

## Contents

### Interest Rates, Financial Markets and the Economy

The Long and Short of our Economy ..... 1

### Questions & Answers

Financial Planning ..... 2

### MCP Business Structures

Company Advantages and Disadvantages ..... 2

### MCP Commercial Lawyers

Indemnity ..... 2

### MCP Financial Planning

Transition to Retirement (TTR) Pensions ..... 3

### MCP Finance

Recent Changes in the Cost for Credit ..... 4

Melbourne's Population Growth and the Demand for Housing ..... 4

## QUOTE

"Don't bunt. Aim out of the ball park"

- David Ogilvy

## Financial Quote

"Household debt has made the household sector more sensitive to changes in interest rates. This has meant that central banks have been able to achieve their monetary policy objectives with smaller interest rate adjustments."

- Ric Battellino  
Deputy Governor RBA

that the full extent of outcomes are yet to come to fruition.

The recent strength of the American share market has been fuelled by promising company announcements relating to the recent operating periods of selected companies, which is certainly contradictory to other revenue projections which indicate a stagnation of profit growth in the short to medium term. However, with historically high credit levels it seems unlikely that the U.S. economy will

continue to be as strong as it has been over the last four years.

## Market Statistics

Official Cash Rate: **6.50%**  
U.S. Fed. Funds: **4.50%**  
90-Day Bill Rate: **6.90%**  
5 Year Bond Rate: **6.42%**  
\$AUD (US cents): **89.74**  
All Ordinaries (Aus): **6,617.3**

As at 11 October 2007

In contrast, the Australian economy still looks strong. There is no doubting the continuation of globalisation in the short, medium and long term, which has been feeding the Australian share market for over four years. It's been said before but the Australian economy has been lucky in terms of what we have to offer developing countries (base metals and other materials).

Companies are not going to stop outsourcing production, and even administrative processes, to countries

with a high labour resource which will, irrespective of short term fluctuations, see the prices and demand of resources remain relatively high. The shift of production for labour intensive



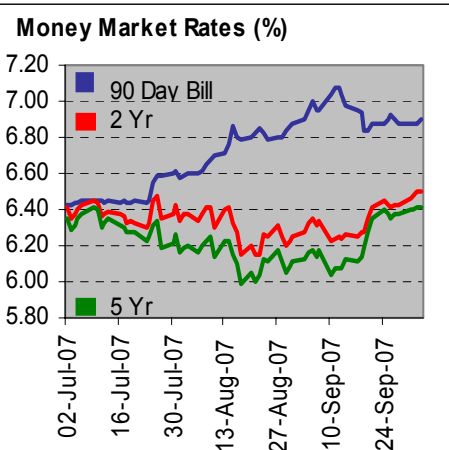
## INTEREST RATES, FINANCIAL MARKETS AND THE ECONOMY

### The Long and Short of our Economy

The Reserve Bank of Australia left the Official Cash Rate at 6.50%, following the Federal Reserve's decision to slice their rate by 0.50%. The U.S. rate cut has certainly had its desired effect, supported by the Dow Jones Industrial Index's rise of over 300 points following the announcement.

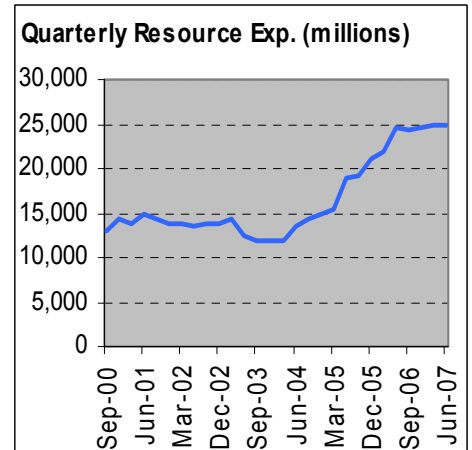
But there is still uncertainty within the American economy due to the sub-prime mortgage market, particularly as their ominous economic fundamentals remain unchanged. There are still many thousands of sub-prime mortgage loans in their introductory, low rate periods in the US, and it is only prudent to assume

## Money Market Rates



**Market Rate:** Domestic money markets have been relatively volatile following the instability in the U.S. due to their sub-prime lending concerns.

## Quarterly Resource Exports



**Resource Outputs:** The shift of labour intensive production to China and India has resulted in a high level of domestic resource exports.

goods to developing nations is set to continue for years, which should provide a base for sound economic growth for some time.

**QUESTIONS AND ANSWERS**

The MCP Group team will answer a selection of our readers' queries in each edition of our monthly newsletter. To submit your query contact our Group by phone on (03) 9620 2001 or by email: [enquiries@mcpgroup.com.au](mailto:enquiries@mcpgroup.com.au).

**What is Beta? I heard that one of my shares has a Beta of 1.1, but don't know what this means?**

Beta is a measure of share volatility. A stock with a Beta of less than 1 is said to be less volatile than the broader market. While a stock with a Beta value higher than one is more volatile in the broader market.

Technology focused shares are more prone to have a Beta value of above 1, while safe haven shares are commonly associated with a Beta below 1. A company such as Woolworths (supermarkets) has a Beta value of 0.60, meaning that the share price would rise by 0.60% if the market were to rise by 1%. Alternatively, a company such as MYOB (accounting software) is more volatile as denoted by its representative Beta value of 1.33. If the market rose by 1% you would expect MYOB to rise by 1.33%.



**The Bronze Bull:** The premise of Beta suggests that individual shares move with the market.



**COMPANY ADVANTAGES AND DISADVANTAGES**

A company is an entity which is owned by the shareholders and managed by its directors. It is governed by a set of rules called a constitution or replaceable rules contained by the Corporations Act (Cth) 2001.

**WHAT IS AN INDEMNITY?**

An indemnity allocates risks under an agreement and shifts liability from one party to another in a pre-agreed acceptance of liability. Arriving at clear

The Advantages and Disadvantages of a Company	
✓	A company is a separate legal entity.
✓	It has a legal personality to do what a natural person can do.
✓	A company officer is not liable for trade debts unless they personally guarantee a company loan.
✓	A company has a continual existence (going concern).
✓	A shareholder's liability is limited to the unpaid value of their share.
✗	Companies are highly regulated.
✗	Greater regulation and penalties result in time and resources spent ensuring the accuracy of registers, accounts and annual returns.
✗	A company is more expensive to establish and requires an annual fee payable to ASIC.
✗	There is always the possibility that a director will be required to guarantee business debt to obtain finance.
✗	Onerous director duties apply.
✗	Companies have less privacy as ASIC and members of the public can search company records.

**Companies:** Companies are subject to strict regulatory guidelines. There is also the possibility that a business owner will be required to offer a personal guarantee for business finance.

indemnities can save stress and funds in the future.



**INDEMNITY**

**WHEN IS AN INDEMNITY USED?**

A party may wish to use an indemnity for the following reasons:

1. To guarantee against any loss which another party may incur. For example, two parties settle a dispute over goods supplied which may be faulty. One party may agree to pay any claims which may arise due to the faulty goods in the future;
2. Protection against future loss;
3. When buying a business, as part of the due diligence of a transaction it will be necessary to consider whether you actually need an indemnity, bearing in mind that an indemnity is a contractual obligation where one party agrees to compensate the other party against specified losses which may arise;
4. Legal exemption from liability for damages;
5. To remove another party's ability to claim defences and make cross-claims (e.g. claims of contributory negligence).

**WHAT SHOULD AN INDEMNITY SAY?**

Ensure that the indemnity is tightly drafted and suitable for your needs. While many parties are reluctant to provide an indemnity, if you manage to persuade the other side to give an indemnity you do not want it to be struck out for being ambiguous.



**Indemnities:** There is no point in having an indemnity unless it spells out clearly the extent of the losses recoverable.

**CAN I STILL LIMIT MY LIABILITY?**

If you have a limitation of liability

clause, make sure that the relationship between your indemnity and the limitation of liability clause is clear.

For instance, is the liability cap meant to restrict liability sustained under the indemnity?

Insurance. If you are required to give an indemnity, consider whether you need to notify your insurer before you do so (this will obviously depend on the reach of the indemnity and the insurance cover held).

#### WHAT VALUE IS THE INDEMNITY?

Always consider who is giving the indemnity. It is pointless having an insolvent company or bankrupt natural person provide an indemnity. It may also be worthwhile requesting both Vendor and Purchaser company directors and/or shareholders provide indemnities.

For more information please contact Michael Poynter at MCP Legal.



#### TRANSITION TO RETIREMENT (TTR) PENSIONS

TTR is a relatively simple strategy to reduce tax for superannuants who have reached age 55 and are still working. The strategy can however be administratively complex if implemented incorrectly. Under a TTR strategy a tax saving is achieved by contributing current earnings to superannuation at a lower tax rate (15%) and drawing an income from your superannuation savings (which has tax rebates and reduces personal income tax).

The example that follows illustrates the workings of a TTR pension. We recommend that you consult your financial adviser for a more detailed and customised approach.

Adam is aged 55 and has \$500,000 in superannuation, he earns \$80,000 per annum. He currently spends all of his post tax salary income and as a result is not generating any additional savings. By simply contributing \$58,528 to superannuation and drawing \$49,780 from superannuation at the same time, his tax is reduced to \$8,762 rather than his current tax li-

#### Transition to Retirement Pensions: Example

Income/Offsets	Non Transition to Retirement Pension Client		Transition to Retirement Pension Client	
<b>Assessable Income</b>	\$	\$	\$	\$
Salary (Post Super Contributions)	\$80,000		\$20,472	
Superannuation pension payments	\$0	\$80,000	\$49,780	\$70,252
<b>Less Notional Tax &amp; Medicare</b>				
<b>Liabilities</b>				
Income Tax	\$19,100		\$15,676	
Medicare Levy	\$1,200		\$1,054	
Medicare Levy Surcharge	\$0	(\$20,300)	\$0	(\$16,729)
<b>Plus Tax Offsets and Credits</b>				
Mature Age Worker	\$0		\$500	
Senior Australians (SATO)	\$0		\$0	
15% Superannuation Pensions	\$0	\$0	\$7,467	\$7,967
<b>Net Income</b>		<b>\$59,700</b>		<b>\$61,490</b>

**Transition to Retirement Pension:** Transition to Retirement Pensions can reduce income tax and increase net income.

Test	Non Transition to Retirement Pension	Transition to Retirement Pension Client
<b>Personal Deductible</b>	<b>\$0</b>	<b>\$0</b>
Percentage (%) of Income from Eligible Employment	100.00%	29.14%
More than 10% of Super Withdrawn	No	No
<b>Mature Age Worker</b>	<b>\$0</b>	<b>\$500</b>
Attained Relevant Age	Yes	Yes
Net Employment / Business Income	\$80,000	\$20,472
<b>Maximum Government Co-Contribution</b>	<b>\$0</b>	<b>\$1,500</b>
Non-Concessional Contribution Required	\$0	\$1,000

**Satisfaction of Tests:** Transition to Retirement Pensions are available to clients who are 55 and over, assuming that they do not withdraw more than 10% of their superannuation in any given year.

ability of \$20,300. In our illustration, this is due mainly to the 15% rebate from his superannuation fund (\$7,467). Please refer to the table above for more information. The savings would be even greater if Adam were over age 60 as the pension income would be tax free.

In addition, Adam now also qualifies for the full "Government Co-Contribution" as his salary is reduced below the high level threshold for this benefit.

The rules on drawing a TTR pension is that no more than 10% of the superannuation balance can be withdrawn in any one year and the pen-

sion is "non-commutable" (cannot be rolled back to superannuation or withdrawn in full) until the super fund member has met a normal "condition of release" (for example retiring).

We recommend you consult your adviser if you believe you would benefit from a TTR pension. TTR can be a time consuming strategy to establish however the longer term advantages are extremely beneficial.

In this example we have only used cash flow equal to post tax income (no saving of income). This strategy is more effective if further salary sacri-

office is used to save for retirement (less tax payable).

**David Mac Manus**  
MCP Financial  
Financial Adviser  
Representative  
AFLS 287660



## RECENT CHANGES IN THE COST OF CREDIT

The sub-prime mortgage market meltdown has had notable ramifications within Australia, including an increase in the cost of some forms of credit and the tightening of credit lending policy amongst some lenders, particularly those that operate in the non-conforming space.

Major domestic lending institutions are able to source a majority of their funds from depositors and, as a result, have not been under the relative stresses of other second and third tier lenders whose main source of funds originate from wholesale debt markets, including the US.

Two Australian businesses that have received much media attention have been Rams Home Loans and, to a lesser extent, Bluestone Mortgages. Both of these mortgage lenders cater/catered for the Australian version of the sub-prime mortgage market, and have limited depositors from which to source their funds for resale.

It was recently announced that Westpac would make arrangements to acquire Rams' loan book due to sub-prime related financing difficulties, which made it one of the biggest victims of the sub-prime meltdown thus far. Advice from Rams' co-founder also advised that they will not compete with Westpac for new business, meaning that it would essentially discontinue operating. Existing loans will continue under the phantom Rams brand, but we envisage that many Rams customers may look to refinance as soon as possible.

The announcement caps off a horror run for shareholders, who initially acquired the shares weeks before the sub-prime mortgage mess for \$2.50 per share (it is currently hovering

around the \$0.60 mark).

The major lenders will generally always move their variable rates for standard home loans in line with the Reserve Bank's Official Cash Rate indicator.

Conversely, non-conforming loans and credit card rates may increase by more than the Reserve Bank's movements, with respect to the underlying risk of the borrower.

On one side of the spectrum, some major lenders have decided to keep their low rate credit cards as is to retain market share, while others have decided to lift their rates by the recent interest rate hike and beyond (it was reported that some credit cards had increased by more than 50 basis points or 0.50%). Also noted was Bluestone Mortgage's advice that they may increase their rates by more than 0.25% to counteract the cost of borrowing funds from wholesale capital markets.

The rates for many term deposits have increased by less than the 0.25% recent rate hike in the Official Cash Rate, which could indicate an increase in the profit margins of some lending institutions.

We urge you to look at the way in which your financier responds to market conditions and the base Official Cash Rate to see if you are receiving the best, and most cost-effective loan.

## MELBOURNE'S POPULATION GROWTH AND THE DEMAND FOR HOUSING

Demographics is the composition of socioeconomic groups characterised by their age, sex, income and education. They have had a tremendous effect on the price of property and the finance industry, which may be evidenced by some recent product offerings such as the Equity Finance Mortgage (EFM) and the Reverse Mortgage.

While our ageing population has driven demand for coastal and investment properties in readiness for their retirement, we have seen a marked decrease in rental yields to counteract the influx of investment properties in the market. While yields have picked up recently, this is one example of how housing/rental supply can

be influenced by demographics.

It was recently indicated in the media that Melbourne would need to house a further 1.2 million over the next 25 years due to the projected intake of overseas migrants. This should bring our total population to 5 million by 2030.

Migration accounted for approximately 60% of the growth in Victoria's population in the March quarter, which is set to continue in the future, albeit at more modest rates. Despite this, Melbourne still experienced very good organic growth.



**Melbourne:** The Melbourne population is estimated to reach 5 million by 2030 in response to migration and organic growth.

Projected growth could also point to a shifting trend of high density housing such as apartments. Migrant inflows and generic population growth may also keep the supply of housing/property in check in the long term.