PROFILE'S CORNER

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CONTENTS

Profile Update 3
Investment Update 3
Annuities – Bridging the Gap 5
Client Profile – Ann O'Brien 6
Staff Profile – Kristine Pham 7

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**Asset class returns referred to in this publication are based on the following indices: Australian shares: S&P/ASX 200 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).*

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Profile Update

Welcome to Volume 24 of our quarterly client newsletter. In this section, I provide an update on what's happening at Profile.

By Sarah Abood, CEO

People

We're very pleased to welcome two new senior staff to Profile.

Firstly, **Jerome Bodisco** joined Profile on 17th October as Head of Investments. In this role Jerome will have overall responsibility for the investment research and operations of Profile; chairing Profile's Investment committee, overseeing the performance, competitiveness and communications of Profile's investment solutions for clients, and ensuring Profile's planners have access to the products, tools and research they need to deliver great results for clients.

Jerome is an investment professional of many years standing, having held senior consulting and research roles at Carnegie Wylie Corporation, QIC, AMP, Genesys and most recently NAB/MLC. He holds a Bachelor of Electrical Engineering (Sydney Uni.), Bachelor of Mathematics and Finance, and Master of Business in Finance (UTS). He is also an IMCA academic scholarship winner, and Certified Investment Management Analyst. Jerome has a real passion for our goals-based investing approach, and is really looking forward to having an impact here, helping us to further grow and deepen our investment capabilities.

On 24th October we also welcome **Todd Stanford** to Profile as Senior Financial Planner. Todd has been known to us for almost 15 years and is a highly respected planner in our industry. Previously, Todd worked at William Buck as a Principal and Senior Financial Planner (for just under 10 years), and before that he held similar roles at BW Capital, and Arthur Andersen. Todd is a Chartered Accountant and a CFP, a Fellow of Finsia, Member of the Financial Planning Association of Australia, and a certified SMSF specialist. Todd brings a wealth of technical knowledge and experience to Profile.

In another important milestone – Kurt has become a father again! Isabelle Leah Ohlsen was born at 1am on the 14th August – a very healthy 3.86 kg, and 53 cms long. A little sister for Scarlett. Mother and baby are both well. Father is still a little sleep deprived, but starting to get into a rhythm…

Superannuation

There has been a lot of change in this area lately, and it can be hard to keep track of where everything is up to since those budget announcements back in May! Two sets of legislation have recently been drafted, and these seem likely to pass before the end of the year. They would (among other things) remove the proposed retrospective $500,000 lifetime non-concessional contributions cap, confirm the $1.6m transfer balance cap, lower yearly concessional contributions to $25,000 and reduce the 15% 'surcharge' income threshold to $250,000. I urge you to speak with your planner if you have any questions or concerns about the changes in this important area.

City office

Regular readers will know that our current city office at 55 Hunter Street will shortly be demolished to make way for the Sydney Metro Stage 2 project. We have recently signed a lease and can confirm we will be moving to 44 Market Street. This is a large modern building diagonally across from the QVB shopping centre; close to Town Hall station and Darling Harbour ferry station. I'm sure clients will find our new location convenient. We will keep you posted on timings; it is most likely we'll complete the move early in the new year. Of course our Parramatta office will continue to operate as usual.

Investment Update

Illiquid assets – Portfolio "must have" or "mirage"?

By Dominic McCormick, Select Asset Management

Period returns to 31st August 2016 (%)

Asset class	1 mth	3 mth	1 yr
Australian Shares	-1.5	+2.0	+9.3
International Shares($A)	+1.2	-0.4	+1.9
Fixed Interest	+0.4	+2.5	+6.2
Cash	+0.2	+0.5	+2.2
Gold($US)	-3.1	+7.7	+15.4

The case for and against illiquid assets is a hotly debated one, as investors increasingly look to alternative sources of investment returns in the current challenging market environment. In fact, this is a current topic of conversation at Profile's Investment Committee.

Illiquids – a definition

Illiquid investments are those that cannot be converted to cash in a reasonable time (1-2 months) or where their conversion to cash over that or a shorter period would, have a significant adverse impact on its realisable value.

The potential benefits

Illiquid investments offer some attractive potential benefits:

- An "illiquidity premium" i.e. a higher expected return compared to listed/liquid assets.
- Diversification benefits for portfolios, because their return drivers may differ from those for listed/liquid assets.
- Reduced volatility compared to listed assets because of how they are priced.

What's not to like? Of course these potential benefits do come with some provisos. For example, the illiquidity premium comes with no guarantees and can vary widely over time. It depends not only on the pricing of the illiquid assets themselves but on that of comparable listed assets.

While there is some controversy around these benefits, there is a strong case that all long term investors should at least consider including illiquid assets in their investment universe. This is particularly the case for funds managed with a long term horizon, with minimal impact from, or risk of, net capital withdrawals or need to price on a very frequent basis. Typical institutional examples of these are endowment funds and sovereign wealth funds. These funds also have the scale to gain greater control over the assets they invest in directly, or through co-investments.

Challenges arise however, when considering some of the practical aspects of including illiquid assets, particularly through more conventional pooled investment vehicles.

Problems with Illiquids

Concerns with illiquid assets in today's superannuation and managed fund structures are twofold.

Spiralling weightings: Firstly, these assets can cause significant problems for funds that suffer sustained or major net cash outflow, or where this illiquid component becomes excessively large in portfolios due to negative market movements for other assets. In extreme cases a fund may get to a point where it is unable to pay redemptions for extended periods. Certain funds experienced this during the GFC.

Of course some funds have extremely reliable cash inflows such that this is unlikely to become a problem for them for the foreseeable future. However, even for these, regulation or circumstances can change unexpectedly. In our view some funds seem overly complacent on this issue.

Inequitable valuations: The other, more neglected issue concerns investor equity. It's an important element of the managed fund structure that all investors should be treated fairly. So for funds that are offering daily or weekly transactions the valuation of illiquid assets is crucial, especially if this is a large component of the portfolio. After all, at any point you may have investors that are taking a very short term view (redeeming or switching within days) versus those who intend to hold for many years. The valuation issue is complicated because the secondary market in many of these illiquid funds is sporadic with very infrequent trading. Standard practice is for funds to ignore such secondary sales for their own fund valuation purposes unless that fund itself is the seller. Moreover, if funds purchase an asset in the secondary market at a discount to NAV - say 10% or 15% - the general practice is to immediately revalue that to the fund's NAV, booking an immediate gain. But this might not be fair to all investors – in this case, for example, are exiting investors being overpaid at the expense of those who stay, considering that the higher price could not actually be realised at the time of exit?

Such inequities only become a major problem if illiquid assets are a very large component of the fund.

How to handle Illiquids

With small weightings in illiquid assets (say under 10%) the impact of the equity issues and cash flow risks noted above are manageable for most funds, in our view.

The case for allocations above this is strong only for those funds with a very high degree of certainty about their future net cash flow position.

Some daily-priced funds in the retail space (where there is less visibility of their cash flow) have determined that their maximum allocation to illiquid assets is zero. For them, the additional flexibility they have in asset allocation outweighs the potential benefits of holding illiquid assets.

When considering a fund, investors need to think not only about the actual allocation to illiquid assets in a fund but how robust its cash inflow position is, and the time horizon, motivations and position size of the other investors in the fund.

Investing directly in a single illiquid asset (such as a property syndicate) is also worth considering, so long as investors fully understand and accept that they cannot exit until a date often well into the future.

Shades of grey

So far we have implied there is a clear distinction between illiquid and liquid. In the real world

though, liquidity and illiquidity are not black and white - rather it's a spectrum.

One of the big problems during the GFC was that assets previously seen as liquid become illiquid in a crisis. Think mortgage funds, hybrid property funds, high yield funds and fund of hedge funds. Such problems will no doubt emerge again, although it may well involve different asset structures next time.

A checklist for investors

Clearly, illiquid assets offer some real challenges as well as opportunities. Key points to consider when investing in illiquid assets include:

- Don't invest in any illiquid assets directly without a long term investment horizon, and a high confidence you will not need access to the investments in a shorter time frame.
- Make sure you are receiving adequate return premium for investing in illiquid assets.
- If investing in a pooled fund that holds illiquid assets, but offers investors frequent liquidity, ask questions about the valuation methodology and, risk of significant outflows and the unitholder structure of the fund.
- Don't overestimate the diversification benefits of illiquid assets, given these may be heavily driven by the valuation process rather than the inherent fundamental characteristics.
- Don't simply accept the conventional wisdom as to what is defined as liquid and illiquid today. Qualitatively or quantitatively "stress test" the liquidity of the assets for a much more hostile market environment.

Annuities – Bridging the Gap

By Scott Ungaro, Financial Planner

One of the biggest concerns our clients express, is that they (or other family members) won't have enough money to last them through. Our lifespans keep expanding and returns from investments can be volatile! As a result, for many people the gap between what they need and the financial resources they have available keeps expanding. Add to that the constant tightening-up of Age Pension entitlements, and the picture gets a little scarier each year – that 'safety net' of the Age Pension keeps getting lower.

It's not just those of us who are getting close to, or already in retirement, who are affected. Increasingly we find we are helping clients whose parents, or even grandparents, are starting to face these issues. So if you or someone you love needs to be sure their money will be there as long as they need it – read on.

What is an annuity?

An annuity is an asset that provides a series of regular payments in return for an upfront lump sum of capital. The rate of return is fixed at the beginning, and once set it is not affected by subsequent share market or interest rate movements.

There are two main types of annuities: fixed term, and lifetime. Fixed term annuities have fixed start and end dates, where payments finish at the set end date. With a lifetime annuity, the payments last the investor's lifetime however long (or short) that may be.

Annuities are similar to a term deposit (secured investment) where you receive regular income but are not able to access capital.

Benefits

The greatest benefit of an annuity is peace of mind. Since annuities pay a pre-determined guaranteed income stream regardless of how markets perform, they remove the fear of major market corrections and provide income security to the investor.

Another benefit of annuities is the fact that they can be purchased with superannuation funds and so can be tax-free from age 60.

An additional benefit is flexibility, with the choice of either a lifetime or a fixed term annuity. As a wise man once said, "if we knew the day we would die, then we would spend accordingly." Since we do not know how long we will live, a lifetime annuity can provide the useful certainty of a lifetime income.

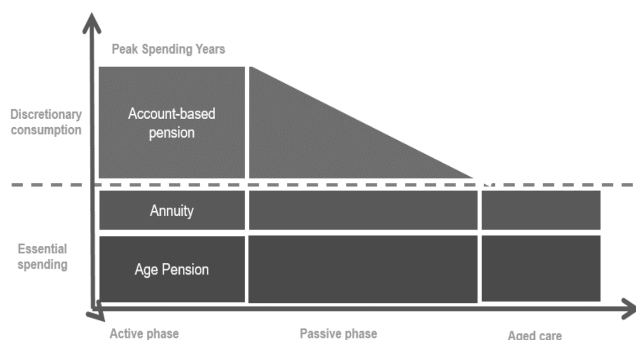
Concerns

- While an annuity can be purchased outside a super fund, in this case the income stream may not be tax-free.
- With whom, and how, is your money invested? Your income stream is only guaranteed as long as your provider does not go broke!
- An annuity should really be all about the peace of mind and not the returns. However, inflation will eat into the return so the income stream will buy less over time, (unless it is specifically indexed to rise with inflation.)
- At the moment we are in a sustained low interest rate environment, and as a result the income rates being offered are relatively low.
- Lastly, you may not be able to access your capital at all, even in the event of an emergency. Some annuities do offer the ability to cash out, but it is likely you will receive less than your original capital and in some cases considerably less.

Strategies

A financial plan is made up of many parts – there is not one single solution to securing your income during retirement.

One way to use an annuity can be to cover your essential spending requirements in retirement (or supplement the Age Pension). To do this, first determine the absolute minimum you require for basic living expenses, such as housing, clothing and food. The Age Pension at the moment, for a single person, is a maximum of $22,721 ($34,252 for a couple) and for many will not be sufficient on its own; and for many others, the amount paid is reduced due to other assets or income. An annuity can bridge that gap. With any remaining capital, you have the option to purchase an account-based pension to fund additional discretionary consumption spending. While returns in account based pensions are volatile, you retain access to capital. With the help of your financial planner, it is worth running the numbers to see how these different products might work for you.



Source : Challenger

An annuity can also help improve one's entitlement to the Age Pension. As we know, the government continues to restrict entitlements by tightening the income and assets tests. Those assessed on the income test are likely to be receiving a defined benefit income stream, and may not have access to sufficient capital to purchase an annuity.

However, for retirees assessed on the assets test, an annuity purchase may assist. This is because an annuity has a built-in deductibility which over time can improve entitlement to the Age Pension. It is worth speaking to a financial planner about this strategy as it does depend on a number of factors including the underlying asset base.

New features

A longstanding concern with annuities has been no return of capital in the event of a death. For example, if you purchase a lifetime annuity but pass away unexpectedly after only a few years; previously the family could not access the capital. Many annuities now have built-in minimum time frames or reversionary beneficiaries. For example, the new lifetime annuities typically have a minimum payment period of 15 years such that if the client dies prior to 15 years and no reversionary beneficiary exists, a portion of the remaining capital may be available as a lump sum. This reduces the fear that your family will be worse off should you die prior to receiving your fair share of income.

Costs

The costs of annuities are embedded in your investment.

How? The annuity provider makes a profit on your investment when they earn a rate of return above your guaranteed income. For example, if you are receiving an annuity income of 3.5% pa, and the provider's fund manager is making 4.5% on your investment, then the provider keeps the 1%. From the provider's perspective, the idea of an annuity is to outperform the guaranteed return over the long term, thus realising a profit.

Conclusion

Annuity providers have improved their offering in the last few years by addressing many clients' concerns and continuing to provide peace of mind with a guaranteed income stream. While annuities might not work for everyone, and they are rarely the whole solution, they should definitely be considered as part of a robust retirement strategy.

Client Profile – Ann O'Brien

By Aine Love, Marketing Manager

Ann talks to us from the perspective of being Power of Attorney for her mother (who is a long standing client of Profile). The aging of relatives is a situation likely to affect everyone at some stage, and Ann shares her experiences and some valuable insights on how she and her family handled the legal and emotional aspects of transitioning a parent through the journey of allowing others to make her life decisions.

Ann's parents were Dutch migrants who moved to Australia after the second world war. As many migrants do, they worked hard to make a new life in Australia. Ann is one of six children. Her father died young, leaving her mum widowed with a large family and a business (a retail shop) at the age of 49.

Ann's mum was very astute and at age 80 started planning in advance by talking to her children about her business and financial affairs. She always had a will in place but started the discussion about Power of Attorney and Enduring Guardianship while she still had all her faculties. She decided to ask three of her children to use their different skill sets and to share the responsibility, but has involved all six of her children in some way. Ann herself is involved in all three documents, which is interesting and probably due to being the eldest daughter!

Due to Ann's geographical proximity she is the person with the most involvement in the care for her mum, and estimates the responsibility can take up to a day per week – between finances, visiting, making medical decisions and communicating with her brothers and sisters. Ann mentions how the time commitment has progressed over time as her mum has become less confident handling her affairs, and more recently has developed dementia so is unable to make decisions for herself. Five years ago for example, Ann would attend a bank meeting with her mum, or pay all the bills together, but she now makes all those decisions on her mum's behalf (with help from her siblings).

All six siblings communicate effectively about any of the decisions that need to be made, and make the use of technology 'Whatsapp' which they dedicate to keeping in touch with each other regarding their mum's affairs. They find this a very effective way of filtering out their own day-to-day communications and ensuring their mum's needs are met. In saying that, Ann acknowledges that it is not all easy or straightforward as there is a lot of consultation involved in the process.

Over time Ann's mum realised another difficult decision had to be made, and while she wasn't keen on the idea she knew she had to move from the family home. This was a particularly hard move as she was leaving behind the six bedroom family home that her husband had built, with its large garden and many memories. In typical form, they planned ahead and did a lot of research on the various options available through visiting friends and attending seminars on retirement options.

With Ann's mum's current living arrangements, the family has shared responsibility in a very unique way. Ensuring her health and wellbeing are looked after they share all aspects of their mum's health and dignity – they have assigned a sibling to a specific responsibility eg. eyes, podiatry, hair etc. which means they don't miss any areas of care and it allows clarity in communication amongst the family!

Having made arrangements early, Ann said as a family they were very clear on their mum's wishes and this has helped them over the years. If they ever have a difficult decision to agree on they always ask themselves "What would mum want?". In responding to lack of conflicts of interest so far Ann says "We are very lucky and it comes from constant communication as we grew up, and the values we were taught".

Ann stresses the power of communication in families, and the importance of really knowing what your parent/parents' wishes are. Also, the importance of having Powers of Attorney/Wills/Enduring Guardianships in place early, plus having an understanding of what your own and parents/relatives financial and emotional wishes are before it's too late. Ann acknowledged that her mum had some complex business and financial affairs and being astute, valued having trusted advisers (such as a solicitor, a financial planner and accountant) around her – whether she listened to them or not!

What we wanted to address in this article is how as people get older, and have less capacity, there are a lot of practicalities that need addressing. Ann gave us an insight into how a real family worked this out very successfully. Ann mentions several times what a strong 'straight talking' and astute woman her mum is, and how her forward thinking of her own capacity made it so much easier to limit any drama in their family.

We are holding a seminar on this topic on 2nd November, so if you haven't already responded to our invite, we urge you to do so or call us if you would like a copy.

Staff Profile – Kristine Pham

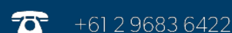
Associate Financial Planner

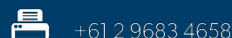
Kristine came to Profile this year with a background in the legal, marketing and insurance industries. She completed her Bachelor of Commerce at the University of NSW, majoring in Finance and Marketing. She began her career shortly after with a full-time role at Zurich Insurance in the service division. Kristine soon realised that although she was gaining valuable insights into the industry, it offered too narrow a career focus.

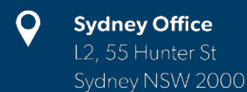
Looking for an alternative, she began her Diploma of Financial Services and started banging on Profile's door. After we opened the door (following an intense screening process!), she was given a warm welcome to the team. Currently working as an associate planner with Scott Ungaro and Laura Donovan, she is engaging with the wider scope of financial planning. Kristine is also dealing with the challenge of dividing herself effectively between two advisers!

With her Diploma of Financial Services safely behind her, Kristine is now in the process of completing her Diploma of Financial Planning, after which she intends to do more study! Kristine's appetite for learning extends beyond the work space - in her down time she likes to read, watch documentaries and experiment with new ideas in the kitchen. A good book (or article) and a decent coffee is all she needs to start the day. Kristine is currently enjoying the company and support that comes with living with her parents and younger brother. She is planning to gather a deposit for a house over the next few years while also broadening her travel horizons.

CONTACT US







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