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V-TYPE RECOVERY OR DEAD CAT BOUNCE?

There is no doubt that watching the finance report on the news has been far more enjoyable for all investors over the past few months. On March 6 2009, the ASX All Ordinaries hit a new low of 3111, a fall of 54% from its market peak in October 2007. This fall exceeded the level of the 1987 crash (of 45%), and is second only to the great Wall Street Crash of 1929.

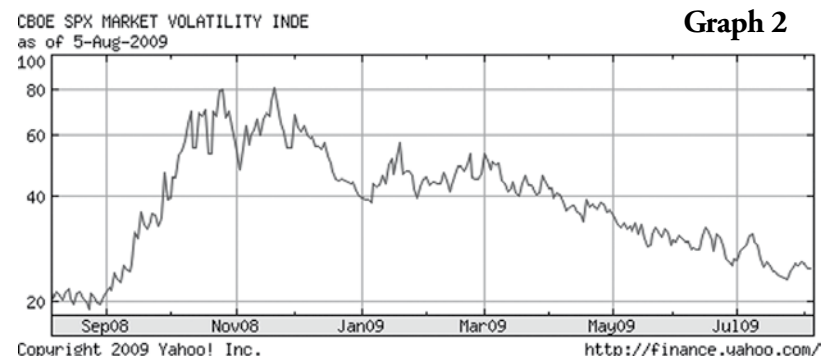
Since this time, the market has officially experienced a 'bull run'. At the time of writing, the ASX All Ordinaries has increased some 1400 points (or 45%) since the March bottom, as shown in graph 1. The \$64 000 question is whether this is the real thing, or whether it is merely a dead cat bounce.

As always, there is no shortage of data that can suggest a case one way or the other. Economists have made an art form of using the term 'on the other hand', so we are never really clear where we stand. There is no doubt that things have settled down since the freefall and madness of September to November 2008. Nowhere is this reduced volatility better seen on the CBOE SPX Market Volatility Index (the VIX index), as shown in graph 2.

The VIX is an interesting index, as its goal is to estimate the implied volatility of the US S&P 500 index over the following 30 days. It is a weighted blend of prices for a range

of options on the US S&P 500 index. The formula takes as inputs the current market prices for all out-of-the-money calls and puts for the first month and second month expirations. If investors see high risks of a change in prices, they will require a greater premium to insure against such a change by selling options.

The VIX is also known as the 'fear index', and clearly shows the fear that was evident in share markets at the end of 2008. Importantly, fear levels are now back down to pre-recession levels, confirming the ever increasing 'glass is half full' view.



Perhaps the best place to look for guidance on this issue is the Reserve Bank of Australia (RBA). As the key player in Australia's monetary policy arrangements, the insight of the RBA, in both actions and words, can obviously be a very significant guide to the economic future.

In terms of actions, the position of the RBA appears very clear. In a deteriorating world economic environment at the end of 2008, the RBA cut rates drastically in September (25 basis points), October (100 basis points), November (75 basis points), December (100 basis points), and again in February 2009 (100 basis points) (there was no meeting in January). Since the February reduction, we have seen only one rate cut of 25 basis points in April, with nothing since. The size and speed of the cuts were unprecedented. So too was the manner in which they came to a grinding halt. Clearly, the RBA wanted to have something up its sleeve should the recessionary impacts be longer or more severe than first thought; however, their powder remains dry.

In terms of words, every policy speech from the RBA is scrutinised for a possible insight into the future interest rate direction and an expert's view of how the economy is travelling. Following the RBA's decision on 4 August 2009 to leave interest rates on hold, the Governor of the RBA (Glenn Stevens) made the following comment:

Economic conditions in Australia have been stronger than expected a few months ago, with both consumer spending and exports notable for their resilience. Measures of confidence have recovered a good deal of ground. This suggests that the risk of a severe contraction in the Australian economy has abated. The most likely outcome in the near term is a period of sluggish output, with consumer spending likely to slow somewhat and investment remaining weak. Stronger dwelling activity and public spending will start to provide more support to overall demand soon, and growth is likely to firm into 2010.

...the downturn we are having may turn out not to be one of the more serious ones of the post-War era...

This positive outlook has not been the first of its kind from Governor Stevens. In a recent speech (28 July), he made the comment:

It appears at this stage, however, that the downturn we are having may turn out not to be one of the more serious ones of the post-War era, in contrast to the experiences of so many other countries.

This was a very interesting comment from a number of angles. In the first instance, the Governor has pretty much signaled that the next interest rate movement is probably going to be up. If they truly believe that this will be a run of the mill downturn, then the monetary policy action taken to date is going to be more than sufficient to aid economic recovery. This places greater urgency on the decision of variable or fixed home loans for borrowers.

Secondly, if this comment is correct, we see a situation where the share market is clearly out of kilter with the economy itself. As mentioned above, the correction on the ASX was some 54% from top to bottom, surpassing all post-war share market corrections (including the October 1987 crash). If this recession indeed turns out not to be one of the more serious ones of the post-War era, then the share

Graph 3



THE HENRY REVIEW OF AUSTRALIA'S FUTURE TAX SYSTEM

market has over-reacted to the economic environment. The current bounce in the share market could well be the start of a V-shaped recovery, back to “fair value”.

The risk with making this assumption lies in the high degree of correlation between our share market and that of the US, shown in graph 3.

As the graph shows, over the last 12 months there has been an almost perfect correlation between the US Dow Jones Index and the Australian All Ordinaries. Quite simply, our share market continues to follow the US lead, rather than react to local factors.

There is little doubt that the RBA is correct. Our economy is in far better shape than the vast majority of those in the OECD and with all other things being equal, we would expect the “green shoots” to blossom earlier and with more veracity in Australia than elsewhere. However, this could prove to be little consolation when the share market continues to react to overseas (particularly US) events rather than on our own fundamentals. As always, the risk remains the *unknown unknowns* out there. The dire financial position of Lehman Brothers was not publicly known, just days before their collapse. If there are equally devastating future US events waiting to unfold, this Indian summer of the share market could become very overcast once again.

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At the end of 2009 the Henry review is due to deliver its final recommendations to the Government on Australia's future taxation system. One of the key objectives of this review is to ensure that:

Raising revenue should be done so as to do least harm to economic efficiency, provide equity (horizontal, vertical and inter-generational), and minimise complexity for taxpayers and the community.

As a general rule of thumb, any review of the taxation system needs to consider the interdependency of the taxation of the superannuation system and the broader taxation system itself. There is no doubt that the legacy of the previous Howard Government is the generosity of the current taxation arrangements of the superannuation. Should retirees be concerned that the Henry review will look to remove some of these advantages?

...Many BL&A clients have expressed concern that the Henry review will remove their existing superannuation taxation concessions...

Perhaps the greatest challenge that one faces in tax reform are the conflicting demands of providing equity and minimising complexity. In general tax law, these two are often mutually exclusive. On the one hand, if the review wished to make things simple, then existing arrangements would be undone on the spot. This, however, would remove rights that individuals already have, and have factored into their arrangements. The immediate loss of these rights could hardly be seen as being equitable. On the flip side of this, the equitable rights of existing superannuants could be protected by the use of transitional (or grandfathering) provisions. These ensure that those, who have already established preferential rights maintain these rights. Unfortunately, these arrangements lead to greater complexity within the rules.

Many BL&A clients have expressed concern that the Henry review will remove their existing superannuation taxation concessions. Although we will not know the specific recommendations of the review until the end of 2009, history often provides a good preview of what we can expect.

In the last 30 years there have been a considerable number of superannuation and taxation changes. It is worthwhile looking at these changes, and seeing what transitional provisions accompanied each.

- **1 July 1983** – On this date a new superannuation tax applied to lump sum payments. The new arrangements applied on a pro rata basis, which meant that individuals were not retrospectively affected. Say an individual was retiring on 1 July 1983, after 20 years of service (7300 days of service before the new rules).

Under the transitional arrangements 7300/7301 of the benefit was taxed at the old rules and only 1/7301 of the benefit was taxed at the new rules.

- **20 September 1985** – This date signalled the introduction of capital gains tax. As a transitional provision, any assets purchased before this date were exempted from capital gains tax. This transitional provision still applies today.
- **15 February 1990** – This date saw the commencement of the new reasonable benefits limits (RBL) legislation, essentially capping the amount of tax concessions available from the superannuation system. As a transitional provision, anyone 50 years of age or over on this date had their RBL set as the total value of their superannuation entitlements, and the earnings on these. This ensured that those who were actively planning for their retirement were not disadvantaged.
- **1 July 1992** – The government announced that the minimum retirement age would be increased from age 55 to 60. As part of the transitional arrangements, the new arrangements would apply only to those born after 1960, ensuring that those who were actively planning retirement were not disadvantaged.
- **1 July 1994** – The government revamped the RBL system. Anyone aged 50 years or over was able to keep their old RBL, ensuring that those who were actively planning retirement were not disadvantaged.
- **20 August 1996** – The new Howard Government introduced the superannuation surcharge. This effectively doubled the level of superannuation contributions tax on high income earners. Importantly, this new surcharge applied only to new contributions made after this date.
- **1 July 2007** – The government capped the level of non-concessional superannuation contributions an individual could make. In the lead-up to this change, the government permitted a window to allow individuals to contribute up to \$1 million. When the new rules came into play, individuals were still able to add up to \$450 000 (each).

- **8 May 2009** – The government announced changes to the age pension eligibility, which would push out eligibility for the age pension from 65 to 67. But importantly, the changes apply only to those under 57 years of age on 1 July 2009, ensuring that those who were actively planning retirement were not disadvantaged.

Each of these changes represented a worsening of the existing laws, another turn of the screw. However, as can be clearly seen from the examples, with every detrimental change to superannuation, taxation and Centrelink rules, transitional provisions provided relief.

The transitional arrangement adds complexity to legislation, in that you are effectively setting up one group of individuals with one set of rules, with a different set for everyone else. However, from an equitable perspective it is understandable as to why transitional provisions are important. If we take the most recent example, that of the shift in age pension entitlement ages. Under these new rules, anyone within eight years of age 65 is exempted from the new laws, and can still access their age pension at age 65. Clearly, it would have been unjust to have a 64-year-old, in the process of actively planning their retirement at age 65, wait another two years. The logic, however, is that a 56-year-old has time to make adjustments to a delayed age pension age.

Transitional arrangements are a necessary evil in legislative change. It would be an extremely courageous government that would make detrimental changes to tax, superannuation and Centrelink laws without providing transitional protection for the voting population. We certainly expect that, regardless of the changes proposed by the Henry review, there will be appropriate transitional provisions to protect those already enjoying preferential tax treatment.

...It would be an extremely “courageous” government to make detrimental changes to tax, super and Centrelink laws, without providing transitional protection for the voting population...



IS CASH STILL KING?

A natural reaction to a volatile economic outlook is to seek the sanctuary of cash. In the three months from September to November 2008, cash deposits in Australia increased by some 8.2%. This was the period of greatest share market volatility, with the collapse of Lehman Brothers almost bringing the whole US banking system down with it.

Over the next three months (December 2008 – February 2009), the rate of cash deposits increased by 3.7%, but only by 2.7% for the March–May 2009 period. In the last month of this period (May 2009), net deposits became almost stagnant at 0.2% for the month. Clearly, the flight to cash is slowing, probably based on two factors.

Firstly, the drastic interest rate reduction of the official cash rate from the RBA directly affected cash investors. A reduction of 4.25% in the official cash rate saw cash investors now accessing returns that did not exceed inflation. As interest rates continued to fall, deposits to cash started to slow.

Secondly, there is considerable anecdotal evidence to suggest that many investors have left the cash environment in an attempt to pick the market. With annual cash rates of around 3% on offer, it takes only a good couple of days in the share market to achieve, in a few days, what one will gain in cash in a year.

What is also interesting is the largely disproportionate playing field within the Australian banking sector. The Commonwealth Bank holds one-third of all cash deposits in Australia, with the big four banks accounting for 82% of the total. In the current environment, it would appear that depositors are shopping on brand names, rather than possibly higher returns by lesser-known institutions. This makes it very difficult for other institutions to get a foothold in the market, forcing them to borrow funds offshore for their lending. Invariably, this comes at a higher cost, making them less competitive in the lending stakes. A newcomer like the Members Equity Bank holds only \$900 million in retail deposits, equivalent to around 0.6% of the Commonwealth Bank book.

THE UNSTOPPABLE \$A

The Australian dollar (\$A) was unceremoniously dumped in late 2008. As the US banking system tinkered on the brink, and the world slipped into recession, there was a flight to safety. In a drastic fall, the \$A fell from \$US0.98 and 105 yen in July 2008, to \$US0.60 (October 24) and 59 yen (2 February). At the time of writing, the \$A purchases approximately \$US0.84 and 80 yen.

Over the last six months the \$A has regained some favour. While we have seen the economic climate turn somewhat over this period, with the green shoots of recovery suggesting an end to the world recession by the end of 2009 or early 2010, there are more specific reasons for the rise of the \$A.

Firstly, during this time Australia seems to have maintained its reputation as the 'high interest rate country of the developed world'. Whereas other countries were forced to cut interest rates back (or close) to 0%, Australia's cash rate remains at 3%. Importantly, the market is now factoring in the possibility of interest rate rises over the next 18 months, rather than any further reductions.

In recent statements the RBA Governor has made it very clear that their number one priority remains the control of inflation. The RBA has been quite vocal in stating that they will raise interest rates, even before unemployment peaks, if there is a risk of an inflationary outbreak.

Secondly, commodity prices have steadily improved as the region's major exporters (China and Japan) experience growth in their respective economies. There are also signs of recovery in the consumer-based US economy, which is good for Japanese and Chinese exporters. Both of these factors have led to an increase in the value of the \$A over recent months.

A rising \$A may be good for those about to embark on international travel, but it is bad for those holding investments in foreign currencies. Quite simply, if the \$A rises against the currency that your investments are held in, it takes more foreign currency to give you the same amount of \$A. The value of your investment therefore suffers.

The sudden collapse of the \$A prompted us to undertake a tactical shift with our investment strategies in October last year. Under normal circumstances, we would maintain a two-thirds to one-third ratio of Australian to international shares. However, over recent months we have been tilting the bias far more in favour of Australian shares.

This has proved to be an effective strategy. Over the past few months, the Australian share market has risen at similar levels to other world share markets, yet returns in Australian share funds have been superior. In a typical unhedged global share index fund, the return from 6 March to the end of July 2009 was approximately 15%. Over the same period, an Australian share index fund posed an average return of approximately 35%. This difference was purely attributable to the rising \$A, reducing global returns.

Since the \$A has increased by over 30–40% against the world's major currencies, it is quite probable that future growth in the \$A will be slower. Short of a full-blown resources boom, it is difficult to see the \$A rapidly returning to its lofty heights of mid-2008. So, given that most of the bite has gone out of the \$A, we will gradually revert to our longer term asset allocations.

NEW \$25 000/\$50 000 CONCESSIONAL CONTRIBUTION LIMITS

The 2009 Federal Budget announced that the existing concessional contribution caps limiting the amount that can be contributed to superannuation without attracting an excess contributions tax of 31.5% will be reduced by 50% effective from 1 July 2009.

The cap will apply to all concessional contributions (that is, employer, salary sacrifice, tax deductible contributions, superannuation guarantee contributions and productivity superannuation contributions) made in the 2009–10 and future financial years.

The concessional contributions cap for those under 50 years will be reduced from \$50 000 to \$25 000 a year (indexed) from 2009–10. The existing transitional concessional contributions cap for those aged 50 (or turning 50 during the financial year) and over applicable for 2009–10, 2010–11 and 2011–12 will be reduced from \$100 000 to \$50 000 a year (not indexed). Harsh financial penalties will be invoked where these limits are exceeded.

The limit applying to after-tax contributions (non-concessional contributions) remains at \$150 000 per financial year.

...Importantly all employees particularly contributing members of defined benefit schemes such as CSS, PSS, PSSap, MSBS, DFRDB and UniSuper should review their existing prospective salary sacrifice arrangements...

It is important that all employees, particularly contributing members of defined benefit schemes such as the CSS, PSS, PSSap, MSBS, DFRDB and UniSuper, review their existing prospective salary sacrifice arrangements in light of the reduction in the concessional contribution limit from 1 July 2009 to avoid incurring an excess concessional contributions tax liability.

We will use the example of Terry, aged 45, who has a prospective superannuation salary sacrifice arrangement that sacrifices 20% of salary and bonus entitlements. Terry's current salary is \$115 000 and his bonus paid on 1 July 2009 was \$10 000. This means that \$25 000 ($\$125\ 000 \times 20\%$) is expected to be salary sacrificed to superannuation over 2009–10. In addition, Terry is a contributing member of the PSS, contributing the maximum 10% (after-tax) to maximise his PSS defined benefit. Importantly, his personal 10% after-tax contributions are not counted as concessional but are included in the non-concessional contribution limit. However, Terry's compulsory employer productivity superannuation contribution (EPSC) of 2% or \$2500 a year (refer to EPSC rates table for 2009–10 in table 1), as shown on his fortnightly payslip, will be included in his concessional contribution.

On his birthday on 1 January 2010, Terry receives a pay increase of \$40 000 but fails to amend his salary sacrifice agreement, resulting in a total of \$29 000 being salary sacrificed (20% of \$125 000 for the first 6 months and 20% of \$165 000 for the remaining 6 months of the financial year). His EPSC would also have increased from \$2500 to \$2900 (2% of \$125 000 for 6 months and 2% of \$165 000 for the remaining 6 months). At the end of 2009–10, Terry will have excess concessional contributions of \$6900 and will be personally liable for an excess tax liability of 31.5% or \$2173.50 on top of the original 15% contributions tax. If Terry had taken the \$6900 as salary and made a non-concessional contribution, he would have saved \$483 (based on total contribution tax of 46.5% compared with his pay as you go tax rate of 39.5%).



Table 1 CSS and PSS employer productivity superannuation contribution (EPSC) rates

For CSS and PSS contributing members, the following EPSC rates will apply from the first pay period of 2009–10 (9 July 2009).

CSS & PSS applicable fortnightly rate of salary for superannuation	Fortnightly employer productivity superannuation contributions
Less than \$1759.33 (\$45 889 p.a.)	\$52.78 per fortnight or \$1372.28 p.a.
\$1759.33 or more, but less than \$2834.00 (\$45 889 or more, but less than \$73 920 p.a.)	3% of the employee's fortnightly rate of salary
\$2834.00 or more, but less than \$4251.00 (\$73 920 or more, but less than \$110 880 p.a.)	\$85.02 per fortnight or \$2,210.52 p.a.
\$4251.00 or more (\$110 880 or more p.a.)	2% of the employee's fortnightly rate of salary

MSBS and DFRDB employer productivity superannuation contribution rates

Both the MSBS and DFRDB defined benefit schemes include an employer-funded component, which represents 3% of a contributing member's salary for superannuation purposes and is paid into each scheme by the Department of Defence on behalf of each member.

UniSuper defined benefit scheme notional taxed contributions

For defined benefit members of UniSuper, the contributions that count towards the concessional contributions cap are calculated using a notional taxed contribution (NTC) formula rather than the actual employer and member contributions. The calculated NTC rates are generally lower than the actual level of employer and employee contributions.

Implementing NTCs is a complex issue and there are a range of variables to take into account in determining the NTC amount for individual members. UniSuper defined benefit members should contact UniSuper directly to confirm their NTC. The NTC amount forms only part of the total contributions reported to the Australian Taxation Office.

The 3% accumulation component, plus any salary sacrifice contributions made in addition to the standard member contributions, are added to the NTC.

Special arrangements for members who were in UniSuper's defined benefit scheme on 12 May 2009 may apply when determining the NTC amount for their defined benefit component. These special arrangements mean that where a member's NTC amount exceeds the relevant concessional contribution limit (\$25 000 for those under 50 and \$50 000 for those aged 50 or over), simply because the standard employer and compulsory salary sacrifice member contributions to the scheme push them above this level, the NTC amount for these members is deemed to be at their cap and no additional tax is payable on their defined benefit component.

It is important to remember that any additional concessional contributions (such as the 3% additional employer and/or any voluntary salary sacrifice contributions) are not covered by this special arrangement and will be subject to additional excess contributions tax if a defined benefit member exceeds their concessional contribution limit.

Summary of the types of contributions and impact on both the new concessional and non-concessional limits

Table 2 details the level of employer contributions and/or EPSCs based on the individual member's salary for superannuation purposes which is included in the new concessional contribution limits over 2009–10 for CSS, PSS, PSSap, DFRDB, MSBS and UniSuper – both defined benefit and accumulation members. In addition, most schemes require a compulsory member contribution (after tax), except for UniSuper members who can elect to contribute their member contributions as a salary sacrifice arrangement (before or after-tax). These compulsory after-tax member contributions will be included in the non-concessional contribution limit of \$150 000 per person per financial year.

It is important to remember that the Commissioner of Taxation will not disregard or reallocate an individual's excessive contributions to another financial year unless there are 'special circumstances'.

The reduction of the concessional contribution limit for 2009–10 may result in some BL&A clients incurring an excessive concessional contributions tax liability because they fail to take into account certain contributions that count towards the limit, such as salary sacrificed contributions and EPSCs for members of the CSS, PSS, MSBS, DFRDB and UniSuper defined benefit schemes. It is important to understand that the EPSC amount will change during the year as it is based on an individual's salary for superannuation purposes, which is adjusted annually on their birthday.

Table 2

Superannuation scheme	Amount of employer contribution or EPSC rate	Employer contribution or EPSC included in concessional contribution limit	Amount of compulsory contributions (after-tax)	Compulsory contributions included in non-concessional contribution limit
CSS	2–3%	Yes	0–10%	Yes
PSS	2–3%	Yes	2–10%	Yes
PSSap	15.4%	Yes	n.a.	n.a.
DFRDB	3%	Yes	5.5%	Yes
MSBS	3%	Yes	5–10%	Yes
UniSuper (defined benefit member)	NTCs plus 3% additional employer	Yes	7% post-tax or 8.25% pre-tax	Yes (post-tax only)
UniSuper (accumulation member)	17% plus salary sacrifice member contributions of 8.25%	Yes	7% post-tax or 8.25% pre-tax	Yes (post-tax only)

SMALL BUSINESS AND GENERAL BUSINESS TAX BREAK EXTENDED

The government has extended the 50% investment allowance tax break for small businesses until 31 December 2009.

Generally, the tax break is available for new investment in tangible depreciating assets for which a capital allowance deduction is available. New investment in an asset must be made between 13 December 2008 and 31 December 2009 for any deduction to apply, and the amount of the investment in an asset needs to meet a certain threshold. The new investment threshold is:

- \$1000 for small business entities
- \$10 000 for all other businesses.

Table 3

Business entity	Investment commitment time (inclusive)	Date of first use or installed ready for use (inclusive)	Rate (%)
Small business	13 December 2008 – 31 December 2009	By 31 December 2010	50
Other business	13 December 2008 – 30 June 2009	By 30 June 2010	30
	1 July 2009 – 31 December 2009	By 31 December 2010	10
	13 December 2008 – 30 June 2009	1 July 2010 – 31 December 2010	10

For the purposes of meeting the thresholds, GST input tax credits are excluded from the above thresholds. Broadly, the definition of a small business entity is one that has a turnover of less than \$2 million for the current and/or the previous income year.

To claim the tax break, the owner must use the asset, or have it installed ready for use before 31 December 2010, and it must be reasonable to conclude that the owner will use the asset principally in Australia for the principal purpose of carrying on a business. The tax break will not be reduced for any non-taxable use of the asset or apportioned based on the actual taxable use of the asset over a particular income year.

Table 3 summarises the key dates and the rate of deduction that applies to each entity.

IS IT A GOOD TIME TO FIX INTEREST RATES?

On 4 August 2009 the RBA left interest rates on hold at 3% for the fourth straight month, after taking a more optimistic view on the outlook for the global and domestic economies.

One of the questions commonly asked by BL&A clients is what are interest rates going to do, and whether mortgagees should switch to a fixed interest rate loan. Obviously, many factors affect the economy (locally and abroad) and setting of interest rates.

While the RBA is responsible for setting interest rates and makes decisions on monetary policy independently, the Australian Government does have some input. The RBA's aim in setting monetary policy is to achieve price stability and promote the economic welfare of Australians. It defines monetary policy as:

The setting of an appropriate level of the cash rate target by the RBA to maintain the rate of inflation in Australia between 2% to 3% per annum on average over the business cycle.

The cash rate refers to the interest rate on overnight loans in the money market. The decision by the RBA to change this rate affects a range of other market and institutional interest rates. When interest rates are high, consumption reduces and business investment and household savings are constrained, and so the economy contracts. Lower interest rates have the potential to expand the economy because credit is easier to obtain and more affordable and, as a result, businesses and individuals are encouraged to borrow.

When interest rates go down, the government is said to be 'loosening' the supply of money.

What we do know is that the cash rate of 3%, despite what the future holds, is currently at a 49-year low after five interest rate cuts from 7.25% in September 2008. The graph below compares the official cash rate against the average bank standard variable rate and average mortgage manager standard variable rate over the past 16 years.

The graph clearly shows the rapid loosening of monetary policy by the RBA since September last year which, in turn, has seen unprecedented falls in standard variable interest rates by the banks and other non-bank mortgage providers.

The graph also shows that interest rates always fluctuate. And, of course, we'd all like to be prepared for any major fluctuations. If interest rates were to drop dramatically over a specified period (as we have seen since September last year), we'd all like to reap those rewards. Similarly, if there were several consecutive rises, it would be ideal to predict that and fix your interest rate beforehand.



For the first time since the economic downturn commenced, the sentiment is now weighted at the next change in interest rates being an increase. Strong recent comments from the RBA suggest that rates could rise by 1% in the coming year, as the RBA ensures that the inflationary pressures which accompany economic recovery do not get a foothold. We are already seeing fixed interest loans now priced well ahead of variable rates.

At the time of writing, the variable rate on a Members' Equity home loan was 5.39%. This compares to 5.85% for a one year fixed rate, 6.85% for a three year fixed and 7.5% for a five year fixed rate.

Clearly, there are pros and cons with fixed and variable interest rates. Fixed interest rates offer certainty and, should official cash rates begin to rise, there would be a benefit in fixing your interest rate. The pitfalls with fixed rates, other than the obvious annoyance if rates actually drop, is that you generally lose most of the flexible features of a variable rate loan, such as the ability to pay extra amounts off your loan, a redraw facility, a line of credit and bulk reduction from a sudden cash windfall.

Arguably, the biggest risk in fixing an interest rate is if you need to break the fixed rate. For example, you may poorly predict what interest rates will do and want to take advantage of a substantial drop in variable rates. Or, let's say you want to move house due to a change in circumstances, or you come into some money and want to repay or make a bulk reduction to your loan. The lender will almost definitely charge you a fee calculated on an economic loss formula and these fees can amount to thousands of dollars.

The benefit of most variable interest rate loans (if not all) is that they allow borrowers to convert their loan to a fixed rate during the term of their loan. Often there is a cost to switch to a fixed rate, but sometimes it is worth paying this cost to protect against the potential of substantial interest rate rises.

At the end of the day, the decision to switch to a fixed interest rate is a personal one and depends largely on an individual's flexibility in making additional repayments and, most importantly, managing their cash flow situation. If working on a tight budget, the best advice is to work out what level of repayments you can afford, based on changes to interest rates. If you cannot afford repayments at a rate above the fixed rates on offer, the safety first approach would suggest you lock in sooner rather than later.

MAJOR BUDGET ANNOUNCEMENTS

Commonwealth Seniors Health Card

In the 2009 Budget, the government announced a number of changes to superannuation, tax and social security arrangements. One of the major announcements related to the assessment of income for the Commonwealth Seniors Health Card (CSHC). Importantly, superannuation income and lump sum withdrawals will no longer be included in the revised income test.

From 1 July 2009, salary voluntarily sacrificed into superannuation by those under age pension age will be assessable as income for Centrelink purposes. Therefore, from 1 July 2009, BL&A clients who receive the Newstart Allowance, low income health care card, disability support pension, carer pension, age pension (for couples where one member is age pension age and the other is under age pension age and salary sacrificing) could receive a reduction or no longer be entitled to a Centrelink benefit.

Increase in age pension age

Although the increase in age pension age does not come into effect until 1 July 2017, it will affect BL&A clients aged 57 on 1 July 2009 as their age pension age will increase from 65 to 65.5 years. For those born after 1 January 1957, the age pension age will increase to 67 from 1 July 2023. The qualifying age for the veterans' service pension will remain at 60.

Table 4 highlights how the pension age will change.

Table 4

Date	New age pension age	Affects people born	When group reaches new age pension age
1 July 2017	65 years and 6 months	1 July 1952 – 31 December 1953	1 January 2018 – 30 June 2019
1 July 2019	66 years	1 January 1954 – 30 June 1955	1 January 2020 – 30 June 2021
1 July 2021	66 years and 6 months	1 July 1955 – 31 December 1956	1 January 2022 – 30 June 2023
1 July 2023	67 years	From 1 January 1957	From 1 January 2024

Increase in pension taper rate from 20 September 2009

From 20 September 2009, the income test taper will increase from 40 to 50 cents in the dollar for a single pensioner and from 20 to 25 cents for each member of a couple, for income above the allowable income-free thresholds. The threshold is currently \$142 a fortnight for single pensioners and \$248 a fortnight for pensioner couples (combined).

...For those born after 1 January 1957 their Age Pension age will increase to 67 from 1 July 2023...

The new taper rates have returned to the levels that they were at several years ago. The income test cut-off threshold will reduce from \$41 119 to \$33 634 for singles and from \$68 705 to \$56 253 for couples combined. Importantly, existing part pensioners affected by the income test will have a transitional safety net apply, allowing them to keep existing entitlements, maintained in real terms, plus an increase of \$10.14 a week for singles or couples combined. They will continue to receive these existing entitlements, including the increase, until they are better off under the new pension rules.

Extension of 50% minimum pension draw-down relief from 1 July 2009

The government also announced that the minimum payment amounts for account-based pensions such as allocated pensions, transition to retirement pensions and term allocated pensions will be halved for 2009–10.

The new 50% minimum pension payment applies only to 2009–10, and will revert to the previous minimum percentage payment as shown in table 5.

Table 5

Age	New 50% minimum annual payment for 2009–10 (%)	Minimum annual payment for 2010–11 and beyond (%)
Under 65	2	4
65–74	2.5	5
75–79	3	6
80–84	3.5	7
85–89	4.5	9
90–94	5.5	11
95 or more	7	14

Note: These limits are based on a pensioner's age at the commencement of the pension and at the start of each subsequent financial year.

Table 6

Contribution year	Co-contribution rate	Phase-out
2009–10, 2010–11, 2011–12	100% (max \$1000)	Reduces by 3.333 cents for each dollar of income above shade-out threshold (\$31 920)
2012–13 and 2013–14	125% (max \$1250)	Reduces by 4.167 cents for each dollar of income above shade-out threshold (\$31 920)
2014–15 onwards	150% (max \$1500)	Reduces by 5 cents for each dollar of income above shade-out threshold (\$31 920)

Note that the income test for co-contribution eligibility is based on 'total income' and from 1 July 2009 this will include reportable employer superannuation contributions (that is, generally amounts above superannuation guarantee contribution). This means that BL&A clients can no longer improve their co-contribution entitlement by entering into a salary sacrifice arrangement.

Increase to Medicare levy surcharge

From 1 July 2010 a Medicare levy surcharge of up to 1.5% may apply to those who do not have qualifying private health insurance and whose income exceeds \$120 000 (singles) or \$240 000 (couples and families). Currently, the maximum Medicare levy surcharge is 1%.

Note that some BL&A clients may inadvertently exceed the relevant surcharge threshold due to receipt of taxable superannuation lump sum benefits/pensions, receipt of taxable death benefits by non-dependants and/or receipt of taxable employment termination payments.

Reduced government co-contribution

As anticipated, there has been a reduction in the maximum rate and amount of government co-contributions for eligible clients who make personal after-tax contributions to superannuation. This is a temporary reduction and applies in the five years from 2009–10 to 2013–14. From 2014–15 the co-contribution again increases to a maximum of \$1500. The reduction to the maximum rate and amounts of government co-contributions are shown in table 6.

Private health insurance rebate from 1 July 2010

The government has proposed to means test the 30% private health insurance rebate for middle to high income earners according to age. This is going to be achieved by introducing a three-tier system with a parallel increase in the Medicare levy surcharge rate to penalise taxpayers who do not have eligible private health insurance. There will be no change to the current 30% rebate for singles who receive less than \$75 000 a year and families with incomes of less than \$150 000 a year. Table 7 summarises the proposed changes.

Table 7

	Under age 65	Age 65 to under 70	Age 70+
Singles with income <\$75 000 or families with income <\$150 000	30%	35%	40%
Tier 1			
Singles with income >\$75 000 or families with income >\$150 000 The Medicare levy surcharge for not having eligible private health insurance will remain at 1%.	20%	25%	30%
Tier 2			
Singles with income >\$90 000 or families with income >\$180 000 The Medicare levy surcharge for not having eligible private health insurance will increase to 1.25%.	10%	15%	20%
Tier 3			
Singles with income >\$120 000 or families with income >\$240 000 The Medicare levy surcharge for not having eligible private health insurance will increase to 1.5%.	No rebate		

The definition of income for this purpose will be the same as the definition used for the Medicare levy surcharge, which includes taxable income, salary sacrifice superannuation, personal deductible superannuation contributions, net investment losses and reportable fringe benefits. This means that high income earners will not be able to salary sacrifice their way into a private health insurance rebate or out of the Medicare levy surcharge.

SETTING THE BUCKETS FOR 2012

Followers of the BL&A bucket methodology will know that the first bucket (B1) should ideally contain sufficient cash to cover your consumption requirements over the next three years. As 2009 rapidly draws to a close, 'bucket lists' need to be dusted off for 2010, 2011 and 2012.

The eternal question facing many of our clients is their rate of consumption. Do they spend more in the short term, and therefore load up B1? Or do they delay consumption until the B2 or B3 timeframe and look to grow their funds between now and then? Maybe there is an easy answer to this after all.

Followers of the Mayan calendar may want to place everything in B1, and look to spend every dollar within the B1 timeframe. The reasoning behind this is that the Mayan calendar predicts that the world will come to an end on 21 December 2012.

The Mayans were a bloodthirsty race who occupied territory between North and South America between 2000 BC and 250 AD. They were good at two things: building highly accurate astrological equipment out of stone and sacrificing virgins.

...The Mayan calendar is like a car odometer, and 21 December 2012 is the day that the entire calendar "goes around the clock"...

Thousands of years ago they managed to calculate the length of the lunar moon as 329.53020 days, only 34 seconds out. The Mayan calendar is like a car odometer, and 21 December 2012 is the day that the entire calendar "goes around the clock". Adding weight to the end of the world in 2012 are several other pieces of hard-core scientific evidence.

- Recent solar storms have been bombarding the Earth with so much radiation energy that it has been knocking out power grids and destroying satellites.

This activity is predicted to get worse, and calculations suggest it will reach its deadly peak sometime in 2012.

- Yellowstone National Park in the US sits on top of the world's biggest volcano. The Yellowstone volcano has a pattern of erupting every 650 000 years or so, and we are many years overdue for an explosion that will fill the atmosphere with ash, blocking the sun and plunging the Earth into a frozen winter that could last up to 15 000 years. The pressure under the Yellowstone volcano is building steadily, and geologists have set 2012 as a likely date for the big bang.
- We all know that the Earth is surrounded by a magnetic field that shields us from most of the sun's radiation. What you might not know is that the magnetic poles we call north and south have a nasty habit of swapping places every 750 000 years or so – and right now we're about 30 000 years overdue. Scientists have noted that the poles are drifting apart at a rate of roughly 20–30 kilometres each year, much faster than ever before, which points to a pole-shift being right around the corner. While the pole shift is under way, the magnetic field is disrupted and will eventually disappear, sometimes for up to 100 years. The result is enough UV outdoors to crisp your skin in seconds, killing everything it touches.

If these factors alone are not enough, consider also that:

- according to the Doctor Who episode, 'Dalek', in 2012 a Dalek breaks loose from under the Utah salt plains and plans to kill every living thing on Earth;
- the X-Files put the conquest and colonisation of the Earth by aliens as 22 December 2012 (they obviously had other plans for the 21st).

If there is any comfort to be taken from this news, at least 21 December is our summer solstice. If we do have to go prematurely, what better day than on the longest, sunniest day of the year. Take pity on our Northern hemisphere friends, who will unfortunately depart the earth on the shortest, gloomiest, darkest day of their year.

So, when Deb and Kim send you your bucket lists, remember to bring forward a bit of that B2 and B3 spending.



AROUND THE OFFICE

If you see a lonely figure walking down the Barton Highway at first or last light, look again, it may be a face you know from BL&A. Kimberley Marshall and Stephen Barnett are presently undertaking some serious training in preparation for the Oxfam 48 hour challenge in late August. Kim and Stephen are part of a four-person team who all have to walk/hike/run 100 kilometres through the Kuringai National Park to the Sydney CBD. Although teams have 48 hours to complete the challenge, the BLA team is aiming to complete the task in under 24 hours.

...During their training, Kim and Stephen have already made some interesting discoveries...

During their training, Kim and Stephen have already made some interesting discoveries about chaffing and blisters. Undoubtedly, they will learn lots more of these interesting and painful facts over the challenge itself.

This is being done in the name of a very worthy cause. Oxfam is a leader in assisting developing nations and this event is one of their major fundraisers. Anyone wishing to sponsor the team (anonymously or otherwise) is more than welcome to do so. This can be done online at

<https://www.oxfam.org.au/donate/twpaymentevent.php?TeamID=6380&EventState=NSW>

As soon as the Oxfam challenge is over, the office swaps running shoes for bike shorts, as the Bla Bla Bla team get ready for the 'around the bay in a day' cycle challenge in October. Team Bla Bla Bla comprises Doug Widdup (team captain), Chris Armstrong, Patrick Kenny (husband of our

receptionist Frances) and Stephen Barnett. As the name suggests, the objective is to cycle the 210-kilometre circuit of Melbourne's Port Phillip Bay in a day. Teams head off at first light and get back, whenever. Due to some confusion over who was entering the team, the team is now riding the clockwise circuit (which sees them head to Portsea first). This is believed to be the least friendly of the routes as it encounters greater headwinds on the way home.

...With an average team age of 54, team Bla Bla Bla is unlikely to attract the attention of any tour de France talent scouts. The team is however committed to putting in a memorable performance...

With an average team age of 54, team Bla Bla Bla is unlikely to attract the attention of any Tour de France talent scouts. But the team is committed to putting in a memorable performance.

Reports on both events will feature in our December edition of Bla Bla Bla



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