

April 2006 Newsletter

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Property versus shares - a different approach!

Which is the better investment, property or shares? This is an often debated topic. I am going to argue that the answer doesn't matter.

If you want to get fit what is the best exercise you can do? Most fitness experts will argue that you do whatever you enjoy the most and suits your body type and fitness level. Some people like the gym, others like running, etc. There's no right or wrong answer it just depends what suits you. I argue that it's likely you can achieve the same return on investment with property or shares. If you pick the one that suits you the best it is likely to produce great results.

Understand it or don't do it

I am a firm believer in the mantra: "don't invest in anything you don't understand". If you follow this rule then the chances of being taken to the cleaners is dramatically reduced. You need to understand why you might achieve a certain return (i.e. what drives the return) and the risks involved with the investment. If you can't fully understand how the investment works then I would suggest not to invest.

A good example is a company that was advertising that they were going to offer interest free loans about one or two years ago. There were many people that blindly believed it was possible. I couldn't understand how it was possible (even though they tried to provide an explanation on their website). You wouldn't be surprised to learn that the business never saw the light of day. What surprised me was that many people were keen to jump on board and hand over their personal information even though they didn't fully understand the product they were buying.

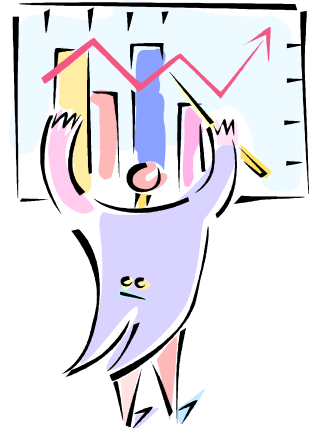
Achievable returns are similar

According to the Sunday Age, shares have delivered an annual return of 12.2% over the past 80 years.

Property has returned 11.8% p.a. over the same period. We need to remember that these are average returns. Some properties and companies would have performed better, and some worse than this average return. Therefore, we cannot be too precise when comparing these two percentages because the assets that we chose to invest in might end up yielding a different return. In my opinion, these figures tell me that both property and shares can deliver similar returns if I invest wisely.

By comparison... Very similar

- ◆ Leverage – one of the biggest promoted advantages of property is the you can borrow a high percentage of the property's value. Therefore, you can contribute a relatively small deposit and increase your exposure.



Well the same is true with shares. Many margin lending facilities allow you to borrow up to 80% of a shares value. There are products called CFD's (Contracts-for-difference) that allow investors to borrow up to 95% of a share's (or index's) value.

- ◆ Tax concession – If you borrow money to invest in shares or property you should be entitled to a tax deduction for the interest incurred to finance the investment. Therefore, the negative gearing benefits are likely to be the same. The only difference between property and shares it that its difficult to find a stock that delivers a high dividend yield and high capital growth. Therefore, you will have to design a portfolio to deliver your overall yield/capital growth requirements. Whereas, all properties generate a rental yield (generally in the range of 3.5% to 4.5%) while generating capacity growth. This income helps service debt repayments.
- ◆ Liquidity – One of the negatives with property is that it's a relatively illiquid investment. That is, if you need to sell an investment property and get your money back then it may take a couple of months. However, shares can be sold and you can have your money in 3 days.

In my opinion, this is a moot argument because both shares and property are long term investments. Therefore, your goal should be to hold your investment for the long term and not sell it. If that's your true strategy then liquidity is not really a big issue. In some ways it might be good for the less disciplined investors because their money is "locked away".

- ◆ **Asset selection** – Unless you are an expert in company valuations then it is difficult to choose which stocks might be good to invest in. In my opinion, a property is easier to pick. You can see it, you can walk through it, etc. You can see what similar properties have sold for. One solution to the stock picking issue is to invest in the stock market index (e.g. via an index managed fund – these funds invest in the stocks that make up the index).
- ◆ **Acquisition costs** – This is one significant downside to property. The stamp duty payable on the purchase of property generally ranges from 3.5% to 5.6% of a property's value. Stamp duty charged on the transfer of shares was abolished in 2001 which dramatically reduces the acquisition cost in comparison to property.

Finance matters

Of course it would be remiss of me not to talk about the finance matters. When financing the purchase of shares investors generally have two options. They can use a margin lending facility. This is a loan that is secured by the shares that you purchase. Margin lending products will generally lend 70% to 80% of the shares value. Borrowers will be subject to margin calls. That is, if your stock falls in value you will have to contribute more cash to reduce the loan percentage to 70% or 80% (whichever is applicable). Another alternative is to use a mortgage secured by your home or investment property. Interest rates for residential mortgages are approximately 1.5% to 2.0% lower than margin loans and you will not be subject to margin calls.

But what suits you?

Investing in property or shares can make you very rich if you stick to a plan, invest for the long term and implement the right strategy. The thing is, if you don't understand or enjoy the investment, then you're unlikely to be totally dedicated to it. Some-

one that understands and enjoys property is likely to achieve superior returns in property investing compared to shares. Returning to the analogy I used at the beginning... if you run 5kms a day or go to the gym for 1 hour a day you are very likely to lose weight. The question just becomes which one are you going to enjoy and associate with the most, because that's the one you're more likely to succeed with over the long term.

Tax planning - Interest-in-advance



Tax time is fast approaching. It is a perfect time to discuss with your accountant whether an interest-in-advance product might be beneficial for your circumstances. These products allow you to prepay 12 months of interest in advance before 30 June. You may be able to claim the full interest deduction in your tax return for the year ending 30 June 2006. It may be worth discussing this with your accountant. If you want to use one of these products then we'll need to lodge an application by 1 June 2006 so that the new mortgage is set up before 30 June.

We are in the process of negotiating a special interest rate with one of our lenders. We'll make an announcement as soon as we finalise the negotiations.

85% without mortgage insurance

Westpac announced on Monday 10 April 2006 that it will now lend up to 85% of a property's value and not charge mortgage insurance. The maximum interest rate discount allowable under its professional package is subsequently reduced from 0.70% to 0.40%. This results in a discounted interest rate of 6.92%. We have calculated that if you are borrowing less than \$400,000 then you are better off paying lenders mortgage insurance and getting the lower interest rate. However, if you borrow more than \$400,000 then you are better off paying the higher rate and avoiding the cost of mortgage insurance.

There are some lenders on our panel that will consider waiving mortgage insurance on loans that are up to 90% of a property's value (where the loan term is reduced to 18 to 20 years). Other lenders will lend up to 85% where the loan to value ratio is reduced to 80% within 5 years.