Axis Superannuation

MAGAZINE July 2012 | Financial food for thought

Market update

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IMPORTANT INFORMATION

Market review and outlook

With focus remaining on Europe, we talk to Felix Stephen, Head of Strategy & Research at Advance, about reactions to the latest events and the outlook for the key economies.

Felix Stephen
Head of Strategy & Research
Advance Asset Management

Australia

In a highly anticipated policy decision from the Reserve Bank (RBA), the RBA Board decided to cut the official cash rate by 0.25% to 3.5% at its June meeting. Slowing growth prospects in China, heightened uncertainty around European banks and European sovereign debt and its negative impact on global and in particular Australian growth would mean that the RBA may need to move much harder should the outlook worsen over the next few months.

US

With the situation in Europe appearing to deteriorate by the day, global financial market volatility increasing, and some rather disappointing US economic data, it looks like the headwinds facing the US economy are becoming more significant.

Japan

Japan's economic growth in the first quarter of 2012 may have surpassed that of other key developed economies, but the outlook is now more subdued.

Europe

Following the elections in Greece and France that sent a clear anti-austerity message to the region's leaders, confirmation that Spain's banking sector is struggling under the weight of bad loans, as well as the increasing prospect that Greece may leave/be forced out of the euro, have continued to plague confidence and activity. This brings the European Central Bank (ECB) into play with the likelihood of a significant long-term re-financing operation being implemented by early July.

UK

The Bank of England's (BOE) May Inflation Report noted that growth forecasts were reduced, whilst inflation is expected to stay higher for longer.

China

The latest economic news from China has been disappointing, leaving little doubt that the economy has continued its slowdown into the June quarter, and prompting the People's Bank of China (PBOC) to pump more money into the economy.

Undecided elections in Greece, a new pro-growth/anti-austerity government in France, the continuing possibility of Greece exiting the euro, and renewed concerns about the Spanish banking sector, have all played havoc with global confidence and markets. Meanwhile, global growth prospects have taken a further tumble with news that China's economy looks to be slowing more sharply.

How has the Reserve Bank in Australia reacted?

In June the RBA Board decided to cut the official cash rate by 0.25% to 3.5%. The cash rate is now at its lowest level since November 2009. The European situation and its negative impact on world growth and markets means the RBA may need to move again in the next few months.

There is still room to make a significant cut in rates from late June if required, which is when many are considering will be crunch time for Europe. The RBA will be closely monitoring if, and by how much, the banks will pass on this latest cut in rates, particularly given that the spread between business and personal lending rates to the cash rate remain near all time highs as shown in the chart opposite.

The June statement suggests a more comfortable outlook for the domestic economy than in May. The Q1 GDP numbers were also strong, particularly in household consumption, lessening the case for any further policy easing.

GDP jumped 1.3% quarter on quarter, more than double market expectation and over the year to March, the economy expanded by 4.3%, the fastest pace since September 2007 and the fastest in the developed world.

hinder much stronger domestic growth from here. Both business and consumer confidence will remain shaky in such an environment. We expect the two-speed economy to continue, driven by strong mining investment.

Outlook for the Australian economy

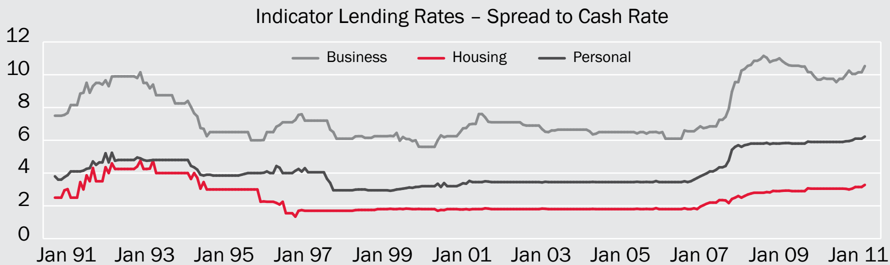
In our view, there will be further cuts in interest rates driven by overseas developments. An intensification of the Eurozone crisis and/or much weaker growth from China and the US, the impact of both which would be detrimental to financial markets and confidence, will see the RBA move decisively.

Over the coming year, we expect the Australian economy to grow around or just below trend. The March quarter GDP numbers are likely to be a peak as the headwinds facing the economy from a weaker global economy will

Outlook for the US economy

We anticipate the second half of this year will be weak as a result of continued uncertainty surrounding Europe, the election and the fiscal cliff. We assume there will be an eventual fiscal compromise which should result in improving business confidence into 2013, and hence supportive of employment growth and household incomes and spending. The biggest downside risks to the outlook will be a fiscal impasse which could result in a 4% contraction in economic activity in Q1 2013 and a collapse of the euro mechanism.

Australia lending rates



Source: DataStream & Advance Asset Management

Can any more be done in the Eurozone?

While the economy escaped a double dip recession in Q1, there is a risk of contraction in Q2 with a continued contraction in manufacturing even in Germany and France. In light of reduced activity and confidence, businesses are continuing to lower costs. Cutting jobs remains a priority with the unemployment rate reaching a new record of 11% in April. The pressure in the ECB to alleviate the crisis situation is intense and besides calls for another long-term refinancing operation, there is also pressure to cut interest rates.

Outlook for the Eurozone economy

The outlook remains precarious, with significant headwinds in place.

Our view is that the economy will expand by 0.7% year on year. This outlook assumes that European leaders will finally agree to a policy mix that aims for growth alongside austerity. We believe the authorities will throw all their weight behind keeping Greece in the Union. To do this will require more unity, and whilst that appears lacking at present, we believe the cost of disunity will prove too high a price. This should help support a gradual recovery in confidence and activity in late 2012/early 2013.

Outlook for the UK economy

Whilst the Government has maintained its commitment to austerity, we see a reasonable likelihood that it may need to move slightly away from that to help support activity at a time of increasing global uncertainty. At the same time, we believe the BOE could potentially lower interest rates further and expand its asset purchase program to help support growth. On the basis of this, we see the economy recovering moderately from its current level over the year ahead, albeit with GDP growth remaining below trend. Our expectation is for the UK economy to grow by 1.5% over the year to June 2013.

How have authorities responded to the slowdown in China?

The latest economic news from China has been very disappointing, leaving little doubt that the economy has continued its slowdown into the June quarter, and prompting the PBOC to pump more money into the economy. Industrial production has slowed to its weakest pace of growth since 2009, and exports are well down on levels a year ago.

Against this much weaker economic background, the PBOC announced a 0.5% cut in banks' reserve requirement ratio (RRR). This means that for the biggest banks, the amount of money they must set aside as reserves is now 20%. This is the second cut in the RRR this year and the third in this cycle, and is expected to add between 350 – 400bn yuan into the financial system.

Outlook for the Chinese economy

With increasing signs that global growth has weakened, thus posing a continued restraining force on China's economy, the authorities are expected to undertake further measures to support domestic demand in the near term. This, we believe, will prevent the economy from falling into a deep downturn, but we do anticipate that China will grow by 7.8% by June 2013 which is below trend but strong relative to world growth.

What impact have these developments had on financial markets?

President Francois Hollande defeated incumbent President Nicolas Sarkozy in the French presidential election. This result was largely expected by markets, who called for more pro-growth measures to be considered along with existing austerity measures, in an effort to stem sovereign debt levels across Europe. These were positive signals, but realisation of the difficulty policymakers face in coming to a collective agreement resulted in further volatility. Risk appetite over the month was weak as further deterioration was evident in European growth with the jobless rate rising to 10.9% in March and manufacturing data remaining soft, and combined with the lack of acceleration in US growth, investors remained cautious on growth assets.

Equities returned their worst monthly performance of 2012. Commodities declined driven by a fall in oil prices, the US dollar was well supported re-affirming its 'safe-haven' status and bonds outperformed with investment grade credit outperforming high yield.

What is the outlook for financial markets?

We should never underestimate the resolve or the resourcefulness of the new breed of central bankers to respond to problems plaguing the global economy. In fact, they are the only group of policymakers who will respond to ongoing economic or financial market dislocations in a timely manner, when the global political system is either broken or dysfunctional. Given that recent events have forced the central banks into action, the upside for growth or so called risky assets to perform well over the next five to six months has improved. However, in this environment, due consideration needs to be given to asset allocation decisions to address risks inherent in the market. ■

The drip feed investment strategy

Trying to time the sharemarket is difficult even for experts, as many people have found in the choppy markets we have been experiencing over the past five years.

While part of your superannuation is probably invested in the sharemarket, for many people the way we invest our super – which is not a once-off lump sum but a regular contribution from your pay – can be a good strategy.

An effective wealth creation strategy is to drip feed your investments so that you steadily take advantage of market falls to buy into the market when it is at its cheapest. By investing a set amount at regular intervals (say monthly), you invest more when the market is cheap and less when it is expensive. This is much like buying more of your favourite food when it is on special.

To illustrate the power of this strategy, let's say that five years ago you had $50,000 you wanted to invest in News Corporation shares. Which do you think would leave you better off today – investing the whole amount five years ago (option A) or investing $10,000 once a year for five years (option B)?

Take a look at the numbers in the table below. Option A would have bought you just over 2,083 News Corporation shares on 30 April 2007. Five years later, that would be worth about $41,333 – a capital loss of about $8,667.

On the other hand, option B would have bought you nearly 3,145 shares over five years. That would be worth about $62,397 – a capital gain of around $12,397.

That makes you about $21,064 better off, simply by drip feeding your investment portfolio and buying more shares when they are cheap and less when they are expensive.

You can use the drip feed strategy to invest in single shares or managed funds. If you receive the 9% Superannuation Guarantee from your employer as part of your salary, you're probably using this strategy already – without knowing it. It's a great way to manage market risk or increase your exposure to growth assets if you feel unsure about market movements in coming years.

Your financial adviser is the best person to talk to and help decide if this strategy could work for you.

1. Decide how much you want to invest or salary sacrifice into your super fund or investment portfolio each month, quarter or year.
2. Plan what you want to invest in over the next five to 10 years – an individual share, a basket of shares or a managed fund.
3. Adopt a disciplined approach to execute your investment strategy – a regular savings plan attached to your super fund can make this easy. ■

A tale of two investment strategies

Investment date	Amount invested	Price per share	Shares purchased	Value of shares
Option A – lump sum investment (Invest $50,000 on 30 April 2007)				
30 April 2007	$50,000	$24.00	2,083	$50,000
30 April 2012 (total)	$50,000	$19.84	2,083	$41,333
Option B – drip feed investment (Invest $10,000 on 30 April every year for five years)				
30 April 2007	$10,000	$24.00	417	$10,000
30 April 2008	$10,000	$18.50	540	$10,000
30 April 2009	$10,000	$9.12	1,097	$10,000
30 April 2010	$10,000	$17.79	562	$10,000
30 April 2011	$10,000	$18.90	529	$10,000
30 April 2012 (total)	$50,000	$19.84	3,145	$62,397

Source: Yahoo Finance 2012

This information does not take into account your personal objectives, financial situation or needs and so you should consider its appropriateness having regard to these factors before acting on it.

Super – Rule changes and the 2012/13 Budget

The Government continues to tweak the super rules almost every Budget and certainly when they're looking for more money to spend.

For some, it can be disheartening to see the rules surrounding your long-term savings change, but it doesn't lessen the importance of putting your money to work for you over the long-term. Super will always be taxed favourably. And it makes sense – more than ever now – to start paying attention to your super as an investment as this really can make a difference in the long run.

The change with the most impact this year is capping the maximum concessional contributions to $25,000. So if you're aged 50 or more and you were looking forward to bumping up your super ahead of retirement, this won't be so easy to do. The rules state that $25,000 will be the cap for the next two years, after which it's likely to be $55,000 for those over 50 with less than $500,000 in super, and around $30,000 for those under 50.

Further, from 1 July 2012, if you earn above $300,000 a year, you'll pay 30% tax on your concessional contributions instead of the 15% that you pay now. This tax rate applies to all super contributions made by your employer too.

On the other hand, if you earn up to $37,000 you'll receive a boost of up to $500 from the Government to your super savings to ensure you're paying no tax on your employer-paid super.

And good news for everyone receiving the Super Guarantee is that from 1 July 2013 you'll receive an additional 0.25% of super, taking the percentage of your salary paid into super up to 9.25%. This will increase by a further 0.25% each six months until it reaches 12% by 1 July 2019. ■

Will employer contributions to my super be enough?

When you're planning for 30 years or more of your life, it's hard to imagine how much you will need to live on. A lot of Australians underestimate how much they need to enjoy even a modest retirement. Generally speaking you need 65% of your pre-retirement income to live comfortably.

The table below illustrates the amount that a contribution of $1000, $2000, $7500 or $10,000 really costs you on the various tax brackets. For example, if you are in the $80,001–$180,000 tax bracket and want to contribute $5000 it will cost you only $3150 when you take into account the amount you will save in tax. ■

2011/2012

Tax Bracket	Tax Rate	$1000	$2500	$5000	$7500	$10,000
0–$6000	0	$1000	$2500	$5000	$7500	$10,000
$6001–$37,000	15c	$850	$2125	$4250	$6375	$8500
$37,001–$80,000	30c	$700	$1750	$3500	$5250	$7000
$80,001–$180,000	37c	$630	$1575	$3150	$4725	$6300
$180,001 +	45c	$550	$1375	$2750	$4125	$5500

Understanding your investor report

Your investor report provides lots of information – so here are some tips on what to look out for, and an explanation of key terms.

Investor report

- This is a summary of your super or pension account, including performance of investments, contributions, transaction history, insurance and a record of all fees and taxes paid.

Total at 30 June 2012

- The value of all investments in your super or pension account at the end of the 2012 financial year.

Your insurance*

- Cover for death or disability. In the event of your death, your beneficiaries or estate will receive your life insurance amount plus your account balance amount.
- In the event of disability, you may receive an insurance payout and can apply to access your superannuation balance before retirement, in special circumstances.

* Insurance is only applicable to superannuation accounts.

- Salary Continuance Insurance (SCI) provides cover if you have an injury that prevents you from working for a period of time, by providing a regular payment in place of salary. SCI is not available in all products – please check with your financial adviser.

Having insurance with your super fund can be a convenient and tax-effective way of arranging financial protection in case of death or permanent or temporary disablement. Talk to your financial adviser about the best insurance options for you.

Performance of your investment (rate of return)

- Your rate of return shows any changes in your investment based on the timing and amount of all transactions.
- The rate of return is always reflected as a percentage.

Statement of Long-Term Returns

- The performance of the investment options in your super or pension account.

Beneficiary

- A beneficiary is someone you have nominated to receive your super and insurance (if applicable) in the event of your death. You must nominate a dependant or legal personal representative (the executor of your estate) and it is important you let your financial adviser know, so that you can make sure your death benefit goes to the right people. You can nominate your beneficiary by using a Binding Death Benefit Nomination form, available from your financial adviser or by calling us on 1800 998 185.

Fees

- Total fees you paid at the end of the financial year. ■

For more information about your investor report please contact your financial adviser, or call Asgard on 1800 998 185.

Case studies

We've put together case studies of some issues that could affect investors. You should speak to your adviser for more information tailored to your individual needs.

Contemplating a self managed super fund

I'm 40 and have $100,000 in super. I'm thinking of buying an investment property soon to help me in retirement. Can I set up a self managed super fund (SMSF) to house the investment or should I keep the investment outside super? What other benefits are there to having a SMSF?

One of the main advantages of a SMSF over other types of super funds is the ability to have an investment property as part of your super. On the flip side, one of the great disadvantages of a SMSF is the fixed costs for administration, reporting, audit and lodgement can make it relatively expensive for people with super balances below $200,000*. The costs vary but generally start from somewhere between $2,000 to $3,000 per year (excluding establishment costs).

If the costs don't deter you, the advantage of holding the property inside your super fund is that you generally only pay 15% tax on any income generated and 10% capital gains tax when you sell (provided you hold the property for at least 12 months). If you're considering following this path, you will definitely need advice from a financial adviser or accountant who specialises in self managed super funds. They can explain to you the restrictions around who your super fund can buy the property from and who you can lease it to.

Of course, there is a balance to this. If you hold the property outside of super, you may be able to take advantage of a negative gearing strategy. A professional financial adviser could help you find out which option is better for you.

As to the benefits of SMSFs, the reasons people set up SMSFs vary but often relate to their specific financial needs. The ability to invest in direct property is a common driver for people who prefer investment properties over other forms of investment or small business owners who lease their own business premises. Others cite the ability to implement sophisticated estate planning, asset protection and tax-effective investment strategies. If you have a very large super balance (over $1 million), then the cost of a SMSF may be lower than other options.

* ATO, ASIC 2011 Thinking about self-managed super, Canberra

This information has been prepared without taking account of your objectives, financial situation or needs. Because of this you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation and needs.

Career break

I'm planning to take a year off full-time work next year to complete my Masters degree. I'm a single 34 year old and owe around $220,000 on a unit I bought five years ago. While I'm confident part-time work and savings will allow me to pay my mortgage and living expenses, I'm concerned about the effect of my reduced income on my long-term wealth creation effort. Can you suggest ways I can organise my finances to make the most of my situation?

Taking time out of the workforce to further your studies can be one of the most rewarding things you can do for your long-term income opportunities. But it can create some short-term financial stress.

To prepare yourself for this, think about a four step strategy. First, get a thorough understanding of your expenses by developing a budget using actual income and expenses from the past year. Secondly, review your current expenses and develop a plan to cut them by at least 20%. This could be as simple as hanging out your washing rather than using your clothes dryer or bringing your lunch to uni rather than buying from the canteen. You may also find some unnecessary expenses to eliminate. For instance, if you have income protection insurance, speak to your financial adviser about temporarily reducing the amount of cover you have to reflect your reduced income. You may also consider moving your home loan to interest only for the year.

Thirdly, you need discipline to implement your strategy successfully. If you don't have a financial adviser, ask someone you can trust to hold you to your plan and report back to him/her at the end of each month with your progress. Give that same person your credit card to look after for the year so you are not tempted to go into debt.

Finally, find out about all the Government incentives you're eligible for and make the most of them. The Government co-contribution strategy is described above, where the Government contributes to your super contributions up to a maximum of $1,000 (2011/12 and $500 in 2012/13) subject to meeting the eligibility criteria. While the maximum co-contribution is being reduced to $500 in the 2012/13 financial year, it's still a very worthwhile strategy. You should also make sure you get your student card and understand all the discounts this entitles you to.

Visit
asgard.com.au/axisnewsletter:

- Use our super calculators to help plan your retirement.
- Learn more about end of financial year strategies.
- Find a financial adviser.

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