

This Week's Top Articles

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Interactive: where will your goals take you?

Robin Bowerman

Introduction

Editor's note: We like to share useful resources with our readers, and Vanguard has updated its excellent Interactive Index Chart on this [link](#).

It shows market performance of various asset classes since 1970, and allows the reader to compare the growth of \$10,000 invested in these asset classes over historical periods.

Developing a plan

Buying your first home. Travelling the world. Enjoying a full and rewarding retirement.

When you invest, it's important to have a plan in place to give yourself the best chance of achieving your goals. Without a plan, it's easy to get distracted. You can end up trying to time the market, chasing performance and missing out on potential long-term returns. With a detailed and measurable plan, you know where you're heading. Along the way, you don't know exactly what each day will bring.

While you can't control investment markets, there are things you can control when it comes to investing, such as focusing on the long term, diversifying your portfolio across asset classes, and making sure you don't pay more than you need to invest.

Focus on strategic asset allocation

Building an investment strategy framework, one that aligns your risk profile with your investments, provides a solid platform for you to achieve your goals and expectations.

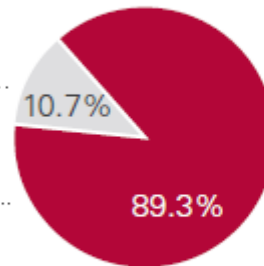
Research shows that the key to long-term investment performance is effective asset allocation. The chart below is from a study Vanguard conducted which looks at the returns of 600 Australian balanced funds across more than 25 years. It found that asset allocation was responsible for 89.3% of a diversified portfolio's return patterns over time. This leaves only 10.7% for factors such as market timing or securities selection.

Investment outcomes determined by asset allocation

Percentage of a portfolio's movements over time explained by:

Security selection and market timing

Asset allocation



*Note: Calculations are based on the monthly net returns for 600 Australian balanced funds from January 1990 to June 2016. For details of the methodology, see the Vanguard white paper *Vanguard's approach to constructing Australian Diversified Funds* (Geysen et al. 2017).*

Source: Vanguard calculations using data from Morningstar.

That's why it is important to dedicate time to asset allocation decisions before you start investing. It can mean the difference between achieving your goals or simply aspiring to them.

Invest for the long term

Market cycles play out against a backdrop of economic, social and political events and many investors can't resist trying to assign causes to every hiccup in the markets. But it's often impossible to explain market activities until long after the dust has settled.

Markets are unpredictable and trying to time them means you must get two important decisions right: when to get out and when to get back in. This means there is a risk of having to pay a higher price to get back into the market, as well as missing out on the growth from any market recovery. Allowing emotions to drive investment decisions, be it overconfidence in rising markets or fear in falling markets, rarely serves investors well.

Historical market returns show that those who ignore the emotional swirl of short-term market conditions and focus on the long term are rewarded for their patience and discipline.

Diversify

The Vanguard Index Chart illustrates the benefit of diversifying investments across asset classes to help reduce volatility and smooth out returns over time. Diversification often starts by investing across different asset classes but it also includes holding a spread of investments within an asset class across a range of companies, industries and even countries.

While this strategy doesn't protect a portfolio against negative returns, it does reduce the impact of poorly performing asset classes.

Keep costs low

All else being equal, investments with consistently low management fees and transaction costs can provide a head start in achieving competitive returns. Management fees create a drag on returns that can make it more difficult for a fund manager to add value. Factors such as high portfolio turnover within a fund can also lower its tax efficiency and drive up transaction costs.

The bottom line is—lower fees mean you get to keep more of your returns, which can help you earn more over time.

Our perspective on diversification

The table below shows the performance of various asset classes over the past 30 years.

When deciding where to invest their money, it is important investors understand that the best and worst performing asset classes will often vary from one year to the next. Having a diversified mix of investments across multiple asset classes can help smooth out returns over time.

Financial year total returns (%) for the major asset classes

Year	Australian Shares	International Shares	International Shares (Hedged) ¹	US Shares	Australian Bonds	International Bonds (Hedged) ²	Cash	Australian Listed Property	International Listed Property ³
1989	3.5	18.1	18.3	26.7	3.0	16.3	15.7	-1.1	
1990	4.1	1.9	5.3	11.5	17.8	13.1	18.5	15.2	
1991	5.9	-2.0	-5.8	10.3	22.4	15.3	13.5	7.7	-15.9
1992	13.0	7.1	-3.0	16.3	22.0	15.8	9.0	14.7	6.9
1993	8.7	31.8	17.3	26.6	13.9	14.7	5.9	17.1	28.3
1994	15.5	0.0	6.7	-6.5	-1.1	2.1	4.9	9.8	8.4
1995	6.4	14.2	3.7	30.0	11.9	13.1	7.1	7.9	7.5
1996	14.3	6.7	27.7	12.9	9.5	11.2	7.8	3.6	2.4
1997	26.8	28.6	26.0	42.6	16.8	12.1	6.8	28.5	35.7
1998	1.0	42.2	22.1	58.2	10.9	11.0	5.1	10.0	25.0
1999	14.1	8.2	15.9	14.2	3.3	5.5	5.0	4.3	-6.8
2000	16.8	23.8	12.6	18.2	6.2	5.0	5.6	12.1	14.1
2001	8.8	-6.0	-16.0	0.5	7.4	9.0	6.1	14.1	38.2
2002	-4.5	-23.5	-19.3	-26.3	6.2	8.0	4.7	15.5	7.5
2003	-1.1	-18.5	-6.2	-15.2	9.8	12.2	5.0	12.1	-5.2
2004	22.4	19.4	20.2	15.4	2.3	3.5	5.3	17.2	28.7
2005	24.7	0.1	9.8	-4.1	7.8	12.3	5.6	18.1	21.2
2006	24.2	19.9	15.0	11.6	3.4	1.2	5.8	18.0	24.2
2007	30.3	7.8	21.4	5.6	4.0	5.2	6.4	25.9	3.0
2008	-12.1	-21.3	-15.7	-23.4	4.4	8.6	7.3	-36.3	-28.6
2009	-22.1	-16.3	-26.6	-12.5	10.8	11.5	5.5	-42.3	-31.2
2010	13.8	5.2	11.5	8.9	7.9	9.3	3.9	20.4	31.3
2011	12.2	2.7	22.3	3.7	5.5	5.7	5.0	5.8	9.2
2012	-7.0	-0.5	-2.1	11.1	12.4	11.9	4.7	11.0	7.5
2013	20.7	33.1	21.3	32.5	2.8	4.4	3.3	24.2	24.3
2014	17.6	20.4	21.9	22.7	6.1	7.2	2.7	11.1	11.8
2015	5.7	25.2	8.5	31.8	5.6	6.3	2.6	20.3	23.1
2016	2.0	0.4	-2.7	7.5	7.0	10.8	2.2	24.6	20.4
2017	13.1	14.7	18.9	13.8	0.2	-1.0	1.8	-6.3	-4.8
2018	13.7	15.4	10.8	19.0	3.1	2.5	1.8	13.0	9.0
Average	9.8	8.6	8.0	12.1	8.1	8.8	6.2	9.9	10.5
Best	30.3 (3)	42.2 (3)	27.7 (4)	58.2 (7)	22.4 (3)	16.3 (3)	18.5 (1)	28.5 (2)	38.2 (4)
Worst	-22.1 (2)	-23.5 (3)	-26.6 (4)	-26.3 (3)	-1.1 (2)	-1.0 (2)	1.8 (6)	-42.3 (4)	-31.2 (4)

The table also reinforces the importance of sticking to an investment strategy and focusing on the long term.

For example, the declining returns from international shares (hedged) in the 2016 financial year may have swayed investors to move out of this asset class in search of better returns elsewhere. In taking this option, investors would then have missed out on the 18.9% return in the 2017 financial year.

Vanguard's interactive index chart: tell the story your way

Build your own customised version of the index chart with 45-years of investment performance of major asset classes as well as key economic, social, political and demographic changes at vanguard.com.au/indexchart.

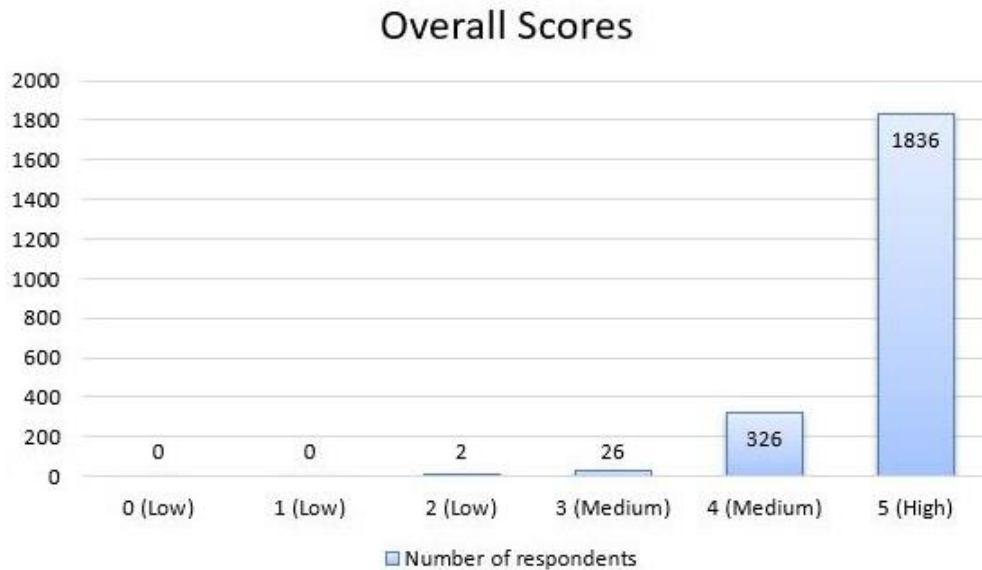
Robin Bowerman is Principal and Head of Corporate Affairs at Vanguard Australia, a sponsor of Cuffelinks. This article is general information and does not consider the circumstances of any individual. For more articles and papers from Vanguard Investments Australia, please click [here](#).

HILDA Survey: Cuffelinks readers smart, perhaps too smart

Leisa Bell

We had a great response to the challenge to take the HILDA financial literacy survey to see how readers of Cuffelinks compared to the broader Australian population. About 2,200 readers have so far taken part, and the [survey is still open](#) if you haven't attempted it already (which you should do before reading further!).

Cuffelinks readers scored an average of 4.8 out of 5, compared with HILDA's average of 3.9. At the date of this article, 84% of Cuffelinks respondents scored 5 out of 5 (high level of financial literacy), compared to 42.5% for the original survey.



Based on the many comments posted on [last week's article](#), it seems that the financial nouse of Cuffelinks readers caused some to read too much into the questions, drawing in other factors that changed their interpretation. The key to success was to keep it simple and assume that all other factors remained equal (or at least, inconsequential).

The five questions respectively covered: numeracy, inflation, portfolio diversification, risk versus return, and money illusion. Here's what we have learned from this exercise.

Q1 – Numeracy

Asked how much money you would have after one year if your \$100 in the bank earned 2% interest per year. The simple (and correct) answer was **\$102**.

While the question stipulated no fees, no additional deposits, and no withdrawals, it was silent on frequency of interest payments and the effects of compounding. Our readers are definitely aware of these additional concepts, but they take the question from simple numeracy to compound interest calculations!

Even so, 99% of Cuffelinks readers were not so easily side-tracked.

Q2 – Inflation

When your savings are earning 1% in interest while inflation is tracking at 2%, in 12 months, you'll have 1% more in cash to pay for goods that have inflated in price by 2%, so you'd be able to buy **less** than you would today.

We had 99% of readers pick that returns would not keep up with the increase in the cost of living.

Q3 – Portfolio diversification

Q3 wanted to know if investing in just one company was safer than investing in a number of different companies. Anyone who remembered the phrase 'don't put all your eggs in one basket' cracked this question, which included (again) 99% of Cuffelinks readers.

Q4 – Risk versus return

This one asked if investments with high returns were likely to be higher risk. The key word being 'likely'. Investors should demand higher returns for higher risk, otherwise, why would the riskier investment appeal to anyone?

This question tripped a few extra people, with 97% answering correctly.

Q5 – Money illusion

The final question was the most controversial among the comments. It asked if you'd be able to buy more, less or the same as today if, in 2020, your income had doubled and the cost of everything you buy had also doubled?

Assumptions that clouded a clear response included income tax (bracket creep), pre-tax or after-tax dollars, whether savings would double too, effect on disposable income, and not spending all income.

Sticking to the basic understanding of money illusion, the correct answer was 'the same' and 89% of Cuffelinks readers got the point.

A selection of comments

- 5 is a tricky one – do we consider bracket creep?
- Tend to agree. If everything doubles, then the amount you save doubles (even if it is only a very small proportion of the total) and hence you will be able to buy more in 2010.
- I suspect you will find that the majority of respondents from cufflinks will only score 80% on the quiz as we would all assume that in a progressive taxation system, double income does not equate to double disposable income.
- #5 is a ridiculous question, really. There seems to be an inherent assumption that right now you spend every cent you earn on "buying things" and that there's no such thing as tax, or progressive tax brackets – if your income doubles then your disposable income, which you "buy things" with certainly doesn't – but I doubt you're expected to think of that. Also the scenario of the price of "everything you buy" and your income both doubling in three years is completely unrealistic.
- I scored 100% because I only considered the calculations required to answer the questions.
- Personally I found each of the 5 questions open to interpretation.
- I answered question 5 based on the rate of tax being higher for the doubled income, and subsequently was marked incorrect. The question would probably be better written to specify that
- For all we know Q5 was deliberately included to gauge understanding of our tax system, which would have been a great idea !
- It seems many Cuffelinks readers are just too smart for their own good (and perhaps that of their clients).
- Lesson 1: KISS!
- It is great to see so many Cuffelinks members forming an opinion. What is better is people involved in testing their financial literature skills. Keep the surveys coming !
- I got all five right and would consider myself as highly financially literate. Just read and answered the questions on their merit. My engineering background I expect. No second guessing.
- These questions are so basic as to be laughable. The results say a lot about the apathetic state of affairs with approaching retirees in the importance of self-educating themselves about their retirement planning. No wonder unscrupulous financial advisers see this market segment as an easy target!
- The designated answer to 5 is wrong. Assuming that your income is greater than your expenditure, there is an increase in the unexpended income.
- I disagree agree with the answer to Q4 – higher returns does not always create higher risk. The higher returns works the opposite way = more assets over time
- Got all 5 right. I knew studying investing and economics was good for something!!!
- I thought it was a joke at first almost looking for the trick in the questions

- I refer to your questionnaire which I responded to achieving 4/5 failing on question 5. My answer was MORE the reason being "most peoples expenditure would not be the total of their income thus having some in reserve but then again how much if any is saved". I am just being pedantic and thought the question may have had a sting in the tail. Outsmarted myself. Thank you for testing my brain.
- I consider myself not all that sharp, but I scored 100%, I just answered the question. I have a mate who I would consider far more financially literate than me and he scored not so well. Simply because he wanted to interpret the questions via an incredibly complex set of variable parameters.
- As far as I can see things, the keep it simple approach has worked for me, diversify, manage cash and one retires early with sufficient funds to have a good life.
- I formed the opinion that the questions were basic maths nothing more nothing less
- With double income, even allowing for taxation implications, I would expect my disposable income would be greater than expenses at double the original cost.
- Based upon the majority of feedback alone, I would suggest the cuffelink readers are smarter, in seeing beyond the simplicity of the questions, but too smart to realise that the question were not designed for their genius, but to seek to ascertain the general level of basic financial literacy, which quite sadly is at a low level.
- These exchanges illustrate the problems that reasonably financially literate people have with financial conversations – even starting with very simple questions. This underscores the vital role of trusted and competent planners in guiding people towards mutually agreed decisions.
- Planners also need better common ground to build relationships with their clients. A simple dialogue based on time (a key variable which we all understand) is likely to be much more effective than one which is initially financially based

Leisa Bell is Assistant Editor at Cuffelinks.

ANZ-IIOF OnePath sale mired by conflicts of interest

Bernard Kellerman

The A\$1 billion sale of OnePath by ANZ is at risk of being stranded in a minefield of internal and external conflicts, caught between doing the right thing by members of the OnePath fund versus obtaining the best deal for shareholders of ANZ, as well as looking after the advisers that will support the fund in future.

And now there is another spanner in the works, one which ANZ's witnesses at the royal commission in Melbourne yesterday were careful not to specify: the reputational risk, in that IOOF may not be the best cultural fit for OnePath after all.

ANZ is now being forced to tread warily, as Victoria Weekes, chair of OnePath Custodians, expressed so diplomatically: "For OnePath Custodians to provide approval, and at this stage it's just talking about in-principle approval, it will be conditional upon various matters, including being satisfied that it's in members' best interests for things to proceed."

Michael Hodge, counsel assisting the commissioner, questioned Weekes on some aspects of the decision by ANZ to sell its Wealth business to IOOF.

On the face of it, there are an increasingly complex number of issues emerging, not the least of which being that the sale to IOOF is beginning to look like not being in the best interests of OnePath's members.

And even so, if the sale is done in a way that minimises capital gains exposure, it will end the payment of trailing commissions to the advisors associated with OnePath under current grandfathering arrangements that stretch back before the introduction of FOFA rules.

This raises obvious questions as to why it is in the OnePath members' best interests to keep paying commissions to advisers when these could be stopped. But if that happens, the attractiveness of OnePath to potential buyers drops – creating a conflict around what is the best deal for ANZ's shareholders.

The structure presently consists of a trustee, OnePath Custodians, which is the trustee of two super funds. One of those funds is OnePath Master Fund and the other is the Retirement Portfolio Service.

The Retirement Portfolio Service effectively functions like a superannuation wrap platform, allowing investments into products of a fund member's choice. In contrast, the OnePath Master Fund contains a variety of different products, including a MySuper product and two Smart Choice Super products – one for retail investors, and another for employers.

The OnePath Master Fund deals with a related party insurer, OnePath Life, and ANZ is also selling this insurance business – although to Zurich.

One consequence of the sale to Zurich is that the OnePath Master Fund will need to unwind its investments through the life insurance policies. The extraction of the investment component parts and superannuation parts from the life insurance, or from the life insurance company, has been proving awkward.

"The preferred method for the trustee of de-linking the OnePath Master Fund from the insurance policy investments is by successor fund transfer of the OnePath Master Fund into the Retirement Portfolio Service," Weekes said.

One of the main advantages of this method is that it has a capital gains benefit, so if you combine the redemption of those investment linked life policies with a successor fund transfer, then there's no impact on members of the fund.

Once that successor fund transfer happens, assuming that it does, there will only be one super fund operated by OnePath Custodians, the Retirement Portfolio Service.

And OnePath Custodians will, as part of the IOOF transaction, be sold to IOOF, meeting one of the preconditions.

What's adding further intrigue to the deal is if the successor fund transfer disturbs Future of Financial Advice grandfathering of commission arrangements – or rather the risk that will flow if grandfathering were not maintained, that was a problem.

"Support from the adviser network is critical for the IOOF sale," Weekes said.

Weekes confirmed that the present status is that OnePath Life pays commissions to advisers, and "the current working assumption is that commissions will continue to be grandfathered."

Hodge asked: "Has the trustee considered previously why it's in the best interests of members to continue paying commissions?"

Weekes: "No, not – not in that specific manner, no."

And then the question of how to deal with IOOF, given their performance in this round of the round commission inquiry.

In response to Hodge's question as to why the board [of OnePath] is yet to have a presentation from IOOF, Weekes launched into a long explanation that could be summarised as:

"It is a complex process and we need to be clear about what input we want from IOOF and how IOOF will treat OnePath and its members. ... to satisfy ourselves as part of a broader package that both the [successor fund transfer] and the transaction will be in members' best interests."

Bernard Kellerman is Deputy editor of [Banking Day](#).

Commission's darkness shows need for clarity

Carden Calder And Gigi Shaw

Complexity and opacity can be the enemy when communicating and building trust, and short-term momentum can cause long-term damage. Consider the numbers in Week 1 of the superannuation round at the Financial Services Royal Commission:

- Over 50 times, NAB's Paul Carter answered with some variation of "I don't recall"
- 178 online articles mentioned the 'dark' or 'darkness' of the superannuation industry
- 0 customers affected took the stand.

As we make sense of the task ahead for the industry in restoring trust, we'll share our observations as communicators. There's no silver bullet fix, but there are ways to stop, or slow, the reputational crisis.

What a difference a month makes

The Commission was back with Round 5 on superannuation, and the difference from the previous round could not be more marked. While the plight of farmers gripped the nation's hearts and minds in Round 4, there's been nothing gripping about the last two weeks of a dry and detailed "war of attrition".

It's not that coverage has particularly dropped off in volume. Media and public appetite for the cut and thrust has waned, as evidenced by the rote reporting and lack of distinguishing headlines or rallying cries familiar in previous rounds. In fact, those pitiable figures forced to sit in the stiflingly warm courtroom trying to understand what's going on have [gripped](#) increasingly openly about the simultaneous boredom and difficulty of faithfully depicting the proceedings.

So anaesthetised by the tedium and complexity have the media become, that they've turned to reporting on the challenges faced by recruiting staff for AMP and CBA, contemplating Andrew Thorburn's pinstripes, Chris Kelaher's pocket squares and Ian Silk's moustache; and even describing [their own routines](#). Hardly surprising for a round with no case studies and "trolleys full of binder books".

This is welcome news for some – the quieter the better – while others have warned of the dangers of turning away. *The Age* said that "Australia's biggest financial swindle" was unfolding in plain sight, saying that "if you have no idea what I'm talking about, or lack the desire to understand the detail to follow, it's even more likely that you're caught up in it. And if you tune out again now, you'll miss ... an opportunity for ... financial redress."

Shot to the foot

But perhaps the settling dust has its upsides. For one, it lessens the risk of Treasurer Scott Morrison's threatened "own goal" of the Commission causing a credit crunch. There have been heavy casualties in the Commission so far – not least a deterioration of public trust in the system and its institutions – and the toll will only rise as it continues. Rightly so many would say; it's time to pay the piper. But others, arguably with motive, have been able to take a more moderate tone this week, thanks in part to the lack of case studies.

Without the relatable and emotive faces reminding us of the human impact, the dialogue has been able to move into a far more sterile and logical space, one that allows for voices saying "We don't want to get carried away or throw the banking baby out with the bathwater." Such comments would have been fatal in the first week of July.

Many continue to see tightening credit, [profit dives](#), falling house prices, and other macros blamed in large part on the Commission, as harbingers of a market shift that could have significant knock-on effects to consumers. Some looking ahead at the longer-term consequences of community anger and loss of confidence see a future where those currently being vindicated end up paying a hefty price.

Just as Commissioner Kenneth Haynes raised the question of criminal conduct, the Greens seized the moment to launch their message that it is "time to break up the banks". Their language had all the evocative decaying mortality of [Metaphysical poets](#), with the "rot", "toxicity" and "cancer at the heart" of the financial system. They spoke of the rotten foundations of our banking and financial system, but even those who agree with them must also concede that it's very hard to keep anything up if you remove all the foundations at once.

Hayne has a responsibility. He redrew the lines in the sand to remind Australia that he is not there to advance victims' interests, air all the case studies, or rule on law breaking, but to find out the truth of "what was done or not done". But does he also have an – at times potentially conflicting – fiduciary responsibility to the overall structure and stability of the system? And where does this trump his more overt role?

Heart of Darkness

From overt to covert, if there is one theme that did manifest this week, it was that of suspicious secrecy. Senior Counsel Assisting Michael Hodge started us off on Monday by asking:

"What happens when we leave these trustees alone in the dark with our money? ... Consumers are unable to do anything more than peer dimly through the darkness of their superannuation trustees... [with] no dedicated and active conduct regulator shining a spotlight on the trustees and searching out bad behaviour".

Not for the first time, Hodge’s imagery found roots, with illustrations of an “opaque”, “sinister”, and “murky” industry “shrouded in darkness”, keeping members in the dark about “the dark art” and “true dark heart” of it, while Hodge is credited by the media with “peeling back the details” and “shining a light”. Bad timing for NAB’s bid for secrecy on documents.

Though revitalised, this language isn’t new to the Commission. The balance of opacity and transparency, simplified to dark and light, has been mentioned before, e.g. with the AFR’s contention that “some funds are beacons of light but there are still too many that are opaque”, and Scott Morrison’s glee over “a rather large spotlight shining on the misconduct within our banks”.

Darkness has always been a cypher for enemy, fear, blindness and misbehaviour, while light is clean, pure and revealing. It’s not always objectively true, but the binary is powerful enough that assumption will overtake.

What does this mean for corporate comms?

Simplicity works, transparency works. It’s not enough, as super funds and others affected by reputational damage and stakeholder mistrust move forward, to have nothing to hide. You must also communicate; consistently, clearly, candidly. The structure of products, the nature of the business, the application of fees, must be understandable and accessible. Even given necessary complexity in the system must be explained to the stakeholder, and especially the consumer.

Carden Calder is Managing Director and Founder of [BlueChip Communication](#). Gigi Shaw is Senior Consultant at BlueChip Communication.

SMSFs hit by loss of tax-free status and franking refunds

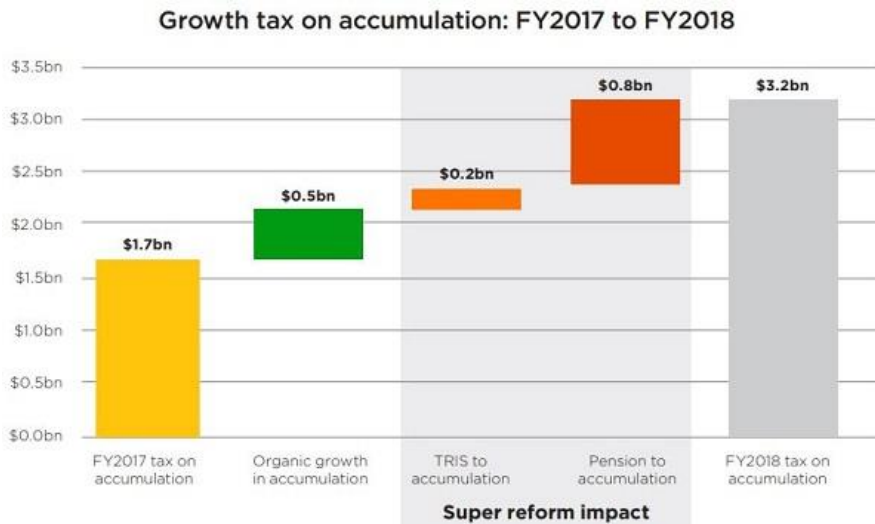
Olivia Long

Analysis on the impact of the legislative changes to superannuation since 1 July 2017 has revealed a massive jump in the amount of tax paid by SMSFs, so much so it should prompt the Labor Party to scrap its proposal to cancel cash refunds for excess dividend imputation credits.

The [June 2018 SMSF Benchmark Report](#) by Class (an SMSF software provider) highlights that the Government’s decision to cap the amount of super an individual can hold in pension phase to \$1.6 million, along with higher taxes for those people in the transition-to-retirement (TTR) phase, has had a dramatic impact on the SMSF sector.

The Class Report calls this impact “tectonic” and “the tax implications are huge” and I agree 100%.

Introducing the \$1.6 million transfer balance cap and changing the tax treatment of TTR streams has meant almost 25% of SMSF assets have lost their tax-free status.



Source: Class Limited

Huge shift in assets out of tax-free pensions

Assuming a modest return of 5% on assets for the 2018 financial year, Class estimates SMSF earnings are generating a tax bill of \$3.2 billion, a “whopping” \$1.5 billion jump from 2017. Remember, too, this estimate is based on earnings only. The tax outcome of a fund also needs to consider contributions taxes, deductible expenses and rebates including franking credits.

The higher tax bill reflects the huge shift in assets. At June 2018, the asset value in accumulation phase was \$422 billion, a **90% increase** from March 2017 when it was \$222 billion. Another way of painting this picture is to note that in March 2017, 31% of assets were held in pension phase and 45% were held in the mixed phase. As at June 2018, only 14% of assets remain in the tax-free pension phase, while the mixed phase has jumped to 57%.

Inevitably, moving the goal posts will usher in new strategies. On this occasion, there’s been a silver lining; an increase in contribution splitting and recontributions has led to a significant improvement in the gender imbalance in SMSF assets and balances and it will be interesting to see if the trend continues.

Based on this data, Class concludes that pension SMSFs should not be hit again:

“Given the impact of the 2016 super reforms, we don’t consider the proposed Labor policy to further increase the tax burden on self-funded retirees by reducing imputation credits for SMSFs is appropriate, especially if it disproportionately impacts SMSFs compared to APRA funds. If the proposed changes go through, SMSFs will not only be subject to 15% income tax on a higher portion of their assets (now in accumulation), but they may also lose their tax credits on their pension and accumulation assets. The system has undergone unprecedented SMSF regulatory changes over the past two years, and we hope the end of the impact of this super reform is now in sight.”

I couldn’t agree more. It’s why the Labor Party should revisit its proposal to cancel cash refunds for excess dividend imputation credits. The arguments why this is not only poor policy but highly inequitable have been well aired.

SMSFs have planned based on franking credit receipts

To begin with, this policy has been well-established for nearly two decades, having been introduced on 1 July 2000. For many SMSFs in retirement phase, it’s a core investment and income strategy.

Calculations by the SMSF Association suggest Labor’s proposal will affect more than one million Australians saving for their retirement. Further, it will cut about \$5,000 from the median SMSF retiree earning about \$50,000 a year in pension income, equal to a 10% pay cut. As the peak body said, “Arguing these people won’t be paying any more tax is just semantics.”

The fiscal benefits Labor believes it will reap are unlikely to eventuate, especially in wake of the 1 July 2017 changes. Changes of this magnitude always have unintended consequences. Expect SMSFs, especially those paying income streams, to seek other sources of yield, potentially from higher risk assets. In retirement, capital security is critical, yet the chase for yield (income) could jeopardise this for some retirees.

Alternatively, less attractive after-tax returns on domestic companies could presage a shift to foreign companies, with ramifications for blue-chip ASX-listed companies where SMSFs have provided much-needed ballast for their shares prices.

There’s a more fundamental issue to be addressed. When Labor introduced compulsory superannuation in 1992, the goal was to encourage people to be self-sufficient in retirement. And SMSFs have taken Labor at their word. They have used the system governments have devised to be financially independent in retirement and off the government pension.

But Labor is now seeing SMSFs as a cash cow, a retirement savings vehicle for the wealthy, to be tapped to meet more immediate fiscal needs. It reflects an attitude of all governments that the superannuation honey pot that has now reached \$2.6 trillion is there to be tapped for any policy that typically only has political merit.

All governments need to remember the sole purpose of superannuation is to give people financial independence in retirement. If changes need to be made, then it should only be after long and considered debate outside the budget cycle.

Olivia Long is Managing Director, Strategy & Operations at [Prime Financial](#). This article is general information and does not consider the circumstances of any individual.

Cuffelinks articles on Labor's franking policy

Vinay Kolhatkar

Cuffelinks continues to receive emails from readers asking about Labor's franking credits policy. Rather than respond in detail individually, we have collected 15 articles into one resource for people to consider. This issue will not go away and will become a major part of the next Federal election. We have had an unprecedented number of comments on this subject.

In addition, we reproduce a 'sample letter' which shows the intensity of reaction from a retiree who will lose \$6,250 from his modest retirement income.

On 13 March 2018, the Labor Party announced its intent to deny cash refunds for excess imputation credits from 1 July 2019, if elected to power. Bill Shorten called it a '[tax loophole](#)' in a speech laden with class warfare, and the public outcry was swift. Two weeks later, Labor capitulated and decided to exempt pensioners, thus sparing over 300,000 full and part-pensioners, people on government allowances, and about 13,000 SMSFs.

Cuffelinks has run a series of opinion pieces on the policy, some of which were published before the 'pensioner exemption' was declared. The op-eds dissect the policy's motives, effects and equity.

The reader response has been considerable, garnering (as at 12 August) **579** comments. The list below links to each of the 15 articles, with a summary of the key message.

1. On 14 March, **Ashley Owen** calculated the impact of franking credits as 1.5% of a total dividend yield on Australian shares of 5.7%, or 25%. Owen saw one upside:

"If franking credit refunds are removed, it may lessen the myopic 'home bias' that many Australians suffer from and encourage them to increase their interest in other opportunities in global markets."

['Impact on returns from loss of excess franking'](#) had 15 comments.

2. On the same day, **Nicholas Stotz** calculated the impact on the after-tax income of a pension or super fund holding only shares paying fully franked dividends at various tax rates, and discussed whether dividend payout ratios and SMSF allocations would be affected.

['Impact on pensions and super from loss of excess franking'](#) had 95 comments.

3. On 21 March, **Warren Bird** spoke to the underlying principles of equitable taxation:

Tax is paid only once by those who are obliged to pay it. In this case, it's the owners, or shareholders. The collection of a 30% tax from the company is a prepayment of tax by the shareholders at a sort of a mid-rate. Shareholders who have a lesser tax obligation must receive a refund that places them in the same position had the company paid no tax and all dividends been taxed fully in the hands of the shareholders at their marginal rate.

['Back to basics shows franking credit refunds are fair'](#) had 71 comments.

4. On the same day, **Brad Newcombe** analysed the impact of Labor's policy on hybrids. He concluded that the pool of potential fully franked hybrid investors will diminish, but there may be an increase in margins attached to new hybrids. For those who can use the franking credits, that is good news. Newcombe said the impact was already visible as he put the case of NAB's hybrid (ASX:NABHA) under focus.

[Impact on hybrids of Labor's franking policy](#) has received two comments.

5. On 29 March, by which time the pensioner exemption had been floated, **Jon Kalkman**, a former Director and VP of the Australian Investors Association, called out Labor's bluff:

"For all taxpayers on low marginal tax rates (especially retirees), the tax paid on dividends from Australian shares will be higher than other sources of income. As this increased tax will lower their income, this will distort investment decisions."

In other words, Labor's policy, even when amended, was not directed at the rich on highest marginal tax rates. Further, Kalkman argued that the policy will backfire in the worst possible way, putting pressure on the age pension system.

['Tax-free super drives the politics of envy'](#) had 21 comments.

6. On the same day, **Geoff Walker** cautioned that logic will not win the day. Extrapolating from ABC's Leigh Sales' interview of John Daley (Grattan Institute CEO), Walker spelt out a hypothetical Q&A by which those ideologically aligned with the ALP could obfuscate the issue enough for radio shock jocks to carry on with 'the rich getting concessions' alarmism that feeds public fears.

['Franking: never mind the logic, let's obfuscate'](#) had 55 comments.

7. On 5 April, **Howard Badger** took on the case of why the policy was unfair to LICs.

Badger compared the tax levied on an accumulation super fund invested in LICs with it being invested in a trust or direct shares and with a HNWI trust. He concluded that, given a large percentage of investors in LICs are super funds and that many investors in LICs are not wealthy, the result is inequitable.

['Labor's new franking policy is unfair to LICs'](#) received five comments.

8. On 17 May, **Michael Hutton** spoke to the investment strategies that SMSF members and self-funded retirees could implement to minimise their losses if the imputation rules changed. Hutton explored choices around asset allocation, asset test thresholds, age pension eligibility, transferring the Australian shares part of the SMSF to a wrap account, and the inclusion of younger family members.

['Four SMSF strategies if imputation credits rules change'](#) had 49 comments.

9. On 23 May, **Matthew Collins** looked at the various options available to SMSFs to reduce the impact of the new franking policy (if it became law), including changing the asset allocation, having one's children included in an SMSF, not hastening from the accumulation to the pension phase, plus closing the SMSF and joining an industry or retail fund in order to avail of the member-directed investments feature.

['SMSFs, member-direct and Labor's franking'](#) had 29 comments.

10. On 30 May, **Noel Whittaker** argued that Labor's policy discriminates against widows and widowers and that the wealthy are largely unaffected. Whittaker also took to task Bill Shorten's rhetoric that the "high-priced medico on \$500,000 is able to split income and pay less tax than the nurse on \$50,000 a year" — alerting us that it cannot happen except by the 'medico' deliberately (or foolishly) investing in numerous loss-making investments. According to Whittaker, the rich already pay more than their 'fair share' of tax.

['Labor, let's face the facts on fairness, women and franking'](#) had 46 comments.

11. On 6 June, **Tom Garcia** articulated the distinction between direct-investment options and a wrap, how direct options work, who offers it, and importantly, showed how the impact from the loss of franking credits can be minimised under direct-investment options.

['How do 'direct investment options' deal with franking credits?'](#) had 29 comments.

12. On the same day, at the request of a Cuffelinks reader (Trustee X), **Graham Hand** published an email sent by Trustee X to Shadow Treasurer Chris Bowen, Bowen's response email, and the reader's subsequent email to Cuffelinks.

Bowen refused to accept that the very wealthy whom the plan is supposedly targeting will not be affected. However, he did accept that the low-level SMSF of middle class Australians will be. Yet, Bowen shows no intent of changing the policy.

['Shadow Treasurer Chris Bowen responds on franking policy'](#) had 68 responses.

13. **Jon Kalkman** returned on 21 June in response to a reader query, by laying out the legal foundations of imputation, being the avoidance of double taxation since franking credits are prepaid taxes.

['What is Labor's franking impact outside of super and pensions?'](#) had 47 comments.

14. On 26 July, **Graham Hand** revived the email trail between Chris Bowen and Trustee X, adding clarifying remarks and the entire set of emails between him and Trustee X.

[‘Labor franking policy creates incentive to close SMSFs’](#) drew 33 comments.

15. On the same day, **Ian Henschke** established how the oft repeated ‘tax the rich’ phrase, fit for the ALP hyperbole, did not align with the facts. He advised of the formation of the ‘Alliance for a Fairer Retirement System’.

[‘Tax on so-called ‘super rich’ could prove costly’](#) had 14 comments.

Call to arms

Wilson Asset Management has proposed that adversely-affected parties write a letter to their local member. A ‘sample letter’ provided by Wilson is published below, although it is specific to someone’s circumstances.

Sample letter to the local member

I recently received in my post box a brochure from you saying that you stood for a “fair go”. I was a ten-year-old when my grandfather told me why he was a Labor man and it was because the Labor party stood for a fair go for everyone. Clearly this is not the case in regard to the Labor parties proposed policy on franking credits. This proposed policy will severely damage the quality of life my wife and I may expect in retirement. Apart from supporting Jo Vallentine in the Senate during the 80’s I have voted Labor up until this point in time. No more.

The current franking credit rules make sure that taxpayers receiving company profits are taxed at their marginal tax rate on this income. This is a fair result under our tax system and it offends me to hear it described as a “loophole” or a “rort”.

The refunding of excess franking credits has been a long-standing feature of the Australian tax system, having been introduced with bipartisan support in 2000. This has seen people saving for retirement factor in having franking credit refunds as part of their retirement income.

Retirement planning does not happen overnight. It takes decades, and is not easily turned around. I planned and saved diligently according to the rules of the day. There is much I would have done differently had I known of Labor’s intent to change the treatment of franking credits. I am horrified by your unfair shifting of the goal posts for vulnerable older Australians who have no like capacity to shift their retirement strategy or increase their income stream in the final years of their lives.

Labor’s announced Pensioner Guarantee does nothing to protect SMSF members, like me, who are self-sufficient and are not eligible for the Aged Pension. This reduces the incentive for people to save for retirement as I did, and in fact punishes me for saving in order not to rely on the Age Pension. It also creates an unequitable two-tiered approach for SMSFs; with an SMSF becoming less competitive, tax wise, than an Industry fund. This is unfair.

My wife and I have worked hard, paid considerable tax, and played by the rules. Now, your changes will result in a considerable loss to our comfortable, yet modest retirement income. We will lose \$6250 and I can’t see any practical way to replace it. To see your rhetoric about these changes being aimed “at the rich” offends me greatly.

I have spoken with a Financial Planner who tells me that if we withdrew capital from our fund and purchased a more expensive home and spent some of our capital that we would qualify for a part-pension and retain our franking credits. I find this advice personally offensive to my values. Interestingly I hear of a number of people I know planning on this strategy. It seems I would be cutting off my nose to spite my face if I do not follow. Albeit at a cost to the Australian taxpayer.

I am in your electorate and voted for you at the last election. Fremantle is a safe labor seat so my changing my vote will not have any effect. However at the next Federal Election for the first time I will be assiduously numbering my Senate Ballot paper and placing the labor candidates at the end. I’ve an email distribution list of 197 people within Australia with whom I share articles of interest. I’ll be putting out on that my proposed Senate voting strategy for 2019. I already know from conversations with friends that they plan to adopt this strategy. There will be a multiplier effect in all of this.

I wish you well in the coming by-election as I know that you’ve been an assiduous local member. I will not be casting my vote in your direction.

Reader response

Readers are advised that the 'sample letter' will not apply to their own circumstances, and that they should consider their own situation.

Vinay Kolhatkar is an Assistant Editor at Cuffelinks. Cuffelinks does not warrant the accuracy of all the material in the articles above.

Five actions to watch in management share buying

Robert Miller

There are many possible reasons to sell a stock, but a good reason to consider buying is when directors and management are investing their own cash into their company. Management alignment is core to the NAOS investment beliefs, backing people who are proven managers who are aligned with their shareholders. When managers are invested alongside fellow shareholders, they run their business for the benefit of all owners rather than their personal near-sighted financial gain.

Management and director buying activity is not to be confused with the issuance of 'free' shares as a form of compensation, but rather those instances where after-tax dollars are invested by these individuals.

What specific actions from management are we looking for?

1. Buying during earnings downgrades

A natural knee-jerk reaction to an earnings downgrade is often a sharp share price fall, followed by analysts pulling back their numbers as the underwhelming result is often assumed to be indicative of future performance. A downgrade can likely lead to not only a reduction in earnings but also a reduction of the multiple applied to a stock. Despite this, downgrades can present an opportunity if the cause of the downgrade is not systemic to the business operations. Whether it is timing related or a one-off, it is important to watch how company management reacts (or doesn't react).

An example in our investment universe is invoice financing business Scottish Pacific (ASX:SCO). SCO was an IPO borne out of private equity combining three businesses into one. After being listed for a few months, it downgraded earnings due to integration issues caused by having all three businesses under one new roof. Over four weeks during late 2016, every SCO director bought shares on market, some buying over \$1 million in multiple parcels. In particular, the CEO published four change of director's interest notices in three weeks. Since that time, a 60% total shareholder return has been generated over 18 months.

It pays to be careful where the opposite is true. If management and directors don't buy after downgrades, there could be more pain to come.

2. Acquisitions on market

It is commonplace for an acquisition to have a cash and equity portion, this can be a great way to foster alignment with the management team who have just sold their business and partially cashed out. A lot less common, but a very powerful statement, is when the acquired management team purchases stock in the parent company on market, in addition to the shares they received for their business. It shows faith when their business is wrapped into the new entity.

A recent example was Gentrack (ASX:GTK), a dual-listed utility and airports billing software company which acquired a competitor in the UK called Junifer Systems in March 2017. The Junifer Systems management team received a blend of cash and shares and stayed on to work within the larger GTK group. Within six months, the Junifer Systems Managing Director purchased circa \$2 million of GTK stock on market. That buying activity proved to be a positive signal for the realisation of revenue synergies, as the GTK share price has almost doubled.

3. Participation in rights issues

A heavily-discounted rights issue can be a sign of a company in trouble, but it could also be a chance to 'reset' the balance sheet or fund a big acquisition. If the market believes a company has a 'funding hole', a non-

renounceable (non-transferable) rights issue can help mitigate a general sell-off. A rights issue can also be a great barometer for a board and management team's long-term commitment to the business.

Take for instance TPG Telecom, a great Australian success story. TPG has two large management and director shareholders: CEO and Founder David Teoh and Robert Millner via conglomerate Washington H Soul Pattinson. During April 2017, in a \$400 million rights issue needed to enter the mobile market, these two pre-committed to take up their full pro-rata entitlements by investing a combined \$240 million of after-tax dollars into the business.

Other recent examples have come from founder- and family-led Australian success stories, Reliance Worldwide Corporation (ASX:RWC) and Reece Limited (ASX:REH).

All three of these businesses have delivered strong results, and the leaders are showing confidence that this will continue. Leaders who want to protect their equity position as they grow their businesses are the ones you want to back.

4. Continual buying

A cynical view on director buying is that sometimes it is done just for market optics. When a director with a minimal shareholding buys a nominal parcel, particularly after negative company news, we give this less weight than a director or manager who acts with conviction with meaningful buying.

We take notice of individuals with an existing large shareholding who are willing to buy more, especially when it is consistent and incremental. Nick Politis of AP Eagers Ltd (ASX:APE) is the master of this. In the ASX announcement records of APE, his change of director interest notices are consistent.

A small-cap business with similar traits is travel agency Helloworld Ltd (ASX:HLO). Managing Director Andrew Burnes and his Executive Director wife Cinzia Burnes own over 30% of issued capital. They do not partake in incentive programmes and pay themselves relatively modest salaries. The outcome is a pure focus on share price and dividend growth, and generating returns for shareholders.

5. Stepping up to the plate

A new CEO appointment is typically accompanied by an announcement to market with the remuneration package containing an incentive plan. It is rare for an incoming CEO or director to commit a substantial pool of capital at the time of appointment. When this does occur, what better sign than buying stock on market to ensure 'sweat equity'?

When appointed in August 2013, GUD Holdings Ltd (ASX:GUD) CEO Jonathan Ling purchased \$500,000 of stock on market within the available trading window post appointment. Five years on and his shareholding has continued to increase whilst a +160% total shareholder return has been generated.

As investors, we are buying into businesses rather than just stocks, and alignment with shareholders from the management and boards is critical. We buy into high-quality, proven management teams with 'skin in the game'. Some of the actions we have discussed here are too rare a sight on the ASX. We would implore more company principals to demonstrate their long-term commitment by adopting some of the above behaviours.

Robert Miller is a Portfolio Manager at [NAOS Asset Management](#), a specialist fund manager providing genuine, concentrated exposure to Australian listed industrial companies outside of the ASX 50, and a sponsor of Cuffelinks. This content has been prepared without taking account of the objectives, financial situation, or needs of any individual.

For more articles and papers from NAOS, please [click here](#).

Can you cover healthcare costs in retirement?

Olga Galacho

This article is the first in a series written by leading retirement website, YourLifeChoices. It reports on the major healthcare burden of many retirees and governments.

Every 1 April, retirees with private health insurance hear one piece of news that they wish really was an April Fool's Day joke – the announcement of a big increase in premiums.

In 2018, the hike was, on average, 3.9%, which, when grouped with medical services, was the biggest contributor to June quarter inflation. Australian Bureau of Statistics figures show that the Consumer Price Index (CPI) rose 0.4% in the quarter. The category that increased inflation the most was health, rising 1.9%.

Retirees want to keep private health insurance

Retired Australians are among the biggest group with private health insurance. In YourLifeChoices' *Retirement Income and Financial Literacy Survey 2018*, 71% of respondents said they had private health cover. While they said the rising cost of insurance was a major burden on their budgets, they were still anxious to retain their cover.

Older Australians are heavy users of the health system. Those aged 65 and older comprise just 14% of the population, according to the 2016 Census, but account for 28% of the 123 million claims for GP visits in 2014–15.

In addition, of the 12.5 million specialist visits claimed through Medicare in 2014–15, 43% were lodged by those aged 65 and over.

The Australian Council of Social Service (ACOSS) believes that affordable health and aged care are just as important in retirement as a decent income. ACOSS Senior Adviser Peter Davidson says:

"It's vital that we avoid a two-tier healthcare system – one for the top half of the population and another for the bottom half, of the kind that has long existed in the United States and still exists in dental care in Australia."

He says the challenge for governments is how to pay for the inevitable increases in the cost of existing healthcare programs given increasing longevity, while closing the worst gaps in services, such as dental and mental health services and the National Disability Insurance Scheme (NDIS).

"The Parliamentary Budget Office estimates that to maintain existing commitments in health, aged care and the NDIS, governments will need to spend an extra \$21 billion a year by 2027," he says.

Lower-income households cut back on health insurance

The Australia Institute Senior Economist Matt Grudnoff says that low-income households traditionally spend a larger proportion of their income on essential goods, but that this principle breaks down when it comes to healthcare. Healthcare can easily be regarded as a necessity, he says, but lower-income households view it as a non-essential category that they can cut back on because their budgets won't stretch that far. As a result, a greater burden is placed on those who can afford to pay.

Mr Grudnoff says that in the past 30 years, the CPI has doubled whereas healthcare costs are 3.7 times higher. He also warns of the dangers of a two-tiered system and questions the Government's strategy.

"In recent decades, Australia has reduced its emphasis on direct government spending on specialised healthcare and has increased indirect funding by subsidising private health insurance. It might be time for the Government to consider if it is getting a big enough benefit from this strategy or if the \$6.4 billion it will spend on subsidies to private health insurers next year might be better put directly into the healthcare system."

Aged Care Steps Director Louise Biti recommends that senior Australians consult a financial adviser to help them plan for the potential high cost of healthcare later in life. She says:

"Having adequate savings opens up your choices and your ability to control the level and type of care you receive. While we don't know what your future holds, with some planning, we can help make your retirement a comfortable one. For example, we could ensure you have a safe and secure income in place for life. This might be pension income, lifetime income streams or drawdown strategies from other investments."

Founder of MyLongevity.com.au, David Williams, says that while we can't predict how long we will live or what health issues may crop up later in life, it is possible to make informed calculations. He has developed a free tool called SHAPE, which analyses your personal factors, current health and daily habits to give an indication of your life expectancy. He says:

"There is no plan without a timeframe and the best timeframe is the one that you develop for yourself. You can then have a constructive conversation with your financial adviser, just as you will have had with your medical adviser. Understanding more about the chapters in your longevity is a step towards taking more control of your life and achieving a more fulfilling future."

Olga Galacho is a Writer with [YourLifeChoices](#), Australia's leading retirement website for over-55s. It delivers independent information and resources to 250,000 members across Australia.

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