

connect

Spring 2015

Has the dragon run out of puff

As China's property market lost momentum in 2014, retail investors shifted their money to the share market, spurred on by the government. China A shares are mainland-based, denominated in yuan and traded primarily by locals on the Shanghai and Shenzhen stock exchanges. A phenomenal rally in China A shares began in July last year, fuelled by many first time retail investors who were gripped by share market fever. More than 40 million new trading accounts were opened in the first five months of 2015 and the value of outstanding margin loans, where brokers lend money to investors to purchase shares, had increased more than fivefold over the previous year to 2.2 trillion yuan (AU \$473bn).

The Shanghai share market reached a seven year high on 12 June, having gained 152 per cent over the preceding 12 months. Investors expected the People's Bank of China (PBoC) to provide further stimulus, action to which they had become accustomed through the Beijing engineered rally.

Retail investors account for around 85 per cent of share trading in China, unlike major global share markets which are dominated by professional investment managers, exacerbating the volatility. By 8 July the market had plunged 32 per cent from its recent high.

As the market tumbled, the government started taking steps to attempt to halt the carnage. This began with injections of liquidity and interest rate cuts before escalating to more extreme measures including indefinitely postponing 28 planned IPOs and halting trade in 89 per cent of shares listed in mainland China.

The aggressive approach adopted by the Chinese government appears to be halting the fall. The moves by the government does however raise some questions over the government's commitment to the liberalisation of capital markets.

“An inch of time is worth an inch of gold, but it is hard to buy one inch of time with one inch of gold.”

Chinese Proverb



US interest rates likely to rise

The US Federal Reserve appeared to again push out the date for its first interest rate rise against a backdrop of underwhelming US economic data. In the March quarter, GDP growth was 0.20 per cent, which was lower than expected, additionally the forecast annual GDP growth rate for 2015 was lowered to 1.80-2.00 per cent. Despite the data, Janet Yellen, the Federal Reserve Chairwoman, reiterated her view that the first US interest rate rise was likely to occur before the end of 2015.

Australian update

The Australian share market, as measured by the S&P/ASX 300, dropped 6.50 per cent over the quarter, bringing the financial year return to 5.60 per cent. The Reserve Bank of Australia (RBA) cut the target cash rate by 0.25 per cent in May, taking the rate to an historic low of 2.00 per cent. The RBA, citing concern over the outlook for global growth and the persistently high level of the Australian dollar indicated that there may be further cuts to come.

The Australian dollar rose from US\$0.76 to US\$0.81 through the first half of the quarter, as commodity prices recovered from their lows. Volatility levels in markets increased globally, as the Chinese bull market

run stalled. The Australian dollar, along with other risk currencies, sold-off sharply through the second half of June.

Australian dollar weaker

While the anticipated increase in US interest rates and the slowing of the Chinese economy may exert further downwards pressure on the Australian dollar through the second half of 2015, the fall since the start of the year, over 9 per cent, means that the risk of large declines from this point is far lower. We believe it is prudent to hedge a portion of foreign investment exposure to Australian dollars.

Source: IOOF

Keys to building financial strength

Lasting success in most things is achieved by having realistic goals, monitoring progress and resisting quick fixes. Building long term financial strength is no different. But it's worth taking time to understand how to use the equipment to build strength.

- 1 **It is about investing** – Buying property can be challenging. Money in the bank is safest but at current rates is barely growing. That leaves the share market. You need to understand the investment choices, recognise that the market goes up and down and develop a view about its prospects over your savings horizon.
- 2 **Muscle up** – To achieve some goals you may need to pump up potential returns by borrowing to invest (called gearing). Gearing lets you make a larger investment. If the market performs well, all the gains on that larger investment belong to you. If the market does not do well, you take the larger losses. There is no set timetable to repay the loan. But you should never borrow beyond your ability to pay interest. For a typical Australian resident taxpayer, the interest is potentially tax deductible.
- 3 **Mind the gap** – A typical loan-to-value ratio (LVR) for a number of shares is 75 per cent; for shares worth \$100 you can borrow up to \$75. Most investors leave a gap between the amount they borrow and the LVR. They may borrow only \$50 for that \$100 portfolio; a gearing ratio of 50 per cent. If the shares fall in value, the gearing ratio increases. If your gearing ratio exceeds the LVR, the bank will demand an immediate fix. This is called a margin call. A larger gap means more breathing space for you should the market fall.
- 4 **Grandma knew** – Old advice is still good advice; don't put all your eggs in one basket. Diversification is the art of mixing your investments so one capricious event does not wipe out everything. By gearing a mixed basket of shares you can reduce the prospect of a margin call.
- 5 **Watched pot never boils** – Do not ignore a geared investment until it boils over into a margin call. The ideal frequency for checking your investments depends on factors such as the gap between gearing ratio and LVR and your degree of diversification. Occasional adjustment may be necessary.

This can be only a brief introduction to borrowing to invest. When used appropriately, gearing can be an effective way to build financial strength.

Source: Leveraged

Speak to your financial adviser for more information.

Insurance through super – with choice comes complexity

Recent changes to superannuation legislation present exciting opportunities when it comes to ways of funding life insurance. With choice, however, comes complexity and the challenge is to isolate the benefits offered by the various funding alternatives.

Behind the scenes

The story behind widening the choice for consumers involves two key factors.

Firstly, recent changes to the superannuation regulations introduced a new obligation for super fund trustees to respond to requests from members to roll over funds to another super fund within specific timeframes. This measure was introduced by the Government to give consumers freedom of choice as to the location and spread of their superannuation money.

The **second factor** is the use of contributions tax rebates. Superannuation funds generally receive a tax deduction for life insurance premiums. Many super funds are now passing that benefit on to the contributing member, allowing the member to reduce the cost of their life insurance cover.

The combination of these two features may provide you with a powerful cost reduction advantage. If your life insurance needs are not being met by your existing superannuation fund, you can access more suitable life insurance cover via another super fund. It is now possible to fund the life insurance by a rollover from your existing fund. The amount rolled over may also be reduced by a 15 per cent tax rebate, delivering a substantial reduction in the cost of your new life insurance arrangements.

The way forward

The broadening of insurance payment options now gives you a substantial opportunity to ensure that your life insurance arrangements are completed on the most cost effective basis.

If you are eligible for this rebate, all that's left is to make sure you are comfortable dipping into retirement savings to pay for peace of mind today.

Source: TAL

But there are considerations...

Before you commit to going down this new path, you should consider the following four points:

- Erosion of retirement savings. The use of accumulated balances in your existing superannuation fund to finance your life insurance needs will reduce retirement savings.
- You may be able to fund the contributions to your life insurance superannuation fund by contributions from your employer under a salary sacrifice arrangement. In this case, as you receive the tax benefit via the salary sacrifice arrangement, you will not be eligible to receive a contributions tax rebate.
- If you are self-employed, the funding of life insurance needs via a tax deductible personal contribution into the super fund may be more efficient. In this case, you would receive the benefit of a tax deduction for your superannuation contributions, you would not be eligible for the contributions tax rebate.
- If you have a self-managed superannuation fund (SMSF), the optimum insurance solution may be to continue the traditional financing structure. Under this structure, the trustee of the SMSF owns the life insurance policy, and can access the benefit of any tax deduction associated with the premium. Introducing the complexity of a rollover arrangement may not deliver any additional benefit.

Speak to your financial adviser for more information about your insurance options.

Ten things to remember when markets are volatile

From time to time, share markets will experience bouts of volatility due to a variety of reasons. But before you make any rash moves, consider our top ten key reminders.

1	Volatility is a normal part of long-term investing From time to time, there will inevitably be volatility in stock markets. By having a mind-set that accepts volatility, you can prepare yourselves to remain focused on your long-term investment goals.
2	Over the long term, share risk is usually rewarded You may be rewarded for the extra risk that you face by potentially achieving higher average returns over the longer term.
3	Market corrections can create attractive opportunities Corrections are a normal part of bull markets. A stock-market correction can often be a good time to invest.
4	Avoid stopping and starting investments When you try to time the market and stop-and-start your investments, you run the risk of denting future returns by missing the best recovery days.
5	The benefits of regular investing stack up Irrespective of your time horizon, it makes sense to regularly invest a certain amount of money, for example, each month or quarter. This helps you avoid investing at a single point in time.
6	Diversification of investments helps to smooth returns Spread risk by investing into different asset classes. Holding a mix of growth assets (shares, property and corporate bonds) and defensive assets (government bonds and cash) can help to smooth returns over time.
7	Invest in quality, income-paying stocks for regular income Sustainable dividends paid by high-quality, cash-generative companies are attractive during volatile markets because they can offer a regular source of income.
8	Reinvest income to increase total returns Reinvested dividends can provide a considerable boost to total returns over time thanks to the power of compound interest.
9	Don't be swayed by sweeping sentiment The popularity of investment themes ebbs and flows. But there are usually always great opportunities at the stock level.
10	Active investment can be a successful strategy When volatility sends markets sideways, successful stock-picking can be rewarding compared with indifferent returns from passively following the index.

Source: Fidelity

Speak to your financial adviser today

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