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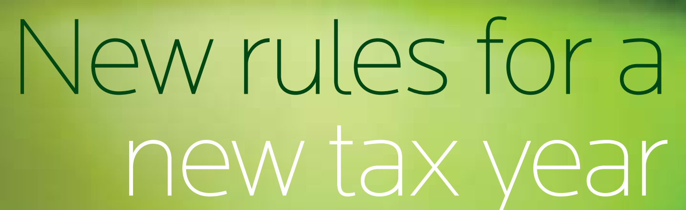
Investment Solutions

Spring 2009



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Snippets

Save our super

In the recent Federal Budget, the government reduced the concessional contributions amount Australians can pay into super. This change puts a 'cap' on annual contributions of $25,000 for people under 50 and $50,000 for people 50 and over. The higher cap for over 50s only applies until 2012.

With many Australians seeing their superannuation balances fall in the wake of the recent investment market downturn, some investment industry bodies have expressed their concern that the government's proposal would prevent older members from contributing more into super to make up for market movement.

Their suggestions include:

- removing employer superannuation guarantee (SG) contributions from the concessional contributions cap
- allowing members to carry forward any unused concessional contribution caps for the 10 years before they retire
- keeping the higher cap for members over 50.

It's hoped that the government will take note of industry concerns: any future changes to the super regime should aim to maintain confidence in the super system.

Australia: No. 1

Australia has been voted the number one place to be in the world during the current economic downturn.

An April 2009 survey was commissioned to understand the current mood, business morale and impact the economic downturn has had on businesses around the world. The Servcorp International Business Confidence Survey asked 7,500 international business people across 24 countries to identify the countries they believed were doing a good job of surviving the global financial crisis.

Australia came out tops. China was voted second for business confidence and India and Singapore were voted equal third.

Taxpayer beware

After handing out billions of dollars in recent stimulus packages, the government is looking for ways to recoup the money to help reduce the massive Budget deficit. Taxation is one sure way they can do this.

At the end of each financial year, the Australian Taxation Office (ATO) alerts taxpayers to the areas – and people – it will be paying close attention to when processing tax returns. This time around the ATO will be paying particular attention to the tax affairs of 'wealthy' Australians.

In the past, a net worth of $30 million would qualify you as wealthy. This year, the ATO has reduced this amount to $5 million, which means it will have its eye on a lot more people. The ATO will also be looking closely at company senior executives and directors; and (as usual) work-related expenses claims.

The global financial crisis has put some sharemarket investors under financial pressure. Many have had to sell their investments quickly (for example, to meet margin calls). The ATO will be keeping an eye on these investors too; it's expecting some to falsely claim sharemarket losses as trading losses, not capital losses. And in these uncertain times, some investors may be attracted to questionable investment schemes that will claim to minimise their overall sharemarket investment losses.

Making a false claim on your tax return in an offence at law. And it's important to remember that the ATO's data-matching capabilities help in detecting undeclared income and capital gains, so it's likely you'll be caught out if you do make any false claims on your tax return. If you have suffered investment losses, we suggest you seek professional tax advice. A tax professional can advise you about the circumstances in which your capital losses can be offset against any capital gains.

New rules for a new tax year

If you contribute money to super, receive super co-contributions from the government or work overseas, you'll be affected in one way or another by changes introduced by the government for the 2009/10 tax year.

Tax changes for overseas income

This change affects Australians working overseas in countries where the tax rate is significantly lower than Australia. For example, the foreign tax rate applicable in Hong Kong can be as little as 16%.

Under the new rules, if you're working overseas on a contract of longer than 91 days and you're an Australian resident for tax purposes, subject to certain exemptions you'll now pay tax in Australia on that employment income. Previously that income would have been exempt from Australian tax.

Case study

Mark is an Australian resident for taxation purposes. He's employed by an international accounting firm as a financial controller, earning $250,000 pa and is regularly sent overseas to work on projects, often on a six-month basis. He is due to be posted to Singapore for four months in August 2009 to work on a new project.

Previously, wages derived from his overseas employment for a continuous period of at least 91 days were exempt from Australian tax, provided that income had been taxed in Singapore.

From 1 July 2009, the tax exemption is not available. Mark's overseas employment income will be taxed at his marginal tax rate in Australia, which is 46.5%. However, he will be entitled to a tax offset for any tax paid in Singapore.

Government co-contributions

Up until this year and depending on your income, the government contributed $1.50 for each after-tax dollar you contributed to super (to a maximum of $1,500). As the table shows, the government has reduced the amount of co-contribution it will pay until the 2014/15 tax year.

Year	2009/10 to 2011/12	2012/13 and 2013/14	2014/15 onwards
Co-contribution	$1 for each $1 you contribute	$1.25 for each $1 you contribute	$1.50 for each $1 you contribute
Maximum co-contribution	$1,000	$1,250	$1,500

Voluntary salary sacrifice contributions will now be included as part of your total income when assessing your eligibility for a government co-contribution, which may affect your eligibility.

Case study

Lisa is 35 and on a salary of $50,000. She salary sacrifices $10,000 to her super fund and wants to make an after-tax contribution so that she will qualify for the government co-contribution.

In 2008/09, Lisa was entitled to a maximum co-contribution of $1,017 (based on a qualifying income level of $40,000 and a personal after-tax contribution of $678).

In 2009/10 her qualifying income level has increased to $50,000 because the $10,000 she salary sacrifices now counts as her total income. The maximum co-contribution she would be entitled to is $397 and she would need to make an after- tax contribution of at least $397 to receive it.

Concessional super contributions

The amount of concessional contributions has been reduced to $25,000 for people under 50 and $50,000 for people 50 and over.

This will affect you if the contributions you make exceed these amounts. It pays to keep a close eye on your contribution levels.

Case study

Graham is 40 years old. In 2008/09 his employer contributed $10,000 to his super and on top of this, Graham salary sacrificed an additional $20,000.

In 2009/10 Graham's employer will again contribute $10,000. If Graham continues to salary sacrifice $20,000 his total contributions of $30,000 will exceed the new reduced limit of $25,000. This means Graham will have to pay additional tax of 31.5% on the excess $5,000 contributions on top of the standard 15% tax already payable on these contributions.

The agribusiness alternative

With the recent collapse of two large agribusiness companies – Timbercorp and Great Southern – investors are understandably cautious about investing in agribusiness. Is there still a place for agribusiness in a diversified investment portfolio?

Investing has become increasingly complex and Australian investors continue to look for new ways to grow wealth via new markets and products. The traditional asset classes of cash, fixed interest, property and Australian and international shares have been joined by an 'alternative' asset class.

Agribusiness falls into this category. Agribusiness is a generic term used to describe businesses involved in food and fibre production. These include farming, seed supply, agrichemicals, farm machinery, wholesale and distribution, processing, marketing, and retail sales.

How does agribusiness investment work?

Like most businesses, the agribusiness sector needs investment to take advantage of business opportunities.

When you invest, for example, in an agribusiness forestry project, the investment costs (establishment and ongoing) are generally treated as business expenses and are tax-deductible against other income. When the crop is harvested and sold, you receive your share of the proceeds. This is treated as assessable income.

Risk and returns

While investing in agribusiness may potentially help you grow your investments, it involves a higher element of risk than defensive assets such as cash and fixed interest. It also means that your investment is unlikely to be as liquid as other investments.

Agribusiness investment projects generally offer higher returns because investments can be tied up for the life of the project (usually at least five years, with some projects running for 20 years or more).

Returns aren't linked to the sharemarket, property market or interest rates. They are determined by the market for the particular commodity. If the demand for a particular commodity is high, it is likely it that it will sell at a higher price. This means the return on your investment should be higher than if you had invested in a commodity where demand is low or (for some reason) the particular crop or project fails. In this situation, your investment can potentially lose value.

Tax deductibility

Many projects allow investors to claim high tax deductions to reflect the cost of establishing and maintaining these investments. While the tax benefits may look appealing, it's important to note that future income will often be fully assessable as agribusiness projects tend to defer tax, not eliminate it completely.

Agribusiness as part of a diversified portfolio

Agribusiness investments can provide further diversification in an investment portfolio. They are long-term investments and are only suited to investors with a higher appetite for risk who are seeking potentially attractive long-term returns and tax efficiency.

Some investors may consider using two or more smaller investments so that any potential gains are realised at different times. This could also reduce the risk to the portfolio if one particular project performs poorly.

The nature of agribusiness investment means that from time to time the project may not perform as expected and there will be disappointments. Your financial adviser can help you decide if agribusiness investments are appropriate to your circumstances and needs in helping you grow your wealth over the long term.

Safe deposit?

When sharemarkets experience a downturn, investing in cash seems to be the safe option. While that may be the case in the short term, if you're investing for the long term you may still need to consider growth assets.

A look at cash in isolation

The interest you receive on a cash investment is generally linked to sharemarket and economic conditions. When times are bad, interest rates are low. When the economy is better and sharemarkets are performing well, interest rates tend to be higher.

When you invest in cash you probably reinvest the interest you receive. But as you know, inflation means that the actual value (what you can buy with your dollars) is eroded. For example, what you could buy for $100,000 in 1985 would cost you substantially more than that today. When you consider the tax you pay on investment income at your marginal rate and the relatively low interest rate, your cash investment in real terms may not be growing much at all.

You need income and growth

When you invest in growth assets such as shares, you get income from the shares by way of dividend payments. If you hold shares for the long term, they also have the potential to grow in value over time.

Although we're still experiencing uncertainty in the sharemarket, history tells us that this is part of a normal cycle and there's every chance that recovery will more than compensate for the losses. This means long-term share investors may potentially receive a much higher return than cash investors.

Experts predict that the sharemarket is at (or close to) the bottom of this cycle, which means many shares may be at a bargain price. If you're invested solely in cash when the markets do recover, you may miss out on returns that are potentially much higher than cash can provide.

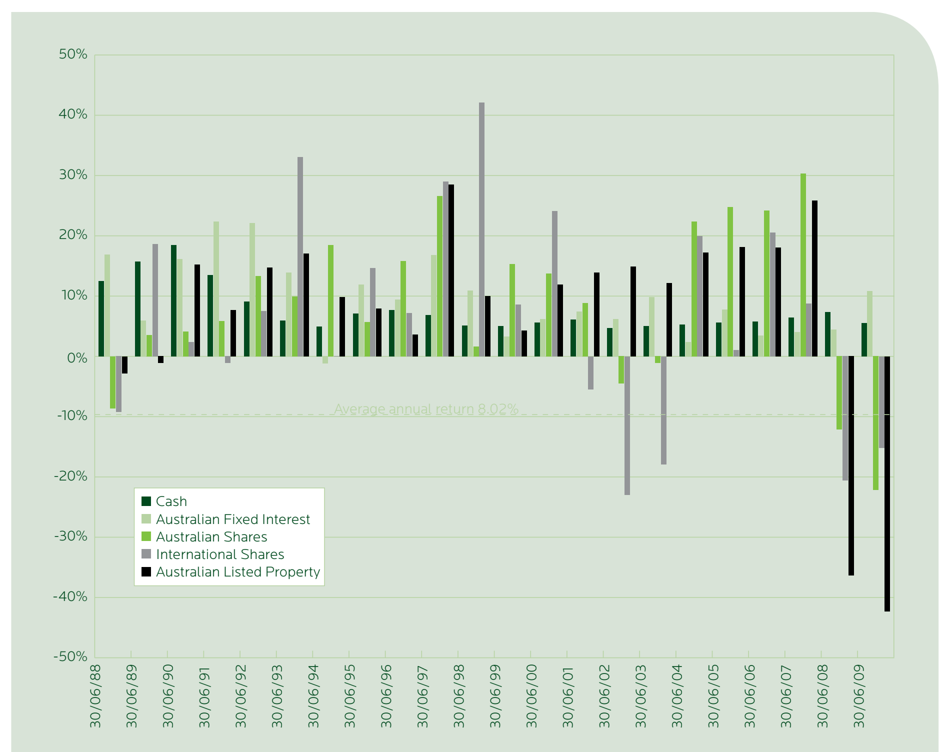
Just how long is long term?

That depends on where you are at with your investments. If you're in your twenties or thirties and you think of long term as being when you retire, you're looking at 20 years or more of investing. Even if you're close to retirement, you'll still need to continue growing your wealth if you want your money to last through your retirement years.

As the chart shows, a lot can happen in 20 years, and the performance of different asset classes is varied.

Benchmark returns June 1988 to June 2009

There's a place for cash as part of your investment portfolio, but to grow wealth you should also consider investing in growth assets such as shares and property. Talk to your financial adviser about the most appropriate mix of assets for your portfolio to suit your needs and investment timeframe.



Long-sighted

‘No news is good news’, or so the saying goes. The reverse can also be said to be true: good news is no news. The media (TV, radio and newspapers) will always deliver the bad news. But there is plenty of good news out there for investors.

The ‘GFC’ (as the global financial crisis has come to be known) was big news. We haven’t seen the like since the Great Depression. While it’s reasonable to expect a high volume of commentary on the GFC, media reports (because of their doom-and-gloom nature) have tended to focus only on the bad news.

This continual negative reporting has had a powerful impact on the individual’s psychology and the collective psychology of the economic community, not to mention investors.

Bad news becomes a conversation starter – everybody knows somebody who has lost their business or their job. People start to worry and stop spending – just in case. The media continues to tout its bad news: good news ceases to exist.

How the media works

Let’s stop and think about media reporting. It’s all about the here and now. And if the news had an equal mix of bad news and good, it simply wouldn’t have the same impact.

It’s short-sighted because it doesn’t consider how things are likely to change in the future. It doesn’t say ‘things are really bad, but…’ it just tells us ‘things are really bad’.

As investors, we need to filter out all the bad short-term news and shift our focus to the long term where the future looks somewhat brighter.

And now for the good news

Interest rates are at 50-year lows. Fuel prices have fallen from last year’s highs. Unemployment and inflation are still within reasonable limits.

Business opportunities abound. The talent pool to recruit from has improved, which means employers can choose the best fit for their businesses. Employees are more focused on job security which is also good for employers as it means staff turnover is lower. Suppliers are offering lower prices, better terms and value-added offerings.

There’s been some good news from the US financial sector, in particular the US Administration’s plan to remove ‘toxic’ assets from the balance sheets of US financial institutions. This may help relieve the global credit squeeze and allow banks to start lending again.

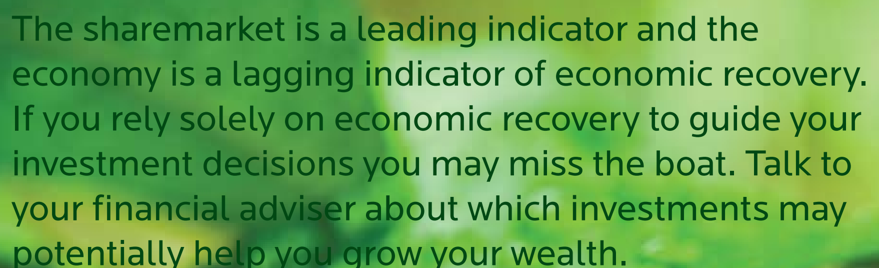
Although March saw the Australian sharemarket plummet to a low of 3120.80, it’s since rallied strongly. It has rebounded 26.7% to 3954.90 as at the end of June. There may still be some uncertainty in investment markets but we consider that the worst may be over.

Don’t wait for economic recovery

Media reports may indicate that the Australian economy may still not be in good shape and we’re experiencing a recession; but historically, investment markets have tended to recover well ahead of the economy.

That’s because investment markets are forward-looking; they anticipate better growth in earnings and then economies follow.

As we’ve already discussed in our article on page 5, we believe that the Australian sharemarket appears to be at or near the bottom of a cycle and therefore there may be bargains to be had if you’re a long-term investor.



The sharemarket is a leading indicator and the economy is a lagging indicator of economic recovery. If you rely solely on economic recovery to guide your investment decisions you may miss the boat. Talk to your financial adviser about which investments may potentially help you grow your wealth.

Market outlook

Market commentary provided by Advance Investment Solutions team

The quarter ending June 2009 saw a return of optimism as investors began to feel that the worst of the global financial crisis had passed. The remainder of 2009 is likely to see this optimism continue, as policy initiatives introduced by global authorities begin to take effect.

Economic overview – June 2009 quarter

By the beginning of the June quarter, there was clear evidence that the worst of the financial crisis may have passed, and the seeds for a slow recovery in the global economy were emerging. In particular, leading surveys of business activity have begun to improve.

In the US, the key Institute for Supply Management indices began to rise, signalling a recovery in both manufacturing and non-manufacturing sectors. Similarly, Purchasing Managers Indices for Europe and China have also improved. Global inflation eased further with US headline consumer inflation running at −0.6% as at April.

In Australia, the economy received an unexpected boost. GDP figures showed the economy actually expanded during the March quarter, with business and consumer confidence improving in recent months.

Outlook by asset class

Australian shares

In the very short term we expect the market to decline in thin market conditions that generally prevail during the Northern Hemisphere summer. We wouldn't be surprised to see some risk reduction and profit-taking, causing the market to drift lower. The ASX 200 has good support around the 3,700 to 3,600 levels, with strong support around 3,500. Our one-year upside target is around the 4,500 level.

International shares

In the very short term, developed markets are likely to decline while investor risk-aversion is likely to be more negative for emerging markets and their currencies. Using the US S&P 500 as a guide, we expect the S&P 500 volatility index to rise from its current 28 level to around the 33 to 36 levels; the S&P 500 index looks set to test the 850 to 830 zone before resuming its medium-term upward trend.

Diversified property

We are slightly positive on diversified property (REITs). A number of factors could set the stage for stabilisation in REIT fundamentals. The extreme volatility in REITs seems to be slowly subsiding, an indicator that could signal a bottom for this asset class.

International bonds

In the very short term we expect yields to decline from the prevailing 3.50% level to around 3.25% before increasing towards the 4.25% level during the next 12 months. We expect credit spreads to widen during this period and then recommence their narrowing trend.

Australian bonds

We believe credit spreads in the Australian market will narrow towards sovereign spreads. The sheer supply of both sovereign and state debt will make the Australian market lag behind global fixed income. We expect the Australian bond market to rally in the very short term, followed by yield increases towards the 6.0% level or higher over the 12 month horizon.

Alternative assets

We favour macro strategies; managed futures funds; equity long-short funds; credit long-short funds; fixed income arbitrage and convertible arbitrage strategies in this category. We are cautious on directional strategies.

Commodities

We expect commodity markets to decline in the very short term as investors reduce their risk appetite and market volatility picks up during the northern hemisphere summer. We remain positive on the asset class in the short, medium and long term.

Currencies

We expect a short-term period of US dollar strength and weakness in major currencies, in particular emerging market currencies. We expect the Australian dollar to drift lower towards the 0.75 to 0.73 levels before moving to a 0.83 to 0.90 range sometime next year. We recommend that overseas investment hedge ratios be increased to protect global investments from capital erosion.

Disclaimer

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