

# the **INVESTORS**voice

Magazine of the Australian Investors Association - *Investors helping Investors*

## DRIVERS & DRAGS

Sept2015

### HOUSING OUTLOOK

### GREEK TRAGEDY

### BIG 4 BANKS



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# Drivers & drags on the road to Christmas

**DAVID CHIA**

Looking beyond the ups and downs of stocks that comprise your portfolio, this calendar year has been dominated by the ructions of the Greek noncrisis.

While the last-minute negotiations in Europe dominated the headlines for some time, it seemed like no one involved had the stomach for the uncertainties that would flow from a Greek default and possible exit from the EU – not a prospect they would have entertained when the Maastricht Treaty was signed back in 1992 to form what is now the European Union.

## Midyear volatility

In June, Chinese share markets caught our attention and hogged the limelight on the global stage when the Middle Kingdom discovered that gravity was alive and well, despite some opinions that the ascent of Chinese shares had somehow escaped the law of physics. We know better now, I guess.

Both events look set to play out their respective concluding chapters as the year unfolds. Try as I may, I struggle to see a happy ending for the Greek affair, not as long as monetary union excludes fiscal co-operation. There is a yawning chasm between what everyone desires and the state of things at present. It is more than likely that Greece's creditors will ultimately take a larger haircut than they care for. To some extent, financial markets appear to have priced it all in, regardless of what a final solution may ultimately look like.

As for Chinese shares, the midyear volatility is large enough to lose sleep over, for sure. After all, it is not normal to see an index move 8% in a day. But I suggest that those nimble enough to navigate the ebb and flow of the market may well be surprised by the possible risk/reward payoff on offer with Chinese shares. And I understand this view may not sit well with many market observers.

My contention is quite simple and it goes like this. The Chinese market is relatively immature by US and West European standards, whether we are talking about participants or governance or transparency. For this reason, it is more susceptible to the bouts of irrational exuberance we have noted on the way up, as well as on the way down.

But when you allow for the sheer size of the population and the emergence of the wealthier middle class, the weight of capital that will underpin the share market's growth in the years ahead is likely to behave like a slowly rising floor beneath the market.

Of course, no one reading this is silly enough to believe that the journey will be smooth and devoid of air pockets. But it is this coming of age for Chinese markets that may well produce returns that exceed the expectations of the investing community.

**It is conceivable that China's economy will swap its 'developing' tag for one that says 'developed'.**

Given China is pushing the IMF hard to have its currency included in the basket that makes up the Special Drawing Rights (SDRs), it is conceivable that its economy will likely swap its 'developing' tag for one that says 'developed'. With its economy in the mainstream of global markets, it may not be too long before the global indexed funds community starts including the likes of Alibaba next to eBay when constructing their portfolio constituents.

Consequently, the liquidity for Chinese shares will come not just from local investors but also from a rising tide of global funds searching for alpha. The whole thing is not really that much a stretch of the imagination; after all, China is already widening its doors for foreigners to do deals. And it is totally conceivable, with time, to see a significant narrowing of the arbitrage between 'A' shares (for locals) and 'H' shares (for foreigners). All signs to watch for as the Chinese market comes of age.

## Bull market end in sight

Finally, the sideshow that has been the US Federal Reserve's 'will they or won't they raise rates' appears headed for 'yes, they will', some time in the last quarter of 2015. There appears to be a consensus among commentators that the reversal of the prevailing accommodative policy by the US Feds and other central banks will likely spell the end of the bull market for equities. Common sense would suggest that to be the case.

Well, in theory that may well be so, but I would like to present some empirical data that may surprise you. The accompanying chart plots the US share market against the Federal Funds rate for the last 50 years. The federal funds rate is the weapon of choice employed by the Federal Open Markets Committee (FOMC) to regulate interest rates.

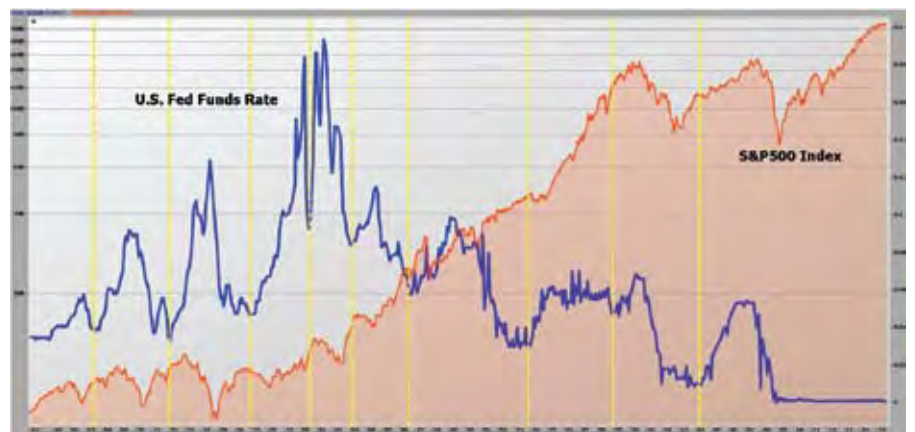


Chart courtesy of IRESS

# Drivers & drags on the road to Christmas

## continued...

It is not difficult to see that there is little correlation – let alone any causal relationship – between a rise in the short-term rate of interest (blue line) and equities (red line) performing poorly. But an urban myth is hard to dispel, despite evidence to the contrary. And they tell me there is no room for behavioural economics!

What is clear from the above chart is that the change in interest rate on its own tells you little about what may happen to stocks. The multitude of pull and push variables at play (including that of the interest rate) in aggregate is what drives equity price reactions and trends.

Just in case you were wondering, I did the same comparison for Australian equities and the RBA's cash rate. It should not surprise you to know the outcome matched the US experience.

In closing, perhaps Christmas cheers may still be in store, notwithstanding what Janet Yellen and crew will do to rates in the US – if we get through the sometimes wobbly months of September and October, that is. I think I worry too much.

Happy and safe investing!

David Chia, Relate Empower Deliver

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## President's Message

### By Bill Shirley



### The Second Half Reporting Season 2015.

We are now nearing the end of this reporting season, and so far some interesting outcomes have occurred.

These can be found in the following sectors or groups - large cap stocks that have had a slowing growth trend, stocks that the market does not seem to comprehend, small caps that could in the coming months show a turn around story of some sorts, and some ASX listed stocks that seem to be way overvalued but just keep on going up.

Finally the stand out feature of the season is the higher levels of dividends being paid resulting in higher payouts, plus the resulting franking credits.

Based on a recent industry research report, these higher dividend returns grew at a rate of around 9.30 per cent, higher than was predicted.

A further interesting parameter was the unexpected growth in the overall company payout ratios rising from 69.8 per cent to an average of 71.5 per cent. The increase is a small 2.44 per cent, however it is a growth result.

It seems that a lot of companies are trying to please investors by increasing their dividend payments, as maybe future growth estimates are going to be a little on the flat side. We can only wait and see what may unfold in the future.

In summary when we consider the recent media coverage, as well as taking into account the data outlined above, things are not all doom and gloom. There are some good companies out in the commercial space which are announcing increased higher yields, we just have to find them!

Locating them is important as they will help us retirees pay our bills and put food on the table, and maybe do a bit of travel. Maybe life is not so bad after all!

### AIA Matters

The 2015 National Conference was once again a resounding success with many of the 320 attendees, including speakers and sponsors saying that "we have done it again – and this was a fantastic event". If you have not attended one in the past maybe one is in your future!

Your new committee has now started the initial review phase and is looking at areas that may be improved in next year's program. It was announced in the closing session of this year's event that the 2016 meeting would be held on the Gold Coast, in August.

Another announcement made at the Conference by me, was that I will not be standing for re-election to the National Board this year, hence this will be my last President's message for Investors Voice.

Over the 13-year journey on the National Board, there have been many challenges and rewards, and I wish to thank all those people who have assisted me during this long period. Further I would like to say a big thank you to the other members of the Board past and present, Donna and Chris in the National Office, and the many volunteers who run our meetings and discussion groups etc., who have made this time one we will remember always.

In conclusion, we would like to wish all our members a successful investment future over the coming years as well as a safe and happy one for all members, friends and their families.

Kind Regards – Bill Shirley

# THINK ABOUT COMPANY STRATEGY

JOHN DALY

By investing in the shares of any listed-company, we are demonstrating our support for its current strategy.

But how many of us can clearly explain the current strategies of the companies we are invested in? And can we really say we've consciously considered their strategies? Can we say we are confident they're likely to deliver growth in share price and/or dividends over our investment time horizon?

If we can't explain the current strategies of the companies we're invested in, it is possible that we don't truly understand them – if that's the case, are we taking greater risks than we realise?

## Take a step back

It's worth beginning this exercise by taking a step back, and understanding the requirements placed on listed-companies by ASIC regarding disclosure of their strategies to shareholders. ASIC requires all companies to include an operational and financial review (OFR) in their annual report. The OFR must set out:

*... information that shareholders or unit holders would reasonably require to assess an entity's operations, financial position, and business strategies and prospects for future financial years ...*

In 2013 ASIC published guidance to companies in relation to what the OFR should contain. Essentially it directs companies to explain:

- the overall business strategies relevant to the entity's future financial position and performance;
- the entity's prospects in terms of future financial performance and financial outcomes; and
- the material business risks that could adversely affect the achievement of the financial performance or financial outcomes described.

It goes on to say that the OFR should present:

**a) a narrative** – providing tailored information about an entity's results and financial position. Information in the OFR should be consistent with and complement the financial report; and

**b) an analysis** – providing a reasoned and meaningful description of the underlying drivers of, and the reasons for, an entity's performance, rather than simply restating information that may be readily determined from the financial statements.

Given that these topics are mandated for discussion – and the format of their disclosure is clearly detailed – it seems unusual that few of us would say we are completely conversant with the strategies of the companies we invest in.

## Some companies comply better

From our experience, companies comply with these requirements in a range of ways and in doing so, some do a better job than others. For example, Caltex describes its strategy under clear headings such as 'Superior supply chain', 'Comprehensive targeted offer to customers across products, channels and geographies' and 'Organisational competitiveness'; this means we can quickly see exactly where the focus of the company is.

*When we do have access to information on strategy – and we are able to spend time considering it – we strongly believe that the most useful way to do so is in the context of the competitive environment in which the company is operating: essentially, how does Company A's strategy compare to that of Company B?*

A detailed understanding of the strategies of competing companies also puts us in a better position to form an opinion as to the likely success of any given strategy. For example, if one operator details a strategy of aggressive cost-cutting to gain market share, it is unlikely another participant in the same market will succeed in raising margins through higher prices. Of course, it is possible for such a strategy to succeed, even given this competitive landscape, but before most investors would be willing to back it, they would require significant additional explanation.

Most people would regard Fairfax and REA Group as competitors. Although their

respective businesses may not look exactly alike, they are both built around classified advertising revenue and therefore they compete aggressively for those advertising dollars.

## What do these statements tell us?

REA talks about its strategy in terms of 'empowering consumers', 'continuing to stimulate the market', and 'continuing to extend our brand and maximise our audience'; while Fairfax discusses 'identifying opportunities for operational cost savings', 'investing in existing and new business areas where company content gives a competitive advantage', and 'investing in and building new portfolio businesses through international and local partnerships'.

These statements suggest that one believes it can continue to grow profits by focusing on building its existing business, in its existing markets, while the other is looking to remove cost and establish news businesses – albeit in related areas – in order to drive profit growth into the future.

Of course, a rewarding investment decision requires the consideration of a broader range of issues – most particularly the value represented by the current share price, and an assessment of management's ability to deliver on its stated strategies – but we believe it is an important part of the investment process to not only think deeply about strategy, but to think about it in the competitive context in which respective businesses operate.

## Do we need better disclosure on company strategy?

In general, we believe investors would benefit significantly from better disclosure on company strategy. It's one of the reasons 'Strategy' is the third of our nine content categories on the Listcorp website. Further, however, we also believe that it is not only investors who will benefit from greater detail in relation to company strategy – many examples show that where companies have clearly detailed their strategies to investors – and then delivered on them – both companies and their investors have been handsomely rewarded.

John Daly is CEO, Listcorp  
<https://www.listcorp.com>



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# THE OUTLOOK FOR THE AUSTRALIAN HOUSING MARKET

ANGIE ZIGOMANIS



Low interest rates will support further price growth in undersupplied residential markets in 2015–16, but the spectre of tightening interest rates and deterioration of affordability will create conditions for price declines in a number of cities from 2017.

However, at BIS Shrapnel, our view is that doomsday predictions for the residential market are overblown. Although Australia's residential property markets are expected to steadily weaken from 2016–17, as a combination of rising supply and the prospect of a tightening in interest-rate-policy impacts on prices, any downturn will be similar in magnitude to that seen over 2011–12.

## Affordability varies

Analysis undertaken for our Residential Property Prospects, 2015 to 2018 report indicates that Sydney and (to a lesser extent) Melbourne have broken away from the other capital cities, with both estimated to have recorded double-digit percentage rises in their median house prices in 2014–15. Solid population growth, reasonably positive economic conditions and an underlying dwelling deficiency have underpinned this rise, and affordability is increasingly becoming a concern.

In contrast, weaker recent price growth in the other capital cities means that affordability is not as strained, and subdued local economic conditions and/or underlying excess dwelling stock have impacted the market.

## Supply & demand key to growth

Low interest rates will continue to support prices. However, the demand and supply balance across the states is the key to price growth in the coming years. Moreover, the boom in apartment construction over the past couple of years has created a disconnect in the supply balance between detached houses and units, with a resulting difference in their price outlook. Most capital cities are building apartments at record rates, driven by investors. As these projects are progressively completed, strong tenant demand will be required to support rents and consequently values upon completion.

***The demand and supply balance across the states is the key to price growth in the coming years.***

However, population growth is now slowing nationally (albeit at different rates across the states). Net overseas migration peaked at 235,700 persons in 2012–13, and fell below 185,000 persons in calendar 2014. This slowdown in net overseas migration is most evident in the mining boom states of Western Australia, Queensland and Northern Territory. With the majority of net overseas migration classified as 'long term overseas visitors' – that is, temporary but not permanent arrivals – the reduction will impact most on the rental sector.

In contrast, the detached house market is less reliant on tenant demand and more exposed to owner-occupiers. Together with the stimulatory effect of variable interest rates at more than 40-year lows, this is expected to support median house prices in most capital cities over 2015–16.

## THE OUTLOOK FOR THE AUSTRALIAN HOUSING MARKET CONTINUED...

The strongest conditions over 2015–16 are forecast for New South Wales, Queensland and Victoria, where we estimate the markets are in overall deficiency at June 2015. While increasingly difficult affordability in Sydney and Melbourne should see price growth return to single-digit percentages over the year, weaker recent price growth in Brisbane is likely to see price growth accelerate as the cuts to interest rates in the first half of 2015 further improve affordability.

Across the other markets, rapidly weakening economies in Western Australia and Northern Territory – as mining investment is wound back – will cause price growth to be flat to negative in Perth and Darwin respectively. With an estimated oversupply, the markets in South Australia, Tasmania and Australian Capital Territory are expected to remain relatively flat.

### Changing gears

***The change in gears from resource investment to domestic demand driving the economy will be slow, although it is forecast to eventually come through and begin to have a positive effect on the economy and employment later in 2016.*** To some extent, the improving economy will support house prices, although it will also signal the beginning of a tightening in interest-rate policy.

Interest rates are expected to enter a tightening phase towards the end of 2016. After recent wage constraint, the Reserve Bank is expected to 'fire a shot across the bow' to curb wage expectations and alleviate the potential for inflationary pressures to emerge.

While we anticipate the cash rate will rise by only 50 basis points in total, this will impact the Sydney and Melbourne residential markets where recent price rises are seeing affordability worsen to levels approaching previous interest rate peaks in 2008 and 2010–11. The rise in interest rates – and anticipated possibility of further increases – will also weaken the other markets, while also having the desired effect of slowing economic growth and inflationary pressures.

### Residential market to weaken

Consequently, residential market conditions are anticipated to weaken over 2016–17 and 2017–18, with the impact of higher rates and a slowing economy compounded by rising supply. Nationally, a record 210,000 new dwellings were commenced in 2014–15, with a further 200,000 forecast in 2015–16. Multi-unit dwellings accounted for a record 45 per cent of the total in 2014–15 at 95,500 dwellings.

This total dwelling construction compares with an average underlying demand for 159,200 new dwellings per annum over the next three years. As these dwellings reach completion, all states with the exception of New South Wales will have moved into oversupply, or be experiencing an increasing oversupply by 2018. With the price pressure of the stock deficiency of recent years being steadily alleviated, all markets are likely to weaken through 2016–17 and 2017–18, with house prices largely flat or in decline over this period.

### Brisbane to shine

The strongest house-price prospects over the next three years are in the Brisbane market, where affordability has improved significantly after weak price performance, and low dwelling construction means there is a dwelling deficiency in place. The momentum in the Sydney market is also expected to continue for now. However, as rising new dwelling supply works its way through to completion, pent-up demand pressures will ease and the strains on affordability as interest rates rise will take their toll, leading to a forecast price decline by 2016–17. House prices in the Melbourne market are forecast to show a moderate rise in 2015–16, but begin to decline over 2016–17 as large swathes of new apartment supply in particular are completed and impact the broader market.

The Perth and Darwin markets are forecast to progressively weaken with declines in prices as resource-sector investment continues to weaken and impact local economic conditions. At the same time, excess supply is forecast to continue to dampen the markets of Adelaide, Canberra and Hobart, together with sluggish local economic conditions. However, without any more significant deterioration in the

economic outlook to cause the unemployment rate to rise sharply, interest rates are expected to remain low enough to provide some support prices as investors should be able to meet their mortgage repayments despite potentially discounting rents, and vendors will also be able to hold on until they achieve their desired prices.

### Excess stock in units

Where state markets are measured to be in overall oversupply, we expect that the excess stock will be concentrated in the unit sector, where there have been investor-driven record levels of construction. The consequences are already being seen in the unit market, with median unit price growth being below median house price growth across nearly all capital cities over 2014–15.

In comparison, median house price growth has been stronger. The upturn in new detached-house construction over the last two to three years has lagged that of apartments, and where state markets are expected to move into a rising oversupply, we estimate that the excess stock will be concentrated in the unit sector, with detached houses either undersupplied, or only experiencing a modest excess.

Nevertheless, the easing of supply pressures means that only the Brisbane market is forecast to have experienced growth in house prices in real terms by June 2018, with all remaining capital cities forecast to have recorded real price declines totalling up to 10 per cent. Across the unit market, all capital cities are expected to experience weaker price growth of unit prices than in house prices over the three years to June 2018. With overseas buyers only able to purchase new apartments, the resale market will be more limited, being confined to local buyers.

The weaker residential market will cause new dwelling activity to decline and supply to fall. Eventually population growth will catch up and absorb any excess stock across the markets, setting the scene for the upturn in the following cycle towards the end of the decade.

Angie Zigomanis is Senior Manager, Residential Property, BIS Shrapnel  
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# DOING WELL & DOING GOOD

*You don't have to give up returns to invest ethically*

DAVID DEVERALL

Climate change, nuclear proliferation and labour exploitation are some of the greatest challenges of our time. Concerned investors have been able to find a voice by investing ethically, but there has been a nagging doubt that they may forego investment returns.

Today, ethical investing is supported by new investment research that recognises that there is not a financial trade-off when investing ethically. In fact, investors can achieve superior investment performance when investing ethically.

## What is ethical investing?

Ethical investing or socially responsible investing (SRI) is the process of aligning the personal values of investors with their investment portfolios.

Ethical investing gained traction alongside the 1970s anti-war protests and the 1980s anti-apartheid movement. It began with negative screening, a strategy that seeks to divest companies that involve themselves in activities detrimental to society. Excluded businesses may include gambling, tobacco, weaponry and factory farming. It remains a dominant strategy today and was recently demonstrated by large funds such as the Rockefeller Brothers Fund and Norway's sovereign wealth fund divesting from the fossil-fuel industry. The benefits of such a strategy lie in its easy-to-understand nature and it is often blended with other strategies such as corporate engagement and shareholder action.

Another approach to ethical investing is ESG integration, which scrutinises companies according to three pillars: environmental, social and corporate governance. It covers a broad range of issues including remediation of mining sites, water scarcity, labour exploitation, supply chain management, board composition and executive remuneration.

It recognises that ESG factors are a fundamental component of a company's long-term value. The strategy is not restrictive: it may be incorporated into stock analysis, selection and ownership. It requires specialist skills and is often partially outsourced to top research firms to provide comprehensive coverage. ESG integration

has expanded rapidly in recent years, predominantly due to a United Nations initiative, Principles of Responsible Investment (PRI). To date, 1380 asset managers who manage in excess of \$US59 trillion have committed to incorporate ESG into their investment process.

## Too good to be true?

A common argument against ethical investing is that it decreases the investment universe and places additional constraints on investors' portfolios. Another argument is that it is economically wasteful. This rationale suggests SRI undermines the ability of firms to maximise shareholder wealth by redirecting resources otherwise allocated for profit maximisation.

***Ethical investing provides a wider analysis of a company's financial health, such as earnings potential and the ability to repay debt, by focusing on non-financial factors.***

These arguments fail to recognise the substantial upsides of ethical investing.

1. SRI is a powerful risk-reduction tool; it provides a holistic, long-term view of the context in which businesses operate. This can lead to better judgement of future investments. For example, prior to the catastrophic BP Mexican Gulf oil spill, shareholders were unaware the company made 760 'egregiously wilful' safety violations at its oil refineries. SRI can provide a systematic way of identifying these material risks.

2. The profit motive is actually enhanced by societal good. Decent working conditions, adequate executive compensation and happy communities indicate strong

stakeholder management. The most effective way to improve shareholder wealth is by nurturing the interests of all stakeholders.

3. Ethical investing provides a wider analysis of a company's financial health, such as earnings potential and the ability to repay debt, by focusing on non-financial factors.

## The numbers don't lie

In one of the most sweeping reviews to date, in 2012 Deutsche Bank published its paper titled Sustainable investing: establishing long-term value and performance. More than 60 academic studies were reviewed to establish the efficacy of responsible investing and the findings were overwhelming: 77% of the studies revealed responsible investing had a positive impact on financial returns; 22% of studies were cost-neutral or mixed; and a mere 1% found a negative outcome.

In a similar study conducted by the Harvard Business School in 2011, 180 companies were reviewed over an 18-year period. The results were significant:

'High Sustainability firms dramatically outperformed the Low Sustainability ones in terms of both stock market and accounting measures.' Notably, the sustainable stocks included some of the most profitable companies in the world: Ford Motor Company, Unilever and Intel.

For the serious ethical investor, this is no surprise. According to David Deverall, our Chief Executive Officer: 'The data is compelling. It's saying if you have a bias towards companies that have a higher ESG score, your returns will be higher and your risks will be lower in your portfolio. Even if you adopt the traditional approach of negative screening, studies are showing you are better off and, at the very minimum, no worse off.'

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# DOING WELL & DOING GOOD

## *continued...*

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### Here come the millennials

There is no question that the global financial system will be reinvigorated as the millennial generation approaches its great wealth transfer. In the US alone, it has been recorded that millennials are set to inherit approximately 40 trillion dollars over the next 50 years.

This coming of age will see a shift in money management to accommodate the values and needs of this generation. Fortunately, millennials are dedicated to the idea of investing, not only for financial gain, but also for ethical considerations.

### So what does this mean for current investors?

The millennial interest in SRI is already causing a ripple effect in the financial system. Demand is penetrating family offices, university endowments, sovereign funds and many large institutions. Product offerings for SRI investments are widening; financial advisors and asset managers are building their expertise and becoming more literate in the ethical space. Furthermore, the quality of ESG data is evolving as research tools become more sophisticated.

Now, more than ever, there is a greater opportunity for investors to select stocks that are compatible with their personal values and beliefs. Most importantly, ethical investing is no longer a fringe solution for gaining good rates of financial return. It can be just as lucrative, if not a better form of investing, so that you can 'do well and do good'.

David Deverall, CEO Hunter Hall Investment Management Limited

# Global performance<sup>2</sup>

Performance 30 April 2015 Net of all fees*	6 months %	1 year %	3 years % p.a	5 years % p.a	Since Inception % p.a
K2 Global High Alpha Fund	20.9	29.8	28.2	26.4	25.8
K2 Asian Fund	24.7	34.9	21.1	10.3	12.2
K2 Select International Fund	23.2	30.4	18.4	12.1	12.6

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# The Real Greek Tragedy

ALAN HULL

Has the third bailout of Greece been a Greek tragedy avoided or just delayed for another year or two?

Certainly a debt default by Greece and resulting grexit (Greek exit from the euro zone) would have meant severe short-term pain, but once again we see the powers-that-be doing anything they can to avoid short-term pain. And the pile of sand (read: debt) continues to build.

**So what did Greece do wrong to get into the situation?**

The Greek government's spending has been greater than its revenues for years. You can get away with it when interest rates are low but when they start to rise, the problems kick in. Now Greece's national debt is 177% of its annual GDP.

It is interesting to note that the US is in a similar situation, but it owns the printing press that produces its currency (the US dollar) and controls interest rates via its Federal Reserve. Greece has no such mechanisms because it is now part of the euro zone with its common monetary policies and central bank (ECB), which owns the printing press for the euro.

It's also interesting to note that Greece only got 10% of the bailout money from the total of 240 billion euro it's already been given in loans. Its creditors, mainly French and German banks, got the rest. So was the bailout money intended to help rejuvenate the Greek economy or to protect large European banks from default?

There is clearly some hypocrisy here: Greece has to endure austerity, which is shrinking its economy faster than it reduces its debt. Its debt to GDP ratio has increased since 2012, the time of the previous bailout package. In the meantime the ECB is printing over one trillion euros to purchase sovereign debt throughout the EU to stimulate growth.

Now if I was Greece, I would have seriously contemplated leaving the euro zone. I would possibly have defaulted on the debt, but I definitely would have switched back to the drachma and simply paid the outstanding debt in drachma. If the US can do it, the Japanese can do it and the euro zone can do it, then why can't the Greeks?

Initially inflation from printing money is okay insofar as it is a tax by stealth. The government prints the money and as it is the first to spend it, there's no inflation in the beginning. Then as the money gradually circulates, inflation results and the Greek people have less buying power than the government originally did with the same money.

This will initially overcome the problem of the Greek people not paying their taxes until structural changes can be implemented. But this is an adrenaline boost and not a sustainable policy, although the world's central banks obviously disagree.

Then there's free market forces such as the self-levelling mechanism of a weaker economy and currency. Hence manufacturing finds the lowest economic level where costs and labour are cheapest – Japan, then Taiwan, then China and India. Africa is

**Greece has sacrificed its economic independence (and a good measure of its political independence) to stay with the European collective. This is the real Greek tragedy as we see collectivism overpower individualism.**

probably next if it can sort out the political risks. And manufacturing is only one of the opportunities that supposedly come from a weak economy, but you need to devalue your currency and stimulate.

However, Greece didn't leave the euro zone and has sacrificed its economic independence (and a good measure of its political independence) to stay with the European collective. This is the real Greek tragedy as we see collectivism overpower individualism on a sovereign scale. Hence this is a watershed event as globalisation leads us ever closer to a worldwide homogeneous blob.

Greece has sacrificed its economic independence (and a good measure of its political independence) to stay with the European collective. This is the real Greek tragedy as we see collectivism overpower individualism.

While globalisation is generally perceived as a good thing, I see its potential for peril. A high degree of interconnectedness and centralised control in financial markets is a recipe for disaster – it will inevitably magnify the impact of any problems, unexpected events or bad policy.

In a simple analogy, take four teacups that you want to carry. You could carry the cups individually, two at a time or use a tray, with the benefit that you would only have to make one trip. But if you have an accident, you are going to be worse off – a simple example of how interconnectedness has the potential to work against us.

It has benefits but also drawbacks, which are often not perceived or deliberately overlooked.

There's an ever-increasing interconnectedness between companies and corporations as we progressively move away from smaller individual firms towards larger corporations. A simple example is the disappearance of strip shops in favour of shopping malls, chain stores and retail warehouses.

This movement away from individualism towards collectivism, as smaller independent businesses are displaced by larger companies, has dangers like the four teacups being carried on a tray. We all see the benefits of bulk buying and one-stop shopping, but we don't stop to think that if a big corporation fails then a thousand times more jobs will be lost.

# The Real Greek Tragedy

continued...

On a sovereign level, there are obvious benefits from centralised planning and regulation. Furthermore, a collective such as the euro zone is a force to be reckoned with and far more capable of standing up to economic superpowers than small individual countries like Greece. But the downside risks are catastrophic if the central policies are wrong. And I suspect they are.

Ultimately there is an optimal balance point between individualism and collectivism, but right now we are too close to the collective end of the spectrum. Hence I suspect there will be another global financial crisis and the ultimate fix is that we will have to start to separate ourselves in order to survive. And that's what Greece should have done this time. But no one seems to have the stomach for the short-term pain – Greece or the EU.

I go back to what I originally said when governments around the world bailed out financial markets and banks in the GFC: who thinks for one second that governments can manage debt better than the private sector? We now have moral hazard on a global scale (private sector and sovereign) and this is pseudo-capitalism driven by collectivist thinking.

There will come a point when all this money printing around the world will mean the only investments worth having are gold and silver – alternate forms of money. And I will be one of those waving a flag.

Alan Hull

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# 2015 Conference Snapshot

The 2015 Annual Conference was held last month at the Marriott Resort, Gold Coast. More than 300 delegates, speakers and sponsors pronounced the event a great success.

We enjoyed three days of talks about 'the Search for Returns', and we learnt about where to achieve some income in a tough economic climate for investors, as well as enjoying the interaction with fellow members during the 'happy hours'.



# FUTURE OF BIG FOUR REMAINS STABLE

CHRISTINE ST ANNE



The outlook for Australia's banks has always been linked with fears of a housing bubble. Given the big four hold the lion's share of mortgages, many believe the banks face an uncertain future.

Not a day goes by without a headline from a major news service questioning the sustainability of Australia's sky-high housing prices.

However, such concerns may have only made bank prices more attractive, according to a global study by Morningstar.

Three of the big four - Australia and New Zealand Banking Group (ANZ), National Australia Bank (NAB) and Westpac Banking Corporation (WBC) – are among the top 11 undervalued banks globally, according to the June 2015 Financial Services Observer report, Where the wide moats are: an analysis of banking systems lends clarity to our bank moat methodology.

Three of the big four banks are among the top 11 undervalued banks globally, according to a June 2015 report.

'We see all three Australian banks as undervalued right now. A primary concern for most investors is the potential that exists for a collapse in the Australian housing market,' the report said.

As noted in the title of the report, moats are a key theme in the study. Morningstar equity analysts evaluated the strengths and weaknesses of banking systems in 22 countries and their direct effect on the economic moats, or sustainable competitive advantages, of banks operating in those countries.

Importantly, the big four all maintained their wide moats.

'While Australian home prices have been undoubtedly strong for quite a few years, we're comforted by several crucial factors,' the report said.

'Tight underwriting standards, lenders' mortgage insurance, low average loan/valuation ratios, a high incidence of loan prepayment, full-recourse lending, a high proportion of variable rate home loans, and the scope for interest-rate cuts if deemed necessary by the Reserve Bank of Australia all combine to mitigate potential losses from mortgage lending, in our view.'

Switching costs are especially high for customers of Australia's major banks, the report said, particularly around mortgage lending.

Most Australian home loans are typically 20 to 25-year variable-rate loans and account for more than 85% of all home loans.

Fixed-rate loans are usually for a much shorter period, typically up to five years, and then revert to variable rates for the remainder of the 20 to 25-year period.

The four major banks typically match each other's mortgage terms, so it is not advantageous to move to another bank on the basis of rates. This oligopolistic pricing has the effect of limiting customer churn,' the report said.

Strong levels of excess returns have always been important to Morningstar's overall moat methodology. When it comes to the banks, Morningstar's focus is on return on assets and return on tangible equity relative to the cost of equity.

Unsurprisingly, wide-moat banks score very well. The Morningstar report looked for a spread between return on equity or return on tangible equity and the cost of equity of at least 500 basis points, and also stable returns over time.

'The Australian banks have turned in outstanding returns for years, benefiting from operating in strong systems, and we do not expect that to change,' the report said.

Morningstar head of financial services equity research Asia Pacific, David Ellis, expects the outlook for Australia's banks to remain stable.

'Australia has one of the most stable (and profitable) banking systems in the world, with only five banking crises over the last 200-plus years. The same four banks have controlled 80%-plus of the country's banking assets for over a century, greatly benefiting from the closed market and national branching system,' he said.

Ellis said a particular point of weakness is that about 35% to 40% of the big four banks' balance sheets are funded from wholesale markets versus deposits. About half of that is also funded from offshore markets.

However, Ellis believed the 'four-pillar policy', which was introduced in 1990 and which prevents the four largest banks from merging, will ensure the currently lucrative competitive environment should remain in place for the foreseeable future.

Christine St Anne, Morningstar's online editor.

# HEDGING IN A VOLATILE MARKET

JODY ELLISS

This year has brought some considerable challenges for traditional share-market investment.

In the beginning of the year we saw Switzerland remove its backing of the euro as the European Union endorsed its own quantitative easing (printing currency as a means of economic stimulation).

We have seen Greece – the first Western economy – struggle with bankruptcy. The US has reportedly ceased its quantitative easing and is preparing for its first interest-rate rise since 2008.

China has lowered its commodity reserves and has reported a slowing economy that has seen the Chinese market retrace 30%.

Commodities across the board have dropped to 2009 lows that saw mining industries stall previously. These make challenging times for traditional BHP Investors – (Buy, Hold, Pray).

In October the IMF is meeting for its five-year world-currency review. It is expected to accept the Chinese yuan as a major world currency – moving away from the traditional US dollar – and this will be a significant shift in power (the first in 35 years) away from the US currency. This will be a major event that will stimulate speculation and volatility in the currency, commodity and finances sectors. The timing of this with a US interest rate rise is not lost on the markets.

## What will the big boys do?

The banks and investment houses are not in a position to convert to cash, and with changes in currency, converting to cash may not be the safest option. We must also consider that major blue-chip shares currently offer dividend returns in excess of current investment yields with many coming into final dividend in the September/October period. Investment houses will be looking to hedge against potential capital loss, while still holding significant stock value.

**Hedging is just another word for insuring. It is not a complicated process and the ability to hedge is not limited to large investors.**



## BHP shares lose value as price falls

In the current market small investors have an advantage here because of the smaller size of transactions.

## Hedging a single share

We can use a traditional method such as put options on the Top 50 shares. This gives us a guaranteed 'sell' price of a Top 50 share at a specific level for a premium. The downside is a potential total loss of premium. Timing is important here as contracts expire on the last Thursday of every month.

A more popular institutional method is to short sell a contract for difference (CFD) against the shareholding. This effectively illuminates downside risk for very little cost. Losses in this covered strategy tend towards zero as any negative movement in the CFD is compensated for by a positive move in value of the underlying asset. This is very useful when we wish to protect against downside risk while still holding the asset.

If we use BHP as the example here, BHP is trading at \$30.00 (May 2015) and we have long-term holdings and a low tax cost base attached to 2,500 BHP shares. However we can see that commodities are falling and BHP is losing value in the international market.

We can sell 2,500 BHP CFDs to effectively neutralise any downside risk for our BHP shares. We are also paid a small revenue stream for 'selling' the CFD as we have effectively loaned the money to the CFD provider. The amount of revenue will vary from provider to provider but will equate to as much as 10% per annum return on margin investment. To initiate this transaction we have to supply a margin to our provider. This will also vary from provider to provider. In this example of \$75,000 worth of BHP, the margin would normally be 5%, so \$3,750. This is not a cost to the transaction. It is only a guarantee to the

## BHP short CFD gains value as price falls

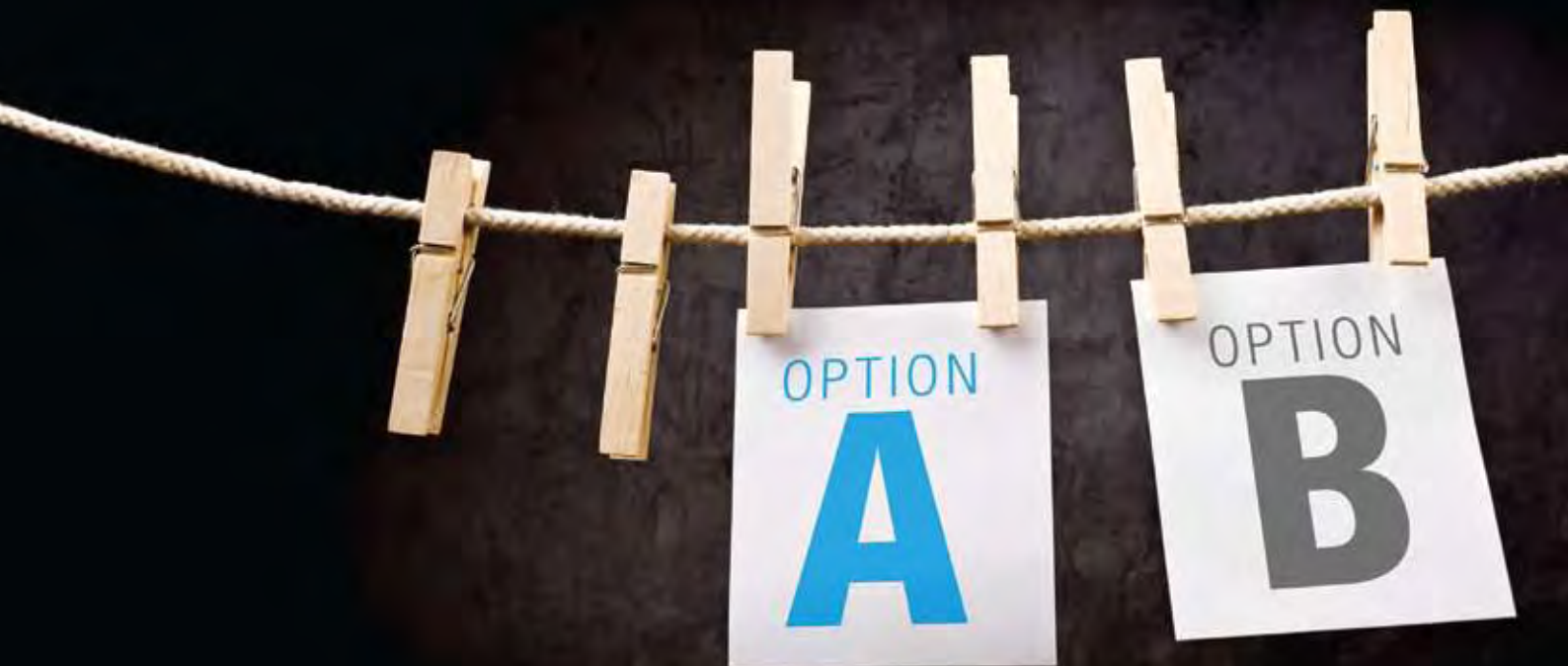
provider that they are covered for upside movement in BHP against your order.

BHP fell to \$25.00 (July 2015). You still own the shares for long-term benefits and the upcoming dividend in September. You closed your 2,500 CFDs sold at \$30.00 and bought back at \$25.00 netting \$12,500 – the value of lost capital in your BHP holding. The loss has not been realised but the profit is now either surplus income or an opportunity to increase your BHP shareholding at a lower cost base prior to final dividend. As a small investor you can increase your capital or increase your yield – whichever is more appropriate for you.

The advantage of CFDs that attract institutional insurers are many:

1. CFDs are available on Top 200 stocks, indexes, sectors and commodities. It is possible to insure Woodside Petroleum against a fall in oil price or Newcrest Mining against a fall in the gold price. Or even Qantas against a fall in \$AUD.
2. They can be individually tailored to the client requirements. If you need to insure 427 ANZ shares, this can be done precisely with 427 ANZ CFDs.
3. CFDs do not expire so time to run is not a consideration of value. The CFDs expire when you wish them to.
4. CFDs are inexpensive with brokerage totalling a fraction of share purchase and sale cost.
5. CFDs as insurance are completely compatible with self-managed superannuation and hedging is a commercially acceptable use of CFDs.
6. You are paid to take protection positions on CFDs – this varies from provider to provider.
7. Losses on a covered position tend towards zero.

For more about hedging, please send to [questions@tradingtigers.com.au](mailto:questions@tradingtigers.com.au). Jody Elliss, CEO & Head of Research Investor Centre Pty Ltd [investorcentre.com.au](http://investorcentre.com.au)



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# TAX on SUPER

JON KALKMAN

When considering tax and superannuation it is important to distinguish between the super fund as a taxpayer and a member of that fund who is also a taxpayer.

Superannuation needs to be seen as two separate phases because they have two distinct tax treatments. In the accumulation phase, before retirement, the fund pays tax on concessional contributions and investment income and capital gains. Concessional contributions are those that have tax concessions attached and include employer contributions, salary sacrifice contributions and contributions for which a tax-deduction has been claimed. The tax on contributions is 15% and the tax on investment income is also 15%. The tax on capital gains is two thirds of the income tax, so it is 10%. Non-concessional contributions are contributions made with after-tax money and do not attract a contributions tax inside a super fund.

## How do super pensions work?

A superannuation pension is only available after retirement (although some pensions are available before retirement). It is important to remember that superannuation was introduced in 1992 as a benefit available to all rather than a few senior public servants and business executives. Super funds paying pensions have been exempt from tax on income and capital gains for more than 20 years. This is not a recent development. Investments in this tax-free environment are clearly intended to prolong the fund's capacity to support the superannuant in retirement. Conversely, any tax on a pension fund will curtail the fund's capacity to provide retirement income. In the context of pressures on the Age Pension and rising life-expectancies this is significant. Despite their tax-exempt status, superannuation pensions have a restriction that is not immediately obvious. To comply as a super pension fund, the member must withdraw a minimum percentage of the value of their fund each year and that minimum increases with the member's age so that eventually all of the capital is removed from this tax haven and then subjected to normal tax rates. This is to ensure that the money in superannuation is used to support the superannuant in their retirement and not passed on to their heirs as a tax-concessional gift. Failure to comply with this rule means the super fund is regarded as an accumulation fund and taxed accordingly.

Imposing tax on super pension payments won't increase tax revenue

Until 2007, a member who took a superannuation pension paid normal tax on their pension but they were entitled to claim a tax offset of 15% which was to compensate them for the 15% contributions tax they paid in accumulation phase. That tax on pensions was abolished in 2007 for people over 60. It is important to note that this tax on pensions still applies to people who access a super pension under the age of 60. These people (under the age of 60) can take a super pension of \$44,500 a year, and still pay no tax because the 15% tax offset is equal to the tax liability. Therefore a couple under the age of 60 can today draw a combined pension of \$89,000 and pay no tax. The 15% tax offset means that there is little tax payable even on quite large pensions. It is also important to remember that the member's tax on a super pension only applies to the concessional portion of the pension. If a member's fund was comprised 50% concessional contributions and 50% non-concessional contributions, that member under age 60 could take a tax-free pension twice as large because half would be subject to the tax outlined above and half of the pension would be a return of their own money and therefore is also tax-free.

It is interesting then to speculate how much tax would be collected from members of super funds paying pensions if the old tax regime was still in place. This question pivots on the number of people drawing more than \$44,500 per year from their concessional portion of their super fund. If there are few members in this category, any reintroduction of tax on pensions after age 60 would collect little tax, as was the case before 2007.

The proportion of concessional to non-concessional contributions is more critical than many realize. Today's annual cap on concessional contributions of \$35,000 for people over 50 and \$30,000 for people under 50 means it would take more than 30 years to accumulate \$1 million, disregarding investment returns. By contrast, the annual cap on non-concessional contributions is \$180,000 and it is possible to contribute 3 years of contributions, or \$540,000, at one time. So a couple with adequate resources could contribute \$1,080,000 every three years. This money would be free of contributions tax once inside a super fund and it would be free of income tax and capital gains tax when they start a pension. It would also dramatically alter their tax position if they needed to pay tax under the age of 60 or if their adult children have to pay tax on their death benefit.

Implications of taxing pension earnings, and pension payments if the FSI final report comments make it into the Tax White Paper, the decision-makers need to seriously consider the following implications:

- Taxing super pension funds at the same rate as accumulation funds would reduce the pension fund's capacity to pay a retirement income and therefore place greater strain on the Age Pension system, because it would accelerate depletion of the super funds.

“

Imposing tax on  
super pension payments  
won't increase  
tax revenue!

”

□ It would make the two types of funds indistinguishable. No sane person would then have a pension fund where the member is required to take more pension than they need and in the process deplete the capital remaining in this low-tax environment.

□ In that scenario, there would also need to be a death tax to stop a member's heirs benefiting from the accumulated benefits in this tax haven.

□ Returning to a regime where pension were taxed in the hands of members after the age of 60, besides being politically fraught, would collect little tax as was the case before 2007.

The tax concessions lost to super funds containing very large non-concessional contributions in pension phase are more significant than the tax concessions lost to high income earners using the 15% tax on their concessional contributions, rather than their own marginal tax rate. This is because concessional contributions, and the associated tax concessions, are now strictly limited but it is still possible to accumulate large super balances with after-tax money which then enjoy tax-exempt earnings in a pension fund and can then be taken as a tax-free pension by the member after age 60.

Clearly, a situation in which pension funds can have \$20 million or more comprising mainly non-concessional contributions and borrowings, is inequitable if it means members can draw pensions of more than \$1 million per year and pay no tax. On the other hand, for a couple who have worked hard to accumulate a nest egg that ensures them a comfortable retirement income, the present tax arrangements around super can mean the difference between being self-funded retirees or dependent on the Age Pension for all or part of their retirement income.

If we are going to return to a concept of a reasonable benefit limit, beyond which a member should enjoy no further tax concessions, the obvious place to start would be look at the total level of non-concessional contributions. Placing limits on the size of the pension fund would automatically limit the size of the tax concession associated with that fund. If we could agree on the size of a fund required to provide a comfortable retirement as well as a reasonable level of tax concessions, there could easily be a tax on

funds over a certain size or there could be a lifetime cap on these non-concessional contributions.

The issue revolves around what is regarded as a reasonable amount a person should be allowed to have in super with all its associated tax concessions. That depends very much on your point of view.

## Comparing Age Pension and super concessions

When discussing the "generous" tax concessions given to super, it is easy to overlook the "generous" government payments make to the Age Pension.

The Age Pension can be seen as an annuity. It pays a guaranteed amount for life and it is indexed to inflation. Michael Rice of Rice Warner Actuaries has calculated the present day value of the Age Pension based on average life expectancy.

For a single male pensioner with a life expectancy of 20 years at age 67 the value of the pension payments is \$402,000. For a single woman with a longer life expectancy the figure is higher at \$461,000 while for a couple, Rice says the pension is worth \$685,000 over their lifetimes.

It is in this context that the government's plans, to increase the pension age to 70 and index pension increases to CPI rather than wages, should be seen. It also provides a valid comparison with the level of superannuation tax concessions a self-funded retired couple receive over their lifetime.

Mercer note in their report "Securing Retirement Incomes, Tax, Super and the Age Pension: Assessing the Value of Total Government Support" (February 2012) that:

- The level of total government support provided for retirement income is remarkably level across most individuals, irrespective of an individual's lifetime income
- This support comprises both superannuation tax concessions and the means-tested age pension, reflecting Australia's three pillar system of retirement income
- The value of the tax concessions increase with income but this is offset by a reduction in future Age Pension payments

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Some commentators suggest that property, shares and bonds have formed a bubble, so are increasing cash holdings. But there are other options.

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# TAX on SUPER

CONTINUED...

The Age Pension is subject to both assets and income tests. After age 65 your super balance is assessed under the assets test and will be “deemed” to earn an income which will be assessed under the income test. This means that people with low super balances will receive more Age Pension and people with healthy super balances should not have high expectations about Age Pension eligibility.

Interestingly, the government’s data on people of pensionable age shows that the number of people receiving at least part pension remains fairly constant around 30% of the eligible population while the number of people receiving a full pension rises as they get older. This reflects their falling super balances as they age.

It is also sometimes forgotten that the Age Pension was made considerably more generous in 2007 when the government changed the assets test. Before that time the assets test ensured that you lost \$3 of age pension per fortnight for every \$1000 that you exceeded the threshold. In 2007 that was changed so that you only lost \$1.50 of age pension for every \$1000 over the threshold. This effectively doubled the assets you can hold and still receive a part age pension. It also greatly enlarged the number of people who are eligible for a part-pension.

The result is today, as a couple, you can hold \$1 million in assets and still receive a part pension of over \$200 per fortnight.

Of course, for Centrelink purposes, the family home is never counted as an asset, regardless of its value, and it is never counted when it comes to capital gains tax. That arrangement has the capacity to greatly distort decision making around retirement planning and the allocation of resources needed to pay for the increasing costs associated with longevity.

So when we talk about distortions in the system, please let’s have all the facts on the table.  
Jon Kalkman is a director of AIA

## KEYS TO BUILDING FINANCIAL STRENGTH

JULIE MCKAY

Lasting success in most things is achieved by having realistic goals, monitoring progress and resisting quick fixes. Building long-term financial strength is no different. But it’s worth taking time to understand how to use the equipment.

### It is about investing

Buying property can be challenging. Money in the bank is safest, but at current rates is barely growing. That leaves the share market. ***You need to understand your investment choices, recognise that the market goes up and down and develop a view about its prospects over your savings horizon.***

### Muscle up

To achieve some goals you may need to pump up potential returns by borrowing to invest – called gearing – which lets you make a larger investment. If the market performs well, all the gains on that larger investment belong to you. If the market does not do well, you take the larger losses. There is no set timetable to repay the loan. But you should never borrow beyond your ability to pay interest. For a typical Australian resident taxpayer, the interest is potentially tax-deductible.

### Mind the gap

A typical loan-to-value ratio (LVR) for a number of shares is 75%; for shares worth \$100 you can borrow up to \$75. Most investors leave a gap between the amount they borrow and the LVR. They

may borrow only \$50 for that \$100 portfolio: a gearing ratio of 50%. If the shares fall in value, the gearing ratio increases. If your gearing ratio exceeds the LVR, the bank will demand an immediate fix – this is called a margin call. A larger gap means more breathing space for you should the market fall.

### Grandma knew

Old advice is still good advice: don’t put all your eggs in one basket. Diversification is the art of mixing your investments so one capricious event does not wipe out everything. By gearing a mixed basket of shares you can reduce the prospect of a margin call.

### A watched pot never boils

Do not ignore a geared investment until it boils over into a margin call. The ideal frequency for checking your investments depends on factors such as the gap between gearing ratio and LVR and your degree of diversification. Markets favour fortitude and perseverance, but an occasional adjustment may be necessary.

This can be only a brief introduction to borrowing to invest. When used appropriately, gearing can be an effective way to build financial strength.

Julie McKay is Senior Manager Technical Research, Leveraged Equities Limited, a subsidiary of Bendigo and Adelaide Bank Limited - [www.leveraged.com.au](http://www.leveraged.com.au)

# AIA SEMINARS

(Full details on AIA Website)

## Perth, 24th October, 8.30AM – 4.30PM AN ENLIGHTENING A – Z OF SMSF & ESTATE PLANNING

Presenter: Shane Ellis, Specialist Lawyer

Venue: Wembley Downs Tennins Club

If you are interested in setting up a Self Managed Super Fund or you already have one and want to get some points of fine tuning recent updates or you are not sure if your wills and estate are set up to protect your assets and family, then this full day seminar is for you.

## Sydney, 30th October, 8.30AM – 4.30PM GENERATING INCOME IN A LOW INTEREST RATE WORLD

Prsenter: A variety of speakers

Venue: SMC Conference & Function Centre

Over the past few years, investors have seen their return from cash and term deposits drop from 8 percent to less than 3 percent, with predictions for even lower interest rates in the future. A question on many retirees' minds is "Where can I invest to replace safe and reliable cash deposits as a source of income?" How risky are the alternatives? How will returns vary with future inflation or deflation? This one-day seminar will address a range of issues related to income – understanding risk, long- and short-term goals, and the role of debt securities (bonds), term deposits and cash, hybrids, real estate, shares and annuities in generating income.



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3. assets in superannuation
4. insurance assets, e.g. life insurance

Of course, sometimes these may be mixed because often insurance policies are owned in self-managed super funds.

## Your quick family estate protection planning checklist

- |  |     |    |
|--|-----|----|
| 1. Personally owned assets are:  | YES | NO |
| <input type="checkbox"/> protected via the gifting strategy (no stamp duty or CGT to do so!)   |     |    |
| <input type="checkbox"/> protected by Enduring Power of Attorney (EPA)   |     |    |
| <input type="checkbox"/> protected by Testamentary Trust Will (TTW)  |     |    |
| <input type="checkbox"/> protected with adequate insurance   |     |    |
| <input type="checkbox"/> held as tenants in common, not joint tenants  |     |    |
| 2. Trust/company-owned assets:   | YES | NO |
| <input type="checkbox"/> are asset protected now   |     |    |
| <input type="checkbox"/> trusts have proper survivorship provisions  |     |    |
| <input type="checkbox"/> companies have EPA for directors' responsibilities  |     |    |
| <input type="checkbox"/> companies have shareholders' agreements in place  |     |    |
| 3. Superannuation assets:  | YES | NO |
| <input type="checkbox"/> are protected by special SMSF EPA   |     |    |
| <input type="checkbox"/> are protected by special SMSF Will  |     |    |
| <input type="checkbox"/> are protected by special SMSF Living Will   |     |    |
| <input type="checkbox"/> have auto-reversionary pensions (quite often your pension can revert to your spouse or a dependent with a ZERO tax result)    |     |    |
| <input type="checkbox"/> have life insurance in the SMSF to pay out borrowings on SMSF property  |     |    |
| 4. Insurance   | YES | NO |
| <input type="checkbox"/> has your Testamentary Trust noted as beneficiary and you have considered the tax implications for non-dependent beneficiaries |     |    |

Hm, did I hear you just say that you don't know what is happening with your trust, superannuation and insurance assets, but you think they might be covered by your will? Wrong! The assets of a trust/company, SMSF and insurance usually fall outside the control of your personal will.

To have complete asset protection and the whole of estate planning, all assets need to be considered and dealt with so you are protected now in the event of your legal incapacity, and when you pass away. And your financial planner, accountant or lawyer probably won't be able to help because they may not even know what an SMSF EPA, Will or Living Will, or reversionary pension is, or how it applies to a SMSF.

These are some of the latest advancements in the law pertaining to SMSF holistic estate planning. You can designate where each asset is to go in the most tax-efficient way and who you want to receive them. It does not need to be same as in your personal will. If done right, the tax result is zero, and this may even include the passing of a tax-free pension on to a beneficiary! How great will that be for your family!

Nicki Strugnelli is Client Relations Manager, SMSF LAW | EquityProtect | Shane Ellis Legal Group - smsf-law.com.au

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Investor Centre

# WHERE THE RUBBER MEETS THE ROAD

ROBERT MARKHAM



## Money goes where money grows.

In all cases investors, driven by the emotions of fear and greed, will put their money where they believe it will do the most good. Those seeking capital appreciation buy shares in spite of the risks involved, and those seeking capital preservation buy bonds in spite of low returns.

In the absence of fear and greed, the Earnings Yield of shares (EY) would equal the Interest Yield (IY) of long-term bonds. In other words  $EY = IY$ , where:

$EY = 100 \times (\text{earnings per share} / \text{stock price})$ , and  
 $IY = 100 \times (\text{interest payment} / \text{bond price})$

Given the presence of fear and greed, EY typically does not equal IY. When greed dominates investor psyche, share prices are high and EY is low. When fear dominates investor psyche, bond prices are high and IY is low.

**When greed dominates investor psyche, share prices are high and EY is low. When fear dominates investor psyche, bond prices are high and IY is low.**

Currently, the average forecasted EY of shares on the ASX 200 is 5.5%, which is about 14% less than the five-year average of 6.4%.

The current IY of Australian government bonds is 2.8%, which is nearly 32% below the five-year average of 4.1%. Since IY is well below the five-year average, fear continues to dominate investor psyche, as it has since the financial crash of 2008.

In order to be compensated for the perceived risks of buying shares instead of bonds, investors demand an earnings yield premium compared to the interest yield of bonds. This yield premium, YP, is currently equal to  $(EY - IY) = (5.5 - 2.8) = 2.7\%$ .

## Why is this important?

Following the crash of 2008, the Reserve Bank of Australia has maintained a policy of relatively low interest rates to stimulate the

economy. Should the RBA continue to lower rates, as many are forecasting, it could further increase the yield premium by causing EY to go higher or IY to go lower.

In either case, share prices would have to rally in order to restore YP to its original level.

It's where the rubber meets the road.

Robert Markham is Managing Director Asia Pacific, VectorVest  
[www.vectorvest.com/vvuniversity](http://www.vectorvest.com/vvuniversity)

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<sup>1</sup>This forecast is dependent on a number of assumptions, which are outlined in the PDS. <sup>2</sup>Refer to PDS for further details.

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# Calendar of Events

**Please Note:**  
As AIA events are confirmed, details are posted to the AIA website [www.investors.asn.au](http://www.investors.asn.au)  
Please note topic is subject to change.

## SEPTEMBER 2015

01/09/15	Geelong Discussion Group	7.00pm	St George Workers Club, 212 Pakington Street, Geelong West VIC
01/09/15	Perth Information Meeting	7.00pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs
02/09/15	Brisbane Information Meeting	1.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill
08/09/15	Adelaide Information Group	7.00pm	German Club, 223 Flinders St, Adelaide (Senatorum Room) SA
09/09/15	Frankston Discussion Group	1.00pm	Private address, please contact event coordinator
09/09/15	Sydney North Shore Information Meeting	7.00pm	The Chatswood Club, 11 Help St, Chatswood
14/09/15	Canberra Discussion Group	7.30pm	Canberra Labor Club, Chandler Street, Belconnen ACT
15/09/15	Brisbane Investment Management Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
15/09/15	Perth Equities Discussion Group	7.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs
16/09/15	Brisbane Share Investments Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
21/09/15	Chermside Equities Discussion Group	7.00pm	Chermside Library, 960 Gympie Road, Chermside QLD
24/09/15	Bayside Discussion Group	4.00pm	Hampton Community Centre, Willis Street, Hampton VIC
29/09/15	Greensborough Discussion Group	7.00pm	Watermarc Complex, Meeting Room 1/1 Flintoff St Greensborough VIC
30/09/15	Kew Discussion Group	7.00pm	Phyllis Hore Room, Kew Library, Corner Cotham & Civic Drive, Kew VIC

## OCTOBER 2015

06/10/15	Melbourne Information Meeting	6.30pm	Telstra Conference Centre, Room 1, Level 1, 242 Exhibition St, Melbourne
06/10/15	Perth Information Meeting	7.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs WA
07/10/15	Blackburn Discussion Group	7.15pm	Naturalist Club of Victoria, 1 Gardenia Street, Blackburn VIC
07/10/15	Brisbane Information Meeting	1.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill QLD
12/10/15	Canberra Discussion Group	7.30pm	Canberra Labor Club, Chandler Street, Belconnen ACT
13/10/15	Adelaide Information Group	7.00pm	German Club, 223 Flinders St, Adelaide (Senatorum Room) SA
14/10/15	Sydney North Shore Information Meeting	7.30pm	The Chatswood Club, 11 Help St, Chatswood NSW
19/10/15	Chermside Equities Discussion Group	7.00pm	Chermside Library, 960 Gympie Road, Chermside QLD
20/10/15	Perth Equities Discussion Group	7.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs WA
20/10/15	Gold Coast Information Meeting	9.30am	Robina Community Centre, Robina Town Centre Drive, Robina QLD
20/10/15	Brisbane Investment Management Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
21/10/15	Brisbane Share Investments Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
21/10/15	Sydney Hills District Discussion Group	7.00pm	B Davis & Associates, Suite 17, 35 Old Northern Road, Baulkham Hills NSW
27/10/15	Greensborough Discussion Group	7.00pm	Watermarc Complex, Meeting Room 1/1 Flintoff St Greensborough VIC
30/10/15	Sydney Seminar	9.00am	SMC Conference & Function Centre, 66 Goulburn Street, Sydney NSW

## NOVEMBER 2015

03/11/15	Perth Information Group	7.00pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs WA
04/11/15	Frankston South Discussion Group	1.00pm	Private address. Please contact Bill Shirley 03 9787 3045
04/11/15	Brisbane Information Meeting	1.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill QLD
09/11/15	Canberra Discussion Group	7.30pm	Southern Cross Club, 92-96 Corina Street, Woden ACT
10/11/15	Geelong Discussion Group	7.00pm	St George Workers Club, 212 Pakington Street, Geelong West VIC
10/11/15	Adelaide Information Group	7.00pm	German Club, 223 Flinders St, Adelaide (Wolf Blass Weinkeller Room) SA
11/11/15	Sydney North Shore Information Meeting	7.00pm	The Chatswood Club, 11 Help St, Chatswood NSW
16/11/15	Chermside Equities Discussion Group	7.00pm	Chermside Library, 960 Gympie Road, Chermside QLD
17/11/15	Perth Equities Discussion Group	7.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs WA
17/11/15	Brisbane Investment Management Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
18/11/15	Brisbane Share Investments Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
24/11/15	Gold Coast Information Meeting	9.30am	Robina Community Centre, Robina Town Centre Drive, Robina QLD
24/11/15	Greensborough Discussion Group	7.00pm	Watermarc Complex, Meeting Room 1/1 Flintoff St Greensborough VIC
25/11/15	Kew Discussion Group	7.00pm	Phyllis Hore Room, Kew Library, Corner Cotham & Civic Drive, Kew VIC
26/11/15	Bayside Discussion Group	4.00pm	Hampton Community Centre, Willis Street, Hampton VIC



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