Quarterly

2016 AUTUMN EDITION

Welcome to the Autumn 2016 edition of the NeoWealth Management Quarterly

INSIDE:

The Carlton Gardens, Victoria.

Quarterly Market Review

Equity markets finished down for the first quarter after a weak start to the year. The quarter began with equity markets falling globally on the back of a weakening Chinese economy, a collapsing oil price and concerns over the US economy. The S&P/ASX 200 Accumulation Index closed down 5.5% at the end of January.

February started off following the same downward trend, weighed down by a global sell-off in bank stocks. A good reporting season sparked a mid-month rally which saw some gains. Macro factors such as concerns over a weakening Chinese economy, deflationary fears from Europe and the possibility of Britain exiting the European Union halted any market traction.

The month of March was strong for equity markets, with most major equity markets posting healthy positive results. Gains across all sectors saw the S&P/ASX 200 Accumulation Index up 4.7% for the month driven by a strong Financials sector. A weakening US$ helped push most commodities prices up for the month with iron ore, steel and oil being the best performers.

News headlines were dominated by the presidential elections in the US with unlikely candidate Donald Trump firming as the favourite to be the Republican nominee. The future of Britain's European Union membership remains a talking point and a cause for uncertainty.

Over the past 12 months, the mid-cap industrials have significantly outperformed the top 20 and this trend is expected to continue. New technologies are breaking down the barriers that have traditionally allowed Australian markets to be cornered by a range of oligopolies, which have been able to extract excess returns and profits due to our isolation. There has already been deterioration of value in the large media and retail organisations and we expect the competitive threats to other industries such as general insurance, telecommunications, energy and food retailers to continue. Also some major sectors are affected by cyclical headwinds. Resources have been suffering from lower commodity prices and banks are suffering from deterioration in single name bad debts (in the resource space). Both of these are expected to pass.

The mid-cap space has seen the emergence of some new industries and companies taking advantage of new growth opportunities. The lower A$ has benefited tourism, education and food and wine exporters. Service sectors exporting their expertise into Asia, and technology businesses taking advantage of demand for software as a service (Saas) have also benefited.

Macroeconomic data coming out of the US was mostly positive with signs of tightening capacity which could see rates rise. However in Japan and Europe there are market concerns around deflation rather than inflation. We believe the risk of a major shift in interest rates/inflation expectations to be low. However caution should be exercised as the potential downside risk in this area is large. Concerns of a softer China will also continue to play on investors' minds.

Five lessons from the recent turbulence in share markets

BY **Don Stammer**

In the first ten weeks of 2016, share markets were often described as turbulent. Globally, shares shed 11% of their value between the start of the year and mid-February. Predictions of a global recession were frequent and shrill. Oil and iron prices tanked. Adding further to the gloom, a cleverly-marketed research report did its rounds, predicting a collapse in Australian house prices and bank shares.

Then, the widespread gloom dissipated. By mid-March, key share indexes in the US and Australia – and, surprisingly, those in emerging economies – had recovered most of their earlier losses. Bulk commodity prices shot upwards, with iron ore up by an impressive 66% from its low point. Bank shares were keenly sought.

Before drawing out the five lessons, what were some of the causes of these gyrations?

Markets often swing widely when big investors take or unwind similar positioning

In January and early February 2016, many large investors – hedge funds particularly – adopted similar investment decisions. This included selling, and in some cases shorting, assets that would likely plunge in price when China fell into a hard landing.

Fiduciary's Michael Mullaney described the January sell-off in shares as reflecting "an oversold condition with everyone on one side of the boat". Later, the rush to close out these short positions added intensity to the share market rebound, often at significant cost to investors still holding the short positions that were so popular among hedge funds previously.

Investors put too much emphasis on soft numbers on the Chinese and US economies

In January and early February, many investors interpreted data on China's external trade and manufacturing as confirming the 'contraction' of the Chinese economy. Subsequent information shows that continuation of useful gains in retail sales and the services sectors in China have partially offset the slowing growth in manufacturing and heavy industry. China faces many problems, but the hard landing predicted since 2011 has, so far at least, been avoided.

In the US, market sentiment in the early weeks of the year focussed too much on the risks of consumer spending remaining soft and on US banks being crippled by the write-downs on their energy loans. As it turned out, US job creation and consumer spending have continued to track at reasonable rates.

Lower oil prices hurt some ... but benefit many

Recently, the key indexes of average share prices have often moved in lockstep with the oil price. It seemed as though the oil price was being taken as an indicator of global growth. As well, there were (exaggerated) concerns the lower oil price would create a banking crisis.

In reality, the fall in the price of oil – which results more from excess supply than from contracting demand – is bad news for most energy producers but will, over time, favourably affect many businesses (lower costs) and households (enhanced spending power).

Investors need to be wary of predictions of an imminent housing crash in Australia

Periodically, claims are made that Australian housing is in a bubble, house prices are about to crash and the prices of our bank shares will crumble because of bad debts.

A report marketed in January and early February by a local portfolio manager and a UK hedge fund argued our house prices and bank shares could soon lose half or more of their value. Their shrill conclusions were given front-page coverage in The Australian Financial Review. It carried no alternative expert views and gave little recognition to the low default rates that are a feature of housing finance in this country given that most loans are full-recourse to the borrower. Excesses in the Australian housing market are usually worked off by average house prices moving sideways for a few years; falling prices are rare.

The Australian Financial Review's Christopher Joye suggested investors who'd shorted bank shares would be scrambling to buy them back to close out their positions. Subsequently he commented,

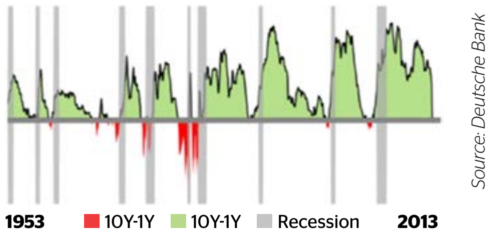
"Bank stocks have bashed the 'johnny-come-lately' hedge fund barbarians that stormed the gates last week. The catalyst has been fact triumphing over the hedge funds' book-spruiking fiction."

What lessons have we learned?

I have distilled these five lessons from the last three months of turbulence:

1. When sentiment on the global economy is fragile, the accumulation of even mildly negative news can drive share markets a lot lower. (Extreme things also happen when the prevailing view in share markets is ebullient. For example, a year ago, share markets rose on both good and disappointing news on economic activity: strong data because they suggested better profits; and weak data because they meant interest rates would be lower for longer).
2. When expectations in share markets build up in a largely uniform way, investor positioning – and the subsequent unwinding of those positions – can trigger big moves in share prices.
3. Sometimes (such as 2008), a sharp fall in share prices portends a lengthy period of difficult times for investors in shares. At other times (for example, 2011 and, it seems, early 2016), the crash in share prices soon corrects and may well be quickly forgotten. As Paul Samuelson famously quipped in 1966, the US share market had predicted nine of the previous five recessions.
4. The challenge for investors is to pick whether or not a share market sell-off will be followed by a lengthy slump in share prices. This requires giving fresh thought to the risk of an early recession. The traditional indicators of imminent recession include, but are not limited to: a sharp rise in unemployment; a sudden tightening in credit; and a flattening or inversion of the yield curve. In the US, the shape of the yield curve has a good record in predicting recessions, as the chart below shows. But much depends on investor confidence and sentiment, and that's hard to foretell.

The US yield curve has always flattened before a recession



5. Investors were too pessimistic early in the year on global growth prospects. Now, there's a more balanced outlook, with shades of grey in assessments on economic prospects in China and the US. But the key concerns of many investors – such as the sustainability of negative nominal interest rates in Europe and Japan and the stretched valuations on shares in companies with strong growth in earnings – have not been overcome. Further swings in investor sentiment should be expected in the months ahead.

Perhaps the most important lesson is that at times of stress, sensible diversification, including a good allocation to cash, makes sense.

Source: Cuffelinks www.cuffelinks.com.au March 24, 2016

Don Stammer chairs QV Equities, is a director of IPE, and is an adviser to the Third Link Growth Fund and Altius Asset Management. The views expressed are his alone and do not address the needs of any individual. This paper draws on material in a column by the author published in The Australian.

Starting a new job? *Don't forget your super*

When you change jobs, make the decision about where you want your super to go yourself — don't let your employer make it for you.

- Take the time to review where your super is, how it is invested, and whether you need to make any changes.
- Think about whether you should consolidate your super funds or salary sacrifice part of your income.

Don't leave your super behind when you change jobs — our checklist will help you get it in order in no time.

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Starting a new job? Congratulations!

One of the decisions we're asked to make when we start a new job is what we want to do with our super. For some people this can be overwhelming, so they let their employer make the choice for them. But it's your money, so it's worth taking the time to make sure your super contributions are invested in a way that makes sense for you.

It's not as complicated as you might think. Here's our checklist of five things you should think about when you change jobs.

1. WHERE DO YOU WANT YOUR SUPER CONTRIBUTIONS TO GO?

Unless this is your first job, you probably have at least one super fund already. If you want the super contributions from your new employer to go into your Colonial First State account, all you need to do is fill out a Super Choice Nomination Form and give it to your employer.

If you don't tell your employer where you want your contributions to go they'll set up an account for you with their default super fund. They should give you some information about this fund along with the rest of your paperwork after you're offered the job. Be sure to compare the fees, insurance and services of this fund to your current super fund (if you have one) so you can make an informed decision about which fund to choose.

2. DO YOU WANT TO BRING ALL YOUR SUPER TOGETHER?

It's easier to keep track of your super when it's all in the one fund. You may pay less fees by consolidating your funds – which could make a big difference to your super balance by the time you retire – and it gives you a clear picture of how your super is invested, as well as how it's performing.

Before you consolidate, check if you'll be charged any exit or withdrawal fees and consider any investment or tax implications and whether you want to keep any insurance cover you may have with the fund.

3. HOW IS YOUR SUPER INVESTED?

Super is a long-term investment, and to get the most out of it it's important to review it regularly to make sure the way it's invested is appropriate for your financial situation and stage of life. A small change to your super now could potentially add thousands of dollars to your super account by the time you retire.

4. CAN YOU AFFORD TO ADD MORE TO YOUR SUPER?

Often when we start a new job we get an increase in salary, so it's a good time to think about how you'll use those extra funds. If you can afford to salary sacrifice a portion of your income into your super fund, there are a number of benefits down the track. You'll grow your super balance faster and reduce the tax you pay because salary sacrificed funds are taxed at 15% rather than at your income tax rate (which could be as high as 49%). Just make sure you don't exceed the contribution limits.

5. IS IT TIME TO SPEAK TO US AND CHAT AT NEOWEALTH MANAGEMENT?

We are experts in helping clients to get the most out of their superannuation, and we will help you get your super organised and advise you on the best fund, investments and insurance to suit your current situation.

Give the office a call!

Client in Focus: Trevor Fox

Trevor is a valued client of NeoWealth Management, and has recently taken the exciting step of becoming a self-employed sub-contractor. Having gained extensive experience at Mozaix, Trevor's business focuses on providing installation services in the audio-visual field, as well as offering a range of general maintenance and handyman services.

Some of Trevor's most challenging but rewarding projects to date have included the installation of the projector system at Hamer Hall and the audio-visual upgrades to both the Palladium at Crown Casino and the Hilton South Wharf.

Trevor prides himself on his work ethic and commitment to providing an excellent end-to-end service, no matter how big or small the job.

You can contact Trevor directly via mobile on **0411 144 522** or email at **trevjfox@gmail.com**.

Who can you trust when it comes to insurance and the big banks?

There has been much uproar in the past couple of months, regarding large financial institutions appearing to negate their obligations when it comes to fairly assessing insurance claims for everyday Australians.

In the case of the recent Comminsure complaints, it appeared that allegedly unethical processes were undertaken to ensure that claims were not paid. This included, pressure on the resident medical manager to deny claims, and also outdated definitions for conditions such as heart attacks.

One of the most important factors when we are considering recommending an insurer, is the robustness of their claims process. Do they have reasonable definitions, and are they supportive of the individual and efficient when it comes to claim time? If you cannot be certain on these points, your insurance premiums are effectively "going down the drain".

The entire purpose of holding insurance is protection and the financial security that the payment will provide in the unlikely event that you might have to claim on the policy.

Importantly, the majority of those people affected by these disappointing practices at Comminsure, had nobody to go to and bat for them. In the end they had to rely on the media and legal support to draw awareness to what exactly was going on.

They had insurance policies through their super fund or via their employment circumstances.

There are two important lessons to be learnt from this Comminsure saga:

1. Make sure you seek advice from a professional when placing insurance. We are paid to not only ensure that you have the right cover, for a price that you can reasonably afford, but we are also remunerated for the advocacy that we can provide at claim time. After all, if you are facing serious illness or injury, the last thing that you want to worry about is dealing with insurance companies!
2. Check the fine print of the insurance that you might hold through your super fund(s), or that you might have taken out without advice. Ensure that the conditions for claim are appropriate. In order to ascertain this, you will more than likely benefit from chatting to NeoWealth Management and we can provide you with a review of the appropriateness of the policies that you hold.

If you would like to discuss this further, or would like to review your insurance arrangements, please do not hesitate to give the office a call.

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