fund have been bought / sold that year (eg, if there were 100 shares, 50 were sold and replaced with 50 new shares). Another way of looking at that figure is that turnover of 50% means the average holding period is 2 years.

Trap 3

High turnover can be a nasty trap for managed fund investors. Funds that frequently trade their underlying investments tend to have higher taxable components than funds which hold onto their investments for longer.

This is partly because high turnover funds might not deliver as many benefits from concessions such as the Capital Gains Tax (CGT) tax concession (where CGT is reduced if you have held an asset for longer than 12 months), or franking credits on local shares (you must have held the shares for 45 days to be eligible). It's also because low turnover funds are delaying crystallising capital gains.

(Of course high turnover can also have other negative consequences for unitholders, including higher transaction costs.)

This can be a tricky area for investment managers because they generally see getting a good investment return for their unitholders as the prime objective and the tax consequences of their investment decisions are often secondary.

If the manager believes an asset has performed well and it's time to crystallise gains by selling the asset, they will usually do so, even though that means crystallising CGT for unitholders. Hopefully, if the holding period is close to the one-year mark the manager might wait until then to trade – but generally, chasing good investment returns will trump the tax consequences.

I think this is at least partly because after-tax returns are not publicly reported in Australia; there's no requirement (as yet) for managers to publish this data for their funds.

The PPS funds have so far tended to be very low turnover and therefore be very tax-effective for unitholders (although it's important to be aware that this is not a specific objective). It's more of an outcome of our style of investing, which emphasises value and tends to have a buy-and-hold approach, rather than using speculative or frequent trading.

Here are some key numbers for the 2013/ 14 financial year:

2013/14 FINANCIAL YEAR	PRESERVATION	ACCUMULATION
Turnover	13%	16%
CGT concessional amounts	39.0%	45.1%
Franking credits and tax offsets	2.2%	1.7%

Tax when you sell

When selling some or all of your units, you are crystallising any capital gain or loss you have made on those units. The tax calculation depends on the methodology used; usually, it will be on a 'first in, first out' basis and your accountant will calculate the relevant tax parcels for you. You will need your complete transaction history for this, for which we can easily provide to you.

If you have any questions or concerns about the tax consequences of investing, don't hesitate to ask your Profile planner.

CLIENT PROFILE – Dr Bernard Kelly AM and Kerry Kelly

By Rick Capel, Senior Financial Planner

Husband and wife Bernard and Kerry Kelly have been loyal clients of mine for a long time now – over twenty years. Over that time I have advised them on their investments and just as importantly been lucky enough to enjoy the company of a wonderful couple who together have done a lot of good for this nation of ours. Unfortunately, one cannot do justice in such a short missive to the vast amount of interesting things accomplished over Bernard's lifetime so far, let alone Kerry's!

Bernard is a General Practitioner who loves the variety that the profession offers, and making a difference in people's lives. In fact from the beginning of his career he has been a champion of the general practice model in Australia; aiming to deliver to the patient a service which is personal, continuing and valuable.

Born and raised in what was the working class suburb of Leichhardt during the 1940's, his parents were battlers: his father a porter on the railways, then a fencer, then a storeman. His mother worked in the WD & HO Wills cigarette factory until she married. Money was always tight.

Bernard was educated by the local nuns and then the Christian Brothers in Lewisham, who offered him a free high school education (albeit without a physics, chemistry or maths teacher). After winning a Commonwealth University Scholarship, Bernard commenced medicine at Sydney University (after a false start in chemical engineering).

After completing his degrees, Bernard spent two years in residency at St Vincent's Hospital, before commencing in private practice as a GP in Redfern. Bernard tells a lot of delightful stories about those times in his memoirs: *A General Practitioner's Journey: Redfern to Arnhem Land 1963 -2007*.

Pervading these stories is a sense of self-deprecating humour and a love of his fellow man. I ask him what has been his moral compass in life, because he has been though some very tough times. He says in in his book he refers to a set of scales. At the left end is the self and at the other end the non-self. His mother used to describe those people at the 'Self' end as, "Self, self, self and if there is anything left over, it's self again." Bernard then says, "To the right side [of the scales] is an expression developed by a resident of Italy, a gentleman of French descent who was born rich and who gave away all to serve those less fortunate; 'It is in giving that we receive'." (St Francis of Assisi).

As Bernard completed his home visits among the poor of Redfern, he often reversed the usual order of things. Rather than collecting a visit fee, he placed food, prescriptions or money into his patients' hands. When considering this in the light of his own somewhat meagre circumstances, you realise this doctor is really something very special, truly a man of the people.

Being a physiotherapist, there was a crying need for Kerry's services in the Redfern area as well, and she delivered her services mostly for free among the community and especially to Missionholme - a 100 patient nursing home run by the Sydney City Mission which had no physio until Kerry arrived - and to The Little Sisters of the Poor.

Too long to tell here are many wonderful stories of their time in Redfern. However I must just mention the one about the frenzied funeral of Joe, his wife Vera who could not outlive him and died at his funeral, the affronted priest, the hypoglycaemic mourner, the looter who saw opportunity in all the confusion, and the doctor (Bernard) who calmly dealt with the series of emergencies, which will stay with me for many years! You will have to read his memoirs for the details...

Apart from GP work, Bernard has contributed hugely to the oversight of medical practices throughout Australia, including establishing the National Accreditation

Programme for General Practitioners, ensuring that young graduates were assigned to senior doctors who could provide a good training ground. Bernard is also an examiner, consultant, mentor, expert witness and judge in cases of professional transgressions by doctors.

The Kellys continue to work voluntarily in their spare time and over the years this has certainly involved family sacrifices – he and Kerry have had four children along the way, and many interstate trips as well as the sacrifice of time have made this an ongoing juggling act for the family!

The clinic at Irrutija, an outstation from Ampilatwatja, 400kms from Alice.

Bernard and Kerry have now retired. However, it is a rather intriguing take on retirement. Kerry continues to provide voluntary physiotherapy services to remote Aboriginal communities. Bernard does locum work for other doctors who might need a break from their rural practices. He might travel as far north as the Northern Territory, providing a whole variety of assistance to Aboriginal communities even as far afield as Arnhem Land. For years, he has been part of a small network of doctors that fly in to Coober Pedy in South Australia for one to two weeks every three months or so as this remote mining town has no doctor in residence. During that time he is on call "25 hours a day, 8 days a week".

Kerry with a patient

He is also writing a first-of-its-kind book about his experiences in the witness box, titled "*Why do some patients sue their doctors? An analysis of 200 medico-legal reports*".

In 2003 Bernard received a Member of the Order of Australia for his services to medicine. This only scratches the surface of his contribution to Australia and its people.

For me it has been a privilege to serve Bernard and Kerry over these many years. They truly live by the creed of service and are guided by the philosopher Oliver Wendell-Homes, who espoused that to work is to live - or to live is to work. They believe one needs to be contributing to society, within one's level of ability, in whatever way one chooses, to be fully alive.

GETTING TO KNOW THE TEAM AT PROFILE

Debbie Fowler

After roles with the Commonwealth Bank, Siemens, and Peter Wynn Score, Profile has been fortunate to have Debbie on board for over 11 years as Finance Manager. You may not be aware she is also an award-winning artist!

After forging a career in the finance industry as well as raising a family, in recent years Debbie has also been pursuing her two other loves: travelling outback Australia, and photography.

With the encouragement of family and friends, Debbie decided to undertake the Certificate IV in Photoimaging, successfully completing the course in 2012.

Since graduating Debbie has been the recipient of many photographic awards. Most noteworthy was recently being selected as a finalist in the 'Emerging Photographer of the Year' category of the Canon AIPP Awards for her *Tree of Life* image, which we hope you enjoy on this edition's cover.

Last year while on long service leave, Debbie covered over 12,000 kilometres through outback Australia with her husband, in their off-road camper trailer & 4WD. While on that trip Debbie took *Tree of Life* from the open door of a helicopter over the Cambridge Gulf near Wyndham, on the north coast of Western Australia.

Debbie is looking forward to documenting many further fantastic outback trips with her photographic skills!