informed investor

threePILLARS
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In this issue:

Economic update

Australia

- Headline inflation rose slightly more than expected in the December quarter. Prices rose 0.7% over the three-month period, the fastest quarterly increase in three years. This took the annual inflation rate to 1.8%.
- The increase was partly due to higher food prices, affected by disruptions to transportation owing to bush fires in November and December. Fruit prices rose nearly 7%, for example.
- Employment data for December was again strong, following a better-than-expected result in November.
- A further 28,900 new jobs were added, almost three times the 10,000 estimate. This lowered the unemployment rate to 5.1%.
- New jobs were again dominated by part-time positions, but the improvement was nonetheless quite pleasing for policymakers.
- Together, the stronger inflation and labour market data prompted the Reserve Bank of Australia to leave interest rates unchanged at 0.75% at its meeting in early February.

United States

- The pace of GDP growth in the US was unchanged in the December quarter. The world's largest economy expanded at an annual pace of 2.1%; the same as in the third quarter of 2019.
- There was a slowdown in consumer spending, however, which may be cause for concern given services sectors account for around three quarters of the overall economy.
- Policymakers will be hoping to see a rebound in discretionary spending in early 2020. It appears that Americans can afford it – wage growth continues to outpace inflation, meaning consumers have greater purchasing power.

Welcome

Welcome to our latest edition of the Informed Investor newsletter.

As always, should you have any questions or would like some further information, please get in touch and we'll be happy to help.

Julian Payne
Three Pillars Wealth Management

3/52 Belford Street
Broadmeadow NSW 2292

Ph: 02 4969 8402

julian@threepillarswealth.com.au
www.threepillarswealth.com.au

- More than two million new jobs were also created in 2019, which took the unemployment rate to a 50-year low of just 3.5%.
- Interest rates were unchanged, with the target Federal Funds rate remaining between 1.5% and 1.75%.

Europe

- The UK's withdrawal from the European Union occurred as planned, finalising the Brexit process that had been three and a half years in the making.
- UK policy makers can now focus on the domestic economy, which remains subdued.
- Consumer confidence has improved slightly following the recent general election, but remains fragile.
- Despite speculation regarding a possible cut, UK interest rates were left unchanged at 0.75% at Bank of England Governor Carney's last meeting.
- At the same time, officials lowered their GDP growth forecast for 2020, to 0.75% from 1.25% previously.
- Meanwhile, German inflation continued to pick up, indicating that activity levels in the Eurozone's largest economy may be improving.

New Zealand

- Inflation also picked up in New Zealand. Consumer prices rose at an annual pace of 1.9% in the fourth quarter of 2019, compared with 1.5% in the prior three-month period and ahead of consensus forecasts.
- According to a Reserve Bank spokesperson, the weaker NZ dollar is helping to moderate the impact of global headwinds.
- The kiwi economy should also be supported by a NZ$12 billion infrastructure spending program. More than half of the expenditure is being brought forward, with various road and rail works set to commence later this year.

Asia

- Coronavirus-related news dominated attention in Asia. Several airlines have suspended services to and from mainland China. This could affect tourism-related sectors worldwide, as Chinese tourists are estimated to account for around 30% of holiday spending globally.
- Official GDP data showed the Chinese economy grew at an annual pace of 6.0% in the December quarter, the same as in the September quarter. Growth is being supported by buoyant consumer spending domestically.

Australian dollar

The Australian dollar depreciated quite sharply in January, recording its worst monthly performance for more than two years.

The currency lost nearly 5% against the US dollar, battered by coronavirus-related concerns. Australia's close ties with China means 'risk off' sentiment around the virus is affecting the Australian dollar more than most other currencies.

A weaker currency may prove beneficial for Australian manufacturers, as it makes locally produced goods more competitively priced internationally.

Commodities

Optimism following the agreement of a 'phase one' trade deal between the US and China quickly gave way to demand and economic growth concerns stemming from the rapid spread of the coronavirus.

Oil (Brent -13.3%) felt the uncertainty sharply, while industrial metals were also lower; copper (-9.5%), nickel (-8.4%) and aluminium (-4.8%) all posted sizeable losses by end January. Iron ore (-10.1%) also fell on China-related demand concerns.

Unsurprisingly, gold (+4.7%) posted solid gains on 'safe haven' demand amid the uncertainty.

Australian equities

The S&P/ASX 100 Accumulation Index delivered an impressive +5.1% return for the month of January, its best return in 26 years. This helped the Index set new all-time highs in terms of price and total return.

All Information Technology constituents helped push the sector +12.8% higher. Given their bond-proxy nature, the Utilities sector lagged the market and provided a modest +0.6% return.

Although Australia's small companies underperformed their large cap peers, the S&P/ASX Small Ordinaries Accumulation Index still delivered a solid +3.4% return.

Listed property

Global listed property kicked off the calendar year with solid gains in January. The FTSE EPRA/NAREIT Developed Index returned 2.2% in local currency terms and a more impressive 5.9% in AUD terms, reflecting the weaker Australian dollar.

The Australian property sector led the charge as A-REITs returned 6.4% during the month. Hong Kong (-7.8%) was by far the worst performing market. Sentiment towards equities in the region plunged, as concerns around the coronavirus outbreak intensified in China and surrounding regions.

Global equities

Momentum in global equities continued from 2019, with the MSCI World Index establishing new highs in the first 20 days of January.

The signing of the 'phase one' trade deal between the US and China, combined with increasing conviction of a gradual recovery in global growth helped support global share markets.

That optimism was quickly snuffed out, however, on mounting fears over the coronavirus and its impact on Chinese, and hence global, growth.

From 20 January, the MSCI World dropped -3.1% in local currencies, to end the month down -0.2%. The AUD's associated plunge helped insulate Australian investors in global shares from negative returns.

In fact the Index ended the month up 4.4% in AUD terms, the strongest January return since 2013.

Global and Australian Fixed Income

The risk that coronavirus results in a prolonged economic slowdown was reflected in fixed income markets worldwide.

Government bond yields were pushed sharply lower in all key regions. US and Australian 10-year yields closed the month 42 and 41 bps lower, respectively, resulting in positive returns from overseas and domestic bond markets.

Moves in Europe were a little more modest, but were substantial nonetheless. In the UK, 10-year gilt yields dropped 30 bps, while German Bund yields closed January 25 bps lower. Japanese JGB yields also fell 5 bps.

Global credit

Credit spreads had tightened sharply in late 2019, resulting in favourable returns from both investment grade and high yield corporate bonds.

In January, however, concerns associated with the virus outbreak – specifically how a slowdown in activity levels might affect corporate earnings – saw spreads retrace some of this earlier movement.

A slowdown in China could have broader reaching implications for companies in other regions. Remember, China now accounts for around 16% of global GDP.

Unsurprisingly, issuers in Asia were among the worst performers. Chinese property companies with exposure to Wuhan, for example, fared particularly poorly.

Source: Colonial First State

Making sense of Medicare and your tax obligations

To help pay for the public health system which we call Medicare, you're required to pay a 2 percent Medicare levy as part of your income tax.

While the low-income tax offset can reduce your individual tax liability, sadly it does not reduce the Medicare levy per se, which can make it that little bit harder to get ahead with your savings.

However, if you're on a taxable income of over $90,000 as a single or $180,000 for families, and don't have private health insurance, you may also be subject to a surcharge of up to an extra 1.5 percent of your income, on top of the basic Medicare levy.

The surcharge was designed to encourage those who can afford it to take out private health cover and use the private hospital system, hence reducing demand on the public Medicare system. But you are exempt from paying the Medicare Levy Surcharge by having private health insurance with a sufficient level of hospital cover.

While taking out private health insurance can be cheaper than the additional surcharge, you need to do your homework beforehand.

Private health cover has come under a lot of criticism for not offering value for money due to a myriad of shortcomings, none the least being exclusions and major out-of-pocket costs.

Rebates for private health insurance

However, if you do decide to take out private health insurance, you may also be eligible for a rebate depending on your income level.

While the private health insurance rebate is income tested, singles and families earning under $90,000 and $180,000 respectively, can expect the highest (base tier) rebate of 25.059 percent (under age 65).

Most people with private health insurance can claim the rebate as an upfront reduction on their private health insurance premium. However, if you don't claim the rebate as a reduction to your premium, you can still claim it as a tax offset in your annual income tax return.

What exactly is the lifetime health initiative?

If you're under age 31 and still in two minds whether to take out private health cover or not, the Federal Government has provided an incentive to help you decide.

Should you wish to buy health insurance after 1 July following your 31st birthday, you'll be required to pay an extra 2 percent for each subsequent year of cover due what's called a lifetime health cover loading (LHC).

For example, if you join at age 35, you'll pay 10 percent more for your hospital cover than if you'd joined five years earlier. Given that the cost of top hospital cover averages around $4,500 for families and $1,250 for singles, a 20 per cent loading means you'd be paying an additional $900 and $250, respectively.

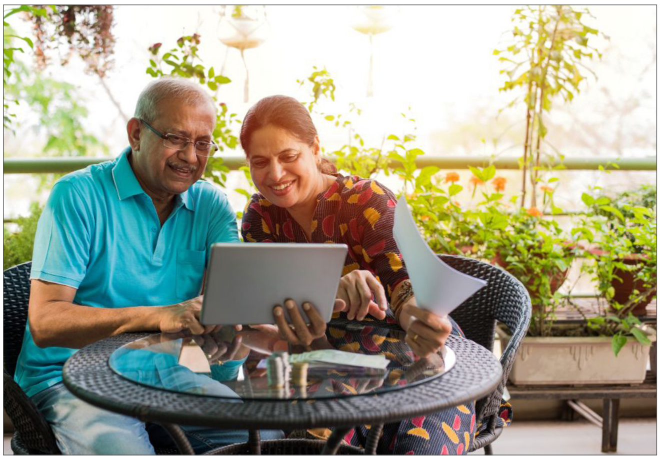
If you take out private patient hospital cover when you are 40 years old, you could pay an extra 20 percent on the cost of this cover annually for 10 years. If you wait until you are 50 years old, you could pay 40 percent more annually.

However, it's important to note:

1. The maximum LHC loading that can be applied is 70 percent
2. The LHC loading applies to the cost of hospital cover only, not extras cover, and you will cease paying this loading after 10 years of continuous hospital cover.

For more information, please contact us.

Source: FPA Money and Life



How to review your SMSF strategy

Super law sets out some requirements that trustees of regulated super funds need to consider when formulating an investment strategy.

These requirements include (but are not limited to) the composition of investments, risk and return, liquidity, insurance and the ability to pay liabilities (including member benefits) as they become due.

Looking first at the composition of investments, there isn't a requirement that SMSF investments must be diversified, and there are some SMSFs that have large investments in a single asset or asset class.

Most commonly this occurs where the SMSF has a direct property investment, with a comparatively smaller investment in cash in order to make relevant payments as necessary.

Whether or not this approach is right is a question for the trustees of each SMSF to determine for themselves, but the old saying of "not putting all your eggs in one basket" is worth considering.

Using this example, what would happen if the property market was to fall? Do you have enough time to ride out fluctuations and get your money back? This points to the next consideration of risk versus return.

With any investment decision, a consideration of the risk involved in a particular investment balanced against the potential returns or reward should probably be undertaken. Of course, these are both forward looking.

History may tell us a little about the risks and returns for particular investments over a period of time, but there are no guarantees about what will happen in the future.

This is why it's usually important for SMSF trustees to spend some time making an assessment of these important characteristics.

However, it is unlikely that a consideration of risk and return is just limited to the actual investments themselves. Often the best starting place is what the SMSF trustee's risk and return parameters are.

If the market was to fall by 10 per cent, how long would they be willing to stay invested in the same asset to recover the capital?

This can help determine how much risk the SMSF trustee is willing to take on. And this consideration may not be about a particular investment, but rather the composition of all the assets in the SMSF.

How much to allocate to growth assets (which usually have higher risk) compared to how much to invest in more stable investments (which are generally subject to less volatility).

Risk may only be one side of the equation – return may be equally as important to consider. In fact, given one of the key objectives of super is to grow wealth towards retirement, generating an appropriate level of return is important, and invariably involves taking on some element of risk.

Another requirement may be liquidity and the ability to pay liabilities as and when they fall due.

There is no doubt that you need to be able to pay for the ongoing running costs of your SMSF, but consideration of liquidity takes on heightened importance as members approach retirement.

With super used to fund members' retirement lifestyles, the need to ensure there is sufficient liquidity is arguably more important, and will involve a consideration of how much should be held in cash (or other liquid investments) and how much should stay invested in less liquid investments to provide for future potential growth in the SMSF.

SMSF trustees are also required to consider the insurance needs of members in formulating the investment strategy.

Given that quite often the trustees of an SMSF are also the members of the SMSF, this is about considering whether you have sufficient insurance of your own, and if not, whether you should acquire more cover through your super.

Depending on the type of investments in your SMSF, you should also consider if you need the fund to take out other types of insurance. This could be an important consideration if you hold property.

So what makes a good SMSF investment strategy? It's likely one that aligns to the future goals of the members (the trust deed should cover this) and what they are trying to achieve, and ensures this is done with appropriate consideration of the risks in achieving these goals. It should also comply with super legislation and the sole purpose test.

Source: BT

Time to consider green investing?

In the wake of recent ferocious bushfires, the climate change debate has climbed the news agenda, with many Australians now considering what they can do to help.

If you'd like your money to make a difference to the environment as well as your future, now might be the time to consider ethical investing.

It's a growing trend. More than half of all investments in Australia are already invested responsibly and ethically according to the Responsible Investment Association of Australia (RIAA).

Responsible investment takes into account environmental, social and governance (ESG) factors into the investment process of research, analysis, selection and monitoring of investments.

Whether it's through super, investments or savings, more and more people are reviewing their financial arrangements to ensure their funds are put to work in a way that does no harm, and ideally leaves the world in a better place.

Here are some tips to help Australians who want their finances to be environmentally friendly.

Understand what matters to you

Everyone's values are different, so you need to first work out what's most important to you. For instance:

- Do you feel strongly about not investing in fossil fuels?
- Are you interested in discovering cutting-edge solutions for climate change or is improving energy efficiency a greater priority for you?
- How will these preferences affect your investment performance?

From here you can identify the areas where you don't want to invest or, conversely, where you'd rather put your money to make a positive impact.

Do your research and get to know the ESG principles

Each investment manager has its own investment policy when it comes to ESG investing. For instance, some may apply a 'negative screening' or 'exclusion' policy, meaning that they steer clear of certain sectors like fossil fuels.

Be mindful of exclusion policies as they may lead to increased volatility in your portfolio. Climate change investing tends to be a form of 'positive screening'—in other words, actively choosing to invest in companies that are making a difference in areas such as renewable energy.

RIAA is a good resource to use when you're starting on this journey as it details the investment strategies of ethical and sustainable funds. Many super funds or investment managers also now have information about sustainability and ESG on their websites. Look to see if they have signed the United Nations backed Principles of Responsible Investing and whether they have published their scorecard.

Start with super

Do you know where your super is invested? Does it offer a socially responsible investment (SRI) option? Make sure you read all the information provided by your super fund about the particular sectors, businesses and investment activities considered for investment.

Don't forget the eggs rule

One of the key principles of good investing is diversification—not putting all your eggs in one basket. It spreads risks and ensures you're not exposed to any single investment or asset class. So consider the risks of crafting a portfolio that's too narrow and concentrated.

Climate-themed funds also haven't been around for a long time, with many having only launched several years ago. This makes their performance hard to assess.

We can help

Being a more responsible investor involves a lot of research and working out exactly how far you want your investment decisions to reflect your sustainable and ethical concerns and can be a minefield (pun intended).

For example, you might not want to invest in coal companies, metallurgical coal miners and mining companies, but what about transport companies that freight coal, coal seam gas, oil and conventional gas, electricity generators, or diversified energy generators that may have large investments in renewables as well as coal?

Source: AMP

Will I pay Capital gains Tax on my Inheritance?

In Australia, special capital gains tax rules apply when dealing with assets of a deceased estate.

The most common types of assets inherited by a beneficiary that could be subject to a capital gain are property, shares and managed funds.

You may have just received (or are about to receive) an inheritance. While this article isn't a substitute for specialist tax advice it considers some of the capital gains tax implications should you ultimately choose to sell an inherited asset of this nature.

Implications for Australian tax residents

Where you're an Australian resident for tax purposes and you inherit assets from the deceased estate of an individual who was also an Australian tax resident, the transfer of these assets from the deceased estate is not a capital gains tax (CGT) event, in and of itself. This means that only if you decide to sell the asset at a later point in time, then the normal CGT rules apply.

In this scenario, CGT outcomes are an important aspect to consider when selling inherited investments like shares, managed funds and investment properties.

The sale of the family home may receive the 'main residence exemption' which means that CGT will not apply. However, this an area where advice is best sought.

Note: where a family home was used for investment (income producing) purposes at some stage, only a partial main residence exemption will occur. We discuss this in a little more detail below.

Implications for non-Australian tax residents

Where the deceased individual was an Australian resident for tax purposes, if you're a non-Australian tax resident CGT may be applicable.

Depending on the type of asset inherited and the circumstances involved, this can be an especially complex area, so specialist advice is key.

Other Capital Gains Tax considerations

Generally speaking, if the asset is:

- a collectable asset, such as rare stamps, then CGT may apply depending on a host of circumstances
- a personal-use asset such as jewellery, a car or boat CGT will typically not apply.

Capital gain (or losses) on an inherited asset

There are several considerations involved in calculating a capital gain or loss. Some of these can include:

- the type of asset, and how it was used prior to the deceased's passing;
- the deceased's date of death;
- the date the asset was inherited;
- your ownership period, prior to selling the asset;
- whether you are selling the asset as an individual Australian tax resident, or not.

Did you know:

Inheriting a family home may involve CGT when it is sold. This depends on a few factors, such as when it was bought, when it was sold and if it was used for investment purposes at any time during the ownership period.

You should keep detailed financial records related to an inherited asset. This information is needed to determine if there's any CGT payable later when the asset is sold.

Source: Perpetual

For further information please contact Julian Payne on 02 4969 8402 or email julian@threepillarswealth.com.au

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