According to us newsletter

Winter 2014

Shining the spotlight on...

By Geoff Greetham, Executive Director

The best way to describe the local investment market over the last six months is benign. In essence, this is not surprising in the face of strong returns over the 18 months or so prior, which have largely resulted from a general revaluation than a major uplift in corporates' earnings. A pause was due.

Nor does this mean there has been a lack of activity. On the contrary, the initial public offering (IPO) market has been very active in this time, with a number of new companies being floated. It is just that these have been hitting the market at the same time as questions have been arising with regard to Australia's next growth engines post the mining boom. A classic case of one counterbalancing the other.

Whilst it is a truism that we will likely be in a "slower growth, lower return" environment globally for the foreseeable future, opportunities to achieve above market growth will arise. There is no doubt. And one should not totally abandon sectors where the current outlook seems poor, but winners therein are likely. These can sometimes offer the best returns. A case in point is resources, with the focus on iron ore, whose price drop has been viewed recently as a barometer of its health. I explore this and where it may pay to invest.

Now also that the end of the financial year has concluded and we trust those superannuation contributions have been made, there is a "post 30th June" strategy worth considering to further maximise these benefits. Jackie Cook outlines this often overlooked strategy and possible applications for different situations. I am sure you will see some relevance for your circumstances.

If you wish to discuss any of the above or know of someone who may benefit from our advice and insights, please do not hesitate to contact Jackie (Ph 8623 3403) or me (Ph 8623 3378).

We are more than happy to field queries.

Iron Ore: Looking beyond the short term

By Geoff Greetham, Executive Director

The 30% or so fall in the iron ore price since the start of the calendar year has had many touting doomsday scenarios for the Australian mining industry.

The focus on iron ore in particular is not surprising. Iron ore has been one of our most successful exports and has been vital to China's growth. Its relationship with Chinese steel consumption has been a dominant theme over the past five years and a key reason Australia was not "sideswiped" by the GFC.

There is no doubt that the mining industry has entered a more challenging time but, like all industries, certain players will likely profit from the transition underway, while others will struggle to survive.

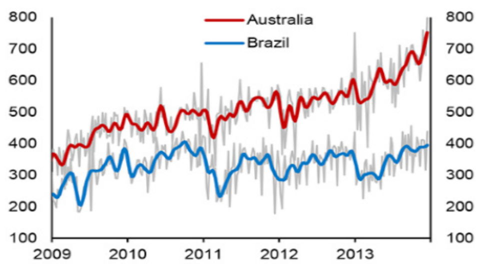
While the peak mining years have passed, 2014 will likely be seen as a year of transition, given our view that the longer term process of Chinese urbanisation is far from complete.

Why has the iron ore price declined?

Simply put, a matter of iron ore supply finally catching up to steel demand.

The major miners, BHP, Rio Tinto and Vale (the Brazilian iron ore miner and the world's largest) have been feverishly developing resources but have been "behind the curve" in sating Chinese appetite.

Iron ore exports (millions of tonnes per year)



Source: Tyndall AM

As can be seen, Australia has not been the problem. The laggard has actually been Brazil for a host of reasons.

Combined with this has been a slowing in domestic Chinese property construction activity, which is steel's single largest component of demand and accounts for 1/3rd of Chinese steel consumption.

What will be the (rational) response?

From the supply side, and at current prices, economics dictates a likely withdrawal of supply.

In filling the gap over the past few years left by Brazil, Chinese domestic supply has grown. However not all iron ore is of similar quality, and Chinese iron ore is of a lot lower ore grade than Australian and Brazilian iron ore meaning it requires significant refinement to be sold to steel makers. It is thus higher cost and likely to be the first removed from the market given Chinese iron ore producers are unprofitable at current levels. This may not though be smooth as, whilst loss making, other considerations in China e.g. employment may see some resistance to closure.

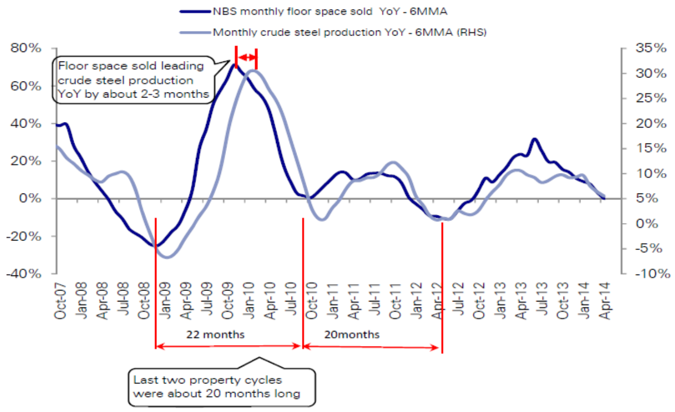
In addition, a similar response is expected from higher cost Australian and Canadian producers, coupled with project delays, at these prices.

But you mentioned earlier a slowing Chinese property sector?

Yes, from the demand side, there has been a slowing.

However, as analysed by Deutsche Bank below, this just seems to be part of the Chinese property cycle, with this perhaps the 3rd in the last seven years and a trough perhaps not too far at hand.

Property Sales v Crude Steel Production in China



Source: Deutsche Bank

Further, we see the case for ongoing Chinese urbanisation as still very much in tact supported by a necessary renewal and upgrading of existing sub-standard building stock.

An often overlooked fact is, that even after 15 years of rapid growth in Chinese residential investment, about half the urban population still lives in pre-reform housing i.e. before recognition of property rights in the mid-to-late 90s, which the government estimates, because of its poor quality, should only last 25 years!

Also recent actions by Chinese authorities, notably more measured than in the past, demonstrate their ongoing commitment to support growth and urbanisation in turn.

What is the Best Investment Approach?

Failing an unlikely significant collapse in Chinse steel consumption, the investment focus should be on the lowest cost highest quality iron ore producers at this point in the cycle, who can still produce profitably into this market and are not so price reliant.

Fortunately, in the Australian context, BHP and Rio Tinto, fit this criteria and are also now in as financially strong a position as they have been for a long time.

Both companies have stressed their focus on wise capital management and now trade on dividend yields close to the market average i.e. 5% fully franked, which has not been the case for a very long time.

Whilst this positioning has not been a profitable strategy in recent times, both have suffered less than their counterparts but stand to benefit more so longer term.

The Simple Strategy That Serves Many Purposes

By Jackie Cook, Financial Strategist

Contribution splitting is a strategy that has been in the superannuation arena for many years, but to many, the rationale behind implementing such a strategy is not entirely clear.

The truth is there are a wide array of reasons why a person would consider superannuation splitting, ranging from (but certainly not limited to) earlier access to superannuation, obtaining increased social security benefits and equalising superannuation balances.

In enacting contribution splitting, you must ensure that you do not look at each individual benefit in isolation, and consider how the strategy will affect all aspects of your ongoing financial planning.

By choosing to contribution split to one spouse as opposed to the other, you must be willing to accept the positive and negative repercussions of your decision.

What is contribution splitting?

Contribution splitting involves one spouse splitting a portion of the concessional contributions they received within a financial year to the other (eligible) spouse.

What types of contributions can be split?

The following contributions can be split:

- Superannuation Guarantee (SG) contributions
- Salary sacrifice contributions
- Personal deductible contributions

The following contributions cannot be split:

- Non concessional contributions
- Rollovers from another fund
- Employment termination payments
- Member and employer contributions to defined benefit funds
- Contributions for an account that is subject to a payment split or on which a payment flag is operating for Family Law purposes.

Striking A-ccord

Did you know....

The median price of a house in Mildura - the well-known town on the Murray - is broadly similar to house prices in Chicago - the 3rd biggest city in the US.

This was sourced from a book by Lindsay David, Australia: Boom to Bust which posits a collapse of the Australian economy. Whilst I might question his arguments, this statistic, which I gather has been independently verified, certainly does put our housing market (and standard of living) into context relative to the rest of the world.

How much can I split?

The maximum amount that can be split is the lesser of:

- 85% of your total concessional contributions*; or
- The concessional contributions cap (currently $30,000 per annum or $35,000 per annum for those aged over 49)

Please note that contribution splitting **does not** reduce the amount assessed as your concessional contributions for the period.

*The 85% maximum allows for the deduction of 15% contributions tax.

Who is an eligible spouse?

A spouse is a person who the member is married to or in a de facto relationship with (this includes same sex couples).

In addition, the member's spouse must be:

- under their preservation age; or
- attained age preservation age but under age 65 and has not met the retirement condition of release (i.e. retirement)

Why would I want to contribution split?

Contribution splitting provides the following benefits:

- Splitting contributions with an **older spouse** will enable earlier access to superannuation benefits. Furthermore, if the spouse is over 60, any withdrawals from superannuation will be received tax free.
- Splitting contributions with a **younger spouse** may result in higher Age Pension entitlements due to the deferral of those contributions being counted under the Social Security income and assets tests.
- Splitting contributions to a **spouse with a lower superannuation balance** may reduce legislative risk through equalising balances.
- Splitting contributions to a **non-working or low-income spouse** can assist in the funding of insurance premiums.

Obviously, building the balance of the older spouse will be beneficial from a superannuation access perspective, however you will need to weigh this up against the fact that the increased balance for the older spouse may result in less social security benefits once they reach age pension age.

Conversely, if the older spouse were to split their contributions to the younger spouse, this could greatly increase the expected Centrelink benefits for the older spouse when they reach age pension age, but with the understanding that there would be an increased timeframe until the "split" contributions could be accessed via superannuation.

Furthermore, while it may seem like equalising balances should be beneficial from a legislative standpoint (and past history has indicated that this most certainly could be the case), no one knows what the future holds in terms of changes to superannuation law and equalising balances could in fact be detrimental to certain members (e.g. if members with smaller balances were given higher tax concessions than those with higher balances).

How to split your contributions

The implementation of this strategy is simple. All that is required is a Contribution Splitting Application Form. This form can be completed at any time in the current financial year for contributions made in the previous year (i.e. you can complete the form to split 2013/14 contribution anytime up until 30 June 2015). The form must then be provided to the superannuation fund of the spouse whose contributions are to be split.

Should I contribution split?

Every couple is different, and has a different set of goals and circumstances, therefore whether it would be appropriate for you and your spouse to contribution split is not a "one size fits all" situation. As such, before making any important decision like this, we strongly recommend you seek financial advice to guide you.

Please feel free to contact me should you wish to discuss this strategy further.

Please note that the information in this publication is for general use only. We would be pleased to talk with you in regard to your particular circumstances should you wish to explore any particular aspect further. Any tax planning matters should be discussed with your accountant before proceeding.

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