Investment Market Update

Issue 56 – Autumn 2015

Message from the Manager

Welcome again. The past few months have been perhaps the busiest of my life. Our previous owner faced insurmountable financial difficulties at the end of last year, and as a consequence many of the original owners of the business (across both the Queensland and Victorian offices), stepped into the breach and bought back the farm. Doing such a deal in such a short time was not an easy task, but successful completion was the right outcome for clients, staff and shareholders, all of whom realise that the success of this firm relies on the trust of clients and the commitment of staff.

Now that the deal is complete, we all realise the extent of the distractions that came with the previous owner. As usual, we have been working on internal initiatives that we expect will lead to ongoing improvements in service levels for clients, and now we are able to speed up those initiatives. Our sincere thanks for your expressions of support over this time.

The media is again awash with financial planning related commentary. The banks are copping a caning, and it seems that once again tax, super and social security is up in the air. At CIPL we spend all of our time working on client related matters. Whether that is running a fee based business or the manner in which we manage assets, we have frequently been ahead of the main game. That is important because the work we do now sets the direction and frequently the outcomes for the future; sometimes the distant future.

Thank you for choosing us to assist with your personal financial needs. Your choice means a lot to us.

David French
Managing Director

More than a decade

February marked CIPL's 14th year of operation. The company was started after I was invited to join The Rock Building Society to establish a financial services offering. With no retail financial qualifications and no Australian Financial Services Licence, it was literally just me and a desk.

What I did have was excellent training and experience in investment analysis and funds management, and a deep seated knowledge and interest in building and managing investment portfolios (for myself, friends and my father). From managing my own self-managed superannuation fund I gained a sound knowledge of the benefits of that approach, and by looking after my mother's financial affairs, deep and unpleasant experience with Centrelink, retail managed funds and a wayward financial planner.

I'll spare you the details over my retail conversion courses, and getting our own AFSL, but the rest is history, and over battles with competitors, regulators and even service providers, we have built an enviable business, managing around $550 million, up and down the east coast of Australia (and a few other spots besides).

Coming from the institutional side of the financial service industry, I have been continually astounded at the amateurish manner in which much of our industry has conducted itself, and indeed at the ham-fisted attempts of government and regulators to tidy it up. The unsettling thing, and it is a fact, is that personal finance has become way, way too complicated for the average person. Most people of a certain age have no choice but to seek the advice of a financial services professional, and because of this you would think that all players would move quickly to fix the system. Instead most players have adopted a self-interested piecemeal approach that on top of volatile markets and issues of integrity, has left financial services legislation akin to the tax act – a complex and conflicting dogs' breakfast.

Why has this happened? First there is the history of the industry. Looking back, you would think that stockbrokers and accountants would have been best placed to provide financial advice to everyday people, but stockbrokers were too addicted to trade based commissions and not at all interested in considering tax, and social security issues, and accountants were addicted to their hourly rates model, which simply cannot be applied to activities which include expensive up-front research applied across many clients and for which outcomes are often market linked. As it turns out it was insurance companies that had in-house investment skills (because behind all insurance companies is the statutory reserve portfolio), and on account of the history of life insurance, they had tax and superannuation experience and a ready-made sales force. In essence the people most suited to provide financial services to private individuals dropped the ball, and that paved the way for the insurance companies, and later banks, to come charging through. Sales driven and with big marketing budgets, regulators were left behind, and have remained so ever since.

Second, there is the complexity of the personal financial services task itself. I am not sure how many clients think about this (it might put you to sleep), but a financial planner needs to know quite a lot about investments, superannuation, tax, social security and estate planning. Not only that, they have to have the personality to discuss all of these things with people from all walks of life. The changes in the last 14 years have been monumental. When I started for example, we had complying pensions, allocated pensions and lump-sum draw-downs as ways of drawing money from super. Now there are account based pensions, market linked income streams, transition to retirement pensions and lump sum drawdowns, all of which are completely different to the options available in 2001 (I won't go into the changes to the ways you can put money into super). Over the time tax rates have also changed. The change in the tax-free threshold makes the use of superannuation redundant as a retirement savings vehicle for some, and creates opportunities for others. The accompanying increase in marginal tax rates significantly changed tax considerations relating to how investments are held.

The GFC was a challenge that competent financial planners needed to face head on, and in my opinion was a watershed for the way in which we advise on client investments. The current low interest rate is likely to persist for some time, and as recognised by ex-RBA governor Glenn Stephens, creates big challenges in maintaining retirement income for any given level of risk. There are constant changes to social security rules, the most recent of which is the phasing in of deeming for superannuation assets that were previously exempt from the aged pension income test (this measure was easy to implement when deeming rates are low – it will have little immediate effect. It is however, a time bomb that will explode when interest rates rise). There is more to go on with, but it is half smart for the press to comment "what do financial planners do to earn their money".

Third, there is the shambolic regulation of the industry. In this there are multiple problems. Those related to "crooks" are well reported and sometimes justified, but the biggest one relates to the regulator and the legislation itself. What many people don't know is that the retail financial services legislation, as legislated under the Corporations Act, is all about regulating product advice. This means if something is not classified as a financial product, it is not covered.

From what I have seen, Storm Financial did not provide deficient advice under the Corporations Act. Its advisers actually recommended a bunch of pretty standard managed funds. All these were regulated, and the written advice covered reams of back-side covering compliance statements and disclaimers. Storm clients came unstuck however, when their advisers recommended that everyone borrow heavily to fund their bog standard investment portfolios.

As we have talked about in client seminars, debt (fixed interest) markets underpin all asset valuations, and that means regardless of the quality of the underlying assets, borrowings join everyone at the hip. At the time margin loans were not classed as financial products, and so with the exception of the banks, almost all the people involved in providing that advice will walk away Scott free.

Fourth, there is the politicisation of personal finance. Unlike tax, which is unpopular and generally poorly targeted, Superannuation and Social Security provide obvious conduits through which political parties can curry favour with their constituents. Consider the Coalition's reduction in the taper rate for the aged pension from $3.00 per $1,000 invested to $1.50. That single measure was not needed to encourage retirement savings, but it suddenly meant that many relatively well-off retirees became eligible for an aged pension and the attendant health care card (note that I'm not arguing it was a bad thing for clients – of course, it has been a great outcome for many). Or later let's look at the ridiculous roll-out of the minerals resources rent tax and the carbon tax. Both taxes probably have their place, but their roll-out was accompanied by an increase in the tax-free threshold, and increased social security benefits – both designed to attract votes to the Labour Party. Labor or Coalition, in each case the result has been less revenue and more spending!

Further, the involvement of the union movement in superannuation is political and nothing short of alarming. Corruption in unions is everyday media fodder, yet unlike companies, industry super funds have few rules as to the constituents of their boards and management and wrongdoers face fines 1/16th the level of the fines faced by corporate wrongdoers.

Lastly, let's look at the media. With few exceptions the issues I have raised above are rarely treated with any consistency in the media and dumbed down reporting lets all manner of kooky "facts" get through to the keeper. The current debate on the budget deficit is a case in point. The increasing deficit is caused by the interaction of three things – the mining downturn which is cyclical, an ongoing fall in the number of people paying "net-tax" (that is, those actually pay tax after taking into account the Government concessions they receive), and a vast reluctance by Governments to address their cost bases. Any solution has to address all of these underlying issues – it's not a pleasant thought; there will be pain. But suggestions like taxing superannuation earnings, removing the franking credit system, or increasing the corporate tax rate are downright stupid. Why? Because superannuation is a savings vehicle for retirement – the surgery needs to be on access to the age pension. The franking system means there is generally no corporate tax (so if you raise corporate tax, you raise the resulting franking credits, and with the exception of overseas investors – evil of course (!) – shareholders'/owners tax position is unchanged).

What should we do about all of this? Here's my suggestions:

- The retail client provisions of the Corporations Act need a complete rewrite. The focus needs to be not on products but on suitability of advice and negligence, as with any other consulting style business.
- The financial planning industry needs to split into those who are selling, and those who are acting as professional consultants.
- ASIC needs to become more market aligned. This means employing less lawyers and more people who understand markets. It also needs to be integrated with the industry it is regulating, acting as advisers as much as policemen.
- Super funds need to be regulated to the same standards as companies.
- The interaction of tax, superannuation and social security is a problem that financial planners grapple with every day. Really they are all aspects of the tax system. Politicians need to start thinking and treating it as such, and set policies looking at the three aspects working together.
- Exemptions relating to the private home have to be modified and even removed (while putting appropriate safety-net measures in place).
- The media needs to become less interested in feeling, and more interested in the facts. In this case, the facts ARE the story.
- Individuals need to begin to take a real interest in personal finance, so that there is a less of a gap in being able to assess what they are told by financial services professionals.

It's a long story, and expecting such change is a big ask. If we don't tackle it, expect another 14 years of complexity, uncertainly, heat and no light.

David French
Managing Director

Corporate Update

We're delighted to confirm that effective 27th February CIPL (including the Pentad Group) was bought from the administrators of ILH Group.

We're also very pleased to confirm that the former owners of The Pentad Group and former owners of CIPL have joined together to purchase the company. Former Directors of The Pentad Group, Lance Livermore and Chris Heyworth, join with David French, Owen Evans and Michael Peet to comprise the new board of CIPL. All Melbourne and Rockhampton advisers (Sue, Bob, Lachlan, Chris, John, Josh, Lance, Morgen, Robert and Russell) and all staff remain within the CIPL / Pentad team.

This is a great outcome for all as the combined resources of both our Rockhampton and Camberwell office. Our ten advisers and around 20 other staff are available to help you achieve your financial objectives.

We are very grateful and respectful of clients' loyalty to our company during what has been a challenging time in our relationship with the ILH Group. We look forward to continuing to work with you to ensure even better financial outcomes from your ongoing relationship with us.

If you would like any more information feel free to give me a call, or speak with your adviser.

Robert Syben
Head of Financial Planning / Senior Financial Adviser

Bank account updates

The Rock changes interest rates

The Rock has informed us of a drop in the level of interest rates payable to deposits held as part of CIPL's Portfolio Administration System. Since 2006 the interest rate has been set at 50 basis points (half of a per cent) above the Reserve Bank of Australia (RBA) cash rate. The rate will now be 30 basis points above the RBA cash rate.

The Rock reports that the preferential margin paid to CIPL clients has become a bigger and bigger portion of the overall interest rate they are paying, and the level of 50 basis points is no longer sustainable. Even with this change, The Rock rate remains competitive, but we know that in such a low interest rate environment, all income counts. We are therefore investigating suitable alternatives.

Insurance

Are your kids protected?

Did you know?

Heart disease in children is the leading cause of death, accounting for more than 30% of childhood deaths? Or that 200 children under the age of 14 are diagnosed with leukemia each year, with treatment taking approximately 2 years?

What would happen if this was your child or grandchild? Would you have adequate funds available to cover costs of hospital and medical treatment? Would you or your partner be able to stop work indefinitely to care for your sick child? Unfortunately for most people there would not be sufficient funds simply 'lying around' to eliminate the financial stress of coping with a sick child.

Thankfully there is a low cost solution that will ensure dollars are available to you when needed most - Child Trauma Protection.

Trauma Protection is designed to pay a lump sum amount in the event of a specified illness or event, for example, cancer, stroke or heart attack. It is now possible to not only ensure your health, but the health of your children.

In the event your child suffers a major illness or dies Child Trauma Protection provide a lump sum payment (as determined by you) to ease the financial burden and help allow for:

- Parents to stop work and take care of the child full-time
- Funding for ongoing medical treatment and hospital costs
- Funding to provide for day-to-day living expenses
- Funding to provide parents with choice (i.e. 'I can stop work because I know there are funds available to provide for my family')

How much does peace-of-mind cost?

Child Protection must be taken out in combination with trauma protection for a parent, guardian or grandparent of the child and can cost as little as $150 per annum!

Here is a simple case study:

Fiona is age 35 and works in a Marketing role full-time. She is a non-smoker and wishes to insure herself for $100,000 in the event she suffers a serious medical condition. The annual premium for this cover would be approximately $400.

Fiona has two children she wants to protect under the policy, each for $100,000. The cost for each child would be $150 per annum making the total cost to cover Fiona and her two children $700 per annum.

What a small price to pay for peace-of-mind, to know that funds are available if your kids suffer a serious illness, or worse, a fatal accident.

Morgen Harris
National Risk Protection Adviser

Financial Planning

Don't leave it too late!

For those of you who are eligible and intending to make superannuation contributions before the end of the financial year, just a word of warning.

Your contribution needs to be **in the fund bank account by 30 June** at the very latest for it to be included as a contribution in the 2014/15 financial year. Transferring your contribution electronically on 30 June is not going to have the contribution in the superannuation fund bank account by 30 June!

If you intend to transfer electronically, to be sure that your contribution is received in time, you must do so by **Friday 26 June at the latest**. If you transfer at a time after this you run the risk of missing the contribution deadline. It is not sufficient that the amount has left your personal bank account by 30 June.

Should you be running late with your contribution, the best solution is to physically hand us a cheque no later than about 3 pm on 30 June so it can be banked at the Rock before close of business that day.

Contribution Eligibility and limits

If you are interested in adding to your superannuation account and are not sure of your eligibility, please contact your adviser. The tables below show the current contribution limits and the ages at which they apply

Pre-tax contributions – including employer contributions and salary sacrifice.

Age at beginning of financial year	2014/15 Limit
49 or more	35,000
Less than 49	30,000

Post-tax contributions

Age at beginning of financial year	**2014/15 Limit**
Under 65 (bring forward rule)	180,000 or $540,000 over 3 years
65-72 (work test met)	180,000

Sue Dunne
Senior Financial Adviser

Investment Briefs

ARB Corp (ARB)

Reputation is an integral component of a successful business. Four wheel drive accessories supplier ARB Corporation (ARB) has this secret ingredient in spades. Operating since 1975, the company has been able to carve out a significant part of the Australian market and parts of the global market. Management place a strong emphasis on product development as a means of maintaining the company's existing competitive advantage over competitors. ARB's brand is the major pillar in developing this economic moat.

ARB supplies a number of products ranging from roof racks and bull bars to safari snorkels. Its ongoing expenditure on research and development has enabled a world class offering of brands consistently sought out by industries and four wheel drive enthusiasts. The company also maintains a healthy client relationship experience derived partly from its global footprint of stores (the company currently operates 91 stores between Brisbane and Melbourne). All of these factors have led to the company generating an elevated return on invested capital that many other companies aspire to. Net Profit after Tax has averaged an outstanding Compound Annual Growth Rate (CAGR) of 13.2% over the last ten years.

At last year's annual results, ARB reported difficult conditions in Australia marked by the slowdown in mining activity. This was offset somewhat by growth from its export markets and management are relatively buoyant moving into FY2015. ARB has a bullet proof balance sheet with no debt and a net cash balance of $39m.

ARB holds many of the prerequisites that we require for an investment in investment portfolios. High returns on invested capital for long periods of time reflect the company's competitive advantage. The company is trading at a slight premium to the market but we see this as well justified due to the underlying quality of the business. Our mentality (to borrow from Warren Buffet) is we would much prefer to buy a wonderful company at a fair price rather than a fair company at a wonderful price. ARB offers a dividend yield of 2.25% fully franked.

Dulux Group (DLX)

Another company that has established a brand that many companies would aspire to is Dulux Group (DLX). DLX has become part of the furniture in the Australian household (which has most likely been painted using DLX's products). DLX dates back to 1918 where it started life as BALM Paints only to be rebadged as Dulux Australia in 1971. In 1988 the company successfully acquired Selley's and British Paints to further expand its paints and adhesives division.

DLX is a testament to the nurturing and development of a brand over decades. The Dulux brand is synonymous with paint in Australia and this is borne out by the company's over 40% market share in the Australian paints market. One only needs to walk into a Bunnings store to see the dominance of the Dulux brand. Furthermore, DLX's extremely effective advertising methods such as the 'Worth doing worth Dulux' and the Old English sheepdog campaigns have helped to successfully lead consumers towards DLX.

DLX's Full Year 2014 results indicated that there are no signs of a slowdown. Its paints and coatings business increased sales by 6.1% and EBIT grew by a respectable 12.1% with a 90 basis point expansion in EBIT margin (16.9%). This division represents 76% of group EBIT so it is a crucial part of the overall business. In January 2013, DLX completed the acquisition of Alesco Group, a company involved in the supply of garage doors and cabinetry. Management have stated the integration is almost complete and full year figures are now being reflected in DLX's accounts.

We hold a favourable view of DLX due to its extremely valuable intangible assets and management's ability to continually reinvest in the brand. Although the company's fortunes are to a degree linked to domestic housing construction we believe the company will be better prepared to ride out downturns. DLX currently offers investors a 3.12% fully franked dividend yield and trades at 21x FY15 estimated earnings.

FLT

There is much going on at the house of Orica (ORI) at the moment. Previous CEO Ian Smith has been given the boot after repeated claims of abuse to make way for interim CEO former BHP executive Alberto Calderon. The company has had a rough ride in the last few years with the abrupt end of the mining boom leading to a downturn in explosives demand. ORI has seen its share price decline by 28% since the mining boom ended in 2011.

However, it is far from all doom and gloom. Like the resources majors, ORI is now predominately ex major development capital expenditure. This means that the business is able to distribute excess cash flows back to investors in the form of dividends or share buy backs. The latter is what ORI is embarking on at the moment. Post the sale of its chemicals division, ORI has decided to buy back $400m worth of outstanding equity or 5.6% of the existing base. This is good news for shareholders providing it is done at an attractive price which looks to be the case with this example.

As investment managers, we are constantly on the lookout for opportunities. In ORI's case we envisage significant levels of future cash flows not being rewarded by the market. The stock trades at a forecast 11.6x FY15 earnings with a forecast free cash flow yield of 8.4% in 2016. Recently, ORI management maintained their profit outlook on the back of a flat explosives market. We see this as an opportunity to add the company to investment portfolios to take advantage of a discounted share price.

It may be a refreshing new beginning for ORI post the appointment of a new CEO after a period of serious cost cutting within the business. ORI's specialised product range helps differentiate it over its competitors and the rush to add iron ore volumes from the majors should assist revenues in the foreseeable future. ORI can be purchased with a partially franked dividend yield of 4.76%.

Lachlan McKenzie-McHarg
Adviser Equities Dealings and Research

Staffing

Welcomes and farewells

We have had a number of changes to staff since our last newsletter. We would like to warmly welcome **Ashleigh Green** who will be job sharing the receptionist position with Jaimi Summerton. Jaimi is studying Psychology and Ashleigh Occupational Therapy, so in future we'll be well covered for all events, physical and mental!

Katrina Tearle has recently joined our team in the Rockhampton office as our support for the CHESS role while Jodie goes on maternity leave. Katrina comes highly recommended with over 15 years' experience in the finance industry with The Rock and Wide Bay. Jodie is due to have her first baby in June.

Adrian Cahill, a past employee, has joined ranks with us again and starts in the Rockhampton office on Monday 4th May as our newest member of staff in the role of Business Analyst / Asset Manager.

Births

Many of you know Bronwyn Nunn, who has been part of the Rockhampton team for a number of years. Bronwyn welcomed a beautiful baby girl into the world last month and is now enjoying her maternity leave. Bronwyn will be back in the office early next year.

We sadly farewell Kathy Donaghey who was also a long standing employee but has recently finished her employment with CIPL due to ill health. Kathy also welcomed a beautiful baby granddaughter into the world this month, she is now spending time getting acquainted. We will miss Kathy greatly (especially her prize winning vanilla slice) and wish her all the best with her future.

Client seminars

Our recent client seminars held in both Melbourne and Rockhampton were very well received by clients. The topics were Poles, Wires and Prices - presented by David French and Asset Allocation, Medibank and Woolworths - presented by Owen Evans.

ABC Radio Segment – Tuesday mornings

David continues to present on ABC local radio in Rockhampton every Tuesday morning at 10am. Tune in to hear more about what's happening in the world of finance and economics.

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Rose Sladden	Client Services Manager
Julie Rush	Compliance Manager
Adrian Cahill	Business Analyst / Asset Manager
Jodie Thompson	CHESS Administrator
Katrina Tearle	CHESS Administrator
Natasha Kuhl	Portfolio Administrator
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Paul Young	Senior Paraplanner
Michael Roberts	Paraplanner
Stephen Coniglione	Investment Research Officer
Colleen Staun	Client Services Officer
Amy Gill	Technical Support Officer

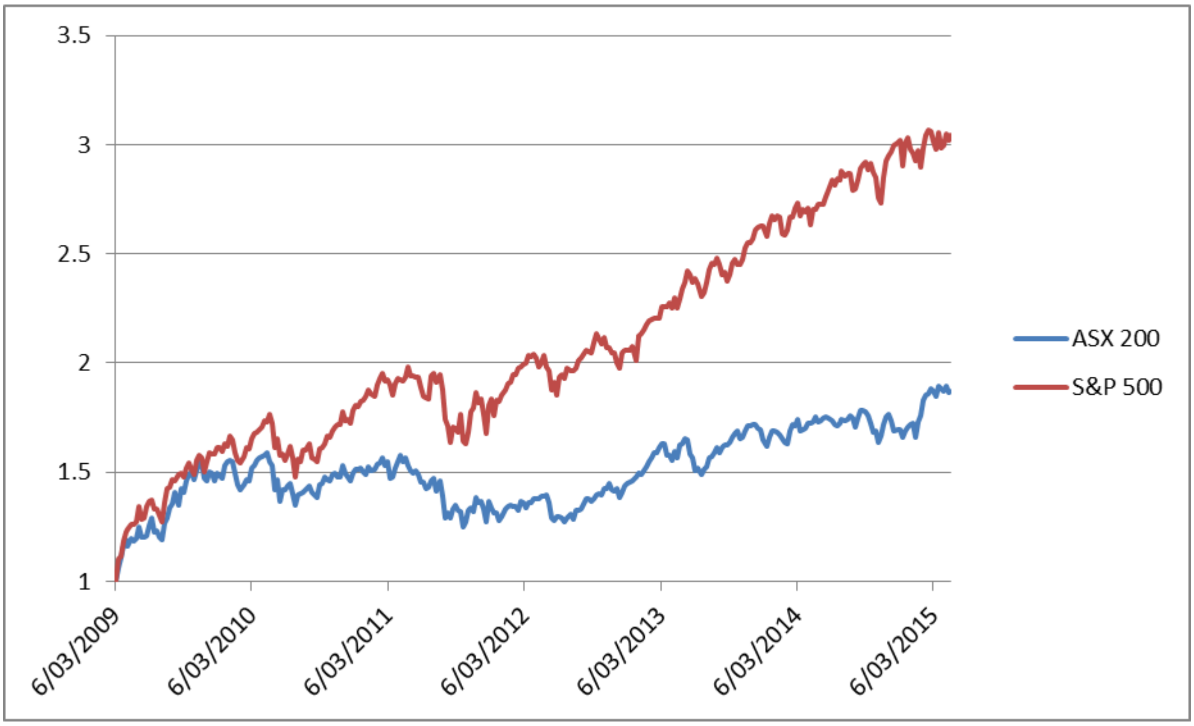
CHART PACK *Information at a glance*

Shanghai Index – Chinese market up 117% in 10 months

Source: *HUBB Financial*

The Chinese market has rocketed recently and is back to its pre GFC highs.

US Outperformance – US market outperformance on back of QE & resources weakness

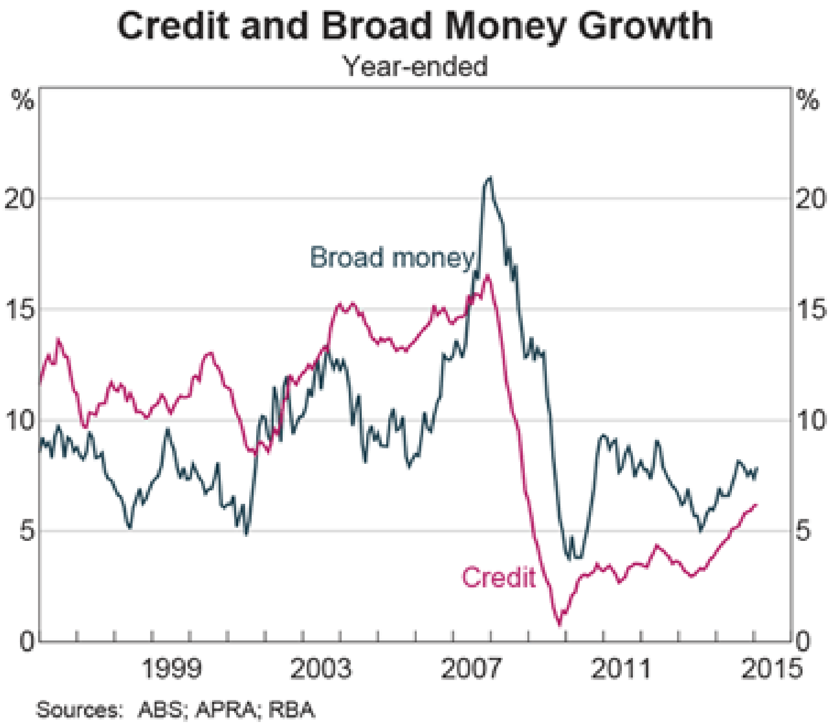


Source: *HUBB Financial*

Stark outperformance from the US market since the depths of the GFC largely on the back of Australia's concentration in resources.

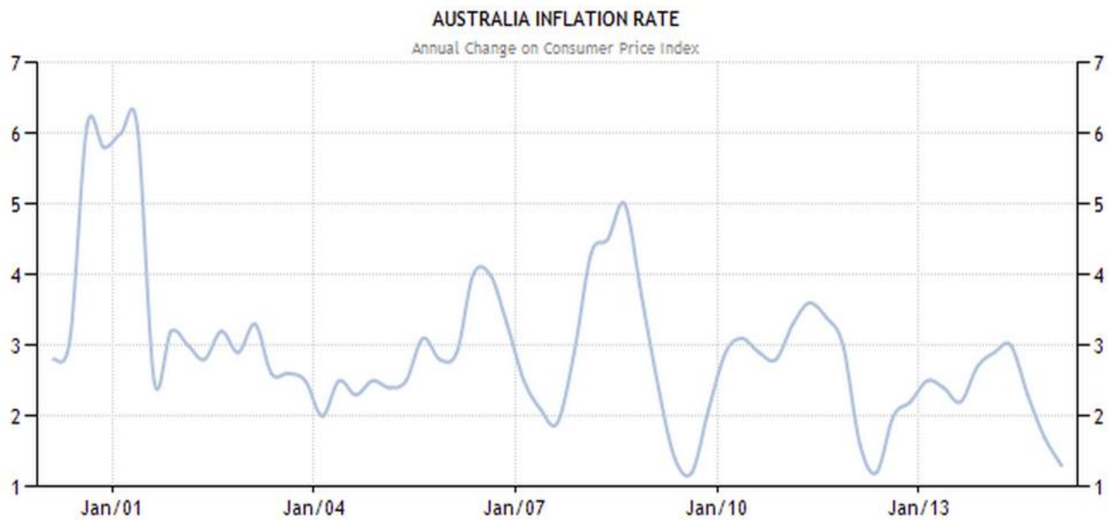
CHART PACK *Information at a glance*

Credit Growth – Easy monetary policy leading to strong credit growth



Source: *Reserve Bank of Australia*
Low bond yields has encouraged credit growth to expand in recent years.

Low Australian Inflation – Inflation continues to fall



Source: *Trading Economics*
Low bond yields look set to stay for the foreseeable future as inflation continues to fall.