connect

Summer 2018

Economic update

International economy – US and China trade update

Trade wars continued to be a theme during the September 2018 quarter as tensions between the US and China escalated. In July, the US and China levied tariffs of 25% on $34 billion of each other's exports. This means consumers in the US and China now pay 25% more to buy tariff-affected products from each other.

In September 2018, the US imposed 10% tariffs on $200 billion of Chinese goods. China responded by imposing 10% tariffs on $60 billion of US goods. The US said that the current 10% tariffs imposed on China will become 25% tariffs by January 2019. China has promised to do the same.

These trade wars have reduced manufacturing activity around the world, apart from the US, since December 2017. Confidence across manufacturing has been affected by the uncertainty surrounding trade policy and this has translated into lower business investment.

To soften the blow of the trade war, the US and China have used government spending to assist those sections of the economy that have been affected.

The outlook does not appear optimistic as neither the US or China appear willing to compromise because they will sacrifice too much domestic political goodwill by being the first to compromise. The most likely outcome is that new tariffs will lower future economic growth by restricting trade, but this will be offset to some degree by greater government spending.

The worst-case scenario for an escalating global trade war that spills out beyond the US and China appears to have been avoided.

Australian economy – property update

In Australia, property markets were keenly watched during the September quarter as national house prices fell 2.7% over the last 12 months. This decline was led by previous market leaders, Sydney and Melbourne, which dropped 6.1% and 3.4% respectively over the period.

What has prompted the decline in property prices?

There are several reasons for the decline in house prices, with the major factor being higher mortgage rates. ANZ, Westpac and the Commonwealth Bank of Australia (CBA) and some smaller banks all increased interest rates during the September 2018 quarter.

Lending standards have also been tightened in response to both the regulator, the Australian Prudential Regulation Authority (APRA), and in anticipation of changes forthcoming from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. This tightening of standards has made it more difficult for people to get a home loan. The reduction in borrowing means there is less money to sustain continued growth in house prices.

An excess in the supply of new apartments and softer immigration numbers has affected unit prices in the important markets of Sydney, Melbourne and Brisbane.

Speak with your financial adviser to discuss your investment opportunities.

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What is the outlook?

The decline in housing financing coupled with weak income growth and tight lending standards will likely continue to act as headwinds for house prices going forward.

Also, if a global economic shock leads to higher unemployment in Australia this could trigger loan defaults and foreclosures. This would further exacerbate price declines.

However, if immigration continues at strong levels or wage growth improves, households may be able to bid up house prices once more. This is unlikely to eventuate as wage growth remains subdued. Also, immigration growth may be curtailed in the future given the populist trend to reduce immigration being seen in politics at the State and Federal level.

Source: IOOF

Keeping up on your super contributions during volatility

After a downturn in share prices and higher market volatility, many super fund members may think twice about continuing to make voluntary contributions. In contrast, compulsory employer contributions power on – regardless of prevailing market conditions.

Members who ease back on their voluntary contributions may be acting against their best long-term interests, depending upon their circumstances.

By adjusting their super contributions in reaction to share-market movements, super fund members are attempting a form of market-timing – that is attempting to pick the best times to invest or not invest.

However, the rewards of maintaining voluntary contributions throughout the ups and downs of markets include: continuing concessional tax treatment, compounding long-term returns, sticking to your long-term investment strategy and paying less for shares after prices have fallen.

And perhaps most importantly, members who keep up their voluntary contributions are taking a disciplined, non-emotional approach to investing.

Dollar-cost averaging

Super fund members having contributions regularly paid into their diversified super accounts are practising a form of a disciplined investment strategy known as dollar-cost averaging.

This involves investing the same amount of money into, say, shares or broadly-diversified managed funds at regular intervals over a long period – no matter whether market prices are up or down.

Under a dollar-cost averaging strategy, investors automatically buy more, eg, shares when prices are lower and fewer when prices are higher. This averages the purchase prices over the total period that an investor keeps investing.

The main attribute of dollar-cost averaging is the adherence to a disciplined, non-emotional approach to investing that is not thrown off course by prevailing market sentiment and higher volatility.

Practising dollar-cost averaging through contributions provides a ready, easy-to-use means to make regular investments into the super portfolio of your choice. Simply inform your employer that you want to regularly make salary-sacrificed contributions.

Tax cushion

Significantly, the tax benefits of salary-sacrificed contributions can help cushion your investments from the impact, on paper at least, of a downturn in market prices. This is because these so-called concessional contributions are made in pre-tax dollars and subject only to the standard 15 per cent contributions tax.

Yet the same amount of money invested outside super would have been first subject to pay-as-you go tax; typically meaning that less is left to invest. With more money initially invested, fund members are somewhat cushioned from a downturn in prices.

Diversification cushion

Keep in mind that most super fund members are investing in diversified portfolios. This diversification typically cushions a member's super savings from the brunt of a turndown in share prices. And fund members can always choose, of course, to direct their new contributions into particular asset classes.

Source: Vanguard

Speak to your financial adviser to discuss your retirement plan.

The cost of retirement

How much do you need to fund your ideal retirement? We take a look at how much income you may need, and what to consider after you retire.

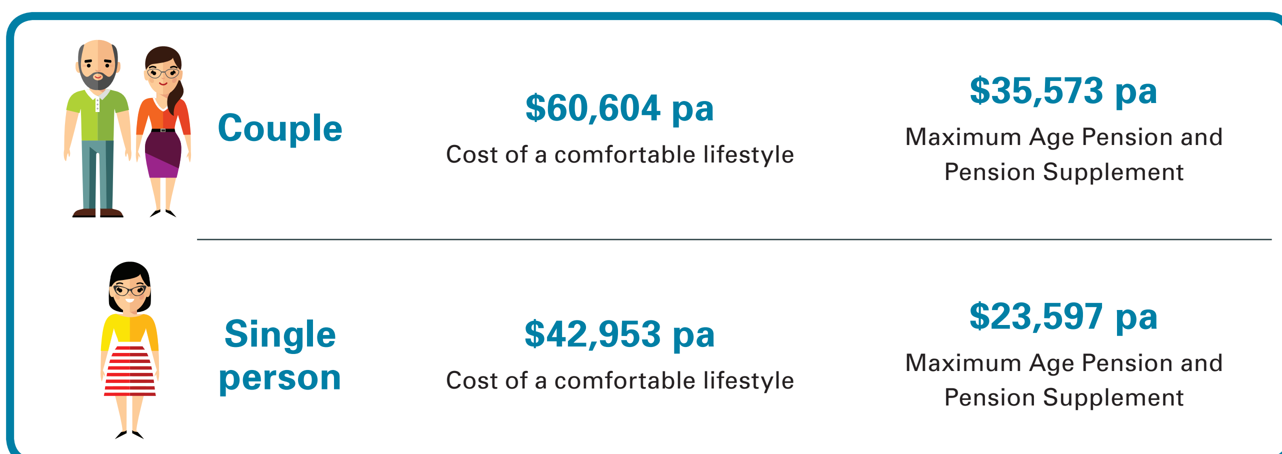
Everyone has a different vision for their retirement. Yours might involve overseas and interstate travel and an active social life. Or perhaps you prefer spending time with family, working in the garden or volunteering.

However you choose to spend your time, it's important to make sure you have enough funds to support your retirement lifestyle. Forward planning now can make all the difference in the future.

How much will your ideal retirement cost?

Increasing life expectancies and inflation can make it tricky to estimate how much income you'll need for your retirement. That's why the Association of Superannuation Funds of Australia put together a guide for how much you might need. A comfortable lifestyle in retirement may include leisure activities, private health insurance and holidays – but everyone's lifestyle is different, so you should take into account your own goals and expenses.

As well as paying for things you enjoy doing, remember to budget for the day-to-day expenses, like utility bills, as well as larger expenses such as upgrading cars and renovations.



	Cost of a comfortable lifestyle	Maximum Age Pension and Pension Supplement
Couple	**$60,604 pa**	**$35,573 pa**
Single person	**$42,953 pa**	**$23,597 pa**

Source: The Association of Superannuation Funds of Australia, 'ASFA Retirement Standard', June quarter 2018.

Figures quoted are for homeowners. Age Pension rates are current as at 1 July 2018, www.humanservices.gov.au

Protecting your nest egg

As well as accumulating enough super to fund your retirement, you also need to manage the amount of income you'll receive when you're retired.

It's vital not to underestimate the impact of inflation on your nest egg. To illustrate: that loaf of bread you bought at the supermarket for $3.00 could cost $4.92 in 20 years.

Share market volatility could also seriously impact your balance and the level of income you may be able to receive each year – particularly the timing of that volatility. That's why it's so important to minimise this risk once you've retired.

One solution could be to set up a lifetime annuity – a secure investment that gives you guaranteed regular payments for life. You can use annuities with other retirement investments, such as an account-based pension, and you can choose to structure your payments, so they keep pace with inflation.

Talk to your adviser today to find out whether an annuity could be the retirement solution for you.

Source: Challenger

1 Calculated as 2.5% inflation per year with compounding interest

This information is general only and does not take into account any person's objectives, financial situation and needs. Before deciding whether to acquire or continue to hold the product/annuity, it is important to consider the current product disclosure statement (PDS) for the relevant product/annuity (available from www.challenger.com.au) and the appropriateness (including the risks) to your circumstances.

The four principles of low-volatility equity investment

Recent market turbulence has heightened many investors' interest in low-volatility equity strategies. While it's well known that a portfolio of low-volatility stocks can potentially outperform the market over time (the "low-volatility paradox"), stock selection is important.

There are four investment principles which, our research suggests, can make a positive difference to the performance of a low-volatility portfolio when applied to the stock-selection process.

1

First – invest in stocks with attractive stability, quality and price. A key attribute of low-volatility stocks is their tendency to fall less than the broad market when sell-offs occur (because they fall less, they have less ground to make up when markets recover). So, it's important to begin by looking for stocks with good price stability.

A focus on earnings and balance-sheet quality can help uncover stocks that may offer more lasting stability, while price or a reasonable valuation is always important, as stability should be bought at the best possible price. Quantitative research can help identify and analyse these factors.

2

Second – avoid "volatility traps", or stocks that have shown low volatility but could change. For example, a utility company in a sector undergoing a large-scale regulatory review might appear to be stable but could become volatile if the outcome of the review hurts the utility.

Quantitative research alone isn't enough to protect against such risks, as stocks that score highly on quantitative factors can fall prey to unusual, real-life events. Good fundamental research, in addition to the quantitative analysis, can help guard against such risks.

3

Third – diversify away from the market index. This is particularly important in Australia, where the market is relatively small and dominated by financials, resources and a handful of large-cap stocks. Compared to markets overseas, some sectors and subsectors are virtually missing here, including those with lower-volatility industries, such as branded consumer goods and pharmaceuticals.

For these reasons, investors seeking volatility in their portfolios should consider small allocations to carefully chosen international stocks that can fill gaps in the Australian index.

4

Fourth – manage macro risks. In Australia, by just buying traditional "defensive" stocks with big index weights, it's possible to end up with a portfolio dominated by REITs, utilities and infrastructure stocks – all sensitive to interest-rate risk.

Other macro risks include foreign exchange, US policy, European Union politics and China's economy, to name a few. Careful portfolio construction should aim to identify and reduce them.

Source: AllianceBernstein

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