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Economic outlook

Australian Dollar Downside

The Australian Dollar has proven resilient over the past year, averaging about 77 cents and continuing the shallow uptrend formed since a multi-year low around 70 cents in early 2016. Looking forward, the Australian Dollar faces downside risks given Australia's lower interest rates, lower economic growth and large foreign debt, a stronger US and possible rollover in China-linked commodity prices.

Australian Interest Rates below the US: First in 17 Years

Historically Australia has offered foreign investors premium interest rate yields. Indeed, since the early-1990's Australian-US cash and 10-year rate spreads have averaged 206bps and 130bps respectively.

In March, however, Australian cash rates fell below the US for the first time in 18 years! If the RBA leaves rates on hold at 1.5%, while the US Fed continues its tightening cycle, the Australia-US cash and bond spread should reach 37-year lows late this year (Figure 1). Beyond that, given Australia's record household debt ratios, Australia is unlikely to regain a rate premium to the US (Figure 2).

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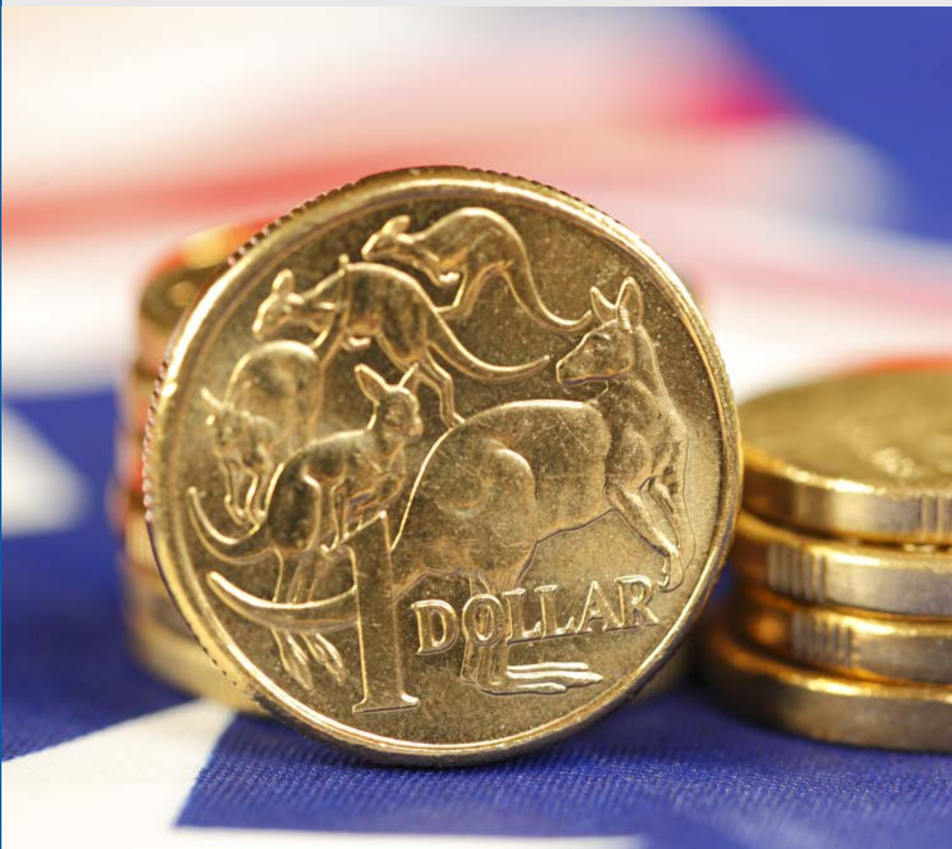
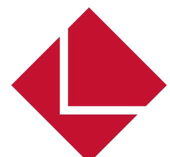


McArthur Financial
45 Cameron Street, Launceston TAS 7250
Ph: 0418 575 496
www.mcarthurfinancial.com.au



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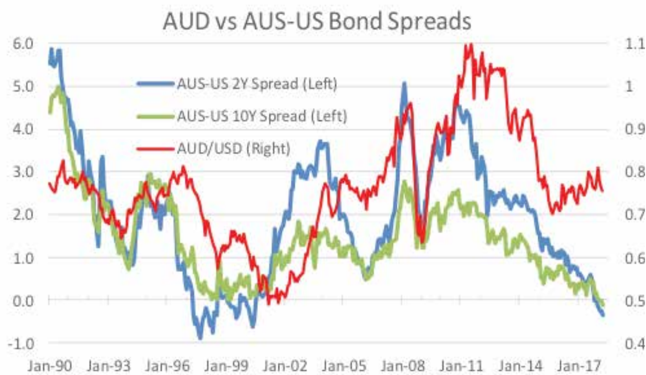
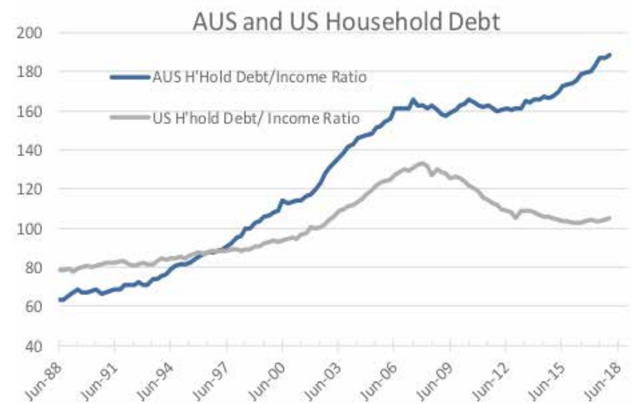
Lonsdale Financial Group Limited
AFSL: 246934
www.lonsdale.com.au

FIG.1: AUS-US Rate Spreads, Negative for the first time in 18 years, should soon reach 37-year lows!



Source: Datastream, Baillieu Holst

FIG.2: AUS Elevated Household Debt Ratio has lowered AUS' neutral cash rate to around US levels



Source: Datastream, Baillieu Holst

Australian Growth below the US and Europe

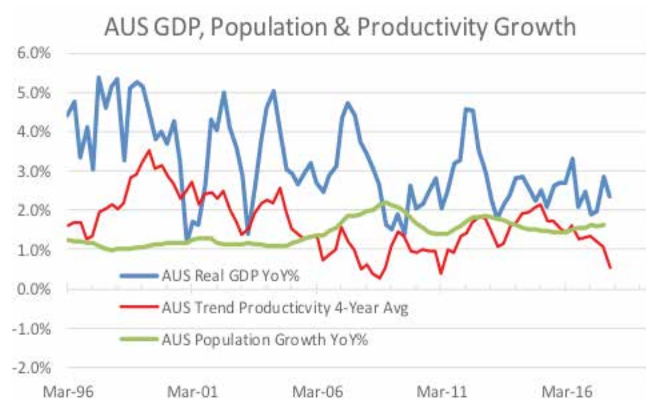
Over the past 25 years, Australia has consistently offered foreign investors exposure to premium GDP growth, outperforming its Advanced Economy peers 89% of the time, and by an average of 1.1%pa. Australian growth, however, has fallen below both the US and Europe (Figure 3), something that should continue given the massive US fiscal stimulus, whilst Australia is held back by pressure on its household sector, elevated housing risks and a moderation in China.

Over the medium-term, Australian growth faces challenges. Population growth is now driving most of Australian GDP growth, with a lack of reforms and the end of the resources boom driving weak productivity growth (Figure 4). Whilst strong infrastructure investment currently underway is positive, rising urban congestion should limit its impact. By contrast, the GFC and Eurozone debt crises have led to renewed reform, while an investment recovery is underway.

FIG.3: AUS GDP Growth has fallen below both the US and Eurozone!

Source: Datastream, Baillieu Holst

FIG.4: AUS GDP Growth now driven by Population growth, not Productivity



Source: Datastream, Baillieu Holst

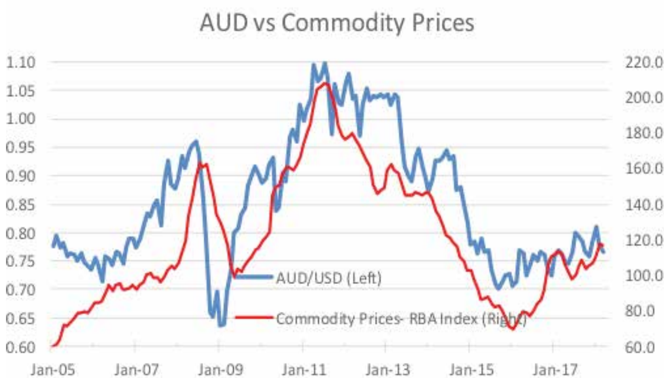
Commodity Prices – The Risk of China Moderation

Booms in China housing and infrastructure investment over 2016-17 delivered a positive growth surprise and surge in commodity prices (Figure 5). With President Xi reappointed for life, however, financial stability and sustainable growth have become key priorities. Policymakers have sharply slowed shadow banking sector growth, curtailed local government borrowing and contained the growth of highly indebted companies, driving money and credit growth to record low levels.

China represents ~50% of global steel production, with a majority of end demand in construction. With record iron ore port inventories, a slowdown in demand could push iron ore prices much lower. The iron ore price has fallen ~16% since the Lunar New Year in mid-February.

Looking further ahead, as China converges on Advanced Economy levels of urbanisation, negative underlying demographics are likely to drive a dramatic decline in underlying commodities demand.

FIG.5: AUD has rallied with higher commodity prices

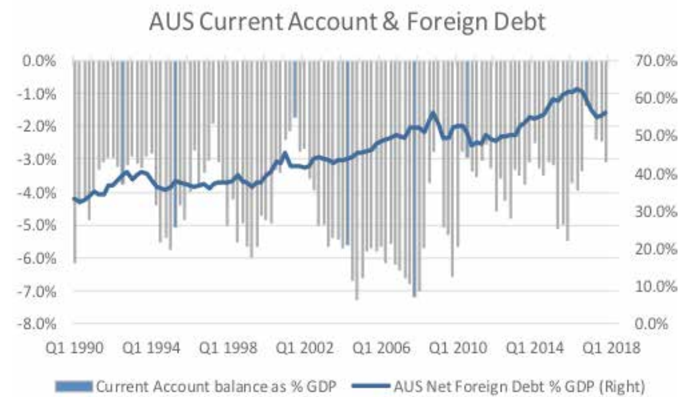


Source: Datastream, Baillieu Holst

US Dollar Weakness Since Early 2017

A key driver of Australian Dollar resilience has been US Dollar weakness, with the US Dollar index falling 9% to below long-term average levels. High and rising US rates and robust US growth, supported by strong fiscal stimulus, should help turn the US Dollar despite its twin budget and trade deficits.

FIG.6: Australia is a large Foreign Debtor



Source: Datastream, Baillieu Holst

Financing Australia's Net Foreign Debt

The vast majority of economies with interest rates below US levels are creditor countries, with net foreign assets. Australia, however, has a high net foreign debt at 56% of GDP. Whilst Australian interest rates and GDP growth were much higher than other Advanced economies, the funding of Australia's current account and foreign debt positions was a non-issue. But with Australian rates and growth below other Advanced Economies, and particularly the US, funding Australia's net debt position may become more difficult.

Investment Implications

Given our views of Australian dollar weakness in the coming few years, it would also be beneficial to consider some unhedged exposure to international equities in your portfolio.

Source: Baillieu Holst Ltd

Big Data is fuelling the AI revolution

Strava is an app that athletes use to track, share and compare their exertions. The US company, for its part, can analyse the data generated by its users. For no particular reason, Strava recently hosted a 'heat map' of three trillion location points it had collected from one billion activities. What could go wrong? Just that it created one of the largest security breaches of recent years.

People used the data trails of folks exercising in remote areas to deduce the location of secret military bases and covert military activities across the world. The error of Strava's military users was to fail to 'opt out' of the default setting that shared their data.

The Strava saga highlights contentious issues surrounding 'Big Data', a term that describes the volunteered and observed information collected from internet users and connected objects. The issues include privacy, ownership, the privileges and responsibilities of data-gatherers and the ignorance surrounding Big Data's characteristics.

From an overarching perspective, the economic traits of Big Data, privacy issues and the lack of clear property rights around this core ingredient of the artificial-intelligence revolution prevent the growth of markets that would steer the data in an efficient and timely way to where it could generate the most benefit for the economy and society. The challenge for policymakers is to define ownership and encourage data markets while minimising the risks that Big Data can pose.

It must be said that the privately owned data-gatherers are conscious of their responsibilities to protect the data that is only valuable because these businesses found a way to commercialise it. The commercial imperative is such, however, that the more data that is gathered the more incentives the accumulators have to profit from that information. While artificial intelligence embeds itself further into everyday living, demand for data will only grow, and its controversial aspects and market failures will demand resolution. But it won't be easy. Big Data is different.

Question of ownership

The data-generated wealth of Big Tech has prompted many people to describe Big Data as the 'new oil'. That comparison, however, doesn't withstand scrutiny.

Oil, like any commodity, is indistinguishable across producers. Oil's supply is finite and it is single use. Oil's worth comes from the difficulty and expense of finding and extracting the substance from the earth. Ownership is usually clear-cut. These features mean that oil is easy to price and trade.

Data, on the other hand, is not a commodity because each dataset is unique. Its supply is infinite. Data is easy to gather, simple to copy and can be reused and multipurposed. The ownership of data is contentious. Privacy concerns restrict data's change of ownership and possible uses, and install security obligations on holders. Buyers are uncertain as to the worth of any dataset. These features make data difficult to price and trade.

One of the most pressing controversies surrounding Big Data is that Big Tech is generating massive gains from Big Data it collects and, by default, controls, and not providing enough in return to users or society.

Europe's response is to make laws that keep the ownership and control of Big Data with the subjects. Australia intends to pass a similar law.

Consumer-slanted data-ownership laws could help people place a value on their data while easing concerns about privacy violations. Such laws, however, usually prove problematic. The laws only cover a portion of the data collected. Compliance can be costly. People are often too complacent to reclaim their data ownership. And even with portable data, entrants to markets will find it hard to dislodge incumbent companies cemented in stranglehold positions by network effects.

As the nature of Big Data embeds it with complexities surrounding privacy and ownership among other issues, society will take a while to work out how to gain the most out of Big Data and minimise Strava-style hiccups.

Lonsdale strongly recommends that all clients take appropriate steps to ensure that their personal information and data is secure to prevent any unauthorised use.

Source: Magellan Group

Earning money from the sharing economy

The sharing economy has become a big part of daily life. It's become easy to hop on an app for a ride-share, find a place to stay or hire someone with skills you don't have to help you. Whether for some extra cash, or as your main job, you might be thinking about offering your services as well.

Here are three tips on success in the sharing economy

1. Paying tax on your earnings

You may need to pay tax on any income you earn from the sharing economy. The Australian Taxation Office recommends you keep records of all the income you earn and any expenses you have. In some cases, you might be able to claim deductions and you can find more information on this at www.ato.gov.au.

Remember that your earnings from the sharing economy count as part of your overall annual income if you have another job, or work multiple share economy gigs, so will influence your marginal tax rate.

There are a few ways you can manage tax payments. Some may choose to make periodic payments (on a time period you choose, such as monthly or quarterly), while others may decide to make a lump sum payment at the end of the financial year. Making a regular payment using a system like PAYG can be a helpful way of keeping track of and staying on top of payments. Otherwise, consider allocating a certain amount into a separate account to ensure you have the money ready to pay your tax when it is due.

Those renting residential property (or rooms in a property), may also need to consider Capital Gains Tax (CGT). Even if the property is otherwise your main residence, the portion of time you rent it out for gain can result in CGT being applied if you sell the property (see more information).

2. Insurance

If you already have insurance on your property or car, renting out a room or ride-sharing can affect your insurance policy. Check in with your provider to ensure you have the right protection for you and adjust your policy if you need to.

For those who don't already have insurance, it may be helpful to investigate different options with insurance providers to make sure you are protected in case of damage to your property, or any accidents that could occur while you are doing your job. Some third party providers like Uber and AirBnB also offer some limited insurance coverage when you partner with them, however, you should review their policy and any restrictions before relying on these as your primary cover.

3. Registering as a business and paying GST

When you decide to work in the sharing economy, you may need to consider registering as a business or sole trader to receive an Australian Business Number. You can register at www.ato.gov.au.

In addition, you might need to register for GST if your income from the sharing economy is $75,000 or more, or if you are working as a driver for a ride-share company. GST also applies to those renting out commercial residential spaces, such as hotel rooms, serviced apartments, Bed & Breakfasts or commercial spaces like function rooms and office spaces. You can find more information at www.ato.gov.au.

These are just a starting point. You might also think about a range of other activities like protective equipment and warranties, invoices, logbooks or even logistics for living off the sharing economy. You might also seek advice from a professional to help you understand and manage the finer details of items like setting up an ABN, paying your own tax or registering for GST.

At the end of the day, one of the most important things to remember when you work in the sharing economy is to keep yourself safe – you are your biggest asset.

Source: BT

How to help ensure your superannuation contributions don't exceed the caps

Changes in the superannuation contribution caps, which kicked-in last year, give an added reason to keep a close eye on your contributions.

From 1 July 2017, the concessional contributions cap was reset to $25,000 for everyone (irrespective of age).

For those earning a salary of $210,000 or more – the compulsory Employer Superannuation Guarantee of 9.5% will total around $20,000 a year and will see your contributions edge close to the cap. For those making additional concessional contributions, such as through salary sacrifice – they may be close to reaching the maximum if they are earning $180,000 (including superannuation guarantee) and contributing an extra 3% or earning $150,000 (including superannuation guarantee) and contributing an extra 5%. In certain cases, employers will match an employee's additional contributions and in this case, the concessional cap might be exceeded.

Going forward, the concessional cap will increase in increments of $2,500 (not $5,000 as was previously the case). There is a formula the ATO applies to determine when indexation takes place, and the concessional cap will remain at $25,000 for 2018/19 also.

From 1 July 2017, the annual non-concessional (after tax) contribution cap reduced from $180,000 to $100,000 per year.

However, the non-concessional cap will be nil for a financial year if you have a total superannuation balance greater than or equal to the general transfer balance cap ($1.6 million in 2017–18) on 30 June of the previous financial year. As a result, if you had more than $1.6m in super at 30 June 2017, you cannot make further non-concessional contributions this year. You may, however, still be able to make or receive concessional contributions up to the $25,000 cap.

Provided you are under 65 or aged between 65 and 74 and meet the relevant work test, and meet all other requirements, you may be able to make contributions to super this year. But it is important to monitor your level of contributions as penalties can be imposed where you exceed the relevant caps.

Using the 'bring forward' rule for your contributions

There are special circumstances where you may exceed the annual non-concessional cap amount, and this is called the 'bring forward' rule. The rules have become more complex since 1 July 2017.

How it works is if you are under 65 and have less than $1.5m in super as at 30 June 2017, you may be able to contribute at least $200,000 as a non-concessional this financial year. If you had less than $1.4m at that time, you may be able to contributeup to $300,000.

However, you might not be able to do this if you started using the bring forward rule in either of the last two financial years. Or the amount you can contribute might be reduced.

The amount you contribute this financial year may impact how much you can contribute in future years, and each year you still need to have less than $1.6m (or the relevant general transfer balance cap for that year) in super in order to make further contributions.

Contribution rules and limits can be difficult to follow, so it may be worth seeing help from a professional adviser to work out what your options are.

Lonsdale strongly recommends that clients who have any potential concerns regarding super contributions or contribution caps, that they contact their adviser immediately.

Source: BT

Lessons from the market

Every market cycle – bull or bear – provides opportunities for investors to improve their process for investing. The best thing to do is learn from past events and apply those lessons to your future investment strategies and circumstances. Here are the top five lessons you can use to help navigate towards your future desired outcomes.

Lesson 1: Keep your cool

This is the most important learning from recent times. Through market cycles, it's easy for investors to react emotionally– through overconfidence in rising markets or, equally, reacting with fear in falling markets. **The best way to reach your financial goals is to remain cool and stick to your long-term investment strategies.** History has shown that markets tend to recover just as quickly as they fall.

Lesson 2: Stay invested.

While short-term market falls are hard to ignore, it's essential to stay invested. **In fact, long-term investment discipline is more important than ever especially in a market crisis.** Markets move in cycles, and that historically each bear market has been followed by a bull market. Therefore, if you remove your investment during a down market, you won't benefit when the market rebounds.

Successful investors understand the importance of sticking to the plan. Those who have built a robust investment strategy, with appropriate diversification, and successfully navigated many market gyrations along the way, keep the 'plan' front of mind in the midst of market volatility and emotional ups and downs.

Lesson 3: Diversification still works.

Without the knowledge of which asset classes or sectors will outperform, the key is to diversify. **Trying to pick the best-performing asset class of the year is very risky, considering that one year's best performing asset class can just as easily end up as the next year's worst performer.** We believe that a sound, well-diversified portfolio with a long-term focus will help reduce volatility and provide steady, consistent returns over the years.

Lesson 4: Investing in the markets is the primary way to meet retirement and financial goals.

The markets can be tough on your nerves, but despite this, it's important to discount short-term market performance when considering your longer-term financial objectives. Investing is still the most prudent approach to beat inflation and help realise your long- term financial objectives.

Lesson 5: Markets are cyclical. Whatever goes down will likely come back up again.

Markets follow cycles of ups and downs. What we don't know is their timing or duration. The global share market experienced strong gains in 2009 following the downturn which commenced in late 2007 and more recently, some global markets (such as US shares) have reached historic highs. **The point is that markets typically recover.**

Different asset classes – like shares, bonds and property securities – carry various levels of risk and return. Investing in a single asset class is risky when you consider no one asset class consistently outperforms on a regular basis.

Strategically diversify your portfolio across asset classes, investment strategies, managers and styles. This approach aims to reduce risk and can help you weather different seasons of the market, no matter which asset, strategy or style is in favour at any given time.

Lesson 6: Partner with a professional adviser to choose strategies aligned with your personal goals.

Investing is personal. It's so important to make sure that your strategies are well suited to your goals, life stage, risk tolerance and other specific factors that matter to you. A professional financial adviser can help you design a plan based on your personal needs—and stay on track over time.

Key Learnings

With recent market volatility, investors may consider making changes to their investment strategy and perhaps exiting markets altogether. However, years of lows and highs – such as 2008 and 2009 – help to demonstrate the key principles of investing:

- **Diversify** – it's essential to have a well-diversified portfolio to help lessen the impact of market downturns.
- **Stay invested** – don't miss your opportunity for financial gains when the market recovers. You have to be in it to win it.
- **Concentrate on the long term** – short-term market returns shouldn't concern the long-term investor.
- **Don't try to time the markets or pick next year's winner** – no one knows when markets will peak and trough, and which asset class will outperform. Consider working with a professional financial adviser to help choose investments aligned with your personal goals.

Source: Russel Investments

Top 5 Risk Management Tips

Morphic Asset Management's Head of Macro and Risk Geoff Wood outlines five tips we apply to manage risk.

1. Work out how much you're willing to lose on any investment.

Don't get too carried away with thinking about the wins too early. While you can't control the outcome of an event, you can control how much you're willing to lose. Controlling the losses is what is part of making a good portfolio that gives good returns over the long run.

2. Plan your exit strategy.

Ask yourself, what is it that it's going to take either in price movement or fundamental news flow for you to admit that you're wrong? It's good to think these things through in advance. We say, what does wrong look like? That means that when you're in the heat of the moment and your investments moved against you and you're losing money, you're not selling in a rash moment. You've thought about this in advance and you have a plan to stick to.

3. Work out your position sizing.

Once you've got your amount you're willing to lose and the price that you're going to admit you're wrong at, you can back out the size that your investment needs to be. That can ensure that you've got consistent sizing across all the investments inside your portfolio.

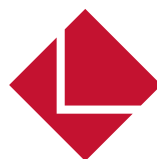
4. Keep an investment log.

It's very important and good discipline, we find, to write down and keep an investment log. You want to write down where you are in an investment, how much you are willing to do, and the reasons you're in it. This helps keep you consistent, and once again it stops panic selling and making rash decisions.

5. Accept your mistakes and learn from them.

Investing, like any competitive discipline, involves making mistakes. Typically, the best investors are those that made the most mistakes and then learned from them and kept getting back up. We'd recommend that you write down the mistakes that you make as you go along and then keep learning from those. Put them in a point that you can see. Maybe it's next to your desk. Try and reemphasize these points and retrain your mind so that you don't make these bad habits time and time again.

Source: Morphic Asset Management Pty Ltd



LONSDALE

Lonsdale Financial Group Limited
ABN: 76 006 637 225
AFSL: 246934
Level 6, 161 Collins Street
Melbourne VIC 3000

McArthur Financial
45 Cameron Street, Launceston TAS 7250
Ph: 0418 575 496
www.mcarthurfinancial.com.au

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