



Financial Planning language definitions

Are we speaking Swahili?

Account Based Pension

An account based pension is a superannuation investment account which pays regular “pension” payments to the investor. The investments in the superannuation fund which are used to pay the pension have the potential to grow in value depending on the underlying investment mix (eg: shares, property, interest-bearing investments, capital guaranteed investments). However, the regular pension payments – which can be annual, quarterly or monthly – reduce the value of the account over time. The amount of each pension payment is flexible within certain limits depending on your age and the account balance.

The investment earnings in the account accrue tax free. If you are between 55 and 60 years of age you pay tax only on the pension payments as you receive them, usually with the benefit of a 15% tax rebate. Once you turn 60 the pension payments are tax free. Apart from the flexible pension payments, you can withdraw in cash (“commute”) any part of the remaining balance at any time, providing you meet a condition of release.

ASX200 Index

An index measuring movements in the value of the top 200 shares listed on the Australian Stock Exchange (ASX).

Annuity

An annuity is a contract with a life insurance company under which the life company pays a guaranteed income stream in return for an initial lump investment. An annuity can be for a fixed term (eg: 10 years) or for life.

Assessable Income

Income for income tax purposes, including capital gains (ie: your total income before deducting allowable deductions).

Asset allocation

The process by which you select how the amount of your investment is spread over of the asset classes. The main asset classes are shares, property, bonds and cash in a managed investment, this task can be the responsibility of the fund manager.

Average Weekly Ordinary Time Earnings (AWOTE)

AWOTE is a statistical series released by the Bureau of Statistics each quarter and measures the average wage paid in Australia (excluding overtime earnings). Changes in AWOTE are used to index a number of thresholds in superannuation regulations. Indexation by AWOTE is meant to help retain the “real value” of an amount (eg: RBL thresholds).

Balanced fund

A balanced fund invests in a mix of different asset classes including shares, property, bonds and cash.

Bonds

Bonds are issued by Governments and large corporations in return for cash. The bondholder receives interest for the fixed term of the bond, which can typically range from 2 to 20 years.

Capital allowance

A tax deduction for the annual write-off of the shell of a building used to produce assessable income. The rate at which a building can be written-off depends on when it was first built.

Capital Gains Tax (CGT)

The tax payable on the disposal of an asset (eg: shares and investment properties)

Cash Management Trust (CMT)

A managed investment that invests in high-yielding money market securities. CMTs tend to provide a flexible, better performing alternative to a bank account.

Compound Interest

A method of interest calculation where, in each period, interest is calculated on both the principal and the interest previously accrued.

Consumer Price Index (CPI)

The CPI is a measure of inflation taken each quarter. It measures the price of a basket of typical household goods and services.

Depreciation

For tax purposes, a deduction on the cost of income producing assets. (eg: office partitions, hotel décor, canopies).

‘Disposal’ of an Asset

This term relates to capital gains tax and refers to the sale or transfer in ownership of an asset.

Diversification

A concept aimed at reducing investment risks (ie: ‘not putting all your eggs in the one basket’). You can diversify by spreading your money across asset classes, sectors, markets and fund managers.

Dividend

Distribution of part of a company’s profits to shareholders expressed as a number of cents per share. A dividend yield is the dividend expressed as a percentage of the last sale price for the price for the share. Companies typically pay dividends twice yearly – an ‘interim’ dividend and a ‘final’ dividend.

Franked dividends

Dividends paid by a company out of profits on which the company has already paid Australian tax, and which entitles shareholders to a tax credit.

Gearing

Borrowing to invest. “Negative gearing” is when interest payable exceeds assessable income from the geared investment, resulting a deduction against other assessable income.

Investment bond

A type of managed investment, which provide investors with access to a range of underlying assets. Tax is paid by the issuing life insurance company at a flat rate of 30%.

Liquidity

The capacity of an investment to be readily converted into cash. Shares, for example, are relatively liquid because they can be easily sold on the market.

Listed company

A company whose shares are listed on the stock exchange and which are available to be bought and sold.

Managed investment

A managed investment (or ‘managed fund’) is the collective term given to investments that pool your money with the money of other investors to form a fund which is then invested into assets based on set investment objectives. A ‘specific sector’ fund invests in only one asset class (eg: global shares) while a ‘multi-sector’ (or ‘diversified’) fund invest in a number of asset classes.

Management expense ratio (MER)

The MER is the total annual fees and expenses of a fund divided by its average net assets.

Margin call

In a margin loan the lender is prepared to lend up to a maximum limit (expressed as a ratio of equity versus borrowings). When you exceed this limit, you will be required to make a ‘margin call’ which means you must either repay part of your loan or increase your loan limit by providing further security.

Margin Lending

A means of borrowing money in order to increase your investment into growth assets such as shares. The geared asset (eg: the shares) becomes the security for the loan.

Marginal tax rate

The stepped rate of tax that you pay on your ‘taxable’ income.

Market value

The price you would get if you sold your asset. The market value of a share would be the last price at which the share traded on the stock exchange.

Portfolio

A 'basket' of investments. A managed investment contains a portfolio of investments, which is managed by a portfolio manager.

Property securities

Property securities, which include shares in listed property companies or units in property trusts, are an alternative to investing in property directly because of greater liquidity and diversification.

Product Disclosure Statement (PDS)

A document that describes the investment being offered (hence the general term 'offer document'). A PDS must be registered with ASIC. You must complete an application form attached to a current offer document in order to invest in shares, and managed investments.

Real rate of return

The return from an investment after taking account of inflation. For example, if your investment pays 5% and inflation is 4%, your real rate of return is 1%.

Reinvestment

The process by which investors entitled to receive dividends from shares or distributions from managed investments automatically reinvest the amount to purchase additional shares or units.

Risk

Put simply, risk means the chance of losing money or not having your expectations met. Risk can mean different things to different people. An investment considered risk-free because the capital is protected (eg: fixed term deposits) may still involve the risk of not keeping up with inflation.

Risk-averse

Someone who adopts a conservative approach with their money is considered 'risk-averse'.

Stock

Another term for shares.

Taxable Income

Your total income (assessable income less deductions) that is subject to marginal tax, and the Medicare Levy.

Tax deduction

An amount that is deducted from your assessable income before tax is calculated. You can claim deductions in your annual tax return or, if your total deduction is significant, you can apply to the Tax Office for a variation of PAYG tax (section 221D) of the Income Tax Assessment Act.

Tax-effective

The term given to a strategy or investment that provides a return that may lead to a tax benefit, such as a tax deduction or tax rebate.

Tax rebate or tax offset

An amount deducted off the actual tax you have to pay. You can claim a tax rebate in your annual tax return.

Term deposit

An account that pays a fixed rate of interest over a fixed term, usually from one to three years. Funds are not 'at call' and a penalty can apply if the term is broken.

Vesting age

Age at which ownership of an investment bond transfers under a "child's advancement policy".

Volatility

Refers to the fluctuating value of an investment. A share is said to be volatile if its price moves up and down frequently over a short space of time.

Yield

The annual return on an investment expressed as a percentage.

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