NEWSLETTER

Spring Edition

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What's happening in the markets

In August, there were varied levels of confidence across economies globally. While there are positive signs of recovery, the fear remains as we continue to see a ‘second wave’ of COVID-19 cases. The effectiveness of new stimulus introduced by Governments and Central Banks will weigh heavily on the success of the global economic recovery going forward.

Market Update

Developments in the Australian economy

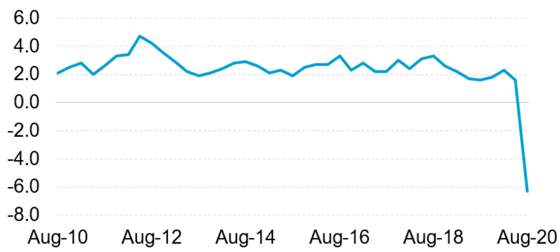
Australian Treasurer Josh Frydenberg has commended the country's economic resilience throughout the COVID-19 pandemic during Question Time in Parliament. Frydenberg commented on the 'staggering' impact the virus has had on GDP around the globe, such as in the UK – where GDP fell by 20%. Despite the devastation seen across the global economy, Australia is expected to see a significantly smaller decrease in GDP compared to other countries. Even with Australia's stronger performance, the RBA have noted that the restrictions in Victoria are likely to offset any of the potential uplift in GDP growth over the next quarter.

Developments in financial markets

Uncertainty remains for the JobKeeper and JobSeeker "2.0" payment schemes as they are set to be the main topics of debate when parliament sits in September. Legislation is needed to pass through the senate prior to the current scheme's expiry at the end of the month. It is expected that employers will need to re-apply for the scheme, with the flat rate payments also being lowered. The RBA commented that the effect of a less supportive JobKeeper scheme will likely lead to job losses that weigh on the labour market and offset any potential employment growth across the country.

The Westpac-Melbourne Institute Index of Consumer Sentiment collapsed by 9.5% to 79.5 in August, a similar level to when Australia entered national lockdown in March. This fall is attributed to Victoria entering stage 4 lockdown restrictions, along with 'hot spots' appearing across the country. Interestingly, NSW's sentiment fell 15.5% alone, significantly higher than that of Victoria at 8.3%. These figures allude to a fear of a second wave outbreak across other states.

Chart 1: Australian GDP Annualised

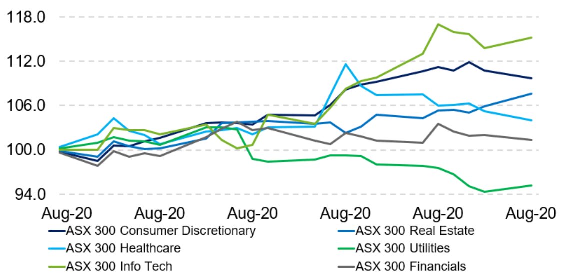


Source: BTIS/Bloomberg

Australian shares

The recovery in Australian financial markets continued over the month of August, acting as a sign of consumer and business sentiment beginning the path towards normalised conditions. The ASX All Ordinaries rose +3.10% over August; with the ASX300 Accumulation rising +3.05%. over the month, the Information Technology sector led the charge with a +15.28% lift, followed by Consumer Discretionary, +7.80%, A-REITs, +7.71%, Real Estate, +7.34%, Health Care, +3.93%, and Industrials, +3.63%. All other sectors closed in the red, with the harshest results being Communications (-5.16%) and Utilities (-5.85%).

Chart 7: Australian Shares (rebased to 100)

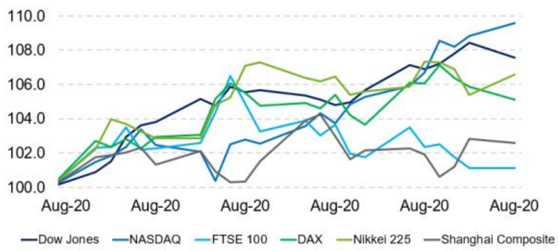


Source: BTIS/Bloomberg

International shares

International markets saw a larger rebound, with the MSCI World ex Australia Unhedged up +3.47% from July. Our New Zealand counterparts had a disappointing result, with a drop of -1.79% over August, compared with their +2.42% July rally. The United States trumped other countries' performance over August, once again lead by tech stocks (the Nasdaq Composite), which rallied +9.59%. The DOW is up +7.57% and the S&P 500 closed at +7%. European shares have a new-found energy, with the Euro STOXX rising +2.52%. The strongest contender was once again the German DAX index, which rose +5.14%, followed by France's CAC All Share Index up +3.42%, and Italy's FTSE MIB at +2.84%. The UK's FTSE 100 bounced back from their disappointing -4.41% drop in July to close +1.12% up in August. Asia's markets showed some stirring performance over August. Japan's Nikkei had an impressive rebound from their -2.60% slump over July to leading Asia with a +6.59% result in August. The Korean KOPSI was up +3.41%, followed by China's Shanghai Composite up +2.59% and the Hang Seng index up +2.37%.

Chart 8: Major Market Indices (rebased to 100)



Source: BTIS/Bloomberg

Fixed interest

In Australia, long-term Treasury yields increased noticeably, signalled by the steepening of the yield curve. August ended with the 3-year/10-year spread widening from 15bps to 68bps. Respectively, the 3-year/20-year spread was 15bps higher at 126bps.

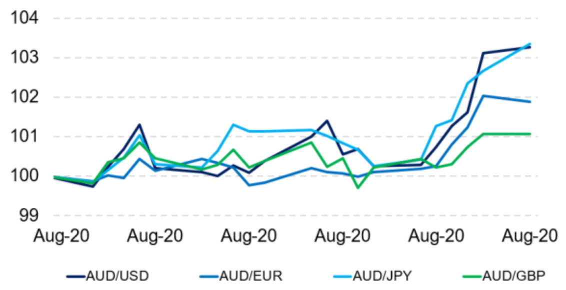
Additionally, the Bloomberg AusBond Composite (0+Y) fell -0.42%, a negative change from the +0.18% return seen in the previous month.

Over in Europe, the Barclays Global Aggregate TR Hedged also saw a significant fall of -0.71%.

Currencies

The AUD/USD has continued to increase throughout August, continuing its upward trend over the last few months. Finishing at 0.7376, the AUD/USD experienced a +3.26% increase this month. The Euro has once again performed well against the USD, with a +1.34% rise to 1.1936. Moreover, the GBP similarly strengthened against the USD again, increasing by +2.18% to 1.337.

Chart 9: Major Currencies (rebased to 100)



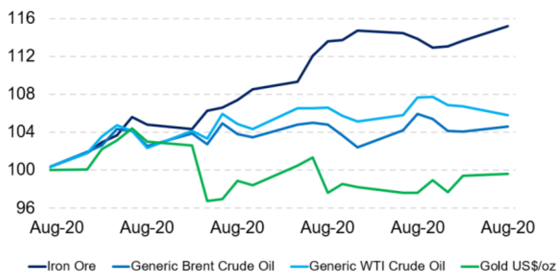
Source: BTIS/Bloomberg

Commodities

Commodities saw strong returns throughout August. Iron ore was a significant outperformer, as it increased +15.19% to a month end price of US$125.84. Gold saw a slight drop after strong performance in the previous month, falling -0.41% to US$1967.8.

Oil has continued to bring investors sizeable returns. Over August, Brent Crude Oil was up +4.57% to US$45.28 while WTI Oil increased +5.81% to US$42.61. These results were reflected in the Bloomberg Commodity Index which increased +6.75% to 73.3150.

Chart 10: Major Commodities (rebased to 100)



Source: BTIS/Bloomberg

The top five risks to global investors

Low returns globally, growth in China, the "failure" of quantitative easing, Donald Trump and the transition of Australia's economy: these are the top five issues you'll be facing as an investor in the coming years.

In a recent webinar, UBS' head of investment strategy for Australia and New Zealand, Tracey McNaughton, noted that 2016 has been a "challenging year". It is, after all, the year that saw two major geopolitical events occur that almost no one anticipated - not the markets, not the political commentators and certainly not the relevant politicians themselves. What is important to remember, aside from learning to expect the unexpected, is that events like these will have long-term impacts on global markets.

According to McNaughton, we're now in a world where growth in emerging economies is rapidly outpacing developed markets. Inflation is low across the board, except in high-risk markets like Russia, Brazil and South Africa. Interest rates and bond yields have fallen, in some cases well below the zero line, and investors have been capitalising on this because bond prices are inversely proportional to yields.

All of this means that investors are now in an unusual environment where risk no longer directly correlates with return.

This ties into the next issue McNaughton highlighted: China. While she said UBS was generally "relaxed" on China at the moment due to the government's strong fiscal stimulus, there remained the looming problem of the Chinese housing market. House prices have risen massively, and 40% of household wealth in China is held in residential real estate. Should China's potential housing bubble burst, this could have significant ramifications on the global economy.

The last time the housing market saw a correction in a major global market was during the Global Financial Crisis (GFC). Which brings us to the third issue McNaughton mentioned: the gradual failure of quantitative easing. She noted that since 2008, there have been 670 interest rate cuts around the world - or, one every three working days.

These cuts were designed to stimulate local economies, but it hasn't stopped growth stalling in developed markets across the board. One of the main reasons for this, McNaughton said, is that developed markets are also usually ageing ones, which means there are fewer people in the workforce, and this usually translates to lower growth.

Lower economic growth and fewer employment opportunities also played a significant part of the narrative behind the election of Donald Trump as President of the United States. Economies have been reliant on monetary policy since the GFC, and this has put upward pressure on asset prices, meaning lower-income workers have had an increasingly difficult time purchasing those assets (housing in particular).

McNaughton said, "Not everybody owns equities and not everybody owns houses, and so as a result of those 670 interest rate cuts, there’s been large proportions of electorates right around the world who have been left behind."

Trump's campaign, she added, reflected similar populist movements erupting around the world, which she argued "hampers the ability for governments to govern".

Australia isn't immune to this type of movement. Due to voters' increasing preference for third parties and independents, we're now in a position where minority governments are becoming the norm. This makes it more challenging than ever for the elected government to get proposed legislation passed in parliament, which can obstruct economic reform. This isn't just because governments are trying and failing to pass reforms; it's also because, as McNaughton said, "Politicians are making policy just for the next election and not for the longer term. This is unfortunate, because we're right at the time where we need governments to step up and support the central banks, and this unfortunately is at a time when they have limited capacity to do so."

Having said that, McNaughton said UBS was "fairly optimistic" on Australia given its 25 years of uninterrupted economic growth, even through the GFC. While Australia's earnings growth has fallen due to the collapse in commodity prices, this trend appears to be gradually reversing.

Summing up her macro analysis, McNaughton said investors should be looking at equities opportunities in emerging markets and the Eurozone and bonds in Australia. In terms of currencies, she recommended looking to the euro, the US dollar and the Japanese yen.

Source: Netwealth

What assets can you have before losing your pension?

There are many benefits to receiving a pension or even a part pension, but there are limits to the level of income or assets you can have to be eligible.

Regarding assets, the key limits as at 20 March 2020 are as follows[1]:

To receive a full pension, assets (excluding the value of the primary residence) must be less than:

	Homeowner	Non-homeowner
Single	$263,250	$473,750
Couple	$394,500	$605,000

Indexed every 1 July. Source: Australian Government Department of Human Services[2].

To receive at least a part of a pension, assets must be less than:

	Homeowner	Non-homeowner
Single	$578,250	$788,750
Couple	$869,500	$1,080,000
Couple – separated by illness	$1,024,500	$1,235,000

Indexed every 20 March, 1 July and 20 September. Recipients of Rent Assistance will have higher thresholds. Source: *Australian Government Department of Human Services[3].*

There are a number of strategies that may be used to reduce asset levels, which may result in qualifying for a part pension or increasing the current pension amount received.

However, before reducing your assets it is important to bear in mind whether your remaining savings can support any shortfall in your retirement income needs, as any increased pension amount may still be inadequate. Personal circumstances can also change and increase the reliance on your reduced savings. For example, future health issues may require a move into aged care, which can bring increased expenses.

With that in mind, here are six possible asset reduction strategies:

1. Gift within limits, or more than 5 years before qualifying age

If there is a desire to provide financial assistance to family or friends, gifting may be able to reduce your assessable assets. The allowable amounts a single person or a couple combined may gift is $10,000 in a financial year or $30,000 over a rolling five financial year period. Any excess amounts will continue to count under the assets test (and deemed under the income test) for five years from the date of disposal. This is called deprivation.

If you are more than five financial years away from reaching your age pension age or from receiving any other Centrelink payments, you can gift any amount without affecting its eventual assessment once you reach Age Pension age.

2. Homeowners can renovate

Your home is an exempt asset and any money spent to repair or improve it will form part of its value and will also be exempt from the assets test.

3. Repay debt secured against exempt assets

Debts secured against exempt assets do not reduce your total assessable assets. An example is a mortgage against the family home. However, using assessable assets to repay these debts may reduce the overall assessed asset amount. Crucially, you must make actual repayments towards the debt; depositing or retaining cash in an offset account is unlikely to achieve this outcome.

4. Funeral bonds within limits or prepaying funeral expenses

If you wish to set aside funds or pay for your funeral costs now, there are a couple of ways to do this which may reduce your assessable assets.

A person can invest up to $13,250 (as at 1 July 2019) in a funeral bond and this amount is exempt from the assets test. Members of a couple can have their own individual bond up to the same limit each. By contrast if a couple invests jointly into a funeral bond, this must not exceed $13,250, not double the individual limit[4].

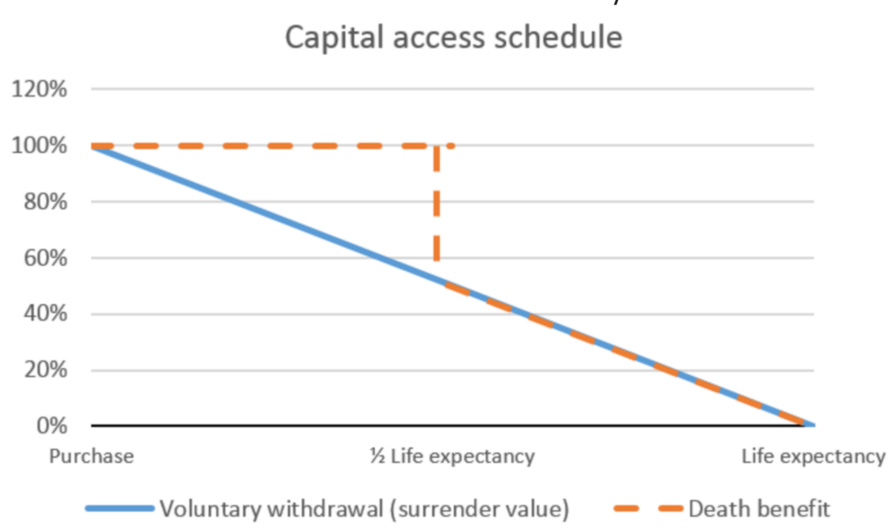
In comparison, there is no limit to the amount spent on prepaid funeral expenses. For the expenses to qualify, there must be a contract setting out the services paid for, state that it is fully paid, and must not be refundable. Importantly, both methods of paying for funeral costs are designed purely for this purpose preventing assets being accessed for any other reason.

5. Contribute to younger spouse's super and hold in accumulation phase
If you have a younger spouse who has not yet reached their age pension age and is eligible to contribute to super, contributing an amount into their super account may reduce your assessable assets. The elder spouse may be able to withdraw from their own super, generally as a tax-free lump sum, to fund the contribution.

Generally, investments held in the accumulation phase of super are not counted towards a person's assessable assets if the account holder is below age pension age. Before using this strategy, you may want to think about any additional costs that may be incurred. Holding multiple super accounts may duplicate fees. Shifting funds into an accumulation account may increase the tax on the earnings on these investments to as much as 15%. Alternatively, earnings on the funds, may be tax-free if invested in an account-based pension or potentially even personally.
Additionally, contributing to a younger spouse who is under pension age and still working may 'preserve' these funds. However, you may want to consider whether contribution caps will be exceeded[5].

6. Purchase a lifetime income stream
Lifetime income streams such as an annuity purchased after 1 July 2019 may be favourably assessed, according to the Social Services and Other Legislation Amendment (Supporting Retirement Incomes) Bill 2018[6]. Where eligible, only 60% of the purchase price is assessed. This drops to 30% once the later of age 84 (based on current life expectancy factors) or five years occurs.

To receive concessional treatment, the lifetime annuity must satisfy a 'capital access schedule' which limits the amount that can be commuted voluntarily or on death[6]. This is illustrated below:



Source: Parliament of Australia[7].

Voluntary commutations must follow a 'straight-line' declining value, falling to nil at life expectancy. The death benefit can be up to 100% until the investor reaches half of their life expectancy, at which point it will follow the voluntary withdrawal value.

Conclusion
Reducing your assessable assets within the relevant assets test threshold may provide provide benefits such as increasing your existing pension or allowing you to qualify for a part pension, if you were currently above the upper asset test threshold.
While it may be tempting to intentionally reduce your asset levels to gain these benefits, it is important to remember the payment rate is determined by applying both an income and assets test. The test that results in a lower entitlement determines the amount payable. If the income test is the harsher test, reducing your assessable assets may provide little or no benefit.
If the assets test is harsher, you should not lose sight of the fact that any reduction in your assets may mean that there are fewer assets for you to call upon if required.

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Source: BT Financial Group

https://www.bt.com.au/insights/essentials/2019/09/what-assets-can-you-have-before-losing-pension.html

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