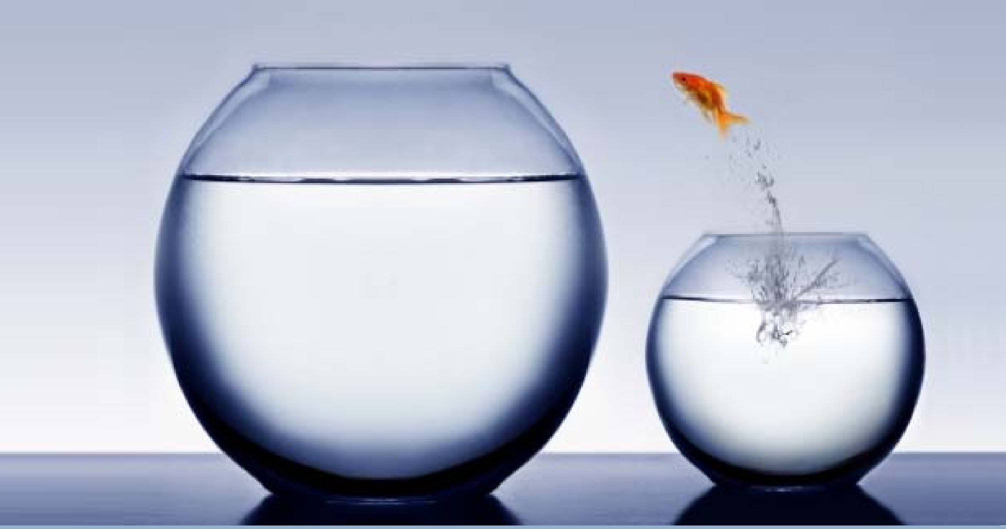
Personal Wealth



Summer 2015

A Quarterly Newsletter for **Lifespan Clients**

What's inside...

Season's Greetings

A special season's greeting to express to you our sincere appreciation for your confidence and loyalty.

We are deeply thankful and extend to you our best wishes for a happy and healthy holiday season.

Are you protecting what matters most?

Risk management and personal insurance must be considered as an integral part of the financial planning process. Just as you insure your house, car and other property against loss, you should also ensure that you hold suitable personal life insurance against illness or death.

Have you thought about how your family or your partner would cope financially if you died or were not able to work? Personal insurance can help to prevent your dependents from being financially disadvantaged if you die, suffer a medical crisis or are disabled.

Most people purchase house, car, and health insurance without much thought, but are either underinsured or uninsured for events such as death, trauma or disablement. You and your ability to earn income is probably your most valuable asset.

Determining the level of insurance

Sometimes, the hardest part of organising personal life insurance is working out how much you should be insured for. When determining how much you should be insured for take into consideration goals such as:

- providing a lump sum to repay your debts and decrease financial pressure on you and/or your family so your assets can be retained
- providing an income stream to either fully replace your salary or to cover any ongoing expenses
- covering expenses that may arise, such as medical expenses, time off work whilst recovering, paying for care, funeral expenses or home modifications.

Even if you are not currently earning an income, you should still consider covering yourself for any expenses which could arise if you die, become disabled or suffer a serious illness.

Calculating the amount

You might wish to calculate how much insurance to have using one of two options: expenses method or replacement method.

Under the expenses method you can try to estimate what expenses need to be covered (over a determined timeframe) and apply for insurance equal to this total amount. Under the replacement method you might take out cover to replace your annual income multiplied by the number of years of your remaining working life. Or you might look at a combination of the two options.

Whichever method you use, you should consider how you will meet the following expenses:

- school fees and education costs for children
- the impact of inflation on expenses
- providing an income for each dependent child for a number of years
- repayment of debts, and
- the costs that would be incurred if you died, became disabled or suffered a serious illness.

It is too easy to miss important considerations and apply for inadequate levels of cover. Advice is important.

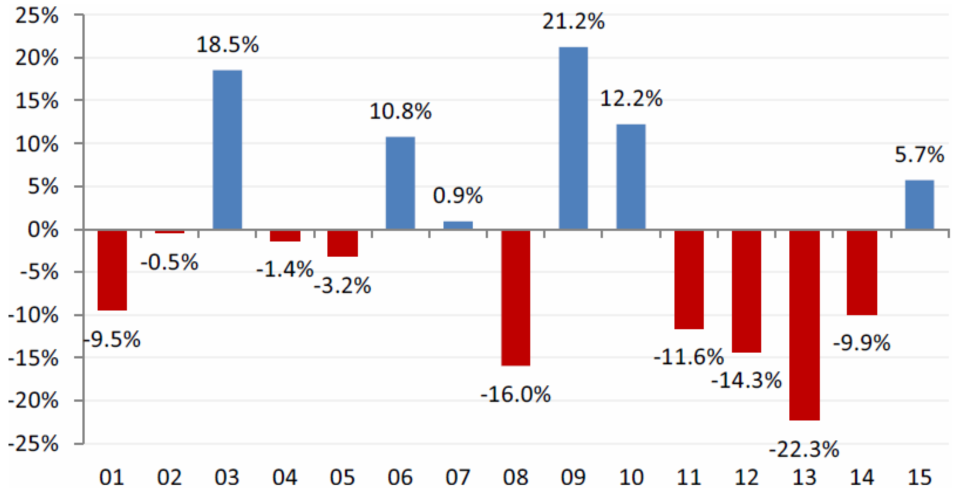
Risk management and in particular personal insurance are a vital ingredient of any comprehensive financial plan.

Just as you insure your house, car and other property against loss, so too you should ensure that you hold suitable personal insurance that may include life and income protection insurance

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

Chart 1: Small Ordinaries Annual Performance (%) versus S&P/ASX 100



Source: RIMES, Morgan Stanley Research, 2 November 2015

Recent History

Global equities were sold off over the June to September period on concerns over the economic slowdown in China and what that meant for global growth. However, most equity markets staged a comeback in October and November and are currently trading at several month highs.

The Australian equity market has been one of the worst performing markets recently and traded under the 5,000 level (S&P/ASX200) in both late September and in mid-November. This underperformance has been mainly driven by the derating of the Banks on higher capital requirements, falling commodity prices, as well as a mine disaster at a BHP mine in Brazil.

Global bonds have given up all their gains from the previous quarter in November as bond yields rose on expectations of an interest rise in the US.

The Australian share market returned -6.6% for the 3 months to the end of October while Australian Small Cap Equities did much better with a return of 1.4%, an outperformance of almost 8.0%.

Global equities were helped by the Australian dollar which fell 2.8% versus the US dollar over the period. Developed Market global shares had a small negative return of -0.35% with Emerging Market equities lagging with a return of -2.6%.

Listed Australian Property returned just 0.4% for the 3 months to end of October although it has returned a healthy 18.3% for the year to October. The Australian fixed interest benchmark returned almost 1.2% while Cash returned 0.54% for the period.

Economy

Markets now expect the US Federal Reserve to raise short term interest rates at their December meeting. This is after a strong jobs number and the unemployment rate falling to 5.0%. Also the core inflation rate has risen to 1.9% which is close to the long term target of 2.0%.

Further evidence has come from recent Fed statements indicating that the economy is strong enough to handle a rate rise. There has also been commentary indicating that the timing of the first rate rise is not important but rather, markets should focus on the rate of interest rate rises. The implication is that any rate rises in the US will be very gradual and should not disrupt markets.

China's 3rd quarter GDP growth came in at a 6.9% annual rate, this is the slowest quarterly expansion since the start of 2009 and the annual growth rate is set to be the slowest since 1990. As a result, China continues to cut interest rates and take other steps to promote growth.

We are awaiting details of the 13th Five-Year Plan covering the years 2016 to 2020. However we do know the government maintained its plan of doubling GDP and disposable income per capita by 2020 from the 2010 level. This implies its target annual GDP growth rate will be around 6.5% versus 7% in the previous plan.

Another major change is to allow two children for all families. However, this has probably come too late as we expect a decline in the working age population from 2016 onwards.

Markets and Outlook

The Australian equity market continues to be growth challenged with earnings per share expected to decline for two straight years (fiscal years 2015 & 2016).

Most of the recent downgrades have been in the resources and energy sectors which are not forecast to improve earnings until 2017. However the major banks are also facing headwinds with higher capital requirements and a likely rise in bad debts from historic lows.

This is likely to constrain profit growth and also dividend increases, particularly given the high payout ratios.

There is also the question of the sustainability of dividends in the Australian equity market as a whole given a payout ratio of over 75%. As an example, as a result of falling commodities prices, the largest mining company is expected to post a 2016 profit below the dividend payout for the last year.

With about 45% of the ASX200 in large banks and resources shares, the short term earnings outlook is lacklustre.

With some of the larger stocks under pressure it should not surprise that the small cap and midcap indices have performed dramatically better so far this year. However it should be noted that small caps have underperformed large caps the previous 4 years (chart 1: which shows the performance of small cap equities versus the largest 100 ASX companies).

It is possible to slant portfolios away from banks and resources if you want more visible growth in earnings. However, one of the issues with chasing higher growth stocks is that they are trading at much higher valuations than the market as a whole.

While we believe the Australian dollar is now at roughly fair value versus the US dollar, it obviously could fall further if commodities prices continue to fall. For instance, iron ore has resumed its decline and is sitting at multi-year lows at about $44 a tonne. We would maintain our tilt towards global equities, not on the basis of the currency, but because we see higher forecast growth there.

The Australian equity market is currently trading at a PE of over 15x which is above its long term average of low 14x earnings. So it is not cheap based on historical PE values. It also has lower forecast earnings growth than most major equity markets. As an example, current forecasts have earnings per share growth in the US at 6.1% above that in Australia (October). This difference was only 0.9% in favour of US equities in February 2015 (Morgan Stanley) so the trend is also against the Australian market.

Global economic growth has disappointed over the last few years, so has been a headwind for equities. Low economic growth has resulted in low interest rates that have contributed to moderately high equity PEs despite the scarcity of growth. However, in terms of relative valuation we continue to prefer equities to fixed interest even though yields have risen recently in anticipation of a US rate rise.

We believe markets will take a US rate rise in their stride as this has been one of the most anticipated rate rises in history. We have had a lot of volatility lately and we think this will continue, so it should provide good entry points for nimble investors.

Chart 2: Investment Returns to 31 October 2015 (% p.a.)

Asset Class	1 month	3 months	1 Year	3 Years	5 Years
Australian Shares	4.37	-6.61	-0.74	9.84	7.08
Global Shares	6.16	-0.35	23.16	24.51	14.75
Listed Property	4.96	0.39	18.26	16.07	14.89
Fixed Interest	0.31	1.18	6.21	4.99	6.71

Source: Mercer

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