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Beyond Brexit

Brexit triggered volatility in markets, including a sharp depreciation of the British pound and dramatic falls in the share prices of British and European banks. However, we believe the probability of a major global systemic risk event due to Brexit is low in the short term. We believe the European Central Bank and Bank of England stand ready to provide sufficient liquidity to ensure their banking systems continue to function. Quantitative easing (QE) could also be redeployed in the United Kingdom (UK) or stepped up in the Eurozone to support sovereign bond markets if needed. The uncertainty and distraction created by Brexit are likely to result in reduced investment, increased savings and lower economic growth in the short term. In response, the Bank of England decided to reduce the cash rate to 0.25 per cent in early August.

It is important to distinguish between the nine nations that are members of only the EU and the 19 nations that are members of both the EU and the Eurozone. Leaving the Eurozone is more problematic than leaving the EU because there is no existing legal process to follow. There are four countries that are outside the EU but are part of the single market as members of the European Free Trade Association (Norway, Iceland, Switzerland and Lichtenstein). We believe it is 50 per cent likely that the UK will proceed to trigger Article 50 and negotiate an agreement to remain in the single market.

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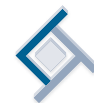

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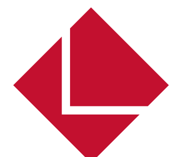

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US interest rates may rise more than markets expect

In the US, a range of economic indicators show that the US economy continues to recover, including an improving housing sector, a likely stable federal deficit, competitive wages - despite the appreciation of the US dollar and a relatively low reliance on exports. Several transitory factors have been keeping inflation below the Fed's two per cent target. However, as the oil price bottoms out, the US dollar stabilises and the labour market continues to tighten, wage growth and inflation pressures are likely to normalise. Consistent with previous cycles, this will require the Fed to tighten monetary policy, probably more so than the market is expecting.

The Eurozone is likely to continue benefiting from a weaker currency, a stronger US economy, lower commodity prices, and an improvement in borrowing conditions and credit flows in an environment of ultra-low interest rates. However, the combined effects of high debt levels, labour market rigidities and unfavourable demographics are likely to present ongoing headwinds for growth. The Eurozone also remains vulnerable to major shocks, such as an escalation of geopolitical tensions with Russia, the election of Eurosceptic governments or a collapse in the Chinese yuan. Each of these scenarios could trigger a dramatic uplift in periphery Eurozone sovereign bond yields, and would heavily test the resolve and mandate of the ECB.

While we remain concerned about the short to medium-term outlook for China, we do not believe that China is about to have a financial crisis or experience a hard economic landing. China's rapid economic growth in recent years, fuelled by the large credit stimulus during the GFC, has been unsustainable. Although credit growth has slowed, it continues to grow at 15 per cent per annum.

Prospects for equity markets

Our base-case outlook for the next three years assumes a continued recovery in the US with modestly rising inflation, a continued slowdown in China (but not a financial crisis or hard landing) and an improvement in the economic outlook for Europe. We remain cautious about the outlook for equity markets given the recent Brexit vote, the environment of abnormally low interest rates, historically elevated price-earnings multiples, risks associated with the recapitalisation of the Italian banking system and the continued withdrawal of US monetary policy stimulus. While the Fed and other central banks believe their policies are highly stimulatory, such policies also act as a tax on the world's savers by reducing or eliminating interest income. We continue to believe markets are mispricing the likely future path of the federal funds rate and long-term interest rates in the US. It is prudent to remain cautious in this environment.

We continue to see attractive opportunities for Australians to invest in high-quality global businesses, although pricing is less attractive than in recent years. Risks to the Australian dollar appear weighted to the downside and the Australian economy remains exposed to the continued unwinding of the commodities boom, domestic housing investment boom and household credit boom, which further weakness in China could exacerbate. Domestic economic weakness and global disinflationary forces are putting downward pressure on Australian interest rates at a time when the US economy is moving towards full employment and higher interest rates. The challenges facing the Australian economy serve as a reminder to investors of the importance of achieving meaningful portfolio diversification to preserve capital and higher risk-adjusted returns over the investment cycle.

Source: Magellan

To find out more about your investment opportunities, please speak with your financial planner.

Timing retirement

When – and how – should you retire?

The answer to this question is never simple. We approach retirement armed with a lifetime of experience but at the same time we have no idea what to expect. Making the transition with confidence requires careful attention to many interconnected issues.

Individual experiences will vary widely, influenced by a host of factors, including family circumstances and the prevailing economic and market environment. But there are a few crucial questions everyone should consider in making a retirement plan.

The overarching goal: to make sure you can live the lifestyle you want for the rest of your life.

How long will you live?

It's not a pleasant thought, but contemplating how long you will live matters hugely for retirement planning. Longevity risk, or the potential to outlive your retirement savings, is by far the biggest worry cited when moving into retirement. This life stage may last 30 years or more, so be conservative by building a retirement strategy that aims to cover spending needs for that timeframe.

How much will you spend?

Whether it is a percentage of pre-retirement income or a percentage of wealth at retirement, rules of thumb can provide helpful guidance as to what you can afford, but in practice they are impractical and inefficient. A more fluid approach to drawing on savings that adapts withdrawal rates and asset allocation in response to changes in economic and market environments and shifts in personal circumstances can produce a better outcome. Because it's a flexible approach it can help protect against the risks of outliving savings while maximising spending over time.

What's your house worth?

A family's home is often thought of as their biggest asset, but depending on mortgages and other costs, it can also be a considerable ongoing expense if repayments or maintenance expenses are high. If you plan to pay down all or part of your mortgage before retirement, make sure the decision won't jeopardise long-term retirement funding and risk making you 'house rich and cash poor'.

How fast will prices rise?

Rising consumer prices and higher inflation is the scourge of any fixed income investor because over time rising prices eat into what that income can buy in 'real' terms. Investment strategies for retirement should include growth and income-generating assets to help protect against the corrosive effects of inflation.

What will the market be like when you retire?

In the decades before retirement, when we're saving and investing for the long term, when we make investment returns makes no difference. The wealth we end up with reflects the long-term average of our lifetime returns. But once we retire, and shift from being savers to spenders, the timing matters a lot. Poor market returns just before, and just after, we retire can put a retirement plan at risk. To mitigate that risk, we need to manage market volatility early in retirement, which can be done through a variety of diversification strategies.

Thinking about transitioning into retirement is both exciting and a little scary. Uncertainty is inevitable: There is no perfect time to retire or perfect retirement plan. Focusing on the issues and risks discussed here – and asking some tough questions – should help you make sensible choices about when, and how, to retire.

Source: J.P. Morgan

Speak with your financial planner to discuss the timing of your retirement.

Five big questions for AREIT investors

Investing in Australian real estate investment trusts (AREITs) is supposed to be boring. The aim is to receive stable distributions that turn up like clockwork, with low share price volatility to match the predictable returns.

Over the past two years the sector has delivered on that commitment, and a whole lot more. While the S&P/ASX All Ordinaries index is below the level of June 2014, the S&P/ASX 200 AREIT index has risen by more than a third. For investors in the sector and those attracted by the yields it offers, that prompts some key questions.

1. What's behind the recent price rise?

We believe interest rates are the key issue. The 'lower for longer' argument refers to the expectation that global growth and inflation will be low for an extended period. Indeed, the emerging theme in financial markets is 'even lower for even longer'.

That's having a big impact on long-term bond yields, which have hit record lows. Not only is this reducing the borrowing costs of the sector, it's driving interest in AREITs. With global interest rates heading towards zero and in some cases going negative, investors seem more willing to pay up for yield.

With term deposits and Australian government bonds paying 2-3 per cent, the AREIT sector's average current yield of 4.50 per cent is comparatively attractive. We believe there are few places where you can find a yield of this quality and number. That's what's making the sector so attractive.

2. Can the rally continue?

If interest rates continue to fall, yes, it's very possible. We expect the 'lower for longer' theme to play out for some years yet. This would be good news as lower rates are likely to equal further price rises.

Why? Because, depending on which valuation tool you use, valuations are not yet stretched. Net Tangible Assets (NTA), a measure which many analysts prefer, indicates valuations are expensive. But we believe this is a distorted figure due to the impact of shares like Goodman Group (ASX: GMG) and Westfield Corporation (ASX: WFD), which include significant amounts of corporation earnings – those delivered by property development activities rather than rents. These shares trade at significant premiums to NTA (as much as 70 per cent to 100 per cent) and represent around 26 per cent of the AREIT sector, distorting the overall market premium to NTA. There are still a number of AREITs that trade below NTA.

Moreover, AREITs are liquid assets and are not liable for stamp duty and legal expenses, which can be as much as six per cent of an asset's value. A 'neutral' 10-15 per cent premium to NTA isn't unreasonable. Exclude Goodman Group and Westfield Corporation and the sector's premium to NTA is 24 per cent.

Although common, NTA is far from a perfect tool to value shares. Many AREITs are structured with securities in a trust and a company 'stapled' together. Both parts should be valued separately. The Net Asset Value (NAV) does that. It indicates the sector is trading around fair value. Further, future growth in rents and asset values should deliver further increases in NTA.

And if you believe that interest rates will stay low for an extended period, then there may be value in the sector. All things considered, the recent surge in AREIT share prices seems to have a foundation and we believe the fundamentals remain attractive.

3. Is the AREIT market reminiscent of the pre-GFC period?

Definitely not. Debt is now lower and better managed, with a greater diversity and longer tenure. The earnings that AREITs produce are driven by rents rather than 'corporate' earnings, where previously the sector chased over-priced assets. Overseas earnings are significantly lower and management teams more realistic and sensible.

We believe the key risks that were substantially responsible for the magnified impact of the GFC on the AREIT sector are now far lower than in 2006/7. The sector has returned to its roots and is all the better for it.

4. Which parts of the sector have the best prospects?

We believe there's long term value in retail property. High barriers to entry typify much of the sector we're invested in. Investments in super regional shopping centres like Chadstone in Melbourne and Bondi Junction in Sydney are likely to perform strongly. Well-located and managed assets catering to daily shopping needs may also provide a steady earnings stream. Office portfolios exposed to the strong Sydney and Melbourne markets should also deliver growth in earnings.

But you're better off in a diversified, balanced portfolio of AREITs than trying to pick individual winners. Diversification is just as important in this sector as any other.

5. What are the key themes to watch next financial year?

The theme of 'lower for longer' is likely to dominate. We agree with the Reserve Bank of Australia that inflation will trend lower and that GDP growth will not be above the long term trend. We expect income investments to remain popular as a result.

If asset values continue to rise, debt, as a proportion of gross assets, should fall for most AREITs, allowing them to borrow more (at low interest rates) to acquire more assets. Correspondingly, we expect growth in AREIT portfolios should deliver higher earnings and greater diversity.

Source: APN

To learn more about your investment options in the Australian real estate sector, speak to your financial planner.

Why having a proper estate plan is so important

Your Will is a legal document that sets out directions for the administration and disposal of your assets after death. While most people are familiar with the concept of a Will, many are surprised to learn that a Will cannot automatically control the distribution of their interests in companies, trusts and other structures.

This is because a Will can only distribute the assets that you owned in your personal name on the date of your death.

Assets that you may think you own, such as those held in privately held companies, trusts or super funds, do not actually form part of your estate, and as such, it is important to understand how the assets held in these structures will be handled when you die.

For this reason, having an effective estate plan – a plan that not only includes the preparation of a Will but considers how assets will be handled in such structures – is a crucial component of your future planning.

The first step in this process is understanding how assets in these structures are controlled.

- **Jointly-owned assets** are assets that are held in joint names. A common asset may be the family home. On death, jointly-owned assets pass by the laws of survivorship directly to the surviving holders.
- **Privately held company assets** are held by the company, and governed by the company's constitution.
- **Trust and superannuation assets** are held by the trustee of the trust/super fund, and are governed by its trust deed.

How can you ensure non-personal assets are dealt with according to your wishes?

While a Will cannot directly control how assets held in these structures are dealt with after your death, you can take measures during your lifetime to ensure that:

- assets held in these structures are provided directly to a beneficiary according to your wishes (where possible), or
- assets are directed to your estate, so they can be dealt with via your Will (where possible), or alternatively
- any interest you have in the structure is passed to your beneficiary.

Examples of control measures you can put in place

SMSFs

A well-drafted SMSF trust deed will enable the members to control the distribution of their super entitlements on their death by directing the trustee to pay their benefits in their desired manner. Mechanisms to achieve this include binding death benefit nominations, death benefit rules, reversionary pensions or the appointment of a death benefit guardian. By using one or more of these methods, you can either direct your super benefits to specific individuals to be paid directly from the fund, within legislative limits, or you can direct your benefits to your estate so they are then dealt with via your Will.

Unit trusts

As the beneficial entitlement in a unit trust lies with the units held in that trust, leaving the units you own in a trust to a beneficiary in your Will provides that beneficiary with access to your entitlement in the trust upon your death.

Discretionary trusts

The ability to receive entitlements from a discretionary trust lies at the discretion of the trustees so care should be taken to appropriately structure the trustee and appointor of the trust, so the beneficiaries you intend to receive benefits from the trust will have the ability to receive distributions after your death.

Privately held companies

The entitlement to receive dividends and capital (upon winding up) from a company lies with the shares held in the company (subject to the share classes held). Leaving the shares you own in a privately held company to a beneficiary in your Will provides the transfer of your interest in the company to your intended beneficiary.

It doesn't stop there

The above examples are just a few measures that can be put in place during your lifetime to ensure your assets – including your interests in structures such as privately held companies, trusts and super funds - are directed according to your wishes upon your death. But more examples do exist – such as what happens to the running of a business or trading company on your death?

Source: Topdocs

For these reasons it's important to consult with your financial planner to ensure you have an adequate estate plan in place.

Changes to the age pension rules – are you ready?

Last year the Government legislated an increase to the assets test thresholds and the assets test taper rate from 1 January 2017. If you are retired or approaching retirement, these changes could have an impact on your retirement plans.

Increase in the assets test thresholds

The first change to the assets test relates to the threshold above which a pensioner's entitlement will start to reduce. The increase in the assets test thresholds from 1 January 2017 will enable approximately 50,000 part-pensioners to qualify for the full pension under the new rules, according to the Government.

Increase in the taper rate

The second change will effectively reverse changes to the taper rate introduced in 2007, increasing the current taper rate from $1.50 to $3 per fortnight per $1,000 of assets over and above the assets test threshold. This means that the amount of assets a pensioner can have on top of their family home and still receive a part pension (assets test upper threshold) will be reduced.

The combined effect of these changes

The combined effect of these changes is that while some pensioners will see either no change to or an increase in their age pension, many will see their age pension reduced, possibly to zero. The Government estimates that this measure will see 91,000 part-pensioners lose their age pension completely while another 235,000 part-pensioners will see their age pension reduced.

The table opposite illustrates the likely impact of these changes to a pensioner couple who own their own home.

Assessable assets	Current age pension indexed	New age pension	Reduction in age pension
$300,000	$34,865	$34,923	($59)
$400,000	$30,965	$32,973	($2,009)
$451,500	$28,956	$28,956	$0
$500,000	$27,065	$25,173	$1,892
$600,000	$23,165	$17,373	$5,792
$700,000	$19,265	$9,573	$9,692
$800,000	$15,365	$1,773	$13,592
$823,000	$14,467	$0	$14,467
$900,000	$11,465	$0	$11,465
$1,000,000	$7,565	$0	$7,565
$1,100,000	$3,665	$0	$3,665
$1,200,000	$0	$0	$0

A pensioner couple who own their own home with less than $451,500 of assessable assets will see either no change, or an increase, in their age pension. Such pensioners with assets above $451,500 will see their age pension fall – in this case by up to as much as $14,467 per year.

Single pensioners and non-homeowners may also be affected, but at different levels of assets.

Understand your options

It is important to understand how the changes can affect your particular situation and the impact on your overall retirement objectives. There may be opportunities to help reduce the impact of these changes and enhance your overall cash flow.

Options you may consider include:

- reducing expenditure in retirement to meet lower age pension payments
- increasing withdrawals from investments
- assets test reduction 'strategies' (eg superannuation fund contributions on behalf of a spouse who is below the age pension age, gifting within the allowable limits, purchasing a funeral bond, bringing forward capital expenditure, home improvement etc), or
- purchasing a lifetime annuity.

Source: Challenger

For more information about Centrelink changes, speak to your financial planner.

How to avoid behavioural investment traps

Many people don't realise the greatest impact on their investment returns could in fact be their own behaviour. Here are four behavioural traps you should be aware of.

1. Making decisions during market volatility

When you see markets up one day and down the next, it's easy to be nervous about investing, and this is when we risk making irrational decisions. It's important to remember that market volatility is inevitable, while markets tend to bounce back over the long term. While there may be good reasons to sell, you should also remember that by selling out if you're nervous, when markets are low, you may only crystallise losses.
One suggestion is to stay focused on your long-term goals and try to ignore market 'noise'.

2. Becoming overconfident in strong markets

Many decisions people make during strong markets will likely come right, because the entire market is rising. This will make many people feel smart and more confident in their ability to invest. It's important to remember that returns from rising markets aren't an indicator of investment skills. It's how people behave and how their investments perform during times of market distress that are the sign of a good investor.

3. Avoiding herd mentality

It's a natural human tendency to position ourselves relative to others and to feel the need to 'keep up'. However this can lead to poor financial decisions. New investment trends can easily get traction and create conversations amongst friends and family. The dotcom bubble is a perfect example as share prices of many internet companies soared, encouraging investors to get in.

By early 2000, markets began to crash and investors suffered. While it's tempting to take part in the latest trend, it's important to take the time to assess any investment on its own merit and whether it suits your personal goals.

4. Being swayed by recent events

We are wired to give undue weight to the most recent events. This is especially true when investing. In 2010, with the GFC fresh in the minds of many, the common view was that Australian shares could do no wrong and international shares were shunned.

But then, in the five years that followed, international shares provided far better returns than Australian shares[1].

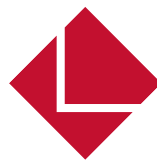
This meant that investors who had sold out of international shares missed the rally. Instead of chasing yesterday's winners, it's usually best to remain patient and stick to your personal plan.

We often go to considerable efforts to maintain the belief that we're in control of situations where we really aren't. It's the same for investments: no one truly knows what lies ahead for markets.

Source: NAB Asset Management

Speak with your financial planner to discuss your investment options.

1 Unhedged international shares returned eight per cent per year more than Australian shares, over a five year period from 1/10/10 – 30/09/15. Based on MSCI All Country World Index and ASX/S&P 200 Accumulation Index.



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