Personal Wealth

Autumn 2016

A Quarterly Newsletter for **Lifespan Clients**

What's inside…

New standards for SMSFs investing in collectables and personal use assets.

Only a few months remain before the grandfathering expires and the new rules apply to SMSFs with art, collectables and personal use assets purchased prior to June 2011.

Since July 2011 new SMSF investments in art, collectables and personal use assets have had to comply with the new rules. However these regulations didn't apply to art and collectables held by SMSFs at 30 June 2011, which were grandfathered under the old rules until 1 July 2016. This is now lonely a few months away.

What is classed as 'collectables and personal use assets'?

SIS Regulation 13.18AA classifies the following types of items as 'collectables and personal use assets':

- artwork
- jewellery
- antiques
- artefacts
- coins, medallions or bank notes
- postage stamps or first day covers
- rare folios, manuscripts or books
- memorabilia
- wine or spirits
- motor vehicles
- recreational boats
- memberships of sporting or social clubs

After 1 July 2016 all SMSFs holding such items will have to comply with the new rules.

The new rules for SMSF art, collectables and personal use assets

The regulations set out a number of requirements for SMSFs which hold art and collectables.

- The item must not be leased to a related party
- The item must not be stored in the private residence of a related party
- Decisions on the storage of the item must be documented, and these records kept for at least 10 years
- The item must be insured in the name of the fund
- there is an exemption for some types of items, there is also a 7 day time limit from the date of acquisition for the insurance to be in place
- The item must not be used by a related party

Breaching any of these requirements results in a fine of 10 penalty units. The Commonwealth Penalty Unit is currently $170, but the 2015 Budget included an increase to $180 from 31 July 2015, making the fine for a breach of the collectables and personal use assets regulations $1,800.

SMSFs with art and collectables not already under the new rules should speak to their SMSF professional about the best course of action well ahead of the end of the 2015/16 financial year.

Your financial planner can assist you to determine which types of personal life insurance are appropriate, how much cover you need and which life insurance companies provide the best products for you. Take action today.

Investment Markets

Recent History

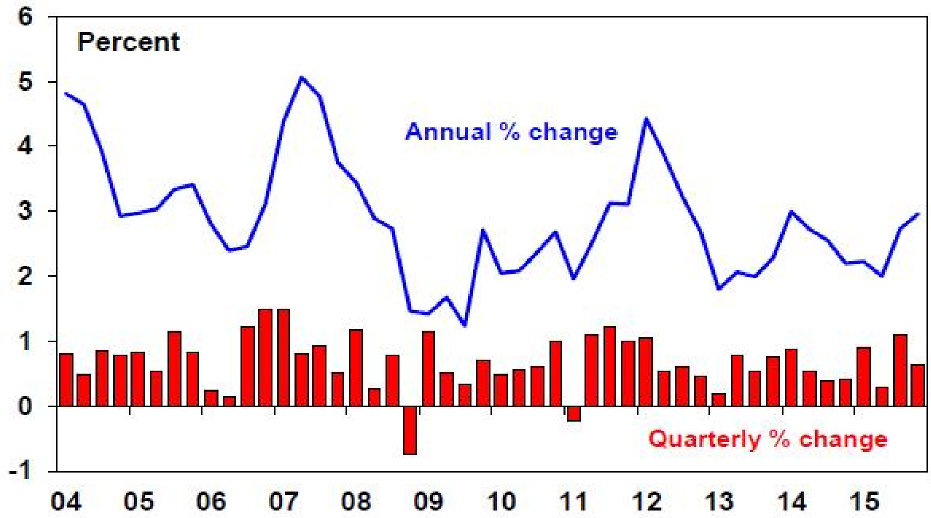
Australian and global equities experienced a massive sell off at the start of 2016, at one stage it was the worst start to any year including the great crash years of the 1930's. Australian large cap shares (ASX 200) briefly entered a bear market, i.e. down 20% from the recent high.

There was so much negativity in markets early in the year, some of the concerns were: a slowing China and potential currency devaluation as well as capital flight, a possible recession in the US and higher US interest rates, falling oil prices and bank exposure to oil related debt, negative interest rates and the damage that was doing to European banks.

Also Japan surprised markets by adopting negative interest rates and the worry was there was going to be competition between central banks for the lowest interest rates which would play havoc with markets and currencies. However since mid-February, markets have bounced back to be only a few percent down for the year. Fears of a US recession have eased and the oil price has rallied by more than $10 a barrel.

Given the fear in markets and influence of negative interest rates, there was a very big rally in bonds to start the year. In Australia, the 10 year government bond yield fell by 0.47% by 10 February. The fixed interest benchmark returned 2.6% from 31 December, 2015 to 10 Feb 2016, the most for a comparable period since 1991 (which was the last recession in Australia). This was more than the return for the whole of 2015. Yields have risen since then but fixed interest has been a good performer in 2016.

The Australian share market returned -4.6% for the 3 months to the end of February while Australian Small Cap Equities did much better with a return of -0.5%. Developed Market global shares underperformed domestic shares with a return of -7.0% while Emerging Market equities returned -7.3%. Global equities underperformed despite the help they received from the Australian dollar which fell 1.4% versus the US dollar over the period. With bond yields falling, it should not surprise that Listed Australian Property was a good performer, returning 8.10% for the period. The Australian fixed interest benchmark returned 2.6% for the 3 months to end of February while Cash returned 0.57% for the period.



Economy

The US Federal Reserve raised interest rates by 0.25% in December 2015 but this was a non-event as the rise was widely anticipated. Markets were initially spooked by a US GDP growth rate of just 0.7% in Q4 of 2015. Also December 2015 retail sales were reported as unexpectedly falling 0.1% compared to a rise of 0.6% the previous December. This raised concerns that the US might go into recession which contributed to the pullback in equities. However December retail sales were revised to up to +0.2%, the same as for January while Q4 2015 GDP was revised up to 1.0%. Also the Atlanta Federal Reserve has a tracker of US growth, which for the first quarter has jumped to a 2.7% annual rate. So markets are less worried about a US recession now.

The latest Chinese Data showed exports fell 20.6% in February and imports fell 8.0% from a year ago. However it is hard to make judgements as the timing of the Chinese New Year massively distorted the numbers. Markets will be closely watching the data in coming months and it has the potential to negatively impact markets.

The Australian economy surprised by growing at 3% for the year to December 2015. This compares to the US at 1.9%, the Eurozone at 1.5% and Japan at 0.5%. This was a really good result as the slowdown in mining investment is subtracting about 1% off annual GDP growth. However we do not expect growth to be as high in 2016 with growth likely slipping back to about 2.5%.

Markets and Outlook

While equities have pulled back

about 15% from the peak in April 2015, earnings expectations have also been steadily revised down. The net result is that the valuation, or PE of the market, is still at above average levels at roughly 15.4 times. This compares to a long term average PE in the low 14 times earnings. However the dividend yield is still very attractive at 5.3%, especially when compared to fixed interest yields of about 2%.

The Australian equity market has had larger earnings downgrades than most developed global markets, mainly due to Energy and resource shares. In mid-January, consensus earnings per share estimates (EPS) for the ASX 200 were -5.2%. Post the reporting season, 2016 estimates have been revised down to -8.0% with resources EPS at -53.1% and a 4.1% increase for non-resources companies. Consensus EPS growth estimates for the 2017 financial year have also been revised down to only +5.2% growth with resources again being the main driver.

With the collapse in commodities prices, resource stocks are now at a decades low percentage of the ASX 200 market capitalisation at about 13%. As recently as 2008 resource made up 35% of the ASX 200. Thus any underperformance in resource stocks will have a much smaller impact on returns going forward.

We should also point out the divergence in performance between the very large stocks and somewhat smaller companies. The ASX 200 index was down about 18% (in price terms) over the year to 29 Feb, 2016, that is very close to a Bear Market for the ASX 200. This is a market capitalisation weighted index and is influenced greatly by the moves in the largest stocks.

For instance the big 4 banks fell 20% to 30%, BHP halved, Rio was down 37%, Woodside was down 25%, Telstra down 17% over the period. Looking at the median share price move (not market capitalisation weighted) for the top 20 stocks, they were down 18%. However the median move for the top 200 shares was a fall of only 7%. While for stocks outside the top 20, the median share price move was a fall of just 5.5%. So we were not close to a bear market once you got away from the largest stocks.

The two major factors here were selling of large resource stocks and Bank shares. Apart from domestic issues, the banks were sold off on worries, largely out of Europe, about how negative interest rates would hurt bank profitability. The conclusion of markets is that banks and the financial system are not designed for negative interest rates which seems to be the new version of QE.. However in a recent meeting the European Central Bank said that interest rates would not be lowered again which pleased markets and should be positive for banks.

In terms of asset classes, we find fixed interest, particularly global fixed interest, unattractive at the moment given the artificially nature of (low) interest rates. Therefore we remain underweight fixed interest. With only moderate earnings growth and equity markets at about historical average valuation levels we see muted returns going forward. This is because we are not anticipating any PE multiple expansion from current levels. We see higher forecast growth in global equities in the short term so we would maintain our tilt towards global shares. This also takes advantage the recent strength of the Australian dollar. There a many issues that concern markets right now so we expect quite a bit of volatility this year. As a result we would advise investors to be nimble and try to add to growth after market pullbacks rather than dollar cost averaging all your funds on a fixed schedule. .

Chart 2: Investment Returns to 29 February 2016 (% p.a.)

Asset Class	1 month	3 months	1 Year	3 Years	5 Years
Australian Shares	-1.76	-4.61	-13.73	3.01	4.87
Global Shares	-1.65	-7.04	-3.91	16.89	11.33
Listed Property	2.86	8.10	6.40	14.37	14.92
Fixed Interest	1.03	2.61	2.96	5.39	6.82

Source: Mercer

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