

PortfolioWatch

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Quarterly newsletter for PortfolioWatch clients

Autumn 2011

Mixed picture locally but US recovery shows hope!

It is fair to say that the Australian economy has faced a number of challenges over the past few months! Natural disasters, subdued consumer consumption and a cautious business sector.

Softer domestic conditions were, however, largely offset by continuing demand for our export commodities, largely driven by China and India. So far, there are few signs pointing to a contraction in demand, although Chinese officials continue to implement policy to slow growth and inflation – successful policy implementation is crucial to the Chinese growth outlook.

Domestically, catastrophic floods in Queensland has led to a loss of coal output and damage to crops in the state's north as well as damage to service activity. Queensland is an important part of the Australian economy contributing 20 per cent to the national economic output. The state comprises 50 per cent of the global seaborne export coal market, 94 per cent of Australia's sugar production and 30 per cent of Australia's cotton production. It also comprises

a large proportion of fresh produce including fruit and vegetables, grain crops, cattle and dairy products – and 50 per cent of these crops have been affected by the floods.

In terms of the overall share market, the impact of the floods seems to be fairly minimal. The key risk, however, is that if rains continue miners may be unable to meet contracts with existing mine sites and shipping port stockpiles have been severely depleted in the December quarter.

Australian consumers have been reluctant spenders over the past twelve months. The household savings rate reached over 10 per cent of disposable income, up from zero per cent or lower a few years ago. The memory of high interest rates in 2007 and the wealth destruction caused by the GFC continues to linger. The Reserve Bank

Contents

Mixed picture locally but US recovery shows hope!	1-2
Welcome to 2011	2
What does an ageing population mean?	3
Shares or residential property?	4-5
Superannuation and estate planning – a case study	6
Investment market review (for quarter ended 31 January 2011) Stockwatch	7
Financial assistance for disaster zones	8





Welcome to 2011

It has been a catastrophic start to the new year for so many and our heart goes out to all those who have experienced the impact of the devastating weather.

Most of the state of Queensland has been declared a disaster zone with ruined crops, disrupted coal exports and lower consumer sentiment as a result. With Queensland accounting for some 20 per cent of Australia's national coal output, the RBA predicts an economic contraction in the first quarter, but also believes that confidence will return. On the upside, inflationary pressures have eased, the unemployment figure continues to drop and many are anticipating the RBA will hold further rate increases until the second half of the year.

Many of our Bridges offices experienced the torment but fortunately, no damage was sustained. However, having first-hand experience, we understand the devastation that has been caused and we are here to provide financial advice to those that need it. While a number of Centrelink entitlements have been made available for those affected, now perhaps more than ever, is a good time to review your financial plan to make sure it remains appropriate for your circumstances.

Financial advice really does make a difference. As research continually indicates, those that seek financial advice are financially better off than those that don't.

If you have any questions, or would like more information about any of the topics covered in this edition of Portfolio Watch, please speak to your Bridges financial planner.

Michael Carter
Chief Executive Officer

Mixed picture locally but US recovery shows hope... *continued*

of Australia (RBA) appears unlikely to lift the official interest rate anytime soon as inflation remains low and banks have been doing the RBA's job by aggressively lifting the retail interest rates while maintaining stricter lending standards.

Business investment, a major driver of employment and economic growth in Australia, has been limited since the financial crisis first unfolded in 2008/09 despite strong profitability following cost cuts. However, latest surveys indicate companies are cautiously optimistic about their circumstances and the health of the economy in 2011. Western Australia and Queensland are due to host major resources and energy projects in 2011/12 worth billions of dollars to their respective state economies. The eventual rebuilding process of infrastructure and housing in the flood devastated areas of Queensland will be another source of economic activity for Queensland, and indeed Australia, with companies providing building materials, engineering services and labour, to name but a few.

World economy

While China remains a major driver of world economic growth, the US remains the largest economy in the world and, therefore, projections of its economic recovery are equally relevant in the global context. The US economy is showing signs of improvement: the latest reading of gross domestic product (GDP) growth for the December quarter was 3.2 per cent pa, much better than 2.6 per cent pa reported for the previous quarter. Consumer confidence in the US has reached an eight month high and consumer spending growth was a healthy 4.4 per cent in the December quarter. However investors remain cautious on the sustainability of an economic recovery in the US with the unemployment rate high at 9.4 per cent and the fragile state of the US housing market.

Outlook

From a medium-term perspective, global equity valuations remain fair and we recommend a neutral stance, up from a previous underweight position.

For the year ahead, we highlight three major known risks:

- 1) a sharper than expected slowdown in China
- 2) potential for further fallout from European debt issues, and
- 3) inflation in some economies.

With respect to European sovereign debt issues, investors can expect further positive intervention from the European Central Bank (ECB) this year although, unfortunately, it appears to take bad news for the ECB to react. A more permanent solution is required for debt reconstruction in some Euro member countries if investor confidence is to be maintained.

Chinese officials will continue the objective of orchestrating a positive, but slower, economic growth profile which should prove accommodative for global growth. Policy decisions in China are also drivers of market sentiment.

What does an ageing population mean?

We are constantly bombarded by messages of an ageing population, but what does it mean? Quite simply, it means people are living longer than they have in previous generations. But, whether it's you or your parents, have you ever stopped to think about the implications of becoming 'aged'? Does it mean it's time to start thinking about aged care accommodation options?

Over the next few decades, the number of Australians who will need to access aged care will almost quadruple, from 1 million this year to more than 3.6 million in 2050¹. This significant increase is mostly because the Baby Boomers – the largest generation – are growing older and in general terms, living longer.

As you get older, it becomes more and more difficult to live independently either because of illness, disability, reduced mobility, isolation or the problems associated with maintaining a large property. While moving in with the kids may be a viable option (or simply pay back!) there are alternative accommodation options that allow you to maintain a level of independence, and also receive the care you may need, such as:

1. retirement villages
2. hostels or nursing homes.

In this edition of Portfolio Watch we look at the differences between these types of accommodation and in the Winter edition we will outline the fees and costs associated with each type of accommodation.

1. Retirement villages

Retirement villages are generally an option if you are over 55 years of age. While there is no set list of services provided, some retirement villages, that also offer aged care facilities, can offer meals as well as personal care. You pay the entry fee via a contribution fee as well as ongoing fees and charges.

There are three common forms of tenure:

- a) Direct ownership – you pay an agreed purchase price to buy the unit from the former resident or the village operator.
- b) Loan and licence arrangements – you give the village operator a loan in exchange for a 'licence' to occupy the premises.
- c) Leasehold arrangements – you pay a lump sum equal to the market value of the dwelling in exchange for a long-term lease (usually 99 years).

2. Aged care facilities – hostels and nursing homes

In Australia, residential aged care facilities provide two levels of care: hostel as well as nursing home services. In both cases, you may be asked to contribute to the cost of care. In the first instance, all applicants need to be assessed by an aged care assessment team to determine eligibility and the level of care required.

The main difference between hostels and nursing homes is the level of care provided: hostels are 'low level' care facilities that provide personal care and accommodation while nursing homes are 'high level' care facilities that provide 24 hour nursing care and accommodation.

Some facilities are able to provide extra services, such as additional 'hotel' type services or lifestyle extras, for example higher standards of accommodation and increased food choices. The facility sets the fees which must be approved by the Department of Health & Ageing and are in addition to the standard fees.

Choosing a suitable aged care facility is an important decision; please consider the following:

- location and access – is it easy to get to, not only for you but for your family
- accommodation, meals and routines
- the culture as well as the level of social interaction amongst residents
- what level of care you need now and in the future, particularly if you have any pre-existing health conditions
- costs (we will discuss costs in the Winter edition).

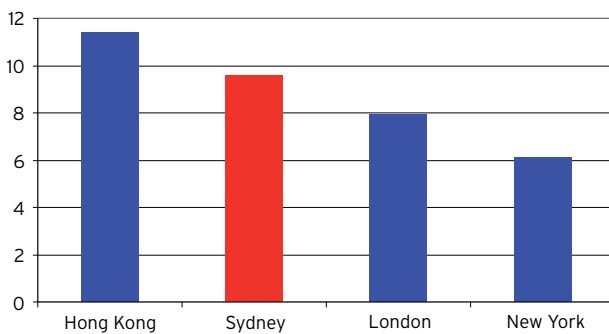
The fees and charges associated with hostels and nursing homes also differ slightly and can be quite costly. It is important to understand how they are charged and ways they may be reduced. We will discuss fees in the next edition.

¹ Intergenerational report 2010

Shares or residential property?

Believe it or not, London and New York are not the most expensive cities in the world in which to live! In recent years, Hong Kong and Sydney have climbed to the top of the list for 'most unaffordable cities in the English speaking world'.

Severely unaffordable world housing markets (Sydney ranks second)



Source: Demographia 2011

Australian house prices have reached an all time high thanks mainly to the low unemployment rate and above trend population growth. However, house prices are facing stagnant growth over the foreseeable future.

In this article we look at both sides of the age-old 'shares vs property' argument to try and find some answers. As an investment opportunity, the first thing to look at is the financial benefit.

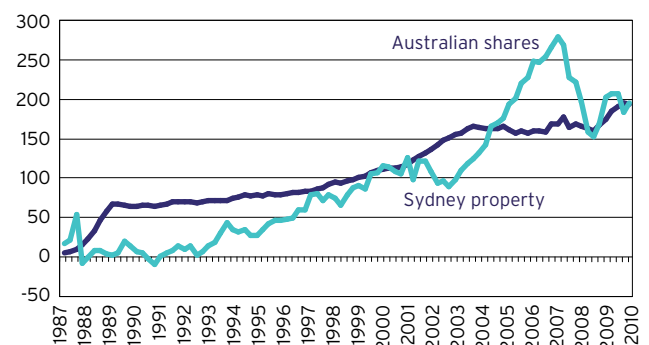
Over the past 10 years, the benefits of investing in the share market have mostly outweighed the benefits of investing in the residential property market and, based on forward looking estimates, we believe that the Australian share market should continue to present greater benefits. As this discussion is around investment opportunities, and which offers the best financial return, we have based our analysis primarily on the 'investment property owner' segment of the market rather than the 'owner occupier' segment of the market; an owner occupier's decision to invest in the residential property market is premised on much broader considerations, some of which may not be centred on achieving the best financial return.

Returns comparison – An historical context

So, let's look at how the financial returns from both these sectors compare over the past 20 years. For the purpose of this illustration we've used Sydney as a proxy for the national residential market, but the trend is evident across Australia. The graph below shows that although residential property was the stronger performer in the mid 1980s and 90s, since then the performance of the Australian sharemarket has taken off. As you would expect, downturns have tended to cramp the market's performance – in the early 2000s share market returns fell below property market returns. However, between 2003 and 2009 you can see that when the Australian share market recovers it tends to outperform the residential property market. In fact, despite the GFC, the share market hasn't really lost ground when compared to the property market; both are sitting neck to neck. Over the next cycle, we believe that the Australian share market may again chart a better recovery than the residential market.

It's important to note that while the share market is more volatile, this is a reflection of the greater number of available buyers and sellers compared to the housing market, which can go through episodes of illiquidity.

Sydney residential property vs Australian Shares



Source: ABS

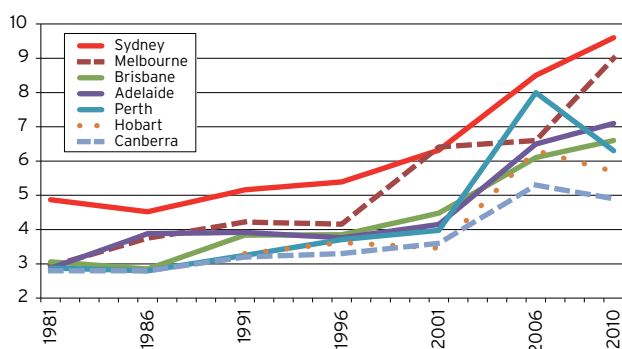
As an investment opportunity,
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Residential property valuation

It has been well documented in the financial media that some commentators consider the Australian residential property market to be significantly over valued and “severely unaffordable”. Researchers often use the median house price : household disposable income ratio (commonly referred to as the ‘median multiple’) to measure the levels of affordability in the residential market. For the Australian market, this median multiple is currently 6.1x. To put it another way, it would take 6.1 years for an average Australian family to save their disposable income to pay for the family home. By the same measure, for the average household in Sydney, it would take 9.6 years.

The median multiple, however, does not tell the full story of housing affordability. In looking at the 20 year history, the median multiple has increased from below 3x (considered ‘affordable’) in the 1980s to currently 6.1x and is now considered to be ‘severely unaffordable’. Today, Australian households are paying more than twice what they paid for housing 20 years ago. All of the major Australian cities have median house price multiples well above 5.1x which is considered severely unaffordable by various international observers such as the United Nations and the World Bank.

Housing affordability – Australia (Markets 1981-2010)



Source: Demographia 2011

Why have Australian house prices become less affordable?

Over the past 20 years, house prices have skyrocketed, principally because there are more restrictive land use regulations imposed by state and local governments which have virtually prohibited new house construction on or beyond the urban fringe.

This is particularly evident where there are “urban containment” measures, such as urban growth boundaries. As the name implies, these boundaries aim to limit the urban sprawl by determining the areas that can be used for high density urban development (inside the boundary) compared to those that can only be used to accommodate lower density development (outside the boundary).

Higher land prices have been the principal contributor to rapidly increasing housing prices in unaffordable markets like the major Australian cities. These land prices include the increasing influence of land supply restrictions (such as urban growth boundaries), excessive infrastructure fees and other overly strict land use regulations. As a result, by some estimates and due to overvaluation, households in Sydney and Melbourne can expect to pay a premium of more than \$750,000 in mortgage principal and interest payments (at current mortgage rates) relative to what they would have paid had housing values been more affordable. This money could otherwise have gone to consumption or financing other productive assets and helped job creation. In Australia, between 1993 and 2006, 95 per cent of the increase in inflation adjusted new house (and land) costs were attributable to land, rather than construction.

Where to from here for the residential property prices?

Given Australia has one of the most expensive residential property markets in the English speaking world, with all major cities categorised as ‘severely unaffordable’, we lack conviction in the prospects for material real rate of returns in the foreseeable future. However, as more people compete for limited housing stock, the above trend population growth and the short supply of residential property will together continue to support the overvaluations in major Australian cities.

Therefore, in light of the benign outlook for financial returns from the residential property front, investors are more likely to achieve better returns in the Australian share market. Share valuations are below their long-term average and the outlook for dividend growth is healthy.

If you would like to find out more about share investment opportunities, please speak to your Bridges financial planner.

Superannuation and estate planning – a case study

Your Will is the document that stipulates who gets what when you die, but what about your super? Unless you have a valid binding death benefit nomination in place, the trustee of your super fund has the ultimate discretion in deciding who gets the death benefit from your super fund. And, even if you have a binding death benefit nomination in place, is it the most tax-effective way to distribute your super death benefit?

In the following case study, Robert and Barbara were unexpectedly killed in tragic circumstances and we look at the strategies that could have saved their beneficiary from receiving an unwanted tax bill at an already difficult time.

Robert and Barbara were both aged over 60 years, and had one child Elizabeth, aged 35, who was married with three young children.

Robert and Barbara both had superannuation (including a tax-free and a taxable component) and they both had simple Wills, leaving everything to each other and then to Elizabeth. When one of them dies, their financial planner told them that the survivor would receive their super death benefit, tax-free. When the other one dies, their daughter Elizabeth will receive their death benefit, but at the age of 35 she is no longer considered a 'dependent' and will therefore be charged tax on the taxable components of her parents' death benefits from super.

One night on the way home from a ten pin bowling event, Robert and Barbara are involved in a tragic car accident. Sadly Robert died instantly and Barbara remained on life support for almost two weeks before she too passed away.

The Trustee of Robert's super fund decided that as Barbara had passed away, Robert's super should be paid to his estate. Whilst Robert's Will leaves all his assets to Barbara (which would include any superannuation death benefit paid to the estate), section 35 of the Succession Act 2006 declares the gift contingent on Barbara surviving Robert by 30 days which, tragically, she did not.

Accordingly, Robert's assets (including his super death benefit) were passed to Elizabeth and she was taxed on the taxable component.

However, if Robert's Will had been drafted in a way to allow Barbara to receive the death benefit, then it could have passed to Elizabeth via Barbara's estate, and it would have been tax-free. While the Succession Act only applies to NSW, there is similar legislation in Victoria, Queensland, Tasmania, ACT and the Northern Territory.

While the taxation of Robert's death benefit can be dealt with by careful drafting of their Wills, the taxable component of Barbara's death benefit would still be taxable when received by Elizabeth, whether personally or via Barbara's estate. However, if Elizabeth held an Enduring Power of Attorney to act on Barbara's behalf, she could have withdrawn the super from Barbara's fund prior to her death, which would have been tax-free. The capital could have then passed to Elizabeth via Barbara's estate also tax-free.

However, Elizabeth would need to ensure that any withdrawal was in Barbara's interests when acting under the Enduring Power of Attorney.

By using these two strategies, Elizabeth could have been able to receive both her parents' super death benefits tax-free. But without these strategies, the taxable component of both Robert's and Barbara's super death benefits would be taxed at up to 16.5%.

This case study illustrates the importance of:

- ensuring your Will is drafted to ensure that not only do the assets pass to your chosen beneficiaries, but that it is done in the most tax-effective way
- having an enduring power of attorney in place
- having your chosen attorney contact your financial planner as soon as possible in the event of a life threatening event.

Make sure your loved ones aren't lumped with a tax bill after you've gone. To ensure your super death benefit is passed to your beneficiaries in the most tax-effective way, speak to your Bridges financial planner.

*Make sure your loved ones
aren't lumped with a tax bill
after you've gone.*

Investment market review

quarter ended 31 January 2011

Asset	Index	1 yr return	5 yr return pa	Comments
Australian shares	S&P/ASX 300 index	8.71%	3.68%	The Australian share market posted a small gain over the quarter, however, Australia has remained the weakest of the major world markets for over a year. The potential economic impact of the floods, together with subdued retail consumption and the rise in the cost of living, has weighed down investor sentiment.
Listed property trusts	S&P/ASX 300 A-REIT index (property)	4.79%	-9.15%	The listed property sector finished the quarter in positive territory, albeit, behind the broader market returns. A number of trusts are currently trading at material discounts to their net tangible asset backing. Instead of focusing on current discount to longer term asset valuation, investors are more focused on pricing these trusts for yield and modest income growth over the near term.
International shares	MSCI World index (AUD)	6.24%	-3.69%	The returns on international shares were better than local market returns over the quarter. International investors have been reacting positively to emerging signs of a recovery in the US economy. Overall, US companies reported higher profitability for the quarter ending December 2010. Collective efforts by major European governments to contain the sovereign debt issues of Greece and Ireland, combined with a generally positive economic environment in larger economies – such as Germany and France – instilled some optimism in the minds of European investors.
Fixed interest	UBS Warburg Comp. Bond All Maturities index	5.62%	5.92%	Bond yields traded in a narrow range over the quarter due to mixed signals about the impact of the recent natural disasters in Queensland on economic growth.
Cash	TPS cash management fund	5.30%	5.17%	The return for the TPS cash management fund was slightly higher than the previous quarter, helped by the general rise in interest rates.

Stock Watch – Lend Lease group (LLC)

Lend Lease is a leading, vertically integrated property group with operations in Australia, Asia, UK/Europe and North America. Operating divisions include: retail (shopping centre development and ownership), Communities (residential development public private partnerships [PPP]), construction and management services, construction project management (through the Bovis Lend Lease brand) and investment management.

We see value emerging in the current share price of Lend Lease Group (LLC). The stock is currently trading at a discounted valuation to its long term fair value. Other positives in the stock include: 1) Construction order book, valued at over \$12 billion, is underpinned by large blue chip projects such as Barangaroo in Sydney, valued at \$6 billion. 2) The development pipeline is expected to give a strong

kick to earnings over the next three years with LLC remaining focused on project execution to achieve target return on equity of 15 per cent pa. 3) Balance sheet gearing (debt) level is low with cash liquidity available to fund the build out of the order book. The key risk to earnings lies in the groups' ability to execute projects within budget and without cost over runs.

Longer term, LLC is focused on key property trends including urban regeneration, building and managing the retirement communities, and increasing funds under management as the group uses third party capital to build property and then manages in perpetuity for a fee.

Short term we believe the market has concerns that LLC "will issue equity should it be successful in bidding for the assets of Centro Property Group".

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Albury – HBS	02 6021 4513
Armidale	02 6771 2989
Bathurst	02 6331 5111
Bathurst – Russell Street	02 6331 0411
Bega	02 6491 6421
Bendigo	03 5441 8700
Bowral	02 4862 1230
Brisbane	07 3217 6044
Brisbane – Bayside	07 3821 1161
Brisbane – North Quay	07 3236 3711
Broadwater	07 5500 6994
Canberra	02 6247 4111
Canberra – Kingston	02 6239 5188
Castle Hill	02 8850 1466
Charlestown	02 4942 2922
Chatswood	02 8448 2006
Coffs Harbour	02 6651 2000
Darwin	08 8981 7722
Doncaster	03 9484 8311
Dubbo	02 6881 8177
Essendon	03 9379 1166
Geelong	03 5221 7557
Gippsland	03 5144 1622
Gold Coast	07 5562 2177
Gosford	02 4323 7468
Griffith	02 6964 2122
Homebush	02 9735 9156
Honeysuckle	02 4927 5833
Hurstville	02 9570 3222
Launceston	03 6334 4900
Laurieton	02 6559 9950
Lismore	02 6622 0353
Liverpool	02 9821 2274
Maitland	02 4934 6133
Melbourne	03 9629 8188
Melbourne CUC	03 8779 5254
Mildura	03 5022 7062
Miranda	02 9525 5900
Morwell	03 5133 7744
Newcastle	02 4926 5255
Nowra	02 4422 1877
Parramatta – George St	02 9635 5305
Parramatta – McNamara	02 9633 9044
Parramatta – North	02 8843 0677
Parramatta – PCU	02 9841 8207
Penrith	02 4721 5800
Perth	08 9221 7566
Perth – King St	08 9481 0501
Port Macquarie	02 6584 5050
Shepparton	03 5821 4711
St Leonards	02 9906 8005
Sunshine Coast	07 5476 0811
Sydney – Maritime Centre	02 8243 6500
Sydney – St Martins Tower	02 8262 4000
Tamworth	02 6701 9100
Toowoomba	07 4638 3611
Townsville	07 4725 2910
Wagga Wagga	02 6931 9744
Whyalla	08 8645 8055
Wodonga	02 6024 1722
Wollongong	02 4226 1233
Wollongong – Figtree	02 4227 3255
Head Office	02 9028 1000

Financial assistance for disaster zones

The most devastating weather Australia has experienced in over a century has seen vast portions of the country declared a disaster zone – Queensland, New South Wales, Victoria, South Australia and Western Australia.

The State Governments, together with the Federal Government, have responded to the crisis by authorising certain payments and services for those affected by the severe flooding, cyclone damage and bushfires. If you are eligible, the following assistance may be available from the Australian Government.

Australian Government Disaster Recovery Assistance Payment

The Australian Government Disaster Recovery Payment (AGDRP) gives you short-term financial assistance if you are adversely affected by a major or widespread disaster. The rates for one-off payments are:

- Single – \$1,000
- Couple – \$1,000 each
- Child – \$400

Note: A 'child' is any person under (but not including) the age of 16 years who is not receiving a social security payment.

To receive this payment, you do not have to meet either the income or assets tests.

Disaster Income Recovery Subsidy

If you are an employee, a small business owner or a farmer and you can demonstrate that you have experienced a loss of income as a direct result of the flooding and severe weather, you may be eligible for financial assistance through the Disaster Income Recovery Subsidy. The subsidy ranges from \$469.70 and \$508.20 per fortnight, depending on your circumstances.

Crisis payment

A one-off payment (equal to one week's income support entitlement) is available to you if you are in severe financial hardship and have left your home, or are unable to return to it, because of an extreme circumstance.

Please note that you cannot receive the crisis payment if you have already received an Australian Disaster Recovery Subsidy payment for the same event.

Lump sum advance payments

If you have been in receipt of income support payments for three months you may receive between \$250 and \$500 of your future entitlement paid in advance, once a year.

Stand downs

If you have been stood down as a direct result of the disaster, for example, due to a lack of work or you become unable to run your business during a period of disaster, you can be regarded as 'unemployed'. If you have used all your leave entitlements, you may be entitled to receive income support payments.

Activity test flexibility

To be eligible to claim for either Newstart Allowance or Youth Allowance, one of the requirements is that you are classified as 'available, and looking, for work'. However, instead of having to actively look for work, you may undertake other approved activities – for example, volunteer work in disaster relief areas – and still qualify for payment.

For more information about the entitlements, call Centrelink, visit the Federal Government's information website www.disasterassist.gov.au or speak to your Bridges financial planner.



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Part of Australian Wealth Management

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