autumnedition 2018

# financiallyspeaking

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# Economic outlook

## Why your chances of a pay increase could finally be improving

With 2018 now underway, many Australians may have noted 'pay increase' in their new years' resolutions list. While the economic conditions over the past few years may not been ideal for having successful conversations with your boss around remuneration, NAB Asset Management's Senior Economist Bob Cunneen explains how changing economic factors could lead to an improving environment for pay rises.

Nominal wages growth is the slowest it's been in 20 years. This is despite a number of strong economic indicators in the past year including a dramatically improved Australian labour market and employment growth running at its fastest pace since 2008 with 3.3% annual growth. Also, the unemployment rate has fallen to 5.5% which is the close to its lowest level since 2013. So why are pay rises as common as finding a Tasmanian tiger barking in the bush?

There has been a shopping list of explanations given for this "wages woe" by commentators and economists. The most frequently cited reasons are the elevated level of unemployment which is also known as "spare capacity", "job insecurity" and the longer-term challenges of "globalisation and technology".

### In this issue





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# Economic outlook continued

All three factors can be considered inter-related. If an individual is insecure about their job given the level of unemployment as well as globalisation and technology putting pressure on their job security, it doesn't provide much support for an increase in pay.

## How are wages measured? - "Just tell us the price"

Australia's nominal wages have been measured every which way with acronyms to astound and confound. Fortunately there is one standardised measure that Reserve Bank of Australia (RBA), Federal Government and financial markets focus upon. This is the "Wage Price Index". This Wage Price Index (WPI) measures nominal wages to ensure "a constant quantity and quality of work performed". The Wage Price Index is adjusted for different levels of hours ("quantity") and skills employed ("quality").

The Wage Price Index has only recorded 2% annual growth in the year to September 2017. This is essentially the slowest pace for wage gains since this measure began in 1997. Wages growth is now lower than that experienced during the Global Financial Crisis (GFC) from 2007 to 2009.

The RBA Governor Dr Philip Lowe is concerned about this slow wages growth, calling it a "major priority" for understanding. Slow wages growth is a major contributor to both the "low inflation" and "high asset prices" which is currently perplexing central bankers.[1]

## Spare capacity

Australia's unemployment rate is cited as a key measure of "spare capacity" in the labour market. The unemployment rate calculates the percentage of the available workforce that is out of work. As the theory goes, the more unemployed Australians, the less pressure on wages as people compete for available jobs.

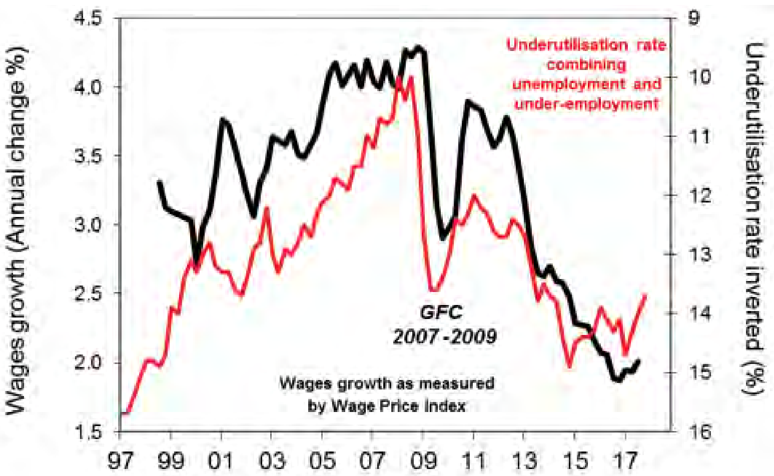
Certainly Australia's current unemployment rate at 5.5% is higher than in 2007 prior to the GFC where the unemployment rate was 4.2%. So there is an additional 1.2% of the available workforce currently unemployed. However this does not fully explain the current slow wages growth. Even in 2009 when the unemployment rate was higher at 5.9%, wages growth was still at a solid 3% annual pace.

Actually the unemployment rate is a debateable measure of "spare capacity". If you work for more than one hour, you are considered employed. So what happens if you are "underemployed". You could be a part time worker who would like to work additional hours but do not have the opportunity. According to the ABS, Australia has an underemployment rate of 8.3% at November 2017.

A potentially more accurate measure of Australia's "spare capacity" is the underutilisation rate. This combines both the unemployment rate (5.5%) and underemployment rate (8.3%) to arrive at a circa 13.7% underutilisation rate. This effectively means nearly 1 in every 7 potential workers are either unemployed or underemployed.

The underutilisation rate when turned upside down in the following chart (red line is inverted) is highly correlated with wages growth (black line). This suggests that the higher the percentage of Australians that are underutilised, then the slower the wage growth.

### Australia underutilisation vs wages




Source: NAB Asset Management Services Limited, Australian Bureau of Statistics.

Fortunately there are encouraging signs that this underutilisation rate is starting to decline. The underutilisation rate peaked in November 2014 at 14.9% and since then has been making a choppy and gradual improvement to now stand at 13.7%. Clearly there needs to be a further sharp downward shift in this underutilisation rate to place upward pressure on wages growth, but at least the labour market's spare capacity is moving in the right direction by becoming 'less spare'.

1 Reserve Bank Governor Dr Philip Lowe, "Some Evolving Questions" Address to the Australian Business Economists Annual Dinner Sydney – 21 November 2017, https://www.rba.gov.au/speeches/2017/sp-gov-2017-11-21.html

## Globalisation and technology…

The RBA Governor, Dr Phillip Lowe, recently suggested that workers' concern over globalisation and technology may also be restraining wages noting the possibility that "workers feel a heightened sense of potential competition, either from advances in technology or from international competition" in curbing their wage demands.

So has this 'brave new world' of integrated global supply systems and machines impacted on wage growth? Currently the evidence is more anecdotal than statistical, so the jury is still out. However let's briefly consider what can be called the "Rage against the machine at the checkout" as a prime anecdotal example of both globalisation and technology weighing on wages growth.

The arrival of Germany's ALDI into the Australian supermarket industry shows globalisation at work. ALDI has become a key competitor to Coles and Woolworths and uses its lower-price model as a differentiator. The "advances in technology" are also now evident in the recent introduction of "self-checkout" scanning machines by Coles and Woolworths. Now consider yourself a cashier employee in any Australian supermarket. Do you have the bargaining power for higher wages given the greater competitive pressures and technological advances that now prevail?

## Job insecurity (is falling)

Since the GFC began in August 2007, the spectre of job cuts has loomed like a black cloud over the workforce. Both the corporate and public sectors have been seeking "efficiency dividends" from employees. Given this plague of management euphemisms about "cost control", "downsizing", "rebalancing" and even "rightsizing", it would be rational for employees to worry about their jobs.

While "job insecurity" may not be exactly measurable, the Melbourne Institute conducts a survey that canvases consumers' expectations for unemployment. Notably unemployment expectations has seen some sharp movements over the past decade, as seen in the chart below.

The GFC witnessed a sharp spike in unemployment expectations (red line is inverted in chart) as consumers became anxious about their job prospects. While there was a brief recovery from 2010 to 2011, unemployment expectations then rose again from 2012 to 2015. Given this apparent correlation between unemployment expectations and wages growth, then "job insecurity" seems to be a key contributor to Australia's wages woes.

## But there is light on the horizon

Fortunately for those in the workforce there are some signs that unemployment expectations are now getting better, rather than deteriorating further into fear and loathing. The Melbourne Institute survey measure (previous chart) has now fallen to its lowest level since 2011. Another alternative measure is NAB's Consumer Anxiety Index which also shows that stress over job security has fallen to its lowest level for the past five years.

Indeed these diminishing survey responses for 'unemployment expectations' and 'consumer anxiety' suggest that employees are coming to terms with the challenges from spare capacity, globalisation and technology. We now seem to be becoming less fearful. Stronger jobs growth over the past year appears to be turning the tide in favour of more bargaining power for employees. This is a particularly welcome development for consumer spending as a moderate rising tide of wages growth should lift the economy's growth performance.

So there are now some hopeful signs for wages growth and that elusive pay increase may not be as far away as you think.

Source: MLC Wealth as at 22 January 2018

# Can Socially Responsible Investing and good returns coexist? Yes.

## Do the right thing. It will gratify some people and astonish the rest. Mark Twain

Over the last few years, there has been a significant increase in the interest in environmental, social and governance (ESG) investing. According to a paper released recently, over $8trn of the $40trn of money managed in the USA is now under some form of Sustainable and Responsible Investing (SRI) or ESG, up 33% since 2014 and up fivefold from $1.4trn in 2012.


Source http://www.ussif.org/files/Infographics/Overview%20Infographic.pdf

In many respects Australian fund managers have been caught unready for this change. If we look at the Mercer survey data for January 2017, the Global Equities strategy section contains 127 global funds that are sold in Australia. Of this, only 5 are classed as SRI funds. It is somewhat better for Australian equities with 157 funds in the survey, of which 13 are SRI.

One reason could be that there is a view amongst many people (and particularly fund managers) that SRI results in lower returns for investors and the investors have to pay a price to be responsible.

In some ways this misconception, of accepting lower returns for being ethical, goes against another tenant of conventional investing wisdom: buy good businesses. The grandfather of long term investing, Warren Buffett, discusses a lot in his letters to shareholders the importance of ethics and the quality of the character of the people running the businesses he owns.

Now admittedly he is discussing the character of the people rather than the nature of the business, and some people would find owning Coca Cola unethical.

### What do the Statistics Say?

UBS recently published an excellent summary of academic literature[2] looking at this question of whether SRI negatively affects investor returns. The conclusion was that it did not.

Verheyden, Eccles & Feiner (2016)[3] wanted to look at whether a portfolio manager would be put at a disadvantage in terms of performance, risk and diversification if he/she were to start from a screen based on ESG criteria. The empirical evidence shows that all ESG-screened portfolios have performed similarly to their respective underlying benchmarks, if not slightly outperforming them. Put differently, the findings of the paper show that – at the very least – there is no performance penalty from screening out low ESG-scoring firms of each industry.

### What does this mean for fund managers?

Investors globally are demanding more focus from their fund managers on ESG issues. The implication of these studies is that ESG does not detract from returns and investors are therefore not irrational to ask for more focus on ESG and SRI issues.

But it also says running a positive screen and a negative screen is a better way to generate returns for investors whilst also satisfying investor's ethical investment needs.

This article is for general information only and should not be relied upon without first seeking advice from an appropriately qualified professional.

Please seek your own advice on the suitability of Socially Responsible Investing that is relative to your own circumstances.

Source: Morphic Asset Management

2 Academic Research Monitor: ESG Quant Investing. Dec 2016. Please email us if you'd like a copy of the paper.

3 ESG for All? The Impact of ESG Screening on Return, Risk, and Diversification. Verheyden, T., Eccles, R. G., & Feiner, A. Journal of Applied Corporate Finance, 28(2), 47-55, 2016

# When can I retire?

There seems to be some confusion among Australians as to the current retirement age, with some commentary linking this to the Age Pension age, others to the age at which you can access your superannuation.

In Australia there is no official retirement age, so you can choose to retire at any time that suits you.

There is a difference though, between choosing to retire, the age you can access your superannuation benefits and the age at which you are eligible for the Centrelink Age pension.

There are three key ages when considering retirement planning;

- Preservation age
- Age 65
- Centrelink age pension eligibility age

## Age Pension eligibility

You can apply for the Centrelink Age Pension once you attain a certain age, and this is gradually increasing from age 65 to age 67. Eligibility age is based on your birthdate[4]:

| Birthdate | Age Pension eligibility (years) |
|---|---|
| Before 1 July 1952 | 65 |
| 1 July 1952 to 31 December 1953 | 65½ |
| 1 January 1954 to 30 June 1955 | 66 |
| 1 July 1955 to 31 December 1956 | 66½ |
| From 1 January 1957 | 67 |

## Age 65

Your superannuation is preserved within the superannuation system until a 'condition of release' has been met, which allows you to access some or all of your benefits. One of these conditions is simply attaining age 65 (regardless of employment status), at which point all of your superannuation will become accessible.

This age is not linked to your age pension eligibility age, meaning even if you cannot access the Centrelink age pension until age 67, you can still start drawing on your superannuation savings from age 65.

## Preservation age

Preservation age for superannuation varies depending on your birthdate[5];

| Birthdate | Preservation age (years) |
|---|---|
| Before 1 July 1960 | 55 |
| 1 July 1960 to 30 June 1961 | 56 |
| 1 July 1961 to 30 June 1962 | 57 |
| 1 July 1962 to 30 June 1963 | 58 |
| 1 July 1963 to 30 June 1964 | 59 |
| After 30 June 1964 | 60 |

Once you reach your preservation age as shown in the table above, you can access up to 10% of your superannuation balance each year, in the form of a superannuation pension payment.

Permanently retiring between your preservation age and 60 will also satisfy a condition of release, allowing you to access all of your superannuation benefits.

Once you reach age 60 the requirement is slightly less stringent, and you only need to cease work – not permanently retire - to satisfy a condition of release. Again, this will allow access to your full superannuation balance.

In summary, despite the government increasing the eligibility age for the Centrelink age pension, you can still access your superannuation savings at age 65 (or earlier if you meet another condition of release) and you can actually choose to retire at any age that works for you.

Now there's some motivation to get independently wealthy!

Source: AIA

4 Source: https://www.humanservices.gov.au/customer/services/centrelink/age-pension

5 Source: http://www.austlii.edu.au/au/legis/cth/consol_reg/sir1994582/s6.01.html

# How will the First Home Super Saver Scheme work for SMSFs?

For those interested in purchasing their first home, the First Home Super Saver ('FHSS') Scheme may be an option worth exploring.

**There are four broad steps that need to be taken if a member wants to take advantage of this scheme.**

## Step 1: Eligibility

The first step is to confirm that the member is eligible to participate in the FHSS Scheme. Broadly, the member must:

1. have never held any freehold interest in land in Australia (including any long-term leasehold interest of 50 plus years). This is either in their individual capacity or through a controlled foreign company title interest;
2. be 18 years or older; and
3. have not previously received any payment under the FHSS Scheme.

A member may still be eligible for the FHSS Scheme if they have previously owned property in Australia if they have suffered financial hardship subject to them satisfying further conditions.

A member should also check whether their fund accepts FHSS contributions as the FHSS Scheme precludes defined benefit funds and constitutionally protected funds from participating.

SMSF members should ensure their SMSF deed authorises and provides the relevant mechanics to deal with the FHSS Scheme including releasing FHSS amounts to the ATO.

## Step 2: Contributions

Once a member has determined that they are eligible to participate in the FHSS Scheme and their fund can accept FHSS contributions, the member can begin making eligible contributions to their super fund. Broadly, an eligible contribution is:

1. a concessional or non-concessional contribution that is not a mandated employer contribution;
2. eligible insofar as it does not result in the member exceeding their concessional and non-concessional contributions caps; and
3. eligible insofar as it does not exceed the $15,000 FHSS contribution limit in any financial year ('FY'), commencing from 1 July 2017.

The maximum amount of contributions that may be eligible to be released under the FHSS Scheme is $30,000. When an eligible contribution is made, the relevant super fund is required to allocate the contribution accordingly and inform the ATO. The member will, in due course, be able to check their FHSS contribution balance with the ATO from time to time.

## Step 3: Determination and Release

Once the member has accumulated a certain amount in their FHSS allocations, they can request a FHSS Scheme determination from the ATO. The ATO will then provide the member with an estimate of the member's FHSS Scheme maximum release amount, which includes:

1. concessional and non-concessional FHSS contributions;
2. associated earnings as calculated by the ATO — shortfall interest charge rate X [FHSS contributions + sum of earlier daily proxy amounts]; less
3. PAYG withholding tax

After considering the amount in the FHSS determination, the member can request a release authority from the ATO. The ATO will then generate a release authority and provide confirmation to both the member and their respective superannuation fund. Once the super fund receives the release authority, it releases the relevant amount to the ATO. The ATO receives the amount from the fund and deducts the PAYG withholding tax. After any tax is deducted, the ATO makes the net payment to the member. The member must include the FHSS amount received in their income tax return for that FY. The member is entitled to a 30% non-refundable tax offset of the FHSS amount received that FY.

### Step 4: Purchase, Recontribution and Tax

Within 12 months after the release of the FHSS released amount, the member can either:

1. purchase or construct a residential premises;
2. recontribute the amount; or
3. request another extension for up to 12 months.

If the member enters into a contract to purchase or construct residential premises, the member is required to notify the ATO within 28 days after the member enters into such a contract.

If the member decides to recontribute the FHSS released amount (eg, they do not purchase or construct within a 12 month period), they are required to inform the ATO shortly after the release of the FHSS released amount.

The recontributed amount will count towards the member's non-concessional caps for the FY the amount was recontributed and the member cannot claim a deduction in respect of these amounts.

A member can request that the ATO extend the period for entering into a contract by up to 12 months.

Alternatively, if the member retains an FHSS amount beyond the relevant 12 month, or if an extension is granted, beyond a 24 month period, they pay FHSS tax of 20% plus applicable levies on the FHSS released amount.

This article is for general information only and should not be relied upon without first seeking advice from an appropriately qualified professional.

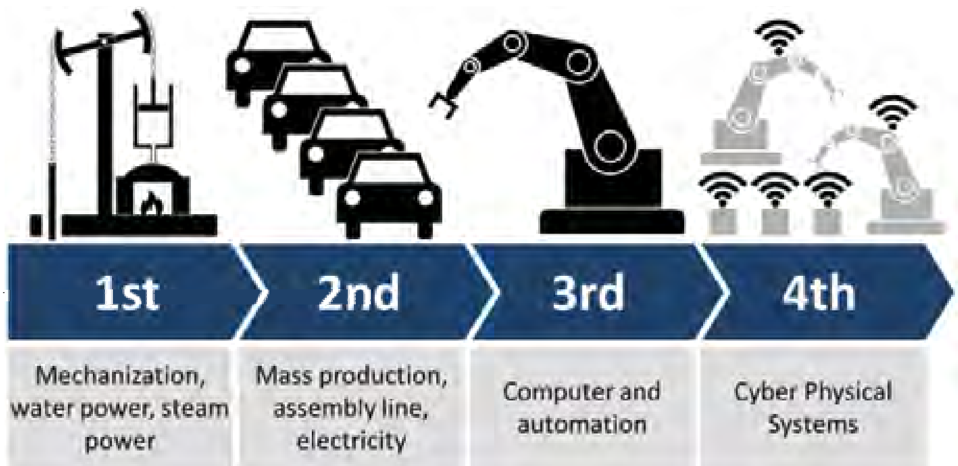
Source: DBA Lawyers

# Telecoms: Keeping pace with the Fourth Industrial revolution

Look around and you can see how technology has changed the way we live our lives, even as recently as five years ago. The pace of change from here is expected to be exponential. Mobility and connectivity have become a must have in human lives and we are just at the start of the Fourth Industrial Revolution.

### The Fourth Industrial Revolution

The Fourth Industrial Revolution is characterised by new technologies that are bringing together digital, physical and biological worlds[1], impacting all disciplines, economies and industries. It is the so called cyber-physical systems, cloud computing and the Internet of Things (IoT), which are not just driving changes and efficiencies through the production line, but are transforming everything we do.

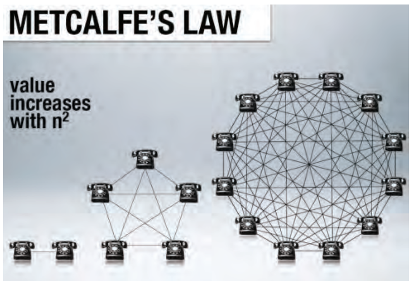



Source: Christoph Roser at AllAboutLean.com

1 The Fourth Industrial Revolution by Klaus Scwab.

Connectivity is pervasive, data storage is limitless with cloud computing, hardware is becoming increasingly cheap and at a price that everyone can afford. Moore's Law continues and Metcalfe's Law is driving value through the network effects.

Think of Facebook, LinkedIn and Twitter, just to name a few. The more users on the network, the more valuable the service is to the community and social networking has already become a big part of our daily life. Billions of people will be connected in real time. Ericsson has forecast that there will be around 26 Billion of connected 'things' by 2020. We are at the verge of a paradigm shift.




Source: List.ly co –founder

## The new wave of Technology Innovation

Businesses that are able to keep pace, be agile and adapt to these changes will benefit the most. The impact of the technology innovation will be disruptive to nearly every industry and process. Connected cars or driverless cars, connected home, smart cities, artificial intelligence, robotics, bitcoin, blockchain, 3D printing, biotechnology and nanotechnology are all examples of new technology innovation and advances that are still in their infancy. The opportunity for new products and services is limitless.

## Is the Telecommunication Sector keeping pace?

We are living in a highly competitive world and competition continues to dial up. The telecommunication sector is at the heart of these changes, and the opportunities arising from this revolution are very significant. Telecoms need to invest and be ready to compete as the change will come thick and fast. Billions of dollars are being invested in this market into network infrastructure and technology platforms to support the needs of devices.

IoT is about the 'Things', connectivity, real-time data in the cloud and analytics. Connectivity and data analytics are the areas where telecoms can play and are playing. We know that the three key players, Telstra, Optus and Vodafone are getting their networks ready for the IoT and the exponential growth in demand for data.

Cellular networks will have a significant role to play in the world of IoT, providing connectivity. Telstra, Optus and Vodafone have been running field trials for their IoT networks and are planning for network wide deployment. They are also getting network ready for 5G, playing a vital role in assisting companies to connect insights back to their business.

IDC, an information technology research firm, has forecast that IoT will grow to a $1.7 trillion market opportunity globally by 2020. A significant part of this revenue opportunity is in the end user products, however, the revenue opportunity in connectivity and analytics remains significant.

The usage of data will be the most significant area of growth. New economic models will continue to evolve and the industry needs to continue to keep pace with the changes, to be competitive, predictive and pre-emptive.

There is also increased focus by the telecom providers to control communication at home. If you control home communication, you will get a large share of the consumer wallet. Connected home will change the way we live. For the provider, it is a new revenue stream as well as churn reduction exercise.

The telecom industry continues to be a highly regulated industry and regulators need to adapt to this new, fast-changing environment to embrace the technology disruption that the Fourth Industrial Revolution brings as it shapes the future and benefits consumers and the economy.

Cloud and SaaS (Software as a Service) providers are also well positioned to ride the wave of the Fourth Industrial Revolution.

Source: Ausbil Investment Management Limited

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