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Macro risks elevated in 2016

Financial markets face an environment of elevated uncertainty in 2016, as China's economy continues to slow and the US Federal Reserve (Fed) moves to normalise monetary policy. With the prospect of quantitative tightening (QT) by the Fed on the horizon, this could cause risk premia to rise from historically low levels across credit and share markets, causing broad asset price declines.

Continued growth in the US, with some headwinds

The Fed commenced the normalisation of interest rates in December as the US economy continues to perform well in the face of growing headwinds. Unemployment is down to 5 per cent and US households are in a relatively strong position following substantial deleveraging. A strengthening labour market and rising household incomes will provide support to the corporate sector through greater consumption.

In this issue

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Key headwinds facing the US economy include the ongoing strength of the US dollar and further declines in energy prices, which collectively impact trade-exposed industries and those reliant on oil and gas investment. However, most of these headwinds are likely to be transitory and, in the case of energy prices, will be offset by material benefits for consumers.

Several transitory factors have been keeping US inflation below the Fed's 2 per cent target. However, as the oil price bottoms out, the US dollar stabilises and the labour market recovery continues, wage growth and inflation pressures are likely to normalise. This may force the Fed to increase interest rates faster and commence QT sooner than markets are expecting.

China's bricks and mortar problem

As the world's second largest economy, contributing around a quarter of world economic growth, China is key to the global outlook. However, China's rapid growth has become unsustainable and the economy faces serious short to medium term risks, principally in the property market and the shadow banking system.

Since the global financial crisis (GFC), credit in China has grown by the equivalent of the entire US banking system. Almost half of this credit growth has gone towards property market activity and a large share of the loans have been made through non-bank or "shadow" lenders. China has now accumulated three to four years of excess housing supply and real estate and related industries account for 20-25 per cent of China's gross domestic product (GDP). As the property market contracts and the economy deals with an excess credit problem, a recession in China cannot be ruled out. However, the Chinese authorities have a number of policy tools at their disposal and appear to be taking steps to slow credit growth and manage the housing market correction.

Muddling through in Europe

Eurozone growth is likely to remain modest for the foreseeable future. The combined effects of high government debt and unfavourable demographics are likely to present ongoing headwinds for growth, while political impediments are holding back much needed economic reforms. The Eurozone remains vulnerable to major shocks, such as an escalation of the Russia/Ukraine crisis, the election of Eurosceptic parties or a disorderly unwinding of quantitative easing (QE) in the US. Each of these scenarios could trigger a dramatic uplift in periphery Eurozone sovereign bond yields and would heavily test the resolve and mandate of the European Central Bank.

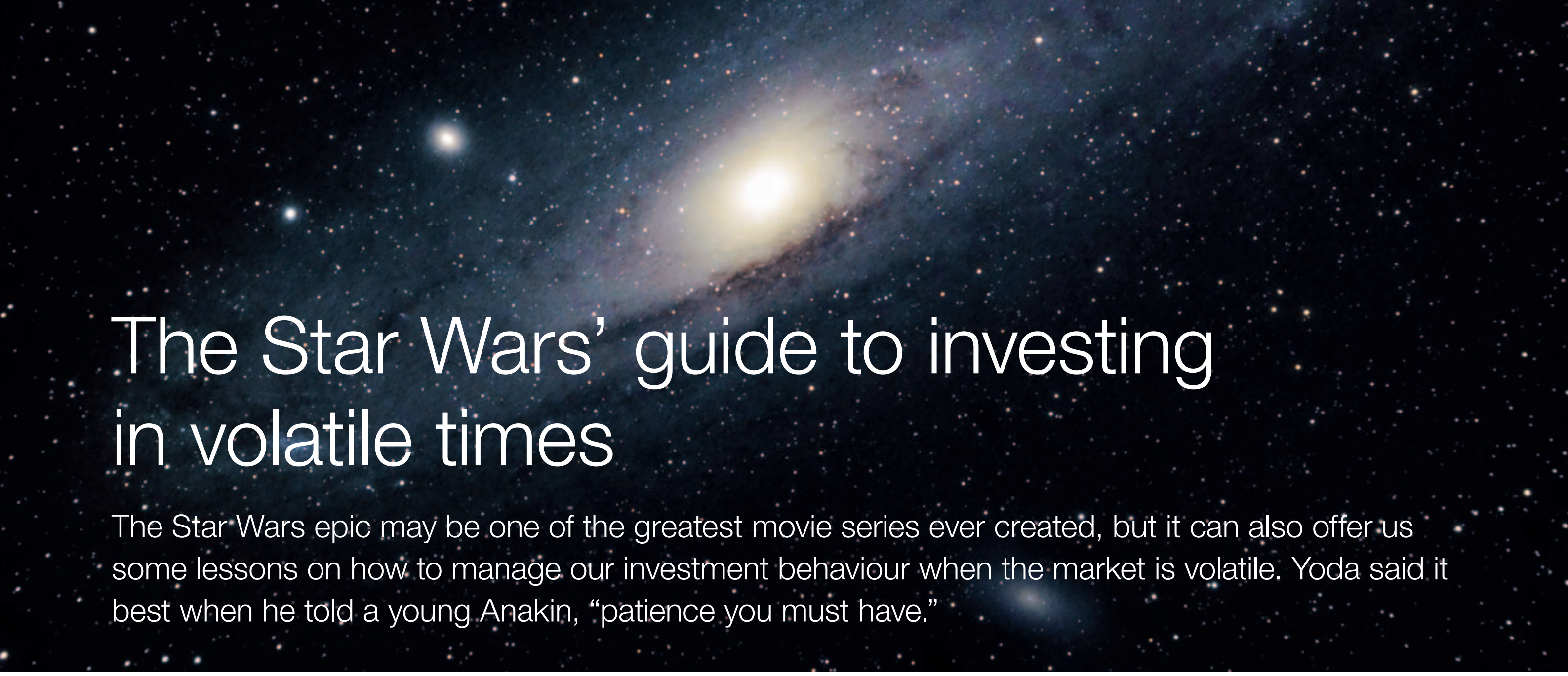
Implications for Australia

Australia's economy faces a number of global and domestic challenges, with China's economy slowing, Australia's biggest mining boom since the 1850s ending and the Fed entering an interest rate hiking cycle. Mining boom conditions and low interest rates have encouraged households to accumulate large debts, fuelling speculative activity in the housing market which is now likely in excess supply. A contraction in mining and construction sectors could tip the economy into recession over the next few years, while scope for countercyclical monetary and fiscal policy response may be limited. Current macro risks facing Australia emphasise the need for diversified portfolios with exposure to offshore revenue sources across a broad array of sectors.

Concluding comments

It is prudent for investors to be cautious in the current macro environment. The normalisation of interest rates by the Fed and the shift to QT could lead to rising risk premia and the repricing of credit and share markets. Meanwhile China's slowing growth makes linked asset markets vulnerable, particularly those in the commodities and emerging markets spaces. Despite the risks, in our view, opportunities remain for investors to achieve attractive returns over the investment cycle by focusing on high quality businesses with exposure to the growing US economy.

Source: Magellan



The Star Wars' guide to investing in volatile times

The Star Wars epic may be one of the greatest movie series ever created, but it can also offer us some lessons on how to manage our investment behaviour when the market is volatile. Yoda said it best when he told a young Anakin, "patience you must have."

For some investors, the recent market volatility has resulted in anxiety and concern. In this article, we've outlined some of the common pitfalls that lead to harmful investment decisions and explain that the most important variable in your investing success – and the only thing you can control – is your behaviour.

Don't be a Darth Vader driven by emotions

Darth Vader is the ultimate example of someone who started off on the right track but, motivated by emotion, ended up on the dark side. Many of us have common emotional behaviours which can threaten our financial security. Fear, greed, indecision and regret are the emotions most frequently linked to harmful investment decisions.

In the case of planning for your future, there is at least one tendency that we've all succumbed to on occasion. It's the feeling of instant gratification that causes people to overemphasise immediate rewards at the expense of long-term needs.

You may recognise your own past decisions in a handful of other frequent behavioural tendencies.

1. Overconfidence in your prowess as market prophets can also be detrimental to making market profits. When markets advance enough to get the casual investor's attention, many often start to think their success is the result of skill, rather than cyclical luck.
2. Obi-wan Kenobi was smart in his advice to a young Luke Skywalker when he told him, "your eyes can deceive you, don't trust them." Many investors have a tendency to overweight recent events. It causes misguided decisions at both good times and bad, as fear and greed override long-term prudence. It's reactive, not proactive, and the response often causes people to buy high for greed's sake and sell low out of fear.
3. Investors often also fear loss more than they seek gain. Loss aversion makes it difficult to put your money to work outside of a "safe" investment (eg term deposits), even if that perceived safety means inflation may destroy your purchasing power over time. Loss aversion causes people to plan for worst-case scenarios to minimise losses rather than trying to maximise wealth.

How to become a super Jedi and avoid dark side behaviour

1. Determine your risk tolerance.

Are you an aggressive investor? Or more conservative? Can you tolerate wide swings in the market, or are you willing to accept potentially lower returns for lower volatility?

Determining your risk tolerance is one of the first steps you should take in setting out your investment plan.

2. Stay diversified.

The very point of diversification is to limit downside losses in difficult markets. If a market correction happens (such as what we've seen recently) and you're properly diversified, you'll be less likely to lose a substantial amount – and thus less likely to sell at the bottom.

3. Think long-term.

Shmi Skywalker (Anakin's mother) was on to something when she said, "you can't stop change any more than you can stop the suns from setting." It's good to remember that markets will always change and to realise that in the history of share markets, very few individual events have had a meaningful impact on long-term returns. Not the assassination of President Kennedy, not the fall of the Berlin Wall, not 9/11, not the start of the wars in Iraq and Afghanistan. In each of these cases, the US share market (S&P 500) stood higher two years after the event occurred.

Broadly speaking, in time, markets tend to recover from events that may seem overwhelming in the near-term.

4. Get advice. Find yourself a Yoda.

With bumpy markets, fear is a natural reaction. One of the best ways to deal with it is to seek advice from the specialists. Having a plan in place means you'll be less likely to deviate from it – even when markets test our emotions with wild swings. Much like Yoda, your financial planner will help to guide you in the right direction.

Source: Russell

Aged care – making an informed decision

It can be difficult to plan, either financially or emotionally, for the move into an aged care facility. Whether the move into care is for yourself or a family member, there are a lot of questions and decisions which need to be addressed. Making the wrong decision could result in a loss of age pension, increased aged care costs and a reduced estate to be passed onto the next generation. This article looks at the current rules around aged care costs.

Aged care homes charge a range of fees to cover care, accommodation costs and living expenses. These can vary enormously between facilities and from resident to resident. The following are the four basic fees associated with aged care:

- **Basic daily fees** – Residents in aged care can be asked to pay a basic daily fee as a contribution towards accommodation costs and living expenses. This includes items such as meals and refreshments, cleaning, laundry, heating and cooling. The basic daily fee for all permanent residents who enter an aged care home is 85 per cent of the annual single basic age pension.
- **Contribution towards accommodation** – There are two types of accommodation charges which may apply:
  - **Accommodation contribution** – For residents who have some assets, they will be required to make a contribution to the cost of maintaining the aged care accommodation. This amount will be variable depending on the operation of the means testing arrangements, but will never exceed a certain figure (currently $53.84 per day).
  - **Accommodation payment** – Residents of reasonable means (where their means tested amount exceeds the $53.84 per day figure) will be required to pay the accommodation provider's fixed costs, which are advertised on MyAgedCare.gov.au Figures listed on this site are set by each aged care facility.

  Importantly, the resident has full control over whether they pay their accommodation costs by a lump sum (known as a Refundable Accommodation Contribution/Deposit), via daily payments (known as Daily Accommodation Contribution/Payment) or a combination thereof. An aged care provider cannot force the resident to make their accommodation payments in any specific way.
- **Means-tested care fee** – Residents in permanent aged care may be asked to pay a fee in addition to the basic daily fee. The amount payable depends on the residents' level of assets, their income and the level of care required. This contributes towards the cost of care. If a resident is paying an accommodation contribution, they will not be required to pay a means-tested care fee.
- **Extra service fees** – Some aged care facilities provide extra services which can be offered across the whole facility or to a designated part. Extra service means that the facility will provide the residents with a higher standard of accommodation and/or services. Examples of extra services could be a bigger room, a wider choice of meals or wine with meals. This does not mean that the resident will get a higher level of care, as all homes have to provide the same level of care.

Renting out the family home

Retaining and renting the family home could provide an exemption for social security purposes, provided:

- the resident is paying a Daily Accommodation Contribution/Payment (even if they have also partially paid a lump sum)
- it is rented out.

If these criteria are satisfied, the asset value of the family home and the income (rent) will be exempt from age pension assessment. However, the value of the property will remain assessable up to a cap (currently $157,987.20) for the calculation of aged care fees. The rental income will also be included for aged care income testing if the person moved into care after 1 January 2016, whilst residents in care before this date benefit from the rental income being excluded in calculation of their aged care costs.

It should be noted the current Government has shown an intention to remove this exemption from social security means testing – however no legislation has been introduced to implement this change at the time of writing.

When retaining and renting the family home, it is important to consider the income tax impact (as the rental income is assessable for tax purposes), the capital gains implications and whether renovations are required.

Get advice

Seeking advice from your financial planner or an aged care specialist will ensure that you can make the right financial decisions. Being able to afford the standard of care that is required, could make a difference to your or a loved one's overall quality of life.

Source: IOOF

Give your bonus a boost this year

For some employees, the New Year marks the end of their company's 2015 employee performance period and possibly a bonus payment. If you are fortunate enough to have an employer bonus payment to look forward to, you may have some tax savings options up your sleeve.

Imagine your employer declares a $30,000 bonus payment in recognition of your performance during 2015. Your manager formally advises you of your bonus entitlement on 1 March 2016. Given the healthy state of your finances, this will be surplus cash and will end up in your savings account, earning a small amount of interest.

Rather than having the entire bonus paid into your bank account, why not consider salary sacrificing part of the bonus into your superannuation fund? While it could save you a chunk of tax, the trick is to make the decision about salary sacrificing part or all of the payment before the bonus amount is declared.

Why salary sacrifice a bonus payment into super?

Primarily, it will save you tax but it will also boost your super balance.

So in the above example, you might opt for half of the bonus to be paid into your bank account and the other half to be paid into your super fund in accordance with a 'salary sacrifice' agreement.

To give you an idea, the tax saving on a $15,000 bonus payment salary sacrificed to super will be approximately[1]:

- $3,600, if your 2015/16 income is between $80,001 and $180,000
- $5,100, if your 2015/16 income is between $180,001 and $300,000
- $2,850, if your 2015/16 income is over $300,000.

By paying less tax, you get more bang for your buck. Assuming your taxable income is between $180,001 and $300,000, $9,900 of the bonus will go in your super fund after the 15 per cent super tax is deducted. That is going to be comparatively higher than what you would have received in net 'take home' bonus if this had been paid directly into your bank account. This is because the bonus amount taken in cash will be taxed at your personal marginal tax rate as salary and wages (eg if you were earning between $180,001 and $300,000 your net 'take home' bonus on this $15,000 portion of the bonus would only be $7,650).

Apart from providing a boost to your retirement savings, salary sacrificing your bonus payment may also help pay for the cost of any insurance that you might have in your super fund, or perhaps pay for your spouse's personal insurance via a superannuation splitting strategy.

What's the trade-off?

A key trade-off is that super contributions are locked away until you retire. So it must be money that you are prepared to immediately forego. You should get specialist advice, particularly if the bonus could have been used, for example, to make an extra loan repayment.

Speak to your financial planner today for more information.

There is a bit of housekeeping required if planning to salary sacrifice a bonus to super:

1. You need to establish a salary sacrifice agreement with your employer before your entitlement to the bonus arises. This is very important as you cannot elect to salary sacrifice income that you have already earned. Also ask your employer what impact salary sacrificing has (if any) on how your super guarantee or other remuneration entitlements are calculated.
2. Be sure to keep track of the total amount contributed to your super fund each year. Any amounts salary sacrificed to super are added to the usual 9.5 per cent super guarantee and any other super contributions that your employer makes for you each year. The law requires you to keep the total of these contributions within annual 'caps' ($35,000 for individuals age 50 and over, otherwise $30,000 for everyone else) so you might not be able to salary sacrifice as much of your bonus as you would like to.

Boosting your bonus

If you're in line to receive a bonus this year and anticipate that part or all of it will be surplus cash flow, consider salary sacrificing it to your super fund to make the most of your hard earned dollars. You will need to weigh up the tax savings with the fact that the money will be locked away in your super fund until retirement.

Source: AIA

1 Calculation includes Medicare levy.

Thinking outside the box

Commercial property vs residential property

Residential property tends to dominate the news and is a topic of choice for Australians. With skyrocketing prices, social concerns regarding affordability, speculation of a looming bust, the eleventh series of "The Block"…you would be forgiven for thinking that the only type of property is 'residential', but did you know that commercial property in Australia is worth a staggering $700 billion (CoreLogic RP Data, October 2015).

For many, owning your own home or buying an investment property and leveraging off Australia's attractive negative gearing laws is an appealing wealth creation strategy. However, there are compelling reasons for investors to look beyond the residential home and broaden their investment portfolio to include commercial property.

Certain income vs uncertain growth

Commercial property is an income investment, known for its high yields and steady long term capital growth. These high yields (which comprise the main component of the total return) are usually backed by commercial rent agreements which are locked in for five or more years, creating a greater level of certainty on short to medium term returns. Most commercial leases have contracted rent reviews (generally meaning that the rent cannot drop) directly linked to CPI, fixed rates or market based reviews.

Conversely, residential property is generally considered a high growth and low yielding asset. The potential for capital growth can be high, but 'punting' on potential growth returns from property can be fraught with danger, especially when you consider variables like interest rate hikes and changes to foreign investment laws. The low initial yield that Australian residential property investors accept presumes an inversely high level of capital growth. But you do run the danger of buying at the wrong time and experiencing low yield and low growth.

Commercial property is attractively priced

Whilst the Australian residential market is considered over valued by many industry experts, our valuation analysts shows that Australian Real Estate Investment Trusts (AREITs) are currently attractively priced. AREITs, formerly known as Listed Property Trusts are made up of a portfolio of property assets listed on the ASX that allow private investors to own a portfolio of large properties that would not normally be accessible to individual investors due to their value and size.

A key metric utilised in our AREIT valuation process includes analysis of a trust's Net Asset Value (NAV), which indicates that the market is currently trading at a discount of around 8 per cent and suggests material upside potential. AREITs are currently yielding in the range of 5.5-8.5 per cent.

Income. Diversification. Liquidity

A well-managed AREIT portfolio can offer investors an ideal way to access high quality commercial property and enjoy greater diversification in their portfolio. Not only is the risk/reward trade-off superior due to the lower reliance on capital growth, but the lower ongoing costs makes exposure to commercial real estate more accessible and attractive than a residential property investment.

A side by side comparison

	Residential property	Commercial property
Effective cash yield	2-4% per annum*	Around 6-7% per annum
Capital growth	Highly variable	Steady, low capital growth
Property types	▪ Houses ▪ Apartments ▪ Flats ▪ Townhouses	▪ Office ▪ Retail ▪ Industrial ▪ Healthcare ▪ Retirement living ▪ Leisure parks ▪ Hotels
Leases	Short term (typically one year)	Long term (typically 5+ years)
Rental reviews	Upon lease renewal, determined by local market conditions.	Most lease contracts have locked in rent reviews directly linked to fixed rates or CPI.
Tenants	Individuals	Businesses, ASX listed corporations, multinational companies and government bodies.
Legal protection	The Residential Tenancy Act favours the tenant.	Balanced legislation between landlord and tenant. Commercial tenancy agreements are dealt with as business contracts and are negotiated at arm's length between the parties.
Property costs	The tenant is required to maintain good order. Costs are largely borne by the landlord.	Most leases will provide for outgoings to be paid by the tenant and typically include: council rates, water rates, land tax, insurance, strata levies and property management fees. Tenants are required to 'make good' conditions factored into the lease. Majority of costs are borne by the tenant.

* Core Logic RP Data Home Value Index. Effective cash yield takes into account deductions such as: agents fees, advertising, repairs and maintenance, vacancy on renewals, insurance, cleaning/damage.

Source: APN Property Group

If you would like to learn more about commercial property investments and AREITs, speak with your financial planner.

Ignore life's trigger events at your peril

You may have a well-constructed estate plan delivering the outcomes that you want regarding your wealth after death. When established, your estate plan may pass the fundamental test which is: "will this plan ensure that the right amount will be paid to the right person at the right time?"

Can you now relax in the comfort that everything is under control? Certainly not. Remember, life is dynamic, and you will encounter major milestones on your journey through life. These milestones can be positive and life affirming. For example, you meet and marry the partner of your dreams or you bring children into the world and face the exciting prospect of watching them flourish and develop. The milestones can also be profoundly sad and traumatic, such as the death of a beloved family member. Sadly these events are part of our existence as human beings.

However, in the joy and sadness accompanying these trigger events, we need to take time out to assess the impact of these events on our future wealth and risk profile.

In the case of a forthcoming marriage, you need to spend some time thinking about the distribution of your property in the event of untimely death or disability after marriage. Marriage, for example generally revokes prior Wills. Everyone contemplating marriage should consider how their property should be distributed after marriage, and also discuss with their financial planners whether or not a new Will is necessary. If the marriage is a second marriage, the position is even more complex. In this situation, you need to think of a distribution of property which is fair to the children of the first marriage and possibly your former spouse.

Many individuals fail to appreciate the limitations of a Will. A Will only operates on death of the testator. It does not operate where a testator survives a traumatic event, such as an accident or stroke, but loses mental capacity. It is preferable for individuals to execute an enduring power of attorney to cater for this contingency. In this document, you can appoint a trustworthy person of your choice to handle your affairs during your period of incapacity. This provides certainty and reduces the risk of state government interference and delays should you lose the capacity to manage your affairs.

Do not forget, in rejoicing over the birth of a child, to review the impact of the new arrival. It may be necessary to review your insurance needs to provide a source of funding for education and living costs in the event of your untimely death. It is also important to consider whether or not your Will and superannuation beneficiary nominations need updating. There have been instances of newly arrived infants being excluded from death benefits simply because the deceased parent had neglected to update nominations to include the new arrival.

Other trigger events in your life which should prompt you to think of the future include:

- buying a home
- divorce
- an accident or traumatic event
- receiving an inheritance or
- retirement or changing jobs.

There is no substitute for having a well-constructed estate plan. However, you need to do more. Major trigger events will occur as you go through life. When these events occur, it is time to review your arrangements in conjunction with your financial planner, insurance and legal advisers. This will ensure that your estate plan continues to be robust and effective.

Source: TAL

Speak with your financial planner to discuss your estate plans.

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