Weekly Review

WEALTH

– Issue – 17 Mar. 2017

The new Eureka Report website is here.

BY TONY KAYE • EUREKA REPORT • 15 MARCH 2017

A New, Improved Eureka Report

For some time now the team at Eureka Report has been working hard to make our product offering to you better than ever.

Under the umbrella and guidance of our listed parent company InvestSMART (ASX:INV), Eureka Report has evolved from a content-only website to a powerful integrated system that incorporates sophisticated portfolio management tools, financial products, research and ASX stock recommendations.

Our team of financial experts is bigger, and growing all the time, and includes around 20 qualified stock analysts, licensed advisors, economists, and experts in self-managed superannuation funds.

Now, to make your investment journey even smoother, we have relaunched the Eureka Report website with a crisp new layout to give you even easier access to our research, our stock recommendations and our portfolio tools.

Don't worry. All the content features of Eureka Report are still available, although some of them have been relocated on our home page to allow for better site navigation.

So, what are the key changes to Eureka Report?

1. The first thing you will notice is the redesign of the home page layout, showing all our latest articles. On the right-hand side are our four most recent stock recommendations, however you can find all of them by clicking on the Recommendations heading at the top of the page.
2. A behind-the-scenes change is that the new Eureka Report website is now much faster than before, with new coding functionality enabling quicker loading of articles and images, including on mobile phones and other devices.
3. We have now added an Events section onto the home page, so you can quickly view and book into our ongoing Smart Investor Sessions and into other regular events, such as Advisor Q&A.
4. Another new feature is Q&A, where you will be able to send specific company and investment questions to our stock analysts, and general advice questions to our licensed financial advisors.
5. The SuperAdvice section recently added to Eureka Report incorporates everything you need to know around Investment Strategy, Superannuation, Retirement, SMSF Compliance and Tax.
6. Our Portfolios area has been expanded, to enable quick access to our Intelligent Investor Growth and Income Portfolios, and to our portfolios and content covering Exchange-Traded Funds and Listed Investment Companies.
7. The new Interactive section includes all our latest videos, including interviews with chief executives, fund managers, product specialists and financial advisors.

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8. You can still access all your other favourite content, including the Weekend Briefing and Weekly Review PDFs for Eureka Report and Intelligent Investor, Stock Market Reports and Broker Alerts.

Expect to see more changes to the website over time as we add on more new features to improve your content and investment experience.

Your feedback to us, especially in terms of how we can improve Eureka Report, has been and will continue to be invaluable.

We hope you really enjoy the new website, and if you have any questions please contact our dedicated customer support team on 1800 458 656.

Yours sincerely,

Tony Kaye

Editor

After a solid performance in February, we have rebalanced the InvestSMART portfolios.

BY PHILIP BISH • EUREKA REPORT • 17 MARCH 2017

Rebalancing our portfolios

After a strong reporting season in Australia, and with the Trump factor continuing to buoy US markets, the InvestSMART portfolios all performed positively in February (see Table 1), with the best-performing portfolios having exposure to equities or property.

Table 1: Performance of portfolios in February

PORTFOLIO	PERFORMANCE	BENCHMARK	DIFFERENCE
INCOME	1.16%	0.87%	0.29%
CONSERVATIVE	0.79%	0.87%	–0.08%
BALANCED	1.16%	1.21%	–0.05%
GROWTH	1.55%	1.54%	0.01%
HIGH GROWTH	1.73%	1.76%	–0.03%
INTERNATIONAL	1.51%	1.45%	0.06%
PROPERTY	3.68%	4.13%	–0.45%
FIXED INCOME	0.16%	0.17%	–0.01%

A standout performance was the Property portfolio, which rose 3.7% after strong earnings results from Goodman Group (ASX:GMG) and Stockland (ASX:SGP). Although the rise was lower than its benchmark (which has a higher exposure to small cap REITs), this was nevertheless a good result.

The High Growth portfolio also stood out with an increase of 1.73%, thanks to its high exposure to Australian and international equities and a lower exposure to bonds.

Strong reporting season

Overall, the profit reporting season went well in Australia – albeit against subdued expectations – and that resulted in a 2.2% rise in Australian equities in February.

International equities rose 1.5%, with US equity markets hitting all-time highs as traders were encouraged by strong corporate results as well as the prospects of deregulation, lower corporate taxes, and increased infrastructure spending.

We'll see how much of that President Trump is able to deliver, but markets will also have to deal with the US Federal Reserve's plans to return monetary policy back to a more normal footing. On top of the interest rate rise just announced, another two are expected this year, with a further three predicted for 2018, and the anticipation of these moves has put pressure on bond prices.

Portfolio rebalancing

Against this backdrop, our investment committee, chaired by Paul Clitheroe, has rebalanced five of the eight InvestSMART portfolios. The changes include a reduction of cash and a move of our equities exposure away from Australian, emerging markets and US mid-cap equities, and into larger US and international equities (ex-US).

We are also increasing our exposure to Australian property and introducing some specific exposure to global infrastructure into our Balanced, Growth and High Growth portfolios. The changes to the portfolio weightings can be seen in Table 2.

Table 2: Portfolio weighting changes

ASSET SUBCLASS	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH	INT'L
AUD EQUITIES	- 7%	- 8%	-9%	- 7%	
US EQUITIES		3%	3%	6%	18%
US MID CAPS	- 2%	- 4%	- 5%	- 5%	- 14%
INTERNATIONAL EQUITIES (EX-US)		2%	2%	7%	11%
EUROPEAN EQUITIES				- 4%	- 4%
EMERGING MARKETS		- 2%	- 3%	- 5%	- 10%
AUD PROPERTY	9%	3%	4%	3%	
GLOBAL PROPERTY			- 2%		
GLOBAL INFRASTRUCTURE		7%	6%	7%	
AUD FIXED INTEREST	4%	4%	2%		
AUD FLOATING RATES	3%	3%	2%		
CASH	- 7%	- 7%		- 2%	

Our increased US and global exposure will be gained via two exchange traded funds (ETFs): the iShares Core S&P 500 ETF (ASX:IVV), which is weighted to the 500 largest stocks in the US, and the Vanguard All-World ex-US Shares Index ETF (ASX:VEU), which is weighted to the 2400 largest companies in the world (outside the US).

> **The periodic rebalancing of the InvestSMART portfolios is important, as it keeps the portfolios aligned to our risk appetite and investment goals.**

These ETFs are managed by two of the world's largest and most reputable investment companies, Blackrock and Vanguard, which manage US$5 trillion and US$4 trillion of assets respectively. Due to the size and scale of the funds, fees are kept low, resulting in the ETFs tracking closer to the respective indices and providing better overall performance.

The periodic rebalancing of the InvestSMART portfolios is important, as it keeps the portfolios aligned to our risk appetite and investment goals. Through our Separately Managed Account (SMA) structure and by investing in low-cost, high-quality, broad-based ETFs, we can gain exposure to some of the best companies in the world while keeping costs low. Indeed, transaction costs within our SMAs are as low as 33 cents plus 0.05%, far lower than a normal broking account.

*You can find out more about investing directly in InvestSMART portfolios by **clicking here**.*

The Fed's tightening will flow through to Australia. But the central bank is still uncertain about the US economy.

BY CALLAM PICKERING • EUREKA REPORT • 17 MARCH 2017

Fed effect will hit dollar, rates

A great deal of optimism has been swirling around the United States stockmarket since late last year. Stocks have flourished and the case for tighter monetary policy has strengthened.

Key Point

- ***The Aussie dollar finds itself in a precarious position, while don't be surprised to see banks hike rates.***

The Federal Reserve obliged markets this week by raising its benchmark interest rate to a range of between 0.75 and 1 per cent. It was the second rate hike in the past three months and is expected to be the first of at least three hikes this year.

Nevertheless, the Federal Reserve doesn't necessarily share the same level of optimism as market participants across the United States. In fact it was the dovish tone from Fed chairwoman Janet Yellen, combined with a broadly unchanged economic outlook, which caused government bond yields to tumble following the official announcement.

Market participants were betting on a more hawkish Fed and when that didn't eventuate repricing occurred among treasury bonds. Both gold and commodity currencies rebounded, with the Australian dollar once again jumping to over US76c, reinforcing the fact that market participants were positioned for a more bullish Fed statement.

Instead the Fed reiterated what has long been its mantra: a slow and gradual return towards policy normalisation.

"The data has not notably strengthened," Yellen told reporters. "We haven't changed the outlook. We think we're moving on the same course that we've been on."

The earlier temper tantrums that plagued rate hikes appear to be a problem of the past. Nevertheless, the Fed's benchmark rate remains incredibly low by historical standards. The big test for markets will occur when real interest rates (that is the benchmark rate minus core inflation) return to positive territory.

Right now the real federal funds rate sits at around minus 1 per cent, so we still have a way to go.

The March meeting also coincided with the release of the Fed's quarterly outlook. This survey is based on the projections of Federal Reserve board members and presidents and is keenly watched by market participants.

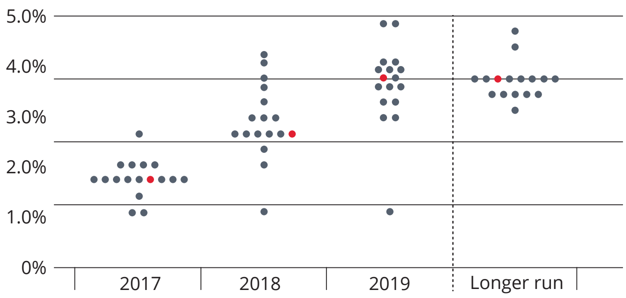
The Fed estimates that long-term sustainable growth in the United States is around 1.8 per cent; so the economy, currently growing at an annual rate of 1.9 per cent, may warrant tighter monetary policy. According to the estimates, the unemployment rate, currently at 4.7 per cent, is already consistent with long-term estimates, which suggests that any further improvement will drive wage growth and inflation higher.

However, the market is most interested in the Federal Reserve's estimates of monetary policy. This provides insight into whether the bank is hawkish or dovish and provides a sense of direction for policy.

The graph below shows the assessment of where participants believe the federal funds rate should be by the end of 2017, 2018 and 2019. There is a fair bit of disagreement among participants in the survey; Federal Reserve officials often and quite openly disagree with one another and that is reflected in their assessment of monetary policy.

The orange circle represents the mid-point for each year. The mid-point for 2017 is a federal funds rate of between 1.25 and 1.5 per cent – which means another two rate hikes this year – and is expected to climb to 3 per cent by the end of 2019.

Chart 1: FOMC participants' assessment of appropriate monetary policy; federal funds rate



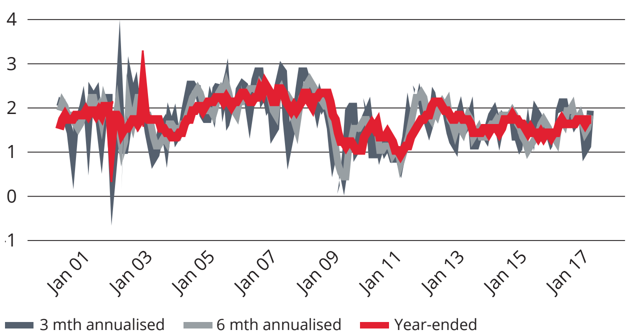
There is still plenty that must occur before those forecasts can be met.

Perhaps the most important is that the Federal Reserve will need to see material progress towards meeting its inflation objectives. The Fed pursues an annual inflation target of 2 per cent, based on the PCE deflator, a mark it has achieved on just four occasions since the beginning of the global financial crisis.

> **One of the key measures to watch will be the spread between US and Australian government bonds – the spread has narrowed significantly over the past year.**

The core PCE deflator has increased by 1.7 per cent over the past year; though shorter-term measures indicate that inflation has picked up a little over the past three-to-six months. Part of the problem is that we haven't seen any material improvement in wage growth over the past six months.

Chart 2: US Core PCE Deflator (Percentage change; seasonally-adjusted)



Source: Bureau of Economic Analysis; via CP Economics

The Fed remains ever hopeful that wage growth will begin to normalise soon. Given the ongoing pace of employment growth, that appears to be a reasonable assumption. Nevertheless, at the present time stronger wage growth remains elusive.

Higher US interest rates will also have important implications for the Australian dollar, capital flows and the banking sector.

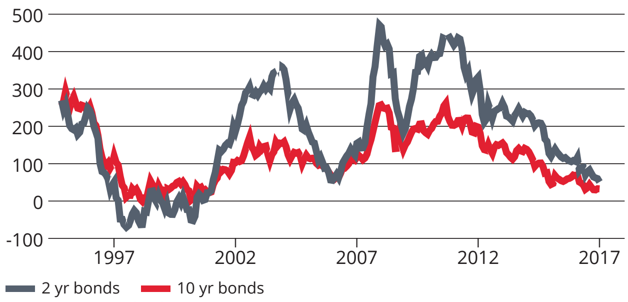
First, higher US interest rates will lead to a more valuable US dollar and that will (a) lead to a depreciation of the Australian dollar; and (b) put downward pressure on the demand for commodities, such as iron ore and coal, that will again lead to a depreciation of the Australian dollar.

Part a) is obviously a welcome development but part b) will create some difficulties. Australia needs a lower currency to support growth in tourism and the non-mining sector. But we also benefit a great deal from higher commodity prices, which boost national income growth and feeds through to greater corporate profitability and wage growth.

Second, higher US interest rates makes the US a more attractive destination for foreign capital. This could lead to less foreign capital inflows into Australia. One of the key measures to watch will be the spread between US and Australian government bonds – the spread has narrowed significantly over the past year and should continue to do so over the remainder of 2017.

If the spread turns negative – that is returns on US government bonds exceed returns in Australia – then I'd expect the Australian dollar to drop like a stone.

Chart 3: Spread on Australian and US government bond yields



Sources: RBA; Federal Reserve of St Louis; via CP Economics

Third, higher US interest rates should increase the funding costs of Australian banks. Overseas funding for Australian banks is estimated at 51 per cent of nominal GDP – a huge amount – and any increase in the cost of those funds is likely to be passed on to consumers via higher interest rates. So don't be surprised if your bank increases your variable mortgage rates by, say, five to 10 basis points in the near future.

Trump's agenda and labour shortages means the US will be forced to push the rate button more than once.

BY ROBERT GOTTLIEBSEN • EUREKA REPORT • 15 MARCH 2017

Imminent Fed rate rise is just the start

Tonight the US Federal Reserve will make its interest rate deliberation. And it is almost London to a brick that the Fed rate will go up by a quarter of a per cent (if it doesn't happen, it will next time around).

Key Point

- ***The Australian equity market is going to become less yield conscious and more interested in growth.***

As nearly certain is the fact that all over the media there will be articles and commentaries about the historic new trend. But that's nothing new.

We have known that the Federal Reserve would increase its interest rates this month for some time, but the avalanche of words and visual commentaries is likely to put a smoke screen under more important events taking place in the US.

Donald Trump came to power with the solemn promise to slash US unemployment and boost employment. As we have discussed previously, he has some dramatic tax and other financial proposals aimed at achieving that goal. But on latest estimates those proposals won't hit the deck until August. Meanwhile, before Trump is ready to act, the US labour market is going gangbusters. US unemployment is down to recent historic lows but, more significantly, the number of excess potential workers classified as 'want a job now, but not in the labour force' has reached its lowest level in 8.5 years – currently as a share of the labour market it is 3.5 per cent.

That is not far above the low of 3.1 per cent achieved in 2007 just before the global financial crisis. And the position would have been even more buoyant but for a spike in February of people aged 65-69 who suddenly re-joined the workforce. They obviously need 'retirement money' and there are now jobs.

Macquarie estimates that in the light of the ageing American population, to maintain the current employment rate all that is required is the generation of just 45,000 new jobs per month.

Currently, the US is generating 200,000 jobs per month and of course Trump expects to increase that further. Suddenly we have a bottom line that older readers will recognise very well – the US will have a supply shortage of labour later this year but, more importantly, throughout 2018. And we all know what that means – wage rises, inflation and, consequently, the level of growth being projected (and that will be required to fund the large tax cuts) becomes in real danger. The US doesn't have the labour to supply the demand that the Trump measures are aimed at triggering. That means American interest rates are going to rise quite a lot in the next two years. And that is going to have an effect across the globe. As inflation and interest rates rise, a lot of US shares will be re-rated. Growth in a labour-short environment will be the key to share prices.

As you know I am always nervous about projecting currencies but if I am right about the basic trends, then the US dollar should rise and higher interest rates will infect Europe as we head into the new environment.

Australia's response

In Australia the Reserve Bank will resist the higher rate trend as long as it can because it wants to stimulate the Australian economy. For a time this will work and I know a number of bankers who are joyfully looking forward to this over the next year. They hope they will be able to keep their deposit rates down because the Reserve Bank is not lifting official interest rates, but then they will blame the US and global interest rates for lifting the mortgage rate. And even better, the Reserve Bank is encouraging them to lift the rate on investor loans. There will be a lot of fuss but the banks will try to lift their margins in the confusion and, if they succeed, that will be good for shareholders.

Longer term the Reserve Bank will have to recognise a higher global rate environment in the local market. So, step by step we are moving to a higher interest rate environment, but it will certainly not happen overnight.

I think over time the local equity market is going to become less yield conscious and, like the US, more interested in growth. After all, growth is what shares are traditionally about. The provision of very high yields is a relatively recent phenomena.

> **Treasurer Morrison is canvassing ideas. Not until the final week, or even the last few days, before the budget can you believe the leaks that you are reading.**

As I have explained in previous commentaries, highly leveraged companies that didn't take their opportunity to lock in long term rates will suffer. And bank term depositors will, over time, get relief from very low rates but the banks will try to extend the suffering of their depositors as long as possible.

Pre-budget stirrings

But here in Australia there is also stirrings on a series of other fronts that you may need to take into account in some of your longer strategies. The Government is at least looking at negative gearing – it probably won't touch it – but it is also looking at allowing first home buyers to access their superannuation. If either of these strategies is introduced on their own it will be a disaster – negative gearing curbs will cut dwelling prices and first home buyers accessing superannuation will boost them.

They must be done together but politically that looks too hard. Yet by freezing young people out of the housing market we are creating a huge long-term retirement cost. Nevertheless, for the first time I can see that state politicians (they restrict supply to boost prices) and federal politicians plus the Reserve Bank are concerned about Sydney and Melbourne house prices. Very, very nervously I predict we may get a Sydney/Melbourne boom cooling off.

Currently those couples in the $400,000 to $800,000 asset bracket and receiving the government pension are being encouraged not to downsize their homes because if they do then any extra cash they receive will substantially cut their pension. It looks like that is going to change.

Remember that at the moment Treasurer Scott Morrison is floating all sorts of ideas through the media to test reactions. For investors, it is a way of gauging what is on his mind – but be careful. He is canvassing ideas. Not until the final week, or even the last few days, before the budget can you believe the leaks that you are reading – until then they are not about real events, just speculation to test the water.

Batteries

And on the lighter side this week I logged on to a commentary about batteries in South Australia. Immediately flashing up on my screen was an advertisement for a Tesla battery. As I **described last week**, I had been the subject of an online advertisement auction which would have taken place in a fraction of a second – and Tesla won.

I don't think I will buy a battery but I actually got a quote from them and found that a battery that would store electricity to help us through any blackouts would cost about $16,000. I checked with True Value Solar and they have a battery package that comes to about $15,000 – on the surface, without further checking, which looked about the same.

It is a lot of money to protect yourself against a blackout. The True Value Solar battery comes from Redflow, which lost $6 million in its latest report. That made me nervous.

But the real fascination is to realise that your eyeballs have been the subject of an online advertisement auction, and the threat that represents to conventional media.

Get acquainted with partial commutations. They are going to be critical for SMSFs in the near term.

BY BRUCE BRAMMALL • EUREKA REPORT • 16 MARCH 2017

A powerful pension top-up strategy

Changes to the law often mean the death to some strategies. But they can equally breathe fresh life into previously unloved strategies.

Key Point

- ***When you are in need of additional retirement income, a 'partial commutation' from your Transfer Account Balance allows you those payments at a lower overall tax level – eventually – than pension payments of the same size.***

Transition to retirement (TTR), thanks to the taxation of TTR pension funds from July 1 this year, is one strategy whose star will fade dramatically under the new rules.

But if you're not familiar with the term 'partial commutation', then it's time to get your head around it.

A partial commutation is a lump sum payment from a pension income stream.

It is not, necessarily, a part of the pension paid from your pension fund. And this will become a critical difference for many, particularly those who are close to, or over, the $1.6 million threshold.

Where a pension is the payment of an income stream from a pension fund, a partial commutation is the payment of a lump sum from the fund that has the impact of reducing the asset base of the pension fund.

From July 1, partial commutations will become an integral part of many superannuation fund income strategies, for those who need more income than just the minimum pension payment requirement.

Why?

Because while a pension payment has no impact on the size of your personal transfer balance account (TBA), a partial commutation reduces it directly.

For example, if you are 65 and have transferred $1.6m into your TBA, you will be required to take a 5 per cent pension. That's $80,000.

At age 65, you can gain full access to your super. It becomes unrestricted, non-preserved. So, technically, if you need more income, you can grab whatever you need from your super fund.

But here's why you should probably take a partial commutation instead of just drawing further income from your fund.

A 'partial commutation' will have the added benefit of providing a 'debit' to your Transfer Balance Account.

That is, if you have taken your minimum pension (on $1.6m, of $80,000), but need further income of $100,000, then taking a partial commutation for that sum will have the impact of reducing your TBA by $100,000, from $1.6m to $1.5m.

Why is this important?

Because you could, then, in the future, effectively put another $100,000 back into your pension fund.

See my example below.

The withdrawal via partial commutation acts as a debit against your TBA total.

The advantages, obviously, are that the sum is taken as a tax-free amount from your pension fund. While some clarification is still being sought/given from the Tax Office via an explanatory memoranda, it is expected that pension funds will still be able to make partial commutations.

Where does the benefit lie?

I'll illustrate this by way of example.

Let's take a 65-year-old who currently has $2m in pension. On July 1, they will have to transfer $400,000 of that out of the pension fund to meet the transfer balance cap requirements, which limit pension funds to $1.6m.

And let's say that they choose to put that back in accumulation (rather than take the $400,000 out of the super system, where it would become subject to marginal tax rates, of between zero and 49 per cent). If left in the super system, that $400,000 will be subject to income tax at 15 per cent on future earnings.

Between age 65 and 75, our member would have to take a minimum pension of 5 per cent each year of the June 30 balance from the previous financial year.

For simplicity's sake, they are drawing 5 per cent, but the fund has only been earning 5 per cent, so they are roughly

> **“The broad strategy seems to be locked in, based on what the ATO has said in explanatory memoranda, to this point.**

drawing what the super fund is earning (ignore how bad that sounds as a return on your investment for the purpose of this exercise).

The member’s income needs are greater than the 5 per cent pension payment. In fact, they are double. They need approximately $160,000 to live on each year.

If they took the amount as pension payments, their super fund would reduce to the tune of an extra $80,000 a year.

If they were, instead, to take the extra $80,000 as a partial commutation, their overall pension fund balance would still be reduced to the tune of $80,000 a year.

However, by taking a pension, their transfer balance account, which started at $1.6m, would still be sitting at $1.6m.

If they took the extra $80,000 a year as partial commutations, they would, instead, have decreased their TBA by $80,000, from $1.6m to $1.52m. Over five years, this would reduce the TBA by $400,000 (5 x $80,000).

The member would then be able to use another $400,000 from their accumulation fund to top up their pension fund account balance.

The rules surrounding this strategy are still far from perfectly clear. But the broad strategy seems to be locked in, based on what the ATO has said in explanatory memoranda, to this point.

But keep an eye on this strategy. I will keep you updated in the months to come.

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

*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**.*

In planning for the distribution of an estate, there are endless variables.

BY THEO MARINIS • EUREKA REPORT • 14 MARCH 2017

The importance of Team Us in estate planning

Take a seat, relax. Unfortunately, I have some bad news for you. Your condition is terminal – you will die at some stage in the next 100 years! Now that you have that prognosis, it is time to do three things about it: get your emotional, spiritual and financial affairs in order.

Key Point

- ***An SMSF can effectively transfer wealth inter-generationally while a family company may have estate planning benefits via the effective and timely distribution of dividends.***

It is disturbing to consider how many Australians do not have a will. One explanation might be that by ignoring making a will, the need to have one might not happen – or conversely, dealing with it might make it happen! Both are what psychologists call 'cognitive distortions'. In other words, these reactions are just not logical.

Not having a will speaks to denial – and makes your family and your estate vulnerable. If you are in this situation, you need to act. Hold a formal 'meeting' with your partner – preferably this week – to discuss your estate planning. Put down on paper the assets and liabilities you have and what you both want to happen with them. Book a get-together within a one-month time frame with your (or any) solicitor, accountant and financial planner. If you don't already have access to these professionals, ask someone you trust (or the professional you do have) for some referrals, and meet with each of them to decide who you can work with.

The conversation should not been seen as morbid. Rather it should be viewed from the perspective as doing your best to help your estate, and making sure the people you want to receive the benefit of your lifetime of hard work will do so.

Getting it right from the start

In planning for the distribution of an estate, there are endless variables, ranging from multiple relationships to disabled children, to potential inheritances from aged relatives.

If you have assets beyond the most basic, I would recommend you build 'Team Us'. Get your financial advisor, accountant and solicitor in the same room and working together for you. Far from sitting on the sidelines, you need to be the 'coach'. This way all professionals from each discipline can better understand your situation and what your outcomes are likely to be. While you may think the initial cost of such a meeting is high, it will save you a fortune in the medium to long term – and you will need only to tell your story once.

I recommend the meeting is convened by your financial planner, who will be well placed to bring together the legal, tax and financial planning considerations needed to structure your assets to achieve your estate planning goals. For example, if you have a company or trust structure, there are a number of tax-effective strategies which can be implemented to ensure your assets are distributed as you wish (or control of the entity – i.e. the trust or company – the assets are held in passes to those you intend should have such control). Similarly, if you have a family self-managed super fund, you can effectively use this structure to transfer wealth inter-generationally.

It is vital to ensure control of all such entities is passed to the right people after your passing. If you have a family company, there may be estate planning benefits in the effective and timely distribution of dividends. As described in my recent article ***How to avoid a deadly super trap***, there are also strategies available to remove the 'Death Benefits Tax' liability, a tax which is levied at almost 20 per cent of your remaining super balance when it is paid to non-dependent beneficiaries.

Emergency or life expectancy crisis

In an ideal world, estate planning will occur when all involved are healthy – and there is a long time before the plans established are activated. But this is not always the case. In the event of an emergency or a life expectancy crisis, estate planning becomes even more urgent. For prompt action, I would recommend working with your financial planner as your guide for the arrangement of:

> **“Increasingly, courts are finding wills are not the ‘black and white’ instruments we all thought they were. This is where the experts can help enormously in your estate planning.**

1. financial and medical powers of attorney (the latter now known as an Advanced Care Directive or Advance Care Planning)
2. a valid will; and
3. the examination (and if required) adjustment of business, insurances and superannuation structures.

This will enable a clear picture of your estate to emerge to enable it to be managed effectively.

Allowing for litigation

Not all potential recipients of your estate are likely to have the same financial maturity and expertise that you may have, and increasingly, courts are finding wills are not the ‘black and white’ instruments we all thought they were. This is where the experts can help enormously in your estate planning.

Given that the cost of legal challenges to a will are borne by the estate, it is wise to think about, firstly, maximising the financial pool available and then dealing specifically (and fairly) with each potential claimant. This may include, for example, a person who has been a long-term relationship partner, your first wife’s disabled child from her failed second marriage or, perhaps, your irresponsible brother-in-law who lives rent free in one of your investment properties. Solutions can be complex, but are not insurmountable. The financial, and dare I say, emotional benefits of having a clear plan for transferring your wealth to the next generation are substantial.

Anomalies

Bear in mind, however, not all assets are the same. A share portfolio of $1 million is likely to carry with it a capital gains tax (CGT) liability, which may reduce its worth to a beneficiary by hundreds of thousands of dollars, while a $1m home is likely to be CGT free. Most of us need advice on these sorts of anomalies.

Estate planning tends to be shrouded in fear and mystery – nobody likes to think about their demise. However, it is a fantastic way to ensure that the legacy of your hard work continues to benefit your loved ones in the way you had hoped.

Having a sensible and robust estate plan in place can be like having a huge weight removed from your shoulders. Have that meeting with your partner, book in a team meeting with your financial advisor, lawyer and accountant – and get a sensible plan in place.

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

The range of housing affordability policies being put forward might require some finessing by investors – but the bottom line is higher house prices.

BY CALLAM PICKERING • EUREKA REPORT • 14 MARCH 2017

Affordability plans won't dent house prices

It has taken a long time but state and federal governments are finally in agreement: our housing affordability problem needs to be addressed. Somewhat counterintuitively, however, their proposals are likely to push prices higher, creating a bonanza for existing home owners and investors.

Key Point

- ***What is clear is that neither the federal or Victorian governments are interested in letting house prices fall.***

Victorian Government

The Victorian Government announced a plan earlier this month to abolish stamp duty for first home buyers on properties worth less than $600,000. Those purchasing a property valued been $600,000 and $750,000 will also be eligible for a reduced concession.

Stamp duty is an incredibly inefficient tax that effectively punishes people for moving house, which undermines labour mobility and leads to a less than efficient use of Australia's housing stock. It's one of the major reasons, for example, why older Australians are reluctant to downsize despite living in houses that are often too large for a couple or single occupant.

Any policy that removes stamp duty, even partially, should be encouraged. What's interesting about the Victorian Government's plan is that the removal of stamp duty for first-home buyers will likely become capitalised into the price, since it increases their ability to pay. In other words, the value of the stamp duty will be transferred from the Victorian Government to the vendor.

Unfortunately for investors, the Victorian Government's new reforms are not without a catch. They plan to remove off-the-plan stamp duty concessions on investment properties. The concessions will still apply for those who intend to live in the property or who are eligible for the first-home buyers' stamp duty concession.

The Victorian Government also plans on introducing a Vacant Residential Property Tax that will tax those properties that have been left vacant by investors. While savvy investors will seek renters to maximise their return on investment, estimates provided by Prosper Australia indicate that the rental vacancy rate is around 6.7 per cent in the Melbourne CBD and 7.6 per cent in the suburb of Carlton.

The tax will be levied at 1 per cent of the capital improved value of the taxable property. For example, if a vacant property has improved in value by $200,000 then the tax will equal $2000.

The removal of stamp duty for first-home buyers will obviously be beneficial to existing home owners and investors. The removal of stamp duty concessions on off-the-plan investment properties will be detrimental, but many of these apartment buildings have already reached the construction stage. Meanwhile, a vacant property tax won't affect smart investors and will most likely affect foreign investors who are using Australian property as a safe haven.

Federal Government

The Federal Government has an unfortunate habit of floating policy ideas and then back-tracking soon after. So I'm a bit reluctant to speculate on any housing affordability policies that we might hear about prior to the Federal budget in May.

Some of these proposals include the Federal Government partnering with first-home buyers to purchase property via shared equity, potential bans on foreign investors owning more than half the apartments in a development, and measures designed to encourage pensioners to downsize by offering additional superannuation concessions.

Let's focus on the 'shared equity' proposal. It basically boils down to the following: imagine you, as a first-home buyer, want to purchase a property for $600,000. The Government or private lender would cover, say, 25 per cent of the value which means that you only need to stump up $450,000.

> **Neither the Federal Government nor the Victorian Government are interested in letting house prices fall.**

It's a policy that would dramatically increase the purchasing power of first-home buyers. Past policies, including the first-home owners' grant and the subsequent boost announced during the global financial crisis, provides a pretty good indication of what this means for the broader market. First-home buyers will enter the market, improving home ownership among younger Australians, but it will also push house prices higher.

In a shared equity model, the Federal Government or a private lender would then claim 25 per cent of the selling price at a later date.

Such a policy would increase the competition against property investors. Suddenly first-home buyers, normally at a clear disadvantage, have the backing of the Federal Government or a private lender that allows them to spend 25 per cent more than they otherwise could. In some cases this may be sufficient to offset the purchasing power of investors who benefit from tax concessions such as negative gearing and the capital gains tax discount.

Investors looking to enter the market may find conditions more challenging; those already in the market would be licking their lips. Government subsidies make it easier to generate capital gains.

But the policy itself also creates other opportunities for investors. If Treasurer Scott Morrison pursues a privately-financed shared equity arrangement then investors may be able to buy indirectly into the housing market.

A bank or other financial institution could bundle and securitise a thousand of these shared equity agreements and float them on the stock exchange, allowing investors to buy shares in the underlying assets. It's actually a cheap and easy way to get exposure to the housing market; certainly more liquid than buying a property outright.

It does run the risk of adding further speculation to a property sector that is already dominated by investors. Would this really be beneficial for financial stability?

The Victorian Government has also proposed a similar $50 million pilot program, called 'HomesVic', which would give about 400 people the chance to co-purchase a dwelling. This program targets couples earning up to $95,000 and singles earning up to $75,000.

There are other affordability measures and, as we approach the Federal budget in May, it will become clearer what these policies entail. What is clear to me, however, is that neither the Federal Government nor the Victorian Government are interested in letting house prices fall. Long-term that isn't a path towards improved affordability, but in the meantime it presents a pretty clear opportunity for investors to make a little cash.

Investors should, nevertheless, be aware of other issues. A big one right now surrounds the Reserve Bank and the Australian Prudential Regulation Authority, which have both become increasingly vocal on housing affordability.

A decision to tighten macroprudential policies could more than offset any beneficial policies arising from the Victoria or Federal governments.

For investors, the outlook is cloudy with the threat of a politics and foreign producers weighing.

BY TIM TREADGOLD • EUREKA REPORT • 1 MARCH 2017

The gas war gets more interesting for everyone

Cold comfort as it might be for gas users in eastern Australia, confronted by rising prices and the threat of rationing, but the exact opposite is the case on the other side of the world where there are rumblings of a gas-price war.

Key Point

- ***Any redirection of Queensland export LNG into the domestic market means the LNG-project owners might face a financial haircut.***

At first glance, a battle for market share in Europe between Russian and US gas producers might appear to have nothing to do with Australia. But that might not be the case because gas, when liquefied, is easily transported.

What's happening in eastern Australia has been well reported, with a combination of soaring exports of liquefied natural gas (LNG) from new processing plants in Queensland bumping into government policies which have banned gas exploration in some states, effectively limiting supply.

The net result is a domestic gas shortage, the threat of factories closing, households facing sharply higher gas bills, and the need for intervention in the energy market such as the South Australian Government's plan to build a new gas-fired power station to supplement that state's high-level of reliance on intermittent power supply from renewables such as wind and solar.

Government, at a national and state level, is starting to panic over a problem which has been glaringly obvious for years and very much falls into the category of a slow-motion train wreck.

It's the exact opposite in Europe, a region traditionally short of gas and largely reliant on pipelined supplies from Russia – a situation which has caused problems in the past when Russia has used its gas as a political weapon.

Enter the US which is enjoying a remarkable oil and gas renaissance thanks to its success in developing technologies to extract oil and gas from rocks long considered too tightly compacted to release their petroleum.

The US effect on oil can already be clearly seen with exports from its shale exploiters neatly matching the production cutbacks by members of the Organisation of Petroleum Exporting Countries, with the net result being an oil price recovery which has stalled at around $US50 a barrel.

What the US has done to oil it seems likely to do to LNG, starting with a gas-price war between Russia and the US in Europe; a potential development raised recently at the International Petroleum Week conference in London).

One of the world's top energy traders, Pablo Galante Escobar, head of the LNG unit of Vitol, said growing exports of US shale gas in the form of LNG would "soon force Russia to slash prices to remain competitive in its main market".

"The next war in Europe will be a price war, and it will be LNG versus Russian pipeline gas," he said.

Escobar could be right and while he didn't mention Australia the company he works for is intimately familiar with the energy market here after spending $3 billion in 2014 to buy the 100-year-old refining and marketing business of Royal Dutch Shell in Australia.

Vitol's trading operations means it understands how easy it is to ship oil and, increasingly, gas from one market to another and that means a wild card could be played in the complex Australian east coast gas tangle; with US product being shipped here.

That is an extremely long shot and might never happen, but it cannot be ruled out given what's happening in the US which has a new president actively encouraging oil and gas production and traditional exporters – such as Russia and OPEC members – fighting to defend market share.

The global energy market, and the prices on offer in different countries, will determine the future flow of LNG shipments; but what seems likely to happen in the short term is that US shipments will be directed at Europe because that's where the prices are highest, gas demand strongest and the shipping distance shortest.

> **"The global energy market, and the prices on offer in different countries, will determine the future flow of LNG shipments.**

Asia, which is in Australia's backyard for LNG sales, will be next for US LNG, and that's when the gas-game in eastern Australia could change because the entry of US LNG into the Asian market could lead to the same sort of gas-price war that Escobar sees developing in Europe.

None of these market changes are going to happen overnight, but then neither did the current gas crisis which has started to produce a number of interesting possible solutions, with the most disturbing for investors being the redirection of gas away from the Queensland LNG plants and into the domestic pipeline network.

If that happens it is highly likely that the price received for pipeline gas will be well below the price for LNG exports, which means the LNG-project owners might face a financial haircut.

Politicians have been, so far, the principal proponents to redirecting gas earmarked for export into the domestic market, but they are not alone.

Last week analysts at the investment bank, Credit Suisse suggested that the best option to solve the domestic gas shortage was to "reclaim the third-party gas currently being exported" because third party gas (provided by gas producers which are not participants in an LNG export project) was not included in the original export plans.

If that happened then the export projects would pay a high financial price because exported LNG commands a higher price than domestic gas.

The longer term is when the gas game gets more interesting because LNG is rapidly revolving into a globally traded commodity with a price structure that will eventually flatten into something more uniform in the same way oil is traded according to its quality and not its production location.

If, for example, the emerging European gas-price war spreads into the Asia-Pacific region, which seems likely, then the current debate about an east coast Australia gas shortage could fade because gas will be readily available and the price will flatten with the LNG price falling and the pipeline price rising.

For investors in Australian LNG the outlook is cloudy with the threat of a political solution weighing on Queensland's LNG projects which might be forced to accept a lower price for gas they had been planning to export, followed by the potential entry of US LNG into the Asian market.

Nothing is likely to happen quickly but it would be wise to keep a close eye on how the east coast gas crisis evolves with the looming European gas war a pointer to where Australian gas is heading if the US gas exports do what US oil exports are already doing to OPEC members.

The disconnect between copper supply and price is finally starting to shrink.

BY TIM TREADGOLD • EUREKA REPORT • 16 MARCH 2017

Copper ignores supply side, but for how long?

In theory, the price of copper should have been rising over the past month rather than falling; not just because demand remains reasonably strong but, moreso, because the world's two biggest copper mines have been hit by production disputes which are limiting output.

Key Point

- ***Deutsche Bank reckons a seachange is underway in copper with 2017 and 2018 being 'transition years' from surplus copper production to years of deficits.***

A strike by workers at the BHP Billiton-led Escondida mine in Chile has removed 2500 tonnes of a copper a day from the market and while some work is restarting with temporary labour the world's biggest copper mine is not expected to quickly return to full production.

It's a different story at Grasberg, the world's second-biggest copper mine, but the result is the same with a dispute between the owner, US-based Freeport McMoRan, and the Indonesian Government over export quotas removing 1700 tonnes a day from the market.

Between them, the two mines account for an estimated 9 per cent of annual global copper output. And while it is expected that both will eventually resume production, there's no way of knowing when.

Less copper reaching the market, coupled with a steady increase in annual consumption of around 2.5 per cent, should be a recipe for a higher price and not the 4.5 per cent price fall since mid-February after trouble started at Escondida and Grasberg.

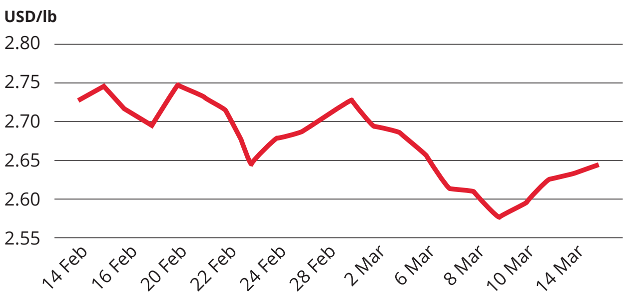
For some copper users, such as China's copper refining companies, the reduced flow of freshly-mined material is starting to hurt, forcing them to consume stockpiles, especially of copper concentrate, the powdery feedstock used to make cathode which leads to the production of wire and other forms of copper used extensively by industry and electrical-goods manufacturers.

Jiangxi Copper, one of China's biggest refiners, reported earlier this week that supplies of concentrate were running low. The company's chairman, Li Baomin, told London's Financial Times newspaper that: "It's the first time in 15 years that copper concentrate has not been over-produced."

There are signs that the disconnection between what's happening in the copper supply chain and what's happening in the copper market is starting to correct, as are the share prices of copper-mining companies.

Over the past four days the copper price has risen by US7 cents a pound from $US2.57 to $US2.64. Pure-play Australian copper miners such as OZ Minerals and Sandfire Resources have also reacted. OZ added 33c (4 per cent) to $8.36 to Wednesday this week.

Chart 1: 30-day copper spot price



Source: Kitco Metals

Sandfire added 15c (2.3 per cent) to $6.55 and continues to rise, but both remain below their price before the troubles started at Escondida and Grasberg. BHP Billiton and Rio Tinto – Australia's two biggest diversified miners with major copper divisions – also appear to be reacting to the copper situation, posting reasonable price rises since the start of the week.

Production disruptions are not new in the copper industry with two of the world's traditional hot spots for industrial and government disputes, South America and Africa, accounting

> **After the current supply disruptions and a price correction to accommodate the return to normal rates of production, the overall copper market is expected to move from surplus to deficit.**

for the lion's share of supply. Australia is the sixth biggest copper mining country.

Why the copper price has not risen steadily since Escondida and Grasberg were hit by workforce and government problems has investment bank analysts scratching their heads because, while the current issues could soon be fixed, the outlook is for a more fundamental shift in the copper market. Deutsche Bank reckons that a seachange is underway in copper with 2017 and 2018 being "transition years" as the past six years of surplus copper production give way to five, and possibly more, years of deficits which should underwrite the future price of the metal.

"Our initial assessment of the market for 2017 was a surplus of 150,000 tonnes, but given the challenging situation with Freeport's Grasberg mine and the part-owned Gresik smelter in Indonesia, we now think the market will be a deficit of 210,000 tonnes," Deutsche said in a note on March 1.

Goldman Sachs shares that positive view about copper, and the wider commodities sector, as supplies of essential raw materials continues to tighten despite concern about a slowdown in the Chinese economy.

Jeffrey Currie, head of commodities at Goldman Sachs, said earlier this week that: "All of these concerns are misplaced. The markets need a little patience to wait for the fundamentals to materialise." Goldman Sachs reckons that copper in the June quarter will rise to $US6200 a tonne, or $US2.82/lb, up 7 per cent on its current $US2.64.

Most other expert forecasts for copper are equally optimistic. UBS is forecasting an average price for this year of $US3/lb, rising to $US3.25 next year.

"Our thesis is that demand growth from China, plus flat global mine supply in 2017 will drive a market deficit," UBS said earlier this month.

"The (market) signals do not yet show what we expect to see soon, a tighter copper market and signs of supply anxiety.

"Grasberg stopped shipping concentrate on January 12 and is now ramping down mining operations. A strike at Escondida started on February 9 but concentrate shipments from stockpiles may have continued.

"So, the impact of these two large supply disruptions many still take a month or so before tightening the physical concentrate trade because of (material available from) stockpiles."

Macquarie Research is concerned about China's rate of economic growth and believes that the copper price could fall sharply when the Escondida strike is resolved.

But after the current supply disruptions and a price correction to accommodate the return to normal rates of production, the overall copper market is expected to move from surplus to deficit.

"By the end of the decade we expect copper to be in a substantial structural deficit," Macquarie said.

In its analysis of the supply/demand balance Macquarie sees a small-copper supply surplus until 2020 when there is expected to be a deficit of 332,000 tonnes a year, ballooning out to 770,000 tonnes in 2021, when the price should average $US6425/t ($US2.91/lb).

For investors, the copper picture is changing and while the current supply disruptions at Escondida and Grasberg are being discounted as one-off events that will eventually be matched by a return to normal levels of output, the longer-term view is of a shortfall in supply which should drive the price higher. At least, that's the theory.

The resumption of primary issuance for the year has seen a weaker performance from the Australia Ratings family of indices.

BY PHILIP BAYLEY • EUREKA REPORT • 10 MARCH 2017

Listed debt finds a weaker patch

This is the latest article on this subject and follows on from Debt securities deliver strong 2016 returns (January 27) and How to find value in the listed debt market (February 3).

Key Point

- ***With three issues announced in February, with known investor demand sitting at $2.6bn and likely to go higher before these issues commence trading, 2017 could be big year for the debt security market.***

February saw a change in secondary market conditions for ASX-listed debt securities. In other words, prices have fallen for some securities relative to where they were at the end of January.

The reason for the decline is the resumption of primary issuance for the year. And with three issues announced in February, with known investor demand sitting at $2.6 billion and likely to go higher before these issues commence trading, 2017 could be big year, unless the volume already coming to the market quickly sates investors' appetites.

Not surprisingly, with $1.8bn of the known new supply poised to enter Australia Ratings' Red index – namely, hybrid securities issued by financial institutions – this index declined over the month by 0.14 per cent, or 1.71 per cent on an annualised basis.

However, it should be remembered that the Australia Ratings' family of ASX-listed debt securities indices are accumulation indices. If the indices were simple price indices, the fall in the Red index would have been more than twice as large, at 0.38 per cent.

And while the constituents of the Red index form the largest group in the Combined index, it was distributions declared during the month by members of the other indices that prevented a decline in the Combined index. The Combined index increased by just 0.05 per cent over February.

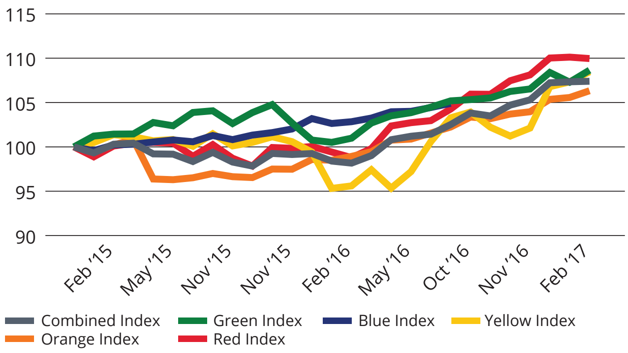
The best performance was again seen in the low risk Green index for senior ranking bonds. The index increased by 1.25 per cent, or 16.12 per cent on an annualised basis.

This strong performance is attributable to strong price growth in the Australian Unity simple corporate bonds (AYUHB), which had gone ex-distribution in January. The price of the securities jumped to $105.10, after ending January at $103.45.

Similar price performance was seen from the Tattersalls (TTSHA) bonds. At the end of December the bonds appeared very expensive on a relative value basis and thus the price eased in January, but after ending the month at $103.08, the price at the end of February had jumped to $104.50.

The Yellow index – which covers securities with deferrable but cumulative distributions – also performed well, increasing by 1.06 per cent over the month. Continuing increases in the price of the Crown Resorts subordinated notes, CWNHA and CWNHB, and the latter in particular, are the cause.

Chart 1: Performance of the Australia Ratings indices excluding the Unfranked and Franked indices



Source: ADCM Services, Ord Minnett

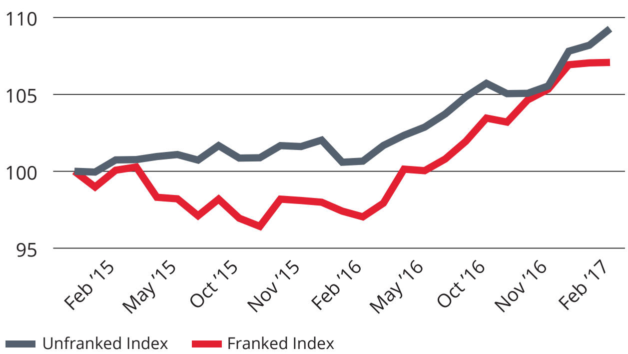
The Orange index – securities with deferrable, non-cumulative distributions – also increased over the month but by a more modest 0.71 per cent. Distributions declared during the month made a significant contribution to the increase in the index.

The weakness in the Red index is reflected in the Franked index, which includes many of the same constituents. The Red index increased by only 0.03 per cent over the month.

> **The best performance was again seen in the low risk Green index for senior ranking bonds. The index increased by 16.12 per cent on an annualised basis.**

The Unfranked index performed better, increasing by 0.99 per cent.

Chart 2: Performance of the Australia Ratings Unfranked and Franked indices

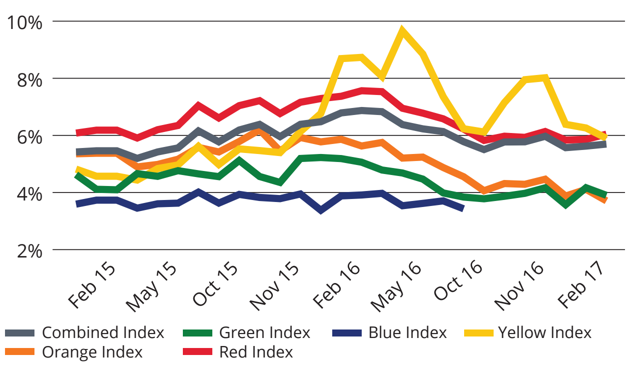


Source: ADCM Services, Ord Minnett

The weighted average yield of each of the indices tells the story about price movements, as yields move inversely to prices, and this removes the impact of distributions on the accumulation indices.

The weighted average yield of the Red index reached a low of 5.84 per cent per annum at the end of 2016. The yield increased by 2 basis points in January but by the end of February it had jumped to 6.04 per cent, clearly showing the impact of the new supply coming into this index.

Chart 3: Movement in Weighted Average Yields by index from December 2014



Source: ADCM Services, Ord Minnett

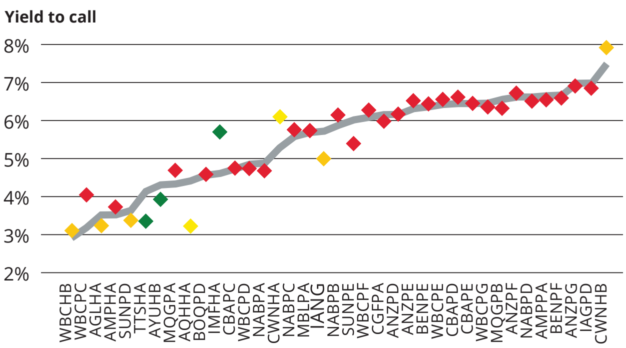
This again shows up in the weighted average yield of the Combined index, which increased to 5.7 per cent at the end of February, up from 5.63 per cent at the end of January. The Green, Yellow and Orange indices experienced further contractions in weighted average yields to 3.90 per cent, 5.90 per cent and 3.71 per cent per annum, respectively.

The apparent discrepancy in the weighted average yields of the three indices is due to the idiosyncratic characteristics of individual issuers in the indices.

Value may be found in securities other than hybrids

The softness that has emerged in the prices of some ASX-listed debt securities over the last month invites consideration of relative value in the secondary market. Applying our proprietary multi-factor regression model reveals that the model can explain more than 85 per cent of the variation in yield to call among the securities included in the Australia Ratings ASX-listed debt securities indices.

Chart 4: Actual yield to call relative to the fair value line



Source: ADCM Services

Thus, it is the 15 per cent of variation that is of interest – the outliers in the group – those that are well above or below the fair value line, as shown in Chart 4. Being positioned above the fair value line suggests the security is cheap relative to others, and vice-versa for those positioned below the line.

Two observations can be made from Chart 4.

> **"The model can explain more than 85 per cent of the variation in yield to call among the securities included in the Australia Ratings ASX-listed debt securities indices.**

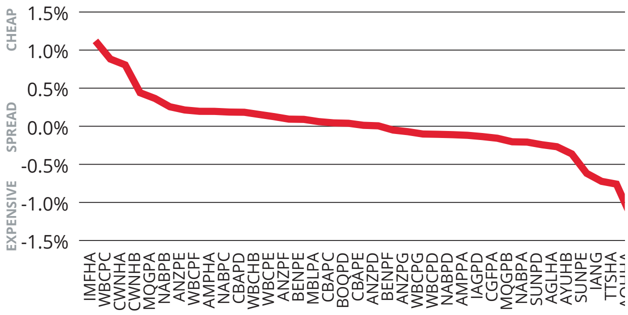
The first is that the market appears to be very efficient in pricing those securities that are the constituents of Australia Ratings' Red index (which covers hybrids, generally released by financial institutions). There is much more variation among the constituents of the other indices.

The second observation is that most of the variation in the yield to call relative to fair value appears toward the left hand side of the chart. Somewhat coincidentally, this generally aligns with a shorter period of time until the call date is reached.

Chart 5 makes relative value among the securities very clear. The securities are ranked from cheapest to most expensive, as estimated by the model.

But remember this is a purely quantitative ranking with no qualitative factors taken into account. No investment or divestment decisions should be made without due consideration of the qualitative factors that could be impacting the market's assessment of individual securities.

Chart 5: A ranking from cheapest to most expensive, as at February 28



Source: ADCM Services

Dr 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.