Investment Market Update

Message from the Manager

Legislative changes, increased competition and the desire to simply provide the best service we can, means that it is incumbent on management and staff alike, to embrace change for the ongoing benefit of clients and the organisation as a whole.

I am happy to say that the staff of both CIPL offices have readily risen to these challenges. In fact it is a credit to all involved that we have such an enthusiastic can-do culture.

As Chris has noted in his contribution to this newsletter, the boutique financial planning arena has a special place in the profession. As a boutique, we are more in control of the types of people that work with us, and the processes and systems that support the business. We are also generally more nimble when it comes to dealing with issues that can arise over the course of any long term relationship, and people within the organisation are empowered to deal with those issues.

After a period of strong markets, the recent volatility is a reminder of the need to focus on the quality of assets, diversity and matching investment characteristics with client risk profiles. Only a boutique can pay attention to those matters on a client by client basis.

In addition to Chris' contribution, this newsletter provides further commentary on the integration of the two offices, an update on the changes to Aged Care rules, and the installation of the new solar system on Suncorp House in Rockhampton. As usual we have some investment briefs and we welcome Supriya Kamat as Senior Administration officer in Melbourne.

I hope you enjoy the read.

David French
Managing Director

Who can you trust?

If you can't trust the CBA for financial advice, who can you trust?

Many observers have been shocked by the recent revelations of bad practice by some rogue advisers working in the Commonwealth Bank's financial planning business and the complicit behaviour exhibited by those supposedly in positions of supervision and control. An aspect of this sad saga that has not received the recognition it deserves is the brave action taken by some advisers in that organisation to "blow the whistle" on what they saw as completely unacceptable behaviour both at individual and corporate levels.

It invites the question, which group is most representative of the advisory industry? Is it the rogues who behaved disgracefully or those who put their jobs in jeopardy to broadcast their legitimate concerns and cause corrective action?

My experience of more than 25 years in the financial planning industry has shown that the majority of advisers are decent, honest people who have the right ethics and put clients' interests first and foremost. Consumer confidence in the industry has been damaged by these recent revelations, however, and a recent article I was reading identified a number of initiatives that would lift the professionalism of advisers. It would be timely to identify some of these initiatives and see how the Capricorn and Pentad advisers measure up.

- "ASIC should undertake intense surveillance of financial planning groups that have previously received enforceable undertakings from the regulator." Neither Capricorn nor Pentad has received an enforceable undertaking from the regulator."
- "Financial planners should have university qualifications and industry experience." Between the 12 Financial Advisers currently employed by Capricorn and Pentad there are 10 tertiary education degrees held, 17 professional qualifications and a combined 197 years of experience in financial services.
- "Ban institutional ownership or association with a financial planning business." Capricorn (which is the owner of Pentad) has no institutional owner or association."

Boutique businesses such as CIPL and Pentad depend on personal relationships for their success, earning trust and confidence over time. It is strictly a "rogue-free" environment.

Chris Heyworth
Senior Financial Adviser - Melbourne

Annual tax reports will not be ready before the end of October due to the necessity for CIPL to wait until all fund manager reports have been received and the details recorded in the system.

Business Update

Business Integration

Over the last few months, staff have had an increased focus on integrating the Melbourne and Rockhampton offices. There have been several visits to each other's office, and in July I (David) spent two weeks sitting with Melbourne staff to better understand the operations of that office.

The increased interaction between staff can only be good for all CIPL/Pentad clients. The business has a wide range of skills and other resources which we are looking to take the best of and make available to all clients across the combined group.

Over the next few months we aim to implement measures designed to improve portfolio management and reporting, improve the information available for client reviews and streamline many procedures.

As part of the business improvements we have employed a new Senior Administration Officer in Melbourne. Josh Scipione in Melbourne and Amy Gill in Rockhampton have been selected for promotions within the business, with Josh moving into an advisory role and Amy moving into a more senior administrative role. Currently in Melbourne we are recruiting for a Data Administrator and a part time Administrative Assistant, and in Rockhampton a full time Receptionist/ Administrative Assistant.

These are significant tasks that take some time, and we trust you will bear with us if teething issues arise as these new measures are put in place.

Suncorp House

Going Green!

On 28 July 2014 Suncorp House in Rockhampton (owned by Capricorn Diversified Investment Fund) and managed by CIPL, finalised one of the biggest solar installation projects in Central Queensland. The project comprising 55kw essentially covers the entire flat roof.

The decision to invest in solar was not solely driven by a desire to project a green image. Analysis undertaken by the investment committee suggests an internal rate of return of about 18 per cent on the $80,000 investment.

While there is a lot of emotive discussion around solar, there are some points that just cannot be refuted. First the sun is up when most people are in commercial buildings so it makes sense to power the building from the sun. Second, coal generated power is not as cheap as it appears. Large coal-fired base load stations have to run at high capacity to be efficient. The trouble is, the demand for electricity in the middle of the night is much lower than in the day, and so this electricity is typically sold at a loss. This leads to a situation where massive infrastructure is being built for the peak load (during the day). Obviously this is grossly inefficient, and it means that the common assertion that coal fired electricity is cheap is overstating the truth.

We expect the solar power to be turned on in the next week or two. In the meantime the endeavour has led to additional opportunities for similar investment projects.

David French
Managing Director

Financial Planning

Aged care changes post June 30, 2014

Did you know that new residential aged care rules took effect from July 1, 2014 for new residents entering into an aged care facility. While the scope of the aged care reforms will not impact individuals already in permanent care prior to July 1, 2014, Aged Care residents entering care from July 1, 2014 will be subject to a new set of complex rules, which could result in significantly higher fees for some (in comparison to the current system).

We have highlighted the key changes to the aged care rules in the table opposite: Other important changes being introduced are as follows:

- The 'refundable accommodation deposit' (RAD) will count as an assessable asset for the purposes of calculating the means-tested fee.
- The family home may count as an assessable asset up to a cap of $154,179 for the purposes of calculating the means-tested fee. The home will not count as an assessable asset if occupied by a protected person (i.e. spouse, dependent child or carer).
- Facilities will be required to publish the payment options for lump sum payments, periodic payments and a combination of both.
- Facilities will also be required to publish a description of the key features of each different type of room that is available.
- Lump sum accommodation payments above $550,000 need to be approved by the Aged Care Pricing Commissioner.

Please call one of our offices if you have any questions.

Paul Young
Senior Paraplanner

Item	Previous Rules	Rules for new residents from July 1, 2014
Entry fee / accommodation cost	Residents were either charged an upfront bond for 'low level care' which is partially refundable, or an ongoing accommodation charge for 'high level care'.	The distinction between low care and high care has been removed. Residents can elect to pay the accommodation component via a fully refundable lump sum or a periodic payment or a combination of both. New residents will have 28 days after entering the facility to finalise how the payment will be made. As such, facilities will not be able to distinguish between residents on the basis of how they elect to pay.
Means tested ongoing fees	In addition to the 'basic daily care fee' residents can be charged an 'income tested daily care fee' based on their assessable income.	In addition to the 'basic daily care fee' residents can be charged a 'means tested fee' based on their assessable income and assets. This fee is determined by adding together a component which is based on assessable income (i.e. an income test) plus a separate component which is based on assessable assets (i.e. an assets test).
Maximum means tested ongoing fees	The income tested daily care fee was capped at $73.86 per day ($26,959 per annum).	The means tested fee will be capped at $25,000 per annum. An additional lifetime cap of $60,000 has also been introduced (i.e. residents cannot be charged more than $60,000 in means tested fees over their lifetime).
Minimum amount of capital residents can be left with	If charged a bond, the resident could not be charged an amount that left them with assets of less than $44,000.	If paying via a lump sum, the resident cannot be charged an amount that leaves them with assets of less than 2.25 times the basic annual age pension entitlement.
Terminology	Upfront payment known as a 'bond' Ongoing payment known as an 'accommodation charge'.	Upfront payment known as a 'refundable accommodation deposit' (RAD). Ongoing payment known as a 'daily accommodation payment' (DAP).

Investment Briefs

RESMED
Waking people up to sleep

Sleep apnoea is a type of sleep disorder characterised by pauses in breathing during sleep. It is a disorder that can cause issues ranging from an increased risk of diabetes to at its most extreme cardiac arrest and the possibility of death. ResMed (RMD) is a company that is at the forefront of addressing sleep apnoea through its range of innovative products such as masks and other sleep enhancing products.

Sleep problems are touted as a 'global epidemic' and it is a growing concern. In 2012, the world sleep apnoea devices market was valued at \$3.805bn and is forecast to grow to \$6.437bn in 2019, representing a very attractive compound annual growth rate of 7.8%. RMD is very well positioned to capitalise on this growth as it shares the majority market share (70%) with US competitor Phillips Respironics.

RMD itself is a well-managed business. It consistently enjoys a high return on invested capital (FY13 14.1%), is a strong cash flow generative business and currently has no gearing. Furthermore, RMD has been able to increase its EBITDA margins since 2008, suggesting strong pricing power in its end markets. This suggests that not only will RMD enjoy the strong growth in the sleep devices market it should be able to increase prices due to the quality of its product range.

Recent changes to US healthcare regulations have impacted RMD directly through the pricing of its products however, Management have stated that they believe this to be a short term aberration and for the environment to normalise before too long. It has resulted in the company's share price languishing the broader market with the stock down 11% from its all-time highs in October last year. We see this as a good opportunity to purchase an attractively priced company with strong future growth prospects.

CommonwealthBank

For quite some time now, we have been hearing in the media about the supposed overvaluation of the banks and specifically Commonwealth Bank (CBA). The move through \$80 in mid-May caused many to start questioning the underlying valuation and whether this current move higher is sustainable.

The reasons for the banks meteoric rise post the GFC are many. Our top four banks are quality businesses supported by world class balance sheets. They enjoy significant returns on equity at levels that consistently are higher than many globally listed peers. Another reason can be attributed to the wide spread in the dividend rate of our top four banks with artificially suppressed US Treasury Yields. This has resulted in a significant flow of foreign capital which in turn has helped support the Australian Dollar at elevated levels.

But at what point are the banks expensive? This is a difficult thing to forecast and at Capricorn Investment Partners we instead take a look at the nature of the individual company and its future forecasts. We then seek to place a valuation on each individual company and in turn attempt to invest when this asset is undervalued with what we consider a 'margin of safety'.

The Australian banks despite being exceptionally good businesses are still highly exposed to the Australian property market. CBA currently has 66% exposure throughout its loan book to the home loan market. With interest rates at currently low levels banks are experiencing very few loan defaults.

However, there is a chance this dynamic will change if interest rates were to normalise. It also must be remembered that despite external theoretical backstops, banks are extremely leveraged businesses generally averaging around 24 – 30 times their capital (ratio of the dollar value of their assets to their core tier one capital level).

We have not been adding to existing CBA positions for some time in portfolios. However, we will revisit this position when we once again see value emerging.

MFG MAGELLAN
ASSET MANAGEMENT LIMITED

When we were seeking out a core international fund for portfolios, one critical measure was for the manager to share similar investment views to us. From our search, we found one fund that most closely mirrored our investment style and methodology. Magellan Global Fund borrows heavily from the Buffet school of investment. They seek out companies with a sustainable economic moat borne out through consistently high returns on invested capital at rates above their cost of capital.

The fund invests predominately in the less volatile portion of the market providing the prospect of some downside protection in falling markets. It aims to provide 9% return per year through the market cycle. Due to the nature of the companies in the portfolio, there is significant exposure to consumer defensives, mass-market retail and Information Technology. The fund is currently capitalising on the thematic of continuing improvement in the US housing market and a normalisation of interest rates which should in turn assist the net interest margins of US banks.

Lachlan McKenzie-McHarg
Adviser Equities Dealings and Research

Magellan generally holds between 20 – 40 companies in its portfolio at any given time. Currently, their largest holdings are stakes of 6.3% in Microsoft (MSFT), 5.8% in Lowe's (LOW), 5.7% in eBay (EBAY) and 5.4% in DirecTV (DTV). The fund has performed extremely well since its inception on the 1st of July, 2007 with 5 year annualised returns of 16.6% (post fees, representing an outperformance against its benchmark of 5.1%) and 9.7% (post fees, representing an outperformance of 7.8%) annualised since inception. These are outstanding performance figures that speak to Magellan's underlying core strategies.

We continue to add Magellan Global Fund (unhedged) to portfolios due to the sound nature of its investment process whilst also capitalising on the elevated Australian Dollar to purchase effectively more units of the fund for less.

Client Services Update

Welcome and Farewell

Our team would like to warmly welcome Supriya Kamat to our Melbourne office. Supriya has been employed as our Senior Administration Officer and will be looking after client reviews first and foremost, along with the many and varied high level administrative tasks we have on a daily basis. Supriya comes with a wealth of knowledge in the field of client services and a masters in Information Technology. We're very excited to include her in our dynamic team.

Moira Bentley left her role as Melbourne Practice Manager in July after almost 12 years of service. Many Melbourne clients will know Moira, and the valuable contribution she made. We were sorry to see her leave, and wish her all the best for the future.

Rose Sladden
Client Services Manager

Our offices Rockhampton / Melbourne / Sydney

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Sue Dunne	Senior Financial Adviser
Bob Stewart	Senior Financial Adviser (Equities Dealings)
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Ken Maher	Senior Financial Adviser
Robert Syben	Senior Financial Adviser
John Robson	Senior Financial Adviser
Morgen Harris	Risk Protection Adviser
Joshua Scipione	Client Support/Financial Adviser
Lachlan McKenzie-McHarg *(Melb)*	Adviser Equities Dealing and Research
Supriya Kamat	Senior Administration Officer
Janice Vass	Reception / Administration
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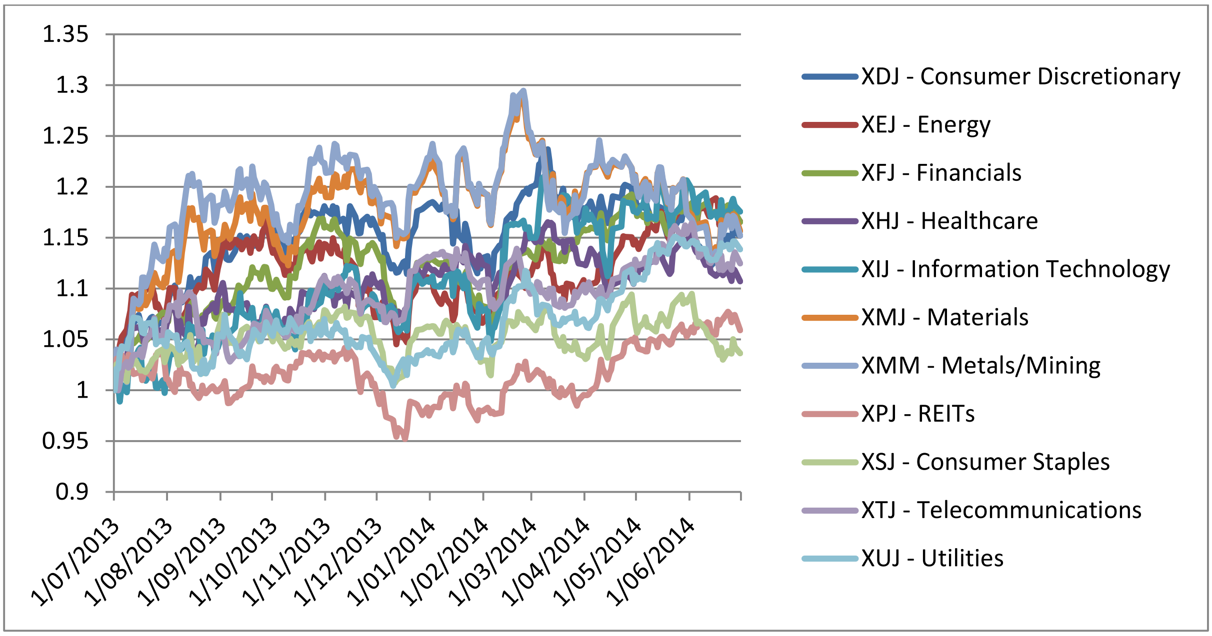
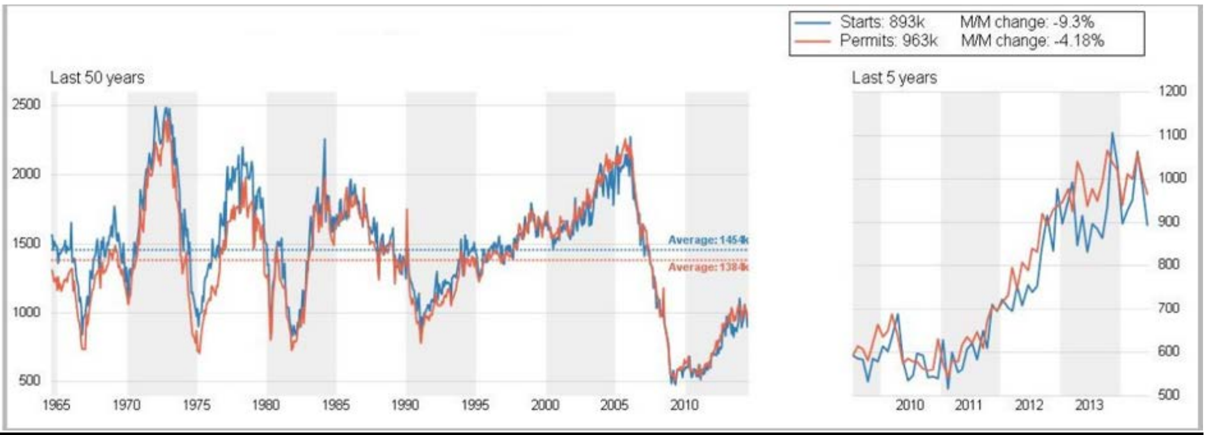
Roger Cameron	Senior Consultant
Alex Evans	Consultant
Kevin Piche	Consultant

CHART PACK *Information at a glance*



FY14 sector performance

Information Technology, Financials and Energy the standouts, Healthcare, REITs and Consumer Staples the laggards.



Build it and they will come

US Building Starts continue to normalise despite brief hiccup in June.

Source: Inside Debt

The content of the newsletter constitutes general advice and does not take into account your particular needs. Please seek appropriate advice before acting on anything contained herein.