



WEALTH CREATION AND INVESTMENT

Managed Investments

Once an appropriate investment strategy has been determined, there are usually a number of possible implementation options. Depending on the strategy, the options may include managed investments, bank products, direct investments such as shares, and direct property. All of these investments could have a place in a portfolio. However, there are some unique advantages with managed investments.

Benefits of Managed Investments

The benefits of managed investments include:

- **Diversification** - The large pool of investors' assets available to fund managers allows them to diversify the spread of investments and provide access to investments which may not be readily available to individual investors. For example, large retail property complexes and international shares.
- **Cost Efficiency** - Most stockbroking firms charge between 1.5% - 2.5% for every transaction made by a client, e.g. buying, selling or switching. The buy and sell price, transaction fees and stamp duty charges of a professionally managed direct share portfolio may easily exceed the total costs of an average equity trust. Similarly, with property, the total costs to buy, sell, hold and manage, may exceed total unit trust costs.
- **Professional Management and Expertise** - Fund managers have the expertise to review and research investment opportunities and apply their experience to actively manage investment portfolios.
- **Liquidity** - Investors in managed investments can usually access funds within 5-30 days (excluding superannuation investments) and are usually able to access a part of their funds without needing to redeem the whole investment.
- **Regular Reporting and Information** - Managed investments take care of the administrative requirements and expenses that often accompany direct ownership of investments. Fund managers provide regular information to investors regarding investment performance and also provide tax summaries at the end of the financial year.
- **Protection** - Managed investments are regulated by the Australian Prudential Regulation Authority and Australian Securities and Investment Commission. Requirements provide for minimum levels of disclosure by the fund manager, and regulate the level of financial resources of the manager.

Types of Managed Investments

Different types of managed investments are used to achieve different investment sector allocations and varying investor goals. Managed investments can be categorised according to four main criteria

- **Investment Tax Structure** - Superannuation (including rollover funds), trusts, insurance bonds, friendly society bonds and allocated pensions or annuities.
- **Asset Classification**
- **Income Fund** - Cash, fixed interest, mortgages.
- **Equity Fund** - Industrial and resource shares, direct, listed and unlisted property, other equity related securities.
- **Multi Sector Funds** - funds which do not fit into the other categories of Income or Equity.
- **Geographical Location** - Australia, United States, Japan, European Economic Community, South East Asia, Global.
- **Product Type** - Retail, Wholesale or Corporate.

Income, Equity and Multi Sector Funds are discussed in more detail below.

Income Funds

Types of Income Funds include:

- **Cash** - consisting of 100% liquid assets, where liquid assets are defined as securities with maturity less than 180 days. These securities include 90-day bank bills, certificates of deposit,
- **Mortgage Fund** - These funds principally invest in residential or commercial property mortgages and provide regular income for medium

treasury notes, promissory notes and non bank bills. These funds are immediately available and are useful for emergency cash needs and short term investing. Interest rates may change daily in accordance with the demand for the securities the funds invest in, but the capital, while not guaranteed, is not expected to fall because of the nature of the underlying securities.

- **Enhanced Cash** - where liquidity is at least 80%, and where liquidity is defined as securities with maturity less than 180 days. Securities included are the same as for Cash.
- **Fixed Interest** - Funds are invested in securities issued by the Australian banks, government and semi-government authorities and major financial institutions where the fixed interest component is 75% or greater. Fixed interest funds provide regular interest income for medium to long term investors. The initial investment is not guaranteed and may rise or fall depending on the current interest rate market.
- **Capital Guaranteed** - These funds come with a guarantee that the capital will not fall and may apply to any Income Fund, i.e. Cash, Fixed Interest, Mortgage or Diversified. With some funds the guarantee only applies to the initial amounts invested, but more typically the guarantee will apply to the total value, including all interest credited to date. These funds may also have some additional conditions regarding redemption.

to long term investors. Such funds will normally contain at least 50% mortgages.

- **Diversified Fund** - These funds may have a mix of cash, fixed interest, capital guaranteed and/or mortgages where none of the specific income funds is dominant.

Equity Funds

Types of Equity Funds include:

- **Industrial Equity** - These funds have a high proportion (75% or more of the fund) of Australian industrial shares. International shares, other equity related securities (e.g. a derivative such as a warrant), resource shares and property constitute less than 15% of the total fund.
- **Resource Equity** - These funds have a high proportion (75% or more of the fund) of Australian resource shares. Other equity related securities (e.g. a derivative such as a warrant), industrial shares, international shares and property constitute less than 15% of the total fund.
- **Property Securities** - These include listed, unlisted and direct property holdings, which in aggregate are generally greater than 75% of the total fund. Listed property alone is generally greater than 65%. Listed refers to funds listed on the stock exchange. Unlisted refers to those funds not listed on the exchange but supported by a prospectus. Direct property refers to the fund's direct financial interest in property.
- **Listed and Unlisted Property** - These include listed, unlisted and direct

property holdings, which in aggregate are generally greater than 75% of the total fund. Unlisted and direct property holdings generally total greater than 65%.

- **Diversified Equity** - The fund may have a mix of equities and property where none of the specific Industrial, Resource or Property funds is dominant.

Multi Sector Funds

Multi Sector funds contain a mix of cash, fixed interest, shares and property investments, which could not be categorised as Income or Equity funds. They include:

- **Conservative** - The equity content of the fund is generally greater than 10% but less than 30%.
- **Moderately Conservative** - The equity content of the fund is generally greater than 30% but less than 60%.
- **Balanced** - The equity content of the fund is generally greater than 60% but less than 70%.
- **Growth & High Growth** - The equity content of the fund is generally greater than 70%.
- **Multi Sector Capital Guaranteed** - These funds come with a guarantee that the value of the capital will not fall. With some funds, the guarantee only applies to the initial amounts invested, but more typically the guarantee will apply to the total value, including all interest and capital credited to date. These funds may also have some additional conditions regarding redemption.

Account-based Pensions

An “account-based pension” or “pension” (formerly known as an Allocated Pension) is a investment vehicle, which enables the investor to receive a regular income stream. It is most commonly used to allow retirees to access unpreserved superannuation funds. However you may purchase a pension at any age with unpreserved or non-super money.

Account based pensions operate like a regular bank account with investment earnings being added to the account balance and withdrawals (or regular pension payments) being deducted.

The taxation treatment of an account based pension payment is as follows:

- If the superannuation proceeds with which you purchase the allocated pension included an Undeducted / Tax Exempt Component then part of your pension payment will be tax deductible, the ‘deductible amount’.
- Your pension payment, excluding the deductible amount, will be subject to tax at your marginal rate. The portion of this amount that is not sourced from an excessive superannuation benefit will attract a 15% rebate if you are over 55 years of age.
- From 1/7/07 if you are over 60 years of age all superannuation pensions including account based Pensions are tax free.

Account based pension income payments are legislatively governed. Payments are subject to a minimum and a maximum amount, which are dependent upon age and remaining capital. These minimum and maximum amounts are recalculated each 30 June and apply for the financial

year thereafter. From 1/7/07 maximum limits have been removed, unless the AP is a Transition to Retirement “TTR” Allocated Pension taking out while you are still working in which case a maximum drawdown of 10% of the start balance of the pension will apply.

At your discretion you may chose to cease receiving income payments, effectively cancelling your allocated pension, by withdrawing the remaining capital. This is known as ‘commuting’ your income stream and the withdrawal is a Superannuation Lump Sum (formerly known as an Eligible Termination Payment or ETP), which can either be rolled over into another superannuation fund, pension or annuity, or taken in cash as a lump sum and subject to Superannuation Lump Sum tax. Again from 1/7/07 if you are over age 60 Superannuation Lump Sum tax will not apply.

The main advantages of these types of investments include:

- **Tax Deferral** - Lump sum tax is generally not paid when funds are rolled into a pension, unless the pension is subsequently commuted to cash. Also from age 60, the pension income and any lump sum withdrawals are tax free.
- **Pension Payment Amount** - The pension payments are very flexible and usually allow for the amount and frequency of the payment to be changed annually, and in some cases more frequently.
- **Commutation** - Lump sums can be withdrawn and are usually taxed under the Superannuation Lump Sum tax rules.

- **Reversionary** - The pension balance can be paid to your estate on death or you can elect to have the pension payment revert to your spouse. Thus there is no loss of capital upon death.
- **Investment Choice** - A range of investment options is available within the fund. These investments may be changed annually, or in some cases more frequently, if desired.
- **Tax Effective Earnings** - The investment earnings added to the account balance are tax free within the fund, and therefore this is a very tax effective way in which to invest capital in your retirement.
- **Tax Concessions** - The pension payments are taxable but may be subject to a deduction if your superannuation contains a Tax Exempt component (arising from Non-concessional contributions which are made out of post-tax income). Additionally a tax rebate of 15% is also available on the taxable pension income. From 1/7/07 if you are over age 60 the pension is not taxed and so this 15% rebate is not relevant.
- **Social Security** - For Centrelink purposes the pension account balance is treated as an asset under the Assets Test. In addition the pension income paid by the account based pension is only partially assessed under the Income Test. The amount regarded as your 'return of your capital' (purchase price divided by your life expectancy) is not assessed as income.
- **No Guarantee** - Account based Pensions do not guarantee that your pension payments will last throughout your lifetime. The factors that govern how long your pension will last include the investment performance of the managed fund and the amount of your annual pension payments.
- **Ownership** - The pension can only be held by the owner of the superannuation fund or rollover assets. Transfer or joint ownership is not permitted.
- **Legislative Risk** - The Federal Government may change the rules governing your superannuation investments. Such changes could have an adverse effect on your entitlements.

Complying Annuities

A complying annuity is an investment that pays a regular fixed income amount that is guaranteed for its term. It may be purchased with superannuation or ordinary money.

The taxation treatment of a complying annuity payment is as follows:

- If the superannuation proceeds with which you purchase the complying annuity included an Undeducted / Tax Exempt Component then part of your annuity payment will be tax deductible, the 'deductible amount'.
- Your annuity payment, excluding the deductible amount, will be subject to tax at your marginal rate. The portion of this amount that is not sourced from an excessive superannuation benefit will attract a 15% rebate if you are over 55 years of age unless the pension is already tax free (from 1/7/07 for those over age 60).

The disadvantages of Pensions include:

Complying annuities are legislatively governed and must have the following characteristics:

- Their term must be either lifetime (if under age pension age) or for a fixed term (whichever is the lesser of life expectancy or 15 years).
- Payments must be fixed. However they may increase with CPI or at a fixed rate no greater than 5% p.a.
- Payments must not be commutable.
- They must not have a residual capital value.
- There are restrictions on reversionary benefits.
- They may have a guaranteed period of no more than 10 years, and only on lifetime products.

The main advantages of these types of investments include:

- **Tax Deferral** - Lump sum tax is generally not paid when funds are rolled into a complying annuity.
- **Reversionary** - A complying annuity may revert to your spouse on death.
- **Social Security** - For Centrelink 50% of the amount invested into a complying annuity is exempt under the Assets Test. Complying annuities will be fully assets tested from 20/9/07. The pension income paid by a complying annuity is only partially assessed under the Income Test. The amount regarded as your 'return of your capital' is not assessed as income.
- **Payment Guarantee** - Complying annuity payments will last for the nominated term of the annuity.
- **Fixed Payment Amount** - Complying annuities are not market linked investments, and the annual fixed

income amount will not be affected by changing market conditions.

- **Guarantee Period** - Some complying annuities offer guaranteed payment periods. If you die during this period, the value of unpaid guaranteed payments may be paid to your estate.
- **Tax Concessions** - A tax rebate of 15% is available on taxable annuity income (this is only relevant from 1/7/07 if you are between 55 and 59).

The disadvantages of a complying annuities include:

- **Capital Loss** - Upon death a complying annuity may revert to your spouse or you may elect to have any remaining guarantee period payments paid to your estate. Notwithstanding, any remaining capital is lost upon death.
- **Not Commutable** - Complying annuities not commutable.
- **Legislative Risk** - The Federal Government may change the rules governing your superannuation investments. Such changes could have an adverse effect on your entitlements.
- **Payment Inflexibility** - Annual payments are fixed notwithstanding annual indexation increases.
- **Interest Rate Risk** - Your annuity payments are set when you purchase your annuity. The prevailing interest rates influence the level of your annuity payments. By purchasing an annuity at a time of low interest rates you are at risk of under utilising your purchase proceeds and receiving low real return over the period of the annuity.

Use of Master Trusts and Wrap Services

Investors and advisers have come to understand the importance of diversification, portfolio reviews, ongoing service and flexibility. In response to this demand master trusts, also known as wrap services, have evolved.

A master trust is an efficient method of investing funds that allows access to a selected range of investments. Master trusts enable investors to invest in selected unit trusts or managed investments via one investment vehicle. Many investors use master trusts for wealth creation, superannuation and post retirement investments such as allocated pensions.

Master trusts allow for the consolidation of all holdings into single financial statement regardless of the number of investments the investor selects. It produces regular reports on the progress of your investments and simplifies the processes of adding, withdrawing or making changes to investments. Some master trusts provide internet connectivity allowing you to follow the trends in the value of your portfolio. A number of reports are prepared by the master trust including portfolio valuations, income and tax reports, realised and unrealised capital gains reports, market exposure reports and corporate action reports.

No matter how many investments an investor has chosen, all are administered centrally on their behalf, reducing paperwork and enabling investment performance to be easily tracked. A wide range of investments, into a variety of asset classes, can be made via master trusts. Each managed investment will have a particular investment style so the

investor can select both diversification of investment and investment manager.

Master trusts generally offer investments at wholesale rates with reduced ongoing annual fees relative to their equivalent retail funds. The master fund provider may charge an entry fee and will often charge an ongoing administration fee.

When all investments are made through one master trust, the investor is better able to monitor the performance of the portfolio. This is because the master trust consolidates all information received from the fund managers and prepares a regular report for the investor. Investors with complex portfolios, or those who simply do not want to be concerned with the task of having to monitor individual investments, can benefit from the use of master trusts.

Master trusts have a manager and a trustee. The trustee holds title to all the trust assets and ensures the manager abides by the trust deed. Depending on the trust deed, the master trust's investments will include unit trusts and direct investments. All assets and income from these investments is pooled and beneficially owned by all investors. Accordingly, the tax treatment of investments held within a master trust is the same as if the investor held the investments in his or her own name. Social security treatment is also the same.

The flexibility of master trusts varies, but in general the advantages of a master trust include:

- Access to a large range of investments despite small invested amounts, thereby achieving portfolio diversification. Some master trusts offer a limited number of products from which to choose, while others offer a very broad range.

- Access to cost efficient wholesale funds when buying and selling.
- Portfolio restructuring is carried out simply and at no cost. You have control over the strategic decision, i.e. which fund to invest in, without the necessity to manage the day to day investment decisions.
- Easier management of paperwork via consolidated reporting. This includes taxation reporting.
- Additional features such as gearing and insurance are often available. These provide the ability to implement complex strategies.
- Managed by dedicated professionals who continuously monitor your assets.
- Access to world wide markets and research.
- Prudential governance and high standards of reporting.

In choosing a master trust look for the following features:

- Diverse list of supported investments.
- Access to specialist managers.
- Competitive annual management fees.
- Efficient reporting and administration.

Operation

A master trust has a Cash Account which acts as the hub of the service. All cashflows pass through the Cash Account. The initial investment is placed in the Cash Account, and from here all investment transactions occur. A minimum balance is maintained in the Cash Account at all times.

If, for example, you were investing in managed funds and direct equities, money would be placed into the Cash Account first, and then invested in the recommended investments from there. Distributions, dividends and investment sales are automatically credited to the Cash Account. Where distributions or dividends are re-invested, they are then automatically re-invested according to your current recurring investment allocation. Should any investments be redeemed the proceeds are initially deposited into the Cash Account, from where they can thereafter be withdrawn.

If you would like to take advantage of our free consultation or would like to know more about our services please contact us on (07) 3832 6020,
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