Profile's Corner

AUTUMN 2010
Volume 2, Issue 3

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Profile update

Welcome to the third issue of our client newsletter. In this section, we give you a quick update on what's happening at Profile.

We have appointed a new CEO to help our firm grow sustainably, in a way that's consistent with our client-centric core values. *Read more about our new CEO, Sarah Abood, later in this newsletter.*

Particularly at this time of year, many of our clients appreciate us working closely with their accountant on their financial strategies. We have recently launched the Accountant Partner Program to formalise the way we work with accountants. The program ensures we can share insights and strategies with accountants so that our mutual clients benefit from consistent and informed advice. *If you would like your accountant to work more closely with us, please contact us to discuss the program in more detail.*

Our new city office (at level 8, 261 George St) is proving very popular with clients, many of whom find it a handy location for review meetings and updates. We have also started to run regular boardroom lunch and evening seminars for prospective clients. (These seminars are also run at Oatlands in North Parramatta). *Do you know someone who might benefit from seeing a financial planner? Give us a call to get the dates for upcoming seminars.*

GENERAL ADVICE WARNING

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Investment update

Period returns to 31 March 2010

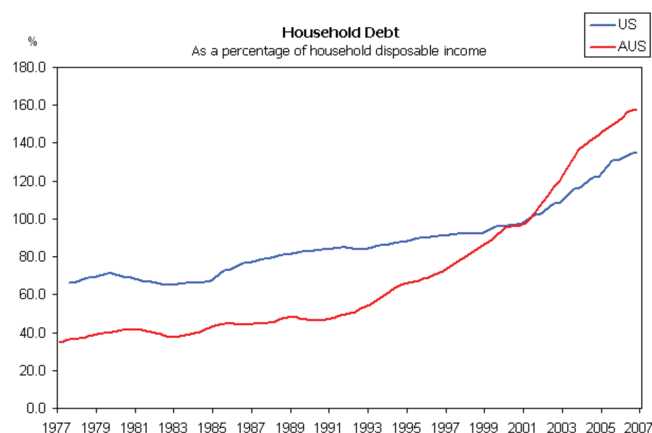
Asset class*	1 mth	3 mths	1 Yr	3 Yr (pa)
Australian shares	+5.7%	+1.3%	+41.9%	-2.6%
International shares	+3.5%	+1.1%	+14.5%	-9.6%
Fixed interest	-0.6%	+1.3%	+2.7%	+6.5%
Cash	+0.3%	+1.0%	+3.5%	+5.7%
Australian Dollar	+2.5%	+2.2%	+32.8%	+4.3%

Investment markets around the world are attempting to recover from what some are describing as the greatest financial crisis of our time, and the market environment is currently very uncertain. For investors, it has never been more important to be actively monitoring portfolio strategy and individual investment selections.

How did we get here?

One of the scariest financial charts in 2007 was the one showing consumer debt to income levels - a useful measure of consumers' ability to service debt. The chart below shows debt to disposable income ratios in the US (blue) and Australia (red) leading into 2007-08.In both economies, the interest payments required to service debt, as a proportion of income, was significantly higher than historically recorded.

Household debt to income: 2007



Source: whocrashedtheeconomy.com; RBA; US Federal Reserve

At the same time, innovative debt derivatives known as "CDOs" (short for Collateralised Debt Obligations) - which bundled risky mortgages together with safer loans - were increasingly being used and traded by banks and other financial services organisations. When over-geared people started defaulting on their loan repayments, these products collapsed, leaving many investors (who thought they had bought a safe product) bankrupt and triggering a global financial meltdown. The Australian sharemarket* had its wost-ever one year return over the 12 months to November 2008, losing 40% of its value.

Leading in to late 2008 and early 2009, governments and central banks were forced to act to avert a global financial collapse. Interest rates were cut to extreme low levels, and governments injected billions of dollars into their economies and banking systems.

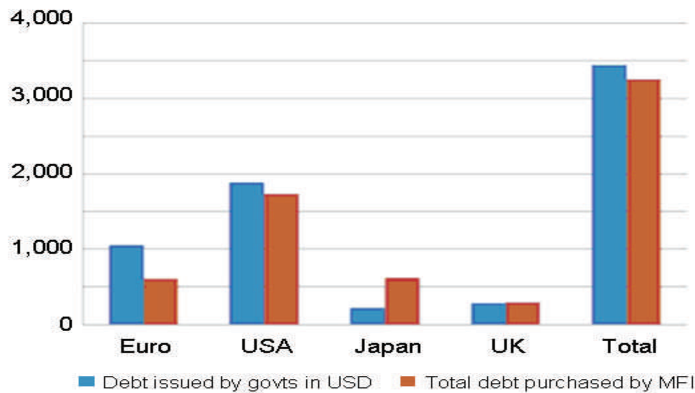
Where are we now?

Money for the rescue packages had to come from somewhere, and governments have incurred significant levels of debt in order to support their economies through the crisis. As a result, markets' focus has shifted from consumer debt to government debt, and to the methods governments are using to fund their debt.

Worryingly, governments themselves seem to be the main buyers of their own debt. "Quantitative Easing Policy" (QEP), refers to a process whereby central banks literally print money to buy their own government's debt. QEPs support prices, and more importantly, the interest rate at which this debt is issued. However, the more money is printed, the weaker the structural foundations of the economy become. The bar chart on the next page shows that about 90% of public sector debt in the G7 has been funded by Monetary Financial Institutions (MFI) under the QEP umbrella.

Investment update – continued

G7: Public sector borrowing and the QEP (USD)



Source: Andrew Hunt Economics

Governments cannot keep printing money to fund their spending without causing more of the very problems they were trying to avert in the first place. So we think the current recovery can be best described as 'cosmetic' - simply transferring our unsustainable debt problems from consumers to governments is not a long-term solution for the global economy.

Where to from here?

At time of writing, markets are focusing on short term data, which indicates that a strong recovery is underway - based on expectations that corporate profitability will return to the good old days when consumers spent more than they earned. However, consumers are now saving and reducing debt rather than spending, and governments are running out of money. It's likely that governments will need to wind back their unsustainable stimulus strategies, sucking money back out of the economy through higher interest rates and higher taxation.

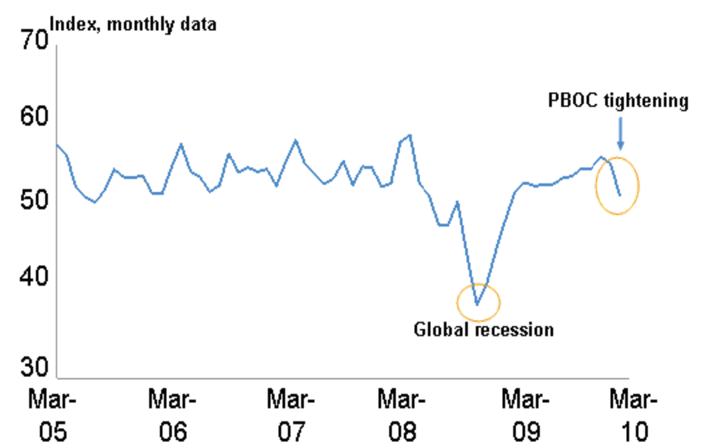
Continuing problems in Greece show that the story of the crisis is not yet over. At the time of writing, the IMF and Europe had recently pledged their support to the debt-ridden nation. However Greece is reluctant to receive support from the IMF given the stringent guidelines it would then be subject to. Greek citizens have been living a well-above-average lifestyle supported by government benefits - unit labour costs are 32% higher in Greece than the European average – and winding this back will be politically unpalatable for the government. Following a recent significant shift, Greek bond yields remain at elevated levels, suggesting the market is not yet at its lowest point. If Greece fails, the rest of the "iPIGS" (Ireland, Portugal, Iceland and Spain) – nations which are often lumped together economically - will also be dealt a serious blow, along with broader financial markets.

In the US, the news is little better. President Obama has pushed his health care bill through congress and while this may be good for the health of the US people, the cost can only put more strain on a very fragile balance sheet (US government debt already tops 100% of GDP). Although April saw the first positive payrolls since the start of the crisis, the US economic recovery has a long way to go with over 8.4 million jobs still needing to be created. Corporate balance sheets are stronger, but small business is yet to start investing back into the economy.

For now, we all rely on China to keep building, spending, and demanding our goods, services and commodities. However even in China, policy makers have started to tighten their belts, with lending requirements tightened twice this year already.

The chart below shows the Chinese Purchasing Managers Index - a good gauge of forward business activity and expectations in China. When the crisis was in full swing, expectations hit a low, as did economic activity. This was followed by central bank loosening activities which supported growth. The latest move in the index is down, and comes just after recent events by the Chinese central bank to tighten lending after excessive loan growth was recorded in late 2009 and early 2010.

Chinese PMI survey – business expectations



Source: DataStream, Bloomberg, UBS

Investment update – continued

This recent tightening indicates that Chinese policy makers are wary of potential overheating in their economy. China is still likely to put another strong year of economic growth on the board. However it cannot indefinitely and single-handedly drag all the other economies of the world along with it.

With significant headwinds clearly remaining in the global economy, a cautious approach to investment seems indicated. Governments are going to have to explore new policy strategies, and corporations need to explore new ways to grow earnings as consumers cut spending. As a result, investors will need to find alternative and diversified sources of portfolio returns. While there are certainly investment opportunities in the current environment, they are not necessarily going to be found in traditional ways - overall market growth alone cannot be relied on to deliver good returns.

At Profile, we are actively researching new sources of portfolio returns. They are being found in investments that offer exposures to unique asset classes, as well as through alternative investment strategies. Portfolio managers must be pro-active in managing risk exposures, and investing in opportunities that are unrelated to traditional financial markets.

* Asset class returns quoted are based on the following indices: Australian shares: S&P/ASX 300 Accumulation Index. International shares: MSCI ex Aust (AUD) Index. Fixed interest: UBS composite bond 0+ Yr Index. Cash: UBS Warburg bank bill Index. Australian Dollar: *(AUD/USD)*

Client case study — Managing cashflow

It's the time of year when many of our clients are thinking about tax planning and managing cash flow. There are often changes that can be made to improve your financial situation for the current financial year – but it's also a great time to plan for 2010/11, to ensure that you are in a position to implement the best strategies next financial year.

These were the issues that a new client came to see us about, a year ago. She had a very healthy asset base, however those assets were not meeting her cash flow needs. While the assets had performed well over the years, a large proportion of this return had come from appreciation of capital value. The modest level of income was being consumed by interest, tax and management expenses. The management of the investments was also time-consuming for her, and the relatively high levels of debt (particularly considering she was a retiree) also added a layer of complexity and stress to the situation.

The investor had been to see an adviser at a large bank, and was unhappy with the recommendations she had received, which involved selling her family home. She decided to seek a second opinion. She had been recommended to us several years ago by another client, and although she had not proceeded then, she decided now was the right time to see what Profile could do for her.

Our brief was to improve the cash flow position without selling the family home, and for the investor to be able to retain control over her assets, and see regularly how her investments and cash flow were tracking relative to plan. We also needed to simplify her financial affairs so that she could spend more time doing the things that she loves – sailing, and travelling in her motor home!

Our extensive modelling showed that there were more than sufficient assets to meet the investor's income needs. However some of these assets (which included investments in a self-managed super fund, and a number of privately owned investment properties with debt against them) were inappropriate for her needs and were not structured in the most effective way.

In order to deliver the most effective result we recommended a strategy of reducing debt, and moving

Client case study — Managing cashflow continued

certain assets into super over time while also reviewing her overall investment strategy (to increase income, diversification and flexibility). Carefully timed transfers would minimise Capital Gains Tax, and maximise the tax deductable (concessional) contributions available to the investor. This strategy delivered sufficient and certain cash flow at all times, reduced ongoing tax, and also significantly reduced ongoing management hassles.

It was also very important for our new client to not just set the strategy, but also regularly review to ensure the strategy stays on track, and adapts to changes in either the legislative or investment environment while continuing to meet her needs.

Most importantly, our client now has both time, and peace of mind!

Letter to Kurt Ohlsen:

"Thank you for putting my mind at rest at the meeting we had on Friday.

Even though I have substantial assets my cash flow worried me and I thought that the best way to fix this was to sell my home which I was reluctant to do.

Kurt you did an excellent job of showing me how I can overcome my present cash flow problem without having to sell my home or change my life-style.......

........You also showed me that by using the special rules for super for people between 60 and 65, I could save a substantial amount in capital gains tax, which had been a big concern for me.

You figured out how to reduce my income tax in two years time to the 15% bracket and still have an ongoing annual income of $xxxxx from a combination of rent and super, stay in my home and maintain my lifestyle as long as I wanted.

I can now go away in my motor home (which I can also keep as long as I want) with no financial worries.

MANY THANKS."

** The investor in this story is currently a client of Profile, however we have not included the name in this article to protect privacy.*

Superannuation update

During February, Profile sent a representative to the Self-Managed Super Fund Professionals' Association of Australia (SPAA) annual conference in Melbourne. SPAA is considered to be the peak industry body for self-managed super funds (SMSFs). We generally find this conference's technical content to be very strong, and the information valuable for our clients.

Attendees included financial planners, accountants, auditors and solicitors, as well as influential figures such as Michael D'Ascenzo AO (Commissioner of Taxation), Tony D'Aloisio (Chairman of ASIC), Jeremy Cooper (Chairman, Super System Review), and The Hon Chris Bowen (Minister for Financial Services, Superannuation and Corporate Law). Other speakers included industry leaders in superannuation strategy and tax law.

During the conference we raised two specific issues with the Minister on behalf of our clients:

- The recent reductions to concessional super contribution limits. We believe the current maximums are too low, and particularly disadvantage clients in small business. We find these clients often make relatively small contributions in early years, with the aim of topping up their super with larger lump sums closer to retirement. Even though these later payments would often be large, their total contributions to super could be little more than a typical employee's. We think it's unfair that these clients should be penalised for preferring to invest in their businesses early on.

- Excess contributions tax. People who exceed these reduced maximums can now be taxed at an effective rate of up 108% on the amounts contributed above the maximum. We consider this to be excessive, particularly as most clients in this position have breached the maximum by accident. It's a particularly difficult situation to deal with, as once the money has gone into super it's almost impossible to withdraw before retirement age, so clients who have contributed extra by mistake can't rectify the situation even if they wish to.

Minister Bowen confirmed these issues are being discussed between his department and the ATO. However, whether any of these issues will be dealt with by the government in this session remains to be seen.

We also spoke with Jeremy Cooper, who chaired the recent review in the superannuation system. At time of writing, the full findings of the review had not yet been released. Mr Cooper noted that he did not think the super system was "broken", and that potential improvements that he saw were mostly in the area of administration. He also diplomatically questioned current contribution limits. He feels it is very important that further changes to superannuation system have bi-partisan support, helping to stabilise the legislative regime so that the community's faith in super as the best means to fund retirement is not compromised by constant change.

Finally we spoke with ATO representatives about a number of strategies, and how various interpretations of the legislation would be treated by the ATO. The Henry review of taxation is also a hot topic, however no definitive information about changes that might result was available at time of writing.

We will be watching with interest the government's responses to the many recent reviews of the superannuation, tax and financial systems, and of course the upcoming Federal Budget (scheduled for 11 May 2010). We will share our analysis of these reviews and the budget with clients.

Stop press

Just as we were going to print, the government's response to the Henry review of taxation was released.
Some major proposals include:

- an incremental increase in the super guarantee levy to 12% by 2020 (from 9%),
- a $500 tax offset into super for low income-earners,
- making permanent the higher $50,000 super contributions cap for workers over 50 (if they have less than $500,000 in super),
- an increase in the age limit for compulsory super contributions,
- a cut in the company tax rate to 28% (from 30%),
- changes to depreciation, and
- a resources "super tax" on miners, which is likely to impact valuations of mining companies (although some expectations around this tax have already been priced in).

The opposition had not announced its formal response at print date, and there is no guarantee these proposals will pass the senate. We will keep you informed of developments that might affect your investments as more detail becomes available. Our next major update will be our analysis of the Federal Budget, due to be handed down on 11 May 2010.

Getting to know our team at Profile: Sarah Abood — Chief Executive Officer

Profile has recently appointed a Chief Executive Officer, after an extensive search over many months in the latter half of 2009. This appointment is part of Profile's strategic growth plan, and includes a number of initiatives such as the opening of our new city office at level 8, 261 George St, Sydney.

It was very important to Profile to find the right CEO who could grow the firm sustainably and in line with the firm's core values. Says founder Garry Ohlsen, "We were looking for someone with very significant experience in financial services, extensive senior executive experience, and strong qualifications. Most importantly, the new CEO also needed to be very aligned with our client- centric culture."

Sarah started her career in financial services with AMP in 1989, moving to Sydney (from Tasmania) and holding diverse roles including IT analyst, technical adviser and sales manager over nine years. She and her husband became clients of Profile during this time.

Sarah has continued her career in the finance industry ever since, holding senior marketing and management roles with Rothschild, Westpac, BT, Colonial First State, and most recently with Fidelity International before joining Profile Financial Services in February 2010.

Says Sarah, "Having been a client for many years, I have a very real insight into Profile's client centric culture and how the firm can deliver real value as financial advisers. Since joining the firm as a staff member, I have also gained an appreciation of Profile as a strong business, with fantastic potential for even more success in the future. The quality of advice is excellent - and in recent times the owners have invested significantly in back-office systems and processes, which are a great springboard for growth as they allow us to efficiently deliver our services to more clients over time."

"I am passionate about financial planning and I firmly believe that every Australian should have access to high quality advice to help them reach their financial goals. It's a great day when Profile can tell a client that they are now financially independent!"

Sarah lives in Sydney with husband Chris and son Jonathan. She's an avid reader and recreational jogger who is trying to progress to runner. She holds a Bachelor of Arts from Sydney University and a Master of Business Administration from Macquarie University.

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