

**Tech**Connect



## Financial planning strategies with the **Challenger Capital Guaranteed Income Fund**

We are very pleased to announce the addition of a new managed fund option with three classes on all IOOF platforms - Pursuit, IOOF Portfolio Service and LifeTrack. This new managed fund is unit linked but the underlying investments are in guaranteed annuities with varying maturity date options.

The Challenger Capital Guaranteed Income Fund (GIF) is like an annuity with 100 per cent Residual Capital Value, but through a managed fund. Interest rates are set at commencement and income from the underlying annuities are distributed to investors in the managed fund on a monthly basis.

Since the Challenger GIF has a 100 per cent Residual Capital Value at maturity, the unit price on maturity will be \$1. However, on application, it will vary<sup>1</sup> from the \$1 unit price on maturity to take into account current interest rates and income accrued.

The income from the underlying annuities is guaranteed by a Life Office (Challenger). Investors can also withdraw from their investment early if required, as the underlying annuities are commutable given they are in a managed fund structure.

Consequently, the Challenger GIF may be attractive to those investors keen on income but cautious about liquidity issues in the light of recent events with mortgage funds and the global economic crisis.

This strategy paper will focus on the financial planning strategies available for your clients with the Challenger GIF.

## Financial planning strategies

### Strategy 1: Structuring an account based pension

This can be a great investment option for your client's pension accounts as they provide monthly distributions to support the payment of their pension.

General investment rules of thumb when structuring a pension account are:

- do not rely on selling growth assets to pay a pension for at least three years;
- do not rely on dividends or distributions from growth assets to pay a pension for current year;
- make provision for emergencies, income shortfalls and one-off lifestyle expenses; and
- dividends and distributions should generally be paid into cash account and not reinvested.

To structure a pension account in line with the above rules of thumb, let's visit Peter the pensioner.

Peter, aged 65, has just retired and is looking for advice to support his retirement income needs of \$30,000 p.a. to cover his living costs. He has an accumulated superannuation account balance of \$700,000 with no other investment assets except a bank account with a current balance of \$25,000.

His balanced investor profile means that his portfolio of \$700,000 will be invested in

a diversified portfolio with a 30 per cent allocation to defensive and 70 per cent growth assets. In dollar terms this will be \$210,000 and \$590,000 respectively.

Table 1 outlines how the defensive asset allocation will be used to assist in the payment of years one to three income needs for Peter.

**Table 1: Investment structure – for defensive asset allocation**

Investment portfolio	\$	% of investment	Income (\$)	Comments
Challenger GIF – 7.10% - Maturity 30 June 2013	150,000	21	10,650	One third of annual pension income provided
Cash	20,000	3	20,000	Cover first year income requirements
Term deposit	40,000	6	40,000	Can invest in a range of 6 and 12 months term deposits to cover the second and third year income requirements
<b>Total</b>	<b>\$210,000</b>			



**Sam Rubin**  
Senior Technical  
Services Manager

**Strategy 1 note:** for Pursuit accounts, it is important to ensure the Distribution Instruction is not set to the default of 'Reinvest'. If it is, the distributions will automatically be reinvested back into the Challenger GIF and your strategy to utilise these funds to provide for pension payments will not work.

<sup>1</sup> The maximum variation in the PDS is 5% of the \$1 unit price.

The remaining 70 per cent of the portfolio will be invested in growth assets and assuming an average income exposure of 2.5 per cent, should provide additional annual cash of \$17,500 p.a. Over a three year period, this will equate to around \$52,500 to assist in the payment of year four and five income needs.

This process can be repeated for years five to ten by reducing the Challenger GIF investment to \$100,000 with the remaining \$50,000 invested in cash and term deposits.

Assuming an annual six per cent growth rate on Peter's growth investments, his portfolio in 10 years should be valued at around \$880,000 whilst satisfying his income needs.

Structuring Peter's pensions this way will remove the short term reliance on income from growth assets. Another added advantage is that Peter shouldn't have to worry about any future issues with frozen funds whilst having around one third of his annual pension requirement being distributed monthly to assist in the payment of a pension.

### Strategy 2: Long term investment power - compound interest for defensive assets

As a default for Pursuit accounts, the monthly distributions are automatically invested back into the distributing Fund. This provides the power of accumulation – interest on interest – and over the long term this can be more profitable than a term deposit due to the nature of interest payments received at maturity.

**Example** Let's assume that your client has the option of investing in either the Challenger GIF at 6.30 per cent with a maturity date of 30 June 2011 or a term deposit offering the same return over the same period.

Assuming the initial investment was \$100,000 and your client didn't require any income payments, their net return with the Challenger GIF would really be 6.485 per cent p.a.

### Strategy 3: Client portfolio defensive asset exposure

The Challenger GIF can be assessed as a defensive asset and can be used to cover a client's defensive asset exposure which usually includes cash, Australian fixed interest and international fixed interest exposure.

You may consider this investment option as complementary to or an alternative for your clients investing in a term deposit. The Challenger GIF<sup>2</sup> may provide a higher return than traditional term deposit and a fixed interest managed fund, especially when you incorporate the effective rate of return based on the example above.

As the Challenger GIF's unit price is around \$1 per unit, there is minimal capital downside risk compared to some of the other fixed interest products available on the market that may offer higher yields.

### Strategy 4: Income stream guaranteed by Challenger (a Life Office)

The monthly income distributions of the Challenger GIF are provided through annuity income guaranteed by Challenger as a Life Office. Therefore, your clients are reducing the risk that has recently happened with some mortgage funds (used previously to provide income to a portfolio as these funds provided higher returns than traditional fixed interest products) which have become frozen and illiquid.

### Strategy 5: Utilise to support a gearing strategy

The Challenger GIF can provide the cash flow required to support a positive gearing strategy in your client's personal name outside of superannuation. A positive gearing strategy may be appropriate where a client has their own capital to invest outside of superannuation but also wish to maximise the long term return of the portfolio by topping up the capital of the initial investment with gearing.

This type of strategy will generally be appropriate for a growth or higher risk profile and based on a minimum seven year investment horizon.

<sup>2</sup> The application unit price will be determined by prevailing interest rates and income accrued at the date of purchase and may be marginally above or below the \$1 unit price. Variations to the purchase unit price may fluctuate up/down five per cent from the \$1 unit price.

**Example** Geoff, aged 40, has \$200,000 of capital to invest and would like to utilise an additional \$50,000 of borrowed funds via one of the margin lending providers available on the Pursuit Select Investment account.

Geoff would **not** like to capitalise the interest costs against the margin loan and would like the funding to come from the investment. The borrowing costs from the margin lending facility are based on an 8.5 per cent annual interest cost. Given his growth risk profile, he will still need to invest around 15 per cent of his total portfolio in defensive assets.

This comes to \$37,500 of the capital of the total portfolio.

Geoff can invest the \$37,500 into the Challenger GIF of 7.10 per cent with a maturity date of 30 June 2013. This means the income received would be \$2,662.50 p.a. in income which covers 62.65 per cent of the annual interest costs. The remaining costs could be covered by additional surplus cash flow if Geoff wished to reinvest into his growth assets or he could use a proportion of the income generated from the growth assets.

This strategy generally will not be viable if you want to use borrowed funds to invest in the Challenger GIF given the current maximum return is 7.10 per cent versus a lending cost via one of our margin lending providers of approximately 8.50 per cent p.a.

### Strategy 6: Challenger GIF vs. traditional annuity

The Challenger GIF offers the benefit of regular income with the added benefit of a unitised product. Generally, the problem with traditional annuity products - especially in today's environment, given no requirements to invest in complying income streams for Reasonable Benefits Limits or social security benefits - is the illiquid nature of the product.

This new product (Challenger GIF) is liquid and should be actively managed based around the Government's monetary policy. This is especially important with the industry's move to fee for service and advisers having to sell their own value proposition to their clients.

For example, if we see cash rates move to 5.50 per cent over the next 12 months, you would assume that the Challenger GIF of 6.75 per cent with a maturity date of 30 June 2012 should be offering a higher return, so you could consider moving your clients' funds into the fund offering the higher return.

### New funds

APIR code	Fund name	Distribution cents per unit	Maturity date	Maturity unit price
HOW0057AU	Challenger Guaranteed Income Fund - 6.30 cents p.a. 30 June 2011 (MV\$1)	6.30 p.a.	30 June 2011	\$1.00
HOW0058AU	Challenger Guaranteed Income Fund - 6.75 cents p.a. 30 June 2012 (MV\$1)	6.75 p.a.	30 June 2012	\$1.00
HOW0054AU	Challenger Guaranteed Income Fund - 7.10 cents p.a. 30 June 2013 (MV\$1)	7.10 p.a.	30 June 2013	\$1.00

### Summary

The Challenger GIF offers advisers and their clients greater flexibility in structuring their portfolios. The fund offers all the benefits of managed funds with the guarantee of a monthly income payment.

This fund provides greater competition in the fixed interest market to support your pension clients but may also be appropriate for many other client scenarios.



IOOF **TechConnect** provides a comprehensive range of technical support tools for professional financial advisers.

You can contact the **TechConnect** team - Sam Rubin, Pam Roberts, Michael Forer and Damian Hearn - via your IOOF Business Development Manager, by calling Adviser Services on 1800 659 634, or emailing [techconnect@ioof.com.au](mailto:techconnect@ioof.com.au)

### For financial adviser use only

This booklet is issued by IOOF Investment Management Limited (IOOF), ABN 53 006 695 021, AFS Licence No. 230524, as Trustee of the IOOF Portfolio Service Superannuation Fund (ABN 70 815 369 818) and the Lifetrack Superannuation Fund (ABN 39 716 243 898) and as Service Operator of the IOOF Investor Directed Portfolio Services. IOOF is a company in the IOOF Group of companies (IOOF Group) comprising IOOF Holdings Limited (ABN 49 100 103 722) and its related bodies corporate. This booklet is intended for financial adviser use only. It contains factual information and general financial product advice only and has been prepared without taking into account your or your client's individual objectives, financial situation and needs. The information in this flyer is not intended to be a substitute for professional financial product advice and you and your clients should determine its appropriateness having regard to your or your client's particular circumstances. The product disclosure statement (PDS) or IDPS Guide should be obtained before deciding whether to acquire, dispose of, or continue to hold an investment in an IOOF product. For all open products, copies of these documents can be downloaded from IOOF's web site ([www.ioof.com.au](http://www.ioof.com.au)).

Find out more

For more information please contact your Business Development Manager or [adviserservices@ioof.com.au](mailto:adviserservices@ioof.com.au) ☎ 1800 659 634 ✉ GPO Box 264 Melbourne VIC 3001