Personal Wealth

Spring 2016 A Quarterly Newsletter for **Lifespan Clients**

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US FED WEIGHS ON MARKETS

Recent History

The last few months has seen some sharp swings in sentiment that has contributed to significant movements in investment markets. Late June 2016 saw a sharp pullback in equity markets as they focused on the negative effects of the Brexit vote. However calm had returned by July with most markets rallying strongly as concerns over Brexit largely dissipated.

The Australian market was one of the best performing developed markets in July with Australian equities (ASX 200) rising by 6.3%. Equity markets struggled in August as market expectations increased that the US Federal Reserve (Fed) would raise rates again before the end of 2016. These worries have persisted in September with equities pulling back and bond yields rising off historical lows. The Reserve Bank of Australia (RBA) cut the official cash rate from 1.75% to 1.50% in August, a new all-time low on lowered inflation expectations.

The Australian share market returned 2.1% for the 3 months to the end of August. However Australian Small Cap Equities extended their period of outperformance over large caps returning 5.5% for the same period. Developed Market global shares were pretty flat with a return of 0.3%, this was despite the Australian dollar falling 1.1% against the US dollar over the period. Emerging Market equities did much better than developed markets with a return of 8.1%. Bond yields were generally lower over the 3 months with the Australian fixed interest benchmark returning 2.5% while Cash returned 0.51% for the period. Australian listed property was a major beneficiary of lower bond yields with a return of almost 6.2%.

Economy

The latest data show that the Australian economy grew at a rate of 3.3% year-on-year in the June quarter, the fastest pace in 4 years. On an annualised basis the economy grew by 2.9% in real terms during the 2015/16 financial year. This was despite falling mining investment and subdued commodity prices. Approximately 230,000 net new jobs were created in the financial year and the unemployment rate fell from 6.1% to 5.7%. The Australian economy has now gone 100 quarters without experiencing a technical recession (i.e. 2 consecutive quarters of negative economic growth). However we would not be surprised if growth was somewhat lower going forward.

The Headline inflation rate (CPI) fell to 1.0% over the 12 months to June 2016 while underlying inflation (or core inflation) came in at 1.5%. This is well below the Reserve Bank of Australia's (RBA) target range of 2% –3% and was the major factor in the RBA cutting interest rates.

The Bank of England (BoE) cut forecast UK GDP growth significantly following the vote to leave the European Union. Before the Brexit vote the Bank of England had forecast growth of 2.3% in 2017, now it expects just 0.8%. This was somewhat offset by the BoE providing additional monetary stimulus for that economy. The feeling in markets right now is that any slowdown will be largely confined to the UK rather than the rest of Europe or the global economy. Also concerns of a global recession that were prevalent earlier in 2016 have now eased. However US economic growth is only hovering around 1% for the first 6 months of 2016 while global GDP growth is likely to be around the same level as 2015 which was an increase of 3.1%.

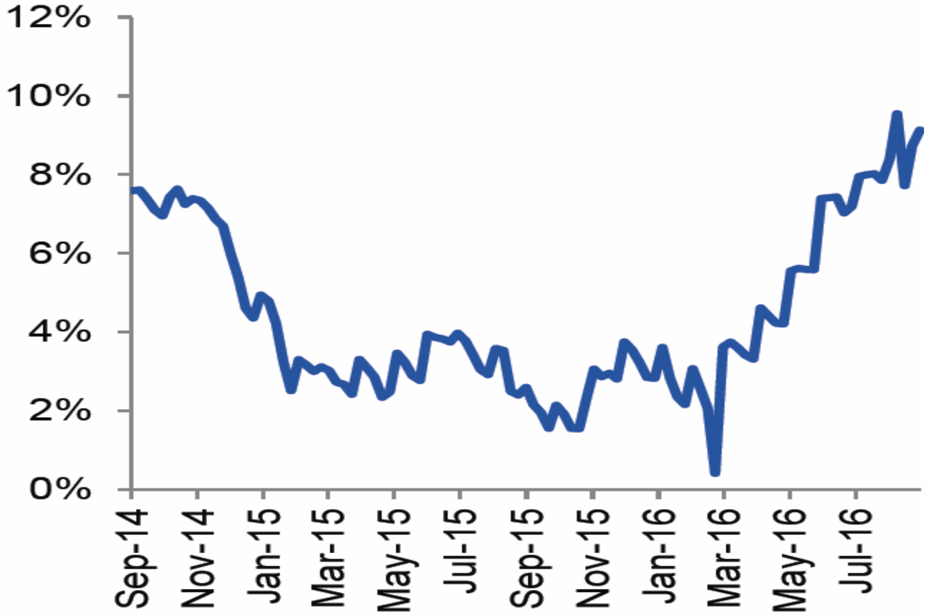
Markets and Outlook

There Equity and bond markets are currently experiencing a pull back on what we believe are fears that the US will raise interest rates again. Ten year bond yields have risen by about 0.3% off historical lows in both Australia and the US. Given that the US election is in early November the most likely date for any rate rise would be in December. This would be a full year after the last rise and would only take short rates to around 0.5%.

We believe equity markets could handle a small rate rise given that the pace of any further rate hikes would likely be very gradual. However any talk of higher interest rates is always going to lead to volatility in equity markets since valuations in most markets are somewhat above average long term levels. Simply put, the rich valuations make equities vulnerable to any bad news. This applies doubly so to bonds which are trading at artificially low yields as a result of central bank policies.

In Both Australia and the US, earnings growth has been hard to find. In Australia for fiscal year 2016, earnings growth was -12% (ASX 200), while in fiscal 2015 it was -3%. In fact 8 out of 11 sectors reported negative profit growth in the last reporting season (Morgan Stanley). The Australian equity market (with the ASX 200 at 5,260) is trading at forward PE of about 16.5x. This is well above the long term average PE which is in the low 14 times earnings .

Chart 1. S&P/ASX200 Consensus Profit Estimate by Forward 12 Months



Source: Datastream, Morgan Stanley Wealth Management Research, Data as at 8 Sept 2016

Over the last few years, Australian earnings expectations have continually been revised downwards. However over recent months they have actually been rising. Chart 1 shows how 12 month forward earnings expectations have moved recently. At this stage earnings are forecast to rise about 6.5% in fiscal 2017, largely driven by resources and financials to a lesser extent.

The risk for resources is that Chinese growth needs to be maintained and we do not see a petering out and the recent stimulatory measures over the second half of the year.

In terms of the portfolios we manage, we marginally reduced our allocation to growth assets when markets were somewhat higher. However we will look to take advantage of any significant market pullbacks to add to our holdings in equities. We have not changed our views on the merits of the different asset classes. We still prefer equities to fixed interest on valuation grounds but accept that returns will be lower going forward than in the recent past. We believe that in a low return world investors should view volatility as an opportunity rather than a threat.

Chart 2: Investment Returns to 31 August 2016 (% p.a.)

Asset Class	1 month	3 months	1 Year	3 Years	5 Years
Australian Shares	-1.55	2.07	9.30	6.59	9.68
Global Shares	1.47	0.28	1.17	12.95	16.27
Listed Property	-2.68	6.16	25.97	19.79	19.51
Fixed Interest	0.42	2.50	6.19	6.47	6.21

Source: Mercer

Life insurance

Be prepared for life's emergencies

Imagine what your family's life would be like if you or your partner died or became seriously ill and couldn't work. Would you be able to survive financially? Being unable to work as a result of an accident or ill-health could expose you or your family to financial difficulty. Insurance can provide the money you or your family need in these critical times.

It is a good idea to review your life insurance regularly, especially if something has changed in your life, for example, if you've taken out a home loan, are having kids or starting a business.

Types of life insurance

There are different types of cover that fall under the broad heading of life insurance. Depending on your circumstances you may need one or more of the following:

Life cover

- also known as 'term life insurance' or 'death cover', pays a set amount of money when you die. The money will go to the people you nominate as beneficiaries on your policy.

Total and permanent disability (TPD) cover

- pays a lump sum to assist with rehabilitation and living costs if you are totally and permanently disabled. TPD is often bundled with life cover.

Trauma cover

- provides cover if you are diagnosed with a specified illness or injury. These policies include the major illnesses or injuries that will make a significant impact on your life, such as cancer or a stroke. It is sometimes called 'critical illness cover' or 'recovery insurance'.

Income protection

- replaces the income lost through your inability to work due to injury or sickness.

Smart tip

When working out what insurance you need, always read up on what's included and excluded in each policy.

How much life insurance do I need?

There is no correct answer, but more insurance gives you more protection. However, it also depends on what you can afford, so you may need to prioritise.

How much cash your family would have if you were to die or become disabled. How much money is in superannuation, shares, savings and existing insurance policies? How much paid leave do you have? What type of support could your family provide? You may also be entitled to government benefits or workers compensation if you get injured (although this may be reduced by income protection claims).

How much cash your family would need if the worst were to happen. Consider the size of your mortgage and any other debts, as well as childcare, education and other costs.

The difference between these is the amount of cover you should get. However, you may need to compromise between what you would like and what you can afford.

Before you start comparing policies, check whether you already have life insurance through your super fund, as you may already have some cover.

You may decide to change your level of cover based on changes to your lifestyle. For example, if you have children and a large mortgage you may decide you need more cover. Alternatively, if you've paid off your mortgage or no longer have financial dependents you may decide to reduce your cover.

Review your life insurance policies every time your income changes or your personal circumstances change to make sure you have the right type and level of cover.

Switching life insurance cover

If you decide to switch your life insurance cover to a different insurer, don't just look at the difference in premium. It is also important to consider:

Level of cover - will you be receiving the same level of cover, and is this the cover you need? For example, if your current insurer covers any pre-existing conditions, will your new insurer do this as well?

Waiting periods - do any waiting periods apply to different types of benefits with your new insurer?

A licensed financial adviser can help you choose the right insurance cover for your needs.

What's the difference between stepped and level premiums?

Insurance premiums usually increase with age because the older you get, the more likely you are to make a claim.

For insurance such as life, total and permanent disability, or trauma cover, you may be able to choose between stepped or level premiums.

Here is the difference between stepped and level premiums:

Stepped premiums - Your insurance premium will increase each year as you get older but is usually cheaper in the beginning. If you're thinking about this option, it is worth looking at what the premiums will be over the next 5 years, or however long you intend to hold the insurance for, to make sure you can afford the premiums.

Level premiums - Your insurance premium does not change due to your age but is generally more expensive than a stepped premium in the beginning. Level premiums may increase over time due to inflation adjustments or changes to the insurer's fees.

If you want to control your costs over time then level premiums may suit you. Premiums are usually higher in the beginning but much cheaper than stepped premiums when you are older. If you intend to hold the insurance for a long time, level premiums are likely to be cheaper in the long run.

How can I get a policy?

You can buy life insurance in three main ways:

Your super fund - Many working Australians have some life and disability insurance with their superannuation. See insurance through super.

Insurance companies

Insurance brokers and financial advisers

It is a good idea to shop around and compare policies based on the level of cover they provide, exclusions and value. If you switch to a different insurer it is important to keep your existing cover until you have a new policy in place so you're always covered.

Before you apply for insurance, check the insurance provider's website or product disclosure statement to find out if they will cover any pre-existing medical conditions. You will need to disclose relevant details of your medical history to the insurance provide if you are asked. Failing to 'tell it like it is' could leave you with a worthless policy.

Whatever insurance you choose, it is important to review your cover against your needs on a regular basis.

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For more information please contact your adviser.

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