informed investor

RESERVE
Financial Consulting

November 2019

In this issue:

Economic update

Australia

- Australian interest rates were lowered by 0.25% to 0.75% in October but left unchanged in November. Most observers expect borrowing costs to be lowered further in the next few months.
- The latest reading of Australian consumer confidence fell unexpectedly sharply. This was a little surprising given generally buoyant labour market conditions and declining mortgage costs.
- There has also been further evidence of an improvement in the Australian housing market. The latest survey suggested prices added 1.4% in October; the third consecutive month where prices rose by more than 1%.

United States

- The Federal Funds rate was lowered for the third time in as many months, as US officials responded to deteriorating economic indicators. The 0.25% cut had been widely anticipated by investors.
- The latest US manufacturing data was dismal, missing all expectations and falling to a three-year low. The downturn has been blamed on the trade conflict with China.
- Worryingly, weakness in the manufacturing sector appears to be spreading to services sectors. The latest gauge suggested activity levels declined to a three-year low during September.
- All that said, the slowdown in the overall economy was less bad than feared. US GDP rose at an annual pace of 1.9% in the September quarter, above consensus expectations.
- September employment numbers were slightly below expectations, but data for the prior month were revised higher.
- This resulted in the official unemployment rate falling to 3.5%, the lowest level in more than 50 years.

Welcome

Welcome to our latest edition of the Informed Investor newsletter.

As always, should you have any questions or would like some further information, please get in touch and we'll be happy to help.

Richard Shermon

Reserve Financial Consulting
Suite 4, 10 Station Road
Cheltenham VIC 3192

Ph: 0401 357 071

richard@reservefc.com.au
www.reservefc.com.au

- Following three consecutive months of modest increases, US inflation was unchanged in September. Importantly, inflation is below the Federal Reserve's target, suggesting policymakers have room to lower interest rates again, if required.

Europe

- Consumer confidence in Europe has deteriorated to its lowest level this year.
- The survey of economic expectations in Germany was less bad than had been anticipated, but still below zero (indicating expectations of economic contraction) for a sixth consecutive month.
- Germany's trade surplus fell sharply in August, primarily reflecting lower exports.
- In the UK, the Brexit process was delayed yet again. European leaders agreed to a further three-month delay in the UK's proposed withdrawal from the European Union, extending the deadline to 31 January 2020.
- Subsequently, Members of Parliament voted to hold a general election in the UK on 12 December, effectively placing the fate of Brexit in the hands of the British public.

New Zealand

- The value of exports was higher than expected in September, which supported New Zealand's trade balance. Imports were little changed from the prior month.
- Consumer confidence rebounded from very subdued levels – September's reading was the worst in more than four years.
- The RBNZ did not meet and interest rates were unchanged.

Asia

- Annual GDP growth in China remained at 6.4% in the March quarter, aided by the Government's pro-growth policies. These supported consumer demand, which helped offset the impact of ongoing tariff-related trade disruptions. Retail sales were 8.7% higher than in the corresponding period a year ago.
- In Japan, there was an uptick in inflation as food and transport costs stabilised. This is unlikely to be sufficient for the Bank of Japan to abandon its zero interest rate policy.

Australian dollar

The Australian dollar appreciated to a three-month high against the US dollar, reflecting optimism that a trade deal between the US and China might be close to being agreed.

The local currency added 2.1% against the US dollar, closing the month of October at 68.9 US cents. The 'Aussie' appreciated on other exchanges too, adding 1.4% against a trade-weighted basket of international currencies.

Commodities

Commodity prices were mostly higher during October, amid easing trade tensions between the US and China. Most industrial metals posted gains, including zinc (+8.1%), aluminium (+2.9%), copper (+2.5%) and lead (+2.2%).

Nickel (-6.2%) was a notable exception, falling amid policy uncertainty around Indonesia's proposed nickel ore export ban. Iron ore (-10.5%) fell sharply, primarily on an improving supply outlook. Brazilian mining giant Vale continued to bring production back online following severe supply disruptions earlier in the year.

Precious metals were mostly higher, including gold (+0.5%), silver (+3.1%) and platinum (+5.0%). Oil (Brent +2.8%) finished higher, as progress appeared to be made towards a resolution of the US/China trade war.

Australian equities

The Australian share market started October with its worst weekly return in nearly a year. Reinvigorated fears of a weakening global economy, disappointing manufacturing data and ongoing Brexit uncertainty weighed on the index. The market since recovered, as Australian shares followed global peers higher following some reasonably solid corporate earnings numbers in the US.

In the month as a whole, the S&P/ASX 100 Accumulation Index declined -0.4%. Small companies (-0.5%) once again underperformed their large cap peers, extending their underperformance to -2.9% in 2019 to date. The S&P/ASX Small Ordinaries Accumulation Index was dragged lower by the drastic decline in Southern Cross Media (-33.6%) following a quarterly update that showed revenues had slumped -8.5%.

Listed property

Global listed property was up modestly in October. The FTSE EPRA/NAREIT Developed Index returned 0.4% in AUD terms, performing in line with the broader global equity market.

The UK was the best performing property market (+5.0%) for the second consecutive month as the perceived likelihood of a 'no deal' Brexit continued to wane.

In Australia, AREITs returned 1.2% for the month, with the Diversified (+1.9%) and Industrial (+1.5%) sub-sectors leading the charge.

Global equities

Global equities maintained their upward momentum from September. Investors were heartened by the announcement of a "limited trade deal" between the US and China and a reasonably solid corporate earnings reporting season in the US. Together, these positive influences powered the S&P 500 Index in the US to new all-time highs.

The MSCI World Index jumped 1.9% in local currency terms in October, also to a new high, although Australian dollar strength reduced the equivalent returns to just 0.4% for Australian-based investors.

The Japanese Nikkei jumped over 5.0% in local currency terms and was the strongest market for a second consecutive month. UK shares struggled with the ongoing Brexit shenanigans.

Having been down as much as -4.4% in local currency terms, the FTSE recovered to be down just -1.9% by month-end as the probability of a 'hard Brexit' dissipated.

The improved trade outlook helped emerging markets to outperform developed markets for the first time since January. The MSCI Emerging Markets Index rose 2.0% in AUD terms, led by particularly strong returns from Russian stocks.

Global and Australian Fixed Interest

Government bond yields rose for a second consecutive month, resulting in negative returns from most fixed income markets.

While economic data remained reasonably downbeat, hopes of a possible partial resolution to the US/China trade standoff saw yields edge higher. Bond market participants appear to be thinking that we have likely already seen most of the likely interest rate cuts worldwide and that further moves could be some time away.

In the US, 10-year Treasury yields closed the month just 3 bps higher, at 1.69%, but there were larger moves elsewhere.Yields rose 16 bps and 14 bps in Germany and the UK respectively, for example, and by 8 bps in Japan.

Ten-year Australian government bond yields closed October 12 bps higher, at 1.14%, despite the Reserve Bank of Australia's interest rate cut at the beginning of the month.

Global credit

Corporate bonds eked out modest gains in October, partly reflecting ongoing strong inflows into the asset class and a limited amount of new issuance. Overall, investors seemed comfortable with September quarter earnings reported by US firms.

Manufacturing-related businesses continue to face headwinds. Encouragingly, however, demand among US consumers for goods and services appears to remain intact.

Source: Colonial First State

Putting a value on your potential

What is your most financially valuable asset? The answer to this question could be quite different depending on your age.

A younger person may say their car or a possession, such as a musical instrument, is their most valuable asset.

As people age their home or super is likely to be what they consider most valuable. However, while these answers seem sensible, the real answer is your capacity to earn an income. This ability likely outweighs the value of any other financial assets you have.

Example:

Alex, an engineer, is age 40 and owns a car worth $45,000, a home worth $750,000, and his super accumulation balance is around $250,000. Alex earns an income of $100,000 per year. If Alex plans to retire at age 65, he has 25 years of his working life left.

Based on this, Alex should earn $2.5 million in income between now and the time he retires – not including any salary increases he may receive.

Despite his earning potential being so high, Alex has never considered it an asset. And, while he wouldn't leave his $45,000 car uninsured and would never let his home insurance for his $750,000 home lapse, he has never considered the impact of losing his future earning capacity.

What are the risks?

The sudden loss of your income could occur due to a major illness or injury which could leave you incapacitated for an extended period, or even unable to ever return to work.

The consequences if the unexpected does happen means that everything you've worked for, the security of your family, your home, lifestyle and your ability to save for retirement will suddenly be at risk.

Life, total and permanent disability cover and income protection insurance can help you retain financial security and replace your income earning potential by providing a lump sum and/or regular income if adversity strikes.

Think it won't happen to you? Think again

You may think the unthinkable will never happen to you but did you know:

- In Australia, a person suffers a stroke every nine minutes and there are an estimated 475,000 stroke survivors living in our communities.
- An estimated 145,000 new cases of cancer will be diagnosed in Australia this year, with that number likely to rise to 150,000 in 2020.
- Almost half a million people are hospitalised each year as a result of injury, and a further 12,000 people die due to injury.
- 43,477 deaths were attributed to cardiovascular disease in Australia in 2017 and kills one Australian every 12 minutes.

That's why it's important to protect your most important asset, you.

How much insurance do you need?

The amount of insurance cover you need depends on your individual circumstances. Factors that should be considered include:

- your age
- how much debt you have
- your income
- how many dependent children you have

It will also differ depending on your specific circumstances, such as your health or pastimes.

Topping up your cover

You can customise your insurance to suit your circumstances at any time. Some of the reasons you may want to apply to increase your cover, include:

- you marry or divorce
- the birth or adoption of your child
- your dependent child starts secondary school
- you take out a mortgage to purchase or renovate your home
- you can also apply to increase your income protection cover if you have a salary increase

To find out more, please contact us.

Source: IOOF

What assets can you have before losing your pension

There are many benefits to receiving a pension or even a part pension, but there are limits to what level of income or assets you can have to be eligible.

Regarding assets, the key limits as at 1 July 2019 are as follows. To receive a full pension, assets (excluding the value of the primary residence) must be less than:

	Homeowner	Non-homeowner
Single	$263,250	$473,750
Couple	$394,500	$605,000

Indexed every 1 July.

To receive at least a part of a pension, assets must be less than:

	Homeowner	Non-homeowner
Single	$574,500	$785,000
Couple	$863,500	$1,070,500
Couple - separated by illness	$1,017,000	$1,222,500

Indexed every 20 March, 1 July and 20 September. Recipients of Rent Assistance will have higher thresholds.

There are a number of strategies that can be used to reduce asset levels, which can result in qualifying for a part pension or increasing the current pension amount received.

However, before reducing your assets it is important to bear in mind whether your remaining savings can support any shortfalls in retirement income needs, as any increased pension amount may still be inadequate.

Personal circumstances can also change and increase the reliance on your reduced savings. For example, future health issues may require a move into aged care, which can bring increased expenses. With that in mind, here are six assessable asset reduction strategies:

1. Gift within limits, or more than 5 years before qualifying age

If there is a desire to provide financial assistance to family or friends, gifting can reduce your assessable assets. The allowable amounts a single person or a couple combined may gift is $10,000 in a financial year or $30,000 over a rolling five financial year period. Any excess amounts will continue to count under the asset test (and deemed under the income test) for five financial years.

If you are more than five financial years away from reaching your age pension age or from receiving any other Centrelink payment, you can gift any amount without affecting the eventual assessment once you reach Aged Pension age.

2. Homeowners can renovate

Your home is an exempt asset and any expenses paid to repair or improve it will form part of its value and will also be exempt from assets testing.

3. Repay debt secured against exempt assets

Debts secured against exempt assets do not reduce your total assessable assets. An example is a mortgage against the family home. However, using assessable assets to repay these debts can reduce asset levels. Crucially, you must make actual repayments; depositing or retaining cash in an offset account will not achieve this outcome.

4. Funeral bonds within limits or prepay funeral expenses

If you wish to set aside funds or pay for your funeral costs now, there are a couple of ways to do this and reduce your assessable assets. A person can invest up to $13,250 (as at 1 July 2019) in a funeral bond and this amount is exempt from testing. Members of a couple can have their own individual bond up to the same limit each. By contrast if a couple invests jointly, this must not exceed $13,250, not double the limit.

In comparison, there is no limit to the amount paid for prepaid funeral expenses.

For the expenses to qualify there must be a contract setting out the services paid for, state that it is fully paid, and must not be refundable. Importantly, both methods of paying for funeral costs are designed purely for this purpose preventing assets being accessed for any other reason.

5. Contribute to younger spouse's super and hold in accumulation phase

If you have a younger spouse who has not yet reached their age pension age and is eligible to contribute to super, contributing an amount into their account may reduce your assessable assets. The elder spouse can even withdraw from their own superannuation, generally as a tax-free lump sum, to fund the contribution.

Investments held in the accumulation phase of superannuation are not counted towards their assessable assets if the account holder is below the pension age. Before using this strategy any additional costs incurred should first be considered.

Holding multiple superannuation accounts may duplicate fees. Shifting funds into an accumulation account may increase the tax on the earnings on these investments to 15%. Alternatively, earnings on the funds are tax-free if invested in an account-based pension or potentially even personally.

Additionally, contributing to a younger spouse who is under age pension age who is still working will 'preserve' the funds. They should also ensure they do not exceed their contribution caps.

6. Purchase a lifetime income stream

Lifetime income streams such as an annuity purchased after 1 July 2019 may be favourably assessed, according to the Social Services and Other Legislation Amendment (Supporting Retirement Incomes) Bill 2018. Where eligible, only 60% of the purchase price is assessed. This drops to 30% once you reach the later of, age 84 (based on current life expectancy factors) or five years.

To receive concessional treatment, the lifetime annuity must satisfy a 'capital access schedule' which limits the amount that can be commuted voluntarily or on death.

Conclusion

Reducing your assessable assets within the relevant assets test threshold can provide many benefits such as increasing your existing pension or allowing you to qualify for a part pension if you were above the upper threshold. While it is tempting to intentionally reduce your asset levels to gain these benefits, it is important to remember the payment rate is determined by applying both an income and assets test.

The one that results in a lower entitlement determines the amount payable. If the income test is the harsher test, reducing your assessable assets may provide no benefit.

If the assets test is harsher, you should not lose sight of the fact that any reduction in your assets means there are fewer assets for you to call upon if required.

Source: BT

For further information please contact Richard Shermon on 0401 357 071 or email richard@reservefc.com.au