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financiallyspeaking

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Market update

The June quarter saw a battle between geo-politics and economics. The quarter was characterised by healthy gains across the US markets, a tepid performance for the European bourses and strong rises across Asia, with the exception of China's Shanghai Composite Index.

Political bickering in Washington was a constant backdrop over the quarter, as investors also dealt with inconsistent economic data.

In May, the Federal Reserve started the process of unwinding its US$4.5 trillion ($6 trillion) balance sheet, and in June, the Federal Reserve delivered a 0.25 per cent interest rate rise, with the federal funds target now between 1% – 1.25%.

On the markets, three winning months in the quarter pushed the S&P 500 index 2.6 per cent higher, while the narrower Dow Jones Industrial Average gained 3.3 per cent. Despite a heavy tech sell-off in June, the Nasdaq Composite Index gained 3.9 per cent for the quarter. It was the seventh straight winning quarter for both the Dow Jones and the S&P 500, while the Nasdaq banked its fourth quarterly rise in a row.

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European stock markets were also impacted by politics over the quarter, which saw elections in France and the United Kingdom.

This contributed to a weak quarter for the UK stock market, which declined by 0.1 per cent after falls in April and June. But in both Europe and the UK, solid company earnings and improving economic data supported markets.

Despite a weakening in June in Germany's manufacturing and services sector, the Munich-based Ifo Institute for Economic Research's index of business sentiment reached its most bullish level since the country's reunification in 1991.

On the markets, the pan-European STOXX 600 lost 1.2 per cent for the quarter, leaving it still however with a solid 18.2 per cent rise for the year to date. In Germany, the DAX index gained 0.1 per cent for the quarter, and the FT-100 ended in the red by 0.1 per cent.

In Asia, China's first-quarter GDP growth figure came in slightly better than expected at a 6.9 per cent annual rate, up from 6.8 per cent in the fourth quarter of 2016. The Shanghai Composite Index lost ground in both April and May, before a 2.4 per cent lift in June saw it close out the quarter with a 1 per cent fall.

In Japan, the export recovery continued, with the country's exports growing at an annualised rate of 14.9 per cent in May, almost double the April figure of 7.5 per cent.

Net profit at Japanese companies for the March 2017 year-end climbed to a record high, with nearly 30 per cent of firms reporting their highest-ever profit. The Nikkei index responded to this improving backdrop with three winning months, gaining 6 per cent for the quarter.

The Australian market struggled over the quarter, hit by a proposed levy to the major banks announced in the Federal Government's budget, and mounting concerns around the Australian residential property market. With the four largest Australian banks accounting for more than a third of the benchmark S&P/ASX 200 Index by market capitalisation, the market gauge responded with losses in May and June, which resulted in a 1.6 per cent loss for the quarter. For the 2016-17 financial year, the S&P/ASX 200 Index benchmark gained 9.3 per cent, or 14.1 per cent with dividends included.

Where to from here?

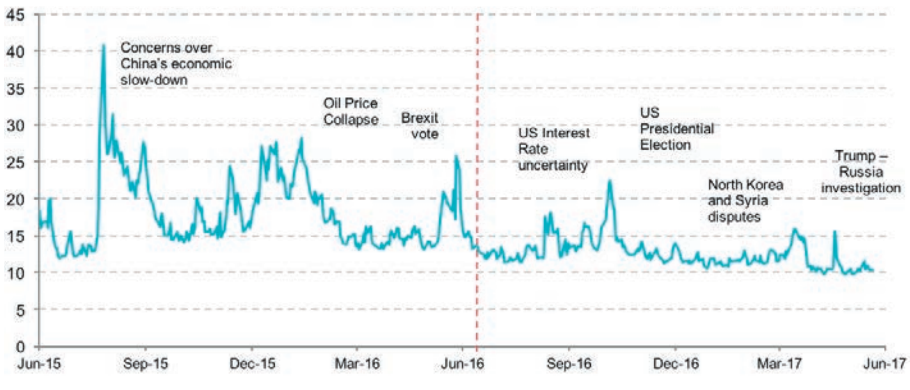
With volatility in share prices, being a forward measure of market risk and investor 'fear', the below chart shows the relative 'calm' the US S&P 500 share market has had over the last financial year when compared to the previous year. With less volatility ('fear') in the markets, we have seen strong returns from share markets, both in Australia and overseas.

Looking ahead, with markets at record levels, and various events on the horizon such as the tightening of interest rates, the US government's promised delivery of tax cuts and infrastructure spending, and future 'unknowns' like the outcome of Brexit negotiations, we expect volatility to increase during the course of 2018.

We do expect markets to continue to rise supported by an overall improving global economy. This will be driven by improving corporate profitability, concerted central bank policy stimulus and a general sense of positive business and consumer confidence.

Closer to home we are seeing housing affordability take centre stage, which in turn has had an impact on the Reserve Bank of Australia's (RBA's) interest rate policy as it seeks to both stimulate economic growth and put upward pressure on inflation.

US CBOE SPX Volatility Index



Source: BT Financial Group
As at 30 June 2017

Speak to your financial planner to discuss your investment options.

The new super rules contain some good news

The 2017 superannuation changes provide new opportunities for you to finance the cost of your life insurance needs.

The 10 percent rule is history!

This rule prevented employees making additional tax deductible contributions into superannuation, even though their additional contributions were within the concessional (tax deductible) contributions cap.

Outline of new measures

From 1 July 2017, you may make personal deductible personal contributions into superannuation, provided that you do not exceed your concessional contribution cap. This means that any unused concessional contribution cap amounts can fund insurance arrangements in a tax effective way.

For example, consider the situation where your employer makes a $15,000 contribution into your super during the income year ended 30 June 2018.

You now have the capacity to make an additional deductible personal contribution of $10,000 in the 2018 income year. If your insurance premium is $5,000 per annum, you can make a tax deductible personal contribution of $5,000 to a superannuation fund, and have the superannuation fund pay the requisite premium.

How does this benefit you?

Substantial out of pocket cost reduction	Funding insurance in superannuation in this way can substantially reduce the cost of insurance. Unfortunately, the cost of insurance outside superannuation is generally not deductible for tax purposes. If we structure an insurance arrangement in super funded by deductible personal contributions, we can achieve a substantially different out of pocket cost outcome for you. For example, if you earn $90,000 per annum in 2017/2018, you will have a marginal tax rate of 39 percent. In order to fund an annual insurance premium of $5,000, you must earn $8,197 before tax. Using the insurance in superannuation route, you can reduce the out of pocket cost of this insurance to $5,000 per annum. The out of pocket cost reduction is based on your marginal tax rates. The higher the marginal tax rate, the greater the reduction.
No erosion of retirement savings	A major criticism is that insurance in superannuation erodes retirement savings. This is certainly true when we are using superannuation balances to fund life insurance costs. However, in this instance there is no erosion of retirement savings. The $15,000 employer contribution made on your behalf is not eroded by this arrangement.
No contributions tax	Everyone gets confused over the imposition of the 15 per cent contributions tax. The good news is that the above arrangement does not carry a 15 per cent impost. Your personal concessional contribution is included in the assessable income of the recipient superannuation fund, but there is an offsetting tax deduction within the superannuation fund for the premium paid on life cover. This means that the contributions tax cost is reduced to zero via this tax deduction. Your insurance arrangements in super therefore do not carry any costs in addition to the premium paid.

One word of warning

Beware the notice formalities

Personal contributions into superannuation are presumed to be non-deductible ("non-concessional") contributions, unless you provide the superannuation fund trustee with a notice of intention to claim a tax deduction.

If a notice is not provided, and other associated formalities are not completed within the prescribed time periods, no deduction may be claimed for the contribution in question. This means that you need to observe these provisions meticulously and diligently to ensure that you do not lose this valued tax deduction.

Way forward

The insurance in superannuation landscape has changed dramatically with effect from 1 July 2017. Speak to your financial planner to ensure your life insurance arrangements give you the best possible outcomes.

Source: TAL

The 150 year old baby

A topic that is currently being debated is the claim that the first person to live to 150 years of age has already been born. This "alternative fact" is, by its very nature, unprovable. Scientific studies can estimate the life expectancy of babies born today, but can't confirm a lifespan with certainty.

While it is worth taking this particular fact with a rather large grain of salt, the implication is the same, people are living longer lives. Advances in medical technology, changing lifestyles and improved sanitation are all aiding in increasing longevity globally.

Over the past several decades, the life expectancy of the average Australian has risen. According to a recent study published in the Lancet, the life expectancy for an Australian male born in 2010 is 80.1 years and 84.5 years for females. Looking at the Australian Bureau of Statistic's mortality table, our analysis shows that Australians who are currently 65 years of age are more likely than not to reach 80. And for couples, the probability of at least one of the pair reaching 80 is almost a certainty, at 93 per cent. Meanwhile, a 65-year-old couple might be surprised to learn that there is a 50 per cent chance that at least one of them will live another 25 years, reaching the ripe old age of 90.

If the timelines, checkpoints and milestones in life shifted to match the lengthening lifespans, this wouldn't be so much of an issue. But it matters hugely for retirement and financial planning for the later years, in which we don't expect steady incomes. An HSBC study, The Future of Retirement, explains that people's expected retirement age shows little sign of changing, despite longer lifespans. On average, the next generation of retirees expects to retire at the same age as their parents. The implication is pretty clear, if we are living longer but retiring at the same age, having a financial plan for those "extra" retired years is absolutely critical.

The startling fact is that people expect their savings to run out during their retirement.

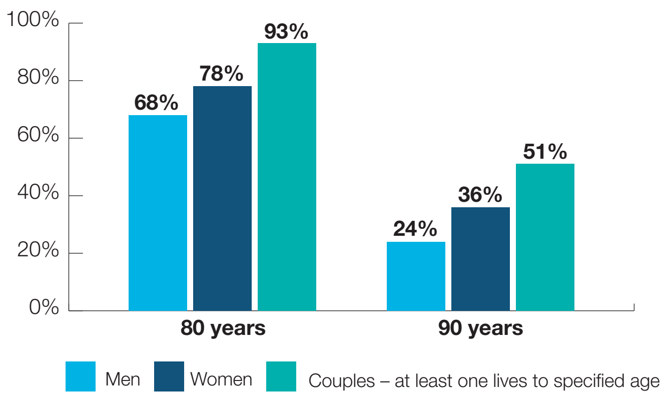
The global average of the number of years that savings are expected to last is 10 years, which leaves roughly eight years of retired life unfunded. The numbers for Australia are not that different: 11 years of savings expected with 10 years of retirement unfunded. This pension shortfall, as it's known, is getting larger.

Being aware of the gap is the first step. Investing is more than just a hobby or a way to make a little extra spending money. It's absolutely vital in the current environment. Starting early, being active, disciplined and diversified are the guiding principles.

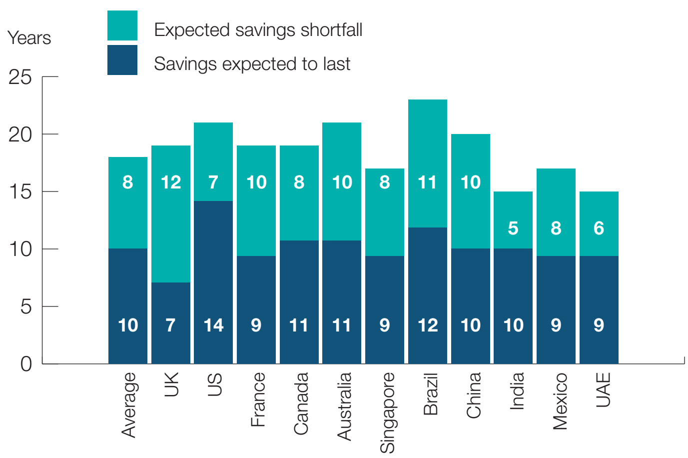
Contemplating one's own mortality is not a pleasant thought and a longer life expectancy may be greeted as good news. But it's good news tempered with some important investment considerations. Investors are often concerned and focused on the day-to-day movements in the markets, the latest trade, or the range of potential risks which may never materialise. However, longevity risk, not market risk, is the biggest threat that many investors face. The possibility of outgrowing or outliving your pension savings is what investors should really be concerned with and just how they might need to continue to grow assets through retirement as well as leading up to it.

Source: J.P. Morgan Asset Management

Probability of reaching ages 80 and 90
Persons aged 65, by gender and combined by couple



Perceived retirement shortfall by country



Figures represent the expected portion of the retirement that will not be covered by retirement savings based on data. Guide to the Markets - Australia. Data as of 30 June 2017

Speak with your financial planner to discuss your retirement strategy options.

What do market benchmarks measure?

Investing and sports can be similar in that good performance can be driven by a handful of superstar shares or players. In 2015, for example, the US S&P 500 index had a total return of 1.4 per cent. But if you took away just four stocks – Facebook, Amazon, Netflix and Google – the index would have suffered a loss of almost 3 per cent.[1]

When making a choice, as a sports fan or an investor, you need to fully understand what you are choosing. So how does a share 'make the team' to be included in an index?

In this article, we look at common myths about benchmark investing versus active investing, and discuss what you need to know about both in order to make choices about what's right for you.

What is a benchmark index?

A benchmark index is a group of stocks that is intended to represent the value of a given market. For example, the Russell 1000 Index, the S&P 500 Index and the Dow Jones Industrial Average (DJIA) are all widely quoted benchmarks for US stocks, even though the Russell index contains about 1,000 stocks and the DJIA contains just 30.

Nearly all benchmark indexes are weighted by market capitalisation (cap). Market cap is calculated by multiplying a company's share price by the number of its outstanding shares. Companies with the largest market cap have the largest weight and therefore have the most influence over the index's overall performance. Companies with smaller market caps have less influence because they represent a smaller portion of the index.

Do companies deserve higher weightings based solely on market cap?

Since market cap weighting is largely determined by share price, it makes sense to use benchmark indices as a compass for recent market sentiment. Historical performance data from various indexes is also extremely valuable in research, but what about as an indicator of future performance? That is what investors are most concerned about.

We don't believe that total market cap alone defines the future potential of any investment. Bear in mind that there are many reasons why shares go up (pushing market cap up), and some have nothing to do with the fundamentals of the company.

Consider what happened to Facebook in December 2013. When the company joined the S&P 500 its stock surged by 4 per cent. Passive index investors were obligated to pay a higher price for Facebook even though nothing changed regarding its business model. Or the Dotcom bubble of 1999-2000, when technology companies were all the rage and became notoriously overvalued. They carried more weight in benchmark indices, but this had nothing to do with business success. Since then, we've experienced bubbles in real estate and commodities as investors flocked to these sectors and pushed up prices.

How will you choose your portfolio 'players'?

Investing in benchmark indices can result in something you want to avoid—buying stocks when prices and emotions are high. Because the most expensive issues can dominate market capitalisation-weighted indexes, you may wind up buying more shares of overvalued companies while leaving potentially much better deals on the table.

On the other hand, active fund managers look at company fundamentals to make investment decisions, and 'smart beta' funds track indexes that are weighted by factors other than market cap. While different managers will be more skilled than others, they all seek tomorrow's opportunities, not yesterday's.

Investment success is far more likely when you truly understand what you own and why you own it. Active, smart beta and traditional passive strategies can all play a role in a well-constructed portfolio, but you have to know why you're choosing these players to join your team.

1 Source: FactSet Research Systems, Inc. Note that Google is now known as Alphabet.

Source: Invesco

Talk to your financial planner about any questions you may have on your portfolio allocation.

Income protection insurance – cover for your way of life

If something happened to you and you were unable to work, would you have enough money set aside to cover your day-to-day bills and look after your family?

Even if you think you'd be 'okay', how long would things be okay for?

These are the questions that thousands of Australians are faced with every day. While many think 'It won't happen to me', the statistics don't lie. It is estimated that one in three Australians will be unable to work due to illness or injury for a three-month period, or longer, during their working life*. Confronted with this situation, many Australian families experience significant financial difficulty, sometimes with no income for more than three months.

Income protection insurance allows you to continue to receive a monthly income, which is generally up to 75 per cent of the income you were earning prior to becoming too sick or injured to work. Income protection policies are very flexible depending on your individual circumstances, and importantly, they give you the financial security you need to be able to concentrate on recovering without having to worry about your bills.

Income protection can be held either within your superannuation or outside of your superannuation account. You should check with your superannuation fund to see if it provides income protection insurance, and consider if the benefit offered is enough to provide you with a sufficient income in the event that something happens and you are unable to work.

Source: AIA Australia

* Australian Disability Table IAD89-93 Class 2

Brendan's story

Brendan is a 32-year-old employee plumber who earns $100,000 gross income per annum. He and his wife have a $400,000 mortgage, with repayments of $2,800 a month. Brendan is very healthy, leading an active life outside of work and with a child on the way, he wanted to ensure that his family would be protected if he was unable to work due to injury or illness.

Brendan did some reading on the internet but wanted professional advice about whether to buy income protection insurance through his super account or not, so he contacted his financial planner. Together, they decided that having income protection outside super would place him in a better financial situation, so he went ahead with an income protection insurance policy outside his super account.

While walking home from work one evening, Brendan slipped and severely twisted his knee. After obtaining medical advice, he underwent a knee reconstruction and was unable to work for four months while his knee healed. His private health insurance was able to cover most of the medical costs, but what about the income that family would lose while Brendan was unable to work for the four months?

Fortunately, his decision to take out an income protection insurance policy provided him with a benefit of $6,250 per month covering 75 per cent of his gross income (inclusive of all his superannuation contributions), after the 30-day waiting period had elapsed. As recommended by his financial planner, Brendan also took out an accident option, which meant the insurer would pay him one-thirtieth of his monthly benefit for each day that he was totally disabled, for a period of up to a month. This payment would be backdated to the day he became disabled, with the first payment available after the first 30 days.

Since Brendan satisfied this definition, he was able to receive the full $6,250 accident benefit after the first month of total disability which covered the waiting period, and $18,750 for the remaining three months that he was unable to work. This meant that Brendan was able to concentrate on recovering, safe in the knowledge that his mortgage, car loan and family's lifestyle would be taken care of while he was unable to work. Could you afford not to have income protection insurance?

This case study is fictional and all figures are a guide only.

Speak with to your financial planner to discuss your income protection options.

Easy ways to improve your home

You don't need millions to give a house a new lease on life – little things can make a big difference.

Investing in improving the principal in your home is very tax-effective and also has advantages when it comes to the way Centrelink assess your entitlements — because your home is excluded from the assets test. The other benefit of renovations, compared to other types of investment, is that you can actively enjoy and experience the improvements you make.

The word 'renovations' doesn't have to be associated with spending up big. Depending on your skill level and how much time you're prepared to put into it, there are several home improvements you can do yourself to increase the value of your property. The two rooms in the house that deliver the biggest return on investment are the kitchen and the bathroom, so focus on these, especially if you're looking to sell. Potential buyers classify these rooms as not only the most expensive to upgrade, but also the most difficult.

To renovate a kitchen or bathroom, there's demolition involved. There's waterproofing, appliances, tiling and potentially a few hidden surprises. However, making these rooms feel clean, fresh and modern doesn't have to cost a fortune.

Updating the doorknobs and the power point sockets are quick fixes that can quickly improve the look and feel of a room. And when it comes to the bathroom, you can't go wrong with white.

Dig deep to uncover your home's potential

If you do have some extra cash to spend, continue to focus on the kitchen and bathroom, as well as the flooring throughout the property. If possible, pull up old carpets and linoleum and check the quality of the floorboards hidden beneath. It all comes back to the surfaces that you touch and use every day, and the flooring ties the whole house together. If the floorboards are in good condition, get the whole place sanded — no one likes threadbare carpets.

From there, using those extra dollars on good quality appliances, modern light fittings and tidying up any outdoor areas will be money wisely spent. People underestimate the power of a good clean. Paying a professional gardener and cleaner to come in and do a thorough tidy up will undoubtedly stand you in good stead if you want to sell.

In terms of the outdoors, as long as it suits the style of the house, you could consider using artificial grass, as well as painting any paved areas in an updated colour palette. A garden that looks tidy and low maintenance will have a greater appeal to potential buyers. It will also give you time to pursue more enjoyable activities.

While renovating can be financially beneficial for you, at a certain time in your life, downsizing or moving can also be an option worth considering, especially if you want to move closer to family or healthcare services.

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