According to us
newsletter
Summer 2015

One small step...

By Geoff Greetham, Executive Director

With the US having just brought an end to seven (7) years of near-zero interest rates and, at the same time, assuring investors that the world's largest economy is resilient enough to withstand future increases in borrowing costs at a gradual pace, it is timely to reflect on the backdrop to this and what the possible impact will be for share markets.

It should be said we have a clear divergence now, with other central banks in China, Europe and Japan, still biased to being more accommodative in stimulating their respective countries/regions. How this offsets US policy and plays out in markets will be something to keep an eye on.

The mere fact that the path to 'normalisation' has commenced, I believe, has to be positive, given some of the distortions which have arisen in markets due to abundant liquidity needing to find a home. This has manifested itself most clearly over the last few years in a global search for yield, sometimes at the expense of growth.

As a rule, when the Federal Reserve (Fed) in the US raises interest rates, share markets (with the US being the benchmark) have tended to de-rate initially but in turn picked up over time, as the reason for the interest rate increase is typically to regulate improving growth to ensure it doesn't spark a surge in inflation.

What is unusual this time is the Fed has raised rates when the Manufacturing ISM (Institute of Supply Management) reading, a bellwether indicator of economic strength, is below 50. A reading less than 50 indicates a contraction, not expansion, in activity.

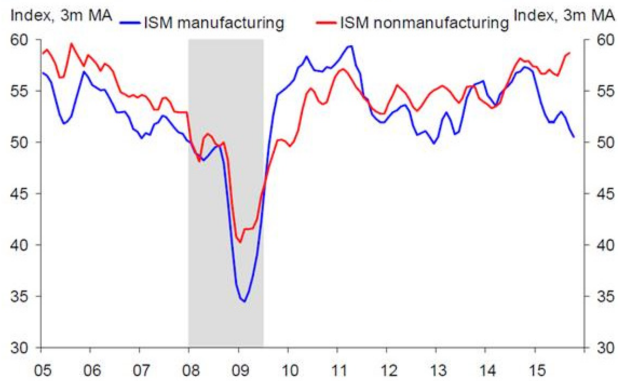
The last time this happened was in Q4 1981 under Chairman, Paul Volcker, but that was when inflation was running near a 10% annualised rate at the time, compared to readings that are at present consistently below 2%, the Fed's target rate.

It is also being done at the same time that US corporate profits fell in Q315, the third drop in the last four quarters. Corporate profits tend to be a leading indicator of the labour market and the broader economy so this bears watching.

The Fed though is confident that the time is right, with US employment numbers clearly strong (the last three (3) months payroll numbers reinforcing this), booming car sales and an improving Services ISM (refer chart), the counterpart to the Manufacturing ISM.

After all, the Services sector does make up a lion's share (85%) of the economy employing an equivalent amount of the workforce.

Rightly or wrongly whether now is the right time to increase interest rates is probably not as important as the timing and path of subsequent increases. And, based on history, future increases are likely to be linked to wages growth, which to date has been tepid – this also being a feature globally, not just a US phenomenon.



How markets will generally react, including Australia, is hard to predict but we can offer the following insights:

1. **There is a recognition that the re-rating of share markets, post the GFC, is probably over.** What I mean by re-rating is the uplift in valuation caused by investors being prepared to pay more for a dollar of earnings, in the hope of growth, and similarly taking the view that low yields ex-shares are here to stay.

2. **Share markets will now depend more than ever on earnings growth.** It is still no easier to find, given the "low return" world we seem to inhabit at present, given sundry debt constraints etc.

3. **Volatility is likely to intensify.** Reinforcing the shift to a "stock pickers" market, evident in the past year, as investors focus on the pursuit of growth, with companies who disappoint to be treated harshly.

From a short term perspective, what will be interesting is whether we have a bit of a rally, given the sell-off that has preceded the US decision.

Whilst more a tactical play than anything else, we would argue share markets have a very lop-sided investor positioning at present, with everyone, for example, negative about mining and energy stocks. It would not surprise, on the back of this decision, if we see a bit of a recovery, given the pace of recent declines.

Longer term though, we trust that the faith that the Fed has in the recovery is borne out providing a supportive backdrop for improving global growth.

When the ATO comes calling?

By Jackie Cook, Financial Strategist

Under its new approach to Self Managed Superannuation Fund (SMSF) compliance, the Australian Tax Office (ATO) is actively calling trustees when a new SMSF has been established (to ensure they are aware of their obligations as trustees of the fund) or when relatively minor breaches have occurred (to try and work through the solution together in order to prevent the fund from requiring a full audit).

Whilst (in most instances) you will have appointed us to advise and manage your SMSF affairs, ultimately the responsibility for the running of your SMSF still resides with you, hence the ATO's approach.

I should say those trustees targeted are generally ones who have been late in lodging personal tax returns or, on certain ATO criteria, are judged to be of 'higher risk'. We are not aware of any calls being made to our clients to date.

To avoid a potentially awkward conversation with the ATO though, it is important that you and **all other trustees** of the fund have at least a basic understanding of your/their obligations as a SMSF trustee. It is not an excuse that one individual out of the SMSF 'team' understands and the others do not. If the ATO call is answered by a trustee of the fund, then that particular trustee is expected to be able to answer some basic questions regarding their responsibilities as a trustee and exhibit some knowledge of the SMSF structure in general. You can't just say "I don't know, my husband/wife takes care of our finances". This would not be looked upon favourably by the ATO. The ATO though is not expecting you to be an expert but just be aware. You have an adviser after all to assist you.

While this may be scary for some, you need to remember they are doing this for your protection too. Do you know the rules around what a SMSF can and can't do? Are you aware of penalties should you breach any of these rules? What happens if another trustee breaches the rules? Could you be held responsible? These are questions you should know the answers to.

In the event of a call, I would refer you back to our advice where we detailed the pros and cons of a SMSF including the responsibilities you assume as trustee, presuming you established the fund via us.

A further way to increase your SMSF knowledge is to visit the SMSF resources page on the ATO website (https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/). In particular, watching the range of short animated videos, which cover hot topics and key responsibilities for SMSF trustees, is suggested.

The SMSF Association, of which Geoff and I are members, has also just released its new SMSF Trustee Knowledge Centre online, as a further resource.

As to a breach, we trust, where we are managing your total SMSF and co-ordinating the accounting/auditing with our preferred supplier, you won't be called without being aware of it in advance. This is because, for the ATO to be made aware of the breach, the SMSF auditor will have already identified the breach via an Auditor Contravention Report (ACR) and this information should have been relayed back to you, your accountant and us. We cannot guarantee this to be the case where we only partly manage and other external parties are involved.

That said, the types of matters included in an ACR could cover:

- Loans to members or relatives;
- Inappropriate investments or investments made outside the SMSF rules;
- Holding in-house assets that exceed the five per cent maximum;
- SMSF assets not held clearly for and on behalf of the SMSF;
- A SMSF bank account going into overdraft (resulting in a 'borrowing' within the fund);
- Failure to meet timelines or prescribed time periods.

All of the above are 'no-nos' to be aware of.

Just remember, when the ATO calls, there is no need to be defensive. Just be prepared, polite and helpful and the ATO is likely to reciprocate.

Striking A-ccord

Did you know....

Despite ongoing concerns about the health of our economy, Australia is due, in 2016, to clock up 100 quarters of economic expansion, that is, without a recession. The definition of a recession is two (2) quarters of negative GDP growth. To date, we sit at 97 quarters.

The only other country to achieve such a feat was the Netherlands who recorded 103 quarters of consecutive growth from 1981 to 2008, until the GFC in Europe hit.

Given the swings in the global economy over this time, Australia's run can be regarded as nothing but an incredible achievement.

Long may it continue!

www.accordius.com.au

Accordius Pty Ltd • ACN: 128 900 603 • AFS Licence No. 321955
Level 24, 333 Collins Street, Melbourne, VIC 3000 • GPO Box 2985, Melbourne, VIC 3001
Telephone: +61 3 8623 3378 • Fax: +61 3 8678 1235 • Email: information@accordius.com.au

ACCORDIUS
Your personal funds manager