MONEYNEWS
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# Market Review and Outlook 2015

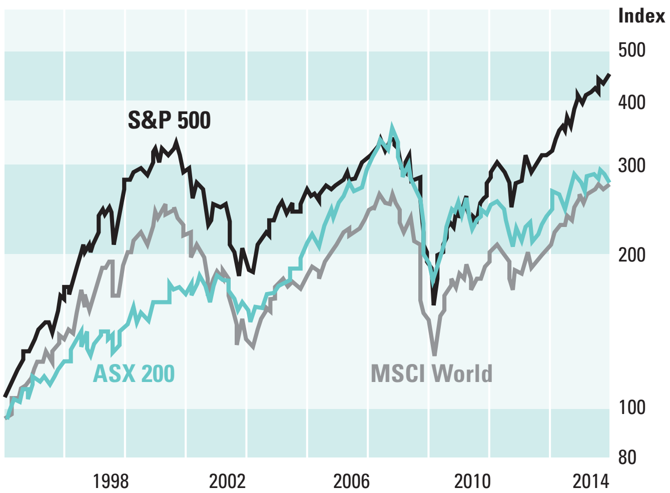
The end of 2014 saw most Balanced funds achieve a return of approximately 7.5% for the calendar year. The outcome for the year was a reminder of the value of diversification, not only across asset classes but also within sectors of the sharemarket. The better performing balanced funds continue to have a greater exposure to international shares. We saw a divergence in the performance of some share markets where Australian shares returned 5.6% compared to Global Shares which returned approximately 15.0% (in Aust dollars).

One of the more positive themes in global markets in 2014 was the strong recovery in the US economy. The strong growth in the US economy has seen the US sharemarket continue to make new highs as companies increase their profits based on strong consumer demand for goods and services. It is no coincidence that some of the better performing Australian companies such as Amcor, CSL & Westfield, have a large exposure to the US economy.

Below is an illustration of the S&P 500 (US Sharemarket) compared to the ASX 200 (Australian sharemarket). The S&P has continued to make new highs, whereas our local sharemarket has not reached new highs since October 2007.

## Australian and World Share Price Indices

Log scale, end December 1994 = 100




Sources: Bloomberg; MSCI; RBA; Tomson Reuters

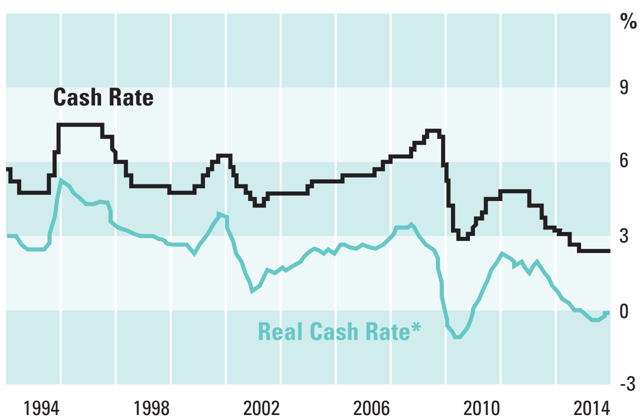
The flat performance of our sharemarket is due to the heavy weighting in the ASX 200 to resource stocks such as BHP, RIO, Santos & Woodside. With the dramatic fall in commodity prices and recently the very large fall in the oil price, this has led to very large falls in share prices for these companies. We have seen share price falls in BHP & RIO of approximately 20-25% and Santos even greater falls of 50% for the calendar year.

The large reduction in our commodity prices has also had some negative and positive flow through effects for the Australian economy. The negative effects mean our export income has and will continue to decline further into 2015, reducing profits for these companies and also tax receipts for the Government, at a time when the Federal budget deficit is growing. The fall in commodity prices also leads to less investment and fewer employment opportunities as mining activity becomes less attractive thereby reducing overall economic activity.

The positive aspect of slower economic growth and lower commodity /oil prices is that inflation (rising prices) remains subdued, with the Reserve Bank more than likely to maintain or even reduce the current cash rate of 2.5 %.

Generally, low interest rates and lower oil prices put more money back into companies and individual's bank accounts. With the costs of servicing mortgage repayments falling and lower fuel prices, it is similar to a person receiving a pay increase. However, one of the challenges facing self-funded retirees who rely heavily on term deposits (which are based on the RBA cash rate) and have seen the cash rate fall from 5.5 % in 2009 to the current rate of 2.5 % is the large fall in income. Addressing how to best deal with the fall in income, highlights the importance of a diversified portfolio of assets in meeting some of these needs.

## Australian Cash Rate




* Calculated using average of weighted median and trimmed mean inflation
Sources: ABS; RBA

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# Market Review and Outlook 2015

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What is our outlook for 2015 given the current state of play? We are starting to see a real divergence in some world regions economic performance. The US economy is now starting to again prosper and once we see the Federal Reserve increase interest rates, it is a clear sign that the era of 'cheap money' is over. The key to further share price rises is the ability of US companies to continue to grow profits, and a strong economy lends itself generally to greater profits. We are still of the view that with a weaker Australian dollar and strong US economy that some share exposure is warranted.

Europe is still a region that is struggling to grow with high unemployment in some countries such as France and Italy. A sign that the region is slowing down is that the 'cheap money' polices will continue to be maintained throughout 2015. This will lead to a much weaker Euro currency, thereby assisting large European companies who have a strong focus on exports.

The other major region is Asia, and in particular China, which still presents opportunities and risks. Our major resource companies are experiencing reduced demand for commodities, although we see more opportunities with Australian agricultural and service export companies as they become more focused on meeting the needs of the Asian consumer. The recently concluded free trade agreements with China, Korea and Japan which account for over 50 % of our exports should be a major positive in the future for our economy.

Our view is generally positive in 2015 for super fund returns although we will see more volatile conditions emerging with the divergence in the economic fortunes of the global regions. Maintaining a diversified portfolio with a bias to strong selection of individual shares and specialist managed funds will assist in reducing risks while taking advantage of any major downturns that may occur. We will continue to provide a discipline over how to best manage portfolios in a low interest environment to ensure our clients' needs are met.

# Funding Income Protection and Trauma Insurance via Super

Until recently, it was tax effective to fund income protection (salary continuance) and trauma insurance via superannuation. There were, however, potential consequences in the decision to fund income protection and trauma cover via superannuation. The considerations relate to accessibility of benefits and the taxation of any benefits paid from the fund. We'll focus on the ability to access benefits, rather than the tax consequences of receiving a payment to the fund or the member.

Since 1 July 2014, a superannuation trustee is prohibited from providing members with insured benefits unless the insured event is consistent with the conditions of release for super i.e. death, terminal medical condition, permanent incapacity or temporary incapacity. This means insured benefits must be able, in all circumstances, to be released to members by having satisfied a condition of release.

Consequently, from 1 July 2014, new trauma insurance will not be available in superannuation.

Income protection insurance within super, on the other hand, would generally be accessible to the member under the temporary incapacity condition of release. However, other changes including the allowable terms and conditions, have taken place that will impact policies taken out after that date. This includes definitions, waiting periods and ancillary benefits; that people who are unemployed or on unpaid leave will not be eligible; and benefit amounts cannot exceed pre-disability earnings, taking into account workers compensation, paid leave entitlements, or a guaranteed or agreed value.

The prohibition does not apply to the continued provision of insured benefits for members covered before 1 July 2014. Income protection or trauma insurance acquired by a superannuation trustee before 1 July 2014 may continue and the level of such existing cover may be increased or decreased. For new policies taken post 1 July 2014, there are still solutions that can be structured to comply with the new regulation.

Finally, anyone with cover established prior to 1 July 2014 should ensure that the insurances cover does not lapse, and be aware that a rollover to another fund in the future may result in losing the exemption.

# Aged Care and Implications for the Family Home

From 1 July 2014, new rules around aged care came into play, making the aged care industry more transparent, and providing simpler options for families deciding how to pay for a relative's care. These rules include a new assets test for anyone wanting government help with their fees, which means selling the house to pay upfront costs may no longer be the best idea.

## What costs are involved?

The cost of care will depend on where care is provided as well as the resident's financial capacity. A major change is that facilities will no longer be classified as "low care" or "high care" – so all subsidised facilities will operate under a single fee structure.

Fees, depending largely on whether the resident uses home care or a residential facility, will comprise a mixture of: "Accommodation Payment" on entry; a "Basic Daily Fee"; a "means-tested care fee"; and "fees for extra or additional services".

## The new Means Testing

Clients moving into residential care will have a "means-tested amount" calculated. This will determine whether the client qualifies for accommodation subsidies from the government as well as to calculate additional (means-tested) care fees.

The means-tested amount includes an amount based on assessable assets and an amount based on assessable income. If the total calculated is less than the maximum accommodation subsidy (MAS) the client only needs to contribute towards accommodation and basic daily care fees (no means-tested fee). But if the total is higher than the MAS, higher care fees are payable.

Some important points to note:

- When determining accommodation payments at entry, the full value of the home will not be included in the assessment of your assets, only a capped value up to $155,823.20 counts and is used for determining your daily care fees.
- Any lump sums paid for entry (refundable accommodation deposits – RADs) will count as an assessable asset for daily care fees but are exempt when determining age pension eligibility.
- Assessable income continues to use Centrelink income test rules.
- RADs will continue to be government-guaranteed and will be fully refundable – no monthly retention amount, although unpaid fees can be deducted

Managing cash flow will be critical for clients. Selecting a facility with a higher RAD may reduce fees, but the client needs to be able to afford to pay the lump sum and still generate sufficient cash flow to pay ongoing fees.

## Upfront deposit or daily payment?

One option is to sell the house and:

- pay the refundable accommodation deposit; or
- invest the proceeds and pay the daily charge from the investment earnings; or
- use a combination of both.

However, selling the principle residence may negatively impact pension eligibility, particularly for people with high value homes and subsequently maximise the means tested fee.

The value of the home for the purpose of an assets test will be capped at $155,823.20. But if the home is sold, its full sale value is taken into account for Centrelink purposes. For many people, this may be enough to make them ineligible for any kind of pension and subsequently any government assistance to help pay the basic daily fee.

So, is it better to keep the house and:

- rent the property, and pay the daily charge from the rental earnings; or
- use the property to secure a reverse mortgage; or
- take out an accommodation bond product against the value of the property?

Every person's situation needs to be analysed individually using their particular details. Keeping the property can often provide a more favourable treatment when calculating eligibility for government subsidies, although this may change in future budget clampdowns. Some industry experts expect that most people will opt for the combination of paying a smaller refundable deposit and supplementing it with a daily payment from rental earnings on the primary home of the person going in to care.

However for families with only one parent going into care and another remaining in the home, or for families who don't have accessible capital to pay the full refundable deposit immediately, other options may need to be considered.

The reality is that around 68 per cent of women and 48 per cent of men over the age of 65 will need to access care services, and many will need advice and support to make the move, or to help their parents make the move.

Professional help could be invaluable to provide peace of mind and guidance towards making the right choice and providing the best outcome.

# Rule Changes to Term Deposits

From 1 January 2015, Australian banks have implemented the next phase of the **Basel III reform measures** – which are new regulations that are designed to maintain the strength and liquidity of Australian banks and deposit-taking institutions.

The changes are a legal requirement – and not subject to individual negotiation by clients or banks.

## How may it affect me?

There will be a number of changes that impact clients who hold Term Deposits.

The changes affect Term Deposits held by both individuals and Self-managed superannuation funds.

If clients wish to access the funds in their Term Deposit before the maturity date, i.e. "break" the Term Deposit, they will need to provide the bank with 31 days' prior notice.

If the remaining term is less than 31 days, the earliest you can access the funds is at maturity.

## For some - No ability for partial early withdrawal

Some institutions have added extra requirements that any early repayment with the appropriate 31 days' notice, must be for the full amount of the Term Deposit – no partial withdrawals are permitted.

In such a situation, a new Term Deposit can be arranged with the surplus funds, but the new Term Deposit will need to be at current market interest rates, not the original rate.

Some banks however, will still allow a partial prepayment, with the remaining funds staying in the existing Term Deposit at the original interest rate, as long as the notice period is respected.

If you hold your Term Deposit to maturity, these changes will not affect you.

If you wish to withdraw your funds at maturity of the Term Deposit, you do not need to give notice.

Hence, it is now essential that any money invested in Term Deposits can remain invested until maturity, alternatively, if early redemption is necessary, that you can adequately give the necessary 31 days' notice.

## Why these changes?

By strengthening liquidity buffers, the reforms aim to promote a more resilient global banking system, and address perceived deficiencies in global financial regulation which were uncovered during the Global Financial Crisis (GFC).

While it has been widely accepted that Australian banks are better regulated than the majority of their global counterparts and do not exhibit the same weaknesses, Basel III is a global standard and will be applied in Australia under the regulation of the Australian Prudential Regulation Authority (APRA).

Similarly, these changes will also affect international banks, both in their home markets (based on how their domestic regulator implements Basel III) and in the way they operate in Australia.

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