

your money your future

FINANCIAL PLANNING NEWSLETTER



Women and the super myth

Careful retirement planning is important for all Australians, but it's especially important for women.

The pay disparity between men and women, combined with the different lengths of time each group spends in the workforce, means many women end up with much less super in retirement than their male counterparts.

The ongoing casualisation of many traditionally female jobs and the fact that much unpaid work falls largely to women further compounds the problem.

When a woman takes a break from paid work to raise children or care for family members, she not only forgoes her wages, but also a portion of her retirement savings, as superannuation payments are linked to paid work.

The figures make stark reading. A 30-year-old woman with an annual salary of \$50,000 who takes six years out of the workforce could miss out on \$58,000 in retirement savings by the time she is 65.*

According to the Association of Superannuation Funds of Australia, in 2006 the average superannuation balance for women was half that of men: \$35,520 compared with \$69,050. And the average retirement payout for men is more than double that of women: \$136,000 compared with \$63,000.†

The current 9 per cent superannuation guarantee paid by employers is already deemed to be insufficient to fund a comfortable retirement according to the Labor Government which plans to increase compulsory super contributions. This leaves most women reliant on the pension to fund their retirement either in part or in full.

Meanwhile more than half of women in their 60s have no superannuation at all, reflecting lower rates of participation in the workforce and the relatively recent introduction of the superannuation guarantee in 1992.

The problem is increased by the fact that many women believe their partner's superannuation will be enough to cover them both and they don't worry about having a Plan B.

Women need economic independence, regardless of how supportive and generous their partners are, in order to have a sense of control and help them to make their own financial decisions.

Sadly, relying on a partner for support may not be an option for all women. An increasing number of Australians are

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* This example is calculated using ASIC's FIDO Superannuation calculator - <http://www.fido.gov.au/fido/fido.nsf/byheadline/Superannuation+calculator?openDocument> - and based on various assumptions including, but not limited to: an annual salary of \$50,000, six years out of the workforce, super invested for 30 years, a return of 7 per cent pa, with all earnings reinvested, no administration fees or charges deducted, no salary-sacrifice contributions, no after-tax contributions, invested in a balanced portfolio (ie \$232,000 - \$174,000 = \$58,000 is lost super).

† Clare, Ross 2008 'Retirement Savings Update', ASFA 2008 - <http://www.superannuation.asn.au/Reports/default.aspx>, <http://www.superannuation.asn.au/mr080211/default.aspx>

Women and the super myth continued

affected by relationship breakdowns, with divorce rates rising from 28 per cent to 33 per cent of marriages between 1987 and 2002.[‡]

And women can least afford reductions in their retirement income. Their higher life expectancy – women outlive men by almost four years – means they will need their retirement savings to last for longer.[§]

This means it's even more important for women to look at boosting their super with strategies such as additional contributions, super splitting, spouse contributions and co-contributions.

The more women put into super at an earlier age, the greater the benefit they can accrue from compounding interest.

Using the government's co-contribution scheme is one way women can increase their super savings in their less-productive years. If a woman is earning less than \$61,920 per annum, she may be entitled to a government co-contribution of up to \$1,000 when she makes a personal after-tax contribution of \$1,000 to her super.

‡ ABS 4102.0 Australian Social Trends 2007

§ Superannuation Savings Gap for Women, IFSA / Rice Warner, March 2010 – <http://www.ifsa.com.au/resource-centre/publications.aspx>

Spouse contributions are another option. If a woman takes time out of the workforce and is earning less than \$10,800 in total income, her partner could contribute up to \$3,000 into her superannuation fund and receive a tax offset of 18 per cent, providing a tax saving of up to \$540 each financial year. Where a woman's income is above \$10,800, the offset is calculated on \$3,000 reduced by \$1 for every dollar her income exceeds \$10,800.

Super splitting is another strategy from which some couples can benefit. It may be advantageous for the spouse on the higher marginal tax rate to salary sacrifice or make additional contributions and split part of this off to the spouse on a lower income.



Whatever strategy works best, there is no doubt that early and careful planning can reduce the impact that years spent outside the workforce and pay disparity can have on women's retirement savings. And the sooner you start saving, the greater the benefit in the long run.

Dividend imputation

Dividends, the Australian way

In a period when investor confidence has taken a few heavy hits, there is something reassuring about dividends. They are good news: they translate to real money in your pocket.

And dividend imputation gives those dividends an extra boost. The Australian system of imputation or franking was introduced in 1987 to avoid double taxation. It is simple in theory if not always in practice; investors who receive dividends from companies which have already paid Australian company tax will receive a tax rebate equal to the tax the company has paid, that is, the dividend is 'franked'. (Dividends are referred to as fully franked, partially franked or unfranked.)

Most companies pay tax each year and when they do they are able to pass on franked dividends to their shareholders. Many larger industrial companies pay enough tax to be able to attach a full tax credit to their dividend – in other words, their dividends are fully franked. If less tax has been paid and a tax credit cannot be attached to the entire dividend then part of the dividend may be franked, and the rest unfranked.

The payoff in your pocket

The effect dividend imputation has on individual investors mainly depends on two things: the investor's own taxable income, and how much tax the company paid before it distributed dividends.

If your marginal tax rate is higher than the company tax rate at which the tax credits have been calculated – currently 30 per cent – then you will have to pay tax to make up the difference between your marginal rate and the company rate.

If your marginal and/or average tax rate is less than 30 per cent, then not only will you pay no tax on the franked dividend, but you will also receive a tax credit. You can use this credit to offset tax that you would otherwise have to pay on other income.

If your taxable income is too low to make you liable for tax, or the franking credit exceeds your overall tax liability, then you are entitled to receive a refund from the Australian Taxation Office (ATO) for any excess franking credit.

This applies in superannuation funds as well. As super is taxed at up to 15 per cent in accumulation phase or is tax free in pension



phase, fully franked dividends received by a super fund result in additional tax credits in the super fund at the end of the financial year, courtesy of the ATO.

For Australian investors, it's reassuring to know that dividend imputation provides substantial tax advantages to every share owner, regardless of their tax situation.

Rebalance – and tone up your investments

What is rebalancing?

Portfolio rebalancing is the process of bringing the different asset classes in your portfolio back into the shape set out in your financial plan. By rebalancing regularly – for example every 12 months or after a significant change in the market – you exercise essential financial disciplines by checking risk tolerance, time horizon and financial goals. And you keep your portfolio in good financial health.

Rebalancing is important because the different asset classes in your portfolio such as shares, bonds, cash or property, are not synchronised. Over any period, some will move more strongly than others, even within the same asset class. Within Australian shares, for example, the performance of mining shares could outstrip retail or bank shares.

But if your portfolio is increasing in value, why does any of this matter?

The reasons may not be obvious at first, but they are important. Because asset classes tend to rise and fall in cycles, a big increase in the value of your mining shares, for example, could leave you exposed and in a loss-making position if there was a fall in mineral prices and a drop in the value of those same shares just months later. In fact, the loss could wipe out a year or more of gains. (Think about the dotcom bust of 2000, for example, or compare Telstra's current price with what it was three years ago.)

The major purpose of rebalancing is to manage risk – to correct any over or under exposure to one or more asset classes. At the same time you are also sticking to the basic rules of disciplined investing, and this in turn is likely to boost the long-term performance of your portfolio.

Why do portfolios need regular rebalancing?

Consider the following case history. Alice invests \$100,000 in a growth-oriented portfolio made up of Australian and international shares (\$65,000), bonds (\$30,000) and cash (\$5,000). The share market has a great year, and 12 months later Alice's portfolio looks quite different: shares \$81,600, bonds \$31,150 and cash \$5,250. Her portfolio has gone up by \$18,000 and she is very happy indeed, as she should be.

At the same time, Alice's portfolio is now out of balance, leaving her more exposed than she wanted to be to the share market, with less of



a buffer from the bonds and cash that provide stable returns. To rebalance, she has to sell some of her shares and reinvest the money in other asset classes to again reflect the original portfolio allocations of 65 per cent in shares, 30 per cent bonds and 5 per cent cash. She can either sell off some growth stocks and reinvest the proceeds in cash, or review the entire share portfolio and weed out underperformers – in practice, usually a combination of both.

Rebalancing for profit

The good news is that while she is bringing it back into balance, Alice's portfolio is getting stronger. She is locking in some profits when share prices have risen, and adding to her cash and bond holdings. She is putting into practice two important principles of successful investing:

- 1 Sell high, buy low. By selling off some of the top performers, you are taking your profit before that asset sector falls, and reinvesting the profits in lower-priced asset sectors that have potential to become top performers in the future.
- 2 Discipline. By investing in a disciplined, balanced way, you resist the temptation to anticipate or guess which sector will come out on top next year. Figures show that taking that approach – chasing the market – usually ends in tears.

Positive money management

By rebalancing your portfolio you will experience fewer negative returns than if you left it alone, and when the market cycle changes you'll have more capital in higher performing asset classes to take advantage of the upswing.

If your money is invested in a multi-asset-class managed fund, your fund manager will almost certainly rebalance to stay aligned with the fund's investment objective. And if you manage your own superannuation fund or have direct shares or other investments, following a regular rebalancing cycle is a simple discipline but one you should take seriously.

However, remember that if you sell some of your shares you may bring forward tax liabilities, depending on your current and likely future tax rates.

Rebalancing may seem simple in theory, but it is good practice to seek the advice of a professional to assess the full implications – the strength and performance of your portfolio depend on it.

Sources

- 1 Chasing the market, P. 1, point 2: Historical Asset Class Performance: Major Market – Risk and Returns, 1987–2009 (AXA data)

Linking up for life

Applying for any insurance policy can often seem like a lengthy and overly rigorous process, and life insurance is no exception. But there is good reason behind these robust application processes. With every life insurance policy, there are two parties: you and the insurer. We take out insurance to protect ourselves against the risk that 'something' might occur, whether that is falling ill, suffering an injury or worse. The insurer takes on this risk in return for payment of an annual premium.

Because of many different factors, some of us carry higher levels of risk, be it through poor health or genetics. To accurately determine the amount of risk that an applicant carries, insurers need to know as much about you as possible. This allows them to ensure premiums and investment incomes received are sufficient to cover claims paid out.

Assessing risks upfront helps to keep your premiums affordable over time, and keep premiums to a minimum for the largest number of people. Because these individual risks are assessed at the outset (called underwriting), 'healthier' applicants don't have to pay higher premiums to subsidise 'less healthy' applicants. This is in contrast to private health insurance where people are not individually risk assessed, but there is an element of cross subsidy used to keep premiums down.

Interestingly, once you have taken out a life insurance policy, your insurer is obliged to offer you the opportunity to renew your policy at the agreed premium every year, even if your health has deteriorated. In other words you could become seriously ill and the insurer will still honour their obligation to offer you cover without charging you more, or refusing cover. While it is not a legal obligation under the Insurance Contracts Act, all companies comply by contractually including this guarantee into their policy definitions, some up to a certain age – say 60 or 65 – and others for life.

All this means that the application process requires thoroughness, especially if you are seeking a significant level of cover. And that's why insurance premiums are calculated by weighing up the key risks – age, gender, employment, whether or not you are a smoker, your medical and family history, plus the amount of cover you want.

Benefits of early cover

The younger and healthier you are, the lower your premiums. That creates a strong incentive to take out cover sooner rather than later, while you are at your healthiest. In some cases cover for younger people or for



lower dollar amounts may be granted without the need for a medical or a blood test.

Maintaining your cover

With the insurer obliged to offer you cover year in, year out, it makes sense from your viewpoint to maintain your cover, at all costs. Once you stop paying premiums, even for a short time, you will need to be reassessed if you decide to take out a new policy. So be warned!

The fact that you may have had cover for 10 years and only stopped for two years makes no difference. If you have high cholesterol levels or your body mass index (BMI) shoots up, your premium will be weighted according to the extra risk that you now present. Potentially you could have exclusions written into your policy meaning your coverage is not as comprehensive as it had been, or you could even be refused cover outright, depending on the seriousness of the change to your health (or occupation or pastime). Your earlier cover, and the guarantee attached to the earlier cover, are not considered.

Covering your mortgage and debts

Life cover has become even more important over recent years, particularly with the levels of debt that Australians now carry

later into life. According to the most recent available figures from the Australian Bureau of Statistics on household income, 74.5 per cent of couples where the eldest dependent child is aged 15–24 still had a mortgage in 2007–08 compared with just 67 per cent in 2000–01. Given the growth in house prices, this figure is more than likely to have increased further.

These figures show how important it is to maintain life insurance cover so that your family is not exposed to great financial hardship if tragedy strikes. Clearly that's not where you want yourself or your family to be.

Coverage when you need it most

Knowing where you stand with your insurer is important, so it's helpful to consider it from their perspective as well as yours. Maintaining your cover over time means that should things unravel at any stage of your life, you have peace of mind knowing your family will be provided for.

If you are unsure about your level of life cover, why not contact us to discuss your situation and make sure you are getting the maximum benefit from your policy.

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