PRINCIPAL WEALTH

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Genesys WEALTH ADVISERS

The Insider - May 2014

Welcome to Principal Wealth's 'The Insider' client newsletter and a great new look. We've been working on this new format and new content to ensure you're up-to-date and well informed on all the latest news.

In this edition you will find articles on a range of finance related topics, prepared based on trending news. With the End of Financial Year approaching, Principal Wealth will be running the first of it's 2014 Education Seminar Series on Thursday, 29th May which will be focusing on a Federal Budget Review/ Transition to Retirement Strategies. We welcome anyone interested in attending and look forward to having Justine Marquet (Technical Strategy Manager - AMP Advice) back this year to present.

If you have any questions about any of the articles in our newsletter, or any other financial planning topic, please contact us on (02) 9240 6657 or by email at admin@principalwealth.com.au.

Happy Reading!

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Tips and traps of credit

Starting out with a HECS debt is bad enough, but abusing a credit card can also mean trouble. Admittedly it's tempting to spend with interest rates at current levels, but most credit cards still have double-digit rates.[1]

Of course a card is useful when you don't have ready cash, but unless you pay off the balance in full each month the interest costs add up.

Credit card statements today must show how long it will take to repay the debt, and how much extra interest you pay if you only make the minimum payment each month. The MoneySmart calculator is also a useful tool to show you how much more you owe on your card.[2]

Running up large credit card debt can result in a poor credit rating that can come back to bite you down the track.

For instance, if you are just five days late in paying your credit card, this fact may be noted on your credit file. If you are 60 days late in paying any form of credit, then you may be issued with a default or other negative listing.[3] That does not sit well when applying for a mortgage.

It is estimated that the average household credit card debt for the 56 per cent of Gen Y's who have credit cards is $6,000.[4] Much of this is lifestyle debt – money spent on clothes, entertainment and holidays rather than appreciable assets like property.

For Gen Y's wanting to get ahead financially, the first step is to pay down a credit card. This will help provide space in a personal budget to think about starting a regular savings plan.

Interest-free store deals

Interest-free store deals can prove lethal, they are not free with both fees and charges attached. If the purchase balance is not paid in full within the interest-free period, you will be charged interest on the outstanding balance at rates that can be close to 30 per cent. In some cases, the interest may revert to when you first made the purchase.[5] Paying huge interest costs on a depreciating asset long past its prime is a wasted effort.

Amalgamating all your debt into the one account and then paying a lower overall interest rate may be an option but this also has a downside as it may mean extending the repayment of what was previously a short-term debt over a longer period, which can cost you more in interest.[6]

There is no doubt credit cards can play an important role in life, but you need to make sure they are working for you and not the other way round. If you are concerned, speak to an adviser about getting a savings plan in place today.

1 http://www.canstar.com.au/credit-cards/compare-credit-card-rates/

2 https://www.moneysmart.gov.au/tools-and-resources/calculators-and-tools/credit-card-calculator

3 http://mycra.com.au/blog/2013/07/16-25-drowning-debt-guide-make-credit-work-you/

4 http://www.genworth.com.au/downloads/4-2-3-Spotlight/spotlight-series-gen-y.pdf

5 https://www.moneysmart.gov.au/life-events-and-you/under-25s/credit-and-debt/types-of-credit Interest-free deals

6 https://www.moneysmart.gov.au/managing-your-money/managing-debts/consolidating-and-refinancing-debts

The future of money

The line "as rich as Croesus" is littered through literature in works as bizarrely diverse as Alexandre Dumas' The Three Musketeers to E.L. James' Fifty Shades of Grey. As the ruler of Lydia (in what is now western Turkey) from 560–546 BCE, King Croesus presided over the introduction of the first Legal Tender coinage.[1] The man deserves his dues.

The coins were made from electrum, a mixture of silver and gold and stamped with pictures that acted as denominations. In the streets of the Lydian capital Sardis, a clay jar might have cost two owls and a snake. Lydia's currency helped the country increase its internal and external trade, making it – and King Croesus – one of the richest empires in Asia Minor.

But civilization had already existed for several thousand years without the presence of such legal tender as money, which in and of itself, is just a device of trade. Dating back to the time of the first pharaohs, items as diverse as cattle, animal skins, rice, tea, clam shells, barley, salt, peppercorns and even bat guano have been accepted as a medium of exchange, a unit of measurement and a storehouse for wealth. These allowed people to trade goods and services and understand the price of an item as simply as a tag reading $1.99.

Money's colourful past

Money also helped cut through the romantic but ultimately time-consuming process of bartering. Anthropologists argue that bartering was nowhere near as widespread as claimed, and evidence shows as soon as an effective form of currency developed, bartering suffered a swift death. Slowly, money, as we know it today, developed through the Middle Ages – first through precious metals including gold, silver and copper until 'paper money' was first used by the Chinese in the early 1400s. The Spanish use of 'pieces of eight' from the 17th century deserves credit as the first true global currency.[2]

But we're wrong to think that the place of today's printed and minted dollars and cents represents anything more than a stable period in the history of money and currency. Interestingly, the first Diners Club card was issued in 1950. It was not until the 1990s when credit cards become truly global and, for the first time, money lost its materiality.

Spending today

Stored-value cards represent the next step in this evolution. Typically anonymous, applications of stored-value cards include transport system fare cards or telephone prepaid calling cards. They're also becoming increasingly popular across a range of services via country specific payment cards like Geldkarte in Germany, EZ-Link in Singapore or the Octopus card in Hong Kong.

Cryptocurrency – Bitcoins

As much of our life is now spent in a virtual space, it's not surprising encrypted virtual currency transactions (known as "cryptocurrency") is such a fast-growing method for peer-to-peer transactions. By using software and specialised hardware, one can mine these currencies in a virtual 21st century gold rush.

Cryptocurrency removes regulatory oversight from central banks and puts it in the power of protocols that control a monitoring process. The most common form of cryptocurrency is Bitcoins, but alternatives (or altcoins including Litecoin and PPCoins) are emerging. Cryptocurrency is gaining popularity through the speed and cost efficiency of transactions and the freedom from government controls that limit the supply of money (and influence its value).

Like any new form of money, cryptocurrency is yet to be widely accepted. Its global acceptance is likely to be delayed after China's largest exchange for the virtual currency recently stopped accepting deposits in yuan (China's local currency). Critics also point to the threat of cybercriminals and the use of Bitcoins in illegal and illicit transactions.[3] What would Croesus have made of the Bitcoin? Probably equated it with a load of bat guano!

1 http://theformofmoney-mammon.blogspot.com.au/2011/10/rich-as-croesus-origination-of-legal.html

2 http://www.bloomberg.com/news/2011-10-25/coins-to-credit-cards-a-short-history-of-money-neil-macgregor.html

3 http://www.marketwatch.com/story/bitcoin-fever-is-a-fools-gold-rush-2013-12-03

Beware SMSF property spruikers

Self Managed Superannuation Funds (SMSF) are becoming increasingly popular with Australians who want to take control of their superannuation investments.

But there are growing concerns that SMSF property investments are being pushed by aggressive unlicensed property spruikers who are not acting in their best interests.

The Australian Securities and Investments Commission (ASIC) recently warned real estate agents that they must have an Australian Financial Services Licence (AFSL) before they recommend the use of a SMSF to invest in property.[1] While a financial adviser is licensed under an AFSL, many unsuspecting people don't realise many "property experts" are not licensed and are sometimes incentivised by developers to "promote" property that may not be appropriate as an SMSF investment.

Property investment has been heavily promoted to SMSF trustees since a change in superannuation legislation allowed them to borrow for investment. At present SMSFs hold around 15 per cent of their assets in direct property.[2]

Residential property has been a reliable investment for generations of Australians, but the decision to buy inside or outside super needs to be weighed up carefully. There are benefits and restrictions with each form of ownership.

Property inside super

The main benefit of buying inside a SMSF is that capital gains are tax-free if you sell your property after you retire and have converted to pension phase. If you sell earlier and have held the property for over 12 months, the effective tax rate is 10 per cent. Of course you can't take the proceeds out of super until you retire or start a super pension.

In addition, the tax benefits of negative gearing are smaller inside super where income is taxed at 15 per cent. What's more, banks will generally only lend up to 80 per cent of the purchase price, and will generally charge higher rates of interest than those on offer outside super.[3]

Outside super

If you buy property in your own name you may be able to borrow up to 100 per cent of the purchase price if you already have sufficient property as security. You can also sell your investment and access the cash whenever you like.

Set-up costs are cheaper outside super and tax deductions for interest and other investment-related costs are often greater. This is because they are made at your marginal tax rate rather than the 15 per cent super tax rate.

On the downside, when you sell the property you pay capital gains tax at your marginal tax rate.

The best outcome will depend on your personal financial circumstances and investment strategy. If you would like to discuss any the points raised in this article, please see your financial adviser.

1 ASIC, 6 Nov 2013, http://www.asic.gov.au/asic/asic.nsf/byheadline/13-304MR+ASIC+warns+real+estate+industry+about+recommending+property+investment+through+SMSFs?openDocument#

2 RBA Financial Stability Review, September 2013, http://www.rba.gov.au/publications/fsr/boxes/2013/sep/d.pdf

3 http://www.yourmortgage.com.au/calculators/affordability/