A SELECT VIEW

WELCOME

Welcome to the first edition of a SELECT View. We have debated on whether we should produce a regular newsletter. Given there are so many newsletters produced these days there is a high risk that any messages will just get lost. On balance, we feel it is important to have a forum to express our views and provide information and ideas on issues that affect asset planning and management.

It is not our intention to crank out newsletters for the sake of it. Rather we will produce and release a SELECT View when we have something to talk about. You will notice the format contains a range of smaller 'bite size' comments wrapped around a more detailed topic of interest. Although for this issue the significance of the latest tax changes has meant we have produced a separate tax supplement. We hope you enjoy it and would appreciate your feedback or comments on any of the material.

Kind Regards

Wayne Ross & Mike Newton

IN THIS ISSUE...

SELECT ASSET MANAGEMENT

ISSUE 1 - FEBRUARY 2007

WHAT RATE OF RETURN DO YOU NEED 4%, 6%, 8%...15%?

At the centre sit the drivers of any decision making . . .

Probably one of the simplest but at the same time most perplexing questions we ask clients is what rate of return do they need to achieve (and what rate of return are they currently achieving). Not just on any one asset or business activity but for all their financial assets combined.

Some have very specific return knowledge or objectives for a business or property development activity but not on a weighted capital or investment basis across all their financial assets.

Most people are just out their doing their thing and trying to get the best return possible…whatever that is. That has worked for them in the past and should be okay for the future.

However, there comes a day when preservation of wealth starts to have a slightly greater focus and emphasis than necessarily growing it.

Most of our clients have made their wealth by taking significant risks in operating their own businesses or having a concentrated exposure to a high returning asset(s). These are high risk and high returning activities that can often generate returns in excess of 40% net p.a. or higher. Their perception of the risk they have taken is often low as they have direct control over the activity. The reality of course is different.

At some stage as the assets build to a certain value or clients want to spend less time directly running active interests, clients need to arrange the way they operate their wealth. At this point an overall asset management plan is essential to set appropriate targets for the rates of return and risk on all their capital in addition to resolving the practical issues of managing it.

Getting this planning right is critical . . .

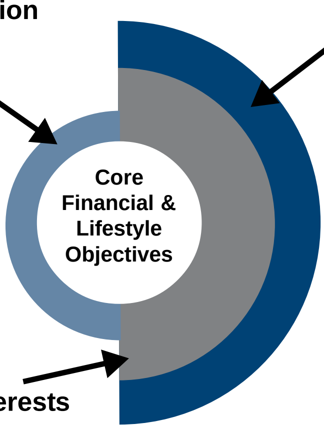
Getting this planning right is critical and it also why SELECT is so different to our competitors. We spend significant time with clients not only understanding their future family lifestyle and financial objectives but also the nature and risk / return characteristics of their active business and property interests. We look at how these assets might then be combined with other portfolio assets such as cash, bonds, shares, property, private equity and alternative assets to produce the required rates of return, risk, liquidity and cash flow. Too often we see asset planning that does not consider these direct business and property interests.

To protect long term wealth is critical to know what you need to be targeting and how to achieve it. Let's take a look at an example of how this process works. We break down client asset interests into three areas. Some clients may only have interests in one of these.

SELECT Total Asset Planning

Wealth Preservation
+5% p.a. to +15% p.a.

- Cash
- Fixed Interest
- Listed Property
- Australasian Shares
- Global Shares
- Alternative Assets



Active Interests
+5% p.a. to +25% p.a.

- Business Interests
  - shareholding/ownership
  - management
- Direct Property
  - residential, commercial, industrial
  - development
- Trading Interests
  - active share portfolio
  - derivatives
- Private Equity Interests
  - executive
  - non-executive

Philanthropic Interests
+0% p.a. to +10% p.a.

- Charitable Trusts

At the center sit the drivers of any decision making - the family lifestyle and financial needs and objectives. The family capital may currently be deployed into active business interests, wealth preservation assets and possibly philanthropic interests.

The active business interests will each have their own risk and return characteristics and we work with clients to agree what these are (this work also references available data for those industries or assets e.g. historical Auckland industrial property returns). We expect these activities to have higher return and risk expectations for capital (or else why do it?).

The wealth preservation interests represent those other ‘passive’ assets in which clients have or could invest their capital. These assets will typically have lower risk and return characteristics and be seen as a capital preservation tool for families if managed appropriately.

A portion of the family capital might also be allocated to a trust for charitable purposes. The objectives and expectations for this capital might be quite different. For example, it may have an income generation focus.

We can then calculate a risk and return profile for each of these pools of capital separately and in aggregate. Depending on the objectives of our clients this might be good enough to achieve their overall objectives, or it might not be.

Clients may inadvertently be taking too much or too little risk. For instance it may be more appropriate to retain a high portion of the wealth preservation capital in lower risk fixed income and cash assets until the active interests are sold down or capital is otherwise released from them.

Or, there may also be a better return and risk combination for the wealth preservation capital given the nature of the active assets. A more efficient combination.

It is our job to research and model the current position for clients and then to work with them to create a better optimal solution to meet their objectives.

We will review more of this work and show some practical examples in our next newsletter.

Are you a Trustee of a Foreign Trust?

There are many trusts established in NZ that have NZ trustees but no NZ settlor. These are called Foreign Trusts. They may have been set up in anticipation of new migrants coming to NZ and may hold NZ and or overseas assets.

If you are a trustee of a Foreign Trust (defined as a trust that has had no NZ resident settlor since the later of its establishment or 17th December 1987) then there are some strict new disclosure requirements you need to comply with. These rules have been brought in to address the use of NZ controlled Foreign Trusts by some overseas investors to avoid tax in their home country (the Australian Tax Office is particularly concerned) or the potential for illegal groups to use them to hide assets. The new rules require trustees to file trust and trustee information with the IRD (from the 1st October 2006) or risk facing fines up to $50,000. This information can be shared by the IRD with the tax revenue departments of other countries. Indeed NZ has to supply information where specifically requested by those countries with whom NZ has a double tax agreement (such as Australia).

If you think you might have an issue then call us and we can refer you to legal specialists in this area.

ECLECTIC SHARE PORTFOLIOS

We get to see a lot of interesting DIY share portfolios. The best ones tend to be where an investor has had the time and resources to actively research companies they have a particular interest in. They are able to ignore the emotional aspect of owning a company and will sell if circumstances change or their strategy requires it.

The weaker portfolios are more eclectic, typically built over time as a result of taking up initial public offerings and the odd share broker or friend's recommendation. The money invested in each share was what was available at the time. Little gets sold unless the cash is needed and generally there is no specific strategy for the type of shares held. The portfolio just is and just does. Whether this type of portfolio does well or not often comes down to luck.

For every investor we would recommend having a process for selecting, holding, combining and finally selling your shares. You should also have specific portfolio return and risk objectives...otherwise how do you measure if you have done well? The great returns you have been achieving may actually be pretty poor relative to the market and other alternatives. After all, if you can't beat the market why not invest passively in an index fund if net returns are the main concern.

In our experience it is well worth getting good ongoing share portfolio construction advice. Particularly in relatively inefficient markets like New Zealand and Australia where portfolio managers have often significantly and continuously outperformed the broader market.

AGGRIEVED CHILDREN

There was recently press coverage of a high profile and ongoing action by aggrieved children trying to improve their share of 'rightful inheritance'.

Where you have complex family situations, large business or single property assets, asset management succession problems or children that have widely different expectations (and probably very different personal financial positions), there is a recipe for real trouble.

The best way to head this off at the pass is to build a family asset management and succession plan that provides and reflects your future intentions and provides clear direction for everyone. The process for building the plan can provide a valuable opportunity to get all stakeholders around the table and resolve their interests (even if it disappoints them). This lets them get on with their lives as they know what they are likely to expect. It may not stop them from being aggrieved and trying to improve their position but it certainly improves the odds. Having an independent person involved during these discussions can be a great help.

Let the stakeholders know what is happening (including your fellow trustees) and don't leave it to your executors or trustees to sort out the mess. They won't thank you for it.

PO Box 2683
Shortland Street
Auckland 1015

Level 7
Old South British Building
3-13 Shortland Street
Auckland

Ph: 09 377 5777
Fax: 09 377 5772
www.selectam.co.nz
email: info@selectam.co.nz

SELECT ASSET MANAGEMENT