CAMELOT
PROFESSIONAL FINANCIAL ADVICE

CLIENT UPDATE

August 2011

IN THIS ISSUE ....

THE REAL COST OF A CUP OF COFFEE

Many years ago, back in our old Rutherford Rede Christchurch days, I wrote an article in our newsletter titled "The Real Cost of a Cup of Coffee". Recently I had cause to use the article as an example for a young KiwiSaver client who argued he couldn't afford to join KiwiSaver. After been shown how KiwiSaver worked, and hearing the coffee story, we both concluded he couldn't afford to <u>not</u> join KiwiSaver. I have dusted off the old article, updated the figures to allow for today's interest rates, today's average size mortgage, and today's cost of a large flat white. I hope you find the article interesting, even the second time around?

The average house value in Christchurch today is $386,000. If we assume our model clients, Mr and Mrs Average, purchased a home for the average price and used the average financing percentage of 66%, then the mortgage Mr and Mrs Average would have is $255,000.

The very average terms of this mortgage are:
- Mortgage Sum $ 255,000
- Mortgage Term 25 years
- 2 Year fixed rate 6.40%
- Repayments $ 787.00 per fortnight

Mr and Mrs Average love their daily flat white coffee. Their local café sells a great cup for $4.50. If they both purchased a flat white every day of the week, they would have bought 14 coffees at a cost of $63.00.

Mr and Mrs Average have a financial adviser who said to them "why don't you drink the coffee provided in the tea room by your employer free, and place the $63.00 saved per week into your mortgage?" Our model clients followed the advice and decided to increase their regular fortnightly payment from $787.00 to the new payment of $913.00 (this is the extra $63.00 per week saved by not buying coffee).

So, what did Mr and Mrs Average achieve by doing this?
1. The term of the mortgage reduced from 25 years to 18 years.
2. Total interest reduced from $256,468 to $177,762.
3. The weekly saving in interest over the 18 years mortgage is $84.00.
4. If we spread the weekly savings over the 14 cups of coffee then the real cost of that flat white is not $4.50, it is <u>**$10.50**</u> - a staggering $6.00 extra per cup!

This is not a new concept. In this case we have used a simple flat white as our example. Imagine the saving if we used a packet of cigarettes, or even a couple of glasses of wine! Now, what does this have to do with KiwiSaver? Remember the young saver who claimed he couldn't afford to join KiwiSaver and I argued he couldn't afford <u>not</u> too? If that young saver was on the average wage of $48,000, and had no mortgage, we could apply the following (post KiwiSaver changes):

- Annual Salary $ 48,000.00
- KiwiSaver Contributions 3.00%
- Employer Contributions 3.00%
  (less Superannuation Withholding Tax)
- Govt. Contributions per week $10.00
- Earnings Rate (after tax & fees) 5.00%
- Savings time horizon 25 years

The 3.00% contribution from our young saver is $27.69 per week. This is approximately the same cost of one flat white per day for the week. If our saver prudently decided not to buy his coffee, and instead placed the savings into starting a KiwiSaver account, then after 25 years he would have accrued $157,400 (in today's money using simple nominal returns and no inflationary increase in salary) for a total cost from his own contributions of $36,000. The gain over and above his contributions is $121,400. If we divide this by the 25 year term, and by the 7 cups of flat white per week, the real cost of that coffee is not $4.50, but **$17.84!!**

Anyone for Coffee?

REGULATION

As most of you will now be aware, regulation of the financial advisers industry is now in place. On the 1st July all financial advisers have to be registered with the new financial markets watchdog – the Financial Markets Authority (FMA). There are three categories of adviser under this new regime:

1. Authorised Financial Advisers (AFA's) - on the 1st July only 1,700 advisers in New Zealand had met the standards to be AFA's – those regarded as the top tier of financial adviser professionals. Only AFAs can provide advice on complex investment products and opportunities, due to their qualifications and experience.

2. Registered Financial Advisers (RFA's) - second tier of advisers, 4,000 of which were registered as at the 1st July. RFA's can provide advice on simpler products such as insurance, bank deposits and mortgages.

3. Qualified Financial Entity Advisers (QFEA's) – the third tier of advisers. There are approximately 20,000 employees working for larger financial institutions who are covered by their employers' Qualifying Financial Entity (QFE) status. QFEA's can provide advice, and recommend solutions, within the strict criteria set by their employer, and can only provide products issued or promoted by their QFE employer.

How does this impact you, our client?
Both Michael and Steve are registered as AFA's, the top tier of financial advisers practising in New Zealand. This means they have met all the educational and practice standards set by the regulator. Both Michael and Steve are also Certified Financial Planners^{CM} (CFP^{CM}), which is the highest international qualification available within the financial planning profession. They are both also Chartered Life Underwriters (CLUs) which is the highest qualification available within the personal and business risk management areas.

Both Michael and Steve therefore have to comply with all the rules and regulations set by the financial markets regulator (FMA), by our professional governing body, the Institute of Financial Advisers (IFA), and by the Chartered Life Underwriter governing body.

Some of the changes you will notice are:

1. Enclosed are new Primary Disclosure Statements for Michael and Steve. These statements are in a set format and set out what category the financial adviser is, details of our complaints procedure and what our dispute resolution scheme is.

2. Also enclosed are Secondary Disclosure Statements for Michael and Steve. These statements are again based on templates and detail how the adviser operates, what products can be advised on, what fees and charges will be levied, and what remuneration the adviser will receive.

3. Both the new Primary and Secondary Disclosure Statements replace our old Disclosure Statement. Essentially, the new replacements reveal exactly the same information as the old document they are replacing.

4. Whenever we complete a movement of funds for our clients or make a new recommendation, we will now also complete a Supplementary Disclosure. This will again spell out the fees and charges you will pay, and the remuneration the adviser will receive, as a result of the recommended transaction or the movement of funds.

Although many of these changes are minor, and certainly not substantially different to the way we have done business in the past, there will be an increase in the paperwork required. Even small changes may now require a new Scope of Service and even a new risk profile questionnaire. The objective for the regulators is to make the advice process more informative and more transparent. In this regard, I don't think our clients will find any noticeable change in how we do business.

INVESTMENT SPOTLIGHT – Heartland Building Society

This month's spotlight falls on NZ fixed interest and more specifically Heartland Building Society (trading as Marac Finance, CBS Canterbury and Southern Cross Building Society).

Heartland, comprising the former businesses of CBS Canterbury and Southern Cross and a 100% shareholding in Marac, is the primary operating subsidiary of the New Zealand Stock Exchange listed Heartland New Zealand Limited. This merger has brought together three complementary financial services businesses, each with an established heritage of providing financial services in New Zealand over many years.

Heartland will have three core divisions comprising a Retail/Consumer Unit, a Business Lending Unit, and a Rural Lending Unit. This structure more appropriately reflects the product offering and customer base following the merger. Products and services offered include lending products, term investments, home loans, finance solutions for small to medium size businesses, rural and seasonal lending products and insurance. Their stated business objective is to create a wholly NZ owned banking group with a parent company listed on the NZX.

Below is our fixed interest assessment of Heartland Building Society:

Crown Guarantee	Guaranteed under the Crown Retail Deposit Scheme until 31/12/2011. Investors choose between guaranteed and non-guaranteed deposits.
Credit Rating	BBB– (negative) from S&P. This is Investment Grade and will enable Heartland to continue along the path to become a registered bank.
Balance Sheet	• Assets $ 2,100,000,000 • Liabilities $ 1,800,000,000 • Equity $ 294,000,000
Profit	• Profit for year to 30/06/2011 (including merger costs) $7.1m • Expected profit for year to 30/06/2012 $20–24m
Funding	• Retail Deposits of $1.6b from 45,000 depositors • NZDX-Listed Corporate Bond • Committed bank facility from BNZ and Westpac for $200m • Securitisation Program
Liquidity	Maturing deposits up to 31/12/2011 $650m Current cash held $634m
Reinvestment Rates	July 2011: 75%, including 90% into non-guaranteed deposits.
New Investments	July 2011: $40m of new deposits - majority non-guaranteed.
Ownership	Heartland's parent, Heartland New Zealand Limited, is NZX listed. The parent has over 8,000 shareholders providing financial feasibility and access to capital.

Based on our analysis, we have approved Heartland for recommendation subject to the following criteria:

1. Maximum investment term – 12 months.
2. Maximum exposure to investments with Heartland – 10% of portfolio.
3. Subject to ongoing review of liquidity and reinvestment rates.

MARKET UPDATE

Given further declines in share markets following Standard & Poors' change in the US Government's credit rating to AA+, we would like to provide an update on performance of Grosvenor portfolios.

Market movements have contributed to a 14% decline in the S&P 500, month to date, while the NZ and Australian share markets are down 6% and 10% respectively.

In comparison with these movements Grosvenor multi-sector profiles have performed very well, with returns for the month to date ranging from flat (Defensive–PS1) to -6.0% (High Growth–PS5) with a Balanced Portfolio (PS3) down only 2.5%. Within a week of markets hitting their lows, they have bounced back to previous levels. This volatility is expected to continue in the short-term.

Of particular note, the lower NZ Dollar has offset around half of the decline in global share markets while insurance protection strategy has also made a positive contribution. We have been progressively locking in gains on the insurance protection strategy as markets decline.

The Income Focus Portfolios have also benefitted from gains in the Corporate Bond Portfolio, with fixed interest returns benefiting from lower bond yields. As a result the Corporate Bond Portfolio is up 1.0% and the Income Focus 18 profile is down only 0.2%, month to date.

NEW WEBSITE – www.rede.co.nz

We have set up a website for our office, separate from the main Camelot Group website. This enables us to cater the content on our website to you, our clients. The website has all our contact details (and photos), background information on us and Camelot, useful reference information on services we offer and copies of our newsletters.

Please feel free to have a look at our new website - we would welcome any feedback.

A Disclosure Statement under the Financial Advisers Act 2008 relating to Stephen Benton and Michael Shears is available on request and free of charge.

REDE ADVISERS LTD - CONTACT DETAILS

• Office	Tel: 03 964 4207	Fax: 03 357 0008	Email: rede@camelotgroup.co.nz
• Steve Benton	DDI: 03 964 4209	Mobile: 027 205 2130	Email: steve_benton@camelotgroup.co.nz
• Michael Shears	DDI: 03 964 4222	Mobile: 021 310 241	Email: michael_shears@camelotgroup.co.nz
• Jasmine Murphy	DDI: 03 964 4208		Email: jasmine_murphy@camelotgroup.co.nz

Office location: Level 1, 567 Wairakei Road, Harewood, Christchurch 8053
Mailing address: P O Box 39 100, Harewood, Christchurch 8545
Website: www.rede.co.nz