Newsletter

October 2016

Introduction

Welcome to our newsletter for October 2016. This newsletter combines the articles that we have published on our site since we last published a discrete newsletter. We provide the newsletter in this format so that you have a single, portable document that you can read at your leisure.

In this newsletter, we introduce a new column – our monthly review of the state of the market. We also examine recent research that has revealed that insurers are systemically trying to refuse claims as a way of boosting profits – a must read for anyone paying insurance premiums. (The good news: claims are far less likely to be knocked back when an adviser is involved than when a client organises their own insurances). We also tell a heart-warming tale of a client, Shirley, and the difference decent financial planning is making to her retirement, before closing with a discussion of why we chose to be a non-aligned financial adviser.

Please feel free to share this newsletter with anyone you think would find it helpful. And please also free to get in touch with us if there is anything that you would like to discuss about its contents.

Did You Know… the month of October

October has been in important month in Australian history. In 1850, Australia's first University (Sydney) was founded. Fast forward to 1973 and Australia's first weirdly-shaped Opera House was also opened – also in Sydney. It remains the only one.

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Share Market Update – 1 October 2016

The share market did very little for the month of September. But it was a different story when you expand your horizons a little bit further than that.

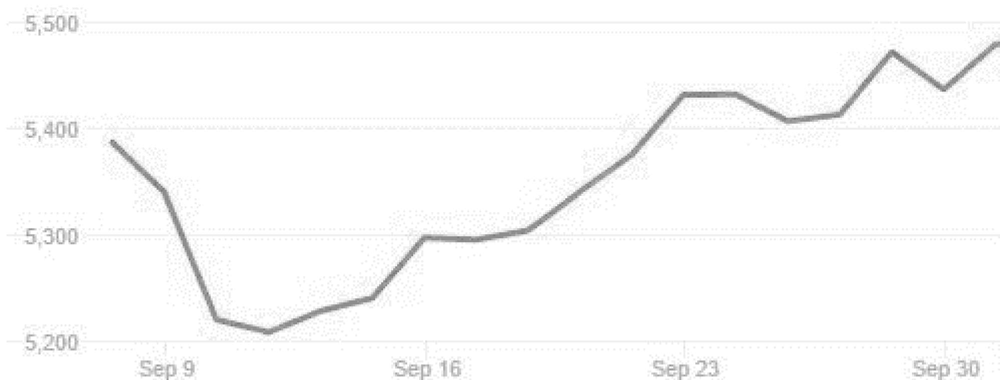
Welcome to our share market update for October 2016. We like to do our updates differently here. We use the updates to teach you a little about the mindset that is required if you are going to succeed in investing into the volatile market that is the share market.

We would love to know what you think of this approach.

Australian Share Market

The Australian share market ended the month of September 2016 basically unmoved from its level at the end of August 2016. As measured by the ASX 200, the market fell just two points, to 5,433.

But sometimes looking at the value of a share market at two single points in time can be misleading. During the month of September, the market actually rose as high as 5,471 and fell as low as 5,207. Depending on which end you start at, this represents variance of up to 5% over the period. You can see this on the following graph (thanks to Google Finance) which is anything but a flat line:



This is, of course, a really common occurrence in volatile markets like the share market. It gives rise to a form of risk known as timing risk. As that name suggests, timing risk is the risk that you will buy or sell on just the wrong day.

In the month of September, the worst day to buy was Thursday September 29, when the market peaked at 5,471. On the flip side, that was the best day to sell. The best day to buy was September 13, when the market was at its lowest point for the month.

The problem, of course, is that no one knew on September 13 that the market's next move was up. If they did, they wouldn't be telling anyone anyway. They would have been too busy buying themselves.

For the twelve month period ending on September 30 2016, the market moved from 5,052 points to 5,433. This is a rate of capital growth of 7.5%.

But once again, during the year things were far more volatile. In February, the market fell as low as 4,765. This was 5.6% below the level at the end of September 2015. On the first of August 2016, the market reached 5,587. Again, depending on which end you start at, this suggests volatility within the year of 17.25%.

Fortunes rise and fall on timing issues. The great news is that they can be managed, in much the same way as the specific risk of an individual share holding can be managed by diversifying across multiple companies. The buying and selling of shares can be diversified over time. Talk to us and we can show you how.

Dividend Yield

Shares create value for their owners in two ways: dividends and capital return. Dividends are the payments you receive when you still own the share. Capital return is the difference between your buy price and your sell price. To realise a capital gain, you need to sell the share. (Shares that have gone up in value since you bought them, but that you have not yet sold, provide unrealised capital gains).

When you look at share price indices over a fixed period of time, you are really only seeing the capital rate of return for that period. Dividends are not really part of the comparison picture. (For the technically-minded reader, you may know that share prices reflect declared but unpaid dividends, and so the market price often does include the dividends that are to be paid, or are expected to be paid. However, because these dividends are in place at both points in time, they tend to cancel each other out when we look at changes in share prices).

The average annual dividend yield for September 2016 was 4.4%. Given 7.5% as the capital return for the previous 12 months, this gives us a total 12 month return of 11.9%.

To put this in perspective, if you obtained this rate of return for 6 years, you would double your money.

To put it in further perspective, interest rates fell as low as 4% for home loans and margin lending rates have fallen as low as 5.2%. People who borrowed to invest in the 12 months to September 2016 did well.

Long Term-ism

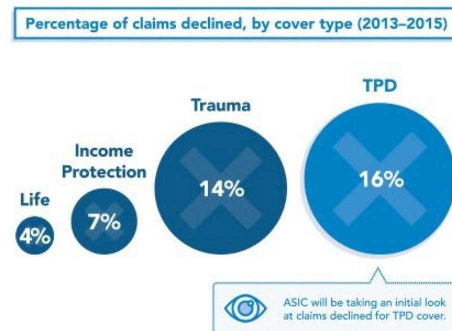
As we always say, investments in the share market simply must take a long term view. The above analysis underlines that advice: over the one month period, the market barely moved. For the 12 month period, it rose by more than 7%.

So, please remember: don't put anything into the share market that you need to get out any time soon. Ten years and more is the best expected investment timeframe.

ASIC Reviews Claim Payments by Life Insurers

ASIC has recently found that some insurance companies are rejecting up to one-third of life insurance claims. Make sure yours is never one of them.

You may have seen reports this week of ASIC's inquiry into the way life insurance companies pay insurance claims.



On average, more total and permanent disablity (TPD) and trauma claims are declined than life and income protection claims

The inquiry was inspired by media reports earlier this year of people being denied claims based on outdated definitions of events such as heart attacks. You can [read one of these reports here](). This report is one in an excellent series of investigative journalism provided by Adele Ferguson and Fairfax.

ASIC's inquiry revealed some really interesting facts about the treatment of life insurance claims. Basically, their inquiry revealed that insurance companies are not very generous when it comes to paying claims. Perhaps we should not be surprised about this: if the insurer pays a claim, their profits fall. But there were also some interesting 'sub-plots' in the report. We will discuss some of them in a second.

Given the ASIC findings, we can expect the insurers to lift their game in terms of paying legitimate claims. But they will only ever have to pay a legitimate claim, and whether a claim is legitimate or not usually depends on the policy that was taken out in the first place. It is really critical that you get this part of the puzzle right.

Claims that are paid

ASIC provides this infographic above, detailing the percentage of claims that are declined. 90% of claims are paid in the first instance.

This might seem like a reasonably high level, but remember that life insurance claims are not like other insurance claims. Death cover, for example, only pays when a person dies. So people simply

don't make claims unless the insured event has actually occurred. 10% rejection is therefore quite high.

TPD is the most rejected type of claim

The most rejected type of claim was for TPD. TPD stands for total and permanent disability. 16% of all claims for TPD were rejected. But there was huge variation here. Some insurers rejected more than a third of TPD claims.

The problem with these kind of claims is often in the definitions. Some insurers use a very strict definition of what constitutes the 'insured event.' The insured event is the thing that you are insured for – in this case, becoming totally and permanently disabled. 16% of people who thought they were covered for TPD actually weren't – or at least, there was enough doubt that the insurer felt it could argue that they were not covered.

Trauma claims are not far behind

14% of all claims for trauma cover were also declined – for pretty much the same reason as TPD. The insurer argued that the trauma had not occurred in the way required by the policy. Of course, they would know: they wrote the policy.

The highest rejection rate by an individual insurer here was 25%.

Claims were most likely to be rejected when the client bought the insurance directly

People seeking life insurance do not have to use an adviser. They can contact the insurer directly and arrange their own cover. The inquiry revealed, however, that claims were much more likely to be accepted when the client saw a financial adviser before taking up the policy. Using advisers led to more successful claims. This makes sense, really. Financial advisers are expert at things like policy definitions and assessing a client's particular need for cover. When clients go DIY, they often pick the wrong policy or agree to something within a policy that they should not agree to.

For example, many clients do not know that the definition of 'disability' in TPD varies. Some insurance policies use an 'own occupation' definition. Others use an 'any occupation' definition. If the policy uses an any occupation definition, then you have to be more disabled in order for a claim to be accepted. While it is not quite this simple, you basically need to be so disabled that you cannot work in any occupation. **Investopedia** puts it this way:

> *The "any occupation" definition is the stricter definition of disability, where you are unable to work in a job that is reasonably suitable for you based on such things as education, experience and age.*

You can see there is a nuance here: you only need to be disabled such that you cannot do suitable work, rather than any work. Physiotherapists who become unable to do that work are not expected to work at McDonalds. But they might be expected to become University tutors, or personal assistants, or something like that.

The own occupation category is a better one for claimants: in this category they need only to be disabled such that you cannot pursue that particular occupation. The point is that simply having TPD cover is not enough: you need to have the right TPD cover.

Whether you can and whether you should prefer an ‘own occupation’ or an ‘any occupation’ kind of claim depends on your circumstances. And the evidence shows that people are not very good at understanding their own circumstances: remember, one insurer is finding a way to reject more than a third of TPD claims. Remember also that the insured person thought they were covered: that is why they made a claim in the first place. When they finally discovered they were not properly insured, it was too late.

Insurance policies can be complex. But insurances are necessary for many many people. People who go directly to the insurer are more likely to choose the wrong policy and then have a subsequent claim rejected. So, if you are looking at life insurances, make sure you at least talk to an adviser before taking out life insurances.

Shirley's Story

Where do you want to be when you turn 75?

Shirley turned 75 earlier this year. She had a very happy birthday. Happier than it might have been had she not had a serendipitous meeting 12 years ago with a new financial planner.

That planner's foresight is now paying off in spades. At the time she met him, Shirley was 63 and already using a 'financial planner.' Although 'planner' was perhaps overstating things a bit. Her financial 'plan' was to live on a Centrelink part pension and periodically withdraw all of her private superannuation by the age of 70. Then she was going to live on the aged pension for the rest of her life. Her plan had been to run out of money by her 70th birthday.

That was five years ago now.

The new adviser had better ideas. He sat down with Shirley and looked across her whole situation. He realised that she was only claiming a part aged pension, as she was managing her assets in completely the wrong way and it was mucking up the assets test. She also had a strange concentration of her wealth (around $170,000) in some highly risky assets. What was even worse, she was paying a fortune to the 'adviser' who had arranged all this for her.

We put 'adviser' in inverted commas like that because, in fact, her 'adviser' was working for someone else. He belonged to an institutional 'dealer group' of advisers, owned ultimately by a big bank, and his real job was to ensure that she kept her wealth within the clutches of the institution for which he was working.

To cut a long story short, Shirley's new adviser assisted her to move her super to a self-managed super fund, which then invested in a combination of a simple cash management account and a couple of index funds. Low-risk, conservative and – most importantly – low cost. She commenced a pension from the SMSF that also allowed her to increase her Centrelink benefits, and in combination the income stream from her fund and the increase in Centrelink benefits gave her almost as much to live on each year as she had previously been withdrawing from her super each year.

Fast forward to now and Shirley still has almost $170,000 in her super fund. She is as wealthy now as she was 12 years ago – even though she has not worked a day since then.

But that is not what made Shirley's 75th such a happy birthday – although 170,000 unexpected dollars surely did not hurt. What made it a really happy day is that she spent it in the UK, where she was visiting her daughter and two grandchildren. It was not quite the party that Queen Elizabeth threw, but it was still a wonderful day. And this was not a one-off. She has visited her family every year since she met her new adviser. Usually, she also tacks on a trip to somewhere else along the way. This year it is Spain.

This summer she is going one better. She is buying her daughter and one of the grandchildren an airfare to Australia. They will spend Christmas together at her place. First time ever.

After that Shirley is off to India for a month.

Until she met her new adviser Shirley thought that trips like this would be beyond her. Remember, the plan was to spend all of her money by the age of 70, and then stay put here in Australia.

Shirley did not get started with her new adviser until she was 63. Imagine how good things could be if she had started when she was 53, or 43, or 33. Time means money, especially when it comes to retirement planning. It is never too soon to start.

So, why not come and see us and let us show you how you can make the most of your retirement. Who knows where you might be able to celebrate your own 75th birthday.

Non-Aligned verses the much (m)Aligned

It is estimated that as few as 15% of financial 'planners' are not aligned with large institutions. A pity: being non-aligned is the only way to be a genuine adviser.

The Australian Securities and Investments Commission ('ASIC') is the Government body in charge of regulating financial planning in Australia. ASIC has been in the news lately, talking about its recent investigation into the financial advice services provided by Australia's big banks, including the AMP.

The report makes for gloomy reading: **more than 200,000 customers** were charged fees for services they simply did not receive. By banks. Banks are not your friend.

Australian financial planners operate under the authority of what is called an Australian Financial Services Licence ('AFSL'). These licences are issued by ASIC. Holders of an AFSL are known as licencees. Each of the big 4 banks (NAB, Westpac, Commonwealth and the ANZ) holds an AFSL, as do all of the second tier banks such as Bendigo Bank and the Bank of Queensland. AMP holds one as well. Some of the banks own more than one AFSL, as they have various subsidiaries that they have acquired over the years.

It is estimated **that as many as 85%** of all financial planners in Australia operate under the authority of one of the big banks' (including AMP) AFSL.

These financial planners are known as 'aligned' planners. This is because the AFSL under which they operate shares common ownership with an institution that also provides financial products such as life insurance or managed funds. The bank owns the AFSL and it owns the products being recommended by advisers within that AFSL. You can see the obvious problem here: the aligned financial planner is much more likely to recommend that clients buy the product issued by their own institution than they are to recommend another product, even if that other product better suits their clients' needs. An AMP representative will recommend AMP products. A Westpac adviser will recommend Westpac products. End of story.

As financial advisers ourselves, we need to operate under the authority of an AFSL. When we went looking for an AFSL under which to operate, we looked specifically for an AFSL that was 'non-aligned.'

Non-aligned means the opposite of aligned: an AFSL that is not tied to any provider of financial products. No bank AFSL for us. We did this because we want to be genuine advisers. We want to make sure that our licencee does not pressure us to sell a specific product, or a specific amount of product, to clients who trust us. We were looking for an AFSL that allows us to operate a practice

where we are free to recommend anything that we truly think is in our client's best interests – no matter which institution is offering it. We wanted to avoid working for an institution that charges people for work it never performed.

This means we can be real advisers. We can look our clients in the eye and tell them honestly that the advice we have given them is what we would do if we were in their shoes. 'What I would do if I were you' is the only way to be a proper adviser.

I have to admit, though, sometimes I can be a bit jealous of aligned advisers. Sometimes I think it would be great to see my AFSL's name being touted around – splashed across the backs of Australia's one day cricketers, or sponsoring an elephant enclosure at the zoo. And it would be nice to get some free tickets to things like the Australian Open.

But then I remember – it is the bank's clients who pay for those ads. And the real cost of being with an aligned AFSL is that I would be working for the bank. A bank which is not covering itself in much glory these days. 200,000 people paid for a service they did not receive. If I was aligned, my clients might be among them.

That would be way too high a price to pay for a restricted practice and some tickets to the tennis. That's why we are proudly non-aligned. It is the only option for a genuine financial adviser.

The Legal Stuff

General Advice and Tax Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

We recommend you seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

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