PortfolioWatch

Quarterly newsletter – Summer 2017

Aussie market **subdued**

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Australian market subdued

The Australian market continued to lag international markets through the September quarter as the S&P/ASX 200 index struggled to break out of its narrow trading range.

This can be attributed to mixed economic indicators. Business confidence was weaker, falling below its long term average for the first time since mid-2016. This was due to concerns over customer demand, margin pressure and government policy. Business confidence did lift in September with the construction industry leading the way but the retail sector continues to struggle.

Consumer confidence is also weak and remains in pessimistic territory due to concerns over housing affordability, interest rates and rising energy prices.

More sanctions for North Korea

North Korean missile tests, South Korean bombing drills and North Korea's war of the words with Donald Trump have increased geopolitical tensions over the last few months. This has prompted a global response in order to tighten the screws on the country.

The UN Security Council has adopted new sanctions on North Korea including limits on oil exports to the nation, a ban on textile imports and the prohibition of work authorisations for North Korean citizens working overseas. China has also ordered North Korean companies operating within China to close up shop within 120 days, a shift in the close relations the two nations have held since the Korean War (1950-1953). If enforced, the order will have a significant impact on the North Korean economy given that China is its largest trading partner. However, China's main priority is still regional stability in order to support the legitimacy of the Chinese Communist Party. War in the region is therefore not an option for China and it remains to be seen whether they will stringently enforce sanctions on North Korea.

Investors have not been deterred by the escalation in geopolitical tensions with North Korea. Markets seem to have grown immune to hydrogen bomb tests and missile launches for example. While North Korea remains a tail risk for financial markets, it's unlikely that markets will be significantly affected unless the situation evolves into armed conflict.

German federal election

At the outset of 2017, the German federal election was viewed as a key risk to financial markets due to the rise of populist and anti-EU political parties during the last few years. However, Angela Merkel's centre-right Christian Democratic Union (CDU) party held a commanding lead in the polls from April onward. Financial markets therefore anticipated that Merkel's CDU party would claim the most seats in the Bundestag (national parliament) and would retain the position of Chancellor of Germany that she has held since 2005. Polls got the call right and as a result the market reaction was muted. However, the process of forming a coalition government will be difficult for Merkel given the decision by the Social Democrats (20 per cent of the vote) to discontinue their 'grand coalition' with the Christian Democrats (33 per cent of the vote). Merkel will have to negotiate with the Free Democratic Party and the Green Party in forming a coalition and this may take some time.

The election result did surprise investors in one respect. That is, the election result followed the widespread occurrence over recent years of right wing parties gaining support thanks to regional voters and those who do not normally vote. Surprisingly, right wing party Alternative for Germany placed third with 13 per cent of the vote which gives it a better platform to expand its support base and agenda. Although Merkel won the election, it came at a cost because her campaign had poorly defined initiatives regarding social security, unemployment and economic welfare. While markets expected Merkel to win the election, they did not expect such strong support for the right wing party which highlights the fact that populist parties have gained supporters and the risk of protectionism has not disappeared.

Secure your children's future education

Giving a child a good education is one of the best things you can do as a parent or grandparent. But what if you weren't around to help make it happen? Fortunately, you can put plans in place in your Will to make sure your children's or grandchildren's inheritance goes towards their education.

Usually, when you die, any inheritance your beneficiaries receive becomes part of their personal assets and are under their control. There's no guarantee that they will use their inheritance for any particular purpose, such as their education.

An education fund established through a testamentary trust in your Will is a tax-effective and flexible way to provide for the education of your children or grandchildren.

Case study

Rob and Amber have two teenage children who are their beneficiaries. They are worried that, in the event of their deaths, their children will not be mature enough to use their inheritance responsibly. They wish to establish an education fund.

As a result, Rob and Amber's Wills state that 40 per cent of their children's inheritances will be held in an education fund with the following terms:

- Until the beneficiary turns 30, their access to the income and capital of the trust is limited to specified purposes, such as:

education expenses, including HECS liabilities

hospital and medical expenses

rent or accommodation charges

- If the children gain a certain level of tertiary education by the age of 30 they are given full control of the trust. If not, the remaining balance of the education fund will be given to charities as chosen by Rob and Amber.

An education fund ensures that your children are adequately supported, but also gives them an incentive to further their education.

For further information please speak to your **financial planner**.

Source: Australian Executor Trustees

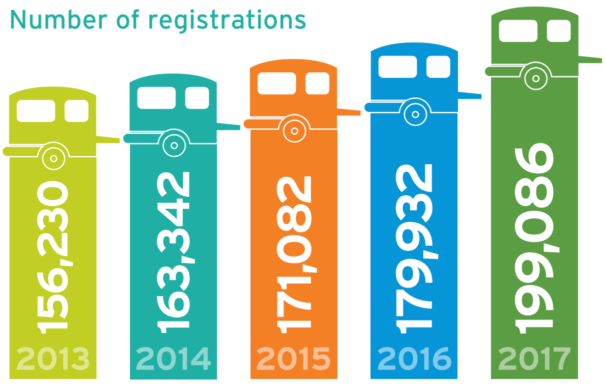
A caravan to call home

Whether you're looking for a holiday away from the daily grind or a longer adventure as part of your retirement plans exploring this great southern land is a must.

From the aqua blue waters of the Great Barrier Reef to the breathtaking burnt red of our rich, dusty centre, caravanning is a great way to explore Australia.

It's certainly a popular choice. Since 2013 the number of caravans registered in Australia has grown by over a third[1]. And, if you live in Queensland you're more likely to own a caravan than any other state.

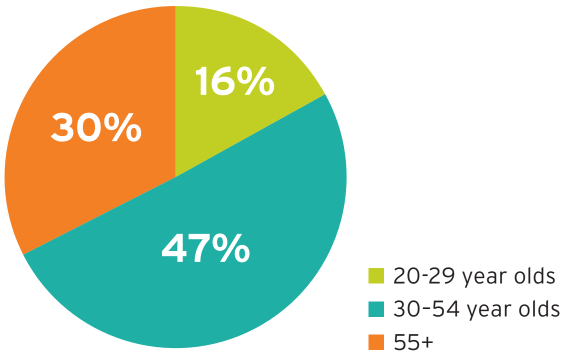
Number of registrations



Combined registrations for caravans, camper trailers and motorhomes between April and June each year.

And it's not just for the older generation with 30 to 54 year olds making up 47 per cent of the caravan and camping visitor market[2].

Caravaning by age



Happy campers

It's no wonder caravanning is becoming more popular. The Caravan Industry Association of Australia's 'Real Richness'[3] study found that Australians who go camping are "more satisfied, happy, optimistic and energised than those who do not go camping". From the study, campers said that camping makes them "more productive, more grounded, more in touch with nature, healthier and gives them the time they need to gather their thoughts. What's more, they are also less stressed, frustrated, bored and lonely."

> "The study also revealed that in the past two years, 7.1 million Australians, in various groups of travellers, have gone on a caravanning or camping holiday."

1 Caravan Industry Association of Australia 'Trade registration report' 30 June 2017

2 Caravan Industry Association of Australia 'Latest Caravan and Camping Visitor Snapshot' 28 June 2017

3 Caravan Industry Association of Australia's 'Real Richness' study. "Camping" included holidays in swags, tents, tent trailers, camper trailers, caravans, campervans, motorhomes and cabin accommodation.

Investing in a caravan

If you want to join the caravanning 'scene' and you're thinking of investing in a caravan, you'll want to weigh up the considerations and costs. Many people rent first. It gives you the chance to try before you buy. Then, when you go ahead and buy, you'll know what features to look for.

Buying a caravan is a big investment. Not just because of the upfront cost. You'll need to budget for ongoing maintenance, registration and insurance. And, there's the cost of the holiday itself. Fuel is a major expense and can be much higher in remote areas. There's also the cost of camping fees, activities such as tours and National Park entry fees.

For some, there may be an opportunity to fund your trip by renting out your home while you're away or, if you're going on a longer trip, doing some occasional work along the way.

Grey Nomads

'Grey Nomads' is a term used to describe people who are usually retired or taking a career break and travel around Australia. Some take over a year to circumnavigate the country. Or, another popular option is to travel north in winter each year to avoid the cold in the southern states and enjoy some warmth.

Even if you're not retired, the Grey Nomads website is a great resource to help plan a trip, look up upcoming events, read blogs and interviews about other people's experiences and information on the destinations they've visited. There's even a classifieds for buying and selling caravans and volunteering opportunities.

What are the perks?

Buying your very own home on wheels has its perks.

- You can go anywhere you're comfortable to drive.
- You can leave anytime.
- Everything can be customised to suit your preferred style of caravanning, such as bigger water tanks or other luxuries.
- Unlike cars, which depreciate rapidly the second you take ownership, caravans are more likely to retain their value should you decide to sell later on.

So, it's time to stretch those caravanning legs, but where to first? The options are endless. You could drive around the Australian border, criss-cross through the centre or base yourself in one place and plan shorter day trips. Or you could follow specific points of interest, such as wine regions, beaches or historical country towns.

So, start making tracks.

Contact your **financial planner** to help manage your big investments and make your aspirations a reality.

Investment market review Quarter ended 30 September 2017

Australian shares

The S&P/ASX 300 Accumulation Index underperformed most global markets in the September quarter.

The index was up 0.8% driven by mixed economic indicators and a marginally disappointing reporting season. The key themes to come out of reporting season were moves toward capital expenditure at the expense of dividends and capital returns, disappointing cost guidance and earnings growth skewed to resources. On a sector level, the best performers were energy up 5.9%, materials up 5.0% and consumer staples up 2.1%. The worst performing sectors were telecommunications down 18.3%, utilities down 7.1% and health care down 6.1%.

	1 year (%)	5 year (% pa)	10 year (% pa)
Australian shares	9.0	9.9	2.9

Listed property trusts

The A-REIT sector generated a positive return of 1.9% for the September quarter despite a rise in bond yields that would normally see a move away from bond proxies such as A-REIT's.

A-REIT's performance was in line with guidance during reporting season but it was evident that many were impacted by softer retail conditions. As a result, retail underperformed office and asset managers.

	1 year (%)	5 year (% pa)	10 year (% pa)
Listed property trusts	-2.0	13.2	-0.4

International shares

Global markets had a strong quarter with the MSCI World Index in Australian dollar terms recording a gain of 2.8%.

The strength can be attributed to improving corporate earnings, economic fundamentals and forward looking indicators such as purchasing manager indices. The synchronicity of these improving factors across the globe is something that hasn't been seen in a number of years and it is providing a lot of support for risk assets. US shares continued to hit all-time highs with buying appetite fuelled by Donald Trump's plan to overhaul the US tax code. Investors weren't deterred by a further escalation in geopolitical tensions between the US and North Korea. North Korea remains a tail risk for financial markets but risk assets are unlikely to be deterred unless the situation evolves into armed conflict. The S&P 500 gained 4.0%, the FTSE 100 was up 0.8%, the German DAX 30 was up 4.1% and the Nikkei 225 was up 1.6%.

The US Federal Reserve announced that balance sheet normalisation will begin in October in a gradual and predictable manner. There is no precedent for a quantitative easing unwind like this which makes it difficult to gauge how markets will react.

	1 year (%)	5 year (% pa)	10 year (% pa)
International shares	16.2	18.1	6.1

Fixed interest

The Australian 3-year bond yield was 24bps higher at 2.15% and the 10-year rose 24bps to 2.84%.

The US yield curve flattened with the 3-year bond yield rising 8bps to 1.62% and the 10-year rising 3bps to 2.33%. Yields rose as President Donald Trump and Congressional Republicans unveiled a plan to overhaul the US tax code and reduce both corporate and individual tax rates. A moderately hawkish US Fed statement including a confirmation that the Fed will begin shrinking its $4.5 trillion balance sheet in October, also helped yields move higher.

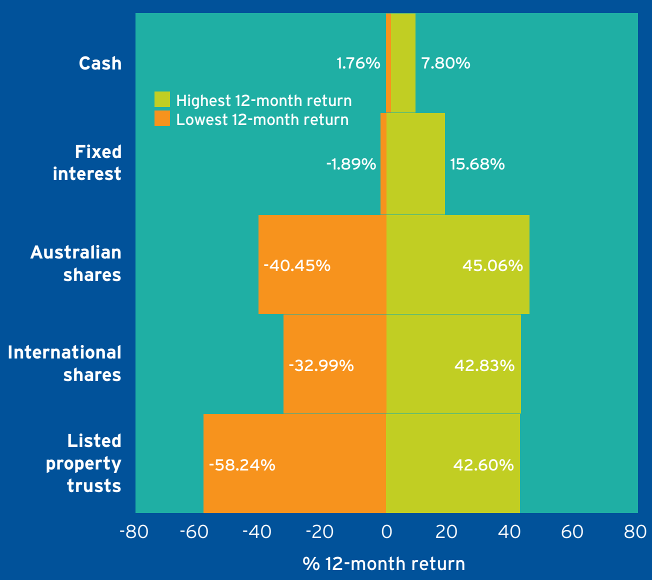
	1 year (%)	5 year (% pa)	10 year (% pa)
Fixed interest	-0.8	3.9	6.1

Cash

The RBA left the cash rate unchanged at a historical low of 1.50% in the September quarter, maintaining their concern over low wage growth, high levels of household debt and Australian dollar appreciation going into the early September meeting, stating it could result in a "slower pick-up in economic activity and inflation".

	1 year (%)	5 year (% pa)	10 year (% pa)
Cash	1.8	2.4	3.8

The long view



This chart displays the highest and lowest 12-month returns of the major asset classes since December 1997.* As you can see, cash provides stability and security, having never generated a negative return over a 12-month period. The trade-off for this stability and lower risk is that cash will be unlikely to match the higher returns generated by other asset classes.

Source: Morningstar. Indices used are: Cash – AusBond Bank Bill; Fixed Interest – AusBond Composite 0+ year; Australian shares – S&P/ASX 300 Accumulation; International shares – MSCI World Accumulation Index (AUD); Listed property trusts – S&P/ASX 300 A-REIT Accumulation.

* The listed property index is only available from June 2001 and the international shares index is only available from January 1999.

Self-service super contributions

The 1 July 2017 super reforms have opened up a fantastic new opportunity to build wealth in super and reduce your tax bill at the same time. That is, it's now easier to claim a tax deduction on your personal super contributions than ever before.

Before 1 July 2017, the only way most people could take advantage of the concessional (before-tax) contributions tax benefits was by salary sacrificing through their employer. Some people, such as the self-employed, could make voluntary personal contributions to super and claim a tax deduction but, most people were simply ineligible.

Now, anyone[1], not just the self-employed, can make voluntary personal contributions to super and claim a tax deduction.

This gives you more flexibility if your employer isn't in a position to arrange salary sacrifice for you – such as a small business owner who doesn't have the time to provide this service to their employees.

As an employee, you rarely have control on the timing of the salary sacrifice contributions made by your employer. This gives you that control so, for instance, you can time your final contributions leading up to 30 June each year and make the most of your contribution limits and the resulting tax benefits.

Remember, concessional contributions are contributions you can make to super either with your before-tax salary or by claiming a tax deduction on after-tax contributions. Either way, for most people, concessional contributions are taxed at just 15 per cent – not your marginal tax rate which could be as high as 47 per cent.

Getting started

To claim a tax deduction on your super contributions make sure you:

- Check the age restrictions to make sure you're eligible. There is a work test if you are age 65 to 75.
- Lodge a 'notice of intent to claim a deduction' to your super fund within the timeframes.

This change represents an opportunity for everyone, including those who are currently salary sacrificing, to gain greater control of their personal super contributions.

Super opportunity for downsizers

After 1 July 2018, if you're over 65 and sell a property, there may be a new opportunity to contribute more to super. If passed by parliament, you will be able to use some of the money from the sale to make a 'downsizer contribution' to super. The property does not need to be your current home. It can be your or your partner's former home as long as you or your partner have owned it for more than 10 years and lived in it at some point in your life.

If you're thinking of selling a property in the near future, please speak to your financial planner first and don't miss this potential opportunity.

If you have any questions, please speak to your **financial planner**.

1 Note: Fund and age restrictions apply.

Sydney
Level 28, 31 Market Street, Sydney NSW 2000
t 02 8262 4000 **f** 02 9283 6331
e sydney@aptwealth.com.au

Melbourne
Level 8, 360 Collins Street, Melbourne VIC 3000
t 03 8779 5254 **f** 03 8779 5262
e melbourne@aptwealth.com.au

Geelong
24 Moorabool Street, Geelong VIC 3220
t 03 5221 7557 **f** 03 5222 5037
e geelong@aptwealth.com.au

Apt Wealth Partners Pty Ltd ABN | 49 159 583 847 | AFSL Number 436121

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