Investment and Super concepts
Brought to you by BT Wrap
For many Australians, investing may seem a daunting experience. The global financial crisis affected the confidence of many investors who now need reassurance and guidance from their financial adviser about what action to take.

We’ve developed the Investment and Super concepts kit to help you explain to investors some key concepts and strategies for successful investing.

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The long-term trend is up

→ There have been a number of major economic and political events in the past 30 years or so that have led to some sort of short-term market uncertainty.

→ After each period of uncertainty the market has recovered and then continued to grow.

→ Too often, investors lose sight of their long-term investment strategy and sell at exactly the wrong time, or they are nervous about entering into the market and put off reinvesting, which means they miss out on potential growth opportunities.

→ History tells us that despite the inevitable market ups and downs, the long-term trend in the Australian market remains up.

→ $10,000 invested in the Australian share market in December 1979 would now be worth $339,155 (peaking at $414,660 in September 2007).
The long-term trend is up

Chart overview

There have been a number of significant economic and political events over the years that have affected the direction of the Australian share market. But despite the short-term uncertainty that these events create, the long-term trend in the local market remains positive.

Value over time of $10,000 invested in Australian shares in December 1979

Assumptions: Based on annual returns to 31 December.
Source: S&P/ASX 300 Accumulation Index.
In the past 108 years, the Australian share market has generated 86 years of positive returns compared with only 22 years of negative returns.

That means an average return of 13.6% over the period.

On 74 occasions the market has managed to post gains of 10% or more. That compares with just 9 losses of 10% or more.

In the past 15 years, there have been only three years where negative returns were experienced.
The positives outweigh the negatives

Chart overview

Since 1900, the Australian share market has continued to generate strong returns for investors, with the number of positive years significantly outweighing the negative ones.

This table shows annual returns in the Australian share market from 1900 to 2009

Assumptions: Based on annual returns to 31 December.
Source: S&P/ASX All Ordinaries Index to April 2000, S&P/ASX 300 Accumulation Index thereafter.
Time, not timing, is important

→ ‘Time heals all wounds’. That’s why it’s time in the market, not timing the market that matters.

→ Timing the market means second-guessing, or choosing the best time to buy and sell. This is very difficult to do.

→ The risks of trying to second-guess market movements far outweigh the benefits.

→ Over the 10 years between December 1999 and December 2009 the Australian share market returned an average of 8.84% pa.

→ Deduct the 10 best days on the market from the 2,608 trading days in the period, and that return drops to just 4.04%. The return falls more and more rapidly as you take away more of the best trading days.

→ This highlights the importance of investing for the long-term and not getting caught up in the hype of short-term market movements.
Time, not timing, is important

Chart overview

Time has always been considered an investor’s best friend. Trying to time your entry and exit in and out of the market is one of the worst mistakes you can make. Not only is it difficult to do, but you also run the risk of being on the sidelines when good gains are made.

The impact on your returns of missing the best days in terms of returns between Dec 1999 and Dec 2009

Assumptions: Based on annual returns to 31 December 2009. Source: S&P/ASX All Ordinaries Index to April 2000, S&P/ASX 300 Accumulation Index thereafter.
Don’t chase returns

→ Whenever you see an asset class return 40%, you invariably kick yourself for not being invested a year ago.

→ But investing in last year’s winner is not always wise. Just because an asset class does well one year doesn’t mean it will do well the next.

→ Only twice in the past 15 years has the same asset class been the best performer two or more years in a row — international shares in 1997–98 and Australian listed property in 2000–02.

→ There are several things you can do to help avoid the trap of chasing returns:
  1. diversify — invest across different asset classes
  2. stick to your guns — avoid changing your investment strategy every year
  3. do your research — don’t always rely on past performance
  4. seek advice — use a financial adviser to help align your investment strategy with your goals.
Don’t chase returns

Chart overview

One of the greatest temptations when deciding where to invest your money is to choose last year’s best performer. But chasing returns like this is one of the most common mistakes investors make. It’s kind of like driving using the rear-view mirror — you can see clearly what’s behind you but not what’s in front.

Best performing asset class each year from 1995 to 2009

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<td>7.6</td>
<td>6.73</td>
<td>6.02</td>
<td>5.74</td>
<td>5.62</td>
<td>4.9</td>
<td>4.77</td>
<td>5.24</td>
<td>6.27</td>
<td>5.01</td>
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<td>3.14</td>
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<td>Property</td>
<td>9.56</td>
<td>-55.31</td>
<td>-8.36</td>
<td>34.05</td>
<td>12.7</td>
<td>32.18</td>
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<td>14.99</td>
<td>18.79</td>
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<td>18.37</td>
<td>21.76</td>
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<td>14.28</td>
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<td>Shares</td>
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<td>16.22</td>
<td>24.51</td>
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<td>27.92</td>
<td>14.96</td>
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<td>6.31</td>
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</thead>
<tbody>
<tr>
<td>Shares</td>
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<td>-2.6</td>
<td>11.49</td>
<td>16.84</td>
<td>9.94</td>
<td>-0.76</td>
<td>-27.44</td>
<td>-9.96</td>
<td>2.19</td>
<td>17.2</td>
<td>32.34</td>
<td>41.63</td>
<td>6.24</td>
<td>26.05</td>
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</tbody>
</table>

Assumptions: Based on annual returns to 31 December 2009.
Source: UBS Bank Bill 0+ years Index (Cash), UBS Fixed Interest 0+ years Index (Australian bonds), S&P/ASX 300 Property Index (Australian Listed Property), S&P/ASX 300 Accumulation Index (Australian shares), MSCI World ex Australia (Net Dividends) Standard in AS Index (international shares).
Each asset class performs better than others at some point during the economic cycle.

For example, shares tend to perform well at the upturn in the cycle while fixed interest investments tend to perform better in the latter parts.

Over the long-term, asset classes that carry higher levels of risk, eg shares, generally outperform those that carry lower levels of risk, eg fixed interest and cash.

If you invested $1,000 in Australian shares on 31 December 1984 it would have been worth $18,439 in December 2009, whereas $1,000 invested in Australian bonds would only be worth $10,514.
Asset class returns

Chart overview

Asset class refers to a type of investment — generally shares, property, fixed interest or cash. Each of these asset classes comes with its own level of risk and performs differently depending on the prevailing economic and political conditions.

The performance of $1,000 invested in different asset classes — since 31 December 1984

Assumptions: Based on accumulated annual returns to 31 December 2009.
Source: UBS Bank Bill 0+ years Index (Cash), UBS Fixed Interest 0+ years Index (Australian bonds), S&P/ASX 300 Property Index (Australian Listed Property), S&P/ASX All Ordinaries Index to April 2000, S&P/ASX 300 Accumulation Index thereafter (Australian shares), MSCI World ex Australia (Net Dividends) Standard in A$ Index (international shares).
The dangers of looking at short-term performance

→ In 2002, the Australian share market fell by 8.6%, meaning if you’d invested $10,000 at the beginning of the year it would only be worth $9,140 at the end of it.

→ If you’d sold out of the market at the end of 2002, you would have realised an $860 loss.

→ However, if you’d stayed in the market for the long-term (31 December 2008), you’d have recouped the $860 you lost and gained a further $4,539.

→ If you held on to that investment for another year until December 2009 you would have made another $5466.00.

→ It’s important to remember that although you might lose money in the short-term, you generally make a gain over the long-term.
The dangers of looking at short-term performance

Chart overview

History shows us that short-term ups and downs in investment returns are greatly diminished over longer timeframes of between five to seven years or more.

Short-term pain...

Movements viewed over a longer period — 2001–2009

Assumptions: Based on annual returns to 31 December.
Source: S&P/ASX 300 Accumulation Index.
Focus on the long-term

- Maintaining a long-term view to investing is critical to achieving your financial goals.

- Over the past 30 years, Australian shares have provided negative returns in nine individual years. But over the full period, the average annual return from Australian shares was 16.5%.

- There will always be Wall Street crashes and recessions, but focusing on these and buying into the headlines they create will do little for your portfolio.

- Staying invested over a long period of time, eg seven years or more, substantially reduces the volatility associated with riskier asset classes such as shares.

Note: The reason the average return figure is different from the previous chart ‘The positives outweigh the negatives’ is that in that chart the average was calculated for the period 1900–2009 and this chart averages returns for 1979–2009.
Focus on the long-term

Chart overview

As hard as it is sometimes to stay calm when the market falls, being invested for the long-term remains an essential investment strategy.

Average annual return 16.5%

Annual returns of Australian shares between 1979 and 2009

Assumptions: Based on annual returns to 31 December 2009.
Source: S&P/ASX All Ordinaries Index to April 2000, S&P/ASX 300 Accumulation Index thereafter.
The economies of most developed countries move through what is known as the ‘economic cycle’.

Certain asset classes, such as shares, property and bonds, perform differently depending on which stage of the economic cycle we’re at.

Six o’clock represents the low point of the economic cycle. It is usually characterised by weaker share prices and falling property values resulting from poor business confidence and tighter monetary conditions.

Six o’clock to midnight represents a recovery period and is generally characterised by rising share and commodity prices, and easier monetary conditions. However, as the market nears midnight — the peak of the cycle — we also begin to see the first signs of the inevitable market correction.

Midnight to three o’clock generally sees a shift away from the share market in favour of property as share and commodity prices begin to correct, or fall.

Three o’clock to six o’clock is a period characterised by poor demand and tightening monetary conditions. It’s a time when investors generally find little value in either shares or property and so begin to favour bonds.
The economic clock

Chart overview

The economic clock combines a number of key economic indicators, including interest rates, property and the share market, to illustrate the sequence of events in the economic cycle that influence the value of different asset classes.

Source: BT Financial Group.
Presentation notes: Risk versus return

- Generally speaking, the higher the risk, the higher the return (and vice versa).
- Different assets carry different levels of risks.
- *Growth assets*, eg shares and property, carry higher levels of risk but have the potential to generate higher returns.
- *Defensive assets*, eg bonds and cash, carry lower levels of risk but tend to produce lower returns.
- Investors have different risk tolerances.
- There are two key strategies you can use to help reduce the level of risk in your portfolio:
  1. *time* — investing for the long-term reduces the effect of short-term market volatility
  2. *diversify* — spread your investments across different parts of the market.
All investing involves a trade-off between risk and return. Risk is simply an indicator of the potential gain or loss associated with an investment. It is often referred to as volatility. The more volatile an investment is, the greater the fluctuations in return from month-to-month or year-to-year will be.

This graph shows a typical mix of defensive and growth assets in an investor's portfolio at different levels of risk tolerance.

Source: BT Financial Group.
The importance of diversification

→ Every asset class has its time in the sun.
→ Diversification is a simple concept: spread your investments across different parts of the market.
→ This reduces the overall level of risk in your portfolio since a fall in one asset class may be offset by a gain in another asset class.
→ There are three main levels of diversification:
  1. asset class, eg shares, property, bonds and cash
  2. individual investment securities, eg individual companies, sectors and even countries
  3. investment manager, eg some investment managers are better than others.
→ By diversifying your investments, you give yourself a better chance of achieving a sound overall return.
The importance of diversification

Diversification is a powerful way to reduce risk, though it’s surprising just how many investors overlook it. We know that various investments perform better at different times, so investing across different parts of the market means you have a much better chance of achieving a sound overall return.

Best performing asset class in each year

Assumptions: Based on annual returns to 31 December.
Source: UBS Bank Bill 0+ years Index (Cash), UBS Fixed Interest 0+ years Index (Australian bonds), S&P/ASX 300 Property Index (Australian listed property), S&P/ASX 300 Accumulation Index (Australian shares), MSCI World ex Australia (Net Dividends) Standard in A$ Index (international shares.)
Dollar cost averaging

→ Put simply, dollar cost averaging lets you make small investments over a longer timeframe.

→ It’s intended to have the effect of lowering the average price paid for an investment. Put another way, it lets you buy fewer units when the price is high, and more units when the price is low.

→ It also means you don’t have to try to time the market.

→ Imagine investing $100 each month for a year into a managed fund that has an initial unit price of $10.

→ During that period, the market falls — causing the fund’s unit price to drop — before it eventually recovers its original value.

→ At the end of the year you have 138.5 units worth $10 each, so you have $1,380.50. You invested $1,200, so your capital growth is $180.50 even though the unit price is the same as when you first invested.

→ Average unit price paid is $8.75.

→ Most fund managers offer regular investment plans that allow you to make small monthly contributions to a managed fund, which is effectively dollar cost averaging at work.
Dollar cost averaging is a smart and simple approach to investing. With dollar cost averaging, you don’t have to focus on where share prices or economies are headed. You simply invest a set amount of money on a regular basis over a long period of time.

Value gained by investing regularly and benefiting from dollar cost averaging

<table>
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<th>Month</th>
<th>Investment</th>
<th>Unit price</th>
<th>Units purchased</th>
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<td>10.0</td>
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<tr>
<td>February</td>
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<td>March</td>
<td>$100</td>
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<td>April</td>
<td>$100</td>
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</tr>
<tr>
<td>Total</td>
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<td>138.5</td>
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<tr>
<td>Total sum invested</td>
<td>$1,200</td>
<td>Total value of investment</td>
<td>$1,380.50</td>
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</table>

Assumptions: Table is for educational purposes only. It is not representative of any particular investment product. No allowances have been made for inflation, taxation, fees or expenses.

Source: BT Financial Group.
This chart depicts $100,000 invested in January 1980 in Australian shares (Industrials Index) vs term deposits for 28 years.

The chart shows both the capital growth and dividend income derived from shares and the income derived from term deposits.

As you can see shares achieve a greater capital growth with the $100,000 invested in 1980 growing in value to over $1 million in 2009.

Capital value of term deposit does not change.

Shares returned over four times the amount of dividend income compared to the interest paid by the term deposits.
Shares vs cash

Comparison of $100,000 invested in Australian shares vs term deposits

1980–2009
Total income received from shares = $1,074,828
Total income received from term deposits = $243,750

The power of reinvestment

- Reinvesting is a simple way to significantly increase the value of your investment.

- Imagine Investor A invests $5,000 in a managed fund when she’s 21 and then adds $1,000 to it each year until she turns 30. Then she stops investing altogether, except for reinvesting her investment income.

- When she hits 65, the $14,000 total she initially invested would be worth $332,413.

- Now let’s imagine an alternative scenario where Investor B invests $5,000 in a managed fund when she’s 31 and then adds $1,000 to it each year until she turns 65 (dividends re-invested).

- That’s a total investment of $39,000 over 35 years, yet it would be worth only $227,077.

- By reinvesting, your investments accumulate a lot faster while also increasing your potential to earn even more returns on your growing balance.
The power of reinvestment

Chart overview

By reinvesting investment income, whether it be a distribution from a managed fund or an interest payment from a term deposit, you give yourself a greater chance of achieving a better return over the long-term.

Benefits achieved over time by reinvesting investment income

Investor A invests $5,000 at age 21 and then adds $1,000 every year until turning 30, then reinvests dividends only. Investor B invests $5,000 at age 31 and then invests $1,000 every year until turning 65 (also reinvests dividends).

Assumptions: Based on annual returns of 8% pa reinvested. No allowances have been made for inflation, taxation, fees or expenses. Source: BT Financial Group.
Don’t wait until tomorrow

→ We know that time is an investor's best friend.
→ History shows us that the longer you're invested, the better off you will be.
→ If you had invested $10,000 in a managed fund 20 years ago it would now be worth $46,609.
→ Compare that with having invested $10,000 in the same fund just 5 years ago. Today it would only be worth $14,693, or $31,916 less than if you’d decided to invest 20 years ago.
Don’t wait until tomorrow

Chart overview

Putting off investing can cost you a lot of money in the long run, which is why it’s important to start investing early.

Investing $10,000 in a Managed Fund.
The earlier you start, the bigger your balance.

Assumptions: Average annual returns of 8% and 4% reinvested. No allowances have been made for inflation, taxation, fees or expenses.
Source: BT Financial Group.
How much is enough?

- The maximum Government Aged Pension affords only basic living, paying singles $14,814.50 and couples $12,373.40 each a year.
- The introduction of the Government’s Superannuation Guarantee contributions encourages us as individuals to take greater responsibility for funding our own retirement.
- It also means that our standard of living in retirement will be significantly affected by how the assets in our super fund perform.
- Consequently, we need to ensure that we are properly engaged in our super.
- Super might be a long-term investment, but it’s important to consider now just how much you might need when you do retire.
- If you are a female and wish to retire at age 60 and have an annual income of $35,000 per year, then you will need to have saved around $580,000 in super to maintain this income level in retirement.
- If you are a male and wish to retire at age 55 and have an annual income of $25,000 per year, then you will need to have saved around $420,000 in super to maintain this income level in retirement.
- Will you have enough money when you retire?

1. Figures correct as at 20 March 2009, not including Pharmaceutical Allowance.
How much is enough?

Table overview

The Superannuation system in Australia has evolved such that individuals are encouraged to save towards their retirement to either supplement or replace the age pension. But just how much money will we need when we do decide to retire?

How the numbers stack up

The following table is a guide as to how much you need to have saved at retirement (depending on your retirement age) to achieve a certain income each year in retirement. Women generally need to save more because their average life expectancy is longer.

<table>
<thead>
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<th>Super lump sum needed to provide your required income level in retirement</th>
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<td><strong>Female</strong></td>
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<tr>
<td>Income required</td>
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<tr>
<td>$25,000</td>
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<td>$45,000</td>
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<tr>
<td>$25,000</td>
</tr>
<tr>
<td>$35,000</td>
</tr>
<tr>
<td>$45,000</td>
</tr>
</tbody>
</table>

**Assumptions:** The calculation assumes that:
(1) the whole amount is invested in a superannuation fund at the assumed retirement age.
(2) Total investment returns on the fund at 7% pa after any associated expenses and tax.
(3) Income is required for a period of years equal to the expected lifetime of the recipient. Expected lifetime is calculated depending on gender and age at retirement using current mortality rates.
(4) Income increases each year at the rate of 3% pa. Calculations are for illustrative purposes only. Mortality rates used are from: Australian Bureau of Statistics Cat. No. 3302.0.55.001 Life tables, Australia, 2003–2005. The projections given are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the projections are based are reasonable, the projections may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these projections.

**Source:** BT Financial Group.
Topping up your super

- Making additional contributions to your super fund can have a significant impact on how comfortable you are in retirement.

- Salary sacrificing is an easy way to top up your super fund.

- Contributions can be made from your pre-tax salary and because they’re taxed at just 15% in most cases, salary sacrificing can not only boost your retirement savings but it can also be a useful tax-effective investment strategy.

- If you had an initial super balance of $10,000 when you were 25 years old and topped it up with $1,000 each year, when you retired you would have $476,302.

- Compare that with how much you would have if you didn’t top up your super at all over the period ($217,245) and the difference is $259,057.

- And the sooner you start topping up your super, the better off you will be.

- If you had an initial super balance of $30,000 when you were 45 years old and topped it up with $1,000 each year, when you retired you would have $185,591. That’s considerably less than if you started at age 25 with an initial balance of only $10,000.
Topping up your super

Chart overview

If you’re employed full-time, the compulsory superannuation guarantee generally ensures your employer contributes 9% pa of your salary to your super fund (up to a maximum limit). However, topping up your super by making additional contributions can make a big difference to your financial security in retirement.

Assumptions: Based on annual returns of 8% pa. Contributions made from pre-tax salary. No allowances have been made for inflation, taxation, fees or expenses. Retirement age is 65.
Source: BT Financial Group.
Consolidating your super

Example highlights two of the three key benefits of consolidating your super:
1. the impact that paying less administration fees has on your overall super balance
2. the greater growth potential that comes with compounding returns.

However, there are a couple of things to consider before you decide to consolidate your super:
1. exit fees — some super funds charge exit fees. Depending on the number of super funds you have, exit costs could end up being higher than your total savings in administration fees
2. insurance — moving money out of a super fund will usually be discontinued. You may have the option to take up the policy outside of super.
Consolidating your super

Overview
If you’ve had more than one job in your life, then there’s a good chance that you have more than one super fund. Having more than one super fund means paying more than one set of fees. It can also limit how much your super can grow over the long-term.

3 key reasons to consolidate your super

1_Less administration fees
Generally speaking, the bigger your super balance the smaller the proportion of fees you’re charged for the account. So if you have more than one super account, you are paying a number of account fees. You can reduce the total amount of fees you pay by creating one super account with a larger balance.

2_Greater growth potential
Consolidating gives your super the potential to really grow. With the power of compounding returns, the money you save in fees could really help grow your super balance.

3_Less paperwork
Having one super account means you only have one set of paperwork to manage. This could make it easier to keep on top of your super and understand exactly how it’s performing.

Example
Let’s imagine Investor A has one super fund with a balance of $10,000 while Investor B has five super funds, each with a balance of $2,000. Both investors pay an annual administration fee of $60 (per fund in the case of Investor B).

Over 30 years, Investor A’s super balance would be $93,830 compared to Investor B’s balance of just $66,642. That’s a difference of $27,188 over the period, simply because Investor A decided to consolidate.

Assumptions: Example — based on annual returns of 8% pa. No allowances have been made for inflation or taxation.
Source: BT Financial Group.
Are you properly insured?

- Australians are significantly underinsured.

- The right mix of insurances can protect you and your family from financial distress in the event of a serious accident, illness or death.

- For less than the cost of buying a coffee every day, you can get life insurance cover of around $750,000.

1. Figures correct as at March 2009.
Are you properly insured?

Overview

Most financial experts agree that insurances such as income protection, life insurance, trauma cover and Total and Permanent Disability (TPD) are fundamental to any good financial plan. Yet the gap between the life cover Australians have and what they need is estimated at around $1.37 billion.¹

The numbers...

- heart disease kills one Australian every 10 minutes and affects 2 out of every 3 families²
- 42,000 Australians are expected to die from cancer in 2009 alone³
- there are over 5 million families in Australia with dependent children⁴
- 96% of Australian families lack enough life insurance to protect their families for 10 years or more.⁵ That means only 4% of families are adequately covered
- someone in their mid-30s with two young children and earning around $50,000 pa will need life insurance cover of between $500,000–$650,000,⁶ or 10–13 times their annual pre-tax income.

... and the insurance you need

<table>
<thead>
<tr>
<th>Insurance</th>
<th>What it does</th>
<th>What it costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life</td>
<td>Pays your beneficiaries a lump sum when you die</td>
<td>Around $2 a day for $750,000 cover</td>
</tr>
<tr>
<td>TPD</td>
<td>Pays you a lump sum if you are unlikely to work again due to a total and permanent disability</td>
<td>Around $3 a day for $750,000 cover</td>
</tr>
<tr>
<td>Trauma</td>
<td>Pays you a lump sum if you suffer a specified and serious illness</td>
<td>Around $7.20 a day for $500,000 cover</td>
</tr>
<tr>
<td>Income protection</td>
<td>Replaces around 75% of your income if you are sick or injured and can’t work</td>
<td>Around $1 a day for monthly income protection of $3,000</td>
</tr>
</tbody>
</table>

Assumptions: The cost of insurance will depend on individual circumstances and insurance needs. All costs examples are for a 45 year old non-smoking female, except income protection where the case study is a 45 year old female. All rates are approximate, assuming no loadings and exclusions. Policy fees and stamp duty are excluded and costs are to be considered a guide only. Rates are for policies written for BT Insurance on SuperWrap or Wrap Platforms.

Source: BT Financial Group.

5. TNS Research, Investigating the issue of underinsurance in Australia, August 2005.
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