Don't spend it all at once

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The case is finally won and over

Basking in a well deserved sense of professional pride you hand the client a cheque for the largest amount the client has ever received. The client looks at the cheque and thumbs it nervously.

The client can't believe that it's all over - feelings of relief and exuberance are already giving way to a new ball of worry welling up from their stomach.

You too sense the discomfort with the termination of the relationship. You liked the client and feel you would like to do more for them - now you are saying goodbye and good luck.

Your parting words are always the same - what else is there to say? You feel inadequate and unqualified in giving financial advice. You think it's best to offer nothing except...

"Don't spend it all at once"...almost tongue in cheek. You shake hands and with the final fond courtesies over you return to your caseload.

But as soon as the clients get that cheque, their lives change. Without warning, the client becomes a target - well meaning and well intentioned advice will flow from unqualified friends and relatives, 'sure thing' schemers offering to "double your money" will materialise from dark quarters and suddenly bank managers, car salesmen and real estate agents will want to become 'friends'.

Without calm, dispassionate and professional guidance, the client's story may end the same way...wasted opportunities, avaricious relatives, misguided attitudes and down right blunders see the client quickly convert the lawyer's hard earned victory to defeat. A defeat that can linger a lifetime.

We have all heard the claims by those that seek to limit damages that lump sum compensation is often "wasted" by the recipient. The best defence to this argument is to ensure that your clients are in the optimal position to make their lump sum work for them - for the rest of their lives.

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You have won the client a victory, but what of the war?

Our experience is that most compensation recipients who receive lump sums of less than $150,000 generally spend the money on assets and lifestyle expenses such as cars, houses and holidays. Compensation recipients who, because of the more serious nature and extent of their injuries, receive larger lump sums are more likely (and justifiably) to be concerned about long term investment issues.

An important point to make is that the above is obviously *general advice* - no two clients will have identical concerns and objectives therefore it is crucial (and a legal requirement) for any specific financial advice to reflect the individual's situation.

Set out below are four key points that will influence how long your client's lump sum will last.

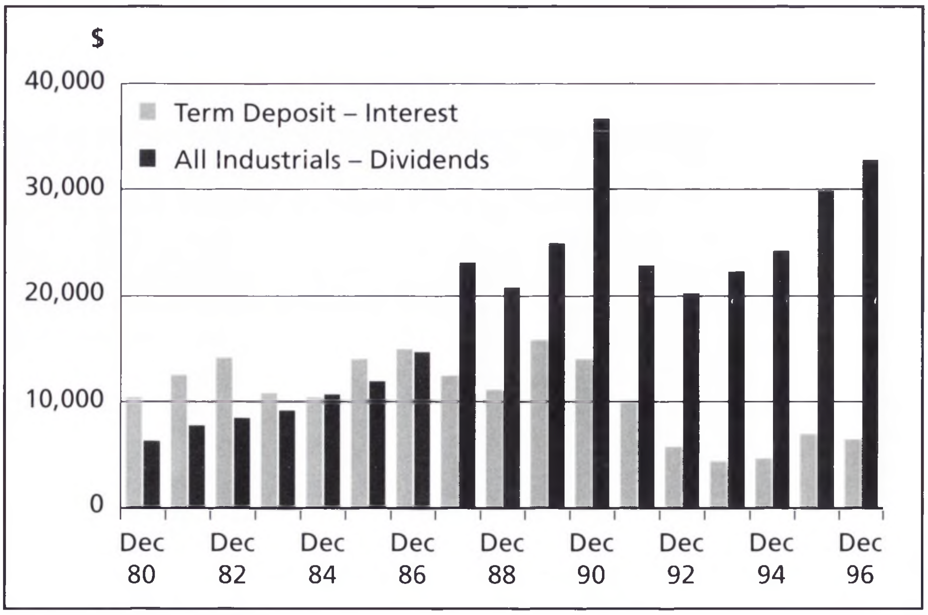
How long your client's lump sum lasts depends on;

1 How much is spent each year;
2 How the lump sum is invested;
3 How much tax is payable; and
4 The level of risk that is acceptable

1. How much is spent each year

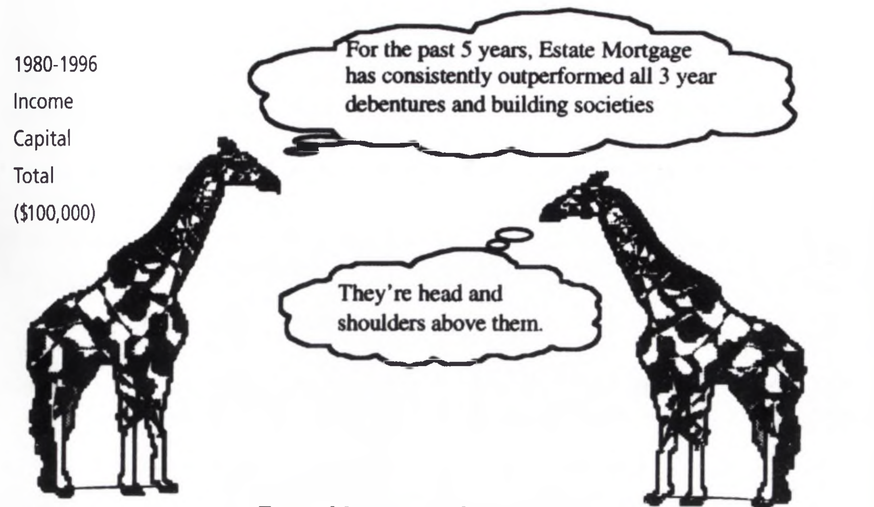
The more that is spent each year, the

Chart 1
Income: Term Deposit versus Shares (1980 - 1996)



Source: FPG Research / IPAC

Returns are often confused with performance...



Estate Mortgage advertisement
Source: Money Management Magazine February 1990.

faster the lump sum will run out. The first step in prolonging the life of your client's lump sum is for them to develop and stick to a budget.

This means working out how much money the client needs to live on each year. Then calculate the amount needed monthly. To make the budget easy to stick to, this monthly amount should be paid into a special bank account and used to fund all living expenses. If halfway through the month more than half of the monthly budget has been spent, the client knows that it's time to slow spending down.

Sticking to a budget requires focus and discipline and for most people, ongoing professional help from a financial planner is needed.

2. How you invest your lump sum

The second step is then to invest the financial resources appropriately. If this were as simple as putting all your money in the bank and then letting "compound interest" do the work it would be fine. But in reality, relying solely on interest rates will produce a disappointing and unacceptable result. The money will probably run out too soon.

Many investors use fixed interest investments because they generate a relatively high guaranteed income.

And for short term investors, it is an appropriate strategy.

But for longer term investors, that strategy is flawed. Consider chart 1, which compares the income generated from $100,000 invested in a term deposit with the dividends received by a sharemarket investor.

You can see that in the early years the term deposit generated significantly more income. But as the shares grew in value, so did their dividends.

As a result, in the 16 years of the study, the shares generated a total income of $338,000, compared to the term deposit's $189,000.

When you take into account the capital gain made by the shares, the result is $799,000 more in shares.

1980-1996 ($100,000)	Term Deposit	Shares
Income	$189,000	$338,000
Capital Gain	NIL	$650,000
Total Return*	$189,000	$988,000

* Figures do not include taxes

The expression "make your money work for you" is synonymous with getting a higher rate of return than the banks offer. It comes from an understanding that unless a client is getting a return above inflation, the value of their money will diminish - they could find themselves slipping backwards!

It is crucial to understand that the *"real rate of return"* received will be entirely dependant on the choice of investments.

The real rate of return is the return above the rate of inflation - for example if a return of 5% is received and inflation is 2%, then the real rate of return is 3%. Real return will be almost completely determined by the range and type of investments selected. Choosing the right combination of investments to generate the desired returns is called "asset allocation".

The right asset allocation for any investor is one that will deliver an appropriate and reliable return over time with the least level of acceptable risk.

3. How much tax is payable

The more tax is paid, the less is left from investments, thus making the task of stretching the value of the lump sum more difficult.

Conservative tax strategies such as:

- Income splitting with your spouse
- Franked dividends
- 'Growth investments' rather than fixed interest
- Discretionary family trusts
- Superannuation
- can produce significant tax savings if applied judiciously.

Minimising the amount of tax payable can produce an increase in (after tax) returns *without* an increase in the level of risk.

4. The level of *risk* that is acceptable

Seeking higher returns, to give extra income or to extend the life of a client's capital, will attract higher levels of risk. The key here is the quality of risks taken.

Poor quality risk can lead to permanent loss of capital.

In the 1980s the promoters of Estate Mortgage were heavily advertising the high returns available from their product.

Investors were seduced by the "higher return, low risk claims" - and by 1990 they had invested $800 million into the Estate Mortgage Trust. Just one year later, that $800 million was virtually worthless, as the Estate Mortgage operation collapsed. ▶

Some people lost most of their life savings.

Investment history is littered with examples like Estate Mortgage. The message here is that in investments, as in life, the following rule holds true:

If it sounds too good to be true, it probably is.

However it is generally appropriate to have some level of exposure to growth orientated investments (ie shares, bonds and real estate).

By investing in growth assets, over time your clients will:

- increase their real rate of return;
- reduce/eliminate the erosion of their capital by inflation;
- help them to save tax; and
- extend the life of their money.

The more a client's capital grows by itself, the more income will be produced leading ultimately to an increase in the amount available to spend.

When clients know that their investment strategy is on track, they feel more comfortable in spending on "lifestyle enhancements" eg new car, new house or holiday.

By *'managing risk'* (applying conservative investment practices) clients can obtain higher returns with less risk over time, but must be prepared to accept that in the short term there still will be 'ups and downs' in the performance of investments. These short-term ups and downs should be largely ignored because as clients invest for the long term, it is the long-term behaviour of the chosen assets that is important.

Finally, not every client will feel inclined to take advice on what to do with their lump sum. Some clients just can't resist the spending frenzy that sudden and unaccustomed wealth can induce. The majority, though, will need and want professional help.

It is important to be aware that whilst a lawyer may give financial advice as incidental to their legal advice, a lawyer must hold an appropriate securities licence or 'proper authority' to give securities advice. ■

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No Pokies MP plays legal card for change

ROY ECCLESTON

POKER machines could require substantial redesign, and gambling addicts could sue to have their losses repaid, if a national coalition of lawyers succeeds in convincing the nation's consumer watchdog that pokies breach crucial sections of the trade practices law.

The lawyers, co-ordinated by South Australian No Pokies MP Nick Xenophon, will submit to the Australian Competition and Consumer Commission that the poker machine industry engages in "unconscionable" as well as "misleading and deceptive" conduct.

Four South Australian barristers as well as lawyers in Queensland, Victoria and NSW were working on the submission and believed there was "a real prospect of success", Mr Xenophon said.

"The unconscionability is more than simply the disadvantage of pitting yourself against the rules of probability, but pitting yourself against an industry which preys on human vulnerability and does so in a systematic way.

"For instance, if you go to the races, you know what the odds are and it's not a repetitive, mechanistic thing.

"The races don't rely on lights and sounds and the jingle. That's one of the things the addicts talk about — the sound of the machine they find incredibly alluring."

Serving of alcohol could also be a factor. Mr Xenophon said a NSW study by psychologists found that alcohol played a major role in gambling, with just three standard drinks doubling the duration of play when losing and causing more players to lose all their original stake.

A High Court decision in 1956, still quoted today, sets out conditions that lend themselves to unconscionable conduct. These include, on the victims' part, poverty, sickness, infirmity of body or mind, drunkenness and illiteracy or lack of education; and, on the perpetrators' part, lack of necessary assistance or explanation.

"The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage vis-a-vis the other," the judgment said.

Mr Xenophon claimed many of these points went to the case against the way machines were operated and designed..

"We want the ACCC to take a test case to the Federal Court, and seek injunctions and declarations to change the design of the machines. That would go to such things as showing the odds, looking at the speed, sound and method of payout, and the design and ambience of the gaming room," he said.

"If it is found to be unconscionable, the obvious remedy is for the person to get their money back."

There is no agreement on how many problem gamblers there are in Australia, but one of the more conservative estimates is 200,000.