spotlight on advice
five top planners light up about their industry
defensive growth investment strategies for uncertain times
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When the editors at Forward Thinking sat down to plan this special December edition, the clear intention was to concentrate a spotlight on advice – bringing into sharp focus the vital importance that is Australia’s burgeoning financial advice industry.

In fact, the magazine is a tidy book-end for a remarkable year of change for the financial services industry across the board.

As the participants in the inaugural Forward Thinking Adviser Roundtable explain – there has never been a better time to be in financial planning.

It might be argued that Australia’s superannuation and pension environment, for example, is in a state of constant change. But you would have to go back a long way to match the past 12 months for its transformational impact.

We have witnessed a raft of major new initiatives that have helped to promote and sustain the momentum of the planning industry beyond its already busy state.

That is not to say that the advice industry is without its challenges – technology, investment markets and the perennial issue of finding quality staff remain a counterbalance to the forward momentum.

Elsewhere in this edition you will find the usually excellent technical articles and insights that Forward Thinking is known for.

And because life – particularly at this time of year – is not always about business, we present a special taste of five of the world’s great holiday destinations to whet your appetite for some well-earned downtime.

Enjoy and our compliments of the season!

Neil Roderick
Executive Director
Head of Macquarie Adviser Services

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Macquarie Adviser Services Magazine
Five top financial advisers, five great business models, many new ideas. The inaugural *Forward Thinking Adviser Roundtable* delivered a comprehensive and lively discussion between five seasoned financial advice practitioners on the role of today’s financial planner, the industry’s future, threats and wins. *Forward Thinking* has distilled their collective wisdom. By Bruce Madden.
Clockwise from right:
Brett Tarlington
Oakwood Financial Group,
Michael Swinsburg Arnheim
Gillard Financial Consultants,
Andrew Rocks Announcer,
John Small Small & Gunn,
Peter Mullens Halcyon
Wealth Advisers
If there is one thing a room of financial planners would currently agree on it’s this: now is a great time to be a financial planner in Australia.

Over the last decade Australia has seen an incredible growth in personal wealth, which, combined with the compulsory superannuation system, has served to create a substantial pool of discretionary investment money and clients needing advice.

John Small (Small & Gunn), Authorised Representative of Wealth Managers, summed up the general sentiment with the comment “I’ve never seen business better than it is now”.

As an example, Small recalled that a “good size client” when he started as an adviser in 1990 was someone “with a couple of hundred thousand dollars” to invest.

“That same typical person today would have $1 million to $1.5 million to invest,” he said.

And, according to Brett Tarlington, principal of Oakwood Financial Group, advisers have at least another decade of boom times to look forward to.

“I think the next ten years will be the busiest ten years of a financial planner’s life as we see the first flow of the baby boomers hitting retirement,” Tarlington said.

The challenge for advisers is to narrow down which part of the market they want to play in and structure their business to capture the opportunities.

The fact that advisers can afford to select who they want as clients (rather than accept all-comers) is a sign of the times.

If anything, the most difficult decision the five advisers involved in the Roundtable admitted to was which clients to turn away.

Tarlington, for one, has decided, after “bitter experience”, to be discerning about who he will engage with.

He said the criteria is “not necessarily those that pay me more” but clients who follow his advice.

“I’ve let the big ones go who haven’t fit my box,” Tarlington said.

Likewise, Peter Mullens, of Halcyon Wealth Advisers, said his business was reaching full capacity.

“Obviously I’m not looking desperately for new clients all the time,” Mullens said. “In fact I wouldn’t care if I didn’t have any new clients.”

While he hasn’t yet developed a method for screening out new clients that may not be far away, “You get to a point where you ask ‘how many can you service?’” Mullens said, leaving him the option of “raising the bar” for which new clients he would consider or hiring a junior adviser to service lower-value clients.

But Andrew Rocks, from the Announcer group, rejected this notion.

“I’m not saying it’s the [institutional] advisers,” Tarlington said. “But if you’re in an institutionally-backed advisory group, your target is to grow FUM, grow FUM, grow FUM… I’m just saying what we wake up each day to do and what their drivers are, are completely different.”

Quality financial advice continues to be a “high touch” business, according to Michael Swinsburg, of Arnheim Gillard Financial Consultants.

Technology can only do so much to reduce the face-to-face time clients require. Swinsburg said if best practice states a client needs direct contact with an

I think the next ten years will be the busiest ten years of a financial planner’s life as we see the first flow of the baby boomers hitting retirement.
But as far as providing a better level of advice to the rapidly growing middle Australia market, it appears that problem will most likely be left to larger institutions or the industry super funds to solve.
“There’s going to have to be more alignment between value of services provided and the fees paid,” he said. “You may be stretched to provide enough value on say a big multi-million dollar account and the onus is to make sure we do deliver on our promises. Retainers are part of the fee mix for the younger, wealth accumulating executive.

“It is all about client perception. Some clients will perceive value for a complete service but there’s always some that won’t. It’s the old ‘value vs. cost’ argument. We are always working hard on this one.”

But it could also be a case of ‘a little knowledge being dangerous’ in the wrong hands. It’s quite possible that clients might be basing their impressions of what a financial planner does on misinformation. Mullens, for example, was incredulous that clients would reject wraps without discussion.

“It fascinates me – these executive guys saying they don’t believe in wraps,” Mullens said. “That classically sounds to me like they don’t understand it for a start. It’s a service provider. So it doesn’t matter whether you provide it through that [wrap] mechanism or through some other mechanism, it’s a service tool and you’re (the adviser) not going to do it for nothing.”

Small blamed clients’ preoccupation with often less meaningful issues on a media that appears obsessed with finding fault in the industry.

“It is in vogue right now for administration platforms and rebates to be beaten around the head. Prior to this was the long standing debate of fees versus commissions, which in many cases is an irrelevant argument,” Small said.

“To get a client to walk in the door and indicate that they do not want a wrap – despite not understanding what a wrap really is – is a classic example of how powerful this sort of stuff actually is. The industry needs more balanced views put forward.”

Either way, financial advisers are dealing with a public more ready than ever to fire difficult questions their way. The good news is that today’s advisers appear better equipped to handle such scrutiny.

The value of advice is clear

The financial advisory industry has suffered more than its fair share of public criticism in recent years. From shadow-shoppers to ASIC enforceable undertakings and media attention, financial planners have been in the spotlight – perhaps for all the wrong reasons. But while the public image might be tarnished, at the individual planner level business has not necessarily been damaged.

Mullens said most advisers see no point in reacting to the bad press “because we’re not being questioned personally”.

“We’re not being threatened personally, so there’s no attack on us individually. So therefore we just ignore it. People say, well it’s not you obviously because you’re not like that,” Mullens said.

Tarlington also adopted a philosophical attitude to the media focus.

“How do you stop it when you’ve got the 6.30 current affairs program saying, ‘next week’s topic is financial advisers, the week after that it’s used car salesmen’. We just have to live with it,” he said.

“I just look at that and think, ‘well I’m responsible for this group of people and beyond that group I can’t control what happens’.

“Your focus on offering the best level of service to your clients and if they’ve got a problem they will generally contact you to discuss. If they don’t understand your service offering and they think you’re acting like that, then they’ll walk anyway.”

Swinsburg, however, said the industry needs to make a concerted effort to change the nature of the public debate – shifting the emphasis away from cost to value.

“I don’t think there’s enough discussion on the value of advice, in terms of advisers continually reminding their clients that value is provided.” Swinsburg said.
Small argued that while advisers act appropriately and provide sound advice, their public image is in many ways at the mercy of the markets.

“The big problem as an industry is that we take a few steps forward and then there’s a handful of product collapses in the space of six months. It puts the industry back five to ten years,” he said.

However, Small said the professionalism of the financial planning industry as measured by “a progression to quality transparent fee advice has grown dramatically in recent years”.

“The fascinating thing is that we are constantly challenged as advisers about the way we charge for advice,” Small said. “The issue should not be about whether a fee for service or commission is appropriate, but that fees paid by the client are transparent, fully disclosed and agreed upon.”

The rise and rise of technology

For Andrew Rocks the role of technology cannot be overstated: “We’re massively bullish on technology in the industry.”

Computers and the internet have altered most industries but perhaps none more radically than financial services.

The dizzying speed of development of investment platforms and front-end software systems has resulted in efficiencies unimagined even a decade ago.

As an example, Rocks described how his business transferred 1,500 clients to a 0% cash interim strategy earlier this year by emailing a record of advice. It was the first time the business had attempted such a broad scale electronic implementation of advice and Rocks admitted he felt “nervous” as the time approached.

“But it allowed us to fundamentally transact those clients, which is a massive amount of clients over about two to three weeks as they clicked on ‘accept’ or ‘not accept’ and up came the disclaimer in our linked email to them,” he said.

Efficiency is key to this development. “Because per client it was a couple of dollars cost to do that exercise and I know that when we used to have to type them all, send them all out, that there would have been a massive cost and I think the client wins in this situation.”

Small, however, added the warning that over-reliance on software and technology has (in some cases) led to the production of templated advice documents.

“I personally believe that technology needs to support not drive the advice process,” Small said.

But essentially, technology has been a good news story for advisers.

Whether to cut down on compliance costs, free up more time to spend with clients or find new ways to interact with the public, the advisers in this group have found technology invaluable.

Tarlington has “invested heavily in the technology to support” the Statement of Advice process.

Swinsburg acknowledged that having all the technology “in the back room” meant he could spend more time on the phone with clients.

Rocks said the Announcer group has even taken it one step further and is using the internet to attract clients and also fast-track them through the data collection process if they choose to sign up.

Rocks said the same type of person is also confident enough to enter personal details on a secure part of a website as the precursor to a face-to-face meeting.

“I don’t believe you can replace that first meeting and the handshake and identification with the client. But what that then allows us to do is the client has entered in their name and address. We never type it again. So that alone saves time which means we can push costs down… none of this is done with big institutional dollars.”

Threats? We have a few

One of the greatest concerns financial planners have is actually a consequence of the industry’s success.
When the Roundtable advisers came to consider threats to their businesses, top of the list was finding and retaining quality staff.

Such a competitive employment market is a natural result of the boom times financial planning is experiencing but, particularly for smaller businesses, the fear of losing key staff is a constant worry.

Swinsburg said the industry has not put enough effort into training staff over the last decade.

However, he also noted that boutique firms generally are the beneficiaries of staff trained in institutions, who eventually seek more rewarding careers in smaller advisory businesses after three plus years working for large institutions.

“Trained staff have got to come from somewhere and they’re going to come from the other larger institutions and come across to us,” Swinsburg said.

As the current crop of experienced advisers reach retirement age many of them also are struggling to hand their businesses over to the next generation.

Mullens said most senior advisers have built their businesses up from scratch – a fact that the younger financial planners vying to take over don’t fully appreciate. He recounted the story of one young adviser who berated older planners for putting too high a price on their practices – effectively pricing the next generation out of the market.

“It seemed to me that what the problem was is that he wanted to sit back on his lot from day one having bought the business and not actually do anything,” Mullens said.

While staff shortages will probably remain a structural issue in the industry over the long term, advisers’ current fears are mainly market based.

**Sitting tight on cash**

After five years of solid markets the recent sub-prime crisis, which came home to Australian advisers with the collapse of Basis Capital, has clearly rattled advisers and investors.

Mullens said after living through “three or four” of these market crises he is reluctant to jump into the market.

“If you looked at all of the people that dumped in big amounts of money towards the end of June, I have not invested $1 other than in cash,” Mullens said.

His reaction is typical of many advisers (see Megan Aubrey’s defensive investing story page 14).

Tarlington also voiced his concern that another serious market correction could damage the advice industry – especially if clients have not been adequately prepared for such a scenario by their advisers.

“The next test will be if we do have 10 or 20% off the Australian share market. It’s the clients who aren’t getting the service that will yell the loudest and they’ll be middle market priced,” Tarlington said.

For Rocks, too, the risks the financial planning industry face are external rather than internal.

“It’s the natural exogenous shocks that could come through acts of terrorism. There’s force majeure which we all read about in our insurance policies,” Rocks said. “But I think I’m comfortable that there are no medium-term threats to the business.”

Tarlington also voiced his concern that another serious market correction could damage the advice industry – especially if clients have not been adequately prepared for such a scenario by their advisers.

“The next test will be if we do have 10 or 20% off the Australian share market. It’s the clients who aren’t getting the service that will yell the loudest and they’ll be middle market priced,” Tarlington said.
The broad message is that clients need to start contributing to superannuation early, as the scope to transfer all or most non-superannuation wealth into a super fund in one go, just before retirement, has been removed for many people.

For wealthy clients, particularly those who are nearing retirement age, there are some important strategic principles to be aware of in optimising non-concessional contributions (NCCs) to superannuation. The strategy is required because the cap on NCCs in a particular income year can vary depending on the circumstances. By ‘wealthy’, we really mean those who can afford to contribute to superannuation as much as they are allowed to (without tax penalty) over the period until age 65.

The focus of our analysis is NCCs in particular. Presumably the relevant clients would also be contributing up to the concessional contribution cap each income year as well.
Planning NCCs in the years leading to age 65

Some basic rules:
Clients under age 65 are subject to an annual NCC cap of $150k in 200/08. However, two future years’ entitlements may be “brought forward” enabling total contributions of up to three times the annual NCC cap over a three year period. That is, an NCC of up to $450k can be made in the current income year – we refer to this as the 3yr-NCC cap.

In planning an NCC strategy for a client who is approaching age 65 and is unlikely to meet the work test after age 65, a common starting point is the income year in which the client will turn 65 (the “final year”). In that income year they may (subject to their previous contribution history – see below) qualify to make an NCC of up to the 3yr-NCC cap regardless of their future work status. Of course, if the client will fail to meet the work test the NCC and any other personal contribution should be made prior to the day they turn 65.

A useful starting point:
So, in many cases the goal will be to ensure that the client qualifies to contribute an NCC equal to the 3yr-NCC cap in the final year. To qualify, some careful planning in the lead-up years may be required. As the 3yr-NCC cap is triggered only when a client contributes more than the annual NCC cap in a particular income year, clients should be careful not to exceed the annual NCC cap in the immediate two lead-up years. Even contributing $1 in excess of the annual NCC cap could severely impact on the maximum NCC in the final year.

Example:
Jan (who turned 64 in September 2007) can contribute up to $150k in 2007/08 without triggering the 3yr-NCC cap. This will allow a further contribution in 2008/09 of $150k, or up to $450k by triggering the 3yr-NCC cap in 2008/09. That is, she can contribute $600k of NCCs in the period from now to her 65th birthday.

However, if Jan contributes $151k in 2007/08 she will trigger the 3yr-NCC cap immediately. In 2008/09, her maximum NCC would be $299k (i.e. $450k less the amount contributed in 2007/08). The maximum amount of NCC she can contribute in the period from now until her 65th birthday is $450k in total.

Extrapolating this further to clients younger than Jan leads to a general pattern of NCC strategies. The table below illustrates this pattern, assuming all NCCs are made in July of each income year and ignoring the effect of earnings and indexation of the NCC caps (refer to table below).

Of course, the table is simplistic. While it is a good starting point in gaining an understanding of the issue, in particular cases we use some reasonably sophisticated modelling to account for:
- indexation of the annual NCC limit;
- the impact of the difference in the after tax earning rate of investing a given amount in superannuation or in the client’s own name (i.e. we’re looking at clients who have money available to invest somewhere, and we’re trying to determine the advantage of investing particular amounts in super at particular times); and
- situations where the client is embarking on his or her contributions strategy in a month other than July (for example, if the client is commencing the strategy in June the appeal of triggering the 3yr-NCC cap in June may often be less than the appeal of triggering the 3yr-NCC cap in July.

Finally, if the client knows they will continue to meet the work test beyond age 65, then the table will not necessarily be relevant for their purposes.

Clients who are seeking to optimise their superannuation at an age other than 65 (either because they will contribute beyond that age or because they intend to commence a pension at an earlier age) are the subject of some related analysis we have been conducting which cannot be covered here.
A client cannot contribute to super if they are age 65 or more, unless (generally) they are under age 5 and have satisfied the work test when making a contribution. The work test requires that the client has been gainfully employed for at least 40 hours in a period of not more than 30 consecutive days in the income year in which the contribution is made.

If a client is aged from 65 to 4 inclusive and meets this work test then the following caps apply.

**Clients for whom the 3yr-NCC cap has ceased to apply:**
In an income year after the 3yr-NCC cap has ceased to apply, a client who is aged 65 to 74 inclusive and who still meets the work test in that year may make an NCC up to the annual NCC cap.

**Clients who have triggered the 3yr-NCC cap:**
A client who turns 65 in the current income year may qualify for the 3yr-NCC cap and therefore can contribute up to $450k of NCCs prior to her or his 65th birthday, even if there is no intention of ever working again.

If the same client triggers the 3yr-NCC cap in the year they turn 65 (or in a year before that) and does keep working beyond age 65, they may make contributions after they turn 65 up to the $450k 3yr-NCC cap over the three relevant income years.

Note, however, that there is a somewhat quirky new rule which prevents a superannuation fund trustee from accepting any single NCC of more than the annual NCC cap in any income year after the income year the client turns age 65. The explanatory statement accompanying the introduction of this rule indicates that the rule would not stop $150k being put in on one day, followed by further contributions in the following days (in the same year). Nevertheless the rule is there to stop people inadvertently breaching the NCC caps.

**Summary**
Careful planning may be required for those clients who will benefit from maximising their NCCs, especially in the lead-up to turning age 65 but also at other ages either less than or more than 65. Knowledge of how the new NCC rules and, in particular, the 3yr-NCC cap operates is imperative to advising these clients.

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**Updated: Little Black Book – new edition October 2007**

A new edition of the Little Black Book is now available. We have amended some typographical errors that appeared in the August 2007 edition, and also taken the opportunity to update the Social Security section of the booklet, providing you with the latest Age Pension payment rates, assets test and income test thresholds and Pension Bonus Scheme information. The changes are as follows:

- Page 6 – The level where payment stops is $97,845 for a family with one child under 18. The base rate per fortnight for a large family is $10.08 for third and subsequent children. Footnote 7 has also changed to $667.95 per child;
- Page 31 – Deceased and Dependent are younger than 60 years of age;
- Page 38 – The Age Pension payment rates, assets test and income test thresholds have been updated to reflect the 20 September 2007 changes;
- Page 40 – The equations for Non-defined benefit income stream have been amended to read more clearly; and
- Page 41 – The Maximum amount of bonus payable table has been updated with the most up to date figures.

To order hard copies, call the National Adviser Contact Centre on 1800 808 508.
positively defensive
Volatile markets usually signal a flight to quality. But, as Megan Aubrey tells *Forward Thinking*, there are more expansive asset allocation choices beyond the traditional, set-and-forget safe havens.

Superannuation funds saw an unprecedented flood of money pouring in this year as Australians rushed in before the tax-free window for lump sum contributions closed on 30 June. But right now much of that investment inflow is doing the money equivalent of twiddling its thumbs – sitting in cash accounts.

Partly it is the sheer volume and speed of the flows that have caused so much of the new super money to be parked in cash. However, anecdotal evidence also suggests that advisers are holding off on making more active investment recommendations because of the recent market volatility.

From the Shanghai shivers in February to the sub-prime meltdown in June, 2007 has had more than its fair share of investment market shocks. Investors and advisers are understandably cautious.

According to Megan Aubrey, Head of Product, Macquarie Professional Series, that caution should not be an excuse to distract long-term investors from their course.

“There’s nothing wrong with taking time to select the right investment opportunities. But once you’ve set your investment strategy it’s better to stick to it,” Aubrey says.

“People do get worried when they see equity market returns moving around. However, if you’ve got a great portfolio of solid fund managers committed to a long-term strategy then you should stick with them, rather than trying to time the market.

“We do need to remind our clients that investing is a long-term strategy and we should try and play it that way.”

Nonetheless, Aubrey says in uncertain times investors are right to adopt a defensive stance. In the past ‘defensive’ might have signalled a switch to fixed income investments but the sub-prime events of 2007 have highlighted how some so-called ‘conservative’ assets can carry a little more risk than the label might suggest.

The fall-out from the sub-prime crisis and the subsequent squeeze on liquidity has seen many advisers looking again at equity based funds as a safer bet. The issue has also underlined the importance of seeking investments that are true to label.

“Advisers are cautious about some credit based investments at the moment – mainly because they’re unsure about what’s underneath the bonnet,” Aubrey says. “Even if this is a short-term aberration, advisers and researchers are keen to move back to more equity based investments. Or at least looking for ways of diversifying their clients’ portfolios so that they can mitigate these risks.”

When looking at equities, she says, advisers should again emphasise to clients the long-term nature of such investments.

But aside from drumming home this number one lesson of investing to their clients (and perhaps considering once again the merits of the tried and true principles of dollar cost averaging), Aubrey says advisers might also want to reassess the type of equity managers they are currently favouring.

“In these times it probably pays to have an equity manager that’s a little more defensive in nature,” she says.

“We’ve seen the Aussie equity market run very hard. So now you should be looking to managers who do well when the markets are more in a normal, fundamental state or even a downward phase.”

The key point here is that it will pay for advisers to look behind a fund manager’s facade to their core investment philosophy. Aubrey says it is crucial to ask what sort of stocks do managers hold in their portfolios and why.
smart investing

As always, it is the managers that can identify quality companies which will deliver earnings through various market and economic cycles who offer investors the best long-term returns.

However, identifying such fund managers is not an easy task, which is why Macquarie has conducted an extensive due diligence before approving any manager for the Macquarie Professional Series, a range of managed funds.

For example, Aubrey says boutique Australian equities manager Concord Capital is one that fits within the ‘quality’ frame. The Concord Australian Equity Fund has been open through the Macquarie Professional Series for almost 18 months.

“They believe in generating wealth over the long term. They love seeing companies with strong earnings growth. They have very high hurdles and that’s the sort of fund that if you can stick with over the long term you’ll be very well rewarded,” she says.

Advisers may be returning to the ‘comforts’ of equities but any decent long-term investment strategy would not depend solely on a single asset class. As a defensive hedge, Aubrey says financial planners should consider assets whose returns are not highly correlated with the traditional assets held in most portfolios. The Winton Global Alpha Fund, again one of Macquarie’s Professional Series offerings, is highly diversified and takes positions in “over a hundred different futures markets”, providing exposure to commodities, currencies, equities, bonds and short-term interest rates.

“It can take long and short positions. So you can imagine with that sort of diversification Winton’s returns have been uncorrelated [to other asset classes] over the long term,” she says.

“Because you’re getting returns from many different sources Winton tends to improve returns and reduce volatility when added to a traditional portfolio.”

After a long period of benign markets for most asset classes, this year has reminded investors that risk is integrally linked with return. However, according to Aubrey, short-term market fluctuations can actually play to the advantage of the well-structured, long-term investor.

“If you can sit tight through these periods in time – committing to a long-term strategy – you’ll be well rewarded.

There’s nothing wrong with sitting in cash and waiting for the right investment opportunities. But once you’ve set your investment strategy it’s sensible to stick to it.
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Where math geeks and Greek meet

If the tongue-twisting, techo stuff of BDM presentations is all Greek to you, here’s a handy guide to help unravel its meaning.

By Bruce Madden.

The ancient geeks who first applied pure mathematical research to the investment industry in the middle of the last century made a surprising discovery: 75% of all fund managers failed to outperform the simple strategy of investing in the relevant stock index.

Clearly, those 25% of managers who outperformed the index had something special and the theorists looked to the ancient Greeks for a word to describe that elusive quality: alpha, or αλφα in the original language, is the first and most prestigious letter in the Greek alphabet.

Experts continue to debate the true nature of alpha and design new ways to manipulate it but this fundamental definition remains useful: alpha is “the measure of a fund or portfolio’s risk-adjusted return relative to the market”.

However, for investors, alpha comes at a premium and if they’re not getting it from their fund manager it might be better to buy some beta.

Beta (thanks again to the Greeks), like alpha, is a mathematical concept first cooked up by the creators of the capital asset pricing model (CAPM) in the mid 20th Century. Essentially, beta is the return offered by passive exposure to a market index. One defining feature of beta is that it should be much cheaper than alpha.

Traditionally, beta has been found in indexes such as the S&P/ASX 300 but today investors can access ‘exotic beta’ constructed around any number of investment themes.

However, in CAPM terms, beta is actually a measure of risk or, in the language of statisticians, the ‘correlated volatility’ of a portfolio (or stock) compared to the total market. The entire market being measured has a beta of one. Funds which have a beta higher than one are more volatile than the market while a beta less than one indicates less volatility than the market.

To some extent a fund’s beta is also reflected in its tracking error. Simply put, tracking error measures how far a fund’s actual returns have deviated from its benchmark – i.e. the closer the fund matches its benchmark, the lower its tracking error is likely to be.

Pure alpha hunters might look on tracking error with disdain but it remains an important signal of how much risk a manager is taking in a portfolio.

The longer a fund has been around the better, and hence more predicative, tracking error data is. For instance, if over the last five years a fund has returned 0.5% above its benchmark, 0% of the time, there’s a good chance that (all else being equal) similar results will be obtained over the next five years. Using tracking error, the statisticians can also dig deeper into the minutiae of a fund’s behaviour – for example, comparing the changing weights of individual stocks in the portfolio over time.

Tracking error is also significant because it is used in calculating a fund’s information ratio.

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Take a fund’s return relative to the benchmark (this can be positive or negative), divide it by the tracking error and you have figured out its information ratio.

Despite its apparent simplicity, the information ratio contains a lot of, well, information about a manager’s performance. If you accept the validity of the underlying data then the higher the information ratio, the better the fund manager has performed considering the level of risk compared to others using the same benchmark.

The information ratio is not to be confused with the Sharpe ratio. But it often is.

William F (for Forsyth) Sharpe devised the ratio bearing his name in 1966. Sharpe originally dubbed his formula the ‘reward to variability’ ratio. Like the information ratio, the Sharpe ratio gives a risk-adjusted measurement of returns. Where it differs, however, is that the Sharpe ratio compares a fund’s returns to the ‘risk-free’ rate of return (originally defined as US Treasury Bills) rather than the relevant benchmark.

In the Sharpe formula the risk-free rate is subtracted from a portfolio’s return and then divided by the tracking error.

What the Sharpe ratio reveals is how much excess returns a manager has delivered considering the increased volatility a fund has endured compared to holding a risk-free asset. In short, Sharpe will tell you whether that wild ride your fund manager gave you was better than leaving your money in the bank.

While some of the underlying assumptions of the ratio have been questioned (particularly the reliance on the statistical ‘standard deviation’ measurement of returns) Sharpe has been one of the influential figures in the field of investment theory. In 1990, Sharpe received the economics Nobel for his work on CAPM – the project that put some statistical flesh on the theory of efficient markets.

As per its title, CAPM (capital asset pricing model, remember), is a method for figuring out how much assets are worth. Using CAPM, fund managers can calculate a theoretical required rate of return an asset must deliver if it is to be added to a fully-diversified portfolio, and from that the fair market price for that security. The model takes into account an asset’s beta, expected future returns for the relevant asset class, as well as the expected risk-free rate of return.

Although CAPM relies on several assumptions and historical data, fund managers can use it to identify mis-pricing opportunities. If the formula identifies securities as over or under-valued, managers can buy, sell or go short in the knowledge that markets, being efficient, will over time return the asset to its fair price and provide the fund with some of that rare alpha.

The search for alpha, which is indeed the core promise of any active fund manager, has become ever more sophisticated as performance attribution techniques have evolved over the last decade.

Managers and academics have begun poring over their performance results to identify the various underlying factors and determining how much each component affected the final result. Was it stock-picking, market-timing, efficient trading or just plain luck?

Undoubtedly each factor will eventually be assigned a Greek letter and a formula to boot. Alpha and beta might be taken but there are 22 other letters to choose from in the Greek alphabet.
China and energy have emerged as two of the great investment themes of the early 21st Century and that has not escaped the attention of Walter Scott & Partners Limited (WSPL).

The Edinburgh based manager, renowned for its long-term approach to investments, has discovered a confluence of the two themes in the China National Offshore Oil Corporation (CNOOC).

WSPL has owned CNOOC in its clients’ portfolios since the company first listed on the Hong Kong Stock Exchange back in 2001. The Chinese government privatised the company, selling roughly one-third as part of a drive to attract foreign capital and expertise to the national energy industry. WSPL saw it as an exciting opportunity to invest in the world’s largest emerging market.

The manager looks to invest in companies with exceptional, long-term growth prospects. It analyses potential investments in exhaustive detail to evaluate the company’s profitability, operational efficiency, capital structure, valuation, and growth profile. Initial analysis is followed by a thorough assessment of the capabilities of the management team. If a company meets the necessary criteria, and gains unanimous approval from the WSPL team, it will invest and hold for the long term, allowing compound earnings growth to translate into strong share price performance for its clients.

And CNOOC ticked all the boxes for Walter Scott when the stock became available in 2001. According to Roy Leckie, the basis of the investment rationale back then, and indeed the current rationale for holding the stock, is relatively straightforward: “CNOOC extracts massive amounts of profits from addressing China’s rapidly growing thirst for primary energy sources, particularly oil, but also increasingly gas.”

As its name suggests, CNOOC concentrates on the offshore region. Chinese waters extend for approximately 500 - 1,000 miles off the eastern seaboard of China, and comprise an area roughly twice the size of the Gulf of Mexico. This is primarily where CNOOC operates. However, as Leckie explains, its key competitive advantage lies in what is known formally as a ‘production-sharing contract’, or alternatively as a ‘farm-in right’.

“There is a key differentiating characteristic of this company that is right at the heart of the investment rationale, and that is its ‘farm-in right’. CNOOC has the right to buy into any successful exploration find in offshore China,” he says.

There are many big, global oil companies, such as Exxon and Shell, as well as smaller operators, drilling for oil and gas in offshore China. If any of these companies make a successful find, then CNOOC has the option to invest in it through its farm-in right. CNOOC has a near monopoly in the region, and the government has granted it the right to develop any successful find.

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(not the obligation) to acquire, on commercial terms, up to 51% of the associated development projects. Leckie says the primary effect of this deal is to “massively reduce the exploration risk that the company is exposed to”.

The key to understanding the potential benefits of this arrangement lies in the yet-to-be-discovered oil reserves under the China Sea.

“Exploration of the area to date indicates that the eastern seaboard of China is potentially as resource-rich as the Gulf of Mexico. It shares some of the geographical features that indicate large potential reserves, such as extensive delta areas [of the Pearl River, Yellow River and Yangtze River], which are traditionally rich in fossil fuel deposits,” says Leckie.

“Less than 1,000 wells have so far been drilled in offshore China, compared to over 10,000 in the Gulf of Mexico and 4,000 in the North Sea. The whole area is massively under explored,” he adds.

CNOOC has a reserve life of 20 years, based on existing proven reserves, but its reserve replacement ratio is well over 100%. This means that CNOOC is growing its reserves each year, despite ongoing production.

In addition, the company estimates production will grow at roughly 8-11% per annum over the next five years. According to Leckie, however, there could even be upside to these numbers.

“This is at the bottom end of what CNOOC has delivered over the last five years, and may be well turn out to be a conservative estimate.”

As well as its resources and the advantages of its production-sharing arrangement, CNOOC’s efficiency, productivity, cost structure and balance sheet, put the company among the best exploration and production companies anywhere in the world.

Leckie sums up the size of the opportunity with the following sentiment:

“If I was a betting man, I would bet on CNOOC being a core holding in WSPL portfolios the day I retire, and I don’t plan to retire any time soon!

“This is a long-term WSPL stock. Of course, we will manage the position, no doubt there will be periods when the stock outperforms and we cut back, and there will be periods of underperformance when we will buy more, but I think this will be a long-term pillar of our portfolios.”
a world away from care

Holidays mean different things to different people. Some like to experience history and culture, others prefer to set sail, view nature close up, hike through pristine valleys or simply plunge into the sea. Jane-Anne Lee takes a closer look at some of the world’s hot destinations this holiday season.
roaming through Romania

The largest country in south-eastern Europe, Romania is fast becoming a mecca for tourists keen to explore medieval towns, traditional villages and the romance of the Danube delta.

There are also fairytale castles, the grand architecture of the capital Bucharest, Black Sea resorts and the Carpathian Mountains to keep tourists coming back.

In Transylvania in central Romania, there are rural Saxon villages, the Baroque city of Brașov, Dracula’s legendary den Bran Castle and the UNESCO world heritage medieval town of Sighisoara.

The renowned painted monasteries in Bucovina are among the country’s most prized treasures. Richly decorated, the frescoes date back to the 15th Century and feature images of apostles, philosophers, angels and martyrs. Founded in 1488, the Voronet Monastery Church, with its blue-coloured frescoes, is regarded as the Sistine Chapel of the East.

In the north-west region of Maramures, village life continues as it has for centuries, with women in traditional garb of headscarves, white blouses and full black skirts with striped panels, threading wool on to spindles outside their homes.

Even on horseback, the history lesson goes on. To the hills in the north, you can book an equestrian holiday riding Hutul mountain horses, Lipizzaners or Arabians through mountain terrain, passing Roman remains on your way.

cruising Croatia

Croatia is a haven for sailing, with one of the world’s great coastlines. You can spend evenings on the waterfront dining on fresh Dalmatian seafood cuisine and days exploring beaches, bays, grottoes, ancient walled cities and palaces.

With a coastline stretching 5,835km, 4,000 of which is made up of islands and reefs, there are more than 1,000 islands to travel around. However, just 66 are populated. Croatia also boasts one of the sunniest coastlines in Europe with dry summers and mild winters.

Depending on your timeframe, there are many itineraries from which to choose. You can sail from Split to the charming town of Dubrovnik or do shorter sails out of either destination. Charter boat companies offer a range of vessels from modern to more classic craft and bareboat to crewed charters.

A typical charter from Split may include a sail south-west past the island of Šolta to Vis with its very own Blue Grotto. The next day, you can visit the large Adriatic island of Korčula, the birthplace of Marco Polo. Then hoist the sails for Hvar Island and enjoy a wonderful night in Stari Grad or the lively old Venetian town of Hvar. Anchor off the island of Brač then sail through some of the smaller islands on the way to Trogir before returning your boat to Split.
For the curious traveller with a penchant for up-close encounters with nature, there is much to observe in the Galapagos Islands – from flightless cormorants and pink flamingos to the world’s only seagoing lizards and 13 species of Darwin finches.

It was this very environment brimming with nature on and off the land that led Charles Darwin to formulate his theory of evolution.

The volcanic group of 13 main islands, six smaller ones and 107 islets and rocks, about 1,000km west of Ecuador in the Pacific Ocean, may have a bleak, rugged appearance, but contains an abundant wildlife, a rare mix of tropical and polar species.

Below sea, there are tropical fish, coral reefs and submerged craters while above there are fur seals, flamingos, inflatable frigate birds, waved albatrosses, diving boobies and sea turtles.

Named after the giant land tortoises inhabiting the area, the islands are best explored by boat where you can witness prehistoric marine iguanas sunbaking on black lava rocks, tiny penguins bobbing in the sea, whales breaching and sea lions lazing around.
five hot global destinations

treks and treatments in Bhutan

After a long day trekking through valleys and clambering up remote mountain passes in Bhutan, there is nothing quite like a soothing spa in a five-star lodge.

Few hiking destinations afford such luxury. But, in Bhutan, you can experience a trek and a treatment, day after day. You can walk among prayer flags, traditional villages and ancient temples and 16th and 17th Century monasteries then be pampered in one of Amanresort’s Amankora lodges. Or you can skip the treks and just enjoy the treatments!

After a self-imposed isolation for much of the 20th Century, the landlocked Himalayan kingdom, nestled between India and China, relaxed its restrictions in 1974, opening its doors to a limited number of travellers each year.

Now the luxury travel market has embraced this pristine place. Five Amankora lodges – Paro, Punakha Gangtey, Bumthang and Thimphu – have been created to allow visitors to enjoy a circular trek in the stunning central and western valleys. Individual itineraries can be tailored to cater to travellers’ desires, taking them from one lodge to another with guides, a cook, horses and yaks to cart gear and provisions.

Each boutique lodge is different, but all aim to capture the character of their environment and to take in dramatic valley, monastery, forest and mountain views.

summer in Sardinia

In Sardinia, it’s easy to combine a beach holiday with superb scenery and a serious dose of history.

For this second largest island after Sicily in the Mediterranean Sea has a history of colonisation and invasion by the likes of Greeks, Phoenicians, Romans and Spaniards.

Even the island’s capital, Cagliari, has a fine beach as well as a medieval town centre.

The Costa Verde stretch of coastline on the west coast is relatively unspoilt, offering some of the best places to take a plunge in a gleaming sea. When you’ve tired of the sun and sand, you can head inland to the fortress Nuraghe Su Nuraxi or explore the archeologically rich city of Tharros.

The beaches and grottoes around the walled fishing port of Alghero should be part of any Italian itinerary. The Lido in Alghero, a Catalan town on the north-west coast, has a lively beach scene in summer. By day, people retreat to sun beds on the sand. By night, they dine at restaurants or pizzerias lining the beach. For a change of scenery, there’s Alghero’s 12th Century old town centre where you can stroll along cobblestone streets in the cool of the day.
To maximise back office efficiencies, some advisers group client portfolios according to an investment strategy. This streamlines transacting and rebalancing, making the administration of client portfolios more efficient. Macquarie Wrap has introduced Presets, a flexible model portfolio solution you can tailor to suit your business.

How do Presets work?

**You control the structure of the Preset**

There are many different ways you can structure Presets to ensure they meet the needs of your business. Unlike other model portfolios, there are no limits to the number of Presets you can have.

**Will Presets suit your business model?**

Presets will suit you if you:

- use managed investments;
- use standardised portfolios for groups of clients based on risk profiles or investment objectives;
- treat groups of clients in a consistent manner;
- co-ordinate portfolio changes across all clients through:
  - use of MDA licence
  - use of Limited Powers of Attorney
  - writing out to clients for their signatures.

**What you need to decide**

- How do I want to manage cash and cashflow for my clients?
- Do I set up the Preset as per my clients’ risk profiles?
- Do I set up multiple Presets based on asset classes?
It’s all about choice and flexibility. Let us take you through some of your options:

### Scenario 1
**Managing cash and cashflow**

Your client’s cash can be managed inside or outside the Preset.

**Managing your client’s cash inside the Preset**

This is done by selecting cash as one of the assets within the Preset. This will result in changes in your client’s cash account balance driving the rebalancing of the Preset. For example, where additional cash contributions are made into a client’s account, this cash will be distributed across their Preset portfolio at the next rebalance date to bring cash back to the desired Preset weighting.

**Pros**

- Simplicity: where no other assets are held by the client, the Preset equals 100% of the client’s portfolio.
- Easy rebalancing: payments into or out of cash will trigger a rebalance at the next rebalance date.
- Ability to set cash as a percentage of the Preset.

**Cons**

- Take care if clients use their CMT as a transaction account. Payments in or out will trigger a rebalance. This will result in the cash balance driving the rebalancing of the Preset.
- Deposits made to the cash account will not be invested until the next rebalance date. (You can always switch a cash dollar amount to a Preset at any time.)

### Managing your client’s cash outside of the Preset

This will enable a client’s cash balance to fluctuate without impacting the rebalancing of the Preset.

<table>
<thead>
<tr>
<th>Total client portfolio</th>
<th>Cash</th>
<th>$5,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preset</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fund A</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Fund B</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>Fund C</td>
<td>30%</td>
<td></td>
</tr>
<tr>
<td>Fund D</td>
<td>35%</td>
<td></td>
</tr>
</tbody>
</table>

**Pros**

- Enables a client’s cash balance to fluctuate without impacting the rebalancing of the Preset.
- Regular credits invested via dollar cost averaging or automatic cash management.

**Cons**

- Less simplicity: the Preset will not equal 100% of the client’s portfolio.
One Preset can be set up for each asset class.

**Pros**
- Enables rebalancing within each individual Preset.
- Enables ‘income’ Preset to pay distributions to cash, while the ‘growth’ Preset reinvests the distribution.
- Automatic cash management can be set up on one Preset to manage cash (for example, ensuring sufficient funds are available for a pension payment) rather than sell growth assets.

**Cons**
- Rebalances within each individual Preset only.
- Additional Presets to manage.

### Scenario 2
**Multiple asset classes within one portfolio**

<table>
<thead>
<tr>
<th>Asset</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$5,000</td>
</tr>
<tr>
<td>Preset 1</td>
<td>$60,000</td>
</tr>
<tr>
<td>Fund A</td>
<td>20%</td>
</tr>
<tr>
<td>Fund B</td>
<td>25%</td>
</tr>
<tr>
<td>Fund C</td>
<td>35%</td>
</tr>
<tr>
<td>Fund D</td>
<td>20%</td>
</tr>
<tr>
<td>Preset 2</td>
<td>$35,000</td>
</tr>
<tr>
<td>Fund E</td>
<td>15%</td>
</tr>
<tr>
<td>Fund F</td>
<td>40%</td>
</tr>
<tr>
<td>Fund G</td>
<td>25%</td>
</tr>
<tr>
<td>Fund H</td>
<td>20%</td>
</tr>
</tbody>
</table>

### Scenario 3
**Managing non-Preset assets**

Other assets can still be managed outside the Preset, using the options previously outlined. If a client has non-Preset assets, such as non-daily priced funds, equities and hedge funds, they can still be included in a client’s portfolio. This further helps you tailor the portfolio to your client’s needs, while taking advantage of the efficiencies of Presets.

**Take advantage of existing features and functionality**

Presets allow you to take advantage of existing functionality, such as automatic rebalancing, automatic cash management and dollar cost averaging should you wish to use it.

- **Automatic rebalancing** can be turned on within the Preset – either quarterly, half-yearly, or yearly. Alternatively, you can choose to rebalance on an ad hoc basis at a cost of $2 per transaction where applicable.

- **Automatic cash management** plans can be established to facilitate cash management where cash is held outside the Preset. Automatic cash management plans run every month on the 20th day of the month. Excess cash can be distributed across Preset assets. Alternatively, required cash can be redeemed across Preset assets at a cost of $2 per transaction where applicable.

- **Dollar cost averaging** automatically invests a regular cashflow. Dollar cost averaging runs on the 16th of every month, at a cost of $2 per transaction where applicable.
Eventually, with all the budget changes coming into effect, I will transfer all the pension clients into Presets.

Adam Gale  
Announcer, Sydney

Business snapshot:  
- $25 million FUA.  
- Clients are mostly Wealth Accumulators.  
- Since implementing Presets eight months ago, Announcer has doubled its book of business.

What is your role at Announcer?
My role is to service clients and research.

Which clients do you use Presets for?
I use Presets for 95% of new clients – including margin lending clients.

How do you use Presets?
I have 300 clients in Presets, mainly using the risk profile structure. Eventually, with all the budget changes coming into effect, I will transfer all the pension clients into Presets.

What do you like most about Presets?
Before Presets, I was doing 1,000 transactions a month. Now, with Presets and dollar cost averaging plans, I’m doing 200 a month.

How has using Presets changed the way you operate?
I think Presets has saved me about 12 hours a week. Reinvesting is also much simpler and automatic cash management alone has bought me at least another four hours a week. Clients see the regular transacting and contributions. This shows them the investment is being worked on. This also allows me extra time to focus on servicing more clients and do my bit to help grow the business.

Can you tell us about some clients you have in Presets?
One retiree client contributes $3,500 as employer contributions and undeducted contributions. I use dollar cost averaging to invest regular contributions and automatic cash management to reinvest the dividends.

Our Margin Lending Preset structure has also made margin lending more feasible. One Wealth Accumulator client, in their early 30s, made a 50/50 contribution upfront in one transaction, investing $2,500 each month. The Preset structure was already established, with a low cash holding and eight funds. Using this example, here is the impact:

<table>
<thead>
<tr>
<th>Without Presets</th>
<th>With Presets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eight upfront transactions</td>
<td>One step results in eight transactions into the Preset</td>
</tr>
<tr>
<td>Eight DCA set ups</td>
<td>One step results in eight transactions into the dollar cost averaging plan</td>
</tr>
</tbody>
</table>

Why use a risk profiling structure and margin lending structure?
We have five different risk profile Presets, and one for margin lending. We find a risk profiling structure and margin lending structure the most efficient way to manage our client base, and our time spent in the office!

How easy is it to set up?
I studied the training document. I took my time doing the first client, double-checking as I went, and getting familiar with the process. My Training and Relationship Manager, Peter Foster, also helped me through this process. A lot of it I picked up myself.

For further information, please contact your Macquarie Wrap Training and Relationship Manager.
How much do your clients trust their insurance company?
In a telling survey carried out by the Investment and Financial Services Association (IFSA) in 2006, insurance companies ranked among the least trusted organisations in Australia.
Only 14% of those surveyed said insurance firms were trustworthy.

It is probably little comfort to life company executives that telcos, oil firms, media groups and real estate agents are trusted (slightly) less than them.
The poor showing of insurance companies in the survey is in stark contrast to the 46% of respondents who rated superannuation funds as trustworthy. Super funds, in fact, topped the poll, followed
New research commissioned by Macquarie shows that innovative electronic insurance application technology can help bridge Australia’s chronic underinsurance gap.

closely by fund managers (35%), airlines (32%) and financial planning companies (30%).

The result, while disturbing, would not come as a surprise to many in the life insurance industry. For the last few years the life industry, spearheaded by IFSA, has been digging deeper to understand how consumers perceive life insurance.

Lack of trust in insurers has emerged as just one of the reasons behind Australia’s chronic underinsurance problem.

In 2005, actuarial and research firm Rice Walker (since renamed Rice Warner) estimated that “the amount of underinsurance for parents in Australia with dependent children is of the order of $1.300 billion”.

In its report ‘A nation exposed: closing the protection gap’ produced in the same year, IFSA presented further startling research that revealed only 55% of parents claimed to have any form of life cover, either through their super, stand alone policies or a mixture of both. The study found 35% of parents had no cover with the remaining 10% unsure if they had life insurance or not.

But even amongst those who had life insurance, most had a level of cover far below that recommended as adequate. Rice Warner says a sufficient level of life cover is between six and 12-times annual income, depending on individual circumstances. However, the IFSA research found 60% of those surveyed had a level of life cover equivalent to less than a year’s income; 26% were covered for between one and five years of income; and, only 14% had life cover equal to six or more years of income.

The statistics are alarming but rather than repeat more of the same, IFSA has directed its research to uncovering the reasons behind the underinsurance problem and how the industry can better engage with consumers.

In a survey last year IFSA found there were a number of barriers to life insurance for consumers – most of which were psychological in nature.

“For many, the answer to the question ‘why don’t you have life insurance?’ is, ‘I don’t know’,” the study says.

IFSA also found that when it comes to life insurance most people:

- couldn’t estimate their financial obligations;
- wouldn’t know where to start;
- have no idea and have never thought about it;
- believe it’s something their partner deals with;
- don’t know what the options are.

The research revealed there were some practical reasons why people chose not to take up life cover such as access to other sources of emergency income or they had no dependants or debt. However, the study found the main reasons why consumers reject life insurance relate to their perceptions of the industry and the supposed difficulties in getting cover.

IFSA identified four psychological themes in the minds of consumers in relation to life insurance:

- many felt they didn’t need life insurance because they were young and/or healthy; social welfare would cover their needs; or, only wealthy people need it;
- a lack of trust in the insurance industry (hence the insurance companies’ low score in the trustworthiness rankings);
- a perception life insurance is expensive; and
- a belief that life insurance will be difficult to understand and obtain as well as absorbing a lot of time to secure cover.

Unsurprisingly, IFSA also found that those consumers who had adequate levels of cover reported a greater sense of trust in insurance companies and the value of life insurance.

However, as the IFSA research has shown, the life industry has some way to go in gaining the trust of a large part of the Australian population who either have no cover or are inadequately insured.
The benefits to clients are considerable, but the financial advisers in the study also reported two main positive effects on their own businesses of the online system: more efficient use of their time and the virtual elimination of the chance of submitting an incomplete application.

**Market research points the way**

In March this year, Macquarie launched its online insurance platform with the aim of dramatically speeding up the application and underwriting process for life insurance policies – and the results to date have been impressive.

In a recent survey of financial advisers and support staff – half of whom had used the Macquarie online insurance platform – research firm Plan for Life found the new system has substantially sped up the process of gaining life insurance for most clients.

For example, Plan for Life found that 72% of those surveyed were able to complete policy applications and be given an initial underwriting decision online in less than 30 minutes. Using the traditional hard-copy applications, only 41% are completed in less than 30 minutes. And that’s before any underwriting has taken place.

But as well adding greater efficiency to the overall application process, Plan for Life reported the Macquarie online insurance platform cut average time spent on any subsequent required underwriting by days, if not weeks.

“One of the most significant findings presented in this survey reflects not just the efficiency of submitting applications online, but the significantly greater capability of the insurer to respond to the adviser, with assessment results, in a vastly more efficient timeframe,” Plan for Life says in its report. “84% report receiving assessment results for online ‘cleanskin’ business inside 45 minutes, contrasted against the hard-copy process, where 1% report receipt of assessment results on the same day.

“For non-cleanskin business, around 62% of survey respondents report receipt of assessment results inside five days, compared with 9% via the hard-copy process.”

The benefits to clients are considerable, but the financial advisers in the study also reported two main positive effects on their own businesses of the online system: more efficient use of their time and the virtual elimination of the chance of submitting an incomplete application.
Like a squash ball, the life insurance administration process has traditionally come in three varieties, according to Gavin Callopy: “Slow, very slow or super slow.”

“To use the word ‘quick’ would not be appropriate for any [insurance company],” he says.

Which is why Callopy, an adviser with Planning Partners in Melbourne, was keen to test out the Macquarie online insurance platform.

He initially approached the new system with a healthy degree of scepticism but, despite describing himself as “not being one that is technologically-minded”, found it all fell into place very quickly.

“And really, the first time I used it, I was pretty much set on it… it sold itself,” Callopy says.

He was sold not just on the ease of use of the software but also on the administration and service that sits behind the intuitive online platform, which Callopy describes as “fantastic”.

He says the online insurance platform has made an immediate difference to his own work practices and the efficiency of the business.

“From a personal point of view, I have less work to do,” Callopy says.

As well as an application process that is usually completed in 20 minutes, Macquarie also takes the follow-up work for those cases that aren’t cleanskins out of the hands of advisers.

For example, advisers no longer have to chase up with clients any medical reports or pathology tests that may be required.

“From a business point of view, it’s the first time I have actually been able to measure what we are getting for insurance,” Callopy says. “And by that I mean, I know that 20 minutes has just occurred, I’ve lodged the application, Macquarie is going to do the rest.

“So when it settles, we are going to get X-amount of income for 20 minutes work. And that is the first time I have ever been able to measure what the income is. And if you can’t measure it then how do you know how profitable it is?”

The effect of the online insurance platform on Callopy’s clients is just as pronounced with the speed of the approval process particularly impressing them.

He says the greater efficiency of the system gives him “extra currency” when advising clients to roll over to Macquarie insurance.

“Sometimes that has been a sticking point for them. We’re now able to say, ‘well look, we’ll see how the application goes’. Often you get an approval on the spot and that’s a really huge thing to a client when they know that they have already been underwritten, they’re more likely to say, ‘I am happy to do all that’, Callopy says. “Rather than having to go for a month and wait and see, whether or not you get loaded, whether the final premiums are going to be what you’ve stated that they’re going to be.”

As well as making it easier to get clients to take up life insurance, the Macquarie system also enables Callopy to profitably handle cases where the premiums are low.

“On small cases, absolutely you can [make a profit] because you are not doing the bloods, and so the more questions and answers that get derived from the client at the application stage the better… if someone has had every disease, every injury known to man, well they’re not going to get the cover anyway, but at least we will be able to determine that at the first step.”

For someone who is “not a computer person” the upfront technology of the Macquarie online insurance platform has certainly impressed him.

Until now he has confined his internet activities to “cricket and footy” sites – even online banking has not lured him from more traditional methods.

“I actually like going into a branch, would you believe it?” he says.

However, Callopy is an enthusiastic convert to the online insurance concept and he expects the rest of the industry will follow quickly in Macquarie’s footsteps.

“I think it is pretty obvious that electronic based underwriting is going to be the way most insurers are going to go and I wouldn’t be surprised if they are all watching the Macquarie product and are all calculating the savings on it and they will all be doing it,” he says.
Christmas is that time of year where everything comes in multiples of $00. It’s similar to when you’re renovating your house – although then everything comes in multiples of $’000.

You know what I’m referring to: your son wants to bring his new girlfriend from Sweden (whom you’ve never heard of let alone met) to Christmas lunch because she has no family here, so you’ll need to buy more food: $100. And of course she’ll have to get a present, it would be awful if she felt left out: $100. The Christmas lights we bought last year now no longer work for some unknown reason and it’s just not Christmas without lights: $100.

The examples could be endless, but the outcome is the same – Christmas is expensive and chances are your clients are likely to be spending up big.

For a lot of your clients this won’t be an issue, after all they have been coming to you for advice over the years so they can afford to have the lifestyle they want, safe in the knowledge that their long-term financial security is still intact.

Inevitably, however, there will be those clients who wake up on Boxing Day with a severe case of cognitive dissonance (or buyer’s remorse as it’s more commonly known) from all the money they have spent. These clients will waste the next few days worrying if they really could afford to have been so extravagant with their Christmas cheer. The next inevitable step is the New Year’s resolution… there’ll be many of course, but without a doubt there will be an absolute resolution that this is the year they are going to really take control of their finances to ensure they don’t feel so silly after the next silly season.

Clients don’t know what they don’t know

The Financial Literacy Foundation, an initiative established by the Australian federal government to increase the financial understanding of all Australians, recently conducted a survey of 7,500 Australians to get a better understanding of how people think about and manage their money.

The survey showed that 77% of Australians are more interested in learning about more complex money management issues such as investing and retirement planning, than they are in learning about everyday money management matters such as budgeting.

On the surface this type of statistic probably doesn’t raise many eyebrows; most people feel that they’re comfortable with budgeting and the basics of looking after their finances, which explains why there is a greater demand for education about the more complex financial issues.

But although 90% of people say they have the ability to budget, nearly 50% of them say that they don’t actually budget regularly for their day-to-day finances, and this is where the problem begins.

Your clients can’t begin to work with you on investment and retirement strategies until they spend time looking at their income and expenses and understanding where their free cashflow is. The foundation of any good financial plan is a cashflow management strategy – this is beyond a budget – it’s a system and a way of managing money that ensures your clients’ money is working as hard as they are.

Once you’ve discussed with your clients where all their income is coming from (and where it’s going to) you need to implement a system that captures all of this.

Generally, your client’s first visit to you will be the only time they spend any real effort focusing on their income and expenses. Once they’ve had the chat with you about how much they spend and how much they can save, the conversation quickly moves onto working out how to invest those savings (also known as free cashflow).

The problem occurs when at the end of the year you discover that their actual spending is much higher than they said it was and consequently they fall short of their goals. Alternatively, you discover the client has saved more than they imagined, leaving a pile of idle cash that’s not working to help them reach their long-term investment goals. Obviously the latter scenario is the more favourable one, but in terms of your role as a financial planner and your value proposition to your client, neither outcome is the ideal.

Overcoming the apathy

A sound cashflow management strategy is the cornerstone of any financial plan – try explaining this to your clients though, and the most common reaction is apathy.
77% of people want to learn about investing, however, nearly 50% of people don’t even budget.

It’s easy to make your clients understand the benefits that will come to them if they consolidate all of their income into a central account; work out how much they need for living expenses every month and move that to a living expenses account; and then direct their surplus income into investment assets which will in turn create more income for them. However, many of your clients will have various longstanding bank accounts and they will try to implement a cashflow strategy through these existing accounts because they perceive this will be easier than consolidating them.

This is understandable. We all know how hard it can be to do anything with some banks these days. You’re on the phone for 15 minutes before you even begin to speak to a human. However, it’s essential that clients embrace a cashflow management strategy wholeheartedly for it to generate financial benefits for them in the future.

As an adviser, you and your staff can work with your clients to help them implement a cashflow system. This includes working through the basics with them such as closing existing bank accounts (except for the one they need to access their monthly spending money from); redirecting direct debits; opening a cash management account that is equipped to provide you with all the tools you need to properly manage and monitor your clients’ cashflows; and then directing any salary, dividends and other income into this account.

Once this has been done, the system is in place and your clients will start to see the benefit of their idle cash being put to work. This means your future client conversations can be focused more on the things they’re interested in, such as understanding investments and what their plans are for the next Christmas season.

That sounds like a New Year’s revolution.

1 Financial Literacy Foundation – Australians understanding money, September 2007
The Walter Scott Global Equity Fund, a member of the Macquarie Professional Series since 2005, has picked up the top prize in the International Equities – Diversified category at the recent Standard & Poor’s Fund Manager of the Year awards.

The award is testament to Walter Scott & Partners Limited’s fundamental “bottom-up” approach to investment management and recognises its strong investment team and ability to generate returns for investors over the long term.

The Walter Scott Global Equity Fund has consistently been one of the most broadly supported funds in the Professional Series, attracting more than $1.1 billion in funds under management since linking up with Macquarie in March 2005.

Macquarie Professional Series is delighted that the Fund has been recognised with this award and thank you for your continued support of the Fund. Should you require further information about the Fund please do not hesitate to contact your Business Development Manager or contact us on 1800 005 056.

Walter Scott Global Equity Fund scoops S&P award

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