



A WARNING: SALARY SACRIFICE

If you salary sacrifice money into super, you may be affected by changes introduced by the government for the 2009/10 tax year. The amount of concessional contributions has been reduced from \$50,000 to \$25,000 for people under 50 and from \$100,000 to \$50,000 for people 50 and over. **And that includes the 9% superannuation guarantee contribution (SGC or employer contribution).** Any contributions over these caps will attract a further **31.5% tax**, on top of the 15% tax which super contributions currently attract.

So if you are salary sacrificing it pays to keep a close eye on your contribution levels, and contact us immediately if you think you will exceed these limits, or if you have any questions about this issue.

Nothing to fear but fear ... and greed

In our last issue we started to delve into the wonders of behavioural finance theory, focusing specifically on the role that investor psychology, emotions and confidence can play in investment decisions and in turn their influence in driving market returns.

Craig Hobart, head of retail for Tyndall Investment Management, now looks at frame dependence and its role in explaining irrational investor behaviour. This concept centres on people having 'frames of reference' when making decisions – particularly when it involves risk or uncertainty. Essentially, these frames of reference centre on an investor's ultimate fear of incurring losses – and this fear can play a powerful role in influencing investor decisions.

Frame dependence

An easy way to think of frames of reference is to picture several boxes or compartments in your mind for different pots of money – and when it comes to making a decision, the outcome depends on which pot of money is being invested.

Let's look at an example of frame dependence. Assume a punter bets \$10 in poker and wins \$50. In their mind, the \$10 is the amount that goes in the 'can't lose' box, and hence goes back in the pocket, while the \$40 goes in the 'can lose' box and stays in the hand. After all, the punter didn't have the \$40 at the beginning of the night (hence seeing it as 'free' money) and is happy to take high levels of risk with that money. By allocating the \$50 between two pots in their mind, the investor fails to make logical decisions. In this example, the punter should look at their total money as if it is in one pot (\$50) and decide how much they wish to risk. This action is likely to result in the punter making more conservative decisions.

The behaviour can apply equally to investing. Investors often focus on the initial capital outlay as the amount 'at risk', rather than the accumulated value over time. For example, assume an initial investment of \$10,000 that in one year rises in value by \$1,000.

Investors will tend to regard the amount of money at risk as being the initial \$10,000, but really the total 'at risk' money is \$11,000. It is this total amount invested that the investor should be constantly re-evaluating when making investment decisions – whether it is to invest more, redeem, or switch to another fund/asset class.

Regret – afraid to make the wrong decision

Another area that falls under frame dependence is regret. The key underlying premise for this behaviour is an investor's fear of incurring losses. Studies by Daniel Kahneman and Amos Tversky have shown that investors feel a loss two-and-a-half times more strongly than a gain of the same amount. They call this phenomenon 'loss aversion'.

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***You don't need to be wealthy to invest.
You need to Invest Well to be wealthy.***

Nothing to fear but fear *cont.* . .

This fear of making the wrong decision often means investors don't assess risk correctly – they tend to over-emphasise risk, which can actually lead to wrong decisions or inertia in making a decision.

Investors need to ask themselves which risk is greater: the risk of making a decision that could lose them money; or the risk of missing out on an opportunity that could make them money? Studies have shown that people tend to have the highest level of regret for actions they didn't take rather than actions they did take.

A different example of regret is investors' difficulty in selling a losing stock. The feeling of regret is strongest when the loss is crystallized – until that point the investor holds out hope of the stock returning to its 'former glory' and avoids generating feelings of regret by holding on to it.

Another aspect to this is that if the investor made the original investment decision by themselves, the feeling of regret is much greater than if they were following someone's advice. It's not so much about the pain of making a loss, but rather the pain of being responsible for that decision. This could explain why investors sometimes find it easier to outsource their investment decisions (that is, to a financial adviser) – apart from needing professional advice, it also means some of the burden of making decisions is shared.

By contrast, professional fund managers acknowledge and seek to control this behavioural risk. This is largely through their disciplined processes that allow them to assess the relative merits of investing in particular stocks and make relatively unbiased decisions – if selling a losing stock is the right decision, the framework will be in place to allow that to occur.

They constantly assess the risk/return trade-off of holding one stock versus another stock. Let's look at an example.

An investor is holding a stock which they paid \$10 for and it is now trading at \$7. They find it very hard to sell the stock and incur a \$3 loss. A fund manager, on the other hand, would look at other stock opportunities and if another stock, identified through their investment process, could offer a forecast gain higher than the original stock, they would have no hesitation in selling the losing stock and buying the other one (after taking into account tax implications and transaction costs).

The fear of regret often leads to inertia in making decisions. In some respects this could be one of the reasons why around 80 per cent of Australians have remained in the default fund in their superannuation plan, despite encouragement from the heavily publicized 'Super Choice' campaigns. As the default option tends to be a balanced fund, this can mean a significantly lower superannuation payout on retirement than if invested in a higher growth option over an individual's full working life.

Not making a choice therefore potentially exposes investors to greater risk – they are swapping the risk of losing money with the risk of not having enough money in retirement. Given many super investors have a very long time horizon,

the latter risk is likely to be significantly higher than the former.

Let's look at an example of how costly an inappropriate investment strategy could be by comparing the outcome of investing in a balanced fund (with a 50/50 weighting in growth and defensive assets) versus a high growth option (with an 85/15 weighting in growth and defensive assets) over a particular investor's working life of, say, 40 years.

Assume:

- The investor in the first year earns an annual salary of \$80,000 which increases at an annual rate of 2.5 per cent per annum in line with inflation and is adjusted monthly.
- The investor invests their compulsory 9 per cent Superannuation Guarantee levy payment (net of contributions tax) each month into a balanced fund over the 40-year period, with the first investment on 1st July 2009.
- Performance is based on projected long-term asset class returns (using the Capital Asset Pricing Model framework, whereby a risk premium for the asset class is added to a risk-free return) for a 40-year period.

By 30th June 2049, by adopting this strategy the investor accumulates a total sum of close to \$2.1 million in the balanced superannuation option.

If, however, the investor had made the same investment into a high growth option over the same period, they would have accumulated a considerably higher amount of around \$2.5 million. That's a difference of nearly 20 per cent or around \$350,000.

That amount would have a significant impact on the investor's lifestyle in retirement. While this example does not include the impact of tax (apart from contributions tax) or fees, it does provide a simple illustration of the difference an investment strategy can make over the long term.

Emotion and the human psyche are indeed powerful forces, often leading investors to make irrational decisions, or sometimes even worse, not making any decisions, both of which can be detrimental to the long-term performance of an investor's portfolio.

The recent turmoil in the global financial markets has highlighted two of the most extreme emotions – that of greed (associated with good times, optimism and hope) followed by fear (reflective of uncertainty and pessimism) – with ironically the former playing a role in causing the latter.

By removing these emotions and psychological behaviours from the decision-making process, investors are in a better position to make logical and rational decisions.

Seeking professional investment advice from a financial planner, taking a long-term view, constructing portfolios based on the investor's risk/return profile, and investing with professional fund managers are steps an investor can take to help them achieve this. ✱

Survey results

We would like to thank all of you who have recently participated in our Client Satisfaction survey. If you have not yet taken the opportunity to take part in this survey, please do so, as we really welcome your thoughts. You can take part by typing the following link in your internet browser.

<http://www.surveymonkey.com/s/W3RSMZH>

If you wish to participate, but do not have access to the internet, please contact Chanel on (03) 9642 1266 and she will organize for a paper-based copy to be sent to you to complete and return to us.

Feedback has been taken on board and we are currently collating the results received to date. We have summarised the results that initially stand out.

Services you find valuable

Annual review

Three-quarters of respondents felt an annual review was a valuable service. We agree, and this year have taken a more pro-active approach.

We are now sending clients an invitation to arrange a one-on-one review, together with a Review Questionnaire on an annual basis in order to update their current situations so that we are provided with an insight as to whether their current portfolios are still meeting their original objectives or whether objectives have, in fact, changed.

When we receive the completed questionnaire, client records are updated in line with the details provided within the questionnaire and the client contacted to arrange an

appointment for a review meeting.

If you have not yet received a Review Invitation and Questionnaire, you should receive one in the next three to six months. Of course, you are welcome to ring at any time and arrange an appointment for a review.

Newsletter

Just over half the respondents found the newsletter valuable. We are pleased with this result, as our financial planners put in a lot of effort to find and write articles that are topical and would appeal to the wide variety of interests and lifestyles of our clients.

Communication topics

More than half of respondents would like information on current market situations and trends, as well as performance updates from their fund managers.

We are therefore reviewing these areas and organizing to send regular updates to those clients that request them. So please let us know if you want to be on this mailing list.

We really appreciate any feedback we get from you, so please don't wait for a survey to let us know how we can enhance your experience with us. We would like to know whenever our contact with you is below your requirements and expectations and welcome any further contributions from you in this area. Of course, we would also be delighted to hear any positive feedback you may have – it helps us to know what we are doing right, so we can ensure we maintain and improve on that level of service as well. ✱

Keep an eye on your employer super (SGC)

If you're employed, you probably take for granted that your employer is paying the compulsory Super Guarantee (SG) contribution (which forms part of your salary package) into your nominated super fund.

A key objective of the SG system is to help you build savings to generate income for your retirement. If your employer goes out of business and you discover your SG contributions haven't been made, it can be devastating — especially if you're close to retirement.

For the majority of Australians, this SG contribution is paid without a hitch. However, last year, the Australian Taxation Office (ATO) received around 20,000 complaints from people whose employers had failed to pay their SG contributions.

This has prompted the ATO to review the SG scheme as part of the wider Australian Government review into Australia's

superannuation system. The ATO administers the SG system, including collecting SG contributions from those employers who don't meet their obligations.

The Association for Superannuation Funds of Australia (ASFA) has made a number of recommendations to improve the SG system, including expanding the requirement that employers provide details of SG contributions on payslips. ASFA recommends that details should include the date that contributions are paid so that employees can monitor the receipt of payments into their super fund.

So keep an eye on your super fund to make sure your SG contributions are being paid. It may be too late for the ATO to get outstanding payments if your employer goes out of business. ✱

Why do we look at risk management?

And how does it benefit you, our clients?

No matter what your circumstances are, having the right risk management plan in place will preserve your freedom to enjoy the life you want for you and your family. As much as we would like to think that “it’ll never happen to me”, the reality is that none of us knows what the future holds.

Protecting your lifestyle? No income equals lots of worries! It’s crazy but our income and our health are often the last things that we insure yet they are the most fundamental assets that we have.

Protecting your family? What if you lose your income either temporarily or permanently? The fact is, suffering a major health setback can actually happen at any time in your life, not just when you’re older. The effects can be financially devastating to you and your family.

Many individuals are poorly prepared for the risks that they now take. For some, retirement savings are inadequate, debts are high, or for many, they are simply vastly underinsured. As financial planners, we can play a crucial role in assisting our clients better manage financial risk.

Look at some statistics - **are the risks really worth it?**

- 50,000 heart attacks in Australia
- Over 1,600 people die on Australian roads every year, most are aged between 26-59 years
- Every day almost 7 women die of breast cancer
- Almost 40% of all deaths in Australia are caused by cardiovascular disease
- 1.10 million Australians are disabled long-term by heart,

stroke and vascular diseases

- One in 9 Australian men will develop prostate cancer by the age of 75
- 1 in 6 men and 1 in 4 women are expected to suffer a disability from the age of 35 to 65 that will cause a loss of up to 6 months from work

Where to from here?

Good financial planning is simply reassurance for yourself and your family. We can work with you to develop a risk management plan. Of course, we all have different situations in life, so we tailor the plan to account for your personal objectives, financial situation and needs. ✱



CHRISTMAS/NEW YEAR BUSINESS HOURS

Our office will close from 12 noon, on Wednesday, 23rd December 2009 and re-open on Thursday, 7th January 2010. If you need urgent advice or help during this time contact:

Michael Russell 0413 000 297, or

Ben Crowe 0413 851 891

We hope you, your family and friends, have a wonderful break over Christmas and the New Year, and we look forward to continuing to give you every assistance to achieve and maintain your financial goals.

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