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# financiallyspeaking

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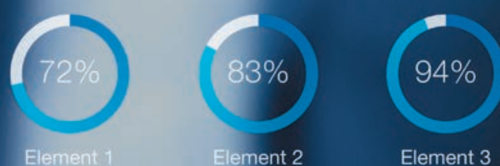
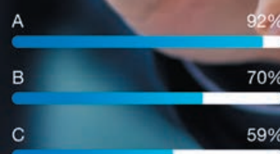
## 2017 market outlook

Last year, 2016, will be remembered for its political upsets – Brexit, the rise of populism in Europe, and the election of Donald Trump – but also the year that we stopped talking about deflation, yields on government bonds rose and investor spirits were reignited. Because of this, there is a new equation for investors; one where better growth plus a bit more inflation adds up to a change in approach to fixed income and the share market.

### Global outlook: Changing seasons

Growth in the world's major developed markets – US, Japan, and Europe – is brighter as a result of rising business and consumer sentiment and a pick-up in manufacturing activity. There is also the anticipated boost to growth from increased government spending and recognition by central banks that higher yields, not lower, is good for economic growth. While not quite as sunny as developed economies, the storm clouds over the emerging world are no longer as heavy. Brazil and Russia are emerging from deep recessions on the back of rising commodity prices and a generally more favourable political outlook.

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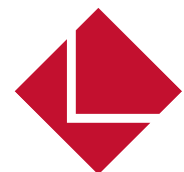

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# 2017 market outlook continued

Most importantly for Australia is the more stable outlook for the Chinese economy. The rate of economic growth in China may slow this year but fears of a collapse are no longer imminent.

US shares should continue to perform well given the potential boost to after tax profits from changes to the corporate tax structure. Elsewhere, weaker currencies should support Japanese shares and possibly the Eurozone.

## Australia: Fairer winds

The outlook is one of reducing headwinds and a stronger pace of economic growth over 2017. The drag from the decline in mining investment is diminishing, higher commodity prices should feed into rising levels of national income and increased trade, a continued strong pipeline of home building, and finally the potential for fiscal policy to be eased.

More vigour in the Australian economy, and concerns around the very high levels of household indebtedness, may stave off further cuts to the official cash rate by the Reserve Bank of Australia but there remains a downward bias. As such the Australian dollar faces further weakness as the US dollar rises, but currencies are never that simple, and demand for commodities may lend support to the 'Aussie'. The domestic share market should perform ok once again this year as commodity prices are higher and rising bond yields help the financial sector. However, much of the promised performance is concentrated within a narrow range and corporate earnings will have to live up to analyst's optimistic earnings forecasts.

## Risks: Politics and populism (international)

The political calendar will be heavy in the coming year and represents some of the biggest risks to investors. Close to half of the population of Europe will vote in national elections this year. The negotiations will start on details about how the UK will extract itself from the European Union and then there is the unknown quantity that is the new Republican government in the US. Political promises from the US should be viewed with some trepidation given the constraints of fiscal spending and an already limited number of workers.

Speak to your financial planner about investment opportunities in the year ahead.

## The new investment equation

The shifting fortunes for bond and share markets through 2016 rewarded those investors with a risk-orientated portfolio and once again highlighted the benefits of diversification. Investors should be thinking of single digit gains on a well-diversified portfolio but changing the way they achieve it. A better economic footing and shift to fiscal over monetary policy should see shares do better relative to bonds and point investors towards more cyclical sectors over 'bond like' shares.

Investors should look to avoid longer maturity government bonds and think more about corporate credit for income. However, while the forces that created the demand for safe assets have diminished, they have not gone away and the search for both income and new forms of 'safety' within portfolios will continue to be crucial.

Source: JP Morgan

# Are you prepared for the new superannuation changes?

In November 2016, the Federal Government passed into law superannuation reforms that were first announced in the May 2016 Federal Budget. Importantly, these changes include reductions in the amount that can be contributed to superannuation, as outlined below:

- A lower pre-tax (concessional) contributions cap which includes the compulsory superannuation guarantee (SG) contributions made by your employer on your behalf as well as any salary sacrifice contributions you choose to make and, if self-employed, your personal deductible contributions.
- A lower after-tax (non-concessional) contributions cap which includes any after tax contributions you choose to make to super (including any capital gains you have made as a result of selling an investment property or receiving an inheritance).

## What are the new caps?

From 1 July 2017, new annual limits will apply to the level of contributions you can make to super, as outlined in the following tables:

### Concessional contributions

| Age | Current annual limit | Annual limit from 1 July 2017 |
|---|---|---|
| Under 50 | $30,000 | $25,000 |
| 50 or over | $35,000 | $25,000 |

### Non-concessional contributions

| Age | Current annual limit* | Annual limit* from 1 July 2017 |
|---|---|---|
| Under 65 | $180,000 or up to $540,000 if utilising the three year bring forward strategy | $100,000 or up to $300,000 if you utilise the three year bring forward strategy |
| 65 or over | $180,000 each year if you meet the work test | $100,000 each year if you meet the work test |

* If your superannuation balance is close to, or exceeds, $1.6million, there are additional rules so please speak to your financial planner.

Although the existing limits have been reduced, there are strategies that can help you 'catch up'.

## What are the 'catch up' strategies?

From 1 July 2018, if your super balance is under $500,000, and the concessional contributions you make each year are less than the allowable cap, you will be able to carry forward any unused portion to the next year, for up to five years.

For example, you make $10,000 in concessional contributions during the 2018/19 financial year and $15,000 in concessional contributions during the 2019/20 financial year. Over these two years, you have accumulated an unused portion of $25,000 that, once added to your annual concessional contribution cap for the 2020/21 financial year, allows you to make a higher concessional contribution of $50,000 in that financial year.

While not a new strategy, the new limits that apply to the amount of non-concessional contributions you can make also change the amount you can contribute under the bring-forward rules. If you are under age 65, you can bring forward three years' of contribution limits to make a larger one-off contribution to your super. From 1 July 2017, these types of contributions will be capped at $300,000 and there are transitional rules that apply.

For example, if you receive an inheritance of $350,000 in the 2018/19 financial year, you could utilise the bring forward rules and make a $300,000 contribution to your super. In so doing, however, the next non-concessional contribution you could make would be in the 2021/22 financial year. Regardless of how close you are to retirement, strategies to maximise your superannuation can be used by everyone. Superannuation helps you to accumulate as much as you can towards your retirement nest egg while utilising the significant tax concessions that are available.

Source: IOOF

Speak to your financial planner to discuss your superannuation options.

# Resisting temptation

Why overcoming our worst human impulses can have great rewards.

We have developed language, conquered gravity, and made the most of our opposable thumbs. What we're not terribly good at though, is overcoming our own worst impulses – particularly as investors.

## Are we wired for failure?

Could it be that the way we are psychologically made up makes it difficult for us to pursue an optimal investment strategy? Are we somehow wired to be more susceptible to behaviour that produces less-than-great results?

This theory comes from various neuropsychological research. In one particular study, after observing a series of light flashes, human subjects were asked to guess whether the next flash of the light would be at the top or bottom of the screen.

The order that the light appeared in each location was random, but over time it appeared at the top of the screen 80 per cent of the time. Rats, were required to do the same thing. If the rats were right they got food and if they were wrong they got a mild electric shock.

The scientists noticed the subjects engaged in two very different types of behaviour. The rats employed a 'maximisation' strategy, while the humans preferred a 'matching' strategy.

## Maximising vs matching

The 'maximising' rats just engaged in the behaviour that most often gave a positive result. They soon learnt that the light flashed most often at the top of the screen so, eventually, they only selected the top – and were rewarded with food 80 per cent of the time.

The human 'matchers' also figured out that the light flashed most often at the top. But they tried to figure out the underlying pattern of the random flashes and then match their guesses to the (non-existent) pattern – and only guessed right 68 per cent of the time.

> Are we somehow wired to be more susceptible to behaviour that produces less-than-great results?

## Our need to be right makes us wrong

The psychologists hypothesised that rats choose a more optimal strategy than we oh-so-smart humans because they accept they're going to be wrong some percentage of the time and simply want to minimise the error (and risk of shocks). Humans, on the other hand, aspire to be perfectly correct and, as a result, we're wrong a higher proportion of the time[1].

So, what does this have to do with investing? The random outcomes tested in these studies are much like the day-to-day variations we see in financial markets. Our need to find patterns in uncertainty actually causes us to do much more poorly than if we, like the rats, simply pursued the best long-term strategy and accepted we'll receive a few 'shocks' along the way.

## Investors are great at predicting the past

Chasing performance is a good example of how we alter our behaviour based on recent events. If a stock does well, investors are likely to flock to it (buying high). If it drops, many investors will flee (selling low).

Studies show super fund members in Australia have a similar mentality. The majority of investment switching during the global financial crisis happened just after market downturns and most of those transfers were from medium- or high-growth portfolios to more conservative strategies. Those who switched to cash during March 2009 (when the market was at its lowest point) were six per cent worse off by August that same year, having missed out on the sharp market rebound.[2]

## How to break the mould

So, what can we do to improve our chances of investment success? The answer, of course, is to ignore your very human gut instincts and behave more like a rat. Determine the optimal plan based on your retirement objectives and tolerance for risk, then stick with it. You don't have to change your super investment strategy as soon as the market moves – in fact, its best not to.

Source: Russell

Speak with your financial planner to discuss your investment options.

1 Gazzaniga, M (2002), The Split Brain Revisited, Scientific American, p26–31

2 Gerrans, P (2009), Member Investment Choice Response to the Global Financial Crisis, The Australian Institute of Superannuation Trustees

# Raising financially savvy kids

If you want your children to grow up making sensible financial decisions, it pays to start early. Guiding your children through the basics of saving, budgeting and spending from a young age will help them to develop good habits for life.

## 1. Start early

Introduce numbers as early as possible with games and books. This is a vital concept young children need to grasp before they can understand money, but almost one in five Australian children start school without knowing how to count or recognise numbers.

Young children are naturally curious so this is a great time to expose them to everyday money. Take them grocery shopping and take them to the bank. Talk to them about what you're doing and answer any questions. When paying for things around young children, try to use cash – it's visual, tangible and easy to understand. Paying on debit or credit can give children the impression that you can get whatever you want if you just have a magic plastic card.

## 2. Introduce pocket money

When they get a bit older, start giving a small allowance to teach short and long-term saving and good spending habits. Talk to them about how to use their money – its okay to spend some but it's also a good idea to keep some for a rainy day.

If they have their sights set on a special new toy, it's time to learn how to save. You can show them the rewards of work by giving them small jobs around the house in exchange for pocket money. When they've saved enough (and if they still want the toy!) take them to buy it and let them hand over the cash themselves.

It's also important to let them make their own choices about what to do with their money, so they can understand the consequences if they run out.

## 3. Involve them in family budgets and shopping

Talk to children about where the family's money comes from and how you use it to cover things like food, household items, utilities and internet. Get them to help you plan, make shopping lists and find the best value products.

Teach them budgeting through delayed gratification. If you're planning a big trip and they want to go out for dinner tonight, let them know you're saving your money for your holiday and if you eat at home now you'll be able to use that money for something fun later.

## 4. Open a bank account that's their very own

Opening their first savings account is a milestone moment, ideally in the later years of primary school. Look for one with minimal fees but the opportunity to earn interest if regular deposits are made. It can be very powerful for children to see how money can make more money (even if it's just a few dollars) through compound interest.

Once your child starts high school and becomes more independent, get an ATM card so they can access their cash and talk to them about keeping their PIN safe and their money secure online.

## 5. Add responsibility

To increase the responsibility you give older children, you could involve them in household budgeting discussions – let them help plan family holidays or decide which sports and other activities will fit into the family's budget.

Encourage teenagers to start work when they can – whether it's a paper run, babysitting for the neighbours or a casual weekend job. A record of small part-time jobs will also look good on their CV when they start their career.

If you do decide to give loans – such as for a new mobile phone or if they do run out of money – use it as a chance to teach them about credit and have the money paid back with interest on set payment terms. And, if your child goes over their phone bill, don't simply pay it for them – give them a strategy to earn the money to pay it back.

## 6. Model good behaviour

As a parent, you have a big influence on your children's spending habits and their attitudes towards money. If you're running up debts, impulse buying or arguing about money with your partner, your children will notice. Make money a regular topic of conversation, answer any questions and model good financial habits. It's important to teach by example.

Teaching your children to be responsible with money is an important life skill but it's not the be-all-and-end-all. We all need to know how to save and make smart decisions but we can also use money to buy things and have fun.

If they end up making a few mistakes along the way, that's OK – everyone does. It's what they can learn from those financial hiccups that really matters.

Source: Macquarie

# Easing the journey into aged care

Whether you're considering options for yourself, or deciding how best to help someone close to you, a transition into aged care is an emotional and life changing process.

It's a daunting move for anyone to make. On top of trying to figure out where to live and the costs involved, important decisions around your assets need to be made that can have a significant financial impact. Trying to navigate these issues at an already stressful time can be overwhelming.

While a financial planner can't remove the emotional aspect of the process, they can help guide you through some of the complex financial elements so you can make an informed decision.

Some of the issues your financial planner can help with include:

## Upfront costs

Your planner can help figure out the most cost-effective way to pay accommodation costs. This could involve a lump sum payment, regular instalments or a combination of both.

## Ongoing care costs

It's possible to put strategies in place to minimise the ongoing care fees payable. A well-executed plan may result in a higher Age Pension and lower aged care costs.

## Keeping or selling the family home?

Your financial planner can help you understand the options you have regarding the family home. If kept, they can determine the best way to structure the accommodation payment to meet your goals. If sold, they can help with the best way to invest the proceeds and get the balance right between generating an income, maximising the Age Pension and minimising aged care costs.

## Maximising cash flow

It's important to understand how the Income and Assets Tests apply, as the way income, assets and investments are structured will impact eligibility for social security benefits and aged care costs. Investments such as annuities may be able to provide additional cash flow benefits. Your planner can determine a strategy, depending on the circumstances, to maximise these benefits.

## Estate planning

Your financial planner can help identify what assets can be included in the estate and look at investment options that can help provide control over estate planning outcomes.

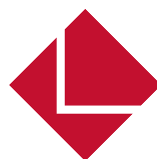
## Tax considerations

An overall financial review can help identify the tax consequences of different investments and the tax offsets that may be available, including the low income, seniors and net medical expense offsets.

Financial planners are well positioned to support clients and their families through this stage of retirement, taking some of the financial stress out of the situation and making a difficult journey a little easier.

Source: Challenger

If you or a family member needs assistance in this area, speak to your financial planner to find out how they can help.



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