accordia

the advantage

Winter 2011

White Envelopes and a New Era

Sweet as PIE

A Box of Fluffies

Putting it Simply

The Acid Test

refreshingly honest investment advice

White Envelopes and a New Era

It's not been all bad news for New Zealand Post. Over the last few weeks, they've delivered thousands of ground breaking letters to investors. Although not necessarily containing ground breaking content, these letters signify a major positive change for New Zealand's financial services customers.

Under the new Financial Adviser regulations that came into force on July 1st, every financial adviser and institution is required to write to investors explaining their obligations.

While it may not be the most exciting reading material you've ever received, it's worth celebrating its significance.
It marks the beginning of a new era for New Zealand where the brand new Financial Markets Authority (FMA) regulates New Zealand's financial markets.

The FMA oversees securities, financial reporting, and company law for financial services and securities markets. They have wide investigation and enforcement powers including:

- Requiring people and entities to supply information, provide documents and give evidence
- Suspending or cancelling offer documents, removing prospectuses or investment statements from the market and banning advertisements
- Investigating complaints about financial advisers and taking disciplinary action
- Enforcing laws on insider trading, market manipulation and disclosure

When enforcing these powers, the FMA's strategy is to work with industry participants to:

- Improve overall behaviour and performance across financial markets
- Encourage participants to quickly report and correct errors or regulatory breaches
- Take appropriate and timely action where breaches are identified

Accordia wholeheartedly supports these initiatives, even if it took a great deal of mayhem and time to get them.
We're steadily providing new Primary and, where needed, Secondary Disclosure Statements to everyone as we carry out investor reviews.

If you'd like to know more about these exciting new changes the FMA's website www.fma.govt.nz has lots of user-friendly information that's worth checking out. There's advice for prospective investors and current investors, all written in plain English. Together with www.sorted.org.nz, these two sites offer real support on financial matters.

We'd be delighted to answer any questions you have on these changes, so please don't hesitate to get in touch with us. (Contact details on page 4)

Sweet as PIE

One of the most common questions we get when we send out Tax Reports is "Where's the income?". It's there, of course, but because of the way it's handled within a PIE, it may not always be obvious.

Think of a PIE as a box of chocolates full of peppermint creams, hokey pokeys, strawberry delights and so on.
The chocolates represent different investment types such as cash, fixed interest, shares etc., and the box represents the tax structure or PIE tax environment.

All the cash and fixed interest investments earn interest income, and the shares earn dividend income, just as if they were held directly. Investors in PIE structures don't get all the notices about the interest or dividends, but they do still hold the investments and earn the income. In the PIE, all income is re-invested back into the portfolio. That means it's not paid into a cash account somewhere but retained in the portfolio, which is much more productive.

Cash can still be raised to meet investor needs as required, and the PIE structure is the sweetest way to manage investments in a very tax efficient way.

A Box of Fluffies

Another common question we've been asked this year is about how fees are treated in the tax report. We don't think tax should be taxing, so here's an explanation.

When an investor incurs expenses generating taxable income, they can claim the expenses in their tax return. For example, a Trust earns income of $39,645. The Trust's investments are all in a PIE with a tax rate of 28%, and the trustees are allowed to claim expenses. The tax actually paid was **$7,753.**

What if the fees were not deductible or the investments were not in a PIE? The table below shows the results of those scenarios.

Tax on PIE investments		Tax on Non PIE investments	
Cost deductible	Cost not deductible	Cost deductible	Cost not deductible
$7,753	$11,101	$9,138	$13,083

- If the investments weren't in a PIE, their tax bill would have been almost **18% higher**
- If their investments were a PIE, but their expenses weren't deductible, their tax bill would have been an eye-watering **43% higher**

The best scenario to minimise tax is to have all investments in a PIE, and for fees or expenses to be deductible. The good news is that Accordia's PIEs do this automatically (provided the PIR is not 0%).

Incidentally, if you have any fees that can't be claimed against the PIE income, your tax report shows that too.
It's a bit like a box of fluffies!

Putting it Simply

"Risk"

is a frequently used investment term but what does it actually mean?

Many people think bank investments are "safe" and other investments, such as shares or property, are riskier. Although that's a perfectly reasonable perception, it focuses on only one type of risk – the risk of not getting your money back or "default" risk.

There are many other risks to be considered even in those forms of investment which have low default risk. One of the most insidious of these is purchasing power risk. The problem here is that inflation eats away at the real value of your money. Another is liquidity risk, which is the problem of not being able to cash up your investments when you need or want to.

By law, an issuer must inform prospective investors about the risks involved with an investment. Investment Statements contain a section called "What are my risks?" which often provide extensive details on all the different types of risk an investor may experience.

It's logical and rational to expect a higher level of return for taking a higher level of risk. This is usually referred to as a "risk premium". Conversely, the lower the risk taken, the lower the expected return.

A more technical definition of risk considers the variability of return. That is, how much the return varies around an average or mean. Standard deviation is expressed as a percentage which shows the amount the return can vary above or below the average return.

It's important to appreciate that risk is neither "good" nor "bad". In fact most investors need to take at least some risk to generate additional return to ward off purchasing power risk. The Adviser's role is to carefully assess and agree with every investor the level of risk they're willing to take to reach their desired outcomes. At Accordia, your Investment Policy Statement records your individual requirements and is a guideline by which we ensure that your portfolio conforms to your needs.

The Acid Test

Does investing in gold make sense?

An "acid" test" is one that results in an unequivocal conclusion. The term was first used in relation to gold as, unlike silver and base metals, only gold is insoluble in nitric acid. Hence, the term "acid test" was born as a definitive test of whether gold was indeed gold.

With the gold price at an all time high now, it may be time for another acid test – this time to determine whether gold is currently a good investment.

Always highly prized as a form of currency, as well as for jewellery and scientific purposes, gold is also one of the most popular precious metals for investment. It's particularly sought after in turbulent times. Gold price rises have been most dramatic during the Great Depression, during World War II and at the time of the first and second oil shocks of the 1980s.

Thanks to its perception as a safe and tradable commodity, gold investors tend to buy it in times of uncertainty to preserve their wealth. This lack of faith is evidenced by the current gold price peak, which has been driven by global economic challenges following the 2008 banking crisis.

Despite its perception as a safe haven, over the last two hundred years or so, shares have outperformed gold. Analysis published on the Wikipedia website notes that even with inflation adjustment:

- $1 invested in bonds in 1801 would be worth nearly $1,000 by 1998
- $1 invested in stocks in 1801 would be worth more than $500,000
- $1 invested in gold in 1801 would be worth just $0.78

This doesn't tell the whole story though, as over that time period, there have been strong cyclical trends where gold, or one of the other assets, has outperformed the others. At the moment, for example, the severity of the current economic situation is causing gold to perform strongly against other asset classes.

Whether gold is a "better" way to invest is a question that has exercised the minds of many over the years. In 2005, Rick Munarriz, a contributor to "The Motley Fool" website, posed the question of whether a share in Google or an ounce of gold would be a better investment over the next 10 years.

We won't know the final answer until 2015 but, right now, gold is ahead. Google got off to a flying start after it listed at $85 but gold is "in" at present. With another four years to run, it's really anybody's guess.

One piece of research forecasts that gold prices will collapse this year but it certainly doesn't look like happening yet. It's a timely reminder though of the cyclical nature of markets and that what goes up…

At Accordia we don't take big punts on specific assets but hold well-diversified portfolios to ensure consistent returns. However, within the Specialty area of our portfolios, we can have exposures to gold and other commodities, and our core equities holdings can also directly and indirectly benefit from the gold price. So even though you may not have bars of gold in your safe deposit box, you may still be benefiting from the current gold price high.

Accordia Christchurch **Phone (03) 348 1689**
Accordia Hamilton **Phone (07) 855 2888**
Email **service@accordia.co.nz**

accordia

www.accordia.co.nz