

Weekly Review

WEALTH

4 START THINKING OUTSIDE
THE SMSF SQUARE

6 THE OIL AND GAS
PICTURE BRIGHTENS

8 ARE NON-MINERS TURNING
THE INVESTMENT CORNER?

– Issue –
27 Jan.
2017

While returns from listed debt securities were down in 2015, strong investor demand coupled with a lack of supply boosted returns in 2016 – and may do so again in 2017.

BY PHILIP BAYLEY • EUREKA REPORT • 27 JANUARY 2017

Debt securities deliver strong 2016 returns

Investors in ASX-listed debt securities enjoyed strong returns in 2016. This comes as compensation for the poor returns experienced in 2015 and reflects the opposing forces driving the market in each year.

Key Point

- ***The performance of the Australia Ratings family of indices over 2015 and 2016 delivered yields in the range of 3.57-6.39 per cent per annum.***

The search for yield, as interest rates continued to fall, and a lack of supply as redemptions exceeded new issues towards the end of the year, drove up prices among listed debt securities in 2016.

2015 suffered a hangover from the excesses of 2014 and earlier years. New issues had been abundant and credit margins had been steadily compressed.

This culminated in October 2014, when the Commonwealth Bank listed the \$3 billion PERLS VII (CBAPD) hybrid notes, paying a credit margin of just 2.8 per cent over the 90-day bank bill rate. This was the largest issue and the tightest credit margin the market had seen, and it hasn't been repeated since.

Credit margins increased throughout 2015 and into 2016, as the market digested supply and repriced risk. As a result, total returns to listed debt investors in 2015 ranged from modest to negative. Security prices generally fell over the year and

positive total returns required distributions paid to exceed the fall in the price of securities held.

Australia Ratings listed debt securities indices

Domestic credit rating agency Australia Ratings produces a family of indices which cover most ASX-listed debt securities. The indices – which I calculate and maintain – are based on data provided by Ord Minnett.

The Australia Ratings' Combined index returned 8.04 per cent for 2016. In 2015, the return was a negative 0.75 per cent.

The Australia Ratings indices are accumulation, or total return, indices. The indices take into account both price movements and distributions paid over time.

The Combined index covers all non-government, ASX-listed debt securities that pay floating rate distributions and have more than one year to go before reaching their call or maturity date. The Combined index is the largest and main index in the family of indices that are based on the product complexity indicators used by Australia Ratings.

Australia Ratings has assigned credit ratings and 'product complexity indicators' (PCI) to most listed debt securities.

The Green PCI index covers simple, senior ranking debt securities and the Blue PCI index covers simple subordinated

Continued on page 2 ...

ARTICLES

	PAGE
Debt securities deliver strong 2016 returns	1
Start thinking outside the SMSF square	4
The oil and gas picture brightens	6
Are non-miners turning the investment corner?	8
The ins and outs of the in-house asset rules	11
Tax with Max: Pensions and the new cap	13
An investment guide for your 30s	15
VIDEO: Tom Millner of BKI	17

IMPORTANT INFO

DISCLAIMER This publication is general in nature and does not take your personal situation into consideration. You should seek financial advice specific to your situation before making any financial decision. Past performance is not a reliable indicator of future performance. We encourage you to think of investing as a long-term pursuit.

COPYRIGHT InvestSMART Publishing Pty Ltd 2017. Intelligent Investor and associated websites and publications are published by InvestSMART Publishing Pty Ltd ABN 12 108 915 233 (AFSL No. 282288).

DISCLOSURE Staff own many of the securities mentioned within this publication.

Continued from page 1 ...

debt securities. (The latter has been suspended, as there are no securities that currently fit this category.)

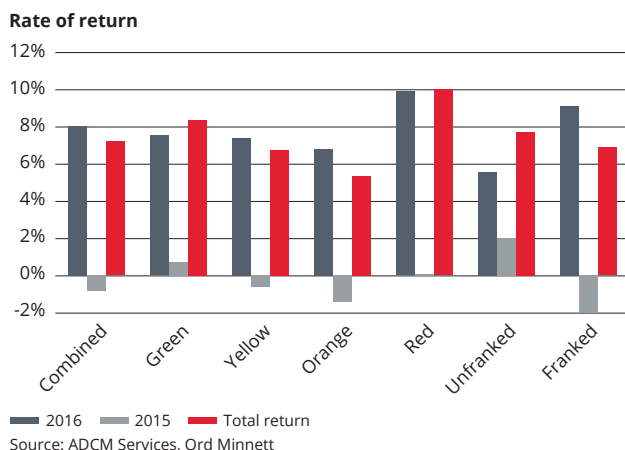
The Yellow PCI index covers securities with deferrable but cumulative distributions, while the Orange PCI index covers securities with deferrable, non-cumulative distributions. The Orange index also includes securities with a non-viability trigger for recapitalisation of the issuer, and the Red index covers those securities with all of these complexities and a capital event trigger, as found in bank-issued hybrid securities.

Australia Ratings also produces a Franked index and an Unfranked index to isolate the differing performance of securities that pay franked distributions, relative to those that don't.

Index performance

The Red index has generated the strongest returns in 2016 and indeed over 2015 and 2016 combined, but has also seen the greatest volatility. The total return over 2015 and 2016 is 10.02 per cent, being the product of a return of 9.96 per cent for 2016 and just 0.05 per cent for 2015.

Chart 1: Australia Ratings index returns, 2015, 2016 and total

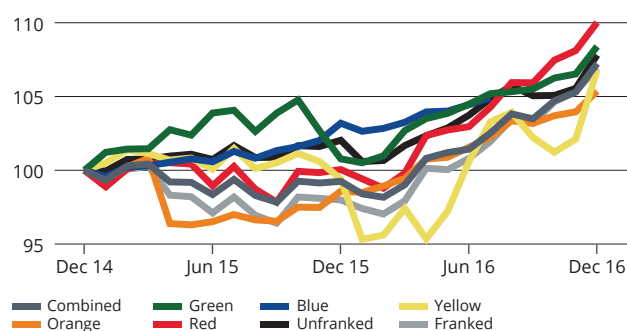


The Red index encompasses the highest risk debt securities listed on the ASX. The Green index encompasses those of the lowest risk, yet this index ranks second with a total return over 2015 and 2016 of 8.39 per cent.

The total return for the Green index is made up of returns of 0.77 per cent and 7.56 per cent in 2015 and 2016, respectively. It is arguable whether the difference in the returns from the Green and Red indices is commensurate with the difference in risk between the indices.

It is also interesting to observe that the less risky Yellow index has produced superior returns in both 2015 and 2016 to the riskier Orange index. And similarly, the Unfranked index has produced superior returns to the Franked index over the two-year period.

Chart 2: Australia Ratings Listed Debt Securities Indices - from December 2014



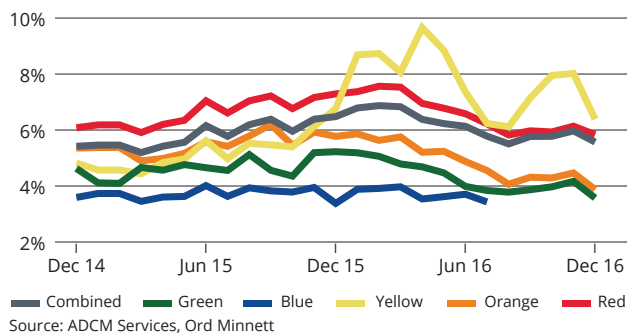
Curiously, there is more than four times the number of securities included in the Red index than there are in the Green, Yellow and Orange indices. Does this suggest that issuers believe listed debt investors want only higher yielding securities or that only the riskiest debt securities are sold in this market because there is little or no demand in the wholesale market?

“It is interesting to observe that the less risky Yellow index has produced superior returns in both 2015 and 2016 to the riskier Orange index.

The performance of the Australia Ratings family of indices over 2015 and 2016 is presented in Chart 2.

A sharp uptick in performance between November and December 2016 can be seen in each of the indices. Origin Energy redeemed \$900 million of subordinated notes (ORGHA) in December, while Insurance Australia Group issued just \$404m of capital notes (IAGPD).

Chart 3: Australia Ratings Listed Debt Securities Indices – weighted average yields



This followed the redemption of \$700m of subordinated notes by Woolworths (WOWPC), just the month before. The holders of the redeemed notes have been looking to the secondary market for other investment opportunities.

As prices go up, yields come down. Of course, as investors drive up security prices, returns in the form of yield to call/maturity are compressed, as can be seen in Chart 3 between November and December.

The weighted average yield for the Green index as at the end of December was 3.57 per cent per annum. For the Yellow index the figure was 6.39 per cent, for the Orange index it was 3.88 per cent, and for the Red index, 5.84 per cent. The Combined index had a weighted average yield of 5.57 per cent per annum.

The differences in the weighted average yields of the Yellow and Orange indices reflects the presence of the longer dated and volatile Crown Resorts Subordinated Notes (CWNHA and CWNHB) in the Yellow index, and the relatively short term to call for the securities in the Orange index.

Further secondary market price increases are expected in 2017, as redemptions are expected to outstrip the supply of new issues by as much as \$5.4 billion. Hopefully, this possible shortfall and consequent increase in investor demand will attract many new issuers to the market and thereby reduce the pressure on prices in the secondary market.

And while any increase in interest rates will have little impact on the price of securities that pay floating rate distributions, any increase in risk aversion will also temper price increases.

Philip Bayley is a former director of Standard & Poor's and now works as an independent consultant to debt capital market participants. He is associated with Australia Ratings.

Self-managed superannuation fund trustees are more likely to look for investment opportunities outside of super as a result of the new limitations being imposed by the Federal Government.

BY TONY KAYE • EUREKA REPORT • 24 JANUARY 2017

Start thinking outside the SMSF square

The new superannuation reforms announced last year and due to come into law from July 1 this year are likely to spur an exodus of funds from the self-managed superannuation fund sector.

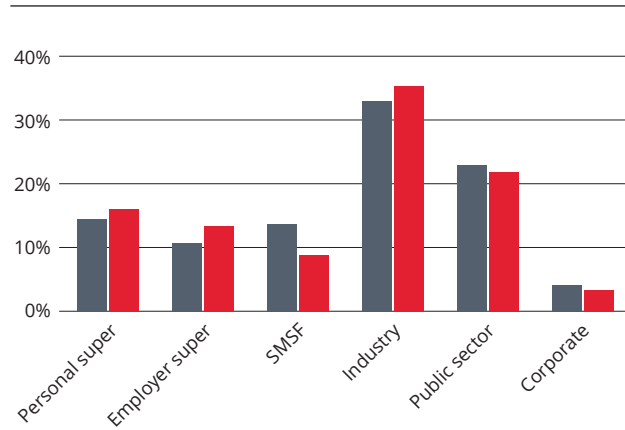
Key Point

- ***Those with high balances in accumulation and pension phase are expected to direct funds into other tax-effective investments over time, including separately managed accounts and other fund products.***

A report by Australian financial research firm DEXX&R has concluded that many SMSF trustees, especially those with larger balances, will look to investment opportunities outside of the superannuation sector to counter the impacts of lower contribution limits, new cap limits and higher taxes.

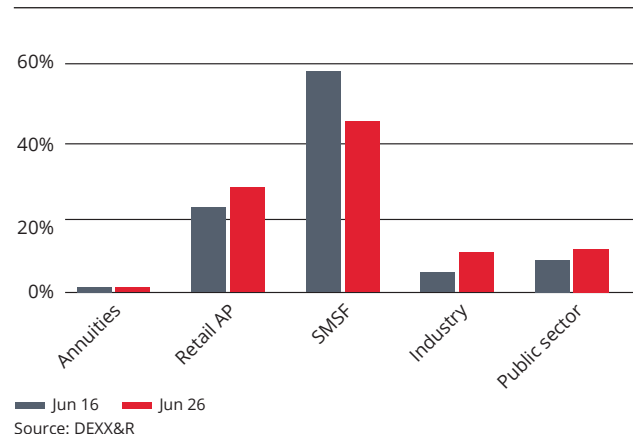
In other words, expect a marked shift in investment strategies over time by self-directed investors into tax-effective non-super products such as separately managed accounts (see [**Investors are swarming to Separately Managed Accounts**](#)), insurance bonds, wrap accounts, master funds and other investment alternatives such as direct property.

Chart 1: Accumulation FUM as percentage of total



As a result of the November super changes, DEXX&R estimates an additional \$9 billion will be available to be invested outside of the super sector in the 12 months from July 1, 2017.

Chart 2: Retirement income FUM as percentage of total



DEXX&R believes that for those still in accumulation phase, the lower cap on concessional contributions and the lifetime cap on non-concessional contributions will result in a slowdown in the rate of growth of assets held in SMSFs and new funds transferred into SMSFs.

Impacts on funds on accumulation phase

The annual growth in funds under management and administration (FUM/A) in SMSFs is expected to fall from 4.1 per cent per annum to 2.9 per cent per annum as a result of the federal budget changes.

Contribution inflows into SMSFs are expected to fall by \$3.4 billion in the 12 months from July 1, 2017 contributing to the slowdown in FUM/A growth for SMSFs in the accumulation phase.

The Government's changes may also result in some leakage of SMSF funds into managed superannuation products.

“Expect a marked shift in investment strategies over time by self-directed investors into tax-effective non-super products.”

Impacts on retirement income phase

SMSFs are also expected to feel the greatest impact of the \$1.6 million maximum account balance, according to DEXX&R.

This is likely to result in increased flows from SMSFs in the retirement income phase back into retail and industry fund allocated pensions as the fixed ongoing cost of compliance for an SMSF income stream account will erode any cost advantage for a self-managed account with a declining balance.

Direct property ownership is the only asset category that is almost exclusive to an SMSF, however DEXX&R noted there are issues around suitability of holding a large, relatively illiquid investment in an account designed for regular drawdown of the account balance.

SMSF pension accounts are projected to hold \$609 billion in FUM, 46 percent of total retirement income assets in 2026, down from the 60 percent in 2016.

Opportunities in outside products

DEXX&R believes life companies and fund managers stand to benefit most from renewed interest in tax advantaged ordinary insurance bonds, particularly for those on higher

incomes with a marginal tax rate in excess of the company tax rate applicable to life companies.

Any future reduction in the company tax rate will increase the tax advantage offered by these products to those on high incomes.

Non-super investments

Retail savings are predicted by DEXX&R to experience the strongest growth of all market segments over the 10 years to June 2026.

FUM is projected to grow 10.6 percent per annum to \$515 billion, up from \$188 billion at June 2016.

“This higher growth rate will be fuelled initially by an expected outflow of funds from the superannuation phase as a result of the November 2016 super changes and the redirection thereafter of discretionary contributions that would have previously have flowed into self-managed funds and to a lesser extent personal super products.”

InvestSMART has a range of **tax-effective managed fund investment products**.

After bottoming out below \$US30, there is newfound optimism around oil in the wake of the OPEC supply deal, with Australian gas producers set to benefit. But there's also a Trump wild card.

BY TIM TREADGOLD • EUREKA REPORT • 25 JANUARY 2017

The oil and gas picture brightens

Oil is shaping up as the resources recovery story for 2017 as the price holds above \$US50 a barrel and looks like moving higher.

Key Point

- ***Currently, LNG is priced against oil but that's changing as a global market in LNG develops and new gas pricing structures emerge – potentially higher than oil.***

And, for Australian investors, an equally interesting change is emerging in the way producers perform financially.

Gas, in its liquefied form (LNG), has become the dominant feature of the local industry, with the traditional LNG leader, Woodside Petroleum, being joined by a newcomer, Origin, and two other oil companies which are increasingly LNG-dependent: Santos and Oil Search.

A glimpse of this LNG-heavy future can be found in the December quarter reports from the big four, with Santos and Origin heavily influenced by their interests in two of Queensland's new LNG projects.

The importance of LNG's rise is two-fold: price and project life.

Currently, LNG is priced against oil but that's changing as a global market in LNG develops and new pricing structures emerge, potentially separate from oil and possibly higher because gas is a premium and less polluting fuel than oil.

Life expectancy is also different with most oil projects enjoying short – and sometimes spectacularly profitable – early years before declining sharply. LNG projects, in contrast, are long-life assets. This feature can turn them into a sort of resource-sector annuity – still carrying resource risk, but less than a pure oil play exposed to daily oil-price moves.

The Australian scene

The Australian LNG-exposed stock of most interest in the next few months will be Origin as it spins off its small oil and gas assets into a new ASX-listed business to become a company with a legacy energy markets division (retail

gas and electricity) and a 37.5 per cent stake in Australian Pacific LNG.

Investment banks are keen on the new-look Origin, mainly because it simplifies a complex corporate structure and creates a company with two fairly predictable sources of income, retail power supply and a long-life LNG interest.

Morgan Stanley believes Origin shares should re-rate as the new structure emerges. *Intelligent Investor* has a hold recommendation **on the stock**.

Woodside and Santos both produced impressive December quarter production reports last week, setting the scene for their full-year financial results next month with Santos also scheduled to finalise a \$1.5 billion capital raising on January 31.

Oil Search, the fourth locally listed LNG stock, released its December quarter report this week with production for the calendar year up a modest 3 per cent.

What's happening in LNG is both a predictable and a fundamental shift in Australian oil and gas which follows the surge of capital investment in new projects in WA, Queensland the Northern Territory.

Changing international dynamics

Layered over the Australian shift into an LNG future are hints that the global oil market is adjusting to the reality of abundant supply in the long term with the price unlikely to rise sharply, and nor is it likely to plunge back below \$US30.

And then there's the wild card in the form of new US President Donald Trump who is keen to see the US expand its conventional and unconventional (shale) oil output to ensure oil and gas self-reliance, while also encouraging increased exports.

More US oil and gas could depress prices, though, while even as the US steps up its exploration effort with more drilling rigs returning (encouraged by a US price of around \$US53, and \$US55 in Europe) there are production cutbacks elsewhere.

“ The return of ‘long’ investors is a sign that an increasing number of fund managers believe that the worst is over for oil.

It is this clash between the free-wheeling US approach to oil and gas (let the market decide the price) and the attempt to control production by members of the OPEC cartel which will set the tone in the oil market for the next few years, and possibly for decades.

The outlook is, in part, an ironic flip in the oil market from a time when ‘peak oil’ meant peak supply, to the new interpretation, which means peak demand.

More US oil increases pressure on OPEC and Russia, an ally of the oil producer’s club, which have cut production faster and deeper than promised before Christmas, helping the oil price to stay above \$US50.

At a weekend meeting of OPEC and Russian officials in the Austrian capital, Vienna, the promised cut of 1.5 million barrels a day was reported to have been achieved despite widespread doubts given a history of OPEC-members cheating in past attempts to limit output.

The return of long investors

That news of a successful reduction in supply has sparked newfound enthusiasm for oil, with more ‘long’ positions (a belief that the future price will rise) being taken by oil investors than at any time since mid-2014 when the oil glut drove the price down from more than \$US100 to – briefly – less than \$US30.

The return of ‘long’ investors is a sign that an increasing number of fund managers believe that the worst is over for oil, though the trend will now probably be a slow upward move tempered by concern that the glut could return.

Strong Asian demand for oil is underpinning this upward trend as the OPEC production cuts deliver the circuit-breaker which will help remove some of the oil surplus which has been depressing the price.

For Australian investors with an interest in oil and gas there is a brightening picture emerging, created by the promise of a steady price for oil with financial performance aided by a significant decline in operating costs and the first substantial flow for cash from new LNG projects.

Good news as that upward trend is in the sector, the wild card is Trump, an unknown factor in both politics and business.

If Trump succeeds in encouraging a US oil and gas renaissance, possibly turning the US into a major oil and gas exporter, he might also achieve two long-held US foreign policy objectives; the destruction of OPEC and financial pain for oil-dependent Russia.

Risk, as ever, is high in oil and gas but the trend today is the most positive it has been since the mid-2014 price crash.

With the mining boom well behind us, capital investment by businesses has been on the wane. But new data showing a pick-up in commercial lending activity suggests the non-mining sector is keen to invest.

BY CALLAM PICKERING • EUREKA REPORT • 24 JANUARY 2017

Are non-miners turning the investment corner?

The missing ingredient in Australia's economic transition – the ongoing shift away from mining investment – has been a lack of investment by the non-mining sector.

Key Point

- **Increased capital investment by businesses should translate into a rise in jobs numbers. But the billion-dollar question is whether the latest lending numbers point to an ongoing rise in investment activity.**

Australian businesses struggled in the aftermath of the global financial crisis and eight years on we continue to see its influence on our business leaders.

The lack of investment from the non-mining sector is most readily apparent in the employment figures we see each and every month. But it's also apparent in the productivity figures that continue to disappoint year after year.

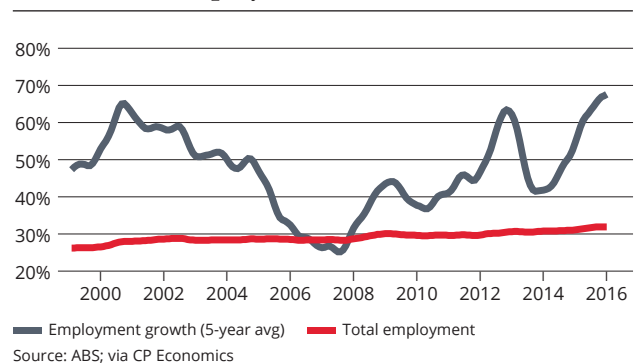
At the heart of the problem is a disconnect between interest rates and the returns that businesses seek from new investment. Evidence suggests that the 'hurdle rates' for new investment tend to be excessively high for many companies. Australian business leaders are often seeking returns that simply aren't reasonable or likely in a low interest rate environment.

In an ideal world, business leaders would look at available investment opportunities and put their money towards the project or projects that offers the highest estimated return. But if that return isn't particularly high, as is often the case in a low interest rate environment, then business leaders may instead decide that it is better to simply hold off rather than lock funds into a long-term and potentially risky project.

Undeniably there is a logic to it and business leaders aren't stupid. But the process of delaying investment and holding out for greater returns isn't without its cost. It's bad for long-term growth and productivity and it's also bad for employment growth, which underpins domestic demand and expenditure.

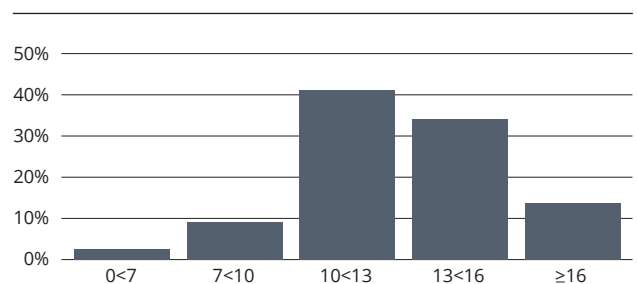
Full-time employment fell throughout most of last year and employment growth has generally underperformed compared with history since 2011. Part-time employment has accounted for two-thirds of employment growth over the past five years, which indicates that employment growth hasn't been centred in high-wage, high-productivity roles.

Chart 1: Australian part-time employment – share of total employment; trend



Another symptom of a lack of investment across the non-mining sector is the high dividend payouts across Australia's largest companies. Over the period from 2005 to 2015, Australia averaged a dividend payout ratio of 67 per cent. This compares to 60 per cent in the United Kingdom; 55 per cent in Europe and 48 per cent in the United States. It jumped to over 80 per cent in 2015.

Chart 2: Hurdle Rates – For investment decisions, share of firms



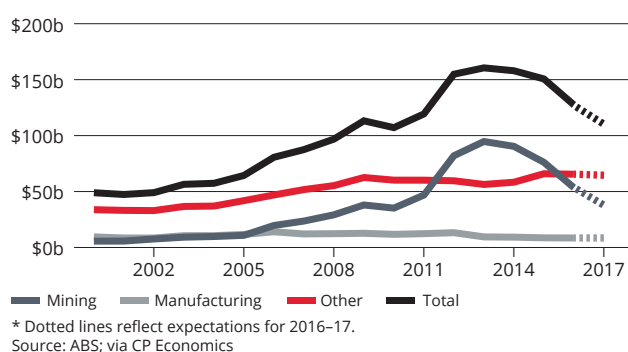
“Current expectations is that investment spending in the non-mining sector will be broadly unchanged from 2015–16.”

A lack of investment has, to some extent, been a positive for investors. At least in the short term. Money that isn't being invested has often ended up in the pockets of investors, which has supported spending and removed pressure on household budgets.

Nevertheless, it will be impossible to maintain existing dividends in the long term unless businesses begin to invest in the productive capacity of the Australian economy. An economy with insufficient investment rarely sees sufficient productivity growth and productivity is ultimately the only source of long-term sustainable growth.

Recent developments on the investment front are pretty mixed and warrant further discussion. We know that mining investment has been falling – it's a natural result of a once-in-a-lifetime investment boom – so we shouldn't focus too much on further investment in that sector.

Chart 3: Australian capital expenditure annual investment; nominal



On a quarterly basis the Australian Bureau of Statistics (ABS) releases a survey that estimates capital expenditure expectations across Australian corporates. It provides some insight into how investment will develop over the next 12 to 18 months.

Chart 3 shows expectations for capital expenditure for the 2016–17 financial year. Current expectations is that investment spending in the non-mining sector will be broadly unchanged from 2015–16.

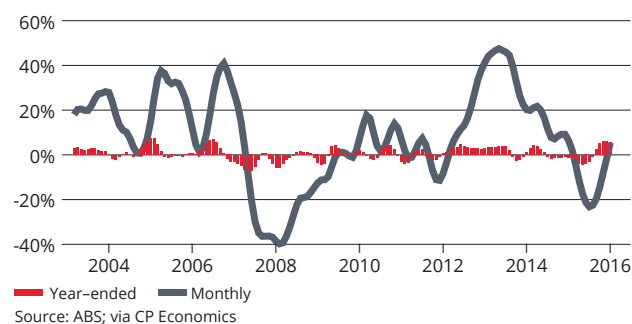
Thankfully other areas of the economy have helped to mitigate this lack of investment. Residential construction has been a key source of growth and household spending has held up a lot better than might be expected given the ongoing weakness in wage growth.

The good news though is that there is mounting evidence that the non-mining sector may be ready to turn the corner. On Monday the ABS released new data on commercial lending activity, which suggests that businesses are beginning to borrow again.

Commercial lending isn't entirely used on investment – around a quarter of commercial lending is devoted to revolving credit facilities – but most of the recent growth has been concentrated in fixed facilities, which are largely related to investment and supporting investment.

Also, by virtue of the fact that the mining sector looks to foreign markets for financing, we can conclude that the growth in commercial lending is concentrated within the non-mining sector.

Chart 4: Value of commercial lending ex. refinancing and net of cancellations & reductions; trend



Whether this persists is obviously the billion-dollar question. If it does then we will begin to see a turnaround in employment and stronger investment and productivity growth. That scenario is an exciting one for investors.

“ By virtue of the fact that the mining sector looks to foreign markets for financing, we can conclude that the growth in commercial lending is concentrated within the non-mining sector.

If I was to play devil's advocate for a moment I'd note that the earlier ramp-up in commercial lending throughout 2014 didn't exactly lead to a boom in non-mining investment. Though it is also worth noting that there can be some lag between receiving approval for a commercial loan and actually making an investment.

The first real evidence we will receive on this front will come on February 23 when the ABS releases its update on capital

expenditure expectations. A sizable upgrade for non-mining investment in February will put the economy and transition on a much surer footing.

I will be paying close attention to the investment and lending data in the months to come, and investors would benefit from focusing on investment as a useful proxy for further performance.

Under the in-house assets rule a fund can place some assets in investments, loans and leases with related parties. If well structured, these arrangements can have considerable tax benefits.

BY GRAEME COLLEY • EUREKA REPORT • 27 JANUARY 2017

The ins and outs of the in-house asset rules

One way of maximising the overall tax advantages provided by superannuation concessions is to use the investment rules, particularly the in-house assets rule, in the Superannuation Industry (Supervision) Act (SIS Act) as effectively as possible.

Key Point

- ***Trustees need to be aware of what the rules allow and disallow. The rules are complex, and getting them wrong will have consequences.***

In a nutshell

The in-house assets rule allows the fund to place a limited amount of its assets in investments, loans or leases with those 'related' with the superannuation fund. The overall benefit is that the fund can earn income from them at a reasonable rate, and may receive tax benefits for the rent, interest or other income paid to the super fund by the 'related' party.

The amount of a fund's in-house assets must not exceed five per cent of the market value of its total assets. This may sound restrictive but there are many exceptions to these rules which allow investments technically treated as in-house assets to be made without the limits applying. Measurement of the fund's in-house assets takes place each time an asset is acquired and at the end of each financial year.

At first blush, the legislation in Part 8 of the SIS Act and the mass of information written on in-house assets seem to be an exercise in working out the detail of the trees from the forest. The detail is more relevant to self-managed super funds (SMSFs) as a minor shift in value or change in ownership can bring an investment within the in-house rules in an instant. Sometimes rectification may be easy, other times much less so.

Is it an in-house asset - or not?

What constitutes an in-house asset is generally easy to understand. It is an investment, loan or lease made to individuals or other entities 'related' to the superannuation fund. Related entities include fund members and trustees as well as certain trusts or companies they control. While the

definition of who is a related party may have some twists and turns, the wide range of exemptions are much more difficult to navigate. The exemptions, however, also provide the best advantages from a tax and retirement planning perspective.

The first group of exceptions are there for two purposes. The first is to avoid unintended consequences and the other relates to the policy behind the rules. From a common sense point of view, some of these exceptions allow superannuation funds of large organisations to make certain types of investments in, or loans to, that organisation without being treated as in-house assets. Examples include superannuation funds of insurance companies that are able to hold insurance policies in the company for fund members, and banks being able to maintain bank accounts of the bank's superannuation fund.

The exceptions due to policy reasons provide advantages mainly to SMSFs. For example, an SMSF can lease business property it owns to a related party. This provides the fund with a level of certainty in relation to the possible income that is expected to be received. For the tenant, it also provides safety in that the landlord is known and may also be a fund member or trustee. However, any lease made must be on a commercial basis to ensure it's compliant with ATO regulation.

Another exception is the fund investing in companies and unit trusts which are controlled by related parties. The value of most of these investments will be included in the fund's in-house assets. However, if the company meets certain rules and is not geared they will be excluded from the limits. One of the benefits of the ungeared companies or trusts is that the fund is able to purchase units or shares in conjunction with others, including related parties. This provides a much more flexible investment compared to the fund owning the investment in its own name or jointly with others. The downside of these arrangements is that a breach of these very specific rules may result in the shares or units being included in the fund's in-house assets. This could result in the fund exceeding the five per cent limit and the fund may be required to dispose of the shares or units.

“In some cases a company or unit trust may be controlled by related parties because they own more than 50 per cent of it or other rules relating to control are met.

The second level of exceptions is the transitional rules which still have their place despite the fact they ended in 2009. These exceptions related to funds with investments in companies and unit trusts in 1999 which were not in-house assets at the time. The funds were allowed to purchase additional shares in the company or units in the unit trust up to the level of any dividends or distributions made between 1999 and 2009. The additional shares or units purchased by the fund are not included in the fund's in-house assets at any time. There was another rule which acted as an alternative to allow additional shares or units to be purchased if there was an outstanding mortgage in the underlying company or unit trust investment.

Yes it's an in-house asset, but...

Once an investment, loan or lease falls within the definition of an in-house asset, does this mean it will always be included as an in-house asset of the fund? It will depend on whether the person, unit trust or company falls within the meaning

of related party. In some cases a company or unit trust may be controlled by related parties because they own more than 50 per cent of it or other rules relating to control are met. Where the ownership by related parties drops to 50 per cent or less then control may not exist. This will mean those shares or units held by the superannuation fund will not then be included in the fund's in-house asset percentage.

Now that we have covered the main parts of the in-house asset rules you can appreciate trying to see the trees, vines and other greenery from the forest can be very difficult. However, for clients that have SMSFs and wish to maximise the overall tax advantages of super concessions, an understanding of the investment rules, particularly the in-house asset rules, can benefit the client's business as well as their retirement planning.

Graeme Colley is Executive Manager, SMSF Technical & Private Wealth, at Super Concepts.

Max: SMSF approaches for CGT and couples for addressing the impending \$1.6m pension cap.

BY MAX NEWNHAM • EUREKA REPORT • 24 JANUARY 2017

Tax with Max: Pensions and the new cap

Q. *Given the introduction of the \$1.6 million limit in pension mode, and aggregating the profits for tax, does it not make sense to sell all shares making reasonable capital gains to consolidate profits prior to implementation of the changes? One could re-buy and perhaps re-weight the portfolio slightly?*

A: Your idea of selling shares now with large capital gains while your fund is in pension phase, to realise the capital gains and not pay any tax, would work but result in the fund incurring transaction costs of selling the shares and is not really necessary.

In addition, your idea of buying back the shares at some later date could be fraught with danger as the ATO has signalled these sale and buyback strategies, where the sole or dominant purpose is obtaining a tax benefit, could be disallowed under part IVA of the Income Tax Assessment Act.

Thankfully, when the final form of the superannuation changes was announced towards the end of last year, the Turnbull Government and legislators recognised SMSF members that had been in pension phase for many years could be seriously disadvantaged.

To this end the legislation introducing the \$1.6m pension transfer cap/limit included some capital gains tax relief for superannuation fund members. The CGT relief not only includes account-based pensions but also transition-to-retirement pensions rolled back to accumulation. To access the exemptions there are a number of actions that must be taken before July 1, 2017, which is being referred to as the 'pre-commencement period'.

For SMSF trustees to access the CGT relief the first step is to ensure that no member's pension balance exceeds the \$1.6m limit by more than \$100,000 at July 1, 2017, and the trustees of the fund must notify the ATO in writing of their choice to apply the CGT relief to assets of the fund.

How the CGT relief is applied to assets and investments of an SMSF depends on whether the fund currently uses the segregation or the proportionate method for calculating tax payable on accumulation accounts.

When a fund has both accumulation and pension accounts, up until the new superannuation changes, they had a choice of using either of the two methods. Under the segregation

method the investments of the fund are allocated and split between pension accounts and accumulation accounts.

The proportionate method does not require assets to be allocated between the two types of accounts but instead an actuarial report must be obtained to identify the income that is related to the accumulation accounts, and therefore taxed at 15 per cent.

The ATO has advised that where all SMSF fund members are receiving account-based pensions, and the combined market value of all of the investments of the fund equals the value of the account-based pensions (in other words, all of the members are in pension phase and there are no accumulation members), the fund is regarded as being a segregated fund.

In this situation members must identify what value of the pension account exceeds the \$1.6m limit, then partially commute the pension and roll back the excess into an accumulation account. At this point the trustees need to identify the assets that will be regarded as supporting the accumulation account and the cost base of those investments will be reset to their market value at the date of them being allocated to the accumulation account.

This will be done by there being a deemed sale and deemed purchase of the asset at the date of the transfer. Trustees of SMSFs will need to ensure that their accounting system will take account of the reset cost base for those assets used to support the accumulation accounts.

From July 1, 2017 SMSFs and small APRA funds, with a member that has a total superannuation balance that exceeds \$1.6m before the start of each year and the member is receiving an account-based pension or similar retirement phase benefits, will no longer be able to use the segregation method.

This will mean from July 1, 2017 SMSFs in this position will need to use an actuary to calculate what proportion of the super fund's earnings relate to the pension account members and what relates to the accumulation account members.

I'm not sure whether actuaries will be required to calculate what part of capital gains made on investments that receive the CGT relief are tax-free, or whether this will need to be done by the trustees or their accountants at the super fund level.

“ If both you and your wife are over 65 and not working there is no way that you can even up your superannuation.

Because the superannuation changes are so new and not finalised – for example, the approved form that must be lodged with the ATO for trustees that want to use the CGT relief has not yet been released – you should seek advice from a professional that specialises in the SMSF area as there are a number of strategies that can be used to reduce the impact of the super changes.

Q. *Until now it didn't matter if a spouse had most of the money and the partner was light on. Is there any way of being able to even it up when both are over 65 and not working? It seems a retrospective tax to me, which is a bad precedent adversely affecting a small number of people.*

A. When the superannuation changes were finalised, and the retrospective limit on non-concessional contributions of \$500,000 was dropped, other parts of the proposed legislation announced during the election were also dropped.

One of the changes that did not make its way into the final legislation was the removal of the work test for people aged 65 and older who wanted to make super contributions. If both you and your wife are over 65 and not working there is no way that you can even up your superannuation.

Even if you were able to pass the work test, due to the non-concessional contribution limit being reduced to \$100,000 it would be very hard to make a significant change where one of you holds the bulk of the superannuation in your SMSF.

Members that find themselves in an SMSF where one of them has most of the superannuation, that member has a pension account balance of more than \$1.6m, and they have little to no investments outside of superannuation, should consider commuting a portion of their SMSF and invest the proceeds in their own names.

If the excess is not paid out and is instead commuted back into an accumulation account, the income earned on that portion of the SMSF assets will be taxed at 15 per cent. Due to the tax-free income threshold of \$18,200, and the low income and senior Australian tax offsets, each member of a couple can earn approximately \$28,000 a year and not pay income tax. On a 6 per cent income yield a married couple could have a combined total of investments outside of superannuation of approximately \$900,000 and not pay any tax on the income.

This means that couples worried about being disadvantaged due to the introduction of the new \$1.6m pension limit should seek professional advice to find ways that the adverse tax impact of these changes can be reduced and limited.

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

General Advice warning: Eureka Report Pty Ltd: ABN: 84 111 063 686 AFSL No: 433424. This article may contain general advice and has been prepared without taking into account your objectives, financial situation or needs. Before acting on this information, you should consider if it is appropriate for your circumstances. Where the information relates to the acquisition of a product, you should obtain the PDS and consider this before making your decision

There are at least seven obvious investment strategies for 30-year-olds that can help put them on the path to financial comfort.

BY CAROL TAWFIK • EUREKA REPORT • 27 JANUARY 2017

An investment guide for your 30s

So it's 2017, and you're approaching or are already in your 30s. If, up until now, your personal financial management has been limited to the basics, you are far from alone.

Key Point

- ***In your 30s, time is still very much on your side. Investing into growth assets such as shares makes sense, however a lot depends on your personal risk appetite.***

I am often asked by friends, “is there anything I should be doing other than just saving for a deposit/paying as much as I can off my mortgage?”.

While these are fantastic things to be doing, there are a number of other financial ducks that can be lined up which, once dealt with, can not only put you on a great footing going forward but also won't necessarily need a great deal of your attention immediately thereafter.

Perhaps, like many of us, the New Year inspires a bit of motivation to get things done. So before the daily grind takes hold, here are some items which place highly on the list if “getting financially sorted” as you settle into your 30s is part of this year's resolutions.

Superannuation asset mix

I wrote here about the importance of making a conscious choice about your superannuation investments, a decision which can make a marked difference to your trajectory and investment value over time. While a hunt for higher returns almost certainly requires acceptance of a higher level of risk, time is a force to be reckoned with and in your 30s you've really got this on your side.

The longer you have to invest, the greater the impact and a 1 or 2 per cent higher average per annum return might make a greater difference than you think. James Carlisle's article ‘The magic of compound interest’ is certainly worth a read and highlights also the value of time.

Growth investment

Paying down non-tax deductible debt like a mortgage as quickly as possible is great and, in most cases, will be the

core strategy and priority. But the strategy could also call for a review, depending on a few things, not least of which is your personal appetite to investment risk.

Any monies applied to your home loan represent an immediate risk-free after-tax return equivalent to the interest rate, which is pretty good.

Is it possible, however, to do better than this? It is, but not without taking some risk, and investing in growth strategies like shares. Particularly, given today's low interest rate environment, establishing a growth investment alongside the investment in a home might be viable (with a long-term outlook).

Income protection insurance

This is a big one. I wrote here about Australia's underinsurance issues so, again, you wouldn't be alone if getting income protection to cover you in the event of a serious illness or injury is something that has kept you up at night.

We tend not to think that bad things will happen to us, especially when you're relatively young, fit and healthy.

But if you had a machine at home that spat out the equivalent of your income every year, you probably would insure it – right?

You can typically cover up to 75 per cent of your income with payments until you are aged 65 (if an illness/injury means you can't work). Getting the cover locked down in your early 30s is a good idea, because it often means you have yet to experience any major health issues that the insurance company might otherwise specifically exclude or attach an additional cost to cover.

Health insurance premium loading

Lifetime Health Cover is a government initiative which was introduced some years ago with the objective of encouraging younger people to get hospital cover. In summary, an extra cost applies to your hospital cover premiums – 2 per cent for every year over 30 – unless you have cover in place by the July 1 following your 31st birthday.

“ You can typically cover up to 75 per cent of your income with payments until you are aged 65. Getting the cover locked down in your early 30s is a good idea.

So, you could end up paying, for example, an extra 20 per cent by age 40 and so on. If there is no other impediment to taking action on health cover, these provisions make it worth getting the ball rolling.

Think about cost of kids ahead of time

Starting a family may or may not be immediately on the cards, but thinking ahead is a good move. It is easy to make the financial commitment that comes with a mortgage based on current circumstances. But just as we might stress test for interest rate movements, testing for other life changes is equally important. Things to think about might include:

- Knowing how you would deal with the upfront financial cost of having a baby;
- Your ability to cope with all household expenses on one income;
- Returning to work and whether flexibility is important to you;
- Whether ‘going backwards’ for a period of time is viable, and so on...

Without some realistic forethought, little room to move financially today might translate into serious financial strain and emotional stress later on.

Wills and estate planning

Isn't it way too early to be thinking about a will, especially when you have yet to amass ‘enough’ assets?

The short answer is no. Dying without a will (called ‘intestacy’) can mean that your assets would be distributed in line with a formula set out by law and will depend on whether you have living parents, children, a partner and so

on. It may or may not line up with either your expectations or your intention. There can also be an extra layer of complexity around the physical administration of your estate, potentially causing unnecessary stress on loved ones (not to mention potential conflict). That's not likely to be a legacy any of us want to leave behind.

Estate planning can be a complex legal area so it is recommended that a solicitor is engaged to make it all happen. Usually it won't take more than one or two appointments, and once it is done you won't likely need to refresh until your circumstances materially change.

Automation

I probably don't need to tell you that technology is your friend. When it comes to saving, investing and budgeting there has been fantastic innovation and development which makes it much easier to get organised, all from your website or smartphone.

‘Micro investing’ is one such great example. More to the point, managing money can be time consuming and exhausting, so using technology to automate the process is just as much about making life easier as it is about consistent action, which is the key.

Though it may seem that you have plenty of time up your sleeve when it comes to money management, there can be no better feeling than knowing things are in order. The long-term impact is likely to be a great return on the upfront ‘time investment’ made at 30.

Carol Tawfik is a Certified Financial Planner and advisor with Affinity Private.

BKI's portfolio manager addresses a flat performance by the large-cap Australian equities portfolio, and gives his views on banks and the dollar.

BY MITCHELL SNEDDON • EUREKA REPORT • 25 JANUARY 2017

VIDEO: Tom Millner of BKI



The results of listed investment companies (LICs) shouldn't come as a surprise to investors who have been following the monthly updates.

For Brickworks Investment Company (BKI), for example, we already knew that its portfolio returned a disappointing 5 per cent for the 12 months to December and that the total shareholder return was just 2.9 per cent. This is compared to the S&P/ASX 300 Accumulation Index returning 13.4 per cent.

There are, though, a few things to look for in annual or half-yearly results. The fees and expenses are on this list, and in this there was good news.

After externalising the management agreement, the management expense ratio has decreased to 0.14 per cent from 0.16 per cent. You cannot get an exchange traded fund at these rates.

It's also worth looking out for the consistency of the message being provided, especially when it comes to explaining performance, good or bad.

Consistency is something BKI has shown and it is on display here. Dividends are such a heavy focus for the portfolio – through holding companies that consistently pay them, to paying out a growing stream to shareholders.

The focus on dividends goes a long way in explaining the underperformance. The portfolio was significantly underweight in resource companies, which have rallied hard over the past 12 months (the S&P/ASX Resource Index increased 42 per cent in the 12 months ending December 31).

We spoke to BKI's portfolio manager, Tom Millner, on the day the results were released, discussing the portfolio performance, BKI's bank exposure as well as plans for an LIC based on investing in the thematic of 'urban regeneration and renewal', conveniently called URB Investments. You can see the video above.

The stock is up 7.05 per cent since we looked at the LIC back in October, and we continue to recommend that you **HOLD**.

To watch the video, please [click here](#).

eureka report