



JULY 2016

Investor Update July 2016

Welcome to the July Edition of Investor Update. Between the budget, the Australian Election and BREXIT, markets have been in turmoil. In this edition we ask the experts what to make of the investment horizon.

Darin Tyson-Chan from selfmanagementsuper magazine analyses the consequences to super following the election and budget whilst Miles Staude, Portfolio Manager at the Global Value Fund dissects the BREXIT and what it means to the Australian and global economies. Nathan Bell of Peters MacGregor Capital Management Limited gives us his insights to why “Mr Macro” is an unreliable guide to investment.

In this issue

- ◆ **Where do we go from here? – Post election analysis**
Darin Tyson-Chan
- ◆ **Two Brexit visions as seen from London**
Miles Staude
- ◆ **Why Mr Macro is an unreliable guide to investment**
Nathan Bell

Where do we go from here?

Darin Tyson-Chan

The uncertainty surrounding the result of the federal election leaves both investors and SMSF trustees in a state of limbo, certainly in the immediate term, but perhaps also for the next three years.

Whatever we think we know now may be totally different depending how the final counting of votes from the 2 July polling booths plays out. However we can make some reasonable predictions based on some likely scenarios.

At the writing of this article in all probability the coalition looks like retaining power with a very slender majority.

Upcoming Events

AIA Annual Investors Conference
7 – 10 August 2016
Marriott Resort and Spa
Surfers Paradise
VOLATILITY RISK AND REWARD
Strategies for an uncertain world

Sydney North Shore Group
Insights into a Fund Manager’s investment philosophy – Romano Sala Tenna
Chatswood, 13th July 2016 7.30pm
Adelaide Information Meeting
Investment opportunities during volatile times –Zac Zacharia
Fullarton, 18th July 2016 7.00pm
Chermside Equities Discussion Group
Chermside Library
18th July 2016, 7.00pm
Brisbane Investment Management Group
Carindale Library
19th July 2016, 7.00pm
Melbourne Information Meeting
Election and Budget; What it means to Superannuation - SuperConcepts
Melbourne, 2nd August 2016, 12.30pm

[View Events Calendar](#)

Where do we go from here? (continued)

Of course the Turnbull government has already put its proposed changes to superannuation on the table with probably only the severity of the measures in question. It would be useful to examine each one and their implications but the days of tax-free pensions appear to be a thing of the past now.

Concessional contributions cap

The government is proposing the concessional contributions cap be reduced from its current level of \$30,000, and \$35,000 for individuals aged 49 or over at 30 June 2015, to \$25,000 coming into effect on 1 July 2017.

These contributions include employer super guarantee payments, salary sacrifice contributions and personal deductible retirement saving payments for individuals who are self-employed.

It would appear this proposal will not meet any opposition as no other party, especially Labor, has spoken out against these lower caps.

Seeing there are just over 11 months before this measure is introduced many sector experts are suggesting SMSF trustees should try to maximise these types of contributions before the lower limits come into play.

Non-concessional contributions cap

Perhaps the most contentious proposal contained in the 2016 Federal Budget was the imposition of a \$500,000 lifetime non-concessional contributions cap. These are contributions individuals make from their post-tax dollars.

The definitive nature of this move has been unpopular but the fact it came into effect at 7.30pm on 3 May this year and includes all non-concessional contributions made from 1 July 2007 onwards has really upset a large portion of the Australian public.

While the government has been putting its best spin into action to convince people this is not a retrospective change most individuals are still viewing it this way which may have gone a long way to explain the post-election limbo we are now experiencing.

The retrospective nature of this change has not escaped the Labor party which, while guilty of constant tinkering with the system itself, claims it would never introduce an amendment this way. So an adjustment to how this

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If you were considering attending, and have not yet booked, there is still time!



40 Sessions covering every aspect of investment strategy for these times.

Speakers include Paul Bloxham, Dr Shane Oliver, Dr Mark Brimble, Alan Kohler, Roger Montgomery, Charlie Aitken, Colin Nicholason, Dr Doug Turek and many others.

[See full program details here](#)

SUNDAY WORKSHOP:**IF NOT SHARES, THEN WHAT?**

Join us at 12.45 for 1.00pm for an interactive workshop focusing on alternate investments and how to achieve positive returns in any market.

1.00: Unlisted Mortgage Trusts

1.45: Build a targeted return bucket

2.30: Afternoon tea

3.00: Instalment warrants

3.45: Technology – IT is only a matter of time

4.30: Finish

new cap is implemented may well be on the cards when the legislation is debated in parliament.

Further the opposition stated during the election campaign it was not convinced \$500,000 was high enough if the non-concessional contributions was to be a lifetime cap. Instead Labor said it would be examining whether a limit of \$1 million was more appropriate.

This proposed change has clearly spooked superannuants with a lot of them asking if it would be prudent to abide by the old rules and make as many non-concessional contributions as they can within the previous caps until the legislation is actually passed.

Most experts though are arguing against doing this and instead are advising all individuals revisit how many non-concessional contributions they have made since 1 July 2007. And this exercise is not as cut and dried as it might appear on the surface.

The government chose 1 July 2007 as the starting point to monitor these contributions because it was confident the Australian Taxation Office (ATO) had reliable records for these types of contributions from this date onwards. The problem is this may not be the case.

The situation is further complicated by the way the contributions rules work, that is, in the past if an individual has exceeded their concessional contributions cap the excess amount has been treated as a non-concessional contribution. These contributions previously had not been recognised separately as non-concessional contributions by the ATO so how this record keeping issue is resolved remains unknown.

In all we can be guaranteed this change alone will create an administrative nightmare for all SMSF trustees and will ultimately increase the cost of running their own funds.



The transfer balance cap

The 2016 federal budget also contained a proposal to impose a \$1.6 million transfer balance cap on superannuants effective 1 July 2017.

While this change has also angered a lot of people, especially those who have been disciplined enough to have built large accumulation phase balances in the effort to facilitate a significant tax-free pension, it is unlikely to be challenged by Labor at least in parliament.

This proposed transfer balance cap is very similar to the opposition's proposal of taxing any pension income above \$75,000 which was effectively applying a \$1.5 million tax-free cap on retirement assets. Industry experts are advising those approaching retirement to consider this cap carefully as they strategise for the pension phase of their life. The desire to have their pension assets fit underneath this limit may require a review on the actual type of superannuation assets they are currently holding.

Experts are also pointing out exceeding this cap will only result in a 15 per cent tax liability on income derived from assets above the limit which, compared to marginal tax rates, can still be considered advantageous.

Other changes

Other proposed changes include the scrapping of the exempt current pension income status for transition-to-retirement income streams.

Considering these arrangements have often been viewed as too generous a tax concession, this proposal is unlikely to be opposed.

Again industry participants are advising people with these arrangements to review them immediately.

The final significant proposed superannuation change is where people earning over \$250,000 per year will have their pre-tax contributions taxed at 30 per cent rather than 15 per cent.

Previously it was people earning over \$300,000 per year who were subject to the 30 per cent tax rate.

As Labor's policy included this exact proposal it would be safe to assume this change will stay.

Conclusion

There is much to contemplate in regard to superannuation strategy over these rule changes. As the picture becomes clearer as to who will form government one last issue comes into play and that is whether the

budget will be passed before the end of the year because if the process drags on into 2017 implementation timeframes will become extremely tight.

Darin Tyson-Chan is editor of selfmanagedsuper Trustee News.

Two Brexit visions as seen from London

Miles Staude – Portfolio Manager at the Global Value Fund – Courtesy of Cuffelinks www.cuffelinks.com.au

[Editor's note: Miles Staude works in London and voted to 'remain', and considers the Brexit result "a very sad turn of events". He received many requests for his reaction and wrote this update exclusively for Cuffelinks late during this week. In an earlier note, he wrote optimistically: "It is important to know however that the final outcome does not necessarily have to be as bad as the initial headlines have made out ... If the UK can maintain access to the common market, then the actual impact will be quite mild."]

The first fight in the 'Brexit' referendum was not in fact between those in the leave camp and those campaigning for remain. It was instead a fight between two very different Brexit parties seeking the nomination to be the official leave campaign from the Electoral Commission. At stake was the ability to raise and spend a large amount of money under the Electoral Commission's campaigning rules. Grassroots Out, the party associated with Nigel Farage's UK Independence Party (UKIP), had a wide support network built up from years of railing from the political edges. Vote Leave, a movement supported by leading conservative MP's like Boris Johnson and Michael Gove, was a newer organisation seeking to run as a cross-party establishment movement. Vote Leave won the contest, becoming the official leave campaign for the referendum. This however did not stop Grassroots Out from raising a significant war chest of its own, and going on to campaign as the anti-establishment party of the referendum.

The different campaigns to leave

For many years, UKIP has campaigned on an anti-immigration platform. Over the past decade the relative economic success of the UK, combined with the free movement of labour rules which govern the EU, has led to a large increase in the number of Europeans living and working in the UK, a situation that has unsettled many voters across the country. Grassroots Out campaigned in

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the referendum on a similar theme, a heavy focus on the perceived risks coming from ‘uncontrollable’ immigration. At a time of austerity, falling living standards and rising levels of terrorism, it was an easy sell to much of the electorate.

Vote Leave in contrast ran on a much more principled campaign. The essence of the Vote Leave argument was a democratic ideal. Britain had ceded too much power to Brussels, an unaccountable, undemocratic Leviathan.

Their argument ran that a UK freed from bureaucratic red tape would go on to prosper outside of the EU, striking trade deals around the world in a manner that reflected its outward-looking, free-trading nature – a nature that was inherently at odds with inward-looking continental countries.

Vote Leave’s vision for Britain was for a European Singapore, free-trading and outward-looking. Grassroots Out’s vision was for an end to immigration mixed with nostalgia for older times.

These two different visions matter greatly today as the UK starts on its path towards renegotiating its relationship with the rest of Europe. In economic terms, the most important feature of EU membership is the access it provides to the European common market, the largest free trading bloc in the world. Access to the common market does not only come through EU membership however. European countries like Norway and Switzerland maintain access, whilst still retaining many of the key democratic powers Vote Leave has argued needed to be returned. Unrestricted access to the common market comes at a price however, including the free movement of labour throughout the economic zone.



Towards the end of the campaign Grassroots Out came under considerable criticism for running highly emotive anti-immigration ads. In response to these ads, Boris Johnson contrasted his own position on the immigration

issue as such, “I am passionately pro-immigration and pro-immigrants.”

Know who will be negotiating with Europe

With these two different Brexit visions in mind, it is important to note that it will be the conservative government of the day, led by those in the Vote Leave camp such as Boris Johnson and Michael Gove, who will be the ones renegotiating the UK’s arrangements with Europe. If, and perhaps it is a hopeful if, those negotiating the new arrangements are true to their cause about a return of UK sovereignty, and less concerned about immigration, then access to the single market could still be maintained. Such a result would lead to a very different, and largely positive, outcome for the UK and Europe when compared to the Grassroots Out vision for the future.

The economic case for immigration is clear. European immigrants to the UK and pay more into the state coffers than they take out in terms of benefits. They are typically younger, healthier and more entrepreneurial than the general population at large. In every economic sense, they are a tremendous asset to a heavily-indebted economy with an aging population. How well this vision is upheld over the coming months will determine what the UK’s future relationship with Europe holds.

Miles Staude is Portfolio Manager at the Global Value Fund (ASX:GVF), which he manages from London.

Why “Mr Macro” is an unreliable guide to investment

Nathan Bell, Head of Research, Peters MacGregor Capital Management Limited

In a recent interview the host was astonished that I had little interest in the macro environment. Unfortunately, I wasn’t able to recite Chris Mittleman (of Mittleman Brothers Investment Management), who explained why in his 2015 letter to investors.

‘There is [a] character out there, to be more ignored than taken advantage of; and that is Mr. Macro. Mr. Macro reads everything worth reading and knows every macro-economic indicator worth tracking, including the price of tea in China, and where the unsustainable imbalances are, and he plans to grab that next big asymmetric risk/reward payoff so The Big Short II will be about him.’

'He even goes to Davos. He speaks of new normals, zero bounds, contagion, contango, unintended consequences, risk premia, risk parity, risk-on/risk-off, Abenomics, QE, BRICs, PIIGS, Grexit, Brexit, and Mr. Macro is the one who whispers in your ear at each sell-off, "Don't do it... It's different this time..." For long-term value-oriented investors like us, Mr. Macro is to be ignored with extreme prejudice. Because, as history has proved, opportunities for successful investment outcomes exist in even the most hostile macro environments imaginable.'

Pain of loss versus joy of gain

As fund managers we're often asked about our outlook for the macro-economic environment. It's understandable. Everyone wants to avoid financial apocalypses like 2009. Remember we feel the pain of losing money twice as much as we feel the joy of earning it. The average Australian doesn't see episodes like 2009 as a huge opportunity (at least not in the thick of it) but rather something to be avoided, judging by the fall in individual stock ownership since.



Although we may feel strongly about certain economic outcomes, such as the future level of interest rates, these issues should only be as important as they relate to having adequate portfolio diversification and the individual investments you've made (i.e. could higher interest rates bankrupt a company you own).

Understanding a stock's intrinsic value and the sustainability of its market position is much, much more important. As Mittleman says, 'as history has proved, opportunities for successful investment outcomes exist in even the most hostile macro environments imaginable.' Research consistently shows economic growth has little to no predictive relationship with investment returns.

If you're waiting for GFC Mach II before buying another stock, you may miss out altogether. Who's to say inflation doesn't take off taking share prices with it as investors favour owning productive businesses over cash.

Eight commandments for dealing with Mr Macro

Here are my eight commandments for dealing with Mr Macro.

1. Focus on the intrinsic value of the businesses you own. The further you think ahead, the less impact the state of the economy has on the value of your investments.
2. Understanding a company's competitive advantage is critical. Good companies increase market share in a recession and emerge stronger than ever. Don't let Mr Macro divert your attention from what really matters.
3. To buy a business very cheaply and make a large amount of money, usually the share price has to fall a long way first. See falling share prices as opportunities, not something to panic about, and be prepared for anything. As John Maynard Keynes said, 'the market can stay irrational longer than you can stay solvent'.
4. Remember no one can predict the timing of recessions consistently, but a good fund manager can consistently identify undervalued stocks.
5. If you fear a financial judgment day, ask what you should do to relax. Usually those with the biggest fears either don't understand their investments, or they have too much leverage. There are no new ways to go broke, it's always debt. In fact, that's why sharemarkets can fall so far. Much of the selling is to cover other financial liabilities, and has nothing to do with the intrinsic value of the businesses being sold.
6. High quality businesses always recover. An economic downturn is your chance to buy them cheaply. There's a major difference between temporary paper losses, and permanent losses due to buying weak or over-leveraged businesses.
7. Never stop educating your clients about simple investment truths. You can measure your success by whether they give you more money to invest in a downturn or whether they're selling out. There's no point trying to educate someone gripped by fear. Being forewarned is forearmed.
8. Lastly, as the long-term owners of businesses we should welcome economic downturns. They clean out years of bad behaviour, make our economies more productive, and they provide the opportunity to earn high returns over many years during the recovery.

See market falls and recessions as opportunities

If we learn not to fear market falls and recessions, and see them for the opportunity they are, then we can focus on what really matters i.e. is each investment compensating me for the risks. For many companies' macro risks are trivial anyway, and for others they're insignificant compared to their ability to maintain and grow their market position.

Economist John Kenneth Galbraith opined that 'The only function of economic forecasting is to make astrology look respectable.' That said, it's becoming increasingly obvious that Australia is over-doing it in the apartment space. If so, we may eventually join the union of countries with zero interest rates and the fall out may not be pretty.



After a golden 24-year run for banks and property, lower interest rates may be causing more harm than good. The best defence is buying undervalued assets. Fortunately, markets are becoming more volatile, which means more opportunities to buy low and sell high. To harness the opportunities investors may need to be more active than they have been. Just make sure to let valuations guide you, not Mr Macro.

Nathan Bell is Head of Research, Peters MacGregor Capital Management Limited

While everything is still calm, now is the best time to educate your clients. Have they got enough overseas exposure? Are debt levels under control if house prices fall 15%, 20%, or more? Is there adequate diversification? Have they written down their action plan to remove the emotion from their decisions and profit from any downturn? How would they deal with zero interest rates?

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