Analytical advice since 1982.

June 2018 Quarter In Review

Contents (Alphabetic)

Legislative changes

Illustrating the ingenuity of the SMSF industry lobby, the AFR reported on 27 April that the Government announced that the maximum number of members of self managed superannuation funds will be increased to six. This provides funds to have more contributors and hence greater tax liabilities to offset against franking credits, thereby reducing the impact of the proposal to prohibit refunds of franking credits. All of this before the ALP is even elected.

The May 8 Federal budget announced a schedule of tax cuts ultimately resulting in a constant marginal tax rate from $40,000 to $200,000. Other changes were relatively minor.

Markets and trend lines

The following charts show, respectively, the best fit of constant compound growth in the Australian and United States of America broad market indices together with some statistically derived probability percentiles. On this statistical basis, the Australian market provides

Level 13, 251 Adelaide Terrace Perth WA 6000

P.O. Box 3584 East Perth, WA, 6892

Telephone: +61 (08) 9225 5899

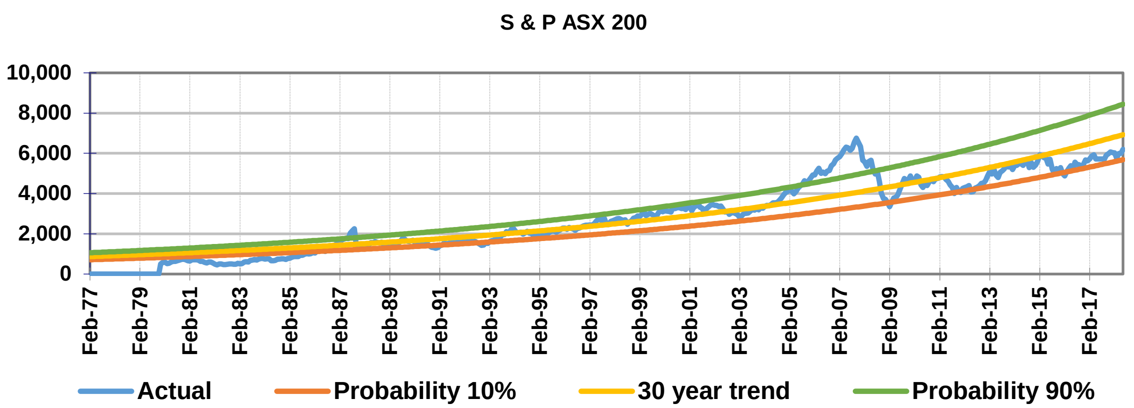
Facsimile: +61 (08) 9225 5877

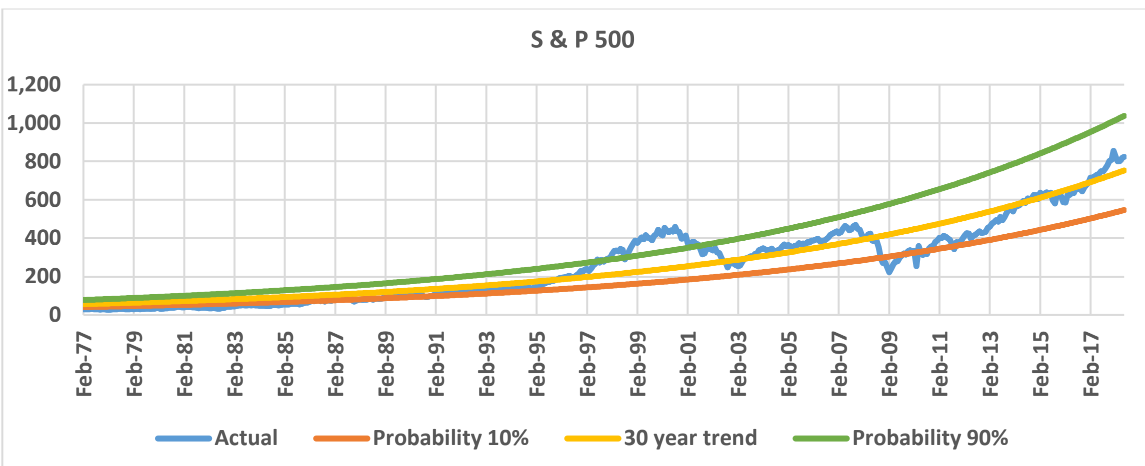
Info@Andep.com.au

www.Andep.com.au

reasonable value and the USA is a little elevated. On other measures, however, the US market, in particular, remains high.

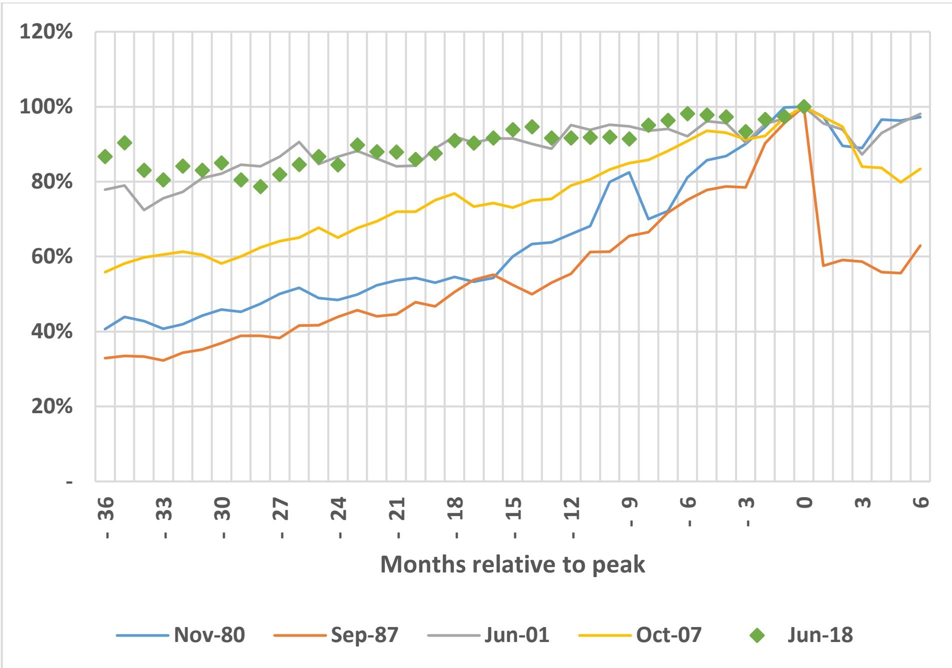
The 30 year trends encompasses a period of steadily falling interest rates, which is at or near its end. These make conclusions from the trend charts optimistic.



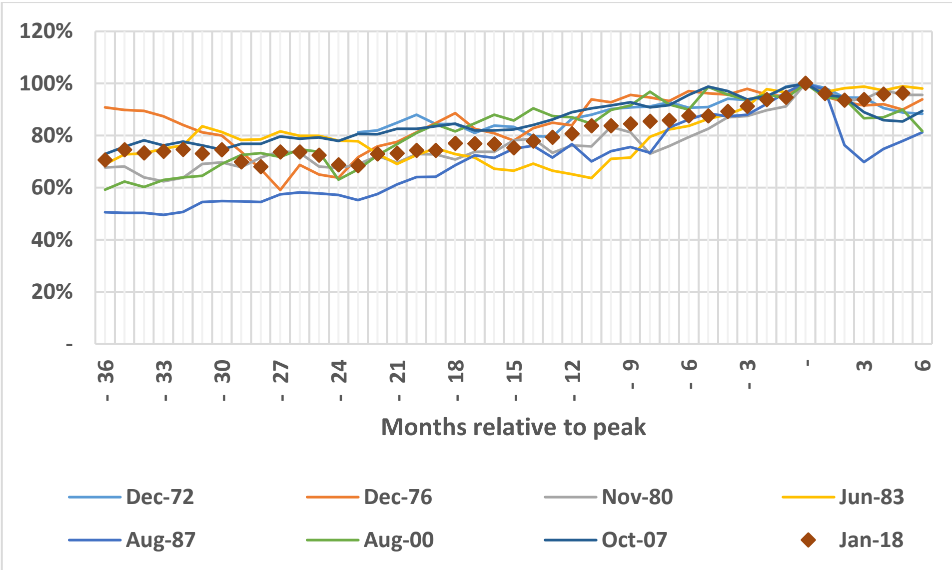


Another graphical view of the markets is a comparison of the movement in the three years leading up to the most recent peak and the three years before and six months after significant peaks.

The following chart relates to Australia and the diamonds of recent progress are above the lines representing the lead up to other peaks except November 1980. Australia has not recently seen the rapid increases that preceded earlier peaks.



One can be less sanguine about the USA market, depicted in the following chart. The recent rise to the January peak was in the mid range of earlier rises preceding major peaks.



It remains true that the USA stock market's three year growth far exceeds that of Australia, UK Germany and Japan.

While many Australian based international fund managers have reduced their exposure to the USA, that market is vulnerable to rising interest rates and a trade spat. The US market continues to ignore these vulnerabilities. The risk remains that a USA fall could flow on to other markets.

Economic milestones

Not yet a milestone achieved, but the AFR of 20 April 'reported that the US government's debt is projected to be 117% of GDP by 2023, higher than that of Italy.

On 25 April, the USA 10 year bond yield briefly exceeded 3% for the first time since December 2013. This is further evidence of normalisation after the Global Financial Crisis.

On 26 April, the prudential regulator, APRA, announced the removal of the previously applicable limit of 10% on annual growth of bank lending, saying that it had achieved its purpose of tightening lending standards.

Twice in May and once in June, the Indonesian Central Bank increased interest rates a total of 1% per annum to stave off capital outflows attributed to resurgent US interest rates.

The Reserve Bank of India raised its benchmark interest rate on 6 June for the first time in four and a half years, citing growing inflationary pressures stemming from rising oil prices and recent global financial turmoil.

On 13 June, the US Federal Reserve added to the pressure and increased its short term interest rate target to 1.75 – 2% per annum and hinted two more increases are to follow this year. None of this was unexpected by markets. However, by 15 June, it had nudged the Australian dollar to its lowest weekly closing price since June 2017.

On 6 June, the ABS released its quarterly Gross Domestic Product figures. Growth for the quarter was 1% and for the year 3.1%. Employee compensation grew 5.1% over the year, reflecting the strong growth in employment.

Industry e–zine, Renew Economy reported continuation of the South Australian thrust into renewable energy. A deal for SIMEC ZEN energy to sell power to a consortium of five major power users from a 220 MW solar farm near Whyalla. While independent of the new government, the deal highlights South Australia's fortuitous combination of abundant solar energy and access to the Eastern States grid.

On 14 June, the ABS announced a 0.2% fall in the unemployment rate to 5.4%, the lowest since November 2012.

Also on 14 June, the European Central Bank announced a scaling back of its Asset Purchase Programme in October and its cessation in December. This means it will no longer be injecting money into the financial system. This joins the US in the pushing the Global Financial Crisis into history with the "normalisation process" which the latter started in October 2017.

On 20 June, the Australian stock market reached a 10 year high, but was still 9% off its October 2007 month end peak.

The march of renewable energy continued with a 21 June announcement of a bid for Adelaide to host a formula E electric grand prix. Currently Formula E cars have about two thirds of the speed and acceleration of Formula 1 cars.

Straight out of the high school economics textbook, the AFR on 27 June reported that Harley Davidson reacted to European tariffs (themselves a response to US tariffs) by announcing relocation of manufacturing of Europe bound motor bikes to Asia and South America.

Economic and market statistics

The following table shows key economic and market statistics.

	Latest date	Now	1 year ago	3 years ago	7 years ago
S&P /ASX 200- Australia	Jun 18	6,195	5,721	5,459	4,608
Annual change to latest date			8.3%	4.3%	4.3%
S&P /ASX 200 dividend yield	Jun 18	4.02%	4.20%	4.78%	4.35%
S&P /ASX 200 P/E ratio	Jun 18	15.4	15.50	15.20	15.60
Topix- Japan	Jun 18	99.8	93.00	94.00	49.00
Annual change to latest date			7.3%	2.0%	10.7%
S&P 500- US	Jun 18	823.2	733.9	624.8	399.9
Annual change to latest date			12.2%	9.6%	10.9%
GDAXI- Germany	Jun 18	12148	12396	11050	7159
Annual change to latest date			-2.0%	3.2%	7.8%
Average weekly earnings $	Mar 18	1,568	1,533	1,477	1,290
Annual change to latest date			2.2%	2.0%	2.8%
Consumer price index	Mar 18	112.60	110.50	106.80	97.95
Annual change to latest date			1.9%	1.8%	2.0%
Unemployment	May 18	5.4%	5.56%	6.12%	5.00%
Gross domestic product $ m per quarter	Mar 18	437,246	423,955	405,466	361,244
Annual change to latest date			3.1%	2.5%	2.8%
RBA cash rate	Jun 18	1.5%	1.50%	2.00%	4.75%
3 year Commonwealth bond	Jun 18	2.1%	1.76%	2.03%	4.76%
10 year Commonwealth bond	Jun 18	2.7%	2.41%	2.98%	5.16%
USD/AUD	Jun 18	0.74	0.77	0.77	1.07
Annual change to latest date	Jun 18		-3.9%	-1.3%	-5.2%

A notable figure in the above table is that the rate of growth of the ASX 200 is near identical over the last 3 years as it has been over the last 7 years. One must go out to the fourth decimal place to distinguish between the two.

Other peoples' views

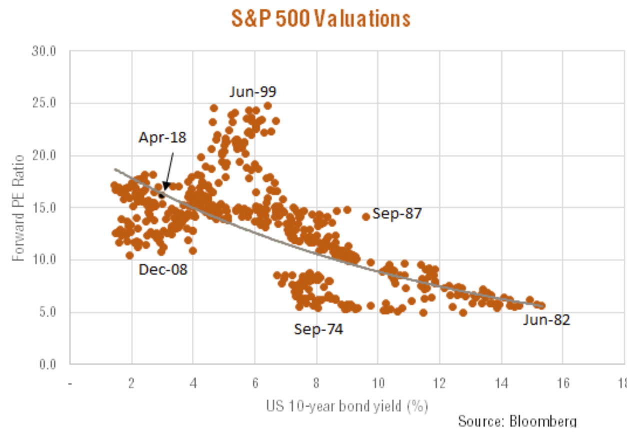
Speaking at an Association of Superannuation Funds function on 14 May, AMP Chief Economist, Dr Shane Oliver, reminded the audience that many good people work for AMP and AMP has done much good in the community before speaking on the budget and the economy. He made the point, in the context of Australian inflation expectations, and hence the likelihood of interest rate rises, that the proportion of the Australian workforce unemployed or under employed is about as high as it gets while the opposite is true for the USA.

Investment house BlackRock quarterly quantifies geopolitical risk and its likely effect on world share markets. The following charts show the May 2018 situation and the history of the index. The explanation below the history chart hints at the process used.

Source: BlackRock Investment Institute. May 2018. *"Notes: The graphic depicts BlackRock's estimates of the relative likelihood (vertical axis) of the risks over the next six months and their potential market impact on the MSCI ACWI Index (horizontal axis). The market impact estimates are based on analysis from BlackRock's Risk and Quantitative Analysis group. See* *the "How it works" section and the 2018 paper "Market Driven Scenarios: An Approach for Plausible Scenario Construction" for details. Some of the scenarios we envision do not have precedents – or only imperfect ones. The scenarios are for illustrative purposes only and do not reflect all possible outcomes as geopolitical risks are ever-evolving. Coloured lines and dots show whether BlackRock's Geopolitical Risk Steering Committee has increased (green) (sic) or decreased (red) the relative likelihood of any of the risks from our previous update."*

Source: BlackRock Investment Institute, with data from Thomson Reuters. Data as of May 18, 2018. *"Notes: We identify specific words related to geopolitical risk and use text analysis to calculate the frequency of their appearance in the Thomson Reuters Broker Report and Dow Jones Global Newswire databases as well as on Twitter. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average BGRI level over its history from 2003 up to that point in time. A score of one means the BGRI level is one standard deviation above the average. We weight recent readings more heavily in calculating the average."*

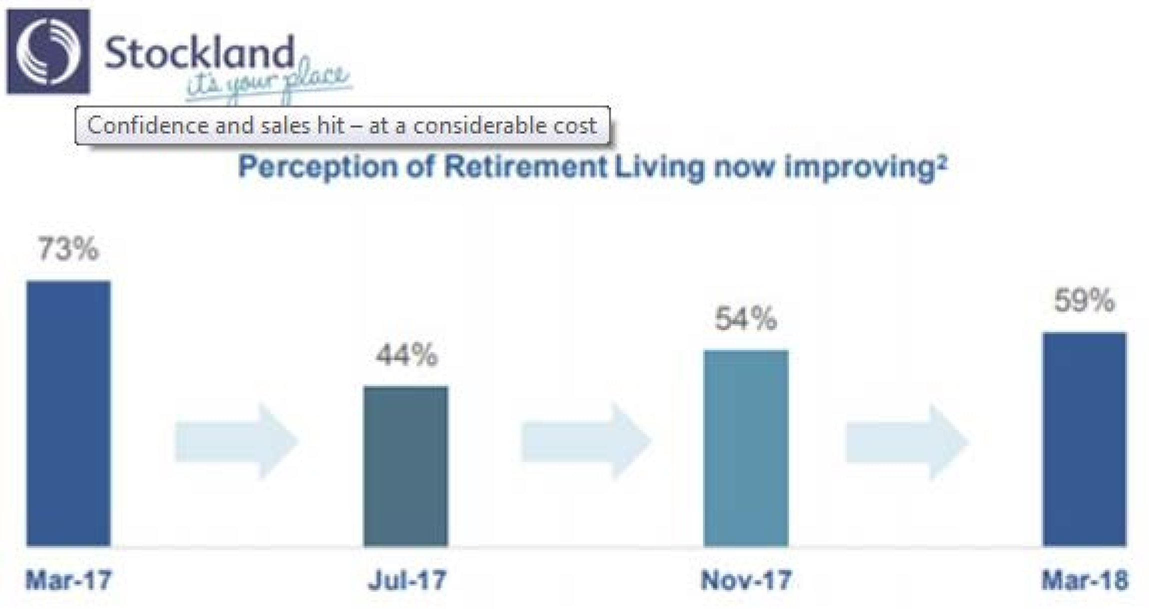
David Bassanese of ETF provider, BetaShares has updated a chart we first published in the review of the September 2017 quarter, following the break above 3% of US 10 year bond yields. It shows the USA stock market as measured by the S & P 500 price earnings ratio is exactly where the relationship between the ratio and the bond yield suggests it should be.



Fairfax journalist Mark Ludlow argued in the context of the Queensland state budget that that state and federal governments have given up on trying to contain debt. If this is true and true of other states, the problem will become larger and more intractable for future generations.

Fund Manager, Roger Montgomery of Montgomery Investment Management Pty Ltd, speaking to a financial advisers' webinar on 14 June, made the point that 49 of the largest 100 stocks listed on the US Nasdaq stock exchange are priced at more than 200 times their earnings. He argued that the flourishing of the "Tech" sector over the last 10 years is partly due to the easy money policies pursued by central banks in USA and elsewhere. He questioned whether, if money ceases to be so available, investors will be as patient with ideas not making a profit. Later in the same presentation, he said *"the concentration of money in the tech stocks is a source for concern of investors."*

On 27 June, retirement village industry e-zine, the Weekly Source noted the first anniversary of an ABC "Four Corners" "demolition" of the industry by reproducing a Stockland chart of perceptions of the industry.



The Weekly Source noted *"Reported sales July to December by Aveo, Stockland and Lendlease varied between 14 and 30% down."* Not for profit retirement village operators and those not mentioned in the publicity experienced either no set back or a quick bounce up.

This is an industry drowning in compliance. Disclosure is so exhaustive that few can absorb it. As mentioned in the December 2017 quarter in review, only 40% of people attending a meeting on villages had a solicitor read the contracts.

Products

On 3 May, National Australia Bank announced it was "spinning off' its financial planning, funds administration and funds management business to a new entity. This removes the incentive for bank staff to direct customers to financial planners. It does nothing else to remove the conflicts inherent in "vertical integration" where one company owns the advisers and the services that the advisers recommend.

On 26 June Commonwealth Bank followed suit announcing the demerger of its mortgage broking and wealth management businesses. The separation of the mortgage brokers will reduce conflicts of interest but the wealth management change probably will not.

On 23 April, industry fund REI Super announced age based default asset allocations for people drawing pensions. This reflects the need to invest through, not to, retirement.

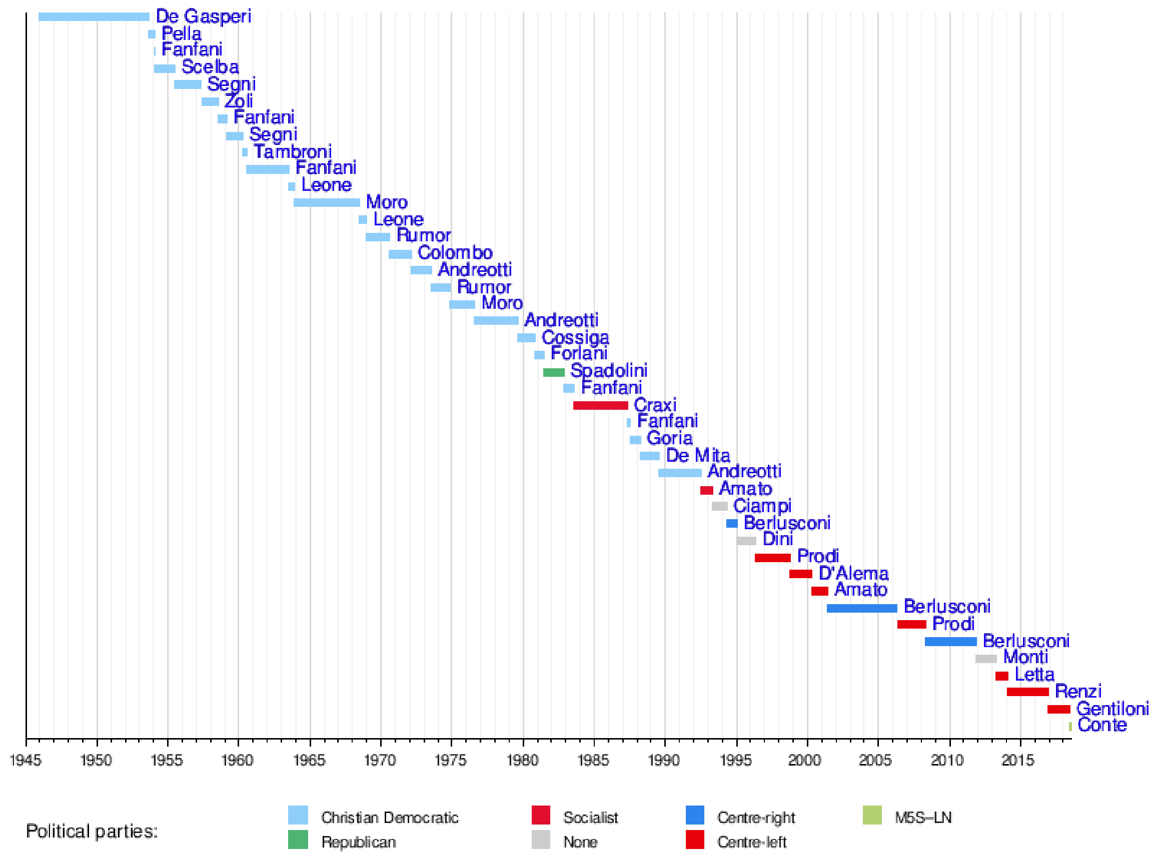
The 6 April announcement that Exchange Traded Funds provider BetaShares is offering an ETF that tracks the S& P / ASX 200 share index for an annual fee of 0.07%, half that of the next lowest, may be the start of a price war.

Politics

In a week that saw more Australian politicians ejected due to dual citizenship, the Malaysian people, on 9 May, showed that they would not tolerate kleptocracy, opting instead for gerontocracy. By the end of the quarter, the net was closing on former Prime Minister Najib Razak.

Following the Italian election of March, a premier supported by a coalition of the moderate to far right League and the comedian founded populist 5 Star Movement was appointed by the president. However, he was unable to secure presidential approval for his nominee as finance minister and a new election fought on the issue of EU membership appeared likely to occur around the end of May. By 1 June, calm was restored with the swearing in of a new prime minister, joining the long list of leaders of that country.

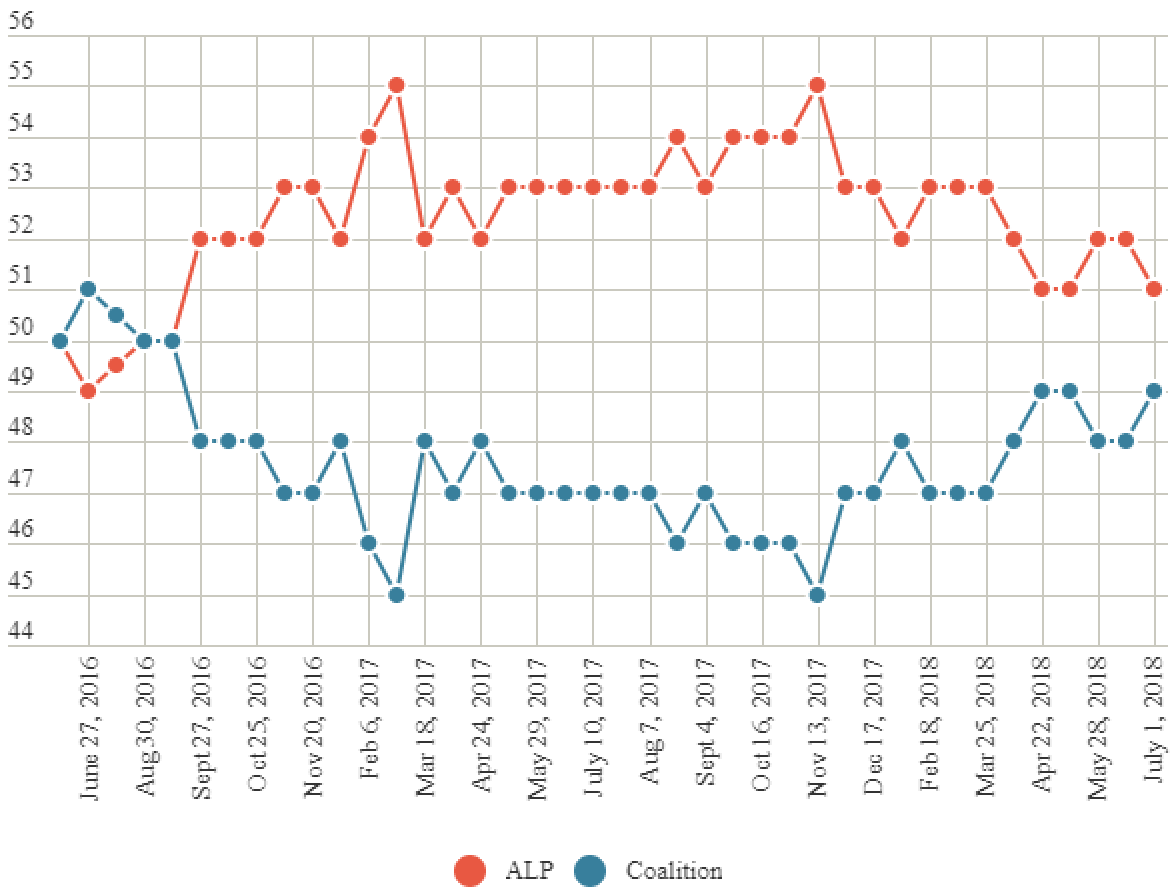
Italian Republic (1946–present) [edit]



Source Wikipedia

On 24 June the people of Turkey endorsed their president Racep Erdigan to continue in the role expanded in last year's referendum. That he won a plurality in the first round was no surprise, but his 53% majority was.

The following chart, from theaustralian.com.au/national-affairs/newspoll, tracks two party preferences.



Courts

Not yet in the courts, but the AFR of 2 May reported that all of the "final four" accounting and consultancy practices have expected or mandated partnership retirement ages between 58 and 62. Lawyers say this could lead to an action for discrimination. This puts a new barrier in front of younger workers aspiring to partnerships.

E-zine Shed Connect reported on 9 April a 26 March judgment against Bendigo and Adelaide Bank thwarting its attempt to recover funds loaned to investors in an olive plantation project. The decision was based on technical legal errors in the documentation. This case sits in interesting juxtaposition with the recently commenced Supreme Court action by a large developer against BankWest claiming the bank improperly tightened conditions causing a liquidation of a company. This is one of a number of similar cases involving the Bank after it was bought by the Commonwealth Bank.

E-zine My Business reported on 14 May that for the first time, an Australian business owner has been jailed for contempt of court by ignoring provisions imposed by the Fair Work Ombudsman. The owner-operator of a tourism business was given a 12-month jail sentence and fined $84,956 by the Federal Circuit Court after he was found to be in contempt of court by breaching a freezing order on his company's accounts. The order related to underpayment of wages.

As we did in the March quarter, we have defined the Hayne Royal Commission as a Court. The first physical casualty has now become the first corporate financial casualty. Dover Financial Group, whose founder collapsed in the witness box, has announced it will surrender its Australian Financial Services License in July ahead of a proposed cancellation or suspension. The closure affects 20,000 investors, 400 financial planners and their ancillary staff.

Not yet in the Courts, but on 28 June the Australian Securities and Investments Commission (ASIC) released a 127 page examination of advice around Self Managed Superannuation Funds (SMSFs). ASIC found failure, in 91% of the cases, to comply with the best interests of the client duty. It noted "*it became clear that members who had used a property one stop shop to set up and run their SMSF had quite different experiences to members who used a financial adviser or accountant.*" and that some of the one stop shops engaged in cold calling.

Disclaimer

This publication does not constitute personal financial advice. Before acting on any suggestion, explicit or implicit in this publication, please contact your Andep adviser.