NEWSLETTER

August 2017

Edgeworth Partners

Introduction

Welcome to our August newsletter.

In this newsletter, we combine our regular property and share market updates and take a very long term view - 10 and 20 years to be exact. We do this because the latest ASX Russell Long-Term Investing Report has just been released and it makes for interesting reading. Once again, the report shows that residential investment property has outperformed all other asset classes over the last 20 years. The report also highlights the shorter-term volatility in the share market, as three poor years out of the last 10 have meant that, overall share market returns have lagged behind returns on bonds.

This newsletter also reproduces two of our more popular blog articles from the month of July, discussing superannuation and in particular to changes to superannuation that took effect on 1 July.

We hope you enjoy our August newsletter. As ever, please feel free to get in touch if you would like to discuss anything to do with your financial management.

Did You Know… the month of August

August has always been important month in Australian history. On 12 August 1829, Perth was founded. It was then, and many say that still remains, the world's most remote city. Six years later, Melbourne was founded on the banks of the River Yarra. It was originally called Port Phillip, and it was a close-run thing as to whether the city would be renamed as Melbourne… Or Bearbrass! In 1903, August saw the establishment of Australia's High Court, although it would be another 83 years before Australians lost the ability to take legal claims to the English Privy Council. Five years later, and far more importantly, Donald Bradman was born in August 1908. The Pacific War ended in August 1945 and August 2010 saw the election of the first indigenous member of the federal House of Representatives, Ken Wyatt. Neville Bonner had been the first indigenous member of the Senate, filling a casual vacancy in 1971 and then being elected in his own right in 1972.

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Property and sharemarket update

This is an exciting week for financial advisers.

Once a year, a very important piece of research becomes available. It is the Long-Term Investment Report. The latest report has just been released and it tracks the long-term performance of various asset classes over the last 20 years.

This long-term emphasis is why the report is so useful. Investors simply must take a long term timeframe if they want to do well in investment markets. And long term means at least 10 years.

Over the last 10 years, the absolute best investment class has been residential investment property. The average gross return has been around 8% per year - well in advance of the average inflation rate of just 2.5%. This is actually a little bit down from the 20 year average return of 10.3% per year.

Of course, as we have said before, Australia does not have a single residential property market. Take Perth, for example. Many people nominate Perth as the most remote city of its size in the world, given its distance from other Australian cities. In fact, Perth is closer to Jakarta than it is to Sydney. And the relative performance of the property markets in Perth and Sydney in recent years demonstrates that they are not part of the same property market. In case you haven't noticed, Sydney prices have almost doubled in the last five years, while Perth prices have at best stayed, but in many cases have fallen.

Nevertheless, the fact that an average residential investment property has outperformed the other asset classes and produced a return much in advance of the inflation rate is clear.

One of the truisms of investing is that it does not make any sense to chase past returns. Just because something rose in value last year does not mean it will rise again this year. And, of course, the key to really successful investing is to buy things that have recently fallen in value - provided that they are about to rise again.

Nowhere is this more evident than in the share market results reported by ASX/Russell. For the 10 years to December 2016, the average gross return was only 4.3%. This is only slightly above inflation and well behind the performance in the bond market. However, the relatively poor 10-year performance was due largely to 3 bad periods of roughly 12 months' duration – 2007/8, 2011 and 2015. If you bought shares before those bad periods, then you did badly. But if you bought them during or just after those bad periods, you did quite well.

Once again, the problem is that nobody knows what is about to happen in the share market. The market peaked in October 2007 with the ASX 200 trading at about 6800 points. In March 2009, just 18 months later, the market bottomed out at 3145 points. This was a fall of almost 54% over an incredibly short period. Then, by March 2010, the market had recovered to 4900 points a rise of 56% in an even shorter period. So, October 2007 was a horrible time to buy. March 2009 was a great time to buy.

The problem is, very few people knew these things at the time. As the prices show, very few people were selling in October 2007 and buying in March 2009. But hindsight tells us that that is exactly what people should have been doing.

The power of long-term results is that it encourages us to look beyond shorter term fluctuations. The ASX Russell report tells us that even though the market fell by more than 50% in the first year of the 10-year period to December 2016, long-term investors still made money in the sharemarket. This would be especially the case if investors did not invest all of their money at a single point of time. Spreading out the purchasing of investment assets such as shares manages a special type of risk known as 'timing risk.' As the name suggests, timing risk is the risk that you will buy when prices are about to fall and/or sell when prices are about to rise. As the fluctuations in the stock market over

the last 10 years have shown, it is quite possible to buy at the wrong time and sell at the wrong time - in fact, many people did.

When you divide an investment amount into smaller portions, and invest those portions at different points in time, you reduce the chance that you will buy all of your investment assets at a time when prices are high and about to fall. And you can do the same thing when you sell: making a series of smaller sales reduces the chance that you are selling when prices are temporarily low.

In investing, as in life in general, controlling the controllables is as much as you can do. One of the few things you can control in share market investing is the time at which you buy and sell.

So, if you are contemplating share-based investment, make sure you talk to us about timing risk and let us show you how you can exert some control over what is actually the most important decision a share market investor can make.

Hitting the Superannuation Sweetspot

Published on our website: 14 August 2017

2017 has meant a major change that affects recipients of benefits such as the aged pension. When a person receives the aged pension, their eligibility for that pension is affected by two tests: an income test and an assets test. Both tests dictate that, once income or assets pass a relatively low threshold, the amount of aged pension to which a person is entitled will fall.

In terms of income, to receive the full aged pension, income cannot exceed $164 per fortnight (if you are single) or $292 per fortnight (combined, for members of a couple). For every $1 of income above these amounts, the aged pension reduces by 50 cents. This means that no aged pension is payable once income exceeds $1,940 per fortnight (single) or $2,970 per fortnight (couple – although if you are a member of a couple and you need to live apart due to ill-health, this 'upper threshold' is higher).

In terms of assets, to receive the full aged pension your assets cannot exceed the following:

	Homeowners	Non-homeowners
single	$250,000	$450,000
in a couple, combined	$375,000	$575,000

For every $1000 by which your assets exceed these limits, your aged pension is reduced by $3 per fortnight. The rate is slightly lower if you are a member of a couple and you need to live apart due to illness. This means that you will not receive any aged pension once your assets exceed:

	Homeowners	Non-homeowners
single	$546,250	$746,250
in a couple, combined	$821,500	$1,021,500
illness separated couple, combined	$967,500	$1,167,500

A family home does not count towards the assets test. But superannuation benefits do.

The reduction by $3 for every $1000 of assets above the bottom threshold is known as the 'taper rate.' And the taper rate was doubled in 2017, from a previous level of $1.50 for every $1000 of assets above the bottom threshold. Doubling the taper rate has substantially reduced the upper threshold beyond which no pension is payable.

The reason for doubling the taper rate is obvious: the government wants to reduce the number of people who receive a 'part pension' (any pension less than the full amount). But the change slipped through unnoticed for many people, which is why we are writing about it now.

One of the (presumably unexpected) consequences of doubling the taper rate has been to seriously reduce the amount of cash available to people with *more* in superannuation. For example, a couple who own their own home and have $500,000 in their super fund (and no other significant assets) will potentially have a lot less cash available than a similar couple with only $400,000 in super. Here is how it looks in a table:

	Full annual pension	Super	Reduction in full pension	Annual aged pension amount
Couple 1	$34,900	$400,000	$1955	$32,945
Couple 2	$34,900	$500,000	$9773	$25,127
Difference		$100,000		$7,818

Couple 2 receive $7,818 less in Centrelink benefits than couple 1. In order to make up the shortfall, they need to withdraw an additional $7,818 from their super fund. Doing this will simply give them the same spending money as couple 1. $7,818 is 7.82% of the additional $100,000 that couple 2 hold in superannuation.

Many commentators are suggesting that this is unfair. Having saved more during their working life, couple 2 now need to withdraw more of their superannuation just to enjoy the same disposable income as couple 1. Some people will point out that couple 2 are in control of more superannuation benefits, but some of this advantage is lost unless the extra benefits can generate total earnings of greater than 7.82%. Retirees often prefer a more conservative investment profiles, so a regular return of 8% or more is perhaps unlikely.

So, having saved more during their working life, couple 2 now find that they have to use up their extra savings at a rate much faster than those savings can generate investment returns, simply to maintain the same spending power as somebody who was less diligent in saving.

The situation can be even more frustrating if non-home assets other than super are considered. For example, we are aware of situations where a retired person owns an asset such as a vacant block of land worth $300,000. Because they own this block, their annual pension is reduced by $23,450 per year - even though the block is vacant and does not generate any income for them at all.

Some commentators have even gone so far as to say that there is little immediate value in owning non-home assets above a value of around $400,000 (for a couple). They are calling this the 'superannuation sweet spot.' These commentators worry that people with non-home assets above that amount will be encouraged either to spend the excess quickly (perhaps by having an absolutely sensational first year or two of retirement!) or to invest the excess into a family home. Unfortunately, simply giving away the excess amount, for example to assist adult children to purchase their own homes, won't work because 'excessive' gifts are added back for the purposes of the assets test.

The good news is that effective planning can solve many of these issues. And it is worth doing, because an entitlement to the full aged pension is worth around $1 million in terms of assets (that is, you need around $1 million in assets to generate income equal to the full aged pension). Now that the taper rate has been doubled, effective planning becomes even more important.

There are things that can be done to maximise your eligibility for the aged pension - but these things should be done as early as possible. That's why we encourage everyone who is either retired now or contemplating retirement in the next 10 years to contact us to discuss show that we can show you how to organise your finances to enjoy the best retirement possible.

There's no need to salary sacrifice any more…

Published on our website on 28 July 2017

Superannuation really is super. Super lets you pay less tax and boost your retirement savings, all in one go. We really like it and we think you should too.

If you are an , then you are almost certainly entitled to receive compulsory super contributions from your employer. Generally, these contributions equal 9.5% of your standard wages or salary. These contributions are only taxed at 15% in the super fund – which is probably less than the tax rate you would pay if you received the same money as wages or salary. So, after-tax there is more left in your super fund than there would be if your employer just gave you the money directly.

The 15% tax rate is capped – it can only be applied to concessional contributions of $25,000 per person per year. $25,000 is 9.5% of $263,000. Most people earn much less than this, which means their super contributions are well below their personal limit of $25,000 per year.

Potential tax benefits are going begging for most people in most years.

It is possible to make concessional super contributions above the compulsory 9.5%. Until now, the main way to do this has been through 'salary .' Salary sacrifice requires an employee to agree with their employer to direct ('sacrifice') some of their pay into their super fund, rather than receive it directly as salary or wages. From the employer's point of view, it does not matter whether remuneration goes to the employee directly or into their superannuation fund - the employer gets a tax deduction just the same. But the employee usually pays less tax when the money goes into super.

Salary sacrifice is good, but it is not great. It has some potential limitations. Firstly, an employer can simply refuse to do it. Provided the employer pays the 9.5%, an employee cannot force them to make payments above this amount into a super fund. Relatively few employers would refuse, of course. After all, the employer gets the same tax deduction and refusing to agree is a simple way to annoy their staff. But they still might.

Secondly, under the law, an employer can actually claim salary sacrificed amounts as part of their compulsory 9.5%. That is, as long as the employer contributes 9.5%, they will not get in trouble - even if some or all of the money they do contribute was financed by the employee's salary sacrifice.

Again, relatively few employers would do this, as the quickly-dissatisfied employee would simply cancel the salary sacrifice agreement, and probably start stealing the tearoom biscuits as well.

The main problem with salary sacrifice is the hassle. Basically, an employee needs to organise the sacrifice well before payday. This can be a problem because not everybody knows in advance whether they will have extra money 'left over' for contributing into super.

On the employer's side, salary sacrifice means extra paperwork and a change to the pay system. To reduce this extra workload, many employers restrict their employees to one salary sacrifice negotiation per year - which can make it hard to change your mind if things change from month to month.

The good news

But there is good news. Things changed on 1 July 2017. From now on, almost all tax-paying people can simply make a private, personal contribution into their superannuation fund which they can then claim as a personal deduction when they do their tax return. Provided that the super fund pays tax on the amount received, the only real limit is that the total contributions – the employer's 9.5% plus the employee's extra contributions – cannot exceed $25,000. There is also a minor limit for people aged 65 or over - they need to meet a 'work test' to qualify.

There is still a little bit of paperwork required between the member and their fund, but the employer does not need to be involved. This will substantially reduce the hassle of making extra contributions.

For example, let's say it is 16 June and you and your partner have some '' cash that you don't need. You have already been paid for June, so it is too late to organise a salary sacrifice arrangement (and then use your savings to replace the sacrificed salary). And the financial year ends in 14 days' time.

Instead of salary sacrifice, you can contribute the cash directly into your superannuation fund. You complete a special form and the super fund gives you back an acknowledgement (so maybe leaving things until mid-June is a bit late!). This paperwork basically tells the fund to pay tax on the extra money because you are claiming a tax deduction for it at your end.

If your tax rate is 37.5%, and you contribute an extra $10,000, you will receive a personal tax deduction of $3750. So the contribution only costs you $6,250. Within the super fund, only $1,500 will be paid as tax. Your wealth will have increased by $2,250. $2,250 is 36% of the $6,250 that the contribution actually cost you.

A guaranteed return of 36% is absolutely outstanding. You simply can't beat it.

As well as the simplicity, this method also means you are in absolute control. It does not matter if your employer does not want to help you make a salary sacrifice, and there is no 'once a year' restriction either. If you want to make the contribution, you simply can.

Direct contributions are also more private. If you salary sacrifice, your employer knows you have some 'spare cash' (which might be a problem next time you are negotiating a pay rise!). The only people who know about the increased super savings are you and the trustees of your super fund. And they are sworn to secrecy.

There is one other important point: if you have a self managed superannuation fund, you can still make personal contributions.

Remember, money contributed into super must stay there until you meet a condition of release. The most common condition of release is reaching retirement age. Obviously, you need to consider whether your spare cash can be 'locked up' until then.

So before you make an extra contribution, we recommend you come to talk to us to discuss whether extra personal contributions make sense in your case. We can help you with the paperwork and generally make sure that you are not effected by the very small number of restrictions that have been placed on the new system.

(The tax component of this article was prepared by Dover Financial Advisers, a registered tax (financial) adviser. You should seek independent tax advice before acting on this issue).

The Legal Stuff

General Advice and Tax Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

We recommend you seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

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