



Beyond bricks and mortar

Property assets continue to attract investor interest due to their appealing attributes and growth possibilities. While they are often considered to be a mainstay of an investment portfolio, there are a number of things to keep in mind when adding property to the mix.

Buying a house or unit, also known as direct property ownership, is the most common way many Australians get on the property ladder. However there are other ways to invest in property, such as managed property funds and property trusts. Like direct property, each has its own strengths and weaknesses which need to be weighed up.

Hot property

Direct property is often considered by investors to be the safest and most effective long term investment vehicle. Many people have experienced significant capital growth with direct property – over the last three decades, Australian house prices recorded an average annual growth rate of 8.4%.¹ An investment property can also deliver a steady income through regular rent payments.

From a tax point of view², direct property can provide many benefits. A number of deductions may be claimed against the rental income you receive from an investment property. These could include the interest expense you have incurred to service the investment loan as well as other borrowing expenses such as legal costs.

As a tangible asset, many feel an emotional attachment to buying direct property. Having control over your own property means you can add value through renovations – often a rewarding and personal project in itself which has its own appeal.

1 RP Data, September 2010.

2 It would be prudent to seek advice from a qualified tax professional.

From an investment point of view, real estate is generally less volatile than other investment strategies and doesn't experience large fluctuations in value. Direct property also has a low correlation to other asset classes which can make it a good portfolio diversifier.

Safe as houses?

But it's not all plain sailing for direct property investors and it's important to consider the risks and costs involved.

Despite lower volatility, property values nevertheless rise and fall. The property market can be unpredictable, and if the market is down when you wish to sell, you could make a loss on your investment.

The risk of the property being damaged by tenants or lying vacant with no rent coming in should be taken into account. Potential costs should also be considered – stamp duty, solicitor's fees, real estate agent charges, as well as ongoing maintenance expenses like council and water rates can all eat into your investment returns.

You should also have an awareness of the interest rate environment and think about how higher rates might affect your expected return.

These factors can make an investment in direct property a more labour and cost intensive option than some other strategies.

The capital involved in purchasing property can make diversification difficult. As a general rule, property should make up about 10–15% of an investment portfolio. Putting considerable savings or borrowings in one property not only ties up capital, but also puts a lot of eggs in one basket.

You should think about all eventualities when assessing the returns from property, and compare this against the risks and return of investing elsewhere. There's a lot to consider, but like any investment option it's important to keep a level head and be realistic rather than rushing into buying a property.

Paper property

Looking beyond buying direct property could present other opportunities to incorporate property into your portfolio.

Investing directly in Real Estate Investment Trusts (REITs – previously known as listed property trusts) via the sharemarket, pooling your funds with other investors via property securities managed funds (which generally invest in REITs), or investing in unlisted property trusts can provide exposure to a range of property investments. These types of trusts and funds enable the average investor to invest in shopping centres, hotels, airports or high rise office blocks.

These avenues for property investing may suit those who are keen to get involved with property but don't want to deal with the costs and risks of managing their own property.

Property funds and trusts may also provide greater diversification across different property markets and locations. And because you can invest in property funds and trusts with smaller amounts of capital, the 'all eggs in one basket' portfolio risk can be reduced.

Property funds and trusts usually produce distributions of rental income and interest on a quarterly or half yearly basis, and can pass on depreciation and building allowances to provide tax effective income.

As these funds and trusts are managed by teams of professional property investment managers, investors can benefit from their expertise and not worry about dealing with day to day issues like maintenance or tenants.

While this involves ongoing management fees, these fees tend to be easier to plan for than the costs involved with direct property.

With the exception of unlisted property trusts, there is generally no issue with converting your investments into cash relatively quickly.

Weighing up the downsides

As with all investments, there are downsides to investing in property funds and trusts. Investors have no control over the investment selections or when assets are sold.

However, the main downside of listed property funds and trusts is their volatility, which needs to be taken into account and be in line with your risk profile and investment timeframe.

As REITs are listed on the stock exchange, buyers and sellers are continuously assessing the current and future value of the underlying property investments. This means the price of the units in REITs and property securities funds is affected by market sentiment making them considerably more volatile than direct property.

Unlisted property trusts are not as volatile as investments in REITs but they are more difficult to exit than listed property funds and trusts, with many having a standard 12 month minimum redemption period.

Property funds and trusts

Advantages

- Easy to purchase
- Medium to high liquidity (ie ability to convert to cash)
- Trusts can pass on depreciation and building allowances to provide tax effective income
- Easier to diversify as entry costs are lower
- Low transaction costs
- Transparent pricing
- Provides access to different types of property

Disadvantages

- Historically more volatile than direct property
- Income returns may vary over time
- No control over underlying investments
- Higher correlation to sharemarket movements
- Fewer tax concessions than direct property

Before investing in any asset, you should consider the benefits and risks, how it fits into your overall investment strategy and seek professional advice.

Phishy business

One in 10 Australian internet users were affected by online fraud and scams over the past year, with losses reaching a staggering \$1.286 billion.¹ However you can avoid most of these scams if you are aware of the warning signs and know how to protect your personal details online.

There are a number of things to be mindful of when making financial transactions on the internet. In particular, being aware of the techniques used by online scammers, being smart about what you download and being careful where you enter your personal details can help you avoid becoming another online fraud statistic.

Phishing

One of the most common ways internet banking crime is carried out is through phishing emails.

With phishing emails, criminals literally 'fish' for banking login details by sending out millions of spam emails that look like they came from a legitimate bank or financial institution. They typically include a link to an identical cloned version of a bank's website and trick their victim into entering their account information and passwords. These details are then gathered by the criminals for fraudulent purposes.

Phishing emails can be quite convincing however legitimate banks never send emails that link to a login page, or that request passwords or account information. Remembering this makes even the most sophisticated phishing emails easy to spot. If you are sent an email that requests this type of information you should delete it straight away. If you believe your personal details have been compromised in any way, you should contact your financial institution immediately.



Spyware

Spyware is another scam used by online fraudsters to steal personal and financial details. Spyware is a type of software that can be downloaded onto your PC without your knowledge, usually by inadvertently clicking on links in spam emails or corrupt pop-up boxes. Once installed on your PC, scammers can spy on the websites you visit and the files you use and even record the keys you press on your keyboard. With access to the websites you visit and the key strokes you enter, internet banking passwords and credit card information can be easily gathered.

As with phishing, if you know the warning signs, you should be able to avoid spyware. The promise of free games, music or website access is often the bait used by scammers to get you to download their spyware programs. Clicking on pop-up boxes that have a button that says 'close' or 'accept' may lead to an inadvertent download of spyware.

New icons on your computer screen or a slower running speed than normal might indicate that spyware has been downloaded to your PC. If you suspect your computer has spyware on it and you have used your computer for credit card purchases or banking, check your accounts. If any suspicious transactions have taken place, notify your bank immediately. Make sure you remove the program from your computer before using it again – you may need to take it to a computer technician to do this.

Protect yourself and your details

You can prevent these corrupt pop-ups and emails from appearing on your computer in the first place by keeping your anti-virus software up to date. If you use your computer for internet banking or online purchases, you need an internet security package that will protect you from malicious software and safeguard your online identity. A security package from a reputable vendor should include anti-virus, anti-spyware and firewall software.

It is also important to ensure your internet security package is set to automatically download daily anti-virus updates to ensure you are protected against the latest threats.

Tips for protecting your finances

- Install software that protects your computer from viruses and unwanted programs and make sure it is kept up to date.
- Do not open suspicious or unsolicited emails (spam) – delete them.
- Beware of free downloads for music, adult sites, games or movies. They may install harmful programs without you knowing.
- Do not use software on your computer that automatically completes online forms. This can give internet scammers easy access to your personal and credit card details.
- Never follow a link in an email to an internet banking or shopping account.
- Before entering credit card details, check the website is secure. You can do this by checking the URL in your address bar begins with 'https', not 'http'. The extra 's' stands for 'secure.' You should also check for a padlock beside the address bar; this will give you the security report for that site.
- Consider using secure methods of paying for products or services online such as PayPal, VeriSign or SecurePay.
- Check your bank and credit card statements frequently and if you see any suspicious transactions contact your bank immediately.
- If you want to download an internet file, make sure it is from a reputable source. If the file is a program, for example, the file name ends in '.exe', make sure you know exactly what it will do.

¹ Galaxy Research, VeriSign Online Fraud Barometer, July 2010.

Market update

An update on Australian and global sharemarkets
from the Investment Markets Research team at Colonial First State

Australian shares – stronger on global news and solid domestic economy

The Australian sharemarket has rebounded over recent months, driven by improvements in the domestic economy and expectations of further monetary policy stimulus in the US. The profit reporting season in August was broadly supportive, but attention now turns to February 2011 to see if earnings can continue to improve on the back of the strengthening Australian economy.

As a result of this strength, the S&P/ASX 200 Accumulation Index rose 10.4% from the end of June to October 2010. Throughout this time, the equity market dealt with a hung parliament, offshore sovereign debt concerns and a weakening US economy.

The Australian economy recorded growth of 1.2% in the 2010 June quarter, with annual growth accelerating to 3.3% – the fastest pace since March 2008. Growth was driven by personal consumption and net exports. Importantly the transition from government stimulus to private demand has started and has been matched by strength in the labour market. In the 12 months to September, over 360,000 new jobs have been added, with the unemployment rate down to 5.1%. Consumer spending and the housing market continue to be the softer sides of the Australian economy, while business investment – especially within the mining sector – continues to be the strength. Around AUD123 billion of capital expenditure is expected to be undertaken in the Australian economy over the 2010–11 financial year.

The Reserve Bank of Australia (RBA) has left the official cash rate on hold at 4.5% since June 2010, given the weakness in the global economy and volatile financial markets. However, the RBA has an optimistic outlook for the Australian economy and has acknowledged that interest rates will have to move higher in the future if this scenario occurs, stating “interest rates would need to rise at some point if the economy evolved in line with the central scenario of a gradual tightening in resource utilisation, as this would most likely result in a gradual strengthening of inflation pressures”.¹ Further interest rate rises are therefore expected in late 2010 or early 2011.

1 Glenn Stevens, Governor, Reserve Bank of Australia, *Board Meeting Minutes*, 19 October 2010.

Note: Data to 8 October 2010. Past performance is no indication of future performance.

International shares – banking on the prospect of further stimulus

International shares have rallied since the end of June 2010 although investor confidence was mixed. Risk appetite remained low, with strong demand for US Treasuries and gold, while the prospects of further monetary stimulus in the US boosted equity market returns. Weak economic data releases were often followed by rallies on the equity market, as the market interpreted any weak data as increasing the chances of further quantitative easing (monetary stimulus) from the US authorities.

Also assisting gains in the equity market over the September quarter was the emergence of a large global mergers and acquisition cycle. Since June in excess of USD500 billion worth of deals were announced, the biggest in two years. This is being fuelled by cheap credit, large cash balances and attractive valuations and helped US equity markets rise sharply, with the Dow Jones (+13.5%), S&P 500 (+13.7%) and the NASDAQ (+14.2%) all recording gains.

Elsewhere, markets in Europe were mixed and largely ignored the different paces of economic growth in the region. Despite Germany's economic strength, its sharemarket underperformed the rest of Europe, rising 5.5% since June. Spain (+16.7%), the UK (+16%) and France (+9.6%) all rose strongly. Asian markets were mixed, with Japan significantly underperforming the rest of the region. The Nikkei rose 2.9% since June and is down 1.6% over 12 months. Hong Kong (+14.8%), South Korea (+11.7%), China (+28.7%) and Singapore (+12.2%) all rose.

Currencies – Australian dollar rises sharply against the US dollar

The AUD has experienced volatile movements in recent months, but has enjoyed a strong appreciation against the USD. The AUD is being supported by the strong domestic economy, the prospects of further interest rate hikes by the RBA and rising commodity prices. On the other side of the equation, the USD is weak, driven by its soft economy and prospects of another round of quantitative easing by the Federal Reserve.

Since the end of June 2010, the AUD closed as high as USD0.9942 at 14 October 2010 (briefly trading above parity on 15 October 2010), rising 16.3% on the quarter. Against the other major currencies, the AUD has risen 2.5% against the Euro, 7.6% against the Yen, 9.1% against Sterling and 6.5% against the NZD.

Your Financial Wisdom Adviser is always available to discuss any questions or concerns you may have.

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