er

Weekly Review

WEALTH

– Issue – 10 Mar. 2017

Inflows into Australian exchange-traded funds are set to surge in 2017.

BY TONY KAYE • EUREKA REPORT • 9 MARCH 2017

ETF investments set to top $30bn

Australia's already-booming exchange-traded funds sector is set to enjoy even stronger growth through 2017, with total investments expected to top $30 billion, according to a new report.

The ETFs report just released by BetaShares and Investment Trends is tipping strong demand from SMSF and retail investors following a 31 per cent increase in ETF inflows in the 12 months to September 2016.

Indeed, more and more self-directed investors are using separately managed accounts (read Investors are swarming to separately managed accounts) to invest across a range of different ETF products and portfolios.

The report also found that 70 per cent of Australian financial planners are now recommending ETFs as a key investment product for their clients.

While ETF investors are on average 51-years-old, including a third who are already retired, the average age of investors who invested in ETFs for the first time in the last year is 39 years, significantly lower than those who first started using ETFs five years ago (58).

Furthermore, millennials are expected to be significant drivers of future ETF growth.

Strong demand from retail and SMSF investors

Repeat investment into ETFs is very high with 70 per cent of investors indicating they would consider reinvesting in ETFs in the next 12 months.

Interestingly, the majority of investments into ETFs represents new money into the industry, with 56 per cent of ETF investors buying the products with incremental investment monies, rather than decreasing their allocation to direct shares or managed funds.

The number of SMSFs holding ETFs has grown in line with the increase in the number of ETF users, with 38 per cent of ETF investors holding ETFs through their SMSFs. This highlights the continued importance of this investor class in driving industry growth.

SMSFs who use ETFs typically cite a wider range of reasons for using them, especially for access to overseas markets and access to specific investment types.

Diversification remains the primary driving factor – with 72 per cent of investors citing this as a reason for using ETFs.

Financial planners can tap into client demand for ETFs

Use of ETFs is widespread among financial planners, with 7500 or 43 per cent of Australia's financial planners currently advising on ETFs. This number looks set to grow, with seven out of 10 planners currently recommending ETFs or intending to do so in the future.

More encouragingly, financial planners who do use ETFs are using these products more extensively for new inflows, and plan to continue to grow their use.

Continued on page 2 ...

CONTENTS

ARTICLES PAGE

Continued from page 1 ...

In terms of motivations for using ETFs, financial planners most often cite low cost as a reason for recommending these products, with diversification the second most commonly cited driver.

There remains significant opportunity for advisers to tap into consumer demand for ETFs, with only 21 per cent of current ETF investors saying an adviser played a role in their most recent ETF investment.

Advisors also have a strong interest in actively managed ETFs with 52 per cent indicating they would like to use these products in the next 12 months if available to them.

Outlook

The report projects a record 315,000 Australians will be invested in ETFs by September 2017.

"The ETF industry is set to continue on its growth path, and is following in the footsteps of more mature ETF markets around the world," said BetShares managing director Alex Vynokur.

"One of the most dynamic investment vehicles available, we are confident that investors will continue to tap into ETFs for a broader range of investment needs. In line with the growth we are currently seeing, BetaShares projects the industry will hit $30-33 billion in funds under management, with approximately 250 exchange traded products, by the end of 2017," Mr Vynokur said.

Salary sacrificing strategies and New Zealand's pension age changes.

BY BRUCE BRAMMALL • EUREKA REPORT • 8 MARCH 2017

Salary sacrificing will soon get easier

Salary sacrifice strategies will be much easier to implement when the new super rules come into force on July 1.

No longer will employees have to wonder whether their employer will actually offer a super salary sacrifice arrangement. Because it won't matter. If they don't, you'll be able to do it yourself.

Key Point

- ***The contribution will be made via your super fund. And the difference between your marginal tax rate and the super contributions tax rate of 15 per cent will be refunded via your tax return.***

One of the biggest problems for salary sacrifice in the past is that employers were under no obligation to offer it as an option to clients.

From July 1, they still will have no obligation to do so.

But employees will simply be able to implement it themselves.

This will be possible because the new rules allow individuals to make tax deductible contributions directly. The change in rules will also remove a more serious anomaly (I'll come back to that).

From July 1, anyone who is able to make concessional contributions to super will be able to make them directly to their super fund.

So let's say you're earning $80,000 from your employer. Your employer is then putting in 9.5 per cent, or $7600 a year, into your super fund.

With the new CC limits of $25,000 for everyone from next year, if you're able to contribute you'll be able to put in $17,400 into your super fund. And then be able to claim the deduction.

The contribution will be made via your super fund. And the difference between your marginal tax rate and the super contributions tax rate of 15 per cent will be refunded via your tax return.

(***Note****: One of the downsides of this for employees is that you will have to pay, up front, the contributions with after-tax money. Then claim the tax deduction, and then get the refund via your tax return. This might prove to be a cash-flow issue for some. And for them, maintaining salary sacrifice arrangements with willing employers might be worthwhile.*)

Another advantage of this new rule is less guesswork to a constant frustration about whether an employer is going to make contributions on time.

Employers are not required to pay their super contributions until the 28th day of the following month/quarter. The problem here is that if you are trying to maximise your super contributions via voluntary contributions, you're at the whim of your employer as to whether the contributions will be made before June 30 (and therefore fall into the current financial year) or before July 28 (meaning they fall into the following financial year.

Contributions count according to the date they were received by the super fund.

It will give a little more certainty if you know that your SG contributions from your employer are going to be paid before or after June 30 (call your pay office to confirm. Then you will be able to maximise deductible contributions, or withhold them, in the lead-up to the last days before June 30.

Disregarding the 10% rule

Another advantage is that the 10 per cent rule will soon be gone. The 10 per cent rule means that if you receive 10 per cent or more of your income as a self-employed person, you're not able to make concessional contributions personally.

You can only make them as an employee, which can be very restrictive, often impossible, to make contributions up to your CC limit.

It's been a big problem for some, particularly those whose employment arrangements change during a financial year.

If you go from self-employed to employee during a financial year, or vice versa, it could play havoc with your contributions and tax deductibility.

Take one client of mine, for example. He was a partner in a law firm for the first half of the year and was considered 'self employed'. So he made regular contributions to his super fund that he usually claimed at the end of the financial year.

> **"From July 1, anyone who is able to make concessional contributions to super will be able to make them directly to their super fund.**

However, one year, he changed employment. And the new employment, though still as a partner, meant that he was partly an employee, receiving SG contributions.

This meant that the contributions that he had made – for which he intended to claim a tax deduction – in the first half of the year, could no longer be claimed. Those contributions had to be made as non-concessional contributions, which, given he was under 40 years of age, was not optimal.

However, from July 1, 2017, this anomaly will be removed. Under most circumstances, he would still be able to claim what he had contributed as a tax deduction, so long as he was still under the $25,000 CC limit for the next financial year.

Dodgy employer super contributions gone …

The biggest anomaly that will be lifted is actually pretty serious. The law has stated that an employer must ensure that the superannuation payments equal to the Superannuation Guarantee are made on behalf of an employer.

But, technically, an employee's request for salary sacrifice could actually reduce the employer's requirement to make SG contributions.

For example, take an employee earning $100,000 a year. The employer would be required to pay $9500 to super as SG contributions. However, if the employee requested to have $10,000 made as a salary sacrifice contribution to super, then that is in excess of the 9.5 per cent that an employer needs to ensure goes to the super fund. The employer would be left with no legal requirement to pay an extra 9.5 per cent in SG to the employee's super fund.

Few employers would actually have done that. But it has been something that the financial advice community has continually warned about – to check to see what your employer is actually contributing to super in these instances.

Employees where this is an issue would be better to cancel salary sacrifice arrangements (post July 1), force the employer to pay the 9.5 per cent, then make their own tax-deductible contributions during that same financial year.

Move in age of access to super?

New Zealand Prime Minister Bill English this week signalled that the age of access to superannuation was to be lifted from 65 to 67.

The decision was based around New Zealanders living longer and is almost certainly a precursor of what is to come here.

It has been talked about on the sidelines here for years. Australia has already raised the age pension access age from 65 to 67. From July 1 this year, eligibility for the age pension will increase from 65 years to 65 years and six months. And it will increase every two years, by six months, until it hits age 67 in 2023.

The only unusual part of the decision in NZ, as far as I'm concerned, is that they have announced it won't kick in for … 20 years!

Yes, access to NZ super will rise from 65 to 65.5 years in 2037. And will then rise by six months each year until it hits 67 years in July 2014. That means that it won't start to affect anyone born before June 1972. And those born after July 1974 will have to wait until they are 67 to fully access their super.

It will happen here in Australia. It's just a matter of when it's announced. Nothing is surer. But don't assume that it will come into place in 20 years. It will be sooner than that.

Bruce Brammall is a licensed financial advisor, a mortgage broker and an expert on self-managed super funds. He is a regular contributor to Eureka Report. To contact Bruce, please ***click here****.*

The information contained in this column should be treated as general advice only. It has not taken anyone's specific circumstances into account. If you are considering a strategy such as those mentioned here, you are strongly advised to consult your advisor/s, as some of the strategies used in these columns are extremely complex and require high-level technical compliance.

Market fluctuations and the pension cap; concessional contributions; segregation; re-contribution strategies.

BY MAX NEWNHAM • EUREKA REPORT • 7 MARCH 2017

Taking it to the pensions limit and beyond

Q. I have an SMSF in pension mode with a balance of approximately $1.7 million. I had planned on withdrawing $100,000 prior to June 30, 2017 to ensure I am under the $1.6m cap. Do market fluctuations allow a target of $1.7m rather than $1.6m?

A. Under the new system the $1.6m pension transfer limit applies to the value of a member's pension account at June 30, 2017. Where a member's pension balance has increased due to market fluctuations, and exceeds the $1.6m limit at June 30, 2017, the excess will either need to be withdrawn or rolled back into an accumulation account.

After June 30, 2017, if the value of the pension account increases due to income earned, including increases in the market value of investments, this does not affect the $1.6m transfer limit.

Q. I am under 65. Can I still make a tax deductible concessional contribution of $35,000 to super this 2017 financial year, and $25,000 next financial year? Will I be allowed to segregate which assets go into the accumulation account from the pension account to ensure that the pension account does not exceed $1.6 million?

A. As you are under 65 you can contribute the $35,000 concessional contribution for the 2017 year but will be limited to $25,000 for the 2018 year. If your current pension account in your SMSF does not exceed the $1.6m limit you can use the segregation method to allocate assets between your accumulation account and your pension account.

Once the combined value of your accumulation accounts and pension accounts exceed $1.6m, you will not be able to use the segregation method and must use the proportional method.

It is interesting to note that nearly all of the limits that will apply from July 1, 2017 under the new superannuation system will increase in $100,000 increments in line with increases in the consumer price index. The $1.6m limit relating to SMSFs not being able to use the segregation method however is set in concrete and will not increase.

***Q.** If you anticipate a significant capital appreciation for a particular asset after June 30, 2017, are you able to keep that asset in the pension account and not use the proportional method but allocate this asset to the pension accounts? Has the segregation method for tax purposes been scrapped for all SMSFs?*

A. If the total value of your accumulation and pension accounts does not exceed the $1.6 million limit you can continue to use the segregation method and allocate the investment to the pension account. This will result in the value of the pension account increasing without it affecting the amount of the new pension transfer balance cap.

For example, if your pension account balance at June 30, 2017 was $1.2m you would have used three-quarters of the new pension transfer limit of $1.6m. If the asset generates the significant capital gain, while you are still able to use the segregation method, all of that gain would increase the value of your pension account without it affecting the pension transfer limit. This means you could transfer a further $400,000 into a pension account.

The segregation method of allocating assets between accumulation accounts and pension accounts within an SMSF can still be used until the combined value of a member's pension and accumulation accounts in the SMSF exceeds $1.6m; from then on the proportional method must be used.

Q. I turned 65 on August 16, 2016, during the time when a $500,000 non-concessional lifetime limit was proposed. I have been retired for over four years with no prospect of returning to the workforce.

I previously used the withdraw/re-contribute strategy with a $540,000 non-concessional contribution in the previous three years and became eligible to do so again on July 1, 2016, which was to be the final piece of my long-term super strategy.

> **“Currently a person who receives the benefit of employer super contributions can only make a tax-deductible super contribution if their employment income is less than 10 per cent of their total income.**

As you would realise, I could not execute the withdraw/re-contribute strategy between July 1, 2016 and August 16 because the proposed $500,000 non-concessional lifetime limit prevented me from doing so.

If I had gone ahead with a three-year bring forward of $540,000 and the legislation was passed, then I would have needed to reverse the contribution and be stuck with $540,000 outside of super. Are there any options available to me with regard to the re-contribution strategy?

A. Unfortunately as you will not be able to pass the work test you cannot withdraw a further $540,000 and re-contribute it as a non-concessional contribution to increase the tax-free percentage of your super fund.

As you have probably found out trying to take up the matter with the ATO and other authorities and politicians, because you are effectively being stopped from using the re-contribution strategy before your 65th birthday, it more than likely falls on deaf ears.

Your only option will be, if you want to use the re-contribution strategy, to try and find some form of work between now and June 30, 2017 that will result in you meeting the 40 hours in 30 continuous days work test.

Q. I have recently turned 56 and due to emerging health issues may need to consider early retirement over the next 12 to 18 months. I currently have approximately $1.75 million in an SMSF and maximised the non-concessional contribution for the 2017 year. After retirement, the only income I will receive personally is from 'managing' my personal investments that are valued at approximately $1m.

Can I make a $25,000 personal contribution into my SMSF after July 1, 2017 to reduce my personal tax payable on investments? Also, just prior to the SMSF moving into pension phase, can I take the excess over $1.6m and invest that in my personal name to give a better overall tax outcome?

A. If you recently turned 56 that should mean you were born between July 1, 1960 and June 30, 1961. This means that your preservation age is 56 and you could commence a pension from your SMSF once you have met a condition of release, such as retiring.

One of the other changes made to superannuation tax policy has been the broadening of individuals being able to claim a tax deduction for personal concessional super contributions. Currently a person who receives the benefit of employer super contributions can only make a tax-deductible super contribution if their employment income is less than 10 per cent of their total income.

From July 1, 2017, as long as there have been no other concessional contributions made by you or on your behalf, you can make a $25,000 tax deductible concessional contribution to reduce the tax payable on your investment income. Under current legislation you will be able to do this until you turn 65, after which time you would need to pass a work test.

You should seek professional advice to determine whether you will be better off tax wise to pay out the excess superannuation over the $1.6m pension transfer limit and invest it in your personal name.

*Max Newnham is a partner with **TaxBiz Australia**, a chartered accounting firm specialising in small businesses and SMSFs.*

Got a question for the Tax with Max column?
*Email: **askmax@eurekareport.com.au***

The ins and outs of commercial property tenants demand and yields.

BY NERIDA CONISBEE • EUREKA REPORT • 7 MARCH 2017

Should you consider investing in commercial property?

Residential property continues to be one of the most popular forms of investment in Australia but far fewer venture into commercial property. Is it something that you should be considering?

Key Point

- ***Right now there is a lot of difference in tenant demand and this may influence where you decide to buy.***

Like residential, the performance of commercial can be highly variable between capital cities and between suburbs.

Right now, there is a lot of money targeting commercial, including money from overseas. Hence, yields are declining across most asset types.

However, there is a lot of difference in tenant demand and this may influence where you decide to buy. For office and industrial space, rental growth primarily depends on the state of the economy. High levels of development also make a difference.

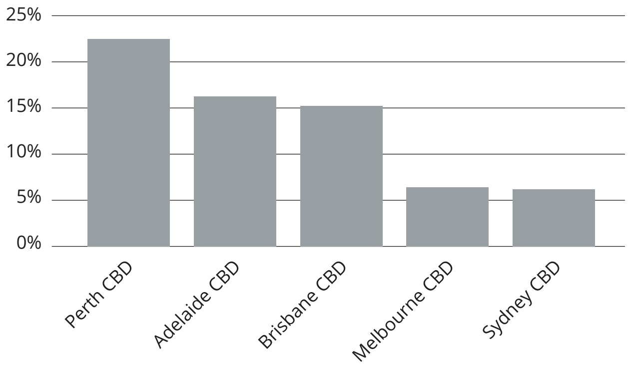
The city with the strongest office and industrial demand right now is, not surprisingly, **Sydney**. Although it is an expensive city for occupiers, a prolonged period of under-building has meant that the surge in tenant demand has left not enough space and resulted in strong rental growth as tenants compete to occupy the best properties. For both office and industrial, Sydney now has the lowest vacancy.

Melbourne is seeing similar levels of demand but because it's an easier city in which to add more floorspace, rental increases tend to not be as marked. Office space tends to do better than industrial in Melbourne for rental growth. Industrial can do well, however it does depend on location. Older grade stock can be unattractive for many occupiers because it is so easy to build new space.

Brisbane saw a slowing of tenant demand following the resources boom and at the same time added a lot of stock. It is now close to peak vacancy and rental growth is looking more positive for both industrial and office. **Perth** still has some way to go to reach peak vacancy and may be a market to consider if you are a higher-risk investor, looking to buy counter-cyclically.

The performance of retail property tends to be more variable and not necessarily linked to a state's economic growth. You need to consider the local trade area and surrounding competition, instead. Expansion of large shopping centres can make a big difference to the performance of small shopping centres. Similarly, population increases can lead to greater sales for a centre.

Chart 1: Office tenant demand in Sydney and Melbourne is back, more mixed elsewhere (office vacancy rate, January 2017)



Source: Property Council Office Market Report

Some **regional areas** are also worth looking at. Central Coast in NSW is currently seeing high levels of tenant demand from office users on the back of white collar migration because of Sydney's affordability problems. In Victoria, places like Geelong, Ballarat and Bendigo are also worth considering. Small shopping centres pretty much anywhere are worth considering, even in very remote locations.

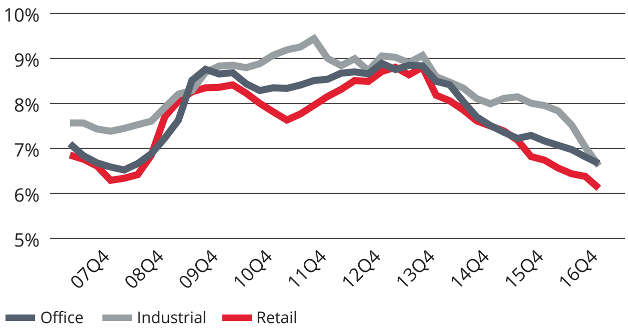
Asset types

While a large regional shopping centre is clearly out of reach but for a handful of investors, there are a lot of options to consider. One reason investors decide to invest in commercial is to get access to higher-yielding investments, a challenge for many residential investors. Diversification can also be a driver with many people moving on from residential investment to commercial. For many commercial property types, performance can often be linked to quite different factors that drive residential performance.

> **Neighbourhood centres, a shopping centre anchored with a supermarket and specialty shops, is generally one of the better performing property types, particularly in growth areas.**

A shop on a **retail strip** is one of the more popular forms of commercial investment. Buyers tend to like the ability to see their investment operating and feel some control over the type of tenant that they lease to. As a result, yields for this sort of investment tend to be lower, similar to residential levels. This type of investment can also be impacted by expansions of nearby shopping centres, as well as the location of the shop within the retail strip. Ideally choose somewhere with high traffic.

Chart 1: Cap rates by asset class, 2007–2016



Source: Real Capital Analytics

Small industrial properties are also popular with high yields making these popular. If you are familiar with an industrial precinct and the types of tenants that typically occupy the precinct, then this is worth considering. Some investors have done very well buying inner urban industrial, holding and then getting a permit for residential. Changes to planning rules in places like south Sydney and inner Melbourne have meant that many owners have done very well over time.

While an entire office building is generally out of reach for many private investors, **strata offices** can perform well and attract high yields. In places like inner Sydney at the moment, tenant demand for this is particularly high, as well as outer suburban areas of Melbourne and Sydney.

Given the high average cost of commercial property, **forming a syndicate** can allow you to move into higher price points which can sometimes perform better. Neighbourhood centres, a shopping centre anchored with a supermarket and specialty shops, is generally one of the better performing property types, particularly in growth areas. The price of these is however generally well over $15 million, which is out of reach of many private investors.

For experienced residential investors, commercial property is definitely worth considering. But just like any property investment, understanding the drivers of demand and doing your research is critical to getting the best yield and capital growth.

Nerida Conisbee is chief economist at REA Group.

The RBA has a difficult balancing act as the property market races ahead.

BY CALLAM PICKERING • EUREKA REPORT • 7 MARCH 2017

Snookered Reserve looks for growth shot

The Reserve Bank of Australia (RBA) left the cash rate at 1.5 per cent at its March meeting. Yet the narrative coming out of Australia's central bank has shifted noticeably over the past month, even if the official board statement was left largely unchanged.

Key Point

- ***The RBA will be hoping for higher commodity prices, and that the US Fed raises interest rates. It is also open to business tax cuts.***

The RBA was active during February. It started with the Statement on Monetary Policy early in the month, followed by four speeches by senior staff and concluded with Governor Philip Lowe testifying before the House of Representatives a couple of weeks ago.

The message from Lowe has been clear: he doesn't want to cut rates again. This doesn't mean that he won't if the situation warrants it, but the hurdle that needs to be cleared is high. It would require a further deterioration in economic growth and employment and signs that core inflation is more likely to head towards 1 per cent rather than 2 per cent.

Why the reluctance? Well the RBA is finding it difficult to balance underwhelming growth and employment against an overheated property sector.

"We'd like the economy to grow a bit more quickly and we'd like the unemployment rate to come down a bit more quickly than is currently forecast," Lowe said to Parliament. "But if we were to try and achieve that through monetary policy it would encourage people to borrow more money and it would put more upward pressure on housing prices and, at the moment, I don't think either of those two things are really in the national interest."

Pull the regulation lever, again?

There is an easy solution to this problem: the Australian Prudential Regulation Authority (APRA) could tighten existing macroprudential policies to slow down investor demand in the property sector. Previous regulations that placed a speed limit on investor credit growth of 10 per cent worked initially but have since been found to be too lenient.

If the housing sector is standing in the way of economic growth and stronger employment, then wouldn't it be prudent for Lowe to work with APRA and tighten investor credit growth down to, say, 5 per cent?

The alternative, as we are quickly finding out, is that monetary policy may be held hostage by the property sector. Many of those reading this article will be okay with that, particularly those with large property portfolios, but in the long-run an economy is built on corporate investment. Speculation in unproductive property assets may be lucrative for a time, but it isn't a path towards future prosperity.

While there is a reluctance to cut rates further we are also unlikely to see rates rise anytime soon.

Underlying inflation remains at around 1.5 per cent and sits well below the RBA's annual inflation target of 2-3 per cent. With private sector wages rising at just 1.8 per cent over the past year, inflation is expected to remain low for some time.

Third-party solutions

The central bank will be hoping that higher commodity prices will begin to flow into stronger employment and wage growth. We have already seen a bounce in corporate earnings and profitability, but it would need to be more than a one-off before businesses begin to prioritise expansion above balance sheet repair (***Profits bonanza has a capex warning***, February 28).

The RBA will also be hoping that the US Federal Reserve decides to raise rates next week. This will help to push the Australian dollar a little lower and provide additional support to the non-mining sector. The dollar has appreciated this year, which is largely due to higher commodity prices but it nonetheless presents a challenge for Australia's trade-exposed sectors.

Shifting from monetary to fiscal policy, Lowe has recently been quite vocal on the issue of company taxes noting that lower taxes may be necessary to maintain foreign investment in an environment where other developed economies are doing likewise.

> **“While there is a reluctance to cut rates further we are also unlikely to see rates rise anytime soon.**

Australia has always relied on foreign capital to fund the standard of living that we have become accustomed to. Foreign capital funds our banks and infrastructure and increasingly the houses and apartments we live in.

A significant fall in foreign capital inflows would surely lead to weaker economic growth both now and in the future. So it is understandable that this is an issue that Lowe would have a keen interest in.

In early February, he noted that “we need to make sure that our tax system is internationally competitive”, which may require Australia to respond directly to company tax cuts in countries such as the United Kingdom and United States.

“Australia has lots of advantages and firms come here for a lot of reasons, clearly a skilled workforce and the political system and property rights, and the wonderful places we have to live, but tax is a consideration,” Lowe said in a speech before the House of Representatives later in the month.

“I think if you are uncompetitive in the tax race you will probably get a few less dollars of capital formation from foreign firms in the country.”

Whether a ‘few less dollars’ in foreign capital is justification for a company tax cut that will cost the budget $48 billion over 10 years is an entirely different matter. Domestic investors would presumably benefit via higher dividend payments, but the majority of the benefits would accrue to foreign investors. Meanwhile, the company tax cut would need to be paid for by cutting domestic programs or raising taxes elsewhere.

Nevertheless, it certainly seems as though Lowe would be grateful for some fiscal policy support. Much of the heavy lifting in recent years has been done by the RBA, but if rates are at their bottom then the economy may need more proactive fiscal policy to navigate our ongoing economic challenges.

Lithium will remain one of the world's most interesting minerals. But the short-term price outlook is worrying.

BY TIM TREADGOLD • EUREKA REPORT • 10 MARCH 2017

Battered by supply, lithium cools

Nothing was hotter last year in the resources sector of the Australian stockmarket than lithium. But with supply rushing to meet demand, and big new mines on the horizon, the outlook for the price of the mineral – which has been dubbed 'the new petroleum' – has cooled.

Key Point

- ***Deutsche Bank sees a consistent fading of the lithium price over the next five years.***

There are fewer questions about demand, which continues to strengthen, especially from vehicle makers as they roll out an increasingly extensive range of models powered by lithium-ion batteries.

But in commodity markets there's always a challenge in achieving a balance between supply and demand. And whereas last year there looked to be a shortage of future lithium supplies, it now looks more likely that there will be a long-run surplus as potential new producers, including the mining giant Rio Tinto, consider entering the lithium business.

Notoriously tricky for investors to value because it is sold in multiple forms with no clearly defined market, it appears that since hitting a peak-price last year of more than $US22,000 a tonne – when sold as lithium carbonate – the price has retreated this year to around $US17,000.

Other forms of the mineral, such as lithium hydroxide and spodumene (the primary hard-rock ore of lithium), have also fallen and are expected to continue declining, according to a recent analysis by Deutsche Bank.

A close watcher of the lithium business, Deutsche Bank stamped its authority on lithium mining with a ground-breaking report in the middle of last year called *Lithium 101*. It was one of the first attempts to test in depth the business case for lithium.

The bank's latest research is titled: Welcome to the lithium-ion age 1.1, and while the tenor remains optimistic the key comment for investors is that there are "short-term risks and medium term upside".

In 60 pages of detailed assessment Deutsche Bank does not see a repeat of the sharp price fall suffered by lithium over the past six months. But it does see a consistent fading of the price over the next five years.

The average price for lithium carbonate in the first quarter of this year is expected to be $US17,000, slipping to $US15,000 by the end of the year, with another significant decline to $US13,250 in 2018, before stabilising at $US11,000 in 2020 and 2021 – half the price of last year.

Deutsche noted that the cost of batteries continues to fall, adding to the attraction of electric cars as well as for household and industrial applications.

"However, incremental supply from Australia and Argentina, along with stricter Chinese electric vehicles subsidies, has seen lithium prices fall 31 per cent since mid-2016," the bank said.

"With two more projects ramping up this half, prices face short-term headwinds."

It's not just rising supply which is generating a headwind for lithium producers. Some have been hit by headwinds of their own making with one of Australia's lithium leaders, Orocobre, suffering a sharp share sell-off late last month when it reported weaker-than expected production and a fresh delay in achieving nameplate capacity.

Problems in managing the lithium content in the brine lakes at its part-owned Olaroz project in Argentina forced Orocobre to downgrade its expected 2017 output from 15,000 tonnes to between 12,000 and 12,500 tonnes.

On the market, Orocobre's shares dropped immediately by 16 per cent to $3.02, and have kept falling, off another 5.6 per cent on Tuesday to $2.83 mid session, its lowest level in 11 months.

The pond problems at Olaroz should be easily fixed as they largely involve miscalculating the amount of lithium lost when impurities are being removed by adding lime to the process. But the production delay is occurring as the lithium price weakens.

> **“ There is the wild card in the lithium pack … the remarkable success of Rio Tinto at its Jadar project in Serbia.**

One cause of the weaker price, even as demand strengthens, is the ability of hard-rock lithium producers – such as Albemarle and Mineral Resources, which operate conventional mining, crushing, and concentrating projects in WA – to get lithium to battery-making customers.

As a rough guide, according to Deutsche, a hard-rock mine, sometimes using surplus equipment from gold or nickel mining, can be switched on within months at a capital intensity as low as $US4000 of lithium carbonate.

Brine-pond operators, which use heat from the sun to evaporate surplus water in order to recover lithium from salt lakes, such as those high in the Andes mountains of South America take years to establish and are estimated to have a capital intensity of up to $US16,000 of lithium carbonate.

A debate has been underway in the mining industry for years as to which is the best production route, without a clear answer evolving, which is why the world’s biggest lithium producer, US-based Albemarle, operates both hard-rock and brine projects.

And then there is the wild card in the lithium pack which is the remarkable success of Rio Tinto at its Jadar project in Serbia.

Originally seen, when discovered in 2004, as a potential future source of boron (an industrial mineral with a wide variety of uses such as detergent) Jadar is also rich in lithium, contained in a mineral not seen anywhere else in the world; jadarite.

Boron is a mineral well-known to Rio Tinto as it operates the world’s biggest boron mine in the Mojave Desert of California. The appropriately-named Boron mine, which has been in production for 145 years, supplies 30 per cent of the world’s boron.

At Jadar, Rio Tinto has spent $US70 million on exploration and evaluation, and last month committed another $US20 million to finalising a prefeasibility study.

If Rio Tinto develops Jadar it could increase global lithium supply by 10 per cent at a time when the market is showing signs of being in long-term surplus as it waits for demand to catch up with supply.

Whether Rio Tinto wants to enter the lithium business, which is small by its standards, even if growing quickly, is another question.

Deutsche Bank estimates that lithium demand grew by 15 per cent last year – but that only lifted consumption to 212,000 tonnes of lithium carbonate equivalent.

For Rio Tinto, with a well-established boron business that generated revenue last year of $US620 million, and a pre-tax profit of $US117 million, Jadar could be seen as a new boron mine with lithium an interesting byproduct with the price-received immaterial to the project’s business case.

Lithium is, and will remain one of the mining world’s most interesting minerals with a fabulous future as battery-storage becomes an ever-more important business. But it is not in short supply and there is a long line of prospective new developments, which will weigh heavily on the price.

The retail sector is travelling well despite weakness in wages growth and slowing household consumption.

BY CALLAM PICKERING • EUREKA REPORT • 10 MARCH 2017

Watch the retail space

Analysis of the Australian economy frequently focuses on housing and mining but it is household consumption that remains our biggest sector. At 57 per cent of economic activity, household spending dwarfs the size of any other sector or industry.

Key Point

- ***Household spending has increased by just 2.7 per cent on average over the past decade – well below average growth of over 4 per cent that occurred from 1993 until 2008.***

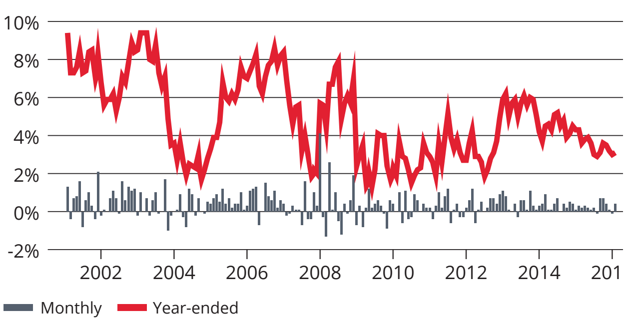
Earlier this week the Australian Bureau of Statistics (ABS) released data on retail trade for the month of January. It marks one of the first pieces of data we have for the new calendar year and provides some of the timeliest insight into how our economy is travelling.

In this article I plan to assess the most recent data but also provide a little historical perspective on how we are travelling in comparison to the past. We will also touch upon some other recent developments, which cannot be quantified statistically as yet but are likely to impact the sector in the immediate future.

Retail trade

Retail spending rose by 0.4 per cent in January, rebounding following a modest decline in December, to be 3.1 per cent higher over the year. Annual growth is tracking a little weaker than has been the average this decade (around 3.6 per cent a year) and well below what was considered normal last decade (around 6 per cent a year).

Chart 1: Australian retail sales growth (seasonally adjusted; monthly)



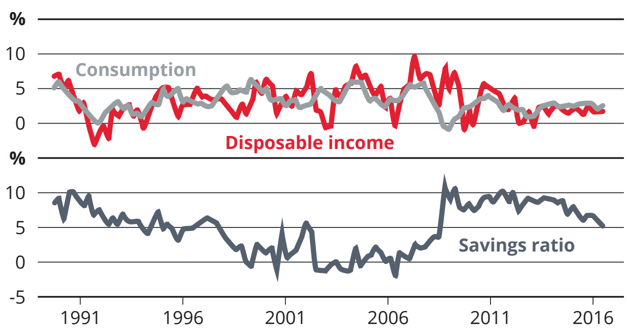
Source: ABS; via CP Economics

Nevertheless, retail spending has held up surprisingly well given the ongoing weakness in wage growth. Private sector wages are rising by just 1.8 per cent a year, with public sector wages a little stronger, falling well short of growth in retail trade and household spending.

Such a scenario is possible because households can either dip into their existing savings or otherwise decide to save less of their income than they did in the past. For example, the household savings ratio has dipped to 5.2 per cent of household income, falling by 4.1 percentage points over the past three years, to be at its lowest level since the beginning of the global financial crisis.

The household savings ratio can and most likely will dip lower over the remainder of 2017. Prior to the global financial crisis it wasn't unusual for Australians to spend more than they earned in a given year. The household savings ratio was actually negative from 2002 to 2004 and negative once again in 2006.

Chart 1: Household income and consumption* (Real, year-ended growth)



* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; income level smoothed with a two-quarter moving average between March quarter 2000 and March quarter 2002; saving ratio is net of depreciation.

Source: ABS; RBA

A low-wage and low-inflation environment has made conditions more difficult for retailers. Nevertheless, some sectors have managed to grow quite strongly throughout this period.

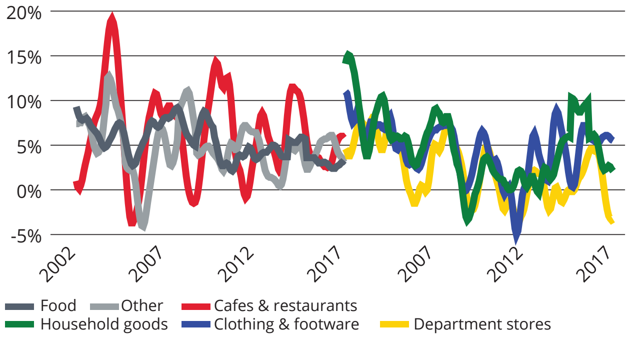
Take cafes and restaurants, for example, where annual growth has averaged 5 per cent this decade. The so-called 'dining boom' has displayed significant volatility on a yearly basis but has been easily the best performed retail sector since 2010.

Spending on household goods has also been quite strong until recently.

> **Amazon stands as a key disruptor in the retail space that will likely benefit consumers even if it isn't necessarily great for incumbent retailers.**

Unfortunately, the same cannot be said for department stores where spending is largely unchanged since 2009 and has fallen by 3.3 per cent over the past year.

Chart 3: Australian retail spending by industry (year-ended percentage change; trend)



Source: ABS; via CP Economics

The relative decline in department stores has been ongoing for at least 30 years. Spending at department stores, as a share of total retail trade, has fallen from 12 per cent in 1990 to just 6 per cent currently.

A longer-run perspective

While the household sector has held-up surprisingly well in recent years, we cannot ignore the fact that growth in household spending has fallen well short of what we have come to accustomed to.

A useful way of assessing this is to look at long-term growth. This removes the noise that is present in the monthly, quarterly or even annual data and paints a clearer picture.

The past decade has been the weakest 10-year period for aggregate household consumption growth since the decade leading up to the March quarter 1993. Household spending has increased by just 2.7 per cent on average over the past decade – well below average growth of over 4 per cent that occurred from 1993 until 2008.

Remove population growth from the equation – to assess household spending per person – and the results are dire still. The past decade has seen the weakest growth in per capita spending in over three decades.

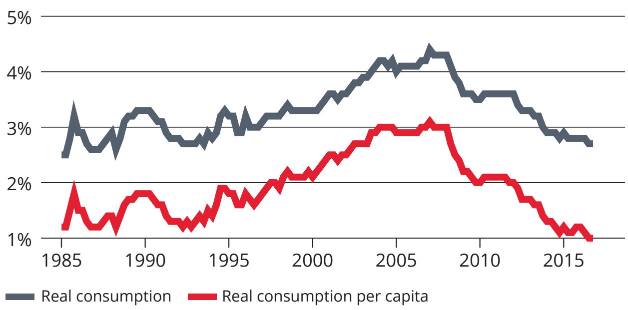
Given the risk that population growth eases – led by lower rates of net migration – as well as ongoing weakness in wage growth, it is likely that average growth will decline further over the next three-to-five years.

Recent developments

Nevertheless, there are some exciting developments in the retail space. Amazon is seeking out warehouses and developing distribution networks for Australian expansion. They are currently advertising 152 jobs in Sydney.

Amazon stands as a key disruptor in the retail space that will likely benefit consumers even if it isn't necessarily great for incumbent retailers. In an ideal world it will spur competition across the retail sector leading to leaner and more tightly run operations and lower prices.

Chart 4: Australian real consumption growth (annualised growth - 10-year rolling average)



Source: ABS; via CP Economics

I view Amazon as an opportunity for consumers but a threat for incumbent retailers. Department stores, who as I already pointed out are struggling, are dreading the introduction of a competitor with such deep pockets.

Gerry Harvey, boss of Harvey Norman, has already accused Amazon of having long-term plans to control the market via predatory pricing. Meanwhile, outgoing Wesfarmers chief executive Richard Goyder has warned that Amazon will "eat all out breakfasts, lunches and dinners", potentially costing local retailers as much as $4 billion in sales (around 1 per cent of current annual income).

However, Amazon may struggle to replicate the supply chain efficiencies that have helped it dominate the US retail space. Australia's lower-density cities and small towns creates a logistical problem that may prove difficult to overcome without hefty delivery costs.

Either way, analysts and investors alike, should closely watch this space.

Tackling risk aversion, the childcare equation and superannuation inequity are good places to start.

BY CAROL TAWFIK • EUREKA REPORT • 10 MARCH 2017

Four ways for women to close the gap

When it comes to money and wealth accumulation, women can be faced with a unique set of factors which can pose a challenge to financial empowerment, independence and confidence.

Key Point

- ***It remains true that women retire with substantially less in superannuation than their male counterparts.***

Furthermore, the impact of time spent away from the workforce while taking on a care role, and the potential flow-on career penalty, will not be the least of these.

Gender-based financial inequity is, of course, a highly complex issue with a broad scope of potential contributory factors. Great efforts have been made in recent years to increase conversation, though challenges will likely continue to exist for some time yet. It remains true that women retire with substantially less in superannuation than their male counterparts, an imbalance which has broad social and economic consequences. In terms of financial action points, there are a few things one can consider for future impacts.

1. Re-thinking risk levels

Much has been written in various research illustrating that men and women can naturally display differing characteristic traits when it comes to investing. Women's generally more conservative and less risk-taking tendencies can result in a, sometimes, overly careful investment approach. This, in turn, can mean less stock market exposure within their superannuation portfolios than men. My observation advising clients over a number of years alone would, on average, largely support this. And when history tells us there is a relationship between risk and return, this tendency can have a major bottom-line impact over time.

Accepting a degree of investment risk is an essential component of long-term asset growth. Put another way, there is 'risk' in taking too little investment risk when it comes to achieving sufficient growth for a sustainable, comfortable retirement. While some of these cautious characteristics can certainly work in one's favour, superannuation's accessibility rules impose, for some, a natural long-term investment time horizon. This might therefore warrant a more measured approach to taking 'risk' given that time may allow ups and downs to be ridden out, while remaining within one's comfort level.

2. Long-term perspective

In her 2013 book *Lean In: Women, Work, and the Will to Lead*, American technology executive, activist, and author Sheryl Sandberg refers to women "drop[ping] out early in their careers because their salary barely covers the cost of childcare". She goes on further to explain that while the decision to utilise childcare can be an extremely difficult one – with a possible range of considerations (both financial and non financial) – for professional women the cost component should be measured against her future earning capacity rather than her current income. And this is not to mention the investment already made up until that point, or the powerful compounding effect of employment superannuation contributions. The childcare cost/investment of today may indeed afford future reward, opportunity and flexibility down the track – particularly if leadership forms part of the career path. Sandberg also speaks of keeping the foot on the accelerator in the lead-up to starting a family so that when it comes time to make a decision, there is indeed a decision to be made.

3. Getting 'in the know'

Education breeds confidence. When it comes to money matters, however, it is easy to feel overwhelmed by the number of interrelating factors that require our attention. Working with women of a range of ages, the recurring theme is not any lack of knowledge or understanding but moreso a lack of confidence when it comes to decision making. Confidence leads to participation, which in turn leads to better outcomes and lower-stress lives. The key to gaining confidence, however, is recognising that no one is expected to know it all – and a good handle on the cornerstone concepts goes an enormous way. Those include getting clear on factors like the workings of superannuation, budget management and base investment principles. Getting in the know, and importantly keeping in the know, on the central ideas will hold anyone in good stead for an empowered financial future.

> **"The childcare cost/ may indeed afford future reward, opportunity and flexibility down the track – particularly if leadership forms part of the career path.**

4. Keeping up contributions

Accumulating sufficient superannuation assets for a sound retirement may be one of the greatest financial challenges women face. The Association of Superannuation Funds of Australia's December 2015 research report indicates that in 2013-14, women aged between 60-64 had an average superannuation balance of $138,000 which was less than half that of males in the same age category. Further, 44 per cent of employed women worked part time in 2015–16, **compared with 15 per cent of employed men**, contributing to the disparity. Outside the compulsory superannuation guarantee, there are a number of avenues for contribution to super – for example, after tax and spouse contributions as well as the ability to access 'catch up' allowances and the government co-contribution.

While family life comes with considerable financial demands and competing financial interests, continuing to invest in superannuation simply should be a non-negotiable in order help to close the gap and minimise **the financial impact of any time out of the workforce**. With some forward planning and a sense of confidence, clarity over our financial future can be well within reach.

Some Australian self-managed super fund trustees have bought into bitcoin, and many of those have achieved phenomenal returns in a relatively short time.

BY TONY KAYE • EUREKA REPORT • 1 MARCH 2017

Would you buy into a bitcoin ETF?

Would you invest into an asset that, quote: "may be illegal now, or in the future, to acquire, own, hold, sell or use", and where "ownership of, holding or trading may also be considered illegal and subject to sanction"?

Key Point

- ***But investors should realise that bitcoin is a high-risk asset. The prospectus for what could soon become the first listed bitcoin exchange-traded fund is a testament to just how risky bitcoin really is.***

It's an interesting question, especially because the warning clause above is taken directly from the prospectus of the Winklevoss Bitcoin Trust – the entity behind what could soon become the world's first exchange-traded fund linked to the decentralised digital currency bitcoin.

The clause forms part of an extensive "Risk Factors" section in the prospectus that runs to some 25 pages, covering potential investment hazards including market manipulation, sovereign intervention, changes to trading regulations, sabotage, fraud, hacking, conflicts of interest, illiquidity and likely taxation costs.

Bitcoin buyers and sellers currently use so-called "digital wallets" to trade over computers using blockchain technology – which is used to record a permanent record of transactions across an online network. An ETF would effectively eliminate the need for investors to trade that way as they would be able to buy units on-market.

But, for would-be investors, there's also the significant risk that, if listed, the ETF securities will trade at a substantial discount or premium to the actual price of bitcoin. That's because of the different operating hours between the niche Kansas-based Bats Global Markets exchange where they would trade and the unregulated global Bitcoin Exchange Market, which operates 24 hours a day.

And bitcoin is well-known for its daily volatility, with the price of the cryptocurrency dropping by more than $US100 in a matter of minutes on Wednesday.

After breaking through parity with the price of gold for only the second time in early March, reaching a record high of around $US1290 as gold slipped below $US1220 per ounce, the bitcoin price slumped more than $US80 mid-week before quickly bouncing back to the mid-$US1240 range.

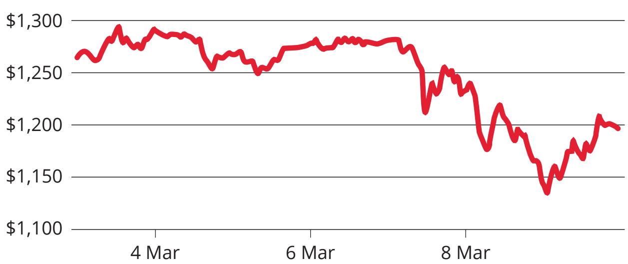
The price drop reflected nervousness around whether the Winklevoss ETF will actually get the green light from the US Securities and Exchange Commission.

Another reason for recent bitcoin price volatility is China. There were concerns during the week over the People's Bank of China's recent crackdown on bitcoin trading as part of anti-money laundering steps being taken by the Chinese government.

A critical deadline approaches

Four years in the making, the only thing standing in the way of the 35-year-old Winklevoss twin brothers, Tyler and Cameron – better known for suing Facebook founder Mark Zuckerberg for allegedly stealing their idea to create the social network – is the US corporate regulator.

Chart 1: Bitcoin price chart



Source: www.coindesk.com

The SEC has the final say on whether the ETF, which would trade under the code COIN, and rival funds seeking approval including the Bitcoin Investment Trust and SolidX Bitcoin Trust, can move ahead to listing. The deadline to block the listing is this Monday, March 13, and if the SEC takes no action by then the ETF will go ahead.

Bitcoin is just one of more than 700 digital currencies that have sprung up in recent years, none of which are formally regulated or supervised by a central banking authority because, in effect, they are not connected to any country.

China and Russia, among others, are said to be considering

> **"With all the inherent and potential risks involved in owning and trading bitcoin, one should tread very carefully.**

alternative state-backed electronic monetary systems and restricting the use of bitcoin. Indeed, the digital currency is already banned in several countries, including Bolivia and Ecuador.

Bitcoin as an investment

So would you invest in bitcoin directly, or a bitcoin ETF that would sell fractional units of bitcoin to cater for smaller investors?

Before you answer, consider that the returns from owning bitcoin have been nothing short of phenomenal over time. The price of bitcoin has rallied almost 30 per cent since the start of 2017, and in 2016 it gained around 120 per cent – more than any other currency.

It seems many investors are prepared to take on the high risks in return for potential high returns. In the case of the Winklevoss Bitcoin Trust, there is an estimated $US300 million of investment capital already lined up to buy into its ETF.

Some market analysts are now tipping that bitcoin could hit $US3000 by the end of the year, representing an annual gain of more than 130 per cent.

In an interview on television network CNBC earlier this week, Adam Davies of global IT and engineering services firm Altus Consulting said he believes bitcoin could go much higher.

"In terms of price this year, I think it will go up to $US3000. As it becomes more pervasive and more generally accepted, I think you'll see rapid growth in adoption," Davies said.

Few, if any, will dispute that the investment demand for bitcoin is intense, especially those involved in selling the online currency in Australia and elsewhere.

Tim Lea, founder of Australian blockchain start-up Veredictum, says the Winklevoss ETF will enable retail investors to invest in bitcoin through a publicly traded vehicle.

"It means individuals do not have to worry about the challenges of holding their own wallets, dealing with online security, having to worry about using public and private keys and other complexities associated with holding bitcoin."

But he warns the current price of bitcoin will come under pressure if the SEC blocks the ETF.

"If the regulation is not given authorisation, I expect the bitcoin price to fall markedly, driven down by the unregulated traders in the marketplace. If it is approved, it is likely there will be a mad scramble to buy bitcoins as quickly as possible … sending the price to rise very quickly.

"All those within the cryptocurrency space are on tenterhooks but enjoying the ride ahead of gold because they know that the chances are high that this significant price level may be very short-lived."

Australian-based bitcoin distributors point to a growing take-up by retail investors here, including self-managed super funds.

But, with all the inherent and potential risks involved in owning and trading bitcoin, one should tread very carefully. For those with a high-risk investing profile, holding bitcoin directly or through an ETF may be worth considering – but only as a very small percentage of an investment portfolio.

A lot will be hinging on the SEC's bitcoin ETF decision.