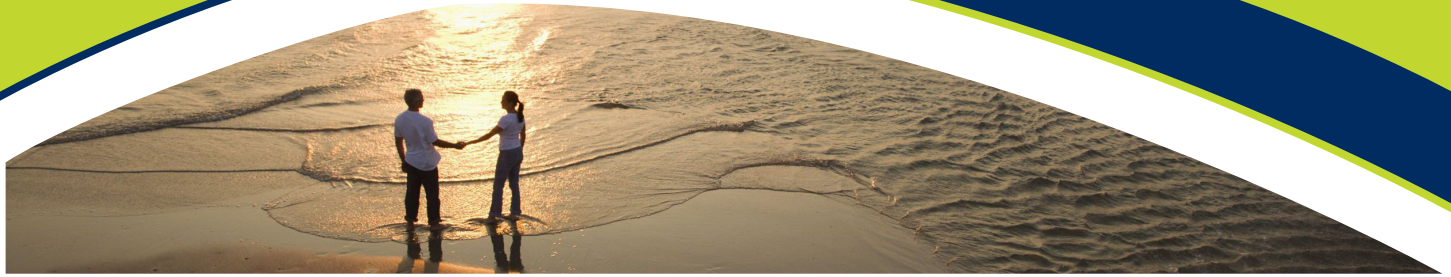


According to us

newsletter

Summer 2010/11



The platform is set

by Geoff Greetham, Executive Director

With summer almost upon us, it is timely to reflect on the year almost past.

Despite navigating the Global Financial Crisis more successfully than most countries, the Australian market has been a relative underperformer this year trading in a fairly narrow range for most of the year.

The relative underperformance to European and US markets has perhaps stemmed more from the fact that other markets had more scope for recovery, given the bleak news which had engulfed them, compared to the relatively robust economic numbers generated locally over the past few years – even allowing for some noticeable pockets of weakness, e.g. retail.

We hope that Australia has witnessed a year of consolidation and that some of the fruits of this will be borne out in the next few years, driven by our northerly neighbours, China and increasingly India.

That said, even though we are well placed – abundant with resources with an open Westernised system of governance – not everything that we dig out of the ground stands to benefit, which Paul Kasian, our Chief Investment Officer, addresses in detail in this edition. The trick is naturally to identify the likely winners and losers.

Another feature of the year just past has been the caution exhibited by investors in actually investing, counterbalanced by a need for reassurance that financial strategies and structures are in place.

The Henry Review delivered in May, came with much fanfare, and was presented under the grand title of Australia's Future Tax System. It promised to deliver significant taxation change but underwhelmed. Changes to superannuation were also expected. Some were announced, and confirmed in the May 2010 Federal Budget, but have yet to be legislated.

We cover one of those changes – the possible extension of the concessional contributions caps for those aged 50 or over, with superannuation balances less than \$500,000 – which it may be well worth planning for, given the benefits it brings.



On a separate note, owing to a variety of reasons, we were unable to hold our Christmas function this year – no, you did not miss the invitation. We therefore wish you and your family a belated Merry Christmas and Happy New Year.

Once again we welcome any feedback from you as to requests for information and suggestions for topics you would like addressed in future editions.

And with that, roll on 2011!

How to divide and rule in superannuation

by Geoff Greetham, Executive Director

A few years ago, the concept of super splitting was introduced. Essentially this enabled a person to split certain super contributions with their spouse, meaning single income families could share super benefits in a similar way to dual income families.

This was particularly pertinent at a time when Reasonable Benefits Limits (RBLs) were in place. RBLs placed limits on the amount of super and lump sum benefits a person could receive that qualified for tax concessions. RBLs though were abolished, as of 1 July 2007, and thus super splitting, which had been introduced only 18 months prior, lost some of its appeal.

However, with FY10 just passed, it is opportune to revisit super splitting, particularly in the context of the May 2010 Federal Budget changes, which, whilst not law yet, proposed a rewriting of certain super rules; one of which may provide significant benefits if enacted.

Why super split in the first instance ?

Firstly, super splitting allows a person to split for **taxed** splittable contributions, the lesser of 85% of the concessional contributions and the concessional contributions cap for that financial year. For untaxed splittable employer contributions, it is 100% of the concessional contributions cap.

Sam is 51 and, by virtue of his age, was able to make a concessional contribution of \$50,000 into super in FY10. His wife, Debbie, 48, has little super. Sam decides to split his super contribution with Debbie. Of the concessional contribution of \$50,000, he can transfer \$42,500 of this to Debbie.

To enact this strategy, Sam will need to confirm that his super fund allows splitting. There is no legal requirement to do so though most funds offer it. And Sam must make an application to split contributions. He has time as an application can be made in the following financial year ie. between 1st July, following the financial year when the contribution was made, and the following 30th June – a full 12 months.

A strategy such as this is often done to equalise as much as possible each spouse's balance potentially acting as a form of insurance against future governments attempting to penalise individuals with higher levels of savings in super.

It also opens up retirement opportunities for both spouses in the future in the form of transition to retirement strategies which typically combine tax breaks associated with salary sacrifice with tax advantages stemming from commencement of an income stream from super.



And with legislation in place now for sometime providing for an interest in super or a super payment to be divided or split by agreement or court order in the event of a marriage breakdown, there is no real protection afforded to one spouse growing their own balance at the expense of the other spouse.

Why may super splitting become more relevant ?

Buried in the detail of the last Federal Budget was a measure aimed at providing greater flexibility for those nearing retirement ie. individuals aged 50 or over. What was proposed was that the concessional contributions cap of \$50,000 currently applying to this age group and scheduled to expire 1 July 2012 i.e. reduce to the universal \$25,000 p.a level, be extended permanently for individuals aged 50 or over with super balances less than \$500,000.

Individuals aged 50 or over with super balances of less than \$500,000 could thus continue to make up to \$50,000 p.a in super concessional contributions, allowing these individuals, in the government's words, to "catch up" on their super contributions at a stage in their lives when they are most able to.

In FY11, Sam reviews his super balance (\$400,000). Debbie's is less than \$100,000. Mindful that the government has proposed the above extension and the fact his own retirement is not too far away, he wishes to maximise the amount that he can put into super for his and Debbie's benefit. As a consequence he decides to continue super splitting, in order to keep his super balance below the \$500,000 threshold and capitalise on the higher concessional contributions cap of \$50,000 p.a.

One issue Sam needs to consider is by putting more super in Debbie's name, access is not as close as putting it into his name, given Debbie is 3 years younger. This is a judgement call he will have to make with his adviser.

However, let's say Sam continues to work until he reaches his preservation age ie. 55. He then decides to take advantage of a transition to retirement strategy whereby he draws an income stream from his super while topping up his super by continuing to work. The salary sacrifice arrangement lowers his gross income thus saving tax while the money going into super enjoys the concessional 15% tax rate – perhaps half his current marginal tax rate. The income he draws from super restores his overall cash flow to former levels.

What Sam's strategy also hopes to achieve, again remembering the concessional contributions cap of \$50,000 applying to individuals aged 50 or over, is to draw enough from his super to keep his balance below the \$500,000 threshold with a larger than normal income stream from his super directed either back to his spouse's super account or into another form of saving.

Whilst everyone's circumstances are unique, the combination of super splitting, the proposed extension of the concessional contributions cap and a transition to retirement strategy for many could be a powerful wealth creation strategy.



Commodities prices: where to from here?

by Dr Paul Kasian, Executive Director

Prices for base metals (e.g. copper, zinc, aluminium, nickel) and the bulks (iron ore, coal) have risen strongly since the Global Financial Crisis and have experienced another sharp rise since the middle of this year. This has occurred in a back drop where many investors and corporations have lingering concerns over the US economic recovery, European debt and the impact on the European banking system, plus the attempts by China to ease inflationary pressures in its economy. However we believe that we are now at a point where across the board rises in commodities are unlikely to occur in 2011 and investors will now have to choose carefully which commodities (i.e. which mining stocks) to own in order to maintain leverage to the emerging economies. Prices for base metals such as aluminium, zinc, nickel and cobalt where significant supply growth is anticipated over the next couple of years are likely to lag while prices for copper, coking coal and iron ore are likely to remain strong as they will be supply constrained for a number of years.

The supply constraint in copper appears to be particularly severe. It is estimated that this year copper demand in China grew by around 20% while in the rest of the world demand grew by more than 10%. In contrast global supply of copper is estimated to have increased by a measly 0.6% during the first six months of 2010. This is hardly surprising given that the top five copper producers, which account for 35% of global production, have made no major discoveries over the last five years. Added to this the cost of extracting copper is also rising. To quote the chairman of Rex Minerals, "mine production is getting deeper and more expensive" while "average mined grade is decreasing" and "production capacity in perceived low risk regions is expected to fall by 10% over the next 15 years".



While it is always difficult to forecast future metal prices at the best of times the announcement that some large investment banks are launching base metal Exchange Traded Funds (ETF), will only add to the confusion. An ETF is an investment-linked fund. It appears that both copper and aluminium are the likely candidates for an ETF. The risk is that these ETFs could reduce the availability of metal inventories and exaggerate the physical tightness.

While all this is supportive of higher copper prices in the near term there will be a limit to how high they can go. Excessive copper prices will lead to demand destruction. We are already seeing a large increase in R&D spend to find ways of substituting copper with other materials. While this may take time it could lead to, in some cases, a permanent shift in the uses of copper. Areas where substitution



are beginning to occur are: architecture, where it has been used as decorative strip and as roofing shingles; plumbing, being replaced by plastics; telecommunications, replaced by fibre optic cable; commercial buildings, where it is starting to be replaced by aluminium cable. Other areas poised for change include the electrical wiring of vehicles as well as in air conditioners where copper is used as a heat exchanger. Again aluminium will be used to replace copper.

The tightness in the iron ore market stems from the difficulty in developing new projects. A combination of rising capital intensity, lack of access to infrastructure, the reluctance of equity markets to provide capital and lack of control over project execution risk continues to push project timescales further out into the future. This has not only affected the junior miners but also the larger producers such as Vale (large Brazilian producer) and RIO. Added to this are issues of grade depletion and legacy costs are prevalent in existing iron ore projects. All this has led to supply growth in the market failing to meet expectations.

Given we see elevated prices for copper, iron ore and coal, it won't surprise investors that our portfolios remain heavily weighted towards the two diversified miners BHP and RIO. We also have some pure play exposure to copper via Equinox and Rex Minerals. Our exposure to iron ore is also increased by the addition of Mineral Resources and Mount Gibson. Although these shares have already appreciated significantly this year it is worth noting that current spot prices for iron ore, coking coal and copper are all above analysts' forecasts for 2011. This implication being that we are more than likely to see earnings upgrades for these stocks if commodity prices hold.

Please note that the information in this publication is for general use only. We would be pleased to talk with you in regard to your particular circumstances should you wish to explore any particular aspect further. Any tax planning matters should be discussed with your accountant before proceeding.

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