Personal Wealth

Winter 2015

A Quarterly Newsletter for **Lifespan Clients**

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Federal Budget 2015 - 16

A guide to the 2015/16 Federal Budget

Federal Treasurer Joe Hockey delivered the Abbott Government's second budget, where the main focus was directed towards small businesses, families and changes to age pension asset test. The Budget also laid out plans which aim to restore confidence in the Australian economy.

It is important to note that the Budget announcements are still only proposed at this stage and need to be legislated.

Changes to pension asset test

Announced in May 2015, the Government has proposed changes to age pension eligibility based on the value of assets that you hold outside the family home. Some wealthier retirees will lose access to the pension as a result of the more stringent asset test thresholds and taper rate for pensions, while others will receive a pension increase.

- The taper rate which is the fortnightly amount, by which a person's pension entitlement decreases under the assets test, will increase from $1.50 to $3 per $1,000 of assets over the lower threshold.
- The value of assets you can have in addition to your family home to qualify for a full pension would increase from $286,500 to $375,000 for couples who are homeowners.
- The maximum value of assets retired couples can hold outside of the family home and still qualify for a part pension would be reduced from $1.15 million to $823,000 under the changes.
- Couples who own their own home and have additional assets of less than $451,500 will get a higher pension.
- Couples who don't own their own home and have assets up to $699,000 will be better off.
- Singles who own their own home and have additional assets of less than $289,500 will be better off.
- Singles who don't own their own home and who have less than $537,000 will be better off.
- The value of assets you can have in addition to your family home to qualify for a full pension would increase from $202,000 to $250,000 for single homeowners.

All people affected by these changes will still be eligible for the Commonwealth Health Seniors Card (CSHC) or the Health Care Card, which provide concessions for pharmaceuticals.

Based on these changes, the Government estimates:

- 91,000 people will lose entitlement to the pension
- 235,000 people will have their pension reduced
- 170,000 people will receive a pension increase.

Families

Families using childcare are one of the winners in this year's Budget, with $3.5 billion to be spent on child care assistance over five years.

What's proposed:

From 1 July 2017, a new single Child Care Subsidy (CCS) will be introduced, based on family income. This will replace the existing child care benefit and child care rebate. The subsidy will be payable to families who use an approved child care service for a child who is under 13 years old.

How it works:

Families earning $65,710 or less will receive a subsidy of 85% of their child care fees (up to an hourly cap).

The subsidy gradually tapers to 50% for families earning less than $185,710.

Families earning $185,710 or more will have a $10,000 annual cap on the total amount of assistance provided per child per year.

To be eligible for the child care subsidy, children must attend an approved child care service and meet immunisation requirements.

The subsidy will be paid directly to child care providers.

- Eligibility for the child care subsidy will be determined by an activity test that aligns the hours of subsidised care with the amount of work, training or study done by parents.

Other measures:

- 'Nannies trial' commencing 1 January 2016 to provide a subsidy to eligible families on incomes below $250,000 a year designed to help shift workers such as nurses, police, firefighters and ambulance officers
- Extra assistance for vulnerable children, including families experiencing temporary financial hardship
- Removal of 'double-dipping' in paid parental leave from 1 July 2016. Access to parental leave pay will be limited to individuals whose employer does not provide parental leave entitlements. In cases where individuals get less generous parental leave entitlements from their employer, the Government will top up the amount paid to be equal to the full amount available under the existing scheme.

Small business

The Treasurer announced a package of measures aimed at small businesses (annual aggregate turnover of less than $2 million), in an effort to encourage them to invest, grow and employ more people.

What's proposed:

- From 1 July 2015, small companies will have their tax rate lowered from 30% to 28.5%.
- From 7:30pm on 12 May 2015 until 30 June 2017, small businesses can claim an immediate tax deduction for "each and every item" purchased up to the value of $20,000. Currently the threshold sits at $1,000.
- From 1 July 2015, there will be an annual 5% tax discount of up to $1,000 a year for unincorporated businesses – these are small businesses which are not run through a company structure.

Other announcements

- Amendments to superannuation conditions of release to make it easier for people suffering a terminal illness to access their superannuation benefits from 1 July 2015.
- $1.2 billion in new funding for national security to bolster our intelligence capabilities and military operations.
- Implementation of a Multinational Anti Avoidance Law to stop large multinational companies avoiding tax.
- A 10% goods and services tax (GST) on internet downloads in an effort to capture more tax from multinational companies providing downloadable music, movies and books. This has widely been dubbed the 'Netflix tax' and will apply from 1 July 2017.
- New listings on the pharmaceutical benefits scheme to give subsidised access to more medicines.
- Current fringe benefits tax (FBT) exemptions or rebates available for not-for-profit and public health sector workers in hospitals and ambulance services on meals and entertainment will now be subject to an exemption cap of $5,000 from 1 April 2016.

What next?

It's important to note that the proposed cuts and changes outlined in the Budget will not necessarily become law – they must first be passed by both the House of Representatives and the Senate.

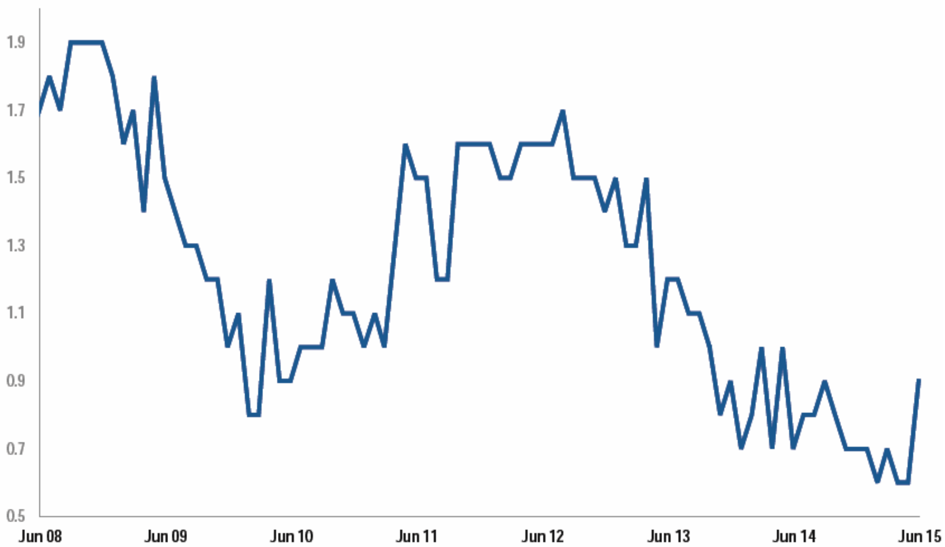
Budget papers revealed that tax receipts have been downgraded by $52 billion since the 2014 budget, against the backdrop of a major fall in the iron ore price. Despite that, the Government's timetable back to budget surplus remains unchanged on last year, with the deficit reducing from $35.1 billion in 2015-16 to $6.9 billion in 2018-19.

*Source: Colonial First State Investments Limited

For further information, please consult your Lifespan adviser.

Investment Markets

Chart 1: Euro Area Consumer Prices Rose for the First Time in Six Months in May



Source: IBES, Datastream, MSWM Research. 2015 and 2016 are forecast.

Recent History

The Australian equity market (S&P/ ASX200) was within 4 points of the 6,000 level two months ago and subsequently fell about 9% to trade below 5,500.

We briefly flirted with a market correction which is defined as a fall of 10% or more from recent highs. The last time we had a correction in Australia was almost 2 years ago in June 2013 when the market fell almost 11%.

Many global markets are also well off their 2015 highs with several of those markets now in a technical correction. In Australia one of the major influences has been the performance of the big banks which had a poor reporting season. Globally the major factors have been poor economic data in the US and bond yields rising off very depressed levels, particularly in Europe.

Bond markets have been particularly volatile and with bond yields rising, returns in fixed interest have been subdued lately. The Australian fixed interest benchmark returned -0.33% for the 3 months to the end of May while Cash returned 0.58% for the period.

The Australian share market returned -1.37% for the same period while Australian Small Cap Equities outperformed with a return of 2.0%. However over 12 months, large cap Australian shares outperformed small caps by over 2%. Listed Australian Property struggled with a return of -0.3% over the 3 months to May although it has returned 29.7% for the year to May.

The Australian dollar was quite volatile and fell about 3% versus the US dollar over the period. This contributed to the good performance of Developed Market global shares which returned 3.5% for the year to May.

Global shares returned 27.8% compared to 9.9% for Australian shares. Again, the large fall in the Australian dollar over the period was a major contributor to the outperformance of Global shares. Emerging Market equities returned 4.3% in the 3 months to May with the Chinese market being the standout performer with a return of 17%.

Economy

Australian GDP growth in the March quarter came in stronger than expectations at 0.9% quarter on quarter. However growth slowed to only 2.3% for the year which is well below the long term potential growth of the economy which is a little over 3%.

Looking at the numbers a little more closely also does not give too much encouragement for the future. Inventories contributed 0.3% to growth and this is not likely to be sustained. Business investment fell 6% year over year led by mining investment.

The biggest concern is that domestic demand was flat in the quarter and is up just 1.1% over a year. A recent survey of business investment plans also indicates more weakness ahead. The bottom line is that the non–mining economy is not picking up the slack from resources as the mining capital expenditure boom winds down. The large fall in commodity prices, particularly iron ore has cut national income and will make life much more difficult for Australia.

In the US, GDP contracted at a .7% annualised rate in the first quarter of 2015, this was revised down from a previously reported 0.2% gain. However there were some contributing factors such as a port strike on the west coast, oil capex down on lower oil prices and bad winter weather.

One relatively bright spot is the European economy with some indications that economy may have bottomed with recent data exceeding expectations. Markets had also been concerned about possible deflation or persistently negative inflation in Europe. However the deflation scare appears to be fading with the consumer price index rising 0.3% in May from 0% in April, this was the first rise in 6 months. (Chart 1)

Markets & Outlook

The Reserve Bank of Australia (RBA) left the cash rate unchanged at 2.0% despite the sub-par economy. One reason the RBA may be reluctant to cut interest rates further is the red hot Sydney housing market which was described as crazy by the Reserve Bank Governor.

We do not know if the RBA will lower interest rates again but we are certainly near the bottom. We are also awaiting the first US interest rise which keeps getting pushed out but is tipped for this September. We believe that when short rates do rise it will be very slowly so should not upset markets too much.

We pointed out last time that bond yields were simply too low and were not an attractive investment. Subsequently the Australian 10 year government bond yield rose from a low of 2.3% to around 3.0%. Global bond yields also rose from historic lows. Despite the higher yields we still do not find fixed interest attractive and we would maintain an underweight to fixed interest, particularly global bonds.

We continue to prefer equities to bonds and listed property even though equities are certainly no longer cheap in historical terms. Australia shares (ASX200 at 5,540) are trading at about 15.3 times earnings estimates for both fiscal year 2015 and 2016. However the market is expecting slightly negative earnings growth (about 1%) for both 2015 and 2016.

Recent downgrades to earnings forecasts have been concentrated in the resources sector and to a much lesser extent the Banks. This puts the PE of Australian shares at roughly a 10% premium or one PE point above the long term average of 14.1 times (Morgan Stanley). One positive is that interest rates were higher in the past so it is possible to justify a higher PE despite the lack of growth.

US shares (S&P500) are also likely to have no earnings growth this year mainly due to lower earnings in oil related stocks. US shares are trading at about 17.5 times 2015 earnings estimates and 16.5 times 12 month forward estimates. The forward earnings estimate is also about one PE point above the long term average.

Local Chinese shares (A-Shares) seem very extended, fuelled by large margin loans. However the Hong Kong listed shares that most international players invest in are far more reasonable. China looks like a good "long term" story as it opens its markets to foreigners and its weighting in global indices increases.

One bright spot is European equities which now seem to be in an upgrade cycle, that is company earnings are exceeding estimates although it is still early days. It should be noted that the current European Quantitative Easing program is the largest recent program in terms of buying up available bonds, even bigger than that in Japan. This is very bullish for European stocks. However Europe is now trading at about 16 times earnings which is in line with the world average although earnings are still below the GFC peak and may play catch up.

The Greek debt situation is likely to come to a head by mid July and will probably result in higher volatility for markets. We would be cautious in allocating to both fixed interest and equities right now as most assets are not cheap. Also the US share market has not had a correction for over 3 years. We would maintain our tilt to global equities over Australian shares with a further tilt to European and Asian shares. We believe Australian listed property is not good value and continue to underweight fixed interest.

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

Asset Class	1 month	3 months	1 Year	3 Years	5 Years
Australian Shares	0.40	-1.37	9.93	17.43	10.31
Global Shares	2.91	3.46	27.77	25.27	13.82
Listed Property	2.92	-0.32	29.66	21.81	15.07
Fixed Interest	0.04	-0.33	7.48	5.09	6.93

Source: Mercer

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