Weekly Review

WEALTH

❸ THE BIG ISSUES OF 2017 | ❻ THE ABCC OF BUILDING, AND PENSION RENOVATIONS | ❽ DON'T WORRY ABOUT VOLATILE MARKETS

– Issue – 2 Dec. 2016

Financial product issuers are in a head-to-head battle to win market share. And more and more fund managers are trying to outflank their competitors by cutting their management fees.

BY TONY KAYE • EUREKA REPORT • 1 DECEMBER 2016

The importance of being fees aware

Investing 101 is all about knowing what you're buying – understanding the asset, its track record, and the variables that will determine its overall performance.

Key Point

- ***In a low-return environment delivering 5–7 per cent before costs, some funds are still charging fees of up to 2 per cent per annum.***

It's not rocket science, you may say, and if you're buying into a financial product such as a managed share fund, an exchange-traded fund, or a listed investment company, there's not much else to know, is there?

To think so would be a dangerous assumption, and many investors continue to miss the big beast in the room that can quickly gobble up gross investment returns – product management fees.

And in a relatively low-return environment such as the one we are experiencing now, the level of overall fees being charged by some product issuers is doing just that. Indeed, investors are being hit with ongoing annual product management fees of 2 per cent or higher on some products, equal to roughly a third of their total gross return.

What's worse is that the highest management fees being charged are by the actively managed investment funds whose primary mandate is to outperform against their market benchmark. In most cases, they haven't.

A recent report from S&P Dow Jones Indices found that of 608 Australian actively managed equity funds benchmarked against the S&P/ASX 200 Index, 60 per cent actually underperformed the index in the year to June 30. Over three years, 66 per cent of managers underperformed, and over five years 69 per cent failed to make the grade.

The S&P Indices Versus Active Scorecard (SPIVA) also found that 81 per cent of 294 active managers had underperformed the S&P Developed Ex-Australia Large-Midcap Index in the last financial year, and 89 per cent of 66 active managers had underperformed against the S&P/ASX Australian Fixed Interest Index.

Why have actively managed funds underperformed? Just ask Warren Buffett, the billionaire US investor who famously bet $US1 million in 2008 against the asset management firm Protégé Partners over whether a fund that invested purely in the S&P 500 Index could outperform five different actively managed funds.

So far, Buffett's 10-year wager is massively ahead, with the S&P 500 Index up more than 70 per cent compared with returns of less than half of that by the hedge funds chosen by Protégé.

But the hedge funds always have had extra lead in their saddlebags, with their investment performance being eroded

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by average annual fees of 2 per cent. On top of those, the funds are able to levy a 20 per cent index outperformance fee. By contrast, Buffett's chosen fund has a flat annual fee of only 0.05 per cent.

In Australia, according to S&P Dow Jones Indices, the average management fee being charged by active equity managers is 1.24 per cent per annum, versus just 0.33 per cent by passive funds that simply track the Australian market.

Listed investment companies, which invest in a basket of stocks, have slightly cheaper fees – averaging around 90 basis points ($90 for every $1000 invested), while the average expense ratio of Australian exchange-traded funds is half again at around 45 basis points.

That's because the majority of ASX-listed ETFs are passive index-tracking funds, essentially requiring far less human effort than an active fund that draws on the investment analysis of professional stock pickers.

The battle for lower fees intensifies

In a highly congested and competitive financial products market, the quest by issuers to lower their management expense ratios (MERs) has intensified.

On top of internal management fees and costs, the components of a MER can include everything from platform access fees to brokerage, accounting and legal fees, and other external costs including listing and registry charges.

Many product issuers are tackling both, to win a larger slice of the investments pie. As well as seeking to drive down their external costs, larger product issuers are also using their financial scale based on funds under management as a lever to cut their own fees.

That's showing up in the data, too. A separate report compiled by Morningstar with the Financial Services Council, released in July, shows that the median fees being charged by Australian product issuers have been trending down over across all major asset classes.

Surprisingly, the report also found that Australian product fees were among the lowest in the world, even the US.

"These results, comprising data from some of the world's largest fund managers, show that investment management fees charged in Australia are among the world's lowest (if not the lowest)," Morningstar said. "Anecdotally, the FSC heard from several fund managers that on most occasions, approval had to be sought on a regular basis from head office to lower the fees charged in Australia in order to win business."

Vanguard head of market strategy and communications, Robin Bowerman, says that at the most basic level, lower fees mean the investor gets to keep more of the return.

"You can't control future performance, but you can control costs. In this low return environment, we are certainly seeing some price competition. The cost of investing has been brought down to very low levels."

The head of strategy and marketing at ETFs issuer BetaShares, Ilan Israelstam, adds that lower MERs are one of the primary reasons behind the success of ETFs.

"Nobody is going to argue about ETFs being cheaper. ETFs are either rules based or passive, and if you don't have to hire fund managers you can achieve lower costs that way."

For investors, fees transparency is key, and it's not always there.

In ETFs and LICs, fees are invariably built into a security's on-market trading price. In managed funds, they are easier to discern by virtue of a fund's product disclosure statement.

But behind the scenes, the launch of new products including ETFs, and the increasing use of index-style products, are putting pressure on fees. Active fund managers are being held to account.

"This is an industry where you get what you don't pay for – if you're paying fees to outperform the market, you're likely to be disappointed," says Bowerman.

The general economic picture for Australia remains solid, but overseas factors will be critical for financial markets.

BY CRAIG JAMES • EUREKA REPORT • 30 NOVEMBER 2016

The big issues of 2017

The Australian economy is in good shape. Home building activity is solid in most states and this is, in turn, is supporting the job market and consumer spending. Mining production remains strong although investment continues to ease.

Key Point

- ***The Reserve Bank is expected to stay on the interest rate sidelines for much of 2017.***

The other support for the economy is coming from infrastructure spending by federal and state governments. The Reserve Bank believes governments have scope for even greater spending.

Economic growth is expected to hold in a 2.75-3.25 per cent band over 2017.

The Reserve Bank expects inflation to gradually lift back towards the 2-3 per cent target band. Firm domestic economic growth and an improvement in global economic growth should lead to a modest uptrend in inflation. But at the other end of the equation, technology and globalisation will continue to cap inflationary pressures.

At present we think the Reserve Bank will stay on the interest rate sidelines for much of 2017. The Reserve Bank still has the ability to cut rates if underlying inflation stubbornly remains below the low end of the 2-3 per cent target band. But the Reserve Bank Governor has made it clear that he is not inclined to cut rates again. It still seems a little too early to contemplate rate hikes.

Unemployment is expected to slowly edge lower over the year, easing towards 5.25 per cent, especially if economic growth remains firm as we expect.

The Australian dollar has ebbed and flowed over 2016, responding to a raft of influences. These influences include higher commodity prices, lower Australian interest rates and varying expectations on US interest rates. Over 2017 these same influences will dominate together with the fleshing out of economic policies by the new US administration.

President Donald Trump

While there are some concerns on the policies that will be adopted, the governing principle is likely to be "America First". Rather than adopting a protectionist policy, Trump believes that agreements like NAFTA and the Trans Pacific Partnership aren't in the best interests of the US. So rather than ditching agreements, Trump may pursue modifications. Same goes for how energy policy is pursued. Now whether these changes will be seen as 'reasonable' is the key uncertainty. Much will depend on the advisers and Cabinet that are appointed by Donald Trump. And much will depend on the views of the Republican Congress.

If the election of Donald Trump was seen as a surprise, so has been the initial reaction of financial markets. In Asian trade on election-day the expectation was that the Dow Jones would slump by as much as 900 points. But instead, investors decided to focus on the businesses and industries that will likely benefit from the Trump victory. And the centre of attention has been the Trump policies of lower tax rates and increased infrastructure. The perception is that fiscal policy will be stimulatory. Importantly though markets are running on expectations. As to what actually is implemented remains to be seen.

Is Inflation at an inflection point?

Inflation has featured in our *Big Issues* for a number of years. Last year we asked '*Will we need to worry about inflation again?*' The previous year we posed the question '*Is Inflation dead?*' – clearly tempting fate. And in the 2013 edition of *Big Issues* we questioned: "*Inflation or Deflation?*"

We have continued to find it remarkable, that with interest rates close to zero across many parts of the world and some central banks still injecting stimulus via bond buying, that concerns about deflation still abound. And we don't think we have been alone. Central banks, governments, consumers and businesses have focussed on 'disinflation' – falling annual rates of inflation; and deflation – falling prices.

But there are good reasons to think that inflation is at an inflection point. Now some will point to the expected stimulatory policies of Donald Trump. The view is that lower taxes and increased government spending will lead to stronger investment, spending and hiring. And with economies like the US and Australia arguably getting closer to 'full employment', the risk is that will lead to higher rates of inflation.

But the US Federal Reserve has been on course to lift rates for a number of months. The Fed has just had the luxury of stubbornly low inflation rates to allow it to wait. The

> **Firm domestic economic growth and an improvement in global economic growth should lead to a modest uptrend in inflation.**

expectation of stronger fiscal policy has probably given US policymakers that extra assurance needed to decide that another rate hike is appropriate.

There have been other signs that the days of super-low inflation rates are numbered. Chinese demand for commodities has lifted, boosting prices of iron ore, coking coal and thermal coal. Iron ore prices have lifted almost 80 per cent in 2016 with coal prices doubling. The deflation in Chinese producer prices has also ended.

In Australia, the Reserve Bank is working on the belief that inflation has bottomed. And as a consequence, interest rates have probably bottomed. But it also has to be remembered that there are still other influences acting to cap inflationary forces. Advances in technology are keeping production costs down, as well as prices. Competition is increasingly global. And 'disruption' has meant there are more businesses competing against incumbents. And those forces will continue to keep prices low.

Fiscal versus monetary policy

Have central banks run out of options? Central banks would say 'no' – there are always things we can do they would say. Indeed central banks have been inventive in recent years with 'Quantitative Easing' and numerous variants. Essentially QE means printing money. But the economic purists would argue that there are subtle differences. Bonds have been purchased from the private sector in exchange for cash. But other assets have been similarly purchased although with the same intent to get more money into the economy, hopefully encouraging people to spend and invest. And if too much money is looking to buy goods, the result may be higher prices (inflation).

Still, when interest rates are effectively at zero or even negative, there are limits about what central banks can do. The problem has been that there has been a weakening of budget positions across the globe as a result of the Global Financial Crisis, weak economic recoveries, low prices and low wages. So with budgets in deficit, there has been a lessening of political will to spend more, in order to boost economic activity.

It hasn't helped that some policymakers, economic advisers and ratings agencies are still using the old mentality that increased borrowing and spending is somehow risky or a negative policy development. Governments and businesses have good reason to borrow when interest rates are low provided the economic return exceeds to cost of borrowing.

The current Reserve Bank Governor Philip Lowe as well as his predecessor has been active in calling for increased government spending, specifically on infrastructure with the proviso: "*where this is backed by a strong business case. Such spending can provide support for the economy and can help generate the productive assets that a prosperous economy needs.*"

Incoming US President Donald Trump also believes that fiscal policy should support monetary policy, aiming to cut taxes and increase spending on infrastructure in order to boost economic growth. The hope is that more central banks and governments will also support a bigger role from fiscal policy and change some misguided views on the topic.

Housing: Hard or soft landing?

Have we cheated by bringing back one of our Big Issues from last year? Perhaps. But the simple reason is that the issue wasn't settled as we expected this year. Last year we stated the view that "the answer will be revealed over 2016." Clearly the issue wasn't settled at all. And we believe that discussion will continue to swirl about what sort of landing the housing market will experience.

As we noted last year, some would question whether the issue should indeed be listed amongst the Big Issues. Because in many parts of Australia, it is not an issue. It is hard to identify a housing boom outside of Sydney or Melbourne. Although many would add Brisbane to the list of cities to watch.

What actually is the issue in contention? Well, a hard landing would be characterised by a housing market moving from under-supply to over-supply. Simply, too many homes get built on the perception that high and rising home prices

> **“Much will depend on the advisers and Cabinet that are appointed by Donald Trump. And much will depend on the views of the Republican Congress.**

will reward developers and speculators. Rather than home prices rising strongly, the excess of supply compared with demand causes home prices to fall. And if rental properties are in abundance, that may cause other investors to sell up their properties, adding to the oversupply. Think of the US or European economies in the Global Financial Crisis.

At present Sydney and Melbourne home prices are rising strongly with annual growth rates above longer-term averages. Sydney home prices are up 10.6 per cent on a year ago, well above the 6.5 per cent decade average. Melbourne prices are up 9.1 per cent on a year ago, whereas the decade average is 7.4 per cent.

In response to high prices, more homes are being built – especially apartments. Demand for property has been exceeding supply, driving prices higher. Over the next year or two, more homes will be available to buy or rent. The question is whether too many homes will be built.

It is important to remember though that strong population growth is underpinning Sydney and Melbourne property markets. Not enough homes were built a few years ago. In fact in 2009, NSW dwelling commencements hit 56-year lows. Also it is important to note that finance for new apartment buildings tends to be dependent on almost all properties being sold “off plan”.

Editor’s note: This is an abbreviated version of the full The big issues of 2017 report.

Craig James in the chief economist of CommSec.

Separate law changes will impact the major construction companies and many pensioners in different ways, while stock pickers are getting their chance to build wealth.

BY ROBERT GOTTLIEBSEN • EUREKA REPORT • 30 NOVEMBER 2016

The ABCC of building, and pension renovations

As I write this commentary, the legislation to reinstate the Australian Building and Construction Commission watchdog has just passed through the Senate in Canberra.

Key Point

- ***For those likely to be affected by the new Age Pension means test, selling up may not be the answer.***

In all the daily press, TV and radio commentary, almost all the messages will be about the anti unions parts of the legislation. But it is really about the management of listed and unlisted corporations and their future.

Today, I also want to share with you a conversation I had with friends – an elderly couple in their 70s who are about to sell their house and downsize. And I also want to make sure that all *Eureka Report* readers at least consider the current strategies available in superannuation. And, finally, we really have the emergence of a stock pickers share market.

Construction changes to build better management

I probably know more about the inner workings of the commercial building industry than I should. It is not a pretty sight. On the corporate side, the management of our big builders and, to some extent, major suppliers have developed skills to minimise the effect of union disruption. Or at least, that is how it started.

But the situation has evolved beyond that starting point because many of our building companies are big beneficiaries from the current situation in the commercial building industry. And their management at all levels has been promoted on the basis of their ability to maximise corporate benefits from the current enshrined ways of doing business, where the unions control much of the work on building sites.

When the ABCC legislation is fully passed, a whole new management skillset will need to be put in place in many of our large builders. Their long-term success or failure will very much depend on the ability of the CEO and the boards to create a management personnel and structure that can adapt to a new environment.

Now, of course, such fundamental change cannot happen overnight. And so it will take time to discover who can play the new game, and who is set for the scrap heap. We will really need to watch the performance of all those in the commercial building industry to determine who are the winners and losers.

Remember, under the ABCC legislation, if you operate in a way inconsistent with the code on any contract you cannot particulate in government-funded contracts. Perhaps being watched more closely than others will be Lend Lease and CPB Contractors (formerly Leighton). Some years ago, when an earlier version of the building code was in operation in Victoria and Australia, Lend Lease actually began to adapt its management to the new environment.

But then the code was abandoned by the government in Victoria, and Lend Lease lost the lucrative East Link contract in Melbourne because the project was cancelled, in part because Lend Lease had strayed from the union's management pattern to obey the code. So it moved back to the old ways and now, under the new ABCC legislation, it must go forward on the different structure.

But the good news for Australia is that we are going to get far more value for our infrastructure and commercial building investment. The national prosperity will be greatly boosted, and there will be greater certainty.

Age pension changes and the family home

Now to my friends. They will sell their extensively renovated older inner-suburban house and move into a retirement village. Out of the sale and purchase they will get some cash. They also have other assets which takes their non-residential house funds to a little over $800,000.

The current pension rate enables them to receive a part pension with even $1 million in non-residential assets. They knew the situation would change on January 1, so the husband called into Centrelink to check the situation assuming he and his wife sell their house and buy into the retirement village. The Centrelink official beamed and gave him some wonderful advice – go out there and take lots of cruises and get your assets down so you can get more of the pension.

> **“When the ABCC legislation is fully passed, a whole new management skillset will need to be put in place in many of our large builders.**

The Centrelink officer explained that for every $10,000 he and his wife spent on cruises their pension would rise by $780 each year. It was a wonderful investment. The message I received was that the current Government’s ‘money saving’ assets and income tests measures will be very costly, | very quickly.

My friend bemoaned to me: “I don’t like cruises”. My advice was simple. Even though your house is too big, you shouldn’t sell it but rather add more rooms. That way you will still increase your pension, but you will have an asset rather than a memory.

We have elected parliamentarians who simply don’t understand how the pension, superannuation and retirement business works for ordinary Australians.

In the case of superannuation, the number of people that can afford to inject over $500,000 into their superannuation as a three-year non-tax deductible payment is relatively small. But if you do have spare cash or can access spare cash, you have a unique opportunity in 2016–17 to inject large sums into superannuation and enjoy a 15 per cent tax rate.

It does not suit everyone, but if you are approaching 60 then you will be able to gain access to the cash if you need it. Superannuation is going to become a game where couples that have well over $1 million will enjoy a self-funded retirement. For those, like my friends, who gain a partial self-funded retirement but rely on the pension, then that reliance on the pension will increase.

Your ability to assemble enough money to afford a self-funded retirement is going to be restricted by looming clamps on superannuation investment. Although negative gearing can help, funds invested outside of superannuation carry a higher tax rate. And, of course, the more you can split your superannuation holdings with your spouse the more advantageous it becomes.

The rise of the stock pickers

Meanwhile, we are seeing a new development in our stock markets that is going to make investing just that little more complex. In the past we have tended to see the vast bulk of stocks move with the market.

More recently, we have seen our property trusts and infrastructure stocks severely discounted compared to the overall market because global rates are rising. But we are also seeing major variations in stock prices, both up and down. Amongst the companies to increase in value more than 20 per cent include Orocobre, Oz Minerals, Sims, Metal, Western Areas, Monadelphous, A2 Milk, Galaxy and Sandfire. Note the high proportion of small resource groups. BT and BlueScope just missed the list.

Conversely, companies that have fallen sharply include Insentia, Resolute Mining, Aconex, Syrah Resources, Virtus Health and N Boral (the market did not like the US move).

Australia is going to see a strong GDP performance in the coming years, but personal prosperity will not increase by anything like that amount and the same will happen with corporations.

It is going to become a stock pickers market.

While Australian share market returns over 2016 have been relatively flat, over the longer term the ASX has achieved average annual growth of around 10 per cent.

BY THEO MARINIS • EUREKA REPORT • 29 NOVEMBER 2016

Don't worry about volatile markets

There is a common expression by speculators in investment markets to "Sell in May, and stay away" (meaning come back into the market in November).

Key Point

- ***The recent local market's reaction to Donald Trump's election shows why investors need to ignore daily volatility.***

Weirdly, this observes the "Halloween Effect" in October where the market has traditionally been spooked; statistically, it is the month when the big corrections occur. I am pleased to say this year the October impact was minimal.

Markets are fundamentally rational over the medium to long term. In other words, they reflect the value (and the outlook in an uncertain world) of the companies whose shares we buy and sell. It is the tension between fear and greed which causes the frequent corrections, spikes and short-term skittishness.

That is why investors (as compared to speculators) buy and hold quality assets and do not "sell in May, and stay away".

While past performance is no guarantee of future returns, over the last 30 years the ASX has averaged growth of almost 10 per cent per year. This is why I like recommending investments in the market.

A lot of commentators earnestly discuss the Australian dollar. What they usually do, however, is see it merely in relation to the US dollar (generally disregarding the euro and the yuan, which represent equally powerful economies) When the $A slides it is often an indication of strengthening in the $US rather than a weakening in Australia.

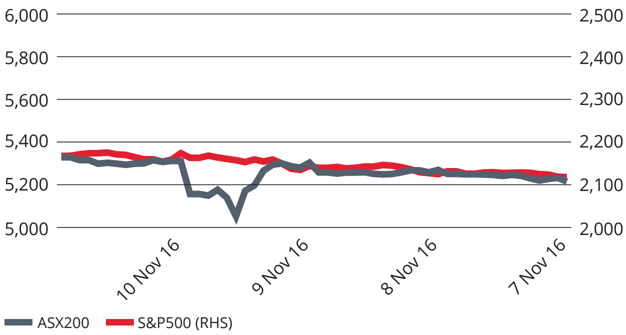
The benefit of a higher Australian dollar is that we can buy things more cheaply from overseas. Conversely, when our dollar is low, our farmers and manufacturers can sell their goods more easily to foreign buyers. So there are both good and bad outcomes of this volatility.

Interest rates are used by the central banks, such as the RBA in Australia, the Bank of England in the UK and 'The Fed' in the US, as a kind of brake on the economy. If the central banks feel economic activity needs a bit of "encouragement", they lower interest rates so money becomes cheaper. If the market is getting "over stimulated", they increase the rates.

Uncertainty, greed and panic drive these market and currency fluctuations, as we saw after the recent US election result in early November.

We saw a similar pattern played out in January this year when the China collapse fears saw the markets fall heavily, only to rebound in February. Then mid-year (with the unexpected Brexit vote) markets tumbled yet again to swiftly rebound above where they were prior to Brexit, with the same panic and bounce back mid-year.

Chart 1: Australian and US benchmark indexes, US election week



Source: Iress, CommSec

During such times I am prompted to think of my clients and friends of more than 17 years, who I have called "Brian" and "Susan" to protect their privacy.

Brian and Susan have been retired throughout the Millennium Bug, the Tech Wreck, Gulf War II, GFC, SARS, Brexit etc, and they have been able to just get on with the full enjoyment of their lives.

I love the fact that they take home more cash in retirement than when they worked full-time.

Like Brian and Susan, everyone should be entitled to enjoy life without worrying about what the financial markets may be doing at any point in time. Indeed, if you are a long-term investor, there is no reason to worry about them at all.

The key is to have a medium- to long-term strategy and to expect (but don't worry about) the inevitable bumps as the market moves around.

After the bumps, the sun will rise again the following day and the markets will start seeking out bargains.

Theo Marinis is a financial strategist and head of Marinis Financial Group.

Infrastructure investments have been seen as a safehaven in times of loose monetary policy but are now coming under pressure as interest rates are slated to tighten.

BY JOHN CONROY • EUREKA REPORT • 30 NOVEMBER 2016

How will infrastructure fare in changing times?

How does infrastructure investing look in late 2016?

The question has been complicated over recent months as, first, global interest rates showed signs of finally lifting and, secondly, this process was bolstered by the surprise election of Donald Trump in the US.

Key Point

- ***Underinvestment in infrastructure in developed economies and hopes of a return to inflation and growth means infrastructure is likely still appealing for long-term investors.***

The question has been complicated over recent months as, first, global interest rates showed signs of finally lifting and, secondly, this process was bolstered by the surprise election of Donald Trump in the US.

After steady growth for years, Australian infrastructure stocks have eased since mid-year, which was the moment many observers are now calling 'the end of the 35-year bond rally', with analysts concerned these stocks had become yield or bond proxies amid the easy money environment.

And while the election of Trump at the start of November mostly saw a bounce in the stocks – in line with broader markets – the big-spending plans of the president-elect are likely to exacerbate the tightening of monetary policy.

So is there a big correction on the cards for infrastructure stocks?

Russel Chesler, investment director at asset manager VanEck, which in May this year launched Australia's first infrastructure exchange-traded fund (ETF), says the retail-focused fund – which is 8.9 per cent domestic with the rest invested in developed markets overseas – was proving mostly immune to the global bond-yield uptick that had accelerated since the US presidential vote.

"From November 8 to current, we've lost only about 1 per cent whereas … the value of bonds has come down more than 5 per cent," he says.

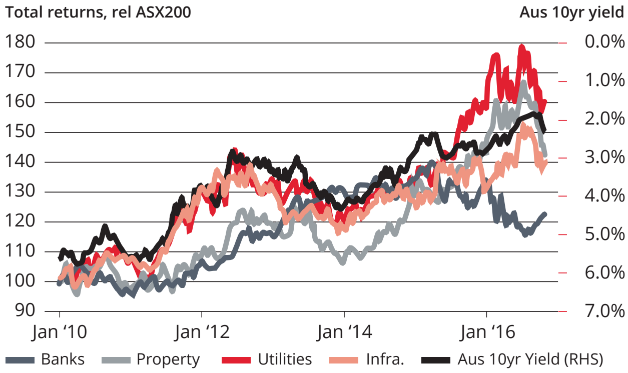
"What you see is that even though interest rates are going up to a certain extent it is offset by inflation expectations going up as well."

But Morgan Stanley this week said "further underperformance" for infrastructure names that had been serving as 'bond proxies' was a possibility.

"With the US potentially joining the fiscal stimulus underway in China and Japan, we flag a scenario that could see further underperformance of bond proxies as markets pull back from what we believe is still a strong deflationary consensus among global and domestic investors that will take time to unwind," the investment bank said in a note.

On a more nuanced level, Chesler says he expected the downside from higher long-term interest rates to weigh more on the debt-heavier stocks.

Chart 1: The fall for 'bond proxies' – property, utilities, infrastructure – in mid 2016 came after years of growth



Source: Morgan Stanley, Datastream

"For infrastructure companies that do carry debt, obviously rising interest rates would have a more negative effect than those that aren't."

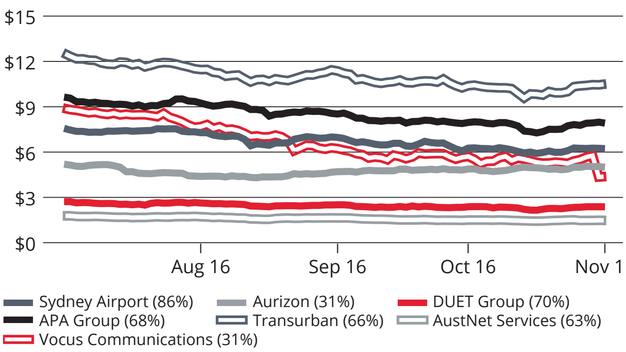
Chart 2 (over the page) shows this theory has not played out obviously since the mid-year falls, although there is patchy evidence for it. (For example, the less geared Aurizon so far appears to have been more resistant to the changing global interest-rate environment.)

> **After steady growth for years, Australian infrastructure stocks have eased since mid-year, which was the moment many observers are now calling 'the end of the 35-year bond rally'.**

A volatility barrier

Meanwhile, a lot of infrastructure is not publicly listed. On the unlisted front, economist Alex Joiner from IFM Investors – Australia's largest infrastructure investment group, which boasts a 10-year performance average of 12.1 per cent – says privately-owned infrastructure was set to benefit from the recent changes in global market dynamics.

Chart 2: Australian infrastructure stocks' performance since mid-year (with their debt ratio in brackets)



Source: Bloomberg, FactSet, Eureka Report

"I think the increasing attractiveness of infrastructure as an investment class is going to be proven again going forward with the increase in volatility in markets," he says.

"This is because, more broadly, infrastructure provides an asset class that usually has a low correlation to other asset classes, particularly equities, where there is probably going to be some volatility.

"Also infrastructure is well placed in our view in the unlisted space because assets are linked significantly to CPI and GDP growth, the growth and inflation thematic we are seeing in global markets."

Nevertheless, further complicating the outlook for the asset class was a report this week from UK-based consultancy Arcadis saying Australia's infrastructure and built asset returns were lagging their peers.

But Joiner says the report needn't be a red flag for investors due to two mitigating factors:

1. Some resources spend – largely in the still-expanding LNG space – was not yet producing, and;
2. The performance figures were also likely weighed down by Australia's recent and notorious electricity "gold-plating" saga, where electricity-grid companies with regulated returns grossly overestimated (purposely or not) peak power-demand levels in Australia, the effects of which are coming towards an end.

"So in Australia there are reasons to be a little more positive on infrastructure in this context," he says.

Indeed, VanEck forecasts Australia needs to spend about $53 billion to 2031 to address its infrastructure needs caused by just "city congestion and the like", while the global economy could splurge as much as $41 trillion to 2030 – with established players in poll position.

"From our perspective, bond rates will have an effect, but over the long term we think that infrastructure is going to continue to grow as it has in the past," VanEck's Chesler says.

Arcadis says it expects a "swing towards growth in the stock of transport infrastructure assets as key regions play catch up."

"In New South Wales and Victoria in particular, major new transport schemes are underway to deal with historic underinvestment and growing populations."

Indeed, despite its doubts over infrastructure stocks, Morgan Stanley this week said it envisioned an up to $60bn federal/state boost to "underlying" Australian infrastructure spending in 2017.

So the choice for investors seems not to be infrastructure or no infrastructure but, rather, how to weight your infrastructure holdings between the more volatile but also more liquid listed options – available through direct share investments as well as ETFs – and the less volatile unlisted space, which is generally accessed via managed funds and tilted towards long-term commitment.

As the Government cracks down on some much-loved oldies, the focus turns to maximising both immediate income as well as the amount in your superannuation pot under the new regime.

BY BRUCE BRAMMALL • EUREKA REPORT • 1 DECEMBER 2016

The new pension normal looms

The death of the 'unlimited pension fund' will send to the dogs plenty of previously good superannuation strategies.

One that was much-loved was to draw a larger pension than ought really be required, with the express purpose of recontributing excess cash flow back into super.

Key Point

- ***For those with money that will be left sitting in, or transferred back into, accumulation/ superannuation you will generally want to draw the minimum from your pension fund.***

First, the income that you drew from your super fund was tax free (if you were over 60). Then you had two options:

The first was to make larger-than-normal salary sacrifice contributions to super via your employer (or deductible contributions if you were self-employed) to make up for the extra cash-flow in your possession from the pension.

The second was to make extra contributions that could be recontributed back into super as non-concessional contributions (NCCs), lowering any tax that might eventually have to be paid by non-tax dependent beneficiaries.

Or combine both, which worked well also.

The old combination of 'transition to retirement and salary sacrifice' – with an emphasis on drawing a pension to assist with the salary sacrifice strategy – was a strategy with few losers.

(Except, of course, the Tax Office. Which is exactly why Treasury suggested, and the Government agreed, to take the fun out of it.)

So, instead of taking 4 per cent of your pension fund as your pension income stream, it made sense in many circumstances to take 10 per cent of the income stream, then to make higher salary sacrifice contributions from pre-tax income.

For those who had met a full condition of release, withdrawing larger amounts from super then recontributing as NCCs also made sense.

Largely, many of those strategies are now either gone, or have been neutered.

(Note: These strategies are still predominantly valid for FY17. So, make the most of them while you can.)

But it's time to put some thought into those strategies now for those who are likely to be affected.

But I need more income …

Drawing the minimum pension is going to become the new norm. To preserve the capital of the pension fund.

For those with money that will be left sitting in, or transferred back into, accumulation/superannuation (that is, you have in excess of the $1.6 million transfer benefit cap) you will generally want to draw the minimum from your pension fund. (And you must meet the minimum pension payment – it's a legal requirement.)

If your pension income stream isn't enough to live on, then you will have a couple of choices.

The first option would be to spend money outside of super. You would do this if you have considerable money outside of super, that is earning income on which you will be taxed.

Depending on your situation, older Australians are generally going to be able to earn up to $32,000 or $33,000 (with the Senior Australians Tax Offset) before they need to start paying tax. If you're earning in excess of that you're going to be taxed at around 21 per cent (including Medicare), so this should be your first spending priority.

If you're earning more than $37,000 in taxable income you'll be paying around 34.5 per cent as a marginal tax rate. Obviously, if you're earning more than $80,000 or $180,000 you move into higher marginal-tax-rate brackets.

The second choice, if you have met a condition of release and have excess money sitting in accumulation, will be to take extra money from there. Earnings on extra money sitting in accumulation will be taxed at 10-15 per cent. But the pension fund is still taxed at zero per cent.

I will write more about the 'three pots' strategy (pension, super and non-super) in the coming months.

> **The old combination of 'transition to retirement and salary sacrifice' was a strategy with few losers.**

How do I get the most into super that I can before June 30?

There are a few things to do here.

1. Make the most of your higher CC limit for FY17. That's $35,000 for the over-50s and $30,000 for the under-50s. After July 1, it's the same $25,000 limit for everyone.
2. Make the most of the higher NCC limits for FY17. No matter how much you have in super, you are still able to put in NCCs if you meet the conditions. For those under 65, that's $180,000 for this year and potentially $540,000, if you put it in before June 30, by using the three-year pull-forward rules.
3. If you're over 65 but can meet the work test for FY17, then you can still also put in $180,000 in NCCs this year.

From July 1, it goes down to $100,000 for everyone (and $300,000 under the pull-forward provisions).

But with an added restriction – you won't be able to make NCCs at all if you already have more than $1.6m in the superannuation system.

Should I start drawing the minimum pension now?

Not really. The new rules don't kick in until July 1, so make the most of the rules as they stand, particularly if you can make extra contributions to super. The 'lifetime NCC limit' was put to the sword some time ago, so that is also less of an issue.

The answer would be 'yes' to drawing a minimum pension if you aren't really able to get any further tax advantages for extra contributions, and you're able to make them.

*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 adviser/s, as some of the strategies used in these columns are extremely complex and require high-level technical compliance.

A 400 per cent increase in the benchmark manganese price in the past 10 months could prompt acquisition action in the space.

BY TIM TREADGOLD • EUREKA REPORT • 29 NOVEMBER 2016

The manganese rollercoaster points skywards

Old miners don't die, they just wait for the next boom to resurface. Which is one way of describing the return of former BHP Billiton chief executive Brian Gilbertson, who has a manganese mine in South Africa that could soon be attracting more attention from Australian investors.

Key Point

- ***Brian Gilbertson's plans with the unlisted Jupiter Mines could be the catalyst to start a chain-reaction of events of the sort seen in the last manganese boom.***

Tshipi, in the northwest of South Africa, is not just any manganese mine for two reasons.

1. It is highly profitable, thanks to a spectacular rise in the price of the steel-making mineral, and;
2. It has a neighbour in the Mamatwan mine controlled by the BHP Billiton spin-off, South32.

With manganese at an eight-year high and South32 having just announced its first corporate deal since listing last year, Gilbertson could be the catalyst to start a chain-reaction of events of the sort seen in the last manganese boom – in which he was also a star player.

Back in 2007 the Gilbertson-led Pallinghurst Enterprises was beaten in a $1 billion bidding duel by a Ukrainian oligarch, Gennadiy Bogolyubov, for ASX-listed Consolidated Minerals, which owned the Woodie Woodie manganese mine in Western Australia.

Tshipi – which Gilbertson injected into another ASX company, Jupiter Mines – became his focus, but it had the disadvantage of requiring capital for its development over the past few years at a time when the manganese price was low.

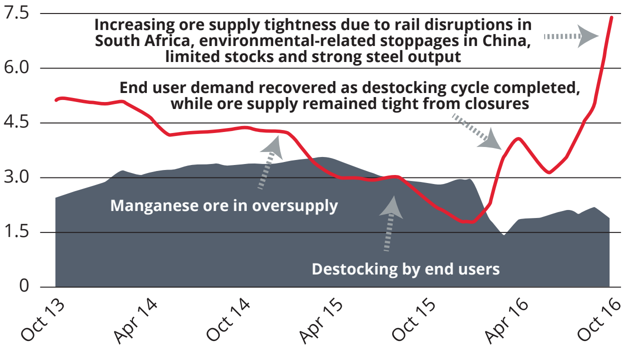
Mine closures, including Woodie Woodie earlier this year, have worked wonders for manganese, a mineral with a notorious reputation for extreme price highs and lows.

When Woodie Woodie closed, displacing 300 mine workers, the price of high-grade manganese had dropped to around $US1.80 per dry metric tonne unit (dmtu), with that strange measurement an example of the generally incomprehensible way in which the mineral is traded with variations according to grade (and sometimes in association with other minerals).

The best manganese pricing tool for most investors is to use the South32 system because it is the world's biggest manganese miner – with operations in Australia and South Africa – and uses ore grading of 44 per cent manganese (as delivered in China) as its key reference price.

The importance of the 44 per cent-ore grade is best illustrated in Chart 1 below from South32's marketing update released late last month. It shows the price dropping to almost $US1.50/dmtu early this year (a price which killed Woodie Woodie) and rising more recently to around $7.50 – a 400 per cent increase in 10 months.

ebt ratio in brackets)



Mn ore 44% Mn, CIF China   Mn Ore Port Stocks
Source: South32 investor presentation, October 31

It is manganese, more than South32's other products such as coal and aluminium, which drove the company's share price to a record high of $2.89 last week – 230 per cent higher than its low of 87c reached in January.

Jupiter Mines, which manages and has a 49.9 per cent stake in Tshipi, has also been a big beneficiary from the sharply higher manganese price. But because it delisted from the ASX in 2014 there is no share-price reference point, only a statement on the company's website that it is making a $US55 million distribution to its shareholders via a share buyback scheduled for March.

> **With manganese at an eight-year high and South32 having just announced its first corporate deal since listing last year, Gilbertson could be the catalyst to start a chain-reaction of events.**

That hefty return to investors who stuck with Jupiter after it delisted is a clue that Gilbertson has big plans for Jupiter. Those plans could include relisting on the ASX now that Tshipi is in full production, or corporate deals may also be a possibility, though whether as a buyer or a seller is the critical question.

Gilbertson hinted at a deal in a curious comment attributed to him in *The Australian* newspaper last week when he said Jupiter was "fielding bids" for Tshipi, with an obviously interested party likely being South32 because its Mamatwan mine borders Tshipi.

The two mines are working the same orebody which is part of the Kalahari Manganese Field, the world's biggest source of manganese. Integrating them into a single operation would yield considerable cost benefits.

A tour group of investment analysts scheduled to visit South32's South African assets this week is certain to seek more detail on any discussions with Jupiter about integration benefits, or other possible deals.

Other miners firing up

South32 and Jupiter are not alone in enjoying the benefits of a rising manganese price.

OM Holdings, an ASX-listed company controlled by Singaporean interests, has the Bootu Creek manganese mine in the Northern Territory as one of its assets, as well as the minority stake in Tshipi. Over the past week OM's share price (in thin trading) has risen 48 per cent from 8.1c to 12c.

Gulf Manganese, also ASX-listed but with its major asset being a manganese project in Indonesia, is up 87 per cent from 1.6c to 3c over the past three weeks.

For newcomers to the world of manganese there is a lot to learn, and it needs to be learned quickly as has been demonstrated by the mineral's extreme price swings – up and down.

South32, which inherited the Groote Eylandt mines and those in the Kalahari Manganese Field from BHP Billiton, is a long-term producer with high-quality assets and long-term marketing arrangements with Asian steel mills that enable it to ride out the lows and prosper in the highs.

What Gilbertson has done with Jupiter is use its time as a private business to develop Tshipi with the support of minority investors in the mine (OM and South African black economic empowerment groups).

With the manganese price soaring he seems ready to either relist Jupiter on the ASX, or strike a deal which would fully monetise the investment.

Whether South32 is interested is another question because its chief executive, Graham Kerr, repeated at the company's annual meeting in Perth last week that a primary focus of management was to protect the company's strong balance sheet and growing cash pile (which reached $US551m at September 30).

But a manganese deal could be on South32's agenda because earlier this month it broke its duck on asset acquisitions, paying an estimated $US200m for the Metropolitan coal mine in NSW which will be integrated with its existing Illawarra coal operations.

While manganese rarely catches the attention of investors it is the world's fourth-most commonly used mineral, slotting into the 'bulks' category alongside iron ore, bauxite and coal.

And when the manganese price catches on fire, like now, it is prodigiously profitable and a proven catalyst for corporate deals.