

Successful Investing



Issue 2 - 2009

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Economic Update

Across a range of global economic indicators, there were signs of some improvement from deeply depressed levels.

In the US, the ISM manufacturing index bounced higher in March and much better regional surveys suggested further improvement in April. The Conference Board's consumer confidence index improved to its best level since November. Even the housing market showed tentative signs of bottoming out. The data flow wasn't all one way however, with non-farm payrolls plunging, the unemployment rate rising to 8.5%, the highest since 1983, retail sales contracting in March, lower housing starts and permits and a lower reading for the Conference Board's leading indicators index.

Across Europe, the tone was similar with widespread increases in various confidence indicators. The UK Budget also detailed public debt soaring from 46.5% in the 2009 financial year to 74% by 2010 financial year.

Across Asia, some positive signs emerged with a range of indicators suggesting the Chinese economy was on the mend, despite annual GDP falling to 6.1%, the lowest rate in about 10 years.

On the policy front there seems to be less of an onslaught compared to previous months as central banks catch their breath. The tentative signs of stabilisation in global economic activity are encouraging but the days of sustainable, robust global growth are still far away. We continue to look for some economic recovery in the second half of this year.

In NZ, the OECD issued a gloomy report projecting GDP growth to contract by 2.8% this year. The Government raised concerns about the projected public debt track and it is likely the Budget will see the cancellation of personal tax cuts already legislated for, a slimming down of the spending track, and a postponement of new money flows for the NZ Super Fund.

Trade data continued to show an improving trend, largely due to a slump in imports, while exports are faring well in the context of the global economic recession. The very weak global and local economic environment allowed the RBNZ to slice another 0.5% off the OCR and indicated it will keep OCR at or below the current level until the latter part of 2010.

Source | AMP Capital Investors

Behaviours that threaten your financial security



Don't panic. But watch out for behaviours that could threaten your financial security.

For most investors, recent market volatility has resulted in heightened anxiety and concern. While we believe that risks do remain in what might ultimately go down as one of the most significant crises in financial markets history - it is clear that many investors are being guided by an unprecedented level of fear and emotion.

Common behaviours that threaten financial security.

We're all emotionally involved with our money at some level. Nobody is immune to factors that influence behaviour. Fear, greed, indecision and regret are the emotions most frequently linked to harmful investment decisions. They all render people susceptible to a variety of pitfalls.

In the case of planning for your future, there is at least one tendency that we've all succumbed to on occasion. It's the feeling of instant gratification that causes people to **overemphasise immediate rewards** at the expense of long-term needs. It's very easy to make a decision today about your investments without comprehending the long-term opportunity cost of that decision. We often assume that long-term financial commitments can be put off for another day. But in reality the earlier you act the more options you are likely to have when you reach important life milestones.

You may recognise your own past decisions in a handful of other frequent behavioural tendencies.

Naive diversification is a frequent contributor to unnecessary risk. This is typically the outcome of dividing money based on rules of thumb without evaluating risk tolerance or return expectations. The classic case is holding several managed

funds without understanding the overlap in them and the lack of true balance across global asset classes. As an example, you may invest across several investment managers, but if their underlying investment processes are similar have you really got a diversified portfolio?

Overconfidence in our prowess as market prophets can also be detrimental to making market profits. When markets advance enough to get the casual investors attention, investors often start to think their success is the result of skill, rather than cyclical luck. Sometimes, **belief persistence** causes us to ignore evidence or indicators that are contrary to what we may believe to be in our own best interest.

Another contributor to financial difficulties is the tendency to **overweight recent events**. It causes misguided decisions at both good times and bad, as fear and greed override long-term prudence. It's reactive, not proactive, and the response often causes people to buy high for greed's sake and sell low out of fear. This is why some investors move in and out of their investments at inopportune times, mistaking growing value for risk and vice versa.

Investors often also fear loss more than they seek gain. **Loss aversion** makes it difficult to put your money to work outside of a "safe" investment (e.g. term deposits), even if that perceived safety means, inflation may destroy your purchasing power over time. It causes people to plan for worst-case scenarios to minimise losses rather than trying to maximise wealth.

Then there is the ultimate cause of going nowhere - **fear of regret**. Right now, fear is by far a more dominant feeling. Frequently, even when a clear course of action is appropriate, people prefer to do nothing or remain indecisive for fear of making the wrong decision.

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Behaviours that threaten your financial security continued...

Crash of 1987 - a time to sell, or a time to buy?

On October 19th, 1987, the now infamous "Black Monday," the US Dow Jones Industrial Average lost 22.6% in one trading session. It was even worse outside of the US, with markets in the United Kingdom, Hong Kong, and Australia all losing more than 25% by month-end, yet only two years later, the US market had recovered all of its losses and gone on to rise dramatically over the next ten years.

In most cases two years is not a long time from the standpoint of a long-term investment plan. Even someone who is about to retire could still have an investment horizon of more than 25 years. Ultimately, Black Monday represented an excellent buying opportunity for investors who had the courage and commitment to act on that perspective.

Of course, not all of us can be so coolly rational. Counterproductive emotions sometimes determine our decisions, and the market's twin Hydra - fear and greed - can be wickedly difficult to ignore. How can we ensure that our decisions stay consistent with our long-term goals?

How can you avoid counterproductive behaviour?

Determine your risk tolerance.

Are you an aggressive investor? Or more conservative? Can you tolerate wide swings in the market, or are you willing to accept potentially lower returns for lower volatility? Determining your risk tolerance is one of the first steps you should take in setting out your investment plan.

Stay diversified.

The very point of diversification is to limit downside losses in difficult markets. If a market correction happens and you're properly diversified, you'll be

less likely to lose a substantial amount - and thus less likely to sell at the bottom.

Think long-term

Realise in the history of sharemarkets, that very few events have had a meaningful impact on long-term returns. Not the assassination of President Kennedy. Not the fall of the Berlin Wall. Not 9/11. Not the start of the wars in Iraq and Afghanistan. In each of these cases, the US sharemarket (S&P 500 stood higher two years after the event occurred). Broadly speaking in time companies (and markets themselves) tend to recover from events that may seem overwhelming in the near-term.

Get information

In difficult times, fear is a natural reaction. One of the best ways to deal with it is to get information. Ask your financial professional questions like, "How do you feel about the economy? How do you think it'll impact the market? Should I adjust my portfolio?" The more you learn, the better you'll feel about your ability to make constructive decisions under stress.

Act with courage

To paraphrase Winston Churchill, courage is the value that makes all others possible. When faced with a difficult market decision, ask yourself, "What would I do if I were going to be brave?" The answer may just be the best move you can make.

So this, of all times, is an excellent opportunity to avoid panicking. Fear is a great motivator - but a bad guide. A better strategy is to stay calm. People who act coolly will make better decisions than those that act emotionally.

What can you do to move counterproductive behaviours?

1. You may benefit from the help of a financial

professional to diagnose biases and correct your course when necessary. Along with determining a prudent strategy for your investments, a professional's role is to protect you from common pitfalls detrimental to your financial security. Their value is demonstrated partly in providing "don't do that" or "it's OK to do that" guidance.

2. Put your money to work with a documented investment strategy. When the plan is established, you may not be as likely to deviate from it - even when markets test our emotions with wild swings.

3. Rather than trying to time your entry points into the market, utilise dollar-cost averaging to contribute to your accounts at regular intervals. Although it does not assure a profit or protect against loss in a declining market, it helps maintain a consistent stream of investing in your accounts.

4. Use funds that automatically rebalance. Or schedule at least an annual rebalancing of your funds that forces you to sell some investments that have grown in value and buy some that have been out of favour. Remember, the idea is to buy low and sell high.

5. Resist impulse when markets are racing or retreating. Make sure your decisions are aligned with your long-term objectives.

Source | Russell Investments

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Foreign Investment Fund Fog



With completion of a second year under the FIF (Foreign Investment Fund) and PIE (Portfolio Investment Entity) taxation regimes, many investors are still confused.

Personal investors, whose FIF investments cost \$50,000 or less in total, do not need to bother with the FIF rules. ("De minimis" exemption). Those with FIF investments above this threshold, family trusts and companies need to comply.

Note that Professional Investment Services' - Discovery custodial service removes complexity in reporting FIF and PIE investment income. Discovery identifies all FIFs and PIEs, crunches numbers and presents simplified reports to investors and accountants for tax return preparation.

The brief treatise below applies to investors holding FIFs on capital account.

What's a FIF?

A FIF is any "equity-like" investment not domiciled in New

Zealand or exempt under the ASX All Ordinaries Index/franking account rule or other exemption. Note, ASX listed trusts and stapled securities are not exempt but IRD now publishes an online list of ASX companies which are excluded from the FIF rules. FIFs do not include offshore "financial arrangements" such as bank accounts or direct investment in bonds or other fixed interest securities. Offshore pension/super funds are covered by specific rules, are complex and usually require specialist advice.

How to calculate FIF income

Individuals and family trusts can use only one of the following methods in any tax year for their portfolio of FIF investments.

1. FDR (Fair Dividend Rate) Income: 5% of the market value in NZ\$ of total FIF interests at the beginning of the tax year (opening balance) PLUS quick sale adjustments. (Needed when the same investment is bought and then sold during a year.)

2. CV (Comparative Value) Income - all NZ\$:

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[closing balance + gross income+ disposals] minus [opening balance + acquisitions]

CV should be used when the total return (capital gains and losses + income) on the FIF portfolio is less than 5%. In the event of losses, assessable CV income is zero. Losses cannot be offset or carried forward.

Exceptions include FIFs which invest predominantly in NZ debt securities and those IRD has determined that FDR should not apply. For these, CV method must be used but losses can be offset against other income.

IRD disclosure

IR3 (individual tax return) and IR6 (trust tax return) forms have only one box for overseas income. This includes FIF income plus any other overseas derived income. Tax paid overseas is allowed as a credit only to the extent that NZ tax is payable on all overseas income. Excess overseas tax credits cannot be carried forward.

IRD has an online calculator which is very useful for calculating FIF income. (<http://www.ird.govt.nz/calculators/tool-name/tools-f/calculator-fif-income.html>)

All FIF income needs to be included in the return

with other overseas income, but FIFs domiciled in countries which do not have a double tax agreement (DTA) with New Zealand need separate, additional disclosure. (Form IR447 for FDR and IR448 for CV).

Which are better – FIFs or PIEs?

Not an easy question to answer! One analysis involves comparison of PIE and FIF as tax structures for international investment options.

Unlisted PIEs which invest in international assets have very simple tax compliance for investors, thus low administration costs. PIE investors also have PIE tax income capped at 30% - an advantage for higher taxed investors.

However PIEs have to assess FIF income internally using only the FDR method, irrespective of underlying portfolio performance but are no longer required to pay tax on dividends.

Individuals and family trusts always have FIF income capped at 5% of opening balance however, unlike PIEs, can use CV in bad years to lower FIF income or reduce it to zero.

The size of the NZ managed funds universe (PIEs) is tiny relative to the rest of the world. Focusing

only on PIEs for offshore investment exposure constrains choice substantially, especially for those with larger portfolios.

The rules are complicated and it is unlikely that we will see simplification any time soon. Seek advice from your Professional Investment Services accountant or adviser to help decide what is best for you.

*Source | John Commins,
Professional Investment Services (NZ) Ltd*

What does blue mean?

Blue is the next of the 'Many Colours of Professional Investment Services' featuring this quarter. Blue is oxygen, the colour of the sky and the primary colour of the Group. It has a calming energy and is the mediator of all the colours.

Blue reflects a friendly and amiable disposition, and for PIS represents the high touch business model and the support that is provided through personalised service to our network. Using blue positively we are able to communicate with clarity for productive and healthy business relationships.

The Value of Income Protection

Matt is a 35-year old self employed electrical contractor living in Melbourne's outer suburbs. He is in a business partnership with his wife, Jenny, aged 30, and they have two young children, aged six and four.



Matt generates the income whilst Jenny organises Matt's work appointments and keeps the books for the business. Matt generates an income of \$110,000 after expenses. The couple have a \$300,000 home mortgage, for which they pay \$2,105 monthly, and a car lease for Matt's work van, with repayments of \$500 per month.

On the weekend, Matt plays baseball with his former schoolmates. One Saturday, whilst sliding into home base, Matt severely twisted his knee. He was taken to hospital, where it was determined that he needed a full knee reconstruction. The prognosis was good, but the doctors instructed Matt to take four months off work to recuperate. Matt's private health insurance covered most of his medical costs. However, what about the income that Matt would lose as a result of his inability to work for the four months?

Fortunately for the young family, about a year ago, Matt had taken out an income protection policy, covering 75% of his after expenses earnings, with a 30 day waiting period. This included the full \$110,000 generated through his personal exertion and amounted to a monthly income (benefit) of

\$6,875. As suggested by his financial adviser, Matt also took out an accident option, which meant the insurer would pay him 1/30th of his benefit for each day that Matt was totally disabled (if he were disabled for at least three days in a row during his waiting period). Since Matt satisfied this definition, he was able to receive the full \$6,875 after the first month of total disability, and a total of \$27,500 for the four months he was off work. The real value of this to Matt would be the ability to pay his mortgage and lease payments, and to maintain the family's lifestyle while he was disabled. Matt was also able to insure his business expenses while he was disabled.

Now consider this: If Matt were permanently disabled due to illness or injury, his lost income until the age of 65 (assuming an inflation factor of 3% p.a.) would be just under \$3.5 million. The amount of income protection that could be paid to Matt in the same period is just over \$2.5 million. This amount would be paid over and above any other insurances he had for total and permanent disability or critical illness. If Matt took a guaranteed agreed-value policy, his income protection benefit, if he were totally disabled would

be payable regardless of a change in occupation, a reduction in income, a change in sporting activities or pastimes or in fact periods of leave or unemployment. In addition, Matt's income protection premiums would be tax deductible based on his marginal tax rate.

Is it expensive? In Matt's case, his after-tax annual premium would be less than 2% of his gross income after business expenses.* This premium would be at blue-collar occupation rates, and would be significantly less for a white-collar professional. In addition, Matt could save money by taking cover at level premium rates (premiums do not increase with age) rather than stepped premium rates (premiums do increase with age), which would initially be more expensive, but would provide considerable cost savings in the long-term.

*Source: Commlnsure - Jeffrey Scott, Executive Manager,
Business Growth Services, Commlnsure*

Don't put your income to chance, contact your Professional Investment Services financial adviser today to protect your most valuable asset – your income!

**Please note that tax rate calculations are based on Australian rates, however the same principle applies in New Zealand.*

Trivia

Adding a drop of olive oil and lemon juice to an ice cube then running it over your face gives you better results than some expensive skin care products.

The national orchestra of Monaco has more individuals than its army.

Tokyo has had 24 recorded instances of people either killed or receiving serious skull fractures while bowing to each other with the traditional Japanese greeting.

The Himalayan goji berry contains, weight for weight, more iron than steak, more beta carotene than carrots, more vitamin C than oranges.

As of 2006, 200 million blogs were left without updates.

Coco Chanel started the trend for suntans in 1923 when she accidentally got burnt on a cruise.

Up to 25% of hospital keyboards carry the MRSA infection.

Music can help reduce chronic pain by more than 20% and can alleviate depression by up to 25%.

The best value consumer purchase in terms of the price and usage is an electric kettle.

The Mona Lisa has no eyebrows. It was the fashion in Renaissance Florence to shave them off.

Honey is the only food that does not spoil. Honey found in the tombs of Egyptian pharaohs has been tasted by archaeologists and found edible.

Source | www.berro.com

Take the drama out of Trauma Insurance

There is a television advertisement running at the moment that suggests it only takes 30 minutes to work out how much insurance a person might need. Unfortunately this is an over-simplification of what is a very serious issue for most New Zealanders.

In the previous article you read a case study about income protection. In this article we will look at trauma insurance which protects you against the impact of a serious illness. Unfortunately, a proper analysis of what you might need should take considerably more than 30 minutes!

When someone becomes seriously ill the implication is that you are unable to carry on your normal activities for a period of time with the possibility that the condition will cause a permanent impairment.

So what do you need to consider?

Firstly, what is going to happen to your income? We have already talked about income protection, but is a lump sum necessary if the condition becomes permanent?

If you are a business owner what would happen to your business and any employees? In this situation you should undertake a detailed review of the implications, for example consider the following issues:

- What is the cost of hiring permanent or temporary staff?
- Will the profitability of the business decline?
- Will you want to sell your business or your share and how much will it cost?
- Will the business stop while you are ill and what would the financial impact be?

Personally, you also need to consider a wide range of issues in the event of serious illness apart from loss of income including:

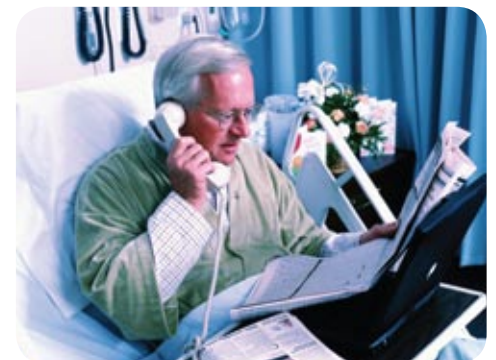
- Will your spouse or partner need to leave work or reduce their working hours to care for you?
- Should you set aside a fund to cover the period of time between diagnosis and any payment of income protection or sickness benefits? This could be up to six months.
- If you are ill for a long period of time how will

you service any debts? Should you consider a sum to pay these off or meet repayments for a period of time?

- Does your health insurance cover all the costs of treatment for serious illness? Would you like to set aside an amount to let you choose alternative treatment?
- Sometimes illnesses result in the need for medical equipment and most medical cover will not provide for the very best support in this area. For example leading edge technology in prostheses may not be available under standard medical insurances.
- What allowance needs to be made for all the extra things that happen when a serious illness is suffered such as taking time off with the family, modifications to the home, getting assistance for things like home maintenance, childcare, transport and rehabilitation.

While trauma insurance, health insurance and income protection can be the financial solution, it is obvious that taking only 30 minutes to consider all of the issues around suffering a serious illness is not enough. As always the best solution is to discuss these issues with your financial adviser to ensure you get the outcome that truly meets your needs.

Source | David Keys, Professional Investment Services (NZ) Ltd.



Wisdom of Great Investors...

Avoid Self-Destructive Investor Behaviour

Chasing the hot-performing investment category or making major tweaks to your long-term investment plan can sabotage your ability to build wealth. Instead, work closely with your financial adviser to outline your long-term goals, develop a plan to achieve them and set the expectation that you will stick with that plan when faced with difficult periods for the market.

Be Patient

Though periods of short-term volatility for stocks are to be expected, it is crucial to bear in mind that historically stocks have rewarded patient, long-term investors.

Source | *Wisdom of great investors - Davis Advisers*

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