Hang in and add to portfolio

NOEL WHITTAKER

The market is very scary at the moment, but it's not all bad news – by a long shot.

WHAT a week it's been. The Dow Jones had its eighth-biggest decline in history, markets all over the world tumbled, and of course the Australian market crashed as well.

For the nervous it was a time to wonder if this is the start of another global financial crisis, for the experienced investor the big decision was whether to sit tight or jump in and buy.

This is definitely not the start of another global financial crisis. That was a credit event caused by billions of bad debts that resulted from irresponsible lending.

The catalyst for the big falls this week was Chinese investors punting on the stock market using margin loans.

As the market fell, shares were forcibly dumped to cover margin calls.

Naturally, the turbulence of the week has resulted in a string of emails asking whether to get out of the market, and if superannuation is still worthwhile.

For starters, it would be extremely risky to exit the market after the huge falls we have just experienced. All you would be doing is converting a paper loss into a real one.

In any event, unless you have a direct shareholding, it is not possible to make a fast exit. Redeeming all or part of your portfolio requires forms to be completed and processing time to occur. Allow a week at the least.

And don't confuse superannuation with assets like property or shares. Superannuation is simply a vehicle that allows you to hold assets in a low tax environment.

Anybody whose superannuation is invested in shares would have suffered a loss of value this week, but so would anybody who held shares in their own name.

Let's look at the situation objectively. The only realistic investment options are cash, property and shares.

In my view, the Australian economy is flat, with jobs continuing to be cut, and action by Green groups stopping infrastructure development.

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The current fall in the share-markets tends to make people feel poorer and less confident of spending, which will make economic conditions even worse.

If this is true, the only direction for interest rates is down.

It is really up to each individual to decide where they want to invest, but do you really think savvy investors will choose to move their money to term deposits paying 2 per cent when they can get better than 6 per cent franked from shares like the banks and Telstra?

If stocks like this are held in a superannuation fund in pension mode the franking credits will take the effective yield to close to 10 per cent.

That's five times what you can get in term deposits.

The Aussie dollar got hammered too, but this has an upside as well as a downside.

It will be great for exporters and the tourism industry, and also it will cushion any falls in shares held by international managed funds.

Think about it: if the international share values fall 4 per cent and the Aussie dollar falls 4 per cent, you will not have lost any value at all.

I think falling rates will push our dollar down further, which should make international equity trusts great performers for the rest of the year.

So don't be concerned about the current turbulence; hang in there and think about adding to your portfolio if you can.

Don't forget there is now more than a trillion dollars in superannuation, and employers are contributing 9.5 per cent of payroll all the time.

Much of this money will find its way into the sharemarket and this will provide tremendous buying pressure year in year out.

Over the long term, share-based investments will still give great returns.

Q I am a 46-year-old, self-employed woman and I own a small home. My income is variable but generally low, hovering around $35,000 per annum. Other than owning my home, I have $27,000 in term deposits. Would you recommend that I put this money into my superannuation? I currently have about $16,000 in super.

A Earnings in your super fund are taxed at 15 per cent from the first dollar earned. However, if your income is generally less than $37,000 a year there is little benefit in moving a big chunk of your assets to super, and losing access, because your current investment earnings are being taxed at 19 per cent now. Furthermore, if you made deductible contributions to super they would also lose 15 per cent in entry tax. However, it is certainly worth making a non-concessional contribution of $500 to super to receive the government co-contribution. This could be done through your existing fund.

Q If I sell my investment property and repurchase another one, can I pay my principal residence home loan down and mortgage the new investment property without incurring capital gains tax on the sale? Or does the capital gain have to be applied directly to the new investment property?

A Once you sell the investment property, CGT – if appropriate – will be triggered. You could certainly pay the net proceeds off your non-deductible home loan and then take out a home equity loan to fund the entire purchase price of the property you intend to buy. The interest on this loan would be wholly tax-deductible as it is for investment.

Noel Whittaker is the author of *Making Money Made Simple*, and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. Email: noelwhit@gmail.com.

They will talk about you when you're gone – nicely

By **MICHAEL HUTTON**

FAMILY trusts and self-managed superannuation funds (SMSF) are both popular options for investors who want to control and direct their family wealth. All too often, however, they are considered an either-or investment choice.

But if used together, they can often maximise wealth creation and wealth preservation.

Most people are well aware of the tax advantages of super for accumulating investment wealth. SMSFs have the added advantage of maximising the benefits you obtain from super due to the flexibility and control they give you. But there are downsides to super. Your money is essentially locked away until retirement, you are limited on how much you can contribute, and your superannuation account must be paid out upon death.

Hand in hand, SMSFs and family trusts work for now and the long-term family future.

Conversely, family trusts are not subject to preservation, so your family money is not locked away.

They are relatively simple to establish and operate and have no limits on how much you can put in.

While beneficiaries of distributions from a trust must pay tax on that income, distributions don't have to be made equally to all family member beneficiaries.

This can be extremely tax-effective when distributions are passed on to family members on lower marginal tax rates.

Family trusts have the advantage of being able to hold personal-use assets – a holiday home, businesses.

Finally, family trusts can continue past your death, making them an excellent vehicle for inter-generational wealth transfer.

The downside of family trusts is that they may not be as tax-effective as super.

What many wealthy families understand is that if you have both a family trust and a SMSF, you can mould your financial affairs to benefit from the combination of investment structures.

Both structures assist in protecting a family's wealth, as personal creditors may be hindered. With improved financial reporting and investment options, and cheaper systemised compliance, family trusts and SMSFs are no longer the domain only of the wealthy.

Family trusts are particularly useful early in the family's wealth-building process. At this stage, people are hesitant to put extra into superannuation because of the preservation requirements, and family trusts provide a tax-advantaged structure for wealth creation.

As retirement nears, wealth can be moved from the family trust to the SMSF, discretionary contributions, building up a concessionally taxed retirement nest egg.

But this is not the end of the usefulness of the family trust structure.

Post-retirement, any extra wealth that can't be recontributed to superannuation can be placed in the family trust.

As money is drawn down from super as a pension, the family trust investment portfolio may be increased. Upon death, the family trust can continue on. Investments can remain and control passed to the next generation. This differs from superannuation, which is designed to be run down through retirement, then sold up and paid out upon death.

For many families, a family trust used in conjunction with an SMSF can be a very beneficial approach, offering intergenerational transfer of wealth benefits, assisting in wealth creation and management, and creating the most tax-advantaged outcomes.

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