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This Week's Top Articles

Strategies for retiring retirement: life, liberty and the pursuit of happiness after full-time work

Jonathan Hoyle

'Leisure is a beautiful garment for a day, but it will not do for constant wear.' Bishop Fulton Sheen

'Retirement is the filthiest word in the language.' Ernest Hemingway

The concept of retirement - a brief period of leisure following four decades of hard work before we shuffle off this mortal coil - is dead. First introduced by German Chancellor Bismarck in the late 19th century, and very much a product of the Industrial Age, retirement has run its course. It's time to call time on this outdated notion. Retirement has retired.

You're excited, right? You've dreamt of this moment for over a decade; no more pointless office meetings, no more stupid emails from your over-promoted boss, no more ridiculous team-building events, no more 6am alarm calls, no more strategic opportunities to leverage our agile, holistic, evidence-driven sustainable blah blah whatever. Soon, it will be just the two of you and endless days spent playing with grandkids who appreciate you for exactly who you are, sunny mornings on the golf course and leisurely walks on the beach, arm in arm with your loved one – your very own Utopian idyll.

But what if it isn't? What if those things you have looked forward to all these years are not enough to sustain you, to fulfil you, to energise you? Was the good bishop right? Can leisure survive 'constant wear'?

Work is more than just a source of income. It is a social life, a sense of utility and purpose, it provides dignity and pride, and self-esteem within a community. Prospective retirees list financial worries as their biggest concern. However, actual retirees rate alienation as their biggest disappointment. It includes loneliness, being cut off from former colleagues, missing their jobs and feeling behind the times (Mitch Anthony, *The New Retirementality*). How will you replace all this?

The questions we ask ourselves become much more profound with age. In our 20s, we obsess over what people think of us; in our 40s we stop caring; in our 60s we realise no one was actually thinking of us anyway. With time fast becoming that most precious of commodities, *'am I living the life I want to live*?' becomes the most profound of all. Retirees focus more on their legacy; not just *'what do I want to leave behind*?', but *'how do I wish to be remembered?'*

Australian palliative care nurse, Bronnie Ware, chronicled the regrets of dying patients in her care in an eclectic and intriguing book, *Top Five Regrets of the Dying*. She found five recurring themes:

- I wish I'd had the courage to live a life true to myself, not the life others expected of me

- I wish I hadn't worked so hard
- I wish I had stayed in touch with my friends
- I wish that I had let myself be happier
- I wish I'd had the courage to express my feelings.

At Stanford Brown, working with our clients to help them enjoy a rich and rewarding retirement is our area of expertise. It's also our passion. The following 11 strategies are the cumulative knowledge of three decades of advising retiring Australians on the pursuit of life, liberty and happiness after full-time work. We hope you find something here of value.

Strategy 1 - Start planning long before you retire

"I retire on Friday and I haven't saved a dime. Here's your chance to become a legend!"

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Many people work furiously all their lives and then stop. This is not a plan. Far better is to start thinking and planning at least ten years prior to retirement. Ask yourself these questions. What do I love doing? What inspires me? What am I good at? What knowledge have I accumulated that I wish to use or to pass on? A good place to start is to reduce your hours or even work in a consulting capacity before leaving for good. This buys you time to experiment. Seek out internships, part-time jobs, volunteering or start studying.

Strategy 2 - Create a list of the things to do in your retirement

Do your homework! Not just those bucket list places you'd like to visit, but experiences you'd like to have, skills to acquire, languages to learn, hobbies to pursue and relationships to rebuild. The following is a list of some of our favourite books and websites to peruse for ideas and inspiration:

encore.org - a website packed full of ideas for second act (or encore) careers

The Big Shift by Marc Freedman, CEO of encore.org

How Will You Measure Your Life by Karen Dillon

The New Retirementality by Mitch Anthony

What Color is Your Parachute by Richard Bolle

Too Young to Retire by Marika and Howard Stone

Strategy 3 - Take a personal inventory check

Before evaluating your Economic Capital, check your Human Capital. What are your skills, your passions, your experiences, your knowledge? Increasingly, our identity is wrapped up in our work. What will you miss the most? What are your key strengths? Start with Gallup's excellent Strengths Finder. It costs just $20 and will produce a detailed report on your strengths.

Then, take the National Seniors Retirement Quiz. This quiz assesses your retirement preparedness in terms of three resource types - health and finance; social; and emotional, cognitive and motivational.

Strategy 4 - Figure out exactly how much income you will need

'I'm living so far beyond my income that we may almost be said to be living apart.' EE Cummings

Sounds simple but it's fiendishly difficult. So it's time to apply the first of our Rules of Thumb. Planning is an art not a science, hence Rules of Thumb are often far more useful than the 30-year projections the financial planning industry insists on. First, determine exactly how much you spend today. Monitor your spending over a 12-month period and do not exclude 'one-offs' as they have a nasty habit of repeating themselves. A really good budgeting tool is Moneysoft.

Then apply the *'Retirement Smile'*. Most retirees assume they will spend less in the retirement years but this rarely happens. In fact, you are more likely to increase spending during the first decade, a time when you have energy and health. This is the time for travel, for exploration, for doing different things. Assume your spending will increase by at least 10%. Then the next decade will likely see a significant drop in spending (how many times can you visit the Pyramids?), followed by a surge in health-related expenses in the final decade. Assume the superannuation rules will gradually become less favourable and don't forget the spectre of inflation, which will erode your standard of living over time. Allow plenty room for error.

Strategy 5 – Estimate if you have enough

'I advise you to go on living solely to enrage those who are paying your annuities. It is the only pleasure I have left.' Voltaire

Another Rule of Thumb. Assume you will require investable capital of at least 20 times your annual spending if you wish to retire from age 65. This will vary according to your age, your risk tolerance, whether your capital resides in a tax-free environment like super and whether you wish to preserve the real value of your capital or gradually run it down (do the kids really need to inherit it all?).

Over the past 40 years, a relatively conservative, well-diversified portfolio of stocks and bonds has delivered strong investment returns. However, past performance is most definitely no guide to the future as interest rates are so much lower today and are likely to remain low. Stepping up your risk profile is not the optimal solution as it will lead to more volatile outcomes than you seek.

What to do if there is a shortfall? You can either work longer, work part-time, spend less or take more risk. There is no magic bullet. However, you can be more creative, for example, by using your existing assets harder by renting your house on Airbnb. You could downsize your home or you could take out a reverse mortgage and remain where you are. These products are safer than in the past and better regulated. In our view, they are the most underused yet value-added products available to retirees.

Strategy 6 - Spend your money wisely

''Money can't buy happiness' is a lovely sentiment, popular and almost certainly wrong.' Harvard psychologist, Daniel Gilbert.

In a research paper intriguingly entitled *'If money doesn't make you happy then you probably aren't spending it right'*, Professor Gilbert recommends the following spending principles.

- Buy experiences instead of things. We like experiences more because we get to anticipate and remember them, whereas the delight of that shiny new BMW quickly fades.
- Spend money to help others instead of yourself. Our happiness is enriched from our social connections and nurturing these friendships is a fruitful way to spend our money.
- Buy many small pleasures instead of few big ones. The 'power of adaptation' is that we get used to the things we have around us all the time. Treating ourselves to many inexpensive indulgences is a neat way to provide regular bursts of happiness.
- Pay now, consume later. Delayed gratification gives the benefits of anticipation.

Strategy 7 - Know your behavioural biases

We are innately dreadful investors. We panic sell during market sell-offs, we buy during the good times, we anchor ourselves to prices paid for stocks rather than future outlooks, we develop an irrational aversion to losses and we overestimate our ability to beat the market. In their landmark study of risk taking behaviour, Daniel Kahneman and Amos Tversky, established that losses loom far greater than gains. More recent research by Professor Eric Johnson of Columbia University has shown that retirees display hyper-loss aversion. They were up to five times more loss averse than the average person.

Strategy 8 - Adopt the Odysseus strategy

The Sirens and Ulysses by William Etty (1837)

Homer's *Odyssey* describes the adventures of Odysseus on his return from the Trojan War. One challenge was navigating his ships past the Sirens. These were dangerous yet beautiful creatures who lured nearby sailors with songs so haunting that they would throw themselves overboard just to get closer to them. Odysseus was aware of his behavioural biases and planned accordingly. He wanted to hear the Sirens but knew that their songs would be too much even for him. So he ordered his men to put bees wax in their ears and tie him to the ship's mast. As they passed the Sirens, he could hear their beautiful songs and tried desperately to untie himself. But the men ignored his pleas for help as he had forbade them to untie him. By knowing how you will react when markets get tough, you can avoid making costly mistakes.

Strategy 9 - Seek professional help

Working with a good financial adviser will provide you with a retirement framework and the discipline to stick with the plan. Index manager Vanguard, in this research paper entitled *Quantifying Vanguard's Adviser' Alpha*, argues that good financial advice will add as much as 3% to investment returns through effective asset allocation, behavioural coaching and wealth management advice. This excellent article, *Seven questions to ask when picking a financial adviser* provides a comprehensive checklist.

Strategy 10 - Set clear goals

'*You know you are getting old when you stoop to tie your shoelaces and wonder what else you could do while you're down there.*' George Burns

At Stanford Brown, we send many of our clients to specialist retirement coaches who work with the individual and their spouse to map out every aspect of their Retirement Plan. Start with the Retirement Goal Heptathlon: Health, Family, Work, Legacy, Giving, Home and Self. Prioritise these goals and when you want them to happen. How will you measure a successful retirement?

Strategy 11 - Commence an encore career

According to encore.org, nearly nine million people aged 44 to 70 are engaged in second-act careers. Says Mark Freeman in *The Big Shift*, '*There is the financial question of how you will support yourself, and then there is the existential question of who are you going to be*.' Some retirement trends in the US include retirees venturing back to college and 'retiring' to university towns; people choosing to retire in their own communities rather than escape to the Sunbelt; retirees are becoming entrepreneurs, reviving shelved passions; and phasing out work rather than stopping overnight.

It's a time to live the dream

Say bah humbug to that old curmudgeon, Mr. Hemingway, and tell him to stick to fishing trips in Cuba. For one brief moment, reflect on your enthusiastic yet naive 18-year-old self, leaving school and entering the big wide world for the first time. What regrets do you have now? What did you not get to be? What is still left to do? Life is not a dress rehearsal. You still have time. Good luck!

Jonathan Hoyle is Chief Executive Officer and Chief Investment Officer at Stanford Brown. This article is general information and does not address the circumstances of any individual.

Why SMSFs should have a corporate trustee

Liam Shorte

Did you know that 78% of SMSFs are set up with individual trustees but that over 90% of professional advisers I have canvassed would always recommend a Sole Purpose Company trustee? In the haste to set up funds, most people miss this vital step in getting the structure right with many having to pay high fees to change trustee later.

The issue is worsening as in the three years to 2015, there was a 4% decline in SMSFs registering with a corporate trustee. Of newly registered SMSFs in 2015, an incredible 95% had individual trustees (see ATO Self-managed super fund statistical report – June 2015 appendix 1, table 6)

Table 6: SMSF trustee type

This table shows the trustee structure (either corporate or individual trustees) of the SMSF population as at 30 June 2015, plus new registrations for the years 30 June 2013 to 30 June 2015.

SMSF trustee type

Trustee type	% of all SMSFs (at 30/06/2015)	2013 registrations	2014 registrations	2015 registrations
Corporate	22.16	3,934 (9.67%)	2,811 (7.70%)	1,777 (5.44%)
Individual	77.84	36,768 (90.33%)	33,716 (92.30%)	30,894 (94.56%)
Total	100%	40,702 (100%)	36,527 (100%)	32,671 (100%)

I believe it is essential to have a company as trustee and that the option to have individual trustees is short-sighted.

Benefits of a corporate trustee

A corporate trustee facilitates:

- Time to grieve or adapt. The strongest reason from 10 years' experience with SMSFs is respect for your spouse or family's needs in times of grief. Do you really want to leave them an awkward and expensive set of tasks to carry out just to save $700?
- Continuous succession. A company has an indefinite life span; it does not die. A corporate trustee can ensure control of an SMSF is more certain following the death or mental or physical incapacity of a member.
- Administrative efficiency. When members are admitted to, or cease, membership of the SMSF, all that is required is that the person becomes, or ceases to be, a director of the corporate trustee. The corporate trustee does not change as a result. Therefore, title to all the assets of the SMSF remains in the name of the corporate trustee, especially useful when dealing with property in an SMSF.
- Sole member SMSF. An SMSF can have one individual as both the sole member and the sole director. Likewise, if a spouse is incapacitated, then the husband or wife can act as director under an enduring Power of Attorney to run the fund on their own without the need for interference by others.
- Meets lenders' requirements. Most lenders require a corporate trustee in the SMSF as it is easier to deal with.
- Higher Loan to Valuation Ratios accepted. With a corporate trustee, many lenders will go to 80% on residential loans and 70% on commercial real estate.
- Greater asset protection. As companies are subject to limited liability, a corporate trustee will provide improved protection for the directors where a party sues the trustee for damages. I use an electrician as an example here when I discuss this with clients. If he is on your property and is electrocuted because of the owner's (SMSF) negligence, then the SMSF may be sued but your own personal liability is limited to your shareholding and member balance rather than your entire wealth.

Problems with individual trustees

Individual trustees cause issues with:

- Paperwork at the worst time. Welcome to a nightmare. When a spouse has barely had time to start grieving, they need to manage the SMSF and administer pensions, investments and deeds. Minutes to record death of trustee, deed update to add a new trustee or move to a corporate trustee, off-market transfer forms and identity forms and probate forms to put every investment in correct name(s). Worse still, deal with the Land & Property Management agency or Office of State Revenue and their endless forms!
- Complexities relating to death. If the SMSF has individual trustees, e.g. a husband and wife, then timely action must be taken on the death of a member to ensure the trustee and member rules are adhered to properly. For example, SMSF rules do not allow a sole individual trustee/member SMSF.
- Extra and costly administration. To bring in a new member to an SMSF with individual trustees requires that person to become a trustee. As trust assets must be held in the names of the trustees, the title to all assets must be transferred to the new trustees.
- Sole member SMSF. A sole member SMSF must have two individual trustees. Does a spouse need to rely on the children, possibly from the first marriage? That's really not going to work as we know what a problem blended families are when it comes to estate planning.
- Tighter lending rules. Lower LVRs are common, due to legal concerns, lenders restrict the maximum borrowing of an SMSF with individual trustees to 70% for residential properties and 55-60% for commercial real estate.
- Less asset protection. If an individual trustee suffers any liability, the trustee's personal assets may be exposed. The trustee as well as the SMSF may be sued by someone doing work for the SMSF.

What do the ATO and ASIC think?

The Australian Securities & Investments Commission (ASIC) and the Australian Taxation Office (ATO) prefer corporate trustees. Last year, ASIC released a number of documents which outlined the advantages of an SMSF corporate trustee.

More recently, the ATO released an article and video on SMSFs titled Choose individual trustees or a corporate trustee that objectively outlines the pros and cons.

And even more advantages of a corporate trustee

With a bit of preparation and planning, combining your will and enduring powers of attorney, minuted resolutions and if needed clauses written into the deed, a person (usually the Executor or Legal Personal Representative) can be immediately appointed as a director so that the fund can continue to operate in the event of death regardless of whether a death certificate or probate have been granted.

Likewise, a person who loses mental capacity needs to be replaced if they were individual trustees. With a company, the constitution can immediately have a mechanism which allows the person holding the enduring power of attorney to be appointed as a replacement director, resigning the incapacitated director at the same time.

Under ASIC's new administrative penalties, if a fine is made in relation to an SMSF that has individual trustees, then each trustee will be fined in their personal capacity. The fine is personally payable and cannot be reimbursed by the fund. Only one fine is payable by a corporate trustee.

It is also easy for Superannuation Industry Supervision (SIS) regulation 4.09A(2)(a) to be contravened by an individual trustee. It says:

"A trustee of a regulated superannuation fund that is a self-managed superannuation fund must keep the money and other assets of the fund separate from any money and assets, respectively: … (a) that are held by the trustee personally …"

For example, if individual trustees receive rental property income or a dividend into a personal account in their own names instead of an account in their personal names but with the account designation of their SMSF, it is a contravention. With a corporate trustee, it's far less likely to mix fund assets with personal assets.

Summary

It's difficult to believe that 90% of SMSFs are currently being established with individual trustees. Even if some costs of registering a company are initially avoided, the trustees are almost certainly inviting complications later in the life of the SMSF.

Liam Shorte is a specialist SMSF advisor and Director of Verante Financial Planning. This article contains general information only and does not address the circumstances of any individual. Professional personal financial advice should be sought before taking action.

SMSFs need care when dealing with related parties

Liz Westover

SMSFs are allowed to invest in and transact with related parties however there are rules that surround these arrangements and sometimes they can be confusing. This article is a guide to the main issues of asset purchases and sales, borrowing and lending and investing in related parties.

The golden rule is at arm's length

The golden rule for all related party interactions is that whenever you are dealing with a related party of the fund, all transactions must be conducted on an arm's-length basis. That is, transactions must be carried out on the same terms and conditions as if they were with an unrelated, third party.

A related party of a super fund is defined under superannuation law as a member of the fund, a standard employer-sponsor of the fund and a Part 8 associate of either of these two. A Part 8 associate generally includes:

- relatives of the members
- the other members and trustees (or trustee directors) of the fund
- business partners in a partnership (and their spouses and children) and the partnership itself
- a trust controlled by a member of the fund
- a company sufficiently influenced, or for which majority voting interest is held by a member

A standard employer-sponsor of a fund is an employer that contributes to a super fund for its employees due to an arrangement between the employer and the fund. Typically, this would not be relevant for SMSFs that have been established in recent years.

It's not always easy to determine whether another party or entity is related, and professional advice is frequently advisable.

Can an SMSF lend money to a related party?

There is a prohibition on lending or providing financial assistance to members of an SMSF or their relatives (as opposed to a related party – see definition above). For these purposes, a relative is a spouse, parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of the individual or their spouse. It also includes the spouse of any of the above.

Financial assistance includes any kind of financial aid, help or benefit using resources of the SMSF (even where it wasn't requested). For example, a gift, debt forgiveness or paying an inflated price for services.

Because this ban on lending only applies to the member and their relatives, an SMSF can therefore lend to a related party that is not a relative but only under very limited circumstances. Such a loan would be termed an in-house asset (IHA).

An IHA is a loan to, or investment, in a related party of the fund. While allowable, IHAs must not constitute more than 5% of the total market value of the SMSFs assets.

Can my SMSF invest in my private company?

Yes, but the value of the investment cannot exceed 5% of the market value of the SMSF's total assets. This is because the private company would be considered a related party and any investment in it is then an IHA. If the 5% level is exceeded, the SMSF trustees will need to put a plan in place to reduce the level back under 5%. This can be problematic if the value of the private company's shares increases significantly such that it constitutes a higher percentage of the fund's overall assets.

Dividends from the private company must also be paid to the SMSF on an arm's-length basis. If dividends are received by the SMSF on a non-arm's-length basis, they will be taxed as special income at a rate of 45% (plus 2% temporary budget levy).

Can my fund borrow from a related party?

A general prohibition exists on any super fund borrowing or maintaining an existing borrowing of money. However, there are limited circumstances in which a fund can borrow including from a related party. Temporary borrowings are possible for benefit payments, settlement of transactions and payment of surcharge but super laws place stringent criteria around when and how these are permissible.

The other exception to borrowing is for limited recourse borrowing arrangements (LRBA). These can include borrowings for assets such as listed securities or real estate but recourse by the lender in the case of default can only be against the actual asset for which the borrowing is undertaken. It is possible for related parties to lend to the SMSF under such arrangements, but there are specific rules that must be adhered to. Importantly, the Australian Taxation Office (ATO) insists that borrowing arrangements involving a related party are undertaken strictly on commercial terms. This includes not only interest rates but other terms and conditions such as repayments and loan to value ratios.

Can an SMSF buy assets from a related party?

Generally, the answer is no but there are a few exceptions. An SMSF can purchase listed securities and business real property from a related party and certain 'in-house assets' (IHA) but remember, always at market value. Business real property refers to property that is used 100% for commercial purposes whether that is by a related party or not.

Can an SMSF sell assets to a related party?

An SMSF can sell its assets, at market value and on an arm's-length basis, to a related party. The SMSF can also transfer an asset to a member of the fund as a lump-sum 'in-specie' member benefit payment where the member has satisfied the relevant criteria to start accessing their super benefits.

Where do trustees generally go wrong with related party investments and transactions?

Even where a particular transaction or asset acquisition is permissible, problems typically arise with trustees not dealing with related parties on an arm's-length basis. SMSF trustees can be at risk of being 'one-eyed' when it comes to related party investments. They must be careful to ensure that investments are undertaken to maximise retirement savings and not using fund assets simply as a source of investment revenue for their personal businesses or for personal use.

An SMSF is a separate legal entity and trustees have an obligation to ensure that their dealings, including those with related parties, are conducted in the members' best interests. Failure to do so is a failure to meet their fiduciary obligations as a trustee and can cause the fund to be scrutinised by the ATO, potentially incurring penalties.

If you are considering transactions between an SMSF and a related party, a professional adviser can help ensure you are operating within the bounds of the law.

Liz Westover is a Director with [PricewaterhouseCoopers](), Private Clients. This article is general information and does not address the circumstances of any individual.

Oil does not have a supply side problem

Romano Sala Tenna

Much has been written about the '*sudden supply side problem'* in the oil market, predicated ostensibly by US shale. In our view, this doesn't make sense. Let me explain why.

First of all, there *was* a not-so-sudden 'supply side problem' in the oil market for much of the past six decades. An oversupply of cheap oil was the very reason that OPEC was formed some 56 years ago, in 1960. The then foundation members – Iran, Iraq, Kuwait, Saudi Arabia and Venezuela - recognised that they possessed large quantities of oil that could be produced very cheaply, and that the best way to regulate the output and hence price, was to form a cartel.

Back in 1960, the average price paid for a barrel of oil was $US1.63, total production was 21 million barrels of oil equivalent (mboe) per day and the US produced just on 7 mboe per day – almost exactly one-third of global production. But most relevant to the current day is that spare capacity was substantial, between 42% (US Office of Oil and Gas) and 50% (Chase Manhattan Bank estimate).

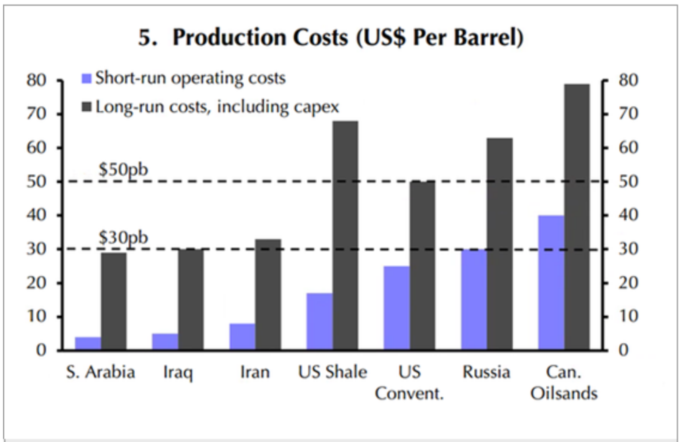
By comparison, and despite the arrival of supposedly cheap shale production, the oil market today is exceptionally tight. Yes, exceptionally tight.

The latest data from the International Energy Agency (IEA) forecasts that worldwide demand for oil will average 96 mboe per day during 2016. Spare capacity – as defined by that which can be brought on stream within 30 days and produce for longer than 90 days – is in the order of 2.4 mboe per day, or approximately 2.5% of global demand.

Spare capacity has declined from around 50% to 2.5%. And alarmingly, approximately 85% of the 'spare capacity' resides with one country – Saudi Arabia. When demand overtakes supply, the dramatic hiatus in oil developments over the past two years will exacerbate the problem.

So talk of a '*sudden supply side problem'* appears ill-founded and indeed there would now not even appear to be a supply side problem from an historical perspective.

Part of the myth around the supply side issue has been generated and perpetuated by a misunderstanding of the true all-in sustaining cost (AISC) of producing a barrel of oil. The graph from Capital Economics below is perhaps the most important graph for oil investors.



Source: Capital Economics, h/t Josh

There is a quantum difference between the short-term costs of producing a barrel of oil from an existing well already tied in to existing infrastructure versus the true long-term cost, which includes sustaining capex, development capex and a host of additional costs including exploration, infrastructure and financing to name a few.

The chart shows the AISC for US shale remains in the vicinity of $US70 per barrel. Much of the current wave of shale production was funded and founded on the premise of $US100/barrel oil, so the supply side will contract at or below this level. In fact, from a peak of 9.61 mboe per day in June 2015, total US production is on the cusp of declining below 9 mboe per day.

Why has the oil price fallen by so much?

If the oil price fall is not from the *natural* forces of supply and demand, then what has driven the move? In summary, it has been driven by Saudi Arabia's desire to achieve three or four goals:

1. Coerce other OPEC and non-OPEC producers into bearing some of the supply side restraint.
2. Cripple the existing supply of high cost production, in particular US shale and Canadian oil sands.
3. Slow the development of new production in general and high cost production in particular.
4. (Possibly) provide a turbo charge to the demand side and a headwind for renewables.

How much this last point is playing on the minds of OPEC ministers is difficult to know, but at the very least it is a nice bi-product of this 'power play'.

When does this end?

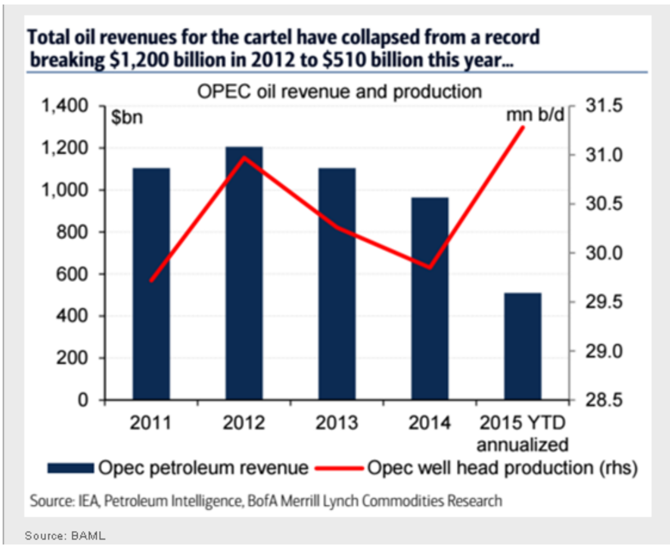
In our view, the oil price will recover when Saudi Arabia has inflicted as much damage as it can whilst bearing as much pain as it can stomach. The second part of this equation is of paramount importance. This process has a finite time line. Saudi Arabia is the largest exporter of oil globally, so the impact of the oil price on their revenues and budget is magnified, as the chart (right) suggests.

When Saudi Arabia has borne as much pain as it can, we will see this Arab leader drive an accord to re-establish order in the oil market. This time may be approaching, as supported by two factors:

Firstly, sentiment has turned as indicated by the break in the downtrend and the upward push through both the 50 and 200 day moving averages (see chart below).

Secondly, the rhetoric emanating from the mouths of the key oil ministers and Government figureheads is undeniably softening. The move to a production freeze is the first tangible evidence of a willingness on the part of the key stakeholders to re-engage.

This price fall is politically driven, so the recovery will also arise from government policy.



The key risk of course is that Russia needs to be brought into the fold (ROPEC?) and forced to abide by a supply quota. In theory, when faced with the prospect of financial oblivion versus a large increase in revenue, the choice is relatively pedestrian. The problem here is that when you go Putin' a gun to the head of the Russian Prime Minister (pun intended) he is just as likely to say '*pull the trigger*'. They don't call it Russian roulette for nothing!

In the investment world, there is no prize for sitting on the fence. At Katana, we have weighed up the risk-return profile and we now believe it is in our favour. Accordingly, we have been positioning ourselves to profit from a recovery in the oil sector. From this level, if we get the short-term direction wrong, then we expect the long-term fundamentals to cover our mistakes and generate a handsome return to boot.

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ETFs are a positive force for disruption

Rita Da Silva

Despite volatile financial markets in the last 12 months, the global exchange traded fund (ETF) industry has continued to expand rapidly. There are nearly 6,000 ETF and exchange traded products (ETP) globally, representing total assets of US$2.8 trillion. While small in the context of total global assets under management, the consistently strong growth of ETFs means all market participants should be taking this product seriously.

Growth driven by low cost, diversification and easy access

The ETF industry's growth over the last two decades represents one of the financial sector's greatest success stories. Institutional and retail investors alike are looking for products that are low cost that offer easy access to a diversified investment product range. EY's recent Global ETF Survey found ETF issuers globally expect their businesses to grow by around 18% per annum for the next three to five years, with higher growth predictions for Australia, within the range of 20% to 25%.

To date, ETF assets equate to less than 12% of the US mutual fund market, 4% of the European market and, despite strong growth of an average of 30% over the last decade, less than 2% across most of Asia-Pacific. The Australian proportion is similarly small, but it is increasing and, with the development of innovative cost-effective products, the local market will grow significantly. While relatively slow to take off, the Australian ETF market has effectively doubled in size over the last two years to now be about $21 billion. In part, this has been driven by change in regulations relating to adviser remuneration and a greater understanding of the role ETFs can play in building more diversified, liquid, transparent and lower cost portfolios. Adviser and broader investor education remains critical to the ETF growth story.

There is also a favourable macro view for investment philosophies that emphasise diversification and cost minimisation as drivers of long-term performance. Tailored portfolios will result in the ETPs taking more market share from traditional active and passive mutual funds.

Retail versus institutional demand

Globally, institutional investors drive the bulk of ETF inflows, but they still remain comparatively underinvested in ETFs in Australia where the vast majority of ETF investors are retail. ETFs offer these retail investors access to products which were traditionally only available to institutions.

Institutional investors on the other hand are commonly using ETFs for core exposures, precision exposures, hedging and access to new markets. They are increasingly seen as a substitute for fully-funded futures, as the cost of holding long positions on key indices increases with every quarterly 'futures roll'. Defined benefit (DB) pension funds are significant users of ETFs and insurers are beginning to use ETFs for long-term investment, although they have been slower adopters.

Active managers listing funds

Active managers with no history of issuing ETFs or ETPs are responding to developments such as smart beta, launching ETPs or partnering with existing providers. The Australian ETF market illustrates the potential that can be unleashed when innovation and regulation complement each other. Prevented from marketing non-passive products as ETFs, local managers have begun to list exchange traded managed funds (ETMFs). The Magellan fund launched in 2015 attracted strong inflows and many other managers are looking at similar structures.

EY's Global ETF Survey asked promoters of ETFs how they planned to differentiate themselves in the market. Over 20% of respondents identified 'innovation' as the key differentiator, a significant increase from 15% in the 2014 EY study. Innovation was also identified as a key to success in distribution, where nearly 25% of ETF providers see the new phenomenon of online retail investor accounts as being fundamental to their success – a massive increase from 6% and 4% in the 2013 and 2014 EY studies respectively.

Innovation has always been integral to the ETF story and new products are critical for the growth of the industry. Product development is arguably now moving forward faster than at any time in the industry's history. This current explosion of innovative effort reflects a combination of factors. On the supply side, ETF providers view innovation as crucial to building profile, generating net inflows and defending profit margins. Demand is created by persistently low yields, self-management of the decumulation of super balances and an increased desire for cost-effective diversification tools.

The launch of active ETFs over the last 12 months and the development of ETMFs to strike a balance between transparency and confidentiality by quoting a price linked to net asset value illustrate the innovative trend.

Online distribution

Our Global ETF Survey found 90% of respondents viewed digital channels as an area of opportunity and 89% expected robo-advisors to accelerate the growth of the industry. Developing an online presence is a leading priority for technology spending among ETF providers. Of course, a sudden focus on digital distribution is not unique to ETFs.

There is obvious potential cross-over between online or automated advice and the use of ETFs to create model portfolios. Although still in its infancy, online advice enables investors to compare a range of criteria, including total costs and overall investment return. In the US, many of the largest ETF issuers offer their own online distribution platforms, however the emerging trend in Australia has primarily been from independent robo-advisors targeting SMSFs.

For ETF providers, investor demand is the most important driver of product development, but market-specific regulation means that most innovation has a strong local flavour. For example, while leveraged and inverse leveraged funds are enjoying significant success in markets such as Japan, Korea and Taiwan, and are soon to be launched in Hong Kong, they have limited demand outside of these markets.

Innovation and creativity always creates controversy and will inevitably come with some risks. Even so, there is a particularly strong sense that the digital dawn could be a 'eureka' moment for retail adoption of ETFs. After all, the product and technology share some common themes: low costs, transparency and breadth of choice.

Rita Da Silva is Ernst & Young's ETF Leader for Oceania. The views expressed in this article are the views of the author, not Ernst & Young. The article provides general information, does not constitute advice and should not be relied on as such. Professional advice should be sought prior to any action being taken in reliance on any of the information. Liability limited by a scheme approved under Professional Standards Legislation.