

Lock in your gains from boom market

Ease those concerns about your super with a few safe havens. **Tim Blue** reports

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WHEN star funds manager Kerr Neilson floats his company and is instantly Australia's fourth-wealthiest man, you know markets are well and truly hot.

Then there's the million-dollar prices for art, the trophy homes and the record sales of Porsches and Ferraris.

And for the lesser mortals among us, there's the record run in super.

Five years of over 10 per cent earnings is the best run for decades, and if you have been bold enough to take the all-shares option instead of the balanced default option, you will be laughing.

Only a killjoy will suggest that this golden run cannot go on, but facts are facts.

"It is hard to imagine that such strong returns can be sustained indefinitely," says Centric Wealth head of research James Foot.

"Experience teaches us that extremely strong rises are sometimes followed by periods of relative weakness."

If you are worried about your super holding up, there are a variety of steps to take. Essentially, you must remove the risky elements that might shrink your super in the event of a market collapse.

This means baling out of the companies with no real earnings or those that are vulnerable, dodgy property investments and exotic financial investments.

"If you were so concerned, you could simply withdraw all your super as cash and deposit it in a bank account," Macquarie financial planner Doug Webber says.

But there are several drawbacks to such a move, he says. First, you'd generally have to be aged at least 55 and be retired.

"Secondly, it will crystallise capital gains within the fund and lead to lesser returns.

"Not only that, but you would potentially pay some lump-sum super tax as you remove money from the fund."

In addition, your fears might be misplaced and you would be investing prematurely in a sector that naturally performs worse than elsewhere, with returns in the order of 3 per cent and 4 per cent a year.

"Judging when to move is hard, and will depend on exactly how much you can afford to wait out a market correction," Webber says.

Even if the share market slides, it may still be tax-effective for many investors to keep share investments within a super

fund.

Tax on capital gains made on assets held for more than 12 months within a super fund in accumulation phase are taxed at 10 per cent.

"When the fund moves to pension-paying mode, capital gains can be realised with a zero tax rate, so it is generally less costly to take profits in super than elsewhere," Centric Wealth technical research manager Anne-Marie Esler says.

Had you been holding the shares personally and sold within 12 months of buying, any capital gains will be taxed at your marginal rate. There's a 50 per cent discount if held longer than that.

"It may be worthwhile thinking about whether to transfer shares held in your own name into a self-managed super fund, in what's known as an in-specie transfer," Esler says.

"An investor will still be realising a capital gain individually, but some investors might be in a position to treat the transfer as a tax-deductible contribution to super to offset some of the CGT payable. This way, any future gains will be subject to the more concessional tax environment."

One question to ask, in any decision to lessen risk, is the wisdom of doing so.

Remember that any correction will necessarily have to be large enough to overcome the gains achieved over the past five years.

A second range of options involves converting a super fund balance into a pension: a cash flow on which to live. These pensions can be bought from financial institutions and planners.

A range of fees might be involved, starting with the front-end fee of up to 5 per cent and falling to nil, if bought through an industry fund or an employer's pension plan. A complication to bear in mind is that the rules on these pensions require a draw-down set between a minimum and maximum each year: the minimum is around 4 per cent of the balance.

From July 1, the minimum draw-down will be a little smaller than previously, yet still exist, to ensure the fund remains entitled to tax breaks.

"For an investor to maintain their capital, funds drawn down from a pension must be the same or less than what the fund can earn from its investments," Webber says.

"So, if you are invested in cash in the pension fund, you'd be pushing to maintain your capital even if you took the required minimum income. This means an investor has to make choices about where to sit the money, and in this market it is not the easiest of tasks."

Perhaps commercial property is the answer, or offshore equities in China or India. Whatever you choose, timing markets is something you're unlikely to get entirely right.

Members of self-managed super funds may have a few more options, in the form of strategies using options to provide insurance for the portfolio.

Strategies exist that not only insure against losses, but can actually make money in a falling market.

Short selling, where you sell "borrowed" shares today in the belief you can buy them back cheaper in a day or so, may also be something to think about.

There is an intermediate strategy for those aged 55 to 65 who want to keep working, albeit at a scaled-down level.

Consider a transition to retirement, where you start a non-commutable allocated pension and perhaps match it with a salary-sacrifice arrangement.

These allow someone to convert their assets from a super balance to an income-flow - a pension - which has the great attraction of not being counted in any tax assessment.

Any income you earn from continuing to work must still be declared and be taxable, though since it will be of lower levels than previously, any tax it attracts will be at a lower rate and on a lower sum.

As Theo Christopoulos, an executive director of Meritum Financial Group, says: "The end income is the same, yet they will have enjoyed some tax savings and in all likelihood their super balance will continue to grow, as it does over time.

"It's a great way to manage super assets in the tax-friendly pension environment.

"It might look complex and it should be done with advice from a financial planner, but it a good answer for many."

Taking a long-term perspective, it may be best simply to sit back and not worry.

Many funds have earned mid-teen percentage gains for up to five years, so a crash will need to be enormous to take us well back.

If it is reassuring, just remember that the biggest crash in stock market history was 25 per cent in October, 1987.

For Centric, the wisest strategy is to maintain a well-balanced portfolio and live with the ups and downs.

Says Anne-Marie Esler: "Our investment philosophy stresses the importance of maintaining a diversified portfolio.

"This applies at all stages of the market cycle - never 100 per cent equities but never 100 per cent cash."