

# How the rich differ from the rest



**ANTHONY KEANE**  
MONEY EDITOR

WHAT is "rich"? Ask 10 people and you will get 10 different answers.

A common definition is a person with at least \$US1 million in assets not including the family home.

Financial services group Perpetual's private client business works with people who have at least \$500,000 in investment assets.

Hood Sweeney Securities director Matthew Rowe says the recent BRW Rich 200 survey had a cut-off point of \$200 million to qualify as being among the 200 wealthiest Australians, and each had an average wealth of \$698 million.

Ord Minnett client adviser Tony Catt says "rich" should not be used to define a financial state.

"I know some very wealthy people who aren't rich in other areas of their life, such as emotional and family," he said.

For the purposes of this article, "rich" is defined as a person with buckets of money, zero or very little personal private debt and the financial freedom to buy what they want when they want.

In other words, very few of us. "The rich are normal human beings, but with bigger wallets, and invest in much the same sectors and asset classes - property and shares - as most investors do, but on a much bigger scale," said Bourke Shaw Financial Services principal Lawrence Orlando.

"There is no desire to have huge holdings in cash or fixed interest investments that have an earning capacity of 4-5 per cent. These asset classes are generally used as short-term parking bays," he said.

The 2008 World Wealth Report by Capgemini and Merrill Lynch found that in 2007, 10.1 million people held at least \$US1 million in financial assets.

It found that equity - or shares - was their biggest investment, with 33 per cent of money allocated to this asset class. Fixed income had 27 per cent, cash 17 per cent and property 14 per cent, while only 9 per cent of their money was in alternative investments such as hedge funds.

Prescott Securities financial adviser Mark Mackintosh said it was often presumed that wealthy investors chose unusual investment options such as wine and art.

"Wine and art are collected more for personal interest or pleasure than as a pure investment strategy," he said. "Our high-net-worth investors make similar investment decisions as so-called mum-and-dad investors. The difference is often only in the amount of money they choose to invest."

"Australian shares and property

## HOW DO FAMILY TRUSTS WORK?

Family trusts - known as discretionary trusts - are a vehicle used to hold a family's assets or conduct a family business.

They are a separate legal entity and can protect a family's assets against creditors and lawyers.

Family trusts also allow investment income to be split between beneficiaries, so those family members on a lower tax-free threshold - such as stay-at-home

carers or children - can receive more income than a wage earner on a higher tax rate.

The costs of setting up a family trust can vary widely, but generally range between \$500 and \$2000.

A family trust will usually be recommended by an accountant, but preparation of the trust deed is done by a solicitor.

Sources: Hood Sweeney Securities, Bourke Shaw Financial Services

are popular with many of our clients who have substantial sums of money to invest. Direct investment in high-risk stocks or private equity usually represents only a very small proportion of their portfolios, in many cases just 5 per cent.

"Wealthy people want to preserve their assets as well as keep building wealth. They are patient accumulators of assets that generate solid income. Within shares, it's the blue-chip Australian companies with a good track record of growth and paying dividends that are most favoured."

International shares and residential and commercial property were other investment destinations, Mr Mackintosh said.

Founder of website Money 100 Peter Grey said wealth was "mainly the result of a lifestyle of hard work, perseverance, planning

**“Wealth is the result of hard work, perseverance, planning and self-discipline**

and, most of all, self-discipline”.

Mr Grey said common characteristics of wealthy people included:

**LIVING** well below their means all their lives.

**ALLOCATING** time, energy and money to increasing their wealth.

**BELIEVING** that financial independence was more important than displaying a high social status.

**THEIR** parents did not provide financial handouts.

"They are extremely focused and passionate about their business or occupation and about earning strong income from that. They are also driven to live within their means, which enables them to invest on a regular basis," Mr Grey said.

Hood Sweeney's Mr Rowe said there was no "simple magic bullet" available only to rich people that was not available to others.

"Private equity and hedge funds used to be the domains of the rich

with us since 1860 - it goes back six generations. Anecdotally, in South Australia there is a higher proportion than interstate of long-term family wealth."

Mr Hender said rich people planned "inter-generationally".

"We average folk plan for our own retirement and security, and it's nice if you can leave something for the kids," he said.

"The wealthy do take inter-generational planning seriously, because they have the capacity to do it."

Structures such as discretionary trusts - also known as family trusts - self-managed superannuation funds and private companies were common tools.

"There is also a perception that wealthy people are not philanthropic. Our experience is the reverse," Mr Hender said.

"There is a concept of giving back and a concept of creating structures for giving long term,

such as gift funds and building bequests into their wills."

A strategy that many home owners can follow is using their home as a building block for wealth. "One thing becoming more popular is taking advantage of the equity in the home for gearing," Mr Hender said.

People can use their home as security to borrow to invest in assets such as property, shares and managed funds, as long as it suits their risk profile.

Rich people often own more expensive homes and, with capital gains on the family home tax-free, they enjoy bigger windfalls when they sell than someone whose home is at the median house price.

Financial Planning Association SA chapter chair Kerrin Falconer said wealthy people were not immune to failure. "While they have the cushion of existing wealth to absorb the failures, it is also their attitude that helps them continue to build wealth despite a downturn or a failure," she said.

"They usually learn from their mistakes. If, for example, a wealth investor had invested in a stock that performed dismally, such as Allico Finance Group, ABC Learning Centres or Babcock & Brown, they do not turn their backs on the share market altogether and say 'I'm never going to invest in the share market again'."

"They analyse the situation, learn and go from there. That is also the benefit of a diversified portfolio, as not all investment funds are concentrated in one stock or one property."

Ord Minnett's Mr Catt said wealthy people typically used direct investments for shares and property.

"Not just residential property - it's also commercial properties and industries properties," he said.

"It's the tax control they want. They much prefer to control their own tax destinies."

Mr Catt said wealthy people took a more global view of investing, taking bigger risks in emerging economies such as China.

"They can afford to do some speculation in those countries because they don't rely on an income stream," he said. "They are looking for growth, and are prepared to give it a long time."

Wealthy people were much like everyone else in that they wanted value for money and good returns "without shooting the lights out", Mr Catt said.

"And they get upset as much as everyone else with under-performance," he said.

"However, they have been through market cycles more and expect bad times. They don't do things with their heart - they react with their head."



## WHERE THE WORLD'S WEALTHY LIVE

High net worth individuals are those with at least \$US1 million of financial assets.

North America .....	3.3 million
Europe .....	3.1 million
Asia-Pacific .....	2.8 million
Latin America .....	400,000
Middle East .....	400,000
Africa .....	100,000
<b>Total .....</b>	<b>10.1 million</b>

Source: Capgemini/Merrill Lynch World Wealth Report 2008

## Don't wait to win lotto, think big to get rich



**anthony KEANE**

I MUST admit I was a little disappointed, when researching this week's theme, to discover there is no secret way to get rich.

However, it did reinforce my theory about why the rich get richer: They have a lot more money than everyone else.

While stating the obvious, this is an important key to building wealth. To make big money, you need big money.

But "big money" doesn't have to be cash and, for tax reasons, it's often better to be property or shares, which have delivered strong returns over the long term.

Australian shares and South Australian residential property have both increased more than 800 per cent in the past 25 years.

In 2000, the median house price in Adelaide was \$130,500. Today, it's more than \$350,000.

So someone who bought a typical Adelaide home eight years

ago has made \$200,000, simply by being a home owner. But rich people are not satisfied with just that.

Why own one house, when you can use the growing equity in it to invest in three, or four, or 10 houses?

So instead of making \$200,000 in eight years, they make up to \$2 million. Of course, there are risks involved, but the rich are happy to take calculated risks because they've seen market booms and busts before.

Shares have been pummelled since November last year amid global financial market worries,

but they will eventually bounce back. History says shares bounce back strongly, often by 20-30 per cent in the 12 months following a bear market.

The winners from this current bear market will be the investors who have picked up quality stocks at bargain prices.

Remember that \$1000 growing at 10 per cent a year makes \$100 a year. But \$100,000 growing at 10 per cent makes \$10,000, and \$1 million at 10 per cent makes \$100,000.

The rich think big, and they don't rely on luck. When someone tells me their retirement plan is to win the lottery, I want to hand them a golf club and send them outside into an electrical storm. Even Powerball says there are better odds of getting killed by lightning.

It may sound boring but setting goals and having a plan are the best ways to become rich.

## Blend investment styles

WE all know how important it is not to have all your money in one asset class such as shares or property.

When investing in managed funds or superannuation, it is equally important to make sure you have a variety of investment management styles.

Blending of investment styles will have a similar effect to diversifying across different asset classes. It will help smooth out investment returns during those volatile times. Value managers and growth managers are two main styles that can have a marked influence on your returns.

Value managers seek undervalued companies and usually deliver better relative performance during declining



**john OLIVER STRATEGIES**

or difficult investment conditions. This does not mean a value manager will always have positive returns because the sharemarket in which they invest will be the ultimate measure.

Growth-style managers have little interest in short-term earnings and will seek out stocks with better profit potential in the future. Growth managers tend to outperform others when the sharemarket is in positive territory,

which is what we saw before the share market downturn experienced over the past year.

There are other management styles such as index, style neutral and growth at-a-reasonable-price. No manager gets it right all of the time.

It is just as hard to predict when various styles will outperform as it is to predict when the asset classes will have their best performance period.

The most important strategy is to make sure that you diversify as much as possible with both asset classes and investment styles.

John Oliver is a director and adviser at Goldsbrough Financial Services.

## Consider insurance risks when buying a business

**Q** I'm about to buy a business and my accountant suggests I talk to a financial planner about types of insurance to consider. What do you think?

**A** There are a number of risks that you are about to take on as a business owner. The first of these is general insurance which is essential to cover fixtures and equipment.

You will need to also have public liability and, depending on the nature of your business, product liability and possibly

**cash coach**



professional indemnity. Income replacement and business expense cover should also be considered as these are designed to provide income at a personal level and to help cover the cost of leases, rents and salaries of non-income

producing staff. There is also workers compensation which is mandatory if you have employees.

If you are going to set up your own company, the directors are effectively employees and must be covered under workers compensation as well.

Answered by Lee Virgin of Hillcross Financial Services. Answers should be used as a general guide only and professional advice should be sought before making investment decisions. To find a financial planner, call the Financial Planning Association on 1800 626 393 or visit www.fpa.asn.au.



**STRONG FOCUS:** Tax Commissioner Michael D'Ascenzo.

## Taxman's hit list

**ALEX TILBURY**

TAX havens, dodgy tax schemes, wealthy individuals and the cash economy are high on the taxman's hit list for this financial year.

Individuals have increasingly complex tax affairs as about 46 per cent of adult Australians (7.26 million) own shares, according to the Australian Securities Exchange, and 1.6 million own rental properties.

People are investing more and actively managing their investments, including through self-managed

super. Six out of seven employees now claim work expenses and the figure rises to nine out of 10 in the higher-income ranges.

Tax Commissioner Michael D'Ascenzo has released the annual compliance program to let people know how to minimise the risk of a tax audit and play by the rules.

"This year we are expanding our coverage of income tax compliance issues across the board with the support of additional government funding," Mr

D'Ascenzo said. "We are continuing our strong focus on detecting and discouraging the abusive use of tax havens and dodgy tax schemes."

"We are also encouraging people who may have done the wrong thing to come forward before we contact them and take advantage of reduced penalties for coming clean."

"This year we will expand our review of executives and directors to include senior executives of private and foreign-owned companies."



# MAKING MONEY



## Patience the best pathway to wealth

**ANTHONY KEANE**  
MONEY EDITOR

INVESTORS who are seeking the secret to becoming rich are likely to be disappointed to find there is no secret.

Rich people invest most of their money in the same assets as everyone else, financial experts say, but there are two key differences: A different mindset to investing and different structures to hold their investments.

The rich – also known as high net worth individuals – are most commonly defined as those with at least \$US1 million of investment assets, not including their home. For most, it takes years of planning and patience to get to this level.

“Don’t think that you can get rich quick,” said Ord Minnett client adviser Tony Catt. “There is no magic formula to becoming wealthy – it’s more about time, patience and sticking to a plan.”

Financial Planning Association state chapter chair Kerrin Falconer said most wealthy people accumulated their wealth over a long period.

“Generally, they invest across a range of growth assets such as

shares and property,” she said. Wealthy people almost always diversified their investments so they did not have “all their eggs in one basket”.

“Importantly as well, wealthy investors usually have ‘patience’ as their middle name,” she said.

“They are prepared to ride out the ups and downs in the market, with the knowledge that at the end of the

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day, it will be growth assets that provide them with the best returns.

“Warren Buffett, one of the wealthiest and most successful investors in the world, says that in difficult times ‘wealth is transferred from the impatient to the patient’.”

Bourke Shaw Financial Services principal Lawrence Orlando said rich investors did not “turn sour” when tough times struck the share market – as they have this year.

“They don’t see a downturn in the market as a negative, but more as a fantastic opportunity to buy more stock at a reduced price,” he said.

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