

### **This Week's Top Articles**

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### **Why are high marginal tax rates bad for workers but good for retirees?**

Graham Horrocks

The 2018 Federal Budget made it clear that the Government believes too many people are moving into higher marginal tax rates. For example, in the Personal Income Tax Plan, it says:

*"The plan begins with permanent tax relief to middle and lower income earners, to encourage and reward working Australians and to assist with cost of living pressures. Under Step 2, the plan will help protect incomes earned by Australians from bracket creep. The third step will make personal taxes simpler and flatter to ensure more Australians are paying lower taxes on every extra dollar they earn."*

Sounds like not only a plan, but a set of principles. It appears that the Government regards it as self-evident that marginal tax rates are too high and this is a bad thing.

#### **Centrelink Pension Income Test**

After a long campaign the then Government agreed in 2009 to increase the rate of the age and other pensions paid to single people to improve the standard of living for the recipients. However, in order to limit the cost of this increase they also increased the rate of taper (ie the reduction in payments as income increases) under the income test from 40% to 50%. This is effectively a marginal tax rate and it exceeds the highest marginal tax rate on income that has applied for many years. Governments since 2009 have done nothing to change this position.

Apparently, high marginal rates of tax are bad for working people earning an income, but not so for those in retirement or otherwise receiving a Centrelink pension.

#### **Centrelink Pension Asset Test**

A 50% effective marginal tax rate under the income test for age and other Centrelink pensions is mild compared with the effect of the increase from \$1.50 per fortnight for each \$1,000 to \$3.00 per fortnight in the taper under the Asset Test which was introduced by the current Government effective 1 July 2017. The taper under the Pension Asset Test is now so steep that the effective marginal rate for a single homeowner with

assets between \$253,750 and \$552,000 and for a homeowner couple between \$380,500 and \$830,000 **exceeds 100%**.

Many superannuation funds are now producing estimates of the income (from superannuation, other savings and Centrelink pensions) which a member can expect to receive in retirement. For people whose assets at retirement are expected to lie within the range of the Asset Test taper, the projections indicate that expected income in retirement could be **lower** if they **increase** their savings. Their age pension will reduce by more than the income they receive from any increase in their savings (whether within or outside superannuation).

Alternately, in retirement, spending money (on travel, a home or elsewhere or by giving some away within Centrelink limits) within this range of assets will actually increase income. The age pension will increase by more than the income lost on any capital amount spent or gifted.

### **The impact of deeming rates**

For many years, age and other Centrelink pensions have been subject to both income and assets means tests. If a pensioner's income from other sources or assets, as defined, exceeds specified minimum amounts the rate of pension is reduced.

In the case of the income test, financial assets, as defined, are assumed to earn a deemed rate of return for the income test. Currently the deemed rate of return on financial assets is 1.75% for the first \$50,200 for a single pensioner and the first \$83,400 for a pensioner couple. Financial assets above these amounts are deemed to earn 3.25%. The lower deeming rate is based on holding this amount in an at-call or cash account at a bank or other financial institution. The higher deeming rate is based on these amounts earning a higher return by being invested on a longer-term basis including shares and property.

This suggests that 3.25% is a reasonable figure to use as the income received by a pensioner on assets within the range of the Asset Test taper. So, an additional \$1,000 in assets within the range of the asset test taper will earn 3.25% or \$32.50 per year in income and result in a reduction in the pension of \$78 per year (\$3 per fortnight). **This is effectively a marginal tax rate of 240%**. The previous taper of \$1.50 per fortnight per \$1,000 in assets reduced the amount of pension by \$39 per year, and this was already an effective tax rate of 120%.

### **More penal marginal tax rates**

Over the years the taper under the Assets Test for Centrelink pensions has always represented a penal effective marginal tax rate. This was recognised in 2007 when the rate of taper was reduced from \$3.00 per fortnight for each \$1,000 to \$1.50. The higher deeming rate at that time was 5.5%. The reduction in the rate of taper reduced the effective marginal tax rate from 142% to 71%. This still exceeded the highest marginal rate of tax on income.

In practice for a short time after, 2007 is the only period in the last 20 years that the taper under the Assets Test represented an effective marginal tax rate that was under 100%. The reduction in interest rates to an unprecedented low level after 2008 has meant that the effective marginal tax rate represented by the taper under the Assets Test was already over 100% even before the increase from \$1.50 to \$3.00 per fortnight per \$1,000.

The assets taper means that a pensioner with assets (savings) within the range of the taper in the Assets Test can increase their total income by spending some of their savings on travel, home renovations or (within Centrelink limits) gifts to their family.

### **Coming back to Budget 2018**

Recapping from the opening quotation in Budget 2018:

*"The plan begins with permanent tax relief to middle and lower income earners, to encourage and reward working Australians and to assist with cost of living pressures."*

Must be no need to encourage and reward pensioners and retirees faced with cost of living pressures.

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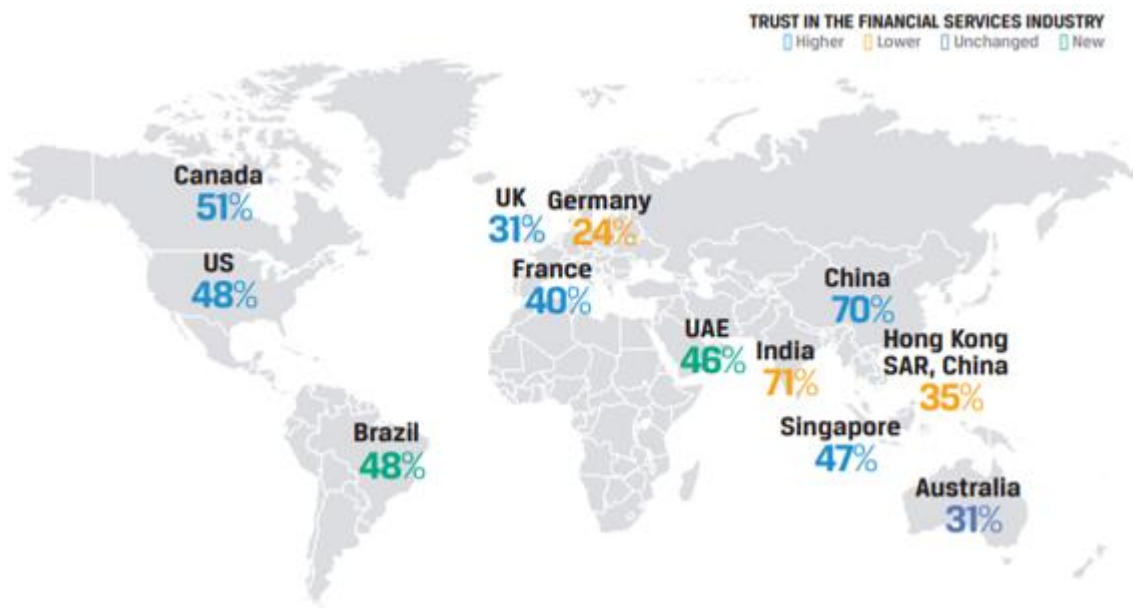
## Trust and why not all LICs are created equally

Andy Forster

The primary focus of the Financial Services Royal Commission to date has been consumer lending, financial advice and small-medium enterprises, but the investment management industry may also be lacking in public trust.

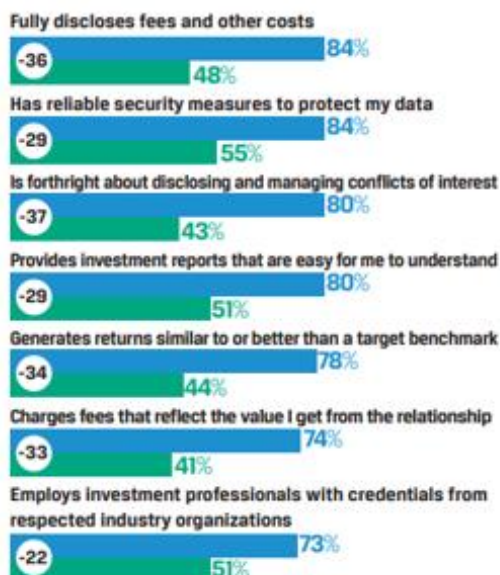
A [survey](#) in November 2017 by the CFA Institute called “The Next Generation of Trust – A Global Survey on the State of Investor Trust” highlighted some alarming signs that resonate here in Australia. The survey highlighted that trust in financial institutions is very low and the reputation of the finance industry compared to other industries remains poor. It also showed a widening gap between investor expectations and outcomes delivered. The map below shows the level of trust in the financial services globally. It is alarming to see that Australia has the equal second lowest level of trust after Germany at 31%. I suspect this outcome for Australia may be even lower today.

### Trust in the Financial Services Industry: Reputation versus Realities



#### RETAIL INVESTOR EXPECTATIONS

Importance Satisfaction



The survey asked retail respondents to rate seven actions that investment firms could take to build trust, ranked in terms of importance and personal level of satisfaction. The areas with the biggest difference between expectations and outcomes included disclosure regarding fees and conflicts of interest.

The CFA survey relates to the broader, and global, investment community. However, in the recent increase in Listed Investment Companies (LICs) in Australia, a key area of focus has been appropriate and consistent disclosure on the reporting of performance and fees.

### Internally managed vs externally managed LICs

The traditional, internally managed LICs offer a low cost, transparent and stable but growing dividend for shareholders. In addition, management works for the company so there are no fees paid to an external manager nor any conflict of interest between the shareholder and manager. These LICs generally have a lower turnover and are considered an investor on ‘Capital Account’ for tax purposes as opposed to ‘Revenue Account’ firms which are considered traders.

Externally managed LICs offer a number of different strategies backed by some strong recent performance. However, the industry sometimes falls short in the reporting of consistent and relevant information for shareholders. Often what is disclosed are performance figures highlighting only a pre-tax portfolio performance, which can differ from the end-result to investors due to management fees, performance fees, dilution and taxes. Another often poorly disclosed factor is whether external fees are calculated pre-tax or post-tax. This makes accurate comparison between different LIC strategies difficult for retail investors.

This is an area where the ASX should assume leadership and create standard disclosure requirements for the LIC sector to ensure investors are fully and fairly informed.

### **Internalising IPO costs on new LICs**

The recent trend for new LICs to internalise IPO listing costs (paid by the manager) is positive, as shareholders in the IPO have an NTA on listing equal to the issue price. However, the external managers are not doing investors a huge favour. Shareholders need to read the PDS/prospectus carefully, as the manager could be seeking to claw back these costs from shareholders over time through management fees and performance fees.

In addition, there are often onerous costs to break an investment management agreement, ensuring the manager will recover the listing costs with little risk. The primary attractiveness of LICs for external investment managers is the 'captive money' such an arrangement brings. While this guarantees the funds for future fee streams, it also removes the implications of money entering and redeeming from the fund, often at the worst times. Certainty of funding should allow for better investment decisions over the longer term. The importance of long-term captive money is intensified by fee pressure in the institutional funds management space and the internalisation trend being pursued by industry super funds.

### **What can Australia learn from the UK?**

LICs have exploded in number and market cap over the last few years in Australia. However, they do go through cycles in terms of investor appetite and tend to trade on yield as much as NTA. The majority of recent LICs conduct financial reporting on 'Revenue Account' and many pay dividends from capital, usually realised gains. These gains may come under pressure in a market downturn, so investors need to be aware of the risk regarding the sustainability of dividends. Investors need to analyse where their dividend is coming from, and how much retained earnings the company has to support future dividends.

An interesting trend in UK investment companies has been the use of 'continuation votes', where a company's articles of association provide for shareholders to vote on whether the company should continue to exist under certain circumstances. They give shareholders the opportunity to vote on a company being wound up. Some continuation votes are conditional on measurement metrics – say, when the discount to asset backing is trading wider than a pre-determined level for a period. Other continuation vote opportunities are offered on a periodic basis. Perhaps this is something that in time LICs in Australia could consider.

### **Survey recommendations**

The CFA Institute survey also offered recommendations for the industry to increase investor trust through a 'trust equation' which is a combination of credibility and professionalism. Credibility addresses factors such as track record, brand, well credentialed people and the use of a code of conduct. Professionalism focuses on areas such as transparency and clarity regarding fees, competency, and values. Like any highly regarded service industry, trust and quality service should be the bedrock of a firm's foundation.

Financial institutions are facing a challenging time with ethics and culture, as greed, dishonesty, and fraud appear to be occurring too often. The investment management industry is competitive. It is critical to provide appropriate products and transparent disclosure, and to ensure investors interests are put first.

### **About the survey**

The Next Generation of Trust data collection was conducted by research firm Greenwich Associates and consisted of a 15-minute online survey conducted in November and December 2017. The survey sampled 3,127 retail investors (25+ years old) with investable assets of at least US\$100,000 in the United States, Canada, Brazil, United Kingdom, France, Germany, the United Arab Emirates, Australia, India, Singapore, China, and Hong Kong. It also sampled 829 institutional investors with assets of US\$50 million or more in these markets. The survey and related data is available at [nextgentrust.cfainstitute.org](http://nextgentrust.cfainstitute.org).

Andy Forster is a Senior Investment Officer at [Argo Investments Limited](#). This article has been prepared for educational purposes and is not a substitute for tailored financial advice.

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## 9 strategies to make the most of EOFY 2018

Gemma Dale

While 30 June is rapidly approaching (and falls this year on a Saturday), investors still have time to take advantage of end of financial year (EOFY) tax concessions and other opportunities.

### 1. Claim up to \$20,000 per asset as a tax deduction

If you are self-employed or have a small business with an aggregate annual turnover of less than \$10 million, you may be able to immediately deduct the cost of a depreciating asset that you purchase for less than \$20,000. In order to access the deduction, the asset must be income producing for your business, purchased between 7:30PM on 12 May 2015 and 30 June 2018, and installed and ready for use before the end of the financial year. There is no limit to the number of eligible purchases that can be claimed.

### 2. Review your portfolio for tax efficiency

Investors should review their portfolios and clean up those loose ends. If you have carried forward losses, these can be offset against capital gains to minimise tax payable. Be aware that the Australian Tax Office (ATO) has issued warnings against wash sales, which is where an asset is sold and repurchased with the intention of minimising tax payable. Ensure transactions are investment driven, not tax driven.

### 3. Claim a deduction of up to \$25,000 for personal contributions to super

Before 1 July 2017, you could only claim a tax deduction for making a before-tax contribution to your super if you earned less than 10% of your income from salary and wages. Now, employees can enjoy a potential tax deduction too.

By making a before-tax contribution into your super, you could boost your retirement nest-egg, and by claiming a tax deduction, you could reduce your taxable income.

The super contribution is generally taxed at 15%, not your marginal tax rate, which could be up to 47% (including the Medicare levy). Note that higher income earners (with income from certain sources above \$250,000 in FY18) may have to pay an additional 15% tax on concessional contributions.

This strategy could suit you if your employer doesn't allow you to salary sacrifice or if you'd rather not salary sacrifice because it reduces other employee entitlements, such as Super Guarantee contributions. And even if you are salary sacrificing, you might use this strategy to contribute the full amount of concessional contributions, if your current salary sacrifice agreement, together with any additional employer contributions before 30 June won't quite get you there. The cap for FY18 is \$25,000.

Finally, you'll need to meet the work test if you're 65 and over, and you wish to use this strategy, and everyone will need to ensure they submit the correct paperwork in order to claim the deduction. As this is the first year this strategy is available, regardless of your employment arrangements, it is advisable you speak to your super fund and your accountant or financial planner to ensure you optimise your contribution and follow the correct process.

### 4. Make a spouse contribution – new higher income limits for receiving spouses

If your spouse earns under \$40,000 each year, their super could probably benefit from a top up. If you contribute to their super, you may receive an offset of up to \$540 in your tax return.

Before 1 July 2017, this tax offset was only available to couples where the spouse earned less than \$13,800 per annum. With the threshold increased to \$40,000, more people will be able to help increase their spouse's retirement savings while potentially improving their own tax position.

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## 5. Receive a co-contribution by making a personal super contribution

If you earn less than \$51,813 in FY18 (before tax), of which at least 10% is from eligible employment or self-employment, you could receive a super top up from the Government when you make a personal after-tax contribution to your fund.

If you earn less than or equal to \$36,813, you could contribute \$1,000 to super and receive the maximum co-contribution of \$500 (based on 50c from the government for every \$1 you contribute). The amount of the co-contribution reduces as your earnings increase and cuts out entirely at \$51,813. To receive the co-contribution, you will need to meet certain conditions, including a requirement to lodge a tax return for the year and be under 71 years of age at the end of the financial year.

If you are thinking of helping your child or grandchild build wealth for their future, you could assist them by giving them funds that they can contribute to super in order to receive the co-contribution. This will be preserved until they retire after their preservation age or meet another condition of release, but can have a powerful compounding effect over their lifetime.

## 6. Prepay interest on your investment loans

When you borrow money to make an investment that will generate assessable income, you are generally entitled to a tax deduction for the interest on the money borrowed.

Towards the end of the financial year, many investors who gear into property or shares will prepay their interest for up to 12 months (with the 12-month period ending before 30 June next year). Doing so will allow you to lock in the interest rate you pay for next financial year and will bring forward your tax deduction to this financial year if you are a small business entity or an individual incurring non-business expenditure.

## 7. Prepay your income protection insurance premium

If you have, or are considering, income protection insurance, you could claim your premium as a tax deduction. If you choose to pre-pay your premiums for the next 12 months and that 12-month period ends before 30 June next year, you can bring forward a tax deduction from next year to the current year. As many Australians are under-insured, this can be a great way to protect yourself, your family and your business, while managing your tax.

## 8. Ensure you take your minimum pension payment for FY18

For those whose superannuation benefits are in pension phase, it is essential that you take your minimum pension amount for FY18 to ensure your earnings remain tax-free. If you have an SMSF, consider contacting your accountant or administrator to ensure you have taken the minimum amount before 30 June.

## 9. Make a tax-deductible donation to charity

Finally, tax time can be a great time to think about helping others. If you donate to an eligible charity, keep your receipt and claim a deduction in your annual tax return.

### Video

Gemma appears in this [short video](#) on the things you should consider for the EOFY period. It provides a general overview only and should be watched in conjunction with this article.

*Gemma Dale is Director of SMSF and Investor Behaviour at [nabtrade](#). Any advice and information in this publication is of a general nature only. It is not intended to be a substitute for specialised taxation advice. nabtrade is not a registered tax agent.*

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## Can Australian credit continue to perform?

Damon Shinnick

We have been living through an extraordinary period of economic stability, characterised by low but stable global growth and fuelled by central bank largesse, persistently low interest rates and a seemingly insatiable appetite for risk assets. With a multi-year strong credit performance, the question arises as to where we are in the credit cycle and whether current valuations warrant further outperformance.

### The credit cycle: a primer

Credit cycles are generally considered to have four distinct phases: expansion, downturn, repair and recovery (Exhibit 1). All credit cycles ultimately end in a downturn but the timing of transition from expansion to downturn is not and the turning points are never easy to predict. Credit cycles do not die of old age. They do, however, tend to follow the direction of the broad economy and are typically presaged by a turn in economic conditions, tightening lending standards and heightened funding costs. As the availability of capital falls, and the cost of servicing debt increases, defaults rise as companies that had over-levered in the good times struggle to meet financial obligations under the weight of excessive debt loads and falling revenues.

### The Australian economy continues to defy gravity

Australian economic conditions remain conducive to a continuation of the current credit cycle. GDP growth currently sits at 3.1%, with the Reserve Bank of Australia (RBA) forecasting growth of 3% and 3.25% for 2018 and 2019, respectively. Growth remains well balanced

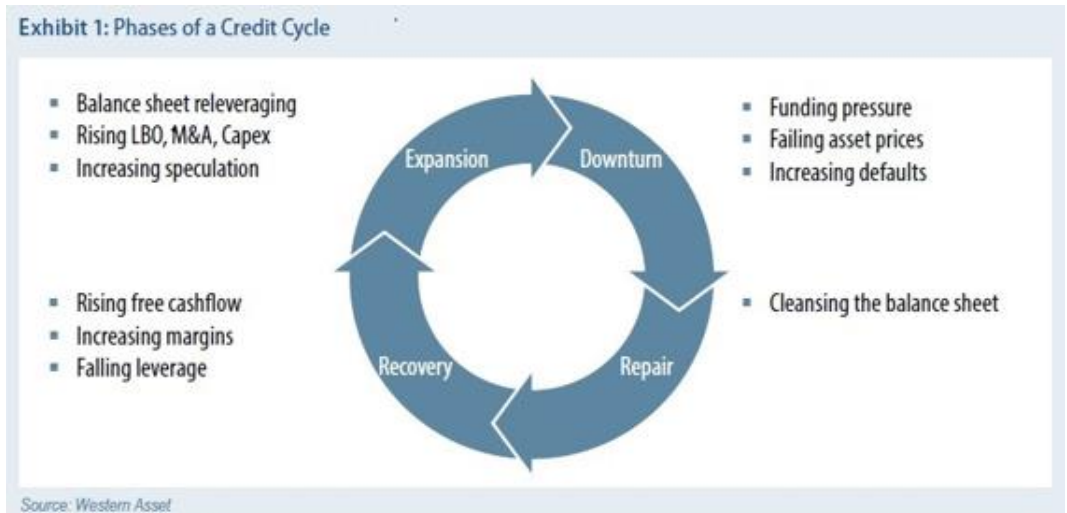
and supportive for domestic companies. Business conditions remain robust. Unemployment is stable and sits at 5.6% with ample spare capacity, and inflation remains below the RBA's target band of 2-3%.

If there is a downside to this picture, it is clearly the consumer. Household debt-to-income has risen exponentially, wages have stalled (recording a cumulative growth rate of 0.2% in real terms since 2012) and savings rates continue to fall. Key risks remain in the housing market, with the rise in investor and interest-only loans.

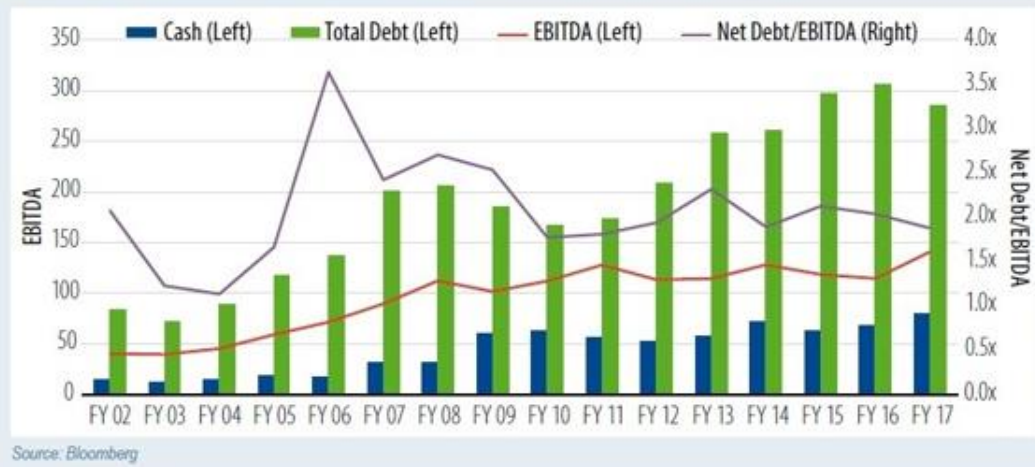
The active use of macro-prudential regulations by the Australian Prudential Regulation Authority (APRA) has been successful in reducing the risks of the housing sector overheating albeit risks still remain. The RBA is cognisant that households remain susceptible to any significant upward shifts in monetary policy and has subsequently been reluctant to raise the cash rate above the low of 1.5% set in August 2016. We do not see any obvious driver for this policy setting to change in 2018.

### Australian corporates remain in good health

Corporate Australia is coming from a position of relative strength. The latest corporate earnings season has shown a continuation of this trend with improved revenue, stronger earnings and a slightly more optimistic outlook. Corporate credit quality remains sound. Gearing ratios generally remain towards the lower end of target ranges (or below) and debt coverage ratios remain healthy (see Exhibit 2 that is based on ASX 100 companies (ex-financials), equally weighted). To date, corporate treasurers have tended to be well behaved, with returns to shareholders via dividends and buybacks being largely credit neutral.



**Exhibit 2: Corporate Fundamentals Remain Robust**



A deeper look into the balance sheets of many Australian corporates highlights that their treasurers have become more prudent in the management of their debt profile post-GFC. An historical reliance on short-term bank funding has given way to more balanced approach, with treasurers actively smoothing out and extending their debt profile and increasing

their use of debt capital markets.

A deepening domestic bond market now provides companies with the opportunity to raise debt funding out to 10 years (up from five years pre-GFC). Australian corporates are now in a stronger position to deal with potential reductions in capital availability from any one source.

**Technical tailwinds continue to support spreads**

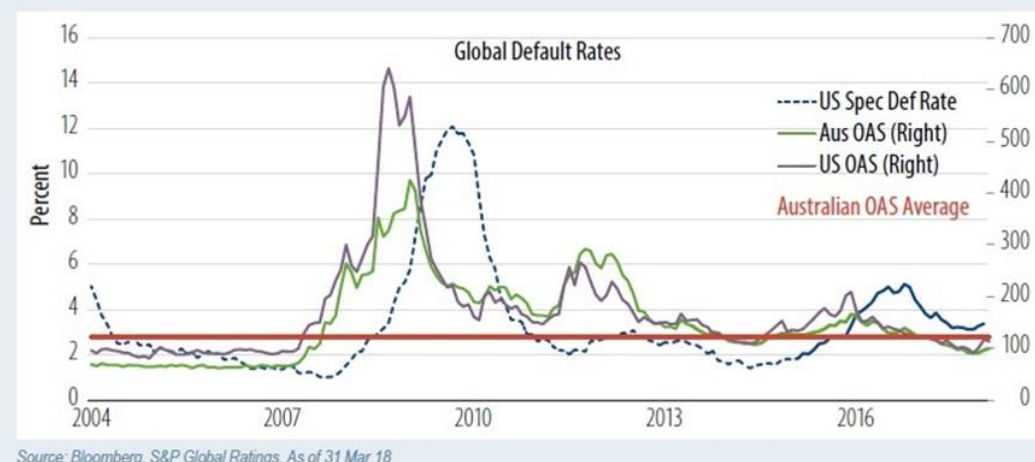
Global quantitative easing, changing demographics and excessively loose monetary policy have driven an insatiable appetite for risk assets as investors hunt for yield globally. The process of normalisation will be gradual, and we expect demand for income-producing assets to continue.

Additionally, corporate issuance is likely to fall for the remainder of 2018 and into 2019. This year of 2018 is expected to be the lowest maturity year in Australian credit markets since 2013, with only a slight pickup in 2019. Additionally, modest growth CAPEX requirements and to date, limited debt funded corporate actions, should also act to curb any significant supply of corporate issuance into the domestic market place.

**Australian valuations**

Domestic credit spreads tend to display lower volatility than global peers due to Australia being a strong investment-grade market with a much shorter duration than global markets (the AusBond 0+years Credit Index is 3.8 years in duration with an average rating of A+ against the Barcap US Credit Bond Index of 7.0 years duration and an average rating of A as of 30 April 2018). However, regardless of the domestic economic outcomes and the relative strength of corporate Australia, the performance of our credit market is largely dictated by movements in offshore, and in particular US, markets. Historically, there has been a strong correlation between US speculative grade default rates and AUD corporate spreads (Exhibit 3).

**Exhibit 3: When the US Sneezes the Australian Credit Market Catches a Cold**



During the GFC, our spreads widened although there was neither a domestic economic recession nor a subprime housing sector because global funding markets are interrelated. Approximately 50% of the value of the Australian corporate bond market is issued by global companies.

Additionally, Australian institutions derive much of their funding from offshore markets, particularly the major banks.

### **Where to from here?**

Absent any exogenous shocks to the system, we do not see an imminent threat to the current credit cycle, either globally or domestically, for the remainder of this year.

Australian spreads have come in a long way since the GFC and are now sitting slightly below long-term averages. While we believe that we are being adequately compensated for default risk at these levels, there is limited upside from taking on too much risk. The cycle is aged and we feel that domestic credit spreads will be largely range-bound for the remainder of this year. Global bouts of volatility will remain a key driver of domestic spreads.

We continue to stay invested in credit, but prefer to focus on those sectors that offer stability of cashflows, in particular infrastructure, utilities and property. While the banking sector clearly has its problems, globally banks remain on sound footing and we are happy to accumulate as valuation opportunities arise.

Investing in shorter-dated credit will act to minimise any volatility that may occur as the market slowly moves towards the turning point in the cycle. In this environment, bottom-up analysis is key. Avoiding companies that have exposure to more cyclical parts of the economy (i.e., exposure to retail in an environment of a stressed consumer). Our tactical positioning includes investing in primary issuance that offer excess premiums and takes advantage of any short-term technical volatility that may result in mispriced opportunities in the secondary market.

*Damon Shinnick is Portfolio Manager / Senior Research Analyst, Fixed Income and Credit at [Western Asset Management](#), a [Legg Mason affiliate](#). This material is issued by Legg Mason Asset Management Australia Limited. This article is for information purposes only and reflects the current opinions of Western Asset Management. It has been prepared without taking into account the objectives, financial situation or needs of any individual.*

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## **Budget 2018 puts aged care at a tipping point**

Rachel Lane

The Federal Budget in May 2018 was widely reported as the 'Baby Boomer Budget' with key elements including an additional 14,000 home care packages, expansion of the Pension Loans Scheme (PLS) and an increase to the pension work bonus. Of course, the headlines don't tell the full story.

### **Home Care packages**

The additional 14,000 Home Care packages over the next four years was welcome news. For the 105,000 people currently on the waiting list for a package based on their needs – a list that grew by almost 25,000 between February and December 2017 – the government seems to have forgotten them. The money to pay for these packages has come out of residential aged care funding, which appears set to see similar waiting lists to home care over the coming decade. The [MUCHE Health Report 2018](#) estimates there is will be a "94,200 gap in residential aged care places by 2025".

### **Pension Loan Scheme**

The expansion of the PLS to provide payments of up to 150% of the age pension and extended eligibility to anyone of age pension age is great news, particularly for full pensioners that are self-funded retirees who currently cannot access the scheme. The interest rate applied to the PLS is a relatively low 5.25% p.a. or around 1% lower than the rates charged for a commercial reverse mortgage. Unlike a reverse mortgage, the PLS is considered income for aged care means testing, meaning that people who use the scheme to fund aged care costs could actually increase those costs by doing so.

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Here's an example: Jack and Jill are homeowners who receive the full age pension. They have \$50,000 in bank accounts, \$150,000 of shares and \$30,000 of personal assets.

Jack has a home care package and pays the basic daily fee of \$10.32 per day. Under the expanded PLS, Jack and Jill would be able to receive payments of up to \$17,787 per year. If we assume they receive \$17,787 per year of payments, because the PLS is included in Jack's assessable income and pushes him over the \$20,704 per year income threshold, his Home Care Package Income Tested Care Fee would go from zero to around \$10 per day. So of the \$17,787 per year of payments around \$3,800 per year would be lost in additional fees.

If Jack moves into residential aged care, and Jill remains at home, Jack will qualify as a low means resident. Jack's liability to contribute towards the cost of accommodation through a Daily Accommodation Contribution (DAC) will be calculated based on his assets and income. Assuming Jack and Jill are receiving \$17,787 per year through the PLS, Jack's DAC will be \$42 per day and his equivalent lump sum refundable accommodation contribution (RAC) would be \$268,468. However, if they didn't receive payments through the PLS, Jack's DAC would be \$32 per day and his equivalent RAC would be around \$66,000 less at \$202,237.

Other budget measures, potentially worthier of headlines, included the government undertaking analysis to change the allocation of residential aged care beds away from aged care facilities and give them to consumers, combining residential aged care and home care from 1 July this year and creating a levy to secure the \$23 billion of accommodation deposits currently being guaranteed by the federal government.

### **What wasn't in the Budget?**

Some highly anticipated changes to aged care were not included in the Budget but could still be announced, possibly in the Mid-Year Economic and Fiscal Outlook (MYEFO). The changes are expected as a result of the [Legislated Review of Aged Care 2017](#) and the 38 recommendations contained within the report tabled to parliament last September, which include:

**In Home Care**, the key recommendation is to make the basic daily fee proportional to the value of the package and ensure that providers charge it. Currently the basic daily fee is set at 17.5% of the pension (\$10 per day), with funding ranging between \$22 and \$180 per day. A number of home care providers choose not to charge the basic daily fee and instead just deliver the funded amount of care at a reduced price or free.

**In residential aged care**, there were several recommendations, including removing the current cap on the basic daily fee which is set at 85% of the pension, \$50 per day with the proposed new cap being \$100 per day. Aged care facilities would be able to charge more than the new cap with approval from the Aged Care Pricing Commissioner and there would be an exception for people who are financially disadvantaged.

Another recommendation is to increase the price threshold beyond which aged care facilities need to seek approval for their Refundable Accommodation Deposit (and equivalent daily payment). The current threshold is \$550,000 and the recommendation is that this be increased by \$200,000 to \$750,000 and an automatic link created between the threshold and median house prices.

Other recommendations of the report have been publicly ruled out by the government but are not impossible. These include removing the current cap applied to the family home of \$165,271, making the full value assessable for residential aged care means testing (except when a protected person is living there). And removing the annual and lifetime caps on income-tested care fees in home care and means-tested care fees in residential aged care.

The industry is now at a tipping point.

The Home Care package waiting list is at 105,000 people and growing, more than 40% of residential aged care facilities are expected to make a loss this year and the industry needs to build an additional 83,500 aged care beds over the next 10 years to meet demand. The industry has only built 35,000 new beds in the last decade. It's no wonder the government wants to introduce a levy to help secure the \$23 billion of accommodation deposits they are guaranteeing.

Change is inevitable, but *effective* change must do more than shift funding between Home Care and residential aged care. Watch this space.

*Rachel Lane is the Principal of [Aged Care Gurus](#) and has co-authored a number of books including '[Aged Care. Who Cares?](#)' with Noel Whittaker. This article is general information only.*

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## Maximising the impact of charitable giving

Rachael Rofe

*"To give away money is an easy matter and in any man's power. But to decide to whom to give it, and how large and when, and for what purpose and how, is neither in every man's power nor an easy matter."* Aristotle

The giving season is upon us as taxpayers look to charitable donations to help balance their year-end tax liabilities. Yet the challenge for donors, as it was for Aristotle, is finding the most effective way to do it. If you want your giving to have an impact, it's not just about how much you give, but how well you give it.

Here are some tips to help you get the most from your charitable giving.

### **Deduct now and distribute later using a sub-fund**

Sub-funds in public ancillary funds are one of the fastest growing charitable structures in Australia. They give a tax deduction immediately with the flexibility to determine the charitable recipients later, can be established immediately (which is especially helpful in the final days of June), and cost nothing to set up.

A sub-fund is a philanthropic giving account established within a public charitable trust known as a public ancillary fund (PuAF). In the Australian Philanthropic Services Foundation, you can establish a sub-fund by making an initial tax-deductible donation of \$50,000. The tax deduction can be claimed in full immediately or spread over the next four years.

You then advise the Trustee of the public ancillary fund which charities are to receive a distribution from your sub-fund and the quantum of the distribution. To be eligible, a charity must have Deductible Gift Recipient Item 1 status, and there are over 25,000 charities to choose from.

A minimum of 4% of the sub-fund's balance must be distributed to charities each year, allowing you to achieve a regular ongoing flow of distributions to your preferred charities as opposed to making larger one-off lump sum direct donations. You can also nominate successors to advise the Trustee, ensuring your giving legacy continues beyond your lifetime.

Whilst you take the time to do your due diligence in deciding which charities you want to support from your sub-fund, the balance is invested. Investment returns are tax-free and franking credits are refunded so there is real potential to grow the amount that you give to charity over time.

After you have built up the balance through donations and investment returns, should you decide that you want to take full control of investment and administrative responsibilities, you can choose to establish your own private ancillary fund. This makes sense for balances over \$1,000,000 and you are usually able to transfer your sub-fund to a new private ancillary fund (some providers have restrictions on this, so it is best to check before establishing the sub-fund).

### **Treat your donation like an investment decision**

Whether you give directly to charity or via a structure like an ancillary fund, allow yourself the time to consider the charities you will support, including:

#### **1. Focus**

Instead of spreading your giving across multiple charities, consider giving more to less. Charities incur costs in processing donations so it follows that the smaller the donation, the greater the percentage absorbed by these costs. There is no 'right' amount to give, but your impact can be enhanced by directing your charitable dollars, whatever the amount, to one or a select few working for the causes most meaningful to you.

#### **2. Research**

Investigate the charities on your shortlist. The Australian Charities and Not-for-profits Commission (ACNC) is a great starting point. It maintains a [public register](#) with information on over 56,000 registered charities in Australia (including public ancillary funds). The register will confirm if a charity is committed to transparency by being up to date with its annual reporting obligations, and you can also download the financial statements of public charities with annual revenue of over \$250,000.

Don't hesitate to speak with the charity and ask about their goals – what they are, how they are measured, and the resources they need to achieve them. You can feel more confident giving to a charity with a clearly articulated goal and a strategic plan to get there.

### **3. Measure effectiveness in the right way**

An investor will look for an opportunity supported by a strong team with solid systems to review and evaluate performance. A charitable investment should be no different. But qualified staff and infrastructure costs money, which is why you should resist measuring a charity's effectiveness by its overheads. It can be more constructive to focus on the social impact of your donation, and not the 'overhead' cost incurred to achieve it.

### **4. Maintain an investment timeframe**

Consider a multi-year charitable investment. You will benefit from deeper engagement with the charity and understanding the progress of their work. The charity will also appreciate the benefits that flow from the certainty of a committed donor. Remember that it takes time to deliver real change and your charitable investment needs sufficient time to mature.

### **5. Incorporate your tax planning**

Donors are generally motivated by the desire to make a difference, but if access to tax deductibility can also be achieved, you can make up to twice the difference by giving to one or more of the 25,000 charities that have Deductible Gift Recipient (DGR) status.

The best results happen when you start early, taking the time to explore the causes meaningful to you and to research the charities working within them. If you find yourself close to 30 June without a clear idea of which charities you want to fund, establishing a sub-fund in a public ancillary fund is smart. You will receive a tax deduction now when you most need it, and the liberty of time to decide which DGR charities you ultimately want to support.

To explore further, check out this video: [Chris Cuffe: A tax effective way to support philanthropy](#)

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## **SMSFs allocating to managed funds and global**

### **Graham Hand**

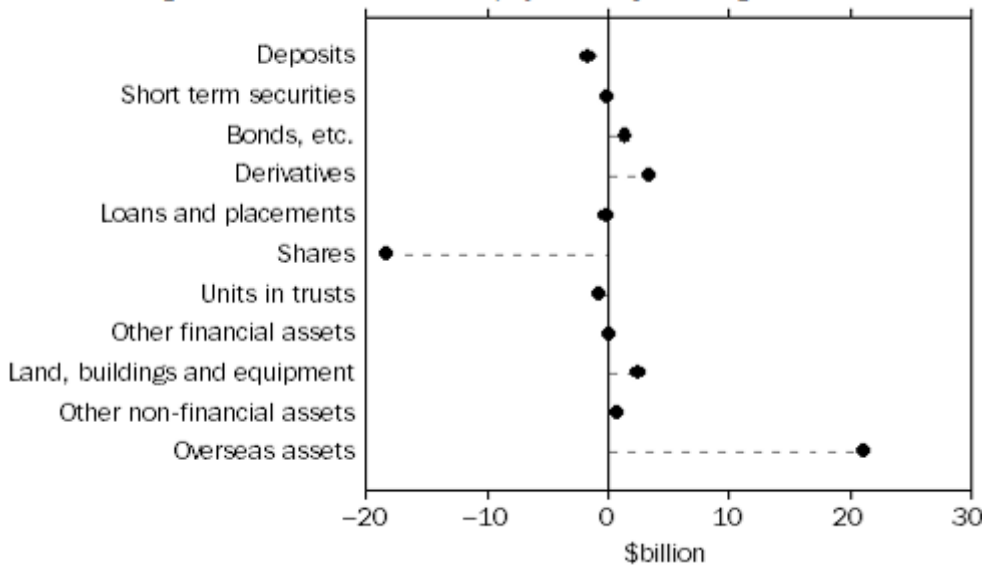
Three recent reports on asset allocation confirm a move by SMSFs and other investors into global equities at the expense of Australian companies. It is no doubt driven by the better performance of the S&P500 versus the S&P/ASX300, the surge in technology opportunities offshore and the struggles of previous favourites, the banks and Telstra.

The official statistics on the asset allocation of SMSFs as recorded by the Australian Taxation Office (ATO) from tax returns are flawed, as [we have written about](#) several times. Other data sources such as the Australian Bureau of Statistics (ABS) and market participants provide a more complete picture.

### **The managed fund industry**

The latest ABS data for 31 March 2018 shows the Australian managed fund industry held \$3.4 trillion, up \$15 billion in the quarter. So much for the claims this is a struggling industry. The strongest increase by investment type was overseas assets, a rise of \$21 billion, as shown below. Domestic shares fell by \$18 billion.

### Managed funds institutions, quarterly change in assets

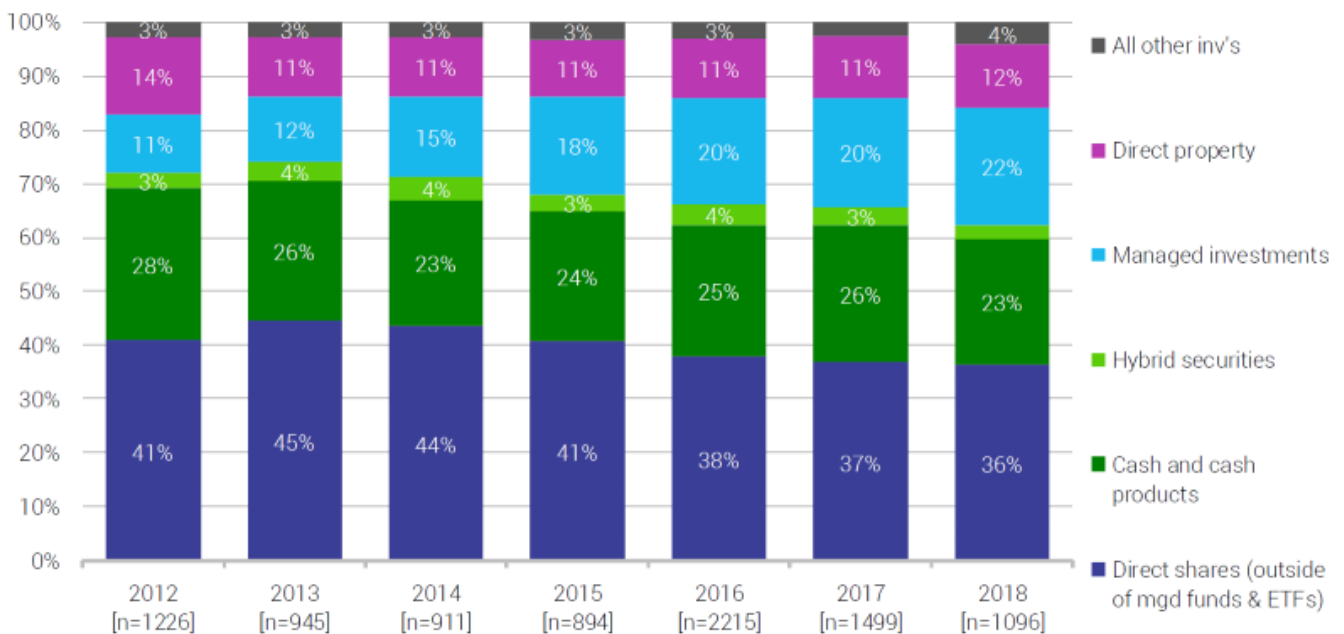


Source: [5565.0 ABS Managed Funds, Australia, March 2018](#)

### SMSF investments move to managed funds

The just-released 2018 Vanguard/Investment Trends Self-Managed Super Fund Reports show a time series since 2012 in investment patterns. The most obvious movement is the growth of managed investments, which include ETFs and LICs, at the expense of direct shares. While SMSF trustees are making their own investment decisions, this should not be confused with making their own stock selections. The share of managed investments has doubled from 11% to 22% in six years. The latest BetaShares Australian ETF Review shows inflows into international equities of \$273 million in May 2018, with this asset class first for inflows in every month of 2018 so far.

Q46 Roughly how much does your SMSF have invested in each type of asset?  
Dollar weighted averages among SMSFs



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Source: Vanguard/Investment Trends Self-Managed Super Fund Reports, June 2018

## SMSF asset allocation

This week, SuperConcepts also released its latest Investment Patterns Survey for March 2018. This is far more up-to-date than the ATO data because it uses SMSF data from funds administered by SuperConcepts, rather than relying on the much-delayed lodgement of tax returns.

The data needs the qualification that SuperConcepts is part of AMP and has a higher proportion of advised clients than most SMSF administrators, and advisers tend to use the functionality of platforms and managed funds. Nevertheless, the change in asset allocation also shows a greater use of international equities over time, up from 12.9% to 14.2% in a year.

Sector	31 March 2017 (%)	30 June 2017 (%)	30 Sept 2017 (%)	31 Dec 2017 (%)	31 March 2018 (%)
Cash and short term deposits	18.0	19.8	18.6	17.3	17.2
Fixed Interest	12.7	12.0	12.6	12.1	12.5
Australian Shares	36.7	35.4	35.6	36.9	35.9
International Shares	12.9	13.1	13.9	14.2	14.2
Property	19.2	19.3	18.9	19.0	19.5
Other (Hedge funds, agricultural funds, private geared & ungeared trusts and collectables)	0.5	0.4	0.4	0.5	0.7
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

A further break-up of the international shares component over the last year shows the steady rise of ETFs and managed funds, and a small rise in SMSFs going directly into foreign stock exchanges.

## SMSF international shares components

	31 March 2017 (%)	30 June 2017 (%)	30 Sept 2017 (%)	31 Dec 2017 (%)	31 March 2018 (%)
Direct Shares	2.2	2.4	2.3	2.5	2.4
ETF's	2.2	2.4	2.7	2.4	2.5
Managed Funds	8.5	8.3	8.9	9.3	9.3
<b>Total %</b>	<b>12.9</b>	<b>13.1</b>	<b>13.9</b>	<b>14.2</b>	<b>14.2</b>

The balanced options of institutional superannuation funds have long allocated around 20% of their portfolios to global equities, and SMSFs have traditionally lagged far behind. In the last five years, SMSFs have started to catch up, and with the Australian index still dominated by some big companies without compelling growth prospects, it's a trend that will continue.

*Graham Hand is Managing Editor of Cuffelinks.*

## Why the tech giants still impress

David Bassanese

Despite concerns regarding high valuations and potential regulatory backlash, the latest earnings reporting season highlighted the strong and well diversified sources of earnings the tech giants are still able to harness. This article delves into the actual earnings performance of some of the leading names in the NASDAQ-100 Index.

## US earnings continue to shine

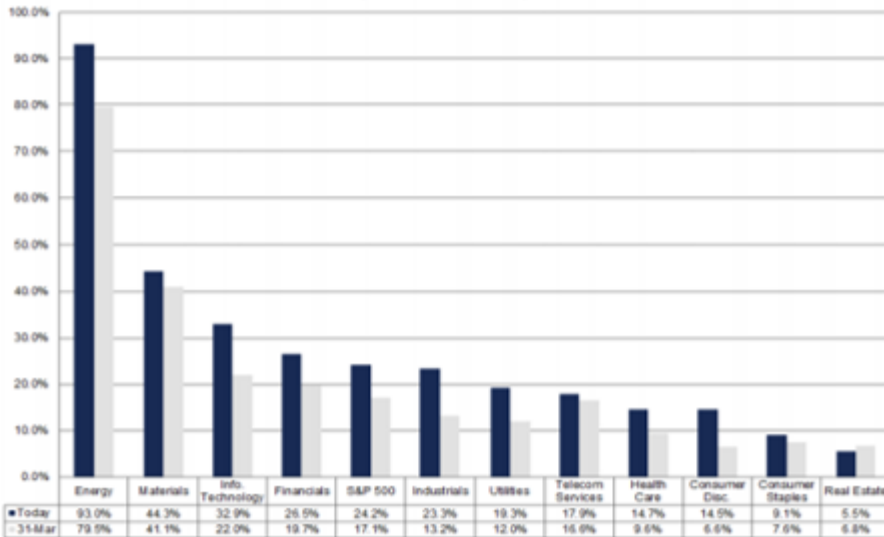
Before focusing on tech stocks in particular, it’s worth noting that the current US earnings reporting season has been strong by historic standards.

According to US research firm FactSet, most of the companies in the S&P500 beat market expectations in first quarter earnings in 2018. Annual growth in quarterly earnings is now estimated at around 24%, up from the bullish expectation of 18% before the reporting season began.

What’s more, while US tax cuts have been an important recent driver of improved earnings performance, other factors such as the economy’s strength, rising oil prices and a weaker US\$ have also played key roles. Indeed, revenue performance has been even more impressive, with 77% of companies beating revenue estimates, compared to a 5-year beat ratio of only 57%.

Rising commodity prices have delivered particularly strong growth in energy and material sector earnings, while the technology and financial sectors have benefited from strong advertising markets and higher interest rates respectively.

**S&P 500 Earnings Growth: Q1 2018**  
(Source: FactSet)



Source: FactSet

## Tech giants still doing well

Given the relatively strong performance of the NASDAQ-100 Index in recent years, particular interest of late has focused on the tech giants such as Microsoft, Amazon, Alphabet (Google), and Facebook. And contrary to concerns that they may be running out of growth options, their latest earnings reports were impressive.

Indeed, although many of the tech giants rose to prominence through a single flagship product or service, they are still able to generate good returns from their traditional ‘cash cows’, due to strong network effects and scale economies.

At the same time, most of the tech giants have also successfully expanded into new areas, such as cloud computing, music, and video streaming services.

Despite recent controversies over the use of private data at Google and Facebook, both their users and advertisers have so far remained loyal. And Apple’s performance has been so good that famed US investor, Warren Buffett, announced recently that he had increased his stake and expressed regret that he could not own the whole company.

More detail on the earnings results, and underlying drivers, for the top five companies in the NASDAQ-100 Index are provided below:

Company	EPS \$US (Actual)	EPS \$US (Expected)	% beat
APPLE	2.73	2.67	2%
Although iPhone sales are slowing, Apple is generating strong sales from related services such as digital music, Apps and cloud storage. It is also branching out into new devices such as the Apple Watch. With lots of cash still on its balance sheet, it also announced higher dividends and a \$100 billion capital return program.			
AMAZON	3.27	1.26	160%
Amazon does more than just sell physical goods online, but increasingly makes more money through cloud storage, advertising on its sites, and subscriptions to music, TV and fast-shipping services. Amazon has the world's leading cloud storage business, and has 100 million signed up to its Prime subscription services.			
MICROSOFT	0.95	0.85	12%
Microsoft's flagship Windows product now accounts for only 16% of revenue, while it has successfully morphed its Office program into an enterprise software subscription business. Its cloud computing business is second only to Amazon's and is generating new growth opportunities from its acquisition of LinkedIn.			
FACEBOOK	1.69	1.35	25%
Despite recent controversy, Facebook is continuing to attract new users and more revenue-per-user through its innovative targeted advertising system. It has successfully transitioned from a desktop to largely mobile phone platform and its diversifying into other platforms such as Instagram and WhatsApp. Augmented and virtual reality services are further growth options for the future.			
ALPHABET (GOOGLE)	9.93	9.28	7%
Paid search ads on Google and YouTube remain Alphabet's dominant revenue source, but is also growing an important cloud storage business. Revenue is also derived from delivering advertising on a growing array of third-party sites. Like other companies, Alphabet is also seeking to extend its reach into more home services through digital assistants.			

*Source: Thomson Reuters*

Of course, new regulations, particularly most recently in Europe, could make it easier for users to delete their private data or opt out of the data collection arrangements by companies such as Alphabet and Facebook, and hence lessen their ability to offer 'micro-targeted' advertisements. The extent to which users eventually avail themselves of these opportunities to better protect their private data remains to be seen.

Nevertheless, it is likely that today's leading companies will retain a dominant position in whatever form of targeted digital ad services remains in the new regulatory era. Companies such as Facebook could also move toward seeking subscription fees for the digital platforms and services that it offers.

### **NASDAQ-100 valuations still not demanding**

More broadly, given the ongoing strong earnings performance of companies in the NASDAQ-100 Index, valuations have become even more reasonable of late.

As at end-April 2018, the price-to-forward earnings ratio for the NASDAQ-100 Index had dropped to 18.8 from a recent end-month peak of 21 at end-January. That's still below the long-run average PE ratio of 24 (which also excludes the bubble years from 1998 to 2000). Based on current Bloomberg earnings expectations, forward earnings are expected to rise a further 8% by end-December 2018, and a further 13% over 2019.



Despite the Australian equity market's low technology weighting, Australian investors can easily gain exposure to the tech giants on America's NASDAQ-100 Index – and diversify their portfolios – via the [BetaShares NASDAQ 100 ETF \(ASX code: NDQ\)](#). NDQ aims to track the NASDAQ-100 Index before fees and expenses and can be bought and sold like any share on the ASX.

*David Bassanese is Chief Economist at [BetaShares](#), which offers exchange traded products listed on the ASX. This article contains general information only and does not consider the investment circumstances of any individual. Nasdaq®, OMX®, Nasdaq-100®, and Nasdaq-100 Index®, are registered trademarks of The NASDAQ OMX Group, Inc. and are licensed for use by BetaShares.*

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