

Newsletter January 2019

Welcome to the January Edition of the Axis Financial Advisers Newsletter. This newsletter will look at what was an extremely volatile quarter (one of the most volatile on record).

I would also like to take this opportunity to wish all our clients a happy new year and we look forward to working with you all in 2019.

Once again thank you to everyone who referred a friend, family member or colleague to my practice. Your continued support is always appreciated.

Economic News

Australia

The tightening of lending standards has started to trickle down to property prices and we are seeing considerable falls in property values across most of the country. This will lead to a slowdown in economic growth as consumer confidence wanes. New car sales for December 2018 were almost 15% less than December 2017 which shows that consumers are being more cautious.

Unemployment figures continue to be strong and the exports are also doing very well which has led the government to bring forward the next budget in a pre-emptive move to highlight their economic credentials before the next election.

The next federal election is important for investors and savers with proposed Labor policies such as the changes to franking credits, limited negative gearing and reducing the capital gains tax discount (from 50% to 25%) all impacting after tax returns from investing.

The next move in interest rates is now likely to be down rather than up which will help the competitiveness of the economy but will not be good for savers and retirees.

China

China and much of Asia has continued to slow as the uncertainty around the trade war impacts sentiment. Commodity prices fell considerably (with the notable exception of Iron Ore) which suggests that a global recession was considered more likely.

Market participants will be looking to see what measures China implements to boost their economy or if they choose this period in time to somewhat reduce forward expectations. Reducing expectations at this point could take the pressure off having to generate GDP growth of 6-7% p.a. which is becoming more and more unsustainable.

United States

In the United States, whilst unemployment remains low, there were some cracks starting to appear in the economy as the prospect of higher interest rates saw some interest rate sensitive parts of the economy start to slow.

The market reacted much faster to this news than the US Federal Reserve and was one of the primary drivers of the sell off.

The US Federal debt has ballooned by more than a trillion dollars as the benefits of the tax cuts for corporations are yet to "trickle down" and in all likelihood wont. Donald Trump lost control of the house of representatives in the mid term elections and will have even more difficulty executing major changes without circumventing the democratic process.

Markets

Global stock markets faltered considerably in the final quarter of 2018. Global shares fell by around 12% in the quarter and Australian shares fell by around 8%. The “flight to safety” saw fixed interest (particularly government bonds) perform strongly and property and infrastructure also performed reasonably well in this environment.

The most common reasons given for the falls in stock markets were as follows:

- Cooling economic indicators coupled with still tightening central banks
- US / China “trade war” impacting sentiment
- Further doubts and confusion with regards to US policies and political uncertainty
- Continued softness in Europe
- Concerns about government and corporate debt levels
- Yield curve inverting (short term interest rates higher than long term interest rates) which has an excellent track record of predicting recessions.

Even after the FED signalled that they were softening their stance on further interest rate rises in 2019 and the US and China showed a greater willingness to negotiate in their ongoing “trade war”, the market continued to falter. This was concerning as it suggested that problems ran deeper in the global economy and that further bad news was coming.

Companies are likely to provide decent results in the upcoming reporting season, but I believe it is also likely that they will tone down future profit expectations.

Factors supporting equities at current (and higher) levels include:

- Reasonable long-term valuations
- Expectation of continued earnings growth (although far more subdued than recent years)
- Low interest rates and lower inflation expectations
- Low unemployment
- Ability for the US and China to reverse the “Trade War”

Whilst there is clearly the prospect of further falls in equities, in particular in the next three to six months, it is impossible to know with certainty. Even if we were sure that equities were to fall further, two decisions would have to be made, when to sell, and when to buy back in.

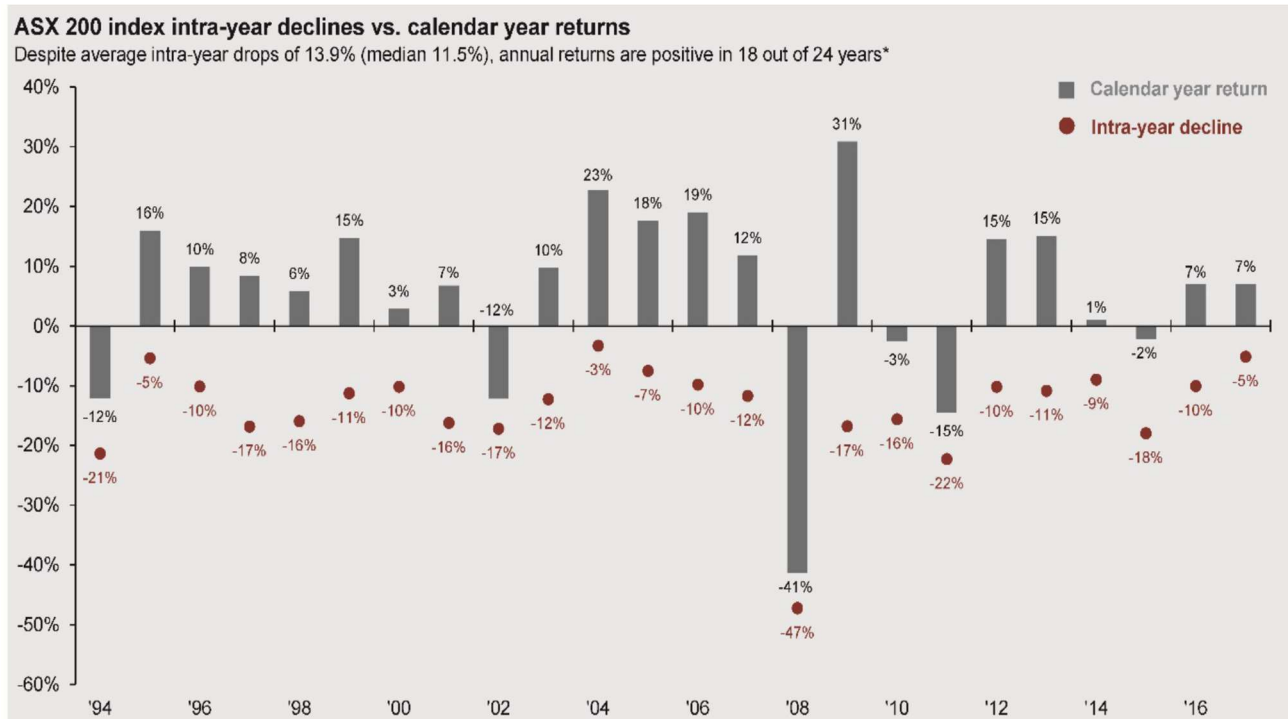
The easy part is selling but the more difficult decision is always when and how to buy back in. The news doesn't get any better before stocks start rising again (and is often worse) so the conviction to repurchase is often more difficult to come by.

The following chart highlights some of the worst quarters for US stocks. Only during the great depression did stocks not subsequently perform very well after such a poor quarter.

S&P 500 Since 1926		Forward Performance		
Quarter Ending	Quarterly Performance	One Year	Three Years	Five Years
June 1932	-37.7%	162.9%	170.5%	344.8%
Sept 1931	-33.6%	-9.6%	13.1%	118.2%
Dec 1929	-27.8%	-24.9%	-60.9%	-40.7%
Sept 1974	-25.2%	38.1%	72.7%	117.5%
Dec 1987	-22.6%	16.8%	48.8%	109.0%
Dec 2008	-21.9%	26.5%	48.6%	128.2%
Dec 1937	-21.4%	31.1%	17.8%	25.4%
June 1962	-20.6%	31.2%	69.2%	94.8%
Mar 1938	-18.6%	35.2%	38.2%	84.5%
Sept 1946	-18.0%	6.4%	24.5%	115.4%
June 1970	-18.0%	41.9%	57.4%	56.3%
June 1930	-17.7%	-23.4%	-34.7%	-32.8%
Sept 2002	-17.3%	0.3%	27.0%	66.3%
Averages	-23.1%	25.6%	37.9%	91.3%

Market falls are a normal part of sharemarket investing and are a necessity to ensure the superior long-term returns which come via the equity risk premium. Unfortunately, the volatility can significantly impact sentiment and cause investors to panic and change long term plans at exactly the wrong point.

The following chart (courtesy of J.P. Morgan) highlights the annual return (grey bar) of the Australian sharemarket (ASX 200) as well as the actual drawdown during each year. The key takeaway is that there are drawdowns every year (the average is around - 14%) and falls are to be expected and in fact necessary to achieve better long-term returns.



This is a good time to remind everyone that if your long-term objectives have changed or your risk tolerance has changed, please feel free to get in touch so that we can discuss it with you.

The following table highlights returns from key asset classes to 31 December 2018*:

Asset Class	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Cash	0.48%	1.92%	1.91%	2.15%
Australian Fixed Interest	2.19%	4.54%	3.70%	4.67%
International Fixed Interest	2.24%	2.73%	3.57%	5.05%
Australian Listed Property	-1.66%	3.27%	7.55%	12.53%
Australian Shares	-8.42%	-3.06%	6.65%	5.60%
International Shares (50% hedged and 50% unhedged)	-12.32%	-3.03%	7.22%	8.61%

**The above returns were compiled from various sources. More information on the source of the data or compilation can be obtained by contacting Axis Financial Advisers. Past returns should not be relied upon to make investment decisions. The above table does not in any way constitute financial advice and should not be interpreted as such.*

Legislative Update

With no significant changes to thresholds or legislation, the following is a summary of some opportunities which may be suitable for yourself or other family members as we start the new year.

First home deposit

Voluntary super contributions made since 1 July 2017, may now be withdrawn to buy a first home under the First Home Super Saver Scheme (FHSSS). The FHSSS allows eligible first home buyers to save their deposit in the concessional tax super environment.

HECS and HELP debts

From 1 July 2019, students and graduates who earn \$45,881 pa or more will need to start repaying their HECS and HELP debts. Currently, repayments don't need to be made until \$51,957 pa or more is earned. Repayment rates will also change and a lifetime debt limit will be introduced.

Instant asset write-offs

Small business owners may be able to claim an immediate tax deduction of up to \$20,000 when purchasing certain assets before 30 June 2019. From 1 July, the claimable amount will reduce to \$1,000.

Catch-up super contributions

Super fund members, who make concessional contributions of less than the cap of \$25,000 in 2018/19, may be able to contribute more than the cap amount in 2019/20 and beyond. This could enable 'catch-up' super contributions to be made in future financial years. Concessional contributions include all employer contributions (super guarantee and salary sacrifice), personal contributions claimed as a tax deduction and certain other amounts.

Super work test exemption

The Government has released regulations to allow retirees aged 65 to 74 with 'total super balances' below \$300,000 to make voluntary super contributions in the first year they don't meet the 'work test' from 1 July 2019. This measure gives eligible recent retirees more time to make super contributions before they become ineligible. Currently, 65 to 74 year olds need to have worked at least 40 hours in 30 consecutive days in a financial year to be able to contribute to super.

Downsizer contributions

Super fund members aged 65 or over may be able to contribute up to \$300,000 per person to super from the sale of their home after 1 July 2018 if they meet certain conditions. These 'downsizer' contributions don't count towards the concessional and non-concessional contribution caps and can be made without needing to meet the usual age, work and other contribution tests.

Tax offset for aged care costs

For the 2019/20 and subsequent financial years, aged care residents will no longer be able to claim a portion of certain care costs (such as daily care fees and means-test fees) as a tax offset when they complete their tax return. This could increase the income tax payable by some aged care residents.

If you have any questions about this report or any other matter, please *don't hesitate to contact me*.

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