INVESTMENT SOLUTIONS

Winter 2016



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THE FINANCIAL ADVICE SHOP

Welcome

In this winter edition of Investment Solutions magazine, we focus on five take outs you should be aware of post federal budget 2016.

Tim Rocks, Head of Market Research and Strategy, BT Investment Solutions considers how negative interest rates operate and how they can positively impact our economy.

BT Financial Group Investment Specialist, Riccardo Briganti, provides an update on the world economy.

Finally, we share some insights that may indicate what keeps your children up at night.

Until next time – happy reading.



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Economic outlook

Signs local and global markets improving.

The Reserve Bank of Australia (RBA) cut the cash rate by 0.25% to 1.75% at its May board meeting. The bank made the move in response to low inflation figures, while also indicating a lower Australian dollar, the result of a reduction to the cash rate, would assist the economy as it makes exports more competitive. Expect at least one more cut to the cash rate in 2016.

Mixed economic data is one of the reasons for the RBA's cut. A positive sign is improving employment figures, with the unemployment rate falling to 5.8% in May from a peak of 6.3% in July last year. Conversely, consumer confidence has been lacklustre, partly reflecting relatively low wages growth. But after the May interest rate cut confidence improved sharply and is now the strongest it has been since January 2014.

Conditions in international markets are mixed. Chinese economic data is continuing its slow downward trajectory. The latest figures indicate GDP growth has slowed to 6.7%, from 7% a year ago.

This trend is expected to continue, which is the normal path of a developing economy. It's worth noting China is successfully transitioning its economy and the services sector now makes up more than 50% of the market. This is in contrast to industrial production, which makes up around 40% of the economy.

In the developed world, central banks are following different paths, which reflect their different perspective of the economic outlook and conditions in their markets. The US Federal Reserve lifted its official interest rate in December 2015 and there were expectations it would continue this trend in 2016. But rate hike expectations have now been wound back, although at least one more rate cut is anticipated this year. Improving employment data, positive consumer sentiment and early signs wages and consumer prices are growing also indicate a more sustained economic improvement in the US.

In contrast, the European Central Bank has kept its official interest rates at extremely low levels. Its decision to continue expanded monetary policy measures is likely to limit deflation and help protect the economy from entrenched downside risks.

Fears of deflation saw the Bank of Japan introduce negative deposit rates early this year with a recent warning rates could move further into negative territory. Negative deposit rates mean commercial banks are, in effect, required to pay a fee rather than receive interest for depositing excess funds with the central bank. This is designed to encourage banks to increase lending instead of leaving excess reserves lying idle.

Top five takeouts from the 2016 federal budget

A number of important announcements about superannuation were released at this year's federal budget on 3 May. But as a federal election was formally called just after the budget was released, no definitive outcomes regarding these announcements will be known until after the election.

Whatever the outcome of the election, it's entirely possible the budget announcements, or variations of them, will ultimately become law. So here are five factors to consider right now to put your super in the best possible position.

1. Maximise current concessions

It's been proposed that the cap on concessional contributions, which include employer, salary sacrificed and voluntary contributions, will be lowered to $25,000 from 1 July 2017. At the moment, people aged 50 and over can contribute up to $35,000 to their fund and offset this amount against their income, and people younger than this can contribute up to $30,000 and receive a tax benefit. So make sure you maximise the level of contributions you can afford to make this year before these changes are likely to happen.

2. Be aware of contributions previously made to super

A lifetime cap of $500,000 has been placed on non-concessional (or after-tax) contributions, with immediate effect from budget night. This cap includes any after-tax contributions made to your super since 1 July 2007. While contributions made before budget night in excess of this amount won't be penalised, if you have reached the limit it's important not to contribute additional funds, or you risk being penalised. It's important to understand how you are placed against this new cap to ensure you don't inadvertently exceed it. It's still good practice to keep a record of previous years' contributions, even if this doesn't become law.

3. Take advantage of positive initiatives

There was good news for older people who still want to work and contribute to their super fund. From 1 July 2017 people aged between 64 and 75 won't have to work a certain number of hours each week to be able to keep contributing to super. Some people in this category, for instance the self-employed, may even be able to claim a tax deduction for some contributions to super.

4.Super is still super

Despite proposed changes to the super system, it's important not to lose sight of the fact the maximum tax rate on earnings within super is still 15% and that withdrawals from your super fund are tax-free when you reach 60. So super remains one of the most tax-effective investments available.

5. Don't over react – take a considered approach

There is uncertainty about the outcome of the proposed changes to the super system. Although changes are likely, some people will be better off if the amendments go ahead.

If you'd like to find out how you can make the most of the current super concessions and ensure you don't fall foul of the law, contact us today.



An unorthodox solution

Challenging times call for unusual solutions, and the idea of negative interest rates is particularly unorthodox. Tim Rocks, Head of Market Research and Strategy, BT Investment Solutions considers how negative interest rates operate and whether they can have a positive impact.

Charged for your savings?

Negative interest rates mean instead of earning interest on a deposit, you would be charged a fee for holding it in the bank. Sounds pretty terrifying when you apply that thought to your own savings account, doesn't it?

When used as a tool by central banks, such as the European Central Bank (ECB) or the Reserve Bank of Australia (RBA), it applies specifically to commercial banks. Commercial banks can use the central bank as a place to hold their money so the official interest rate set by the local central bank will indicate whether they earn, or pay, interest on the money they hold with the central bank.

While many central banks lowered official interest rates to extreme lows during and in the years since the global financial crisis, some have had to take a step further and go beyond zero. These have included some European countries led by Sweden and Switzerland and, more recently, Japan.

Turning a negative into a positive

While many investors have been concerned about negative interest rates, they have been used for very specific results. By charging commercial banks to hold money with them, central banks hope to encourage those banks to lend more money thus increasing business investing and consumer spending to boost the economy. They also hope to depreciate the local currency to encourage the exports market.

The question is whether this approach actually works given it hasn't been done until now.

The case in point: Sweden and negative interest rates

The Swedish central bank, the Riksbank, introduced negative interest rates along with asset repurchase programs in early 2015. There are early signs this has been supportive for them.

- Based on recent data, Sweden is now one of the fastest growing advanced economies with more than double the GDP growth year-on-year compared to the broader Eurozone. (Source: Datastream)
- Housing prices have risen by approximately 10% per annum in recent years creating a housing boom and increased household debt (representing increased confidence to borrow and increased access to loans. (Source: Datastream).
- Inflation levels have increased and are now moving towards the Riksbank's target (Source: Riksbank)

Since Sweden was one of the earliest to move to negative interest rates, these results have also been encouraging for other countries.

Interest rates for my investments

As negative interest rates seek to encourage lending and consumer spending, sharemarkets and property can benefit from these because it is cheaper to borrow money, and there is less return from holding funds in the bank in countries with those rates. Alongside Sweden, other European countries have seen some benefit in these areas from the negative official interest rate from the ECB.

On an Australian front, we still have one of the higher official interest rates on offer, despite the recent decrease from the RBA. There is plenty of room to move before the RBA would need to consider a negative interest rate and a number of policy actions in play to support the economy already. Australian fixed interest tends to offer better returns at the moment when compared to international fixed interest, though as a whole, the best opportunities for investments are likely to be areas that can benefit from low interest rates like sharemarkets or property. To find out if your money could be working harder for you, please speak to your financial adviser.

Baby Boomers need to get their financial house in order

New research by super fund REST has found younger people are concerned about their financial future and worried they will have to support their parents in retirement.

REST surveyed 1000 people between the ages of 18 and 34 – the group known as the 'Millennials' – in early 2016 and found 30 per cent said they were concerned they would have to give up work to look after their Baby Boomer parents.*

While this finding is troubling, there are plenty of steps Baby Boomers can take to help ensure they can fund their own retirement.

Building a retirement nest egg

Superannuation remains one of the best ways to build retirement savings. If you're still in work, think about making voluntary contributions to your super fund over and above the super guarantee. Doing this will help to build your nest egg, and at the same time help reduce your taxable income.

Ensure you have insurance

Another way to help secure your financial future is to put in place insurances so that in the event you do suffer an accident or illness, you can still pay your bills.

There is a range of different types of insurances that can help you to do this. Income protection insurance will pay out if you suffer an accident or illness and cannot work for a period of time. You might also consider taking out trauma or total and permanent disability cover, which will pay out if you suffer a serious illness such as cancer or a heart attack.

If you do have this cover in place, it's likely you will be able to cover basic expenses while you get back on your feet again.

Finding an aged care solution

All too often, people leave it too late to plan for a time when they are not able to live in their own home anymore. Often, elderly people put this off and when the time comes, it falls to their children to find a solution.

To avoid this, talk to your financial adviser about what your options are, including remaining at home and receiving at-home care, so that when the time comes, you won't have to rely on others to make decisions about your aged care accommodation needs.

The earlier you start to focus on building your wealth, the better your outcomes will be in retirement and the less chance you will be a financial burden on your children. To find out how we can help build a stronger financial future for you and your family, please contact us today.

* www.rest.com.au/News-Media/Media-Releases/2016/Australian-Dream-alive,-but-not-well-among-Millenn



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