



SMITH COFFEY

VANTAGE Points

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“PANACEA” INVESTMENT OFFERINGS



Investment bankers are nothing if not opportunists, so with the recent market volatility it is not surprising to see a rash of new-wave capital protected “structured product” investments being targeted to potential investors.

These products commonly focus on current “hot theme” investments that have experienced rapidly rising prices in recent times, which at the moment would suggest themes such as Asian or other Emerging Market investments and Commodities.

Typically, they are presented as offering the upside of share or commodity investments (or even more) without the downside risk – and possibly with the promise of a tax benefit to boot... a seemingly attractive proposition - especially for investors who have experienced falls in the value of their conventional investments recently.

So, lets delve behind the veneer of sophistication to understand what the ingredients are and how they work.

The main ingredients are typically Capital Protection and Leverage, and these elements are often achieved through the use of derivatives. Derivatives are merely securities, instruments or agreements that are based on underlying securities such as shares or various financial rates or indices.

Capital Protection

This involves the promise of a minimum predetermined return at a future date. Most commonly, the promise is a return of capital or in other words a minimum return of zero. This is normally achieved through at least one of three methods, and often a combination of them.

1. Through purchasing derivatives such as put options, which are effectively a form of insurance where a counterparty is paid to insure against prices of the underlying investment falling in the future.

2. Secondly, by diverting a portion of the investment and placing it in conservative investments akin to term deposits, so that the amount invested plus interest will be enough to return the capital at the future date.
3. The third method to limit downside is called “threshold management” and this involves progressively selling the investment down if prices fall and placing the remaining proceeds into the second option noted above.

Leverage

This involves increasing the sensitivity of invested funds to movements in the price of the underlying investment. The most obvious method to achieve this is through some form of borrowing, however, derivatives are frequently involved whereby in effect a counterparty is paid to provide additional exposure to an underlying investment in the event that its price rises above a certain level. As can be seen, leverage and capital protection both alter the likely return profiles of the underlying investment – but in opposite directions. They also involve fees and/or costs on each side of the equation.



Whilst the initial amount of the investment is protected, the ongoing annual cost of financing these products (where applicable and bearing in mind that there is an almost unlimited range of possible combinations for structured products) is often significantly higher than that of a more traditional investment in the same investment class, and this cost is not usually part of the guarantee.

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MARKET COMMENTARY

Global Market Analysis

- 2008 to date has been extremely volatile across all financial markets.
- Since New Year there have been very sharp falls in listed property markets, many stockmarkets and most credit markets with partial recoveries in most of these markets in the last month or two.
- Lending conditions have significantly tightened, although not as severely in Australia as overseas.
- Widespread falls in residential property prices in other countries that suffered from chronic overpricing (eg. USA, UK and Spain) although only a muted slowdown in Australia.

Australian Economy

- Australian Dollar, Australian property and Australian lending markets may all be holding up relatively well due to Australia's more commodity based economy. Mining and Energy sectors continue to stand out above other sectors. Business investment is skewed towards increasing our concentrated reliance on these markets.
- On the other hand, our interest rates have been heading up due to rising inflation, whilst overseas in many countries interest rates are falling due to perceptions of weaker economic conditions.

Sector	Year to Date	Outlook
Australian Shares	Australian share prices lower despite partial recovery.	Australian shares still looking a little expensive compared to overseas counterparts.
International Shares	Major market prices also weaker.	Large multinationals now cheaper than for many years.
Listed Property Trusts	Start of 2008 saw worst price falls EVER, following on from falls in 2007.	After massive price falls we can no longer justify lower recommended allocations and have increased recommendations to normal levels.
Fixed Interest & Cash	Corporate debt dramatically sold off although prices now recovering. Lenders now demanding a substantial reward for taking any risk. Government Bonds benefitted a little from the flight to safety.	Long-term fixed interest rates still appear moderately unattractive to us although corporate debt investments are relatively cheap. Still prefer cash over Government fixed interest.
Alternatives	Once again, varied performance from recommended funds ranging from negative to excellent – overall better than traditional investments. Gold bullion price has moved in the opposite direction to stock markets, in Australian Dollars, approximately flat for the year so far.	Slightly reduced allocation to fund improved value opportunities in traditional markets.

TAX PLANNING 2008

*“If you have not already reviewed your financial position,
there is still time to take action prior to 30 June.
Phone your Consultant on 9388 2833 ”*



Federal Budget 2008

The Rudd Government's first Budget was touted as being both boring and designed to restrict tax benefits received by high income earners. It was probably more the former.

Key measures announced include:

- Previously announced personal income tax cuts will go ahead.
- Opportunities for family trusts to utilise tax losses will be restricted.
- Laptops will only be eligible for salary sacrifice where use is predominately work related.
- Laptops and PDA's salary sacrificed will no longer be eligible for depreciation deductions.
- Salary sacrificing joint investment loan expenses will no longer be allowed.
- Various new and existing concessions available will now be subject to income thresholds including:
 - the Education Tax Refund
 - Child Care Benefits
 - Family Tax Benefit Part B and Dependent Spouse Offset
 - Baby Bonus

State Budget 2008

The State Government has announced the following key measures:

- Cuts to land tax rates and increasing the exemption threshold from \$250,000 to \$300,000.
- Reducing payroll tax and stamp duty.

Luxury Car Tax

The Government has increased the luxury car tax rate from 25% to 33% from 1 July 2008 for cars costing in excess of \$57,123.

Changes to Medicare Levy Surcharge

Originally introduced to encourage Australians to take out private health cover once their incomes exceeded particular thresholds, the Medicare Levy Surcharge thresholds have been increased as follows:

- Singles from \$50,000 to \$100,000
- Families from \$100,000 to \$150,000

It is anticipated this could lead to a significant reduction in the number of Australians who have private health cover. Time will tell what impact this will have on the healthcare industry, with significant debate already ensuing.

Private Practice Practitioners

Year end tax planning opportunities may include:

- Deferring income to the following year.
- Consider bringing forward deductible expenditure, but beware of prepayment rules.
- The prepayment rules can require expenses be claimed over the period the expense relates, rather than the year paid.
- Medical Companies are required to pay out the majority of their profit as either wages or super each year.

Hospital Practitioners

Waiting until the end of the year is generally too late for employee tax planning opportunities, which may include:

- Salary sacrificing into superannuation to enhance employer contributions.
- Other salary packaging opportunities — e.g. laptop (business use), private dining.
- Prepaying investment expenses, such as interest and for employment expenses (e.g. conference).

Superannuation

Want to make a guaranteed return of up to 58%? Consider a taxpayer on the top marginal tax bracket with \$100 pretax income. If the taxpayer takes the income as cash, the after tax amount actually received is \$53.50. However, if the taxpayer makes a deductible contribution to superannuation of \$100, the after tax amount available to invest for their future security is \$85. This is an additional \$31.30 or 58% compared to taking as cash.

Negative Gearing

The process where interest on money borrowed to invest and other costs of the investment are greater than the income received. Ideally, the value of the investment will grow over time to produce a small profit. The initial loss on the investment can be offset against other income to reduce the overall tax liability.

Some expenses may be prepaid e.g. interest to maximise deductions in the current year.

TAX PLANNING 2008 (CONTINUED FROM PAGE 3)

Capital Gains Tax Strategies

CGT is a significant cost that can reduce your net asset position on disposal of an asset. Consider the following strategies to minimise liability:

- If you have made a capital gain during the year, check for opportunities to realise capital losses, but beware the new ATO ruling on “wash sales”.
- Conversely, if you have made capital losses, consider realising gains to avoid carrying forward a capital loss.
- If possible, defer the gain by not selling the asset until next year.

- Maximising the benefit of capital losses by offsetting against short term or indexed gains before any long term gains eligible for the 50% discount.
- Utilising the CGT small business and retirement exemptions available.
- Whether non-deductible costs may be included in the cost base to reduce the gain.
- Offsetting capital gains against additional deductible superannuation contributions (subject to limits).

Contact your Smith Coffey Consultant before commencing a negative strategy or prepaying expenses to ensure appropriate to your circumstances.

“PANACEA” INVESTMENT OFFERINGS (CONTINUED FROM PAGE 1)

In addition, the complexity of these products often means that ongoing tax compliance is significantly more expensive and the recent Commonwealth Budget appears to have significantly dented the tax effectiveness of many structured products. And due to this complexity, how many investors really understand what they are buying?

We routinely examine a wide range of investment offerings for potential recommendation to you, the vast majority of which you will never see recommended. Whilst behavioural finance studies could be used to correctly predict that people will be attracted to the altered risk/return profile of many structured products (beyond the point of rational behaviour), this does not mean that they are the best alternative. Leverage can be an effective wealth creation strategy in the right circumstances and at the right cost, however, in considering the various structured products, we place emphasis on fees and costs - and research that indicates that on average the high cost of purchasing protection outweighs the average benefit.

Panacea or Placebo?

The best third party research endorsement for these type of products suggests that they may be worthwhile not due to actual investment merit but because it may be a way to lure excessively conservative investors to have some exposure to growth assets (due to the presentation of a capital guarantee). In this regard perhaps these products are more placebo than panacea.

Overall, we believe that there are no miracle panacea investments, but there are fundamental reasons why tried and true investment strategies such as diversified exposure to growth assets with the right ownership and finance structures work over the long term.



SMITH COFFEY

20 Nicholson Road, Subiaco WA 6008
PO Box 268 Subiaco WA 6904

Telephone (08) 9388 2833 Facsimile (08) 9388 1566
Email: smith.coffey@smithcoffey.com.au

For all enquiries call (08) 9388 2833

Smith Coffey Financial Management Pty Ltd
A.C.N. 008 812 226
As trustee for the Smith Coffey Trust
A.B.N. 28 754 975 431

Smith Coffey Pty Ltd
as trustee of the Bon Unit Trust A.C.N. 008 819 458
A.B.N. 72 940 948 949
AFSL No: 237 972
FICS Membership
Number F-3557

Smith Coffey Securities Pty Ltd
A.C.N. 008 812 208
A.B.N. 19 008 812 208
AFSL No: 237 971
FICS Membership
Number F-1296

Smith Coffey Finance Solutions Pty Ltd
A.C.N. 090 885 857
Licensed Finance Broker (Lic. FB 1285)
A.B.N. 9909 088 5957

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