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This Week's Top Articles

More please: FY2019 was almost everything up

Ashley Owen

The month of June 2019 capped off a rare half-year when all of the main types of investment posted higher returns than their long-term annual averages for a full year. Everything went up except cash and residential property.

A game of two halves

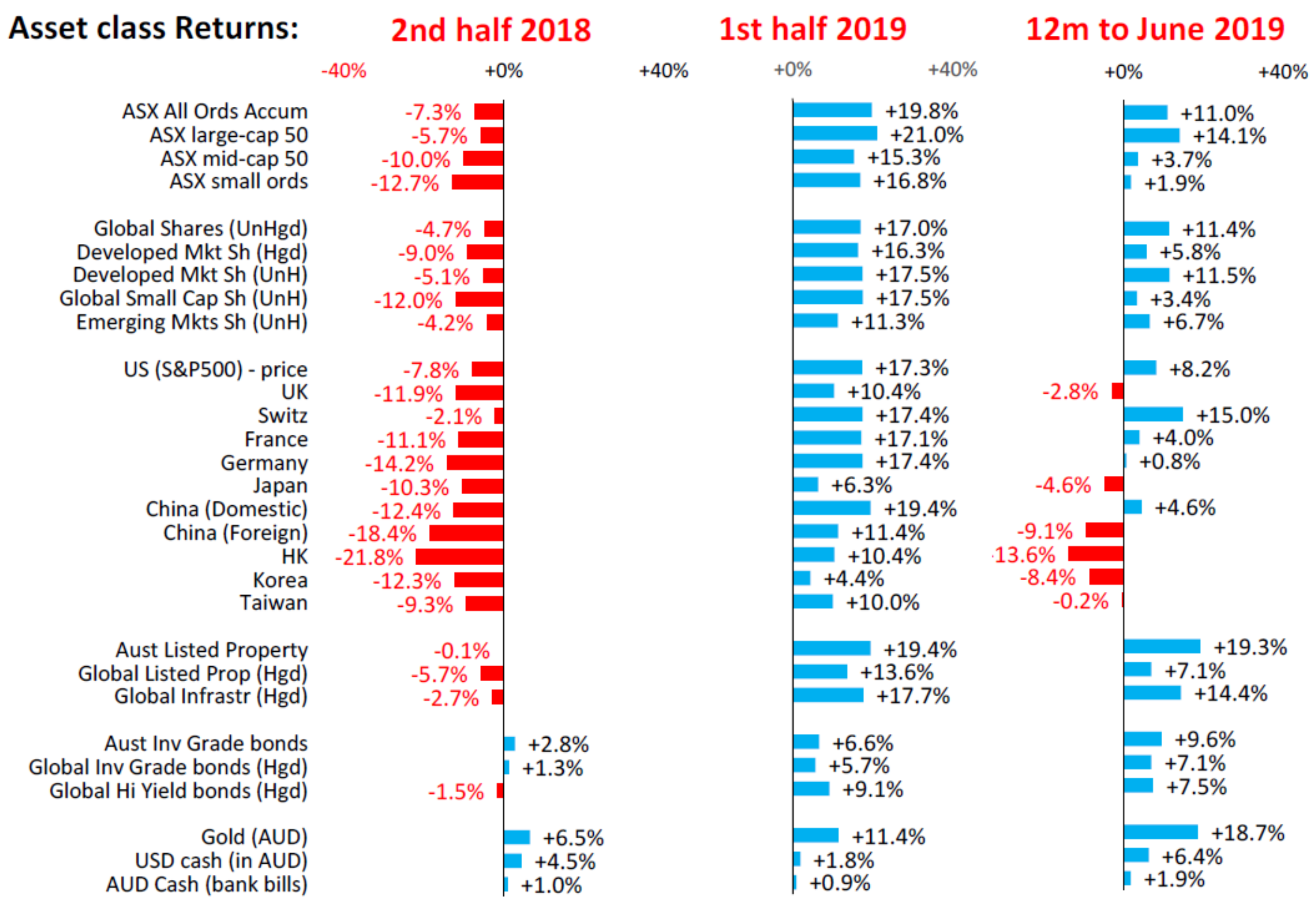
Although the overall returns for the 12 months turned out to be good, it was a 'game of two halves', with a sea of red ink in the first half and strong rebounds in the second half.

In fact, if an investor had been living on the moon or under a rock for a year, they would have returned delighted at the end of June. If they looked at their portfolio balances for the first time in a year, they would have said something like, "What a great year – everything must have been good in the world. I'll have another one of those, thanks!"

All they would see is the returns for the full 12 months, shown below in the right-hand set of bars in the chart. The broad Australian share market returned 11%, as did unhedged international shares. Bonds also returned better than their long-term averages: 9% for Australian bonds, and 7% for global bonds. Returns from the Australian listed property market were nearly double their long term average. And all with inflation so low at just 1.3% for the year.

Why such a difference?

In the first half (July to December 2018) share prices fell sharply in a global slowdown scare, driven by fears of Trump's trade wars slowing global growth rates, China's reluctance to stimulate its slowing economy, two more rate hikes from the US Fed, and fears the Fed would continue to raise rates despite early signs of a slowing US economy. Australian shares followed the global rout, although by not as much as the sharp -20% fall in the US market from late September to late December. It was the worst December for US shares since 1931. In the midst of this global panic, I fielded numerous calls and emails from worried investors asking if this was 'the next GFC' or even worse.



The first half of 2019 turned out to be a complete turnaround. The Fed stopped raising US interest rates and even started talking about possible rate cuts, the Bank of Japan and European Central Bank also talked up the prospect of providing more support, and China ramped up its stimulus efforts with spending increases, tax cuts and subsidies. In Australia, the RBA shifted its stance toward lower rates. Bank shares benefited from being let off lightly by the Hayne Royal Commission and the re-election of the Morrison government.

Some highlights among Australian stocks

Australian shares have beaten most other countries this year, driven largely by three broad themes:

1. Collapsing local and global bond yields
2. Hopes of a housing turnaround following the re-election of the Morrison government, the easing of APRA lending restrictions, and rate cuts from the RBA, and
3. One-off commodity price rises.

The collapse in bond yields helped utilities (mainly APA +36% this year, and Ausnet +26%), infrastructure (Transurban +30%, Atlas Arteria +27%), listed property trusts (mainly Mirvac +46%, Goodman +45%, Dexus +29%, Stockland +25%, but the retail trusts were very weak), and also Telstra (+36%).

Hopes of a rebound in housing has helped the banks, especially after the election. Shares in the Big Five are up 13-15% each.

Miners have done well despite the general global slide in most commodities prices with the global slowdown. Iron ore miners have benefited from rising iron ore prices caused by mine closures in Brazil (Fortescue +119%, BHP + 25%, RIO + 32%), and rising gold prices lifted the gold miners (led by Newcrest +47%). The mini-recovery in oil prices this year thanks largely to the escalating Trump/Iran conflict has also benefitted oil/gas stocks (Santos +29%, Woodside +16%).

Most global share markets have also been strong this year. The US tech giants have led the rebound: Apple +25%, Amazon +26%, Facebook +47%, Microsoft +32%, Netflix +37%, and even Uber has climbed back above its IPO price after a poor start. Only Alphabet (Google) has been flat this year (+4%).

Every other global sector, and every major country (apart from Japan +6%), has also returned more than 10% this year, which is more than their usual annual averages.

Bond prices and returns in Australia and around the world have benefited from the continued broad decline in bond yields across the board.

But there is a major disconnect here

The global collapse in bond yields reflects increasingly grave fears of slower growth and even possible recessions in Australia, US, Europe, Japan and many other countries, but share prices everywhere have been surging in anticipation of more sugar hits in the form of lower interest rates and more stimulus to try to arrest these slowdowns. These two are incompatible of course and cannot last for years.

We will no doubt have another 'global reflation' scare or two (like February and October 2018), and share prices are sure to correct once again as they are starting to run ahead of weakening profit growth rates.

Ashley Owen is Chief Investment Officer at advisory firm Stanford Brown and The Lunar Group. He is also a Director of Third Link Investment Managers, a fund that supports Australian charities. This article is for general information purposes only and does not consider the circumstances of any individual.

How 'bucket companies' work in family trusts

Jacob Carswell-Doherty

There is a common belief that family trusts have limited uses unless there are beneficiaries on lower rates of tax to distribute income to. In fact, some argue their purpose is lost.

This view is simplistic because there are other benefits of trusts beyond distributing to individuals on lower incomes. This article focusses on the use of 'bucket companies' in family trusts.

The use of bucket companies

A bucket company is a corporation and a beneficiary of a trust whose job it is hold on to distributions. In other words, it is a corporate beneficiary. The advantages of distributing trust income to corporate beneficiaries lie in the facts that:

(a) companies, as opposed to individuals, pay a flat rate of tax on income which is often less than the applicable individual tax rate, and

(b) whilst a trustee is compelled to distribute the income of the trust, thereby incurring a tax liability for those individuals who receive a distribution (at whatever rate), a corporate beneficiary can hold those distributions. If there are franking credits available, there might also not be a 'tax differential' to pay on those distributions.

There are tax rulings which require care when structuring these arrangements so as not to fall foul of the provisions of Division 7A of the *Income Tax Assessment Act 1936,* which deems certain payments to shareholders or their associates as dividends.

Please also note that this article considers trust income, rather than distributions of capital gains through trusts, which are taxed differently. Furthermore, the examples used here only apply to private company and not listed companies.

Prerequisites for a bucket company structure

Three preconditions must exist for a bucket company to function:

- There needs to be a trust with income to distribute.
- The trust deed of the trust must allow for corporations to be beneficiaries.
- The corporate beneficiary must fall within the definition 'beneficiary' under the trust deed.

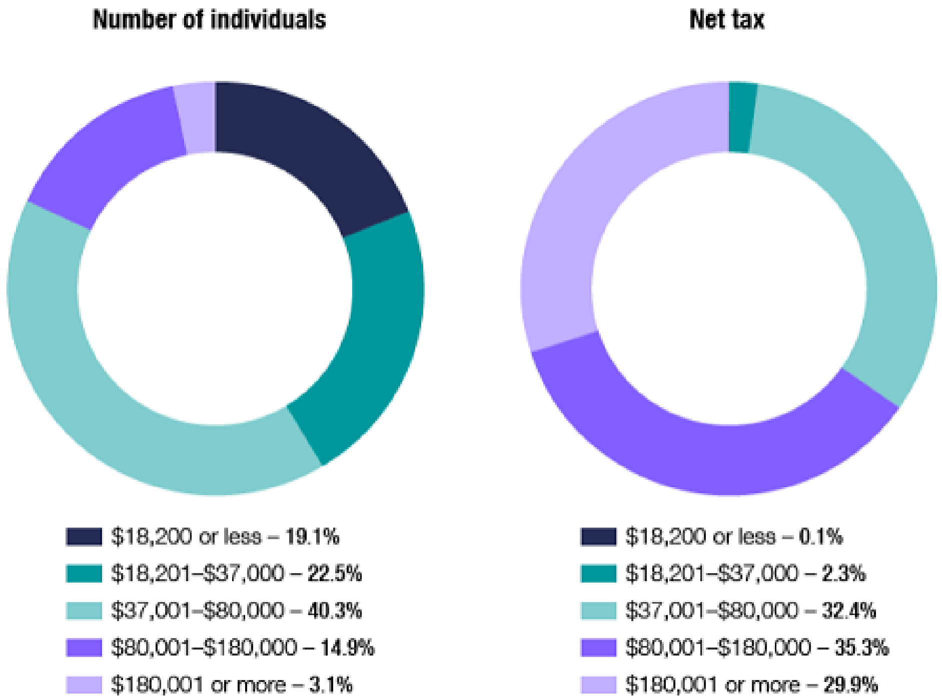
Taxing of trust income

The general principle is that the net income of a trust is taxed at the hands of the beneficiaries. Individuals and company beneficiaries pay tax on their portion of the trust's income at the rates that apply to them.

Currently, the highest marginal tax rate for individuals (not including the Medicare levy) is 45% for people with a taxable income of $180,000 or more. For companies, there is a flat tax rate of 27.5% (which is proposed to reduce to 25% by 2021-22).

So, all things being equal, the current difference between these two tax rates is 17.5%, and assuming individual tax rates remain unchanged, by 2021-22, the difference will increase to 20%. On the same income distribution, say $100,000, a corporate beneficiary would pay $20,000 less tax While corporations do not have a minimum threshold, as they pay a flat rate of tax, most individuals have a marginal tax rate over 30%. The 32.5% marginal tax rate kicks in at $37,000.

Number of individuals and net tax by tax bracket, 2016/2017 income year



Source: ATO Taxation Statistics

Corporations as beneficiaries

Beneficiary of a trust can be specifically named or they otherwise fall within the broader definition of being within a "class of beneficiary" under the trust deed. For instance, where a corporation is not specified as a beneficiary, a typical trust deed should have a definition creating beneficiary classes which includes corporations that are wholly or partly owned by individual beneficiaries.

For example, Joanna is a beneficiary named in a trust deed. Most trust deeds should include a clause which allows for distributions to a corporation that Joanna controls, even though that corporation is not specifically named in the trust deed.

What to do with the distributions in the company

Once it is established that the corporation may be classified as eligible for a distribution, it will receive the distribution and be liable to the ATO for the tax payable at the corporate tax rate.

As the distribution and (usually) cash now sits in the corporation, there arises a practical question about what to do with it. This depends on the strategy in place. For some, the purpose of a bucket company (having paid tax on it at a lower rate) is to hold the distribution until some point in the future when it can be distributed to individuals.

Another strategy involves loaning the cash. If the loan is to a related entity, a Division 7A-compliant loan arrangement is needed. Always be cautious when loaning funds from corporations to related entities because they can run foul of tax rules.

Consider this example: John has set up a trust to be the shareholder of his company. He also has a corporation he can nominate as a bucket company to be a beneficiary of this trust. John is on the highest marginal tax rate and has no one else who he can distribute to. The company declares fully franked dividends, and John uses the bucket company to take the distribution, and after that then loans that money to himself so he can purchase an asset. John would have to enter into a Division 7A loan arrangement with the company and repay the loan in accordance with those terms. The benefit here is that John can realise the benefit of the dividends (via the corporate beneficiary) without incurring the obligation to pay the highest marginal tax rate on those funds upfront. The tax obligation is spread over a longer term.

It may also be possible for the corporate beneficiary to deduct expenses from the income it receives from the trust. A possible scenario might be to distribute to a corporation that has carried over tax losses from previous financial years. The value in this alone could be considerable because, in the case of dormant companies with carried-over losses, it does not have to go back into trade to realise the benefit of those losses from a tax perspective.

Sometimes it makes commercial sense to move only the retained earnings out of a company. This is a 'balance sheet exercise' which involves moving profit out of a company without transferring cash right away. Examples include where the company has been using its profits to aggressively pay off debt. In these situations, the company will accumulate valuable franking credits and retained earnings and it can make sense in some circumstances to move these out of a company rather than leaving them there exposed to commercial and legal risk. The franking credits can be used up thereby creating a channel for the distribution of income in the future.

Approach with caution and professional advice

This article has summarised the potential benefits of using bucket companies such as:

- To take advantage of lower rates of tax paid by corporations.
- To hold retained earnings and franking credits until needed.
- To offset expenses and carried over losses incurred by corporate beneficiaries against distributions.
- To use loans to related (and unrelated) entities to purchase assets without paying upfront tax at the highest tax rates.

A note of caution and technical qualification.

Although the use of bucket companies in family trusts in particular is common, simply taking advantage of the lower rates of tax applicable to corporate beneficiaries is not without consequence or risk. For instance, the ATO considers that Division 7A may apply to an unpaid present entitlement of a corporate beneficiary where the trust and the beneficiary are related entities. This position is found in *TR 2010/3: Income tax: Division 7A loans: trust entitlements*, which is not without its critics. Practice Statement PS LA 2010/4 sets out the procedure and requirements for the establishment of a sub-trust to take advantage of exemptions from Division 7A.

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Insane prices as private equity quits market

Roger Montgomery

Recently, sitting at lunch among reputable, intelligent and enormously-successful fund managers, there was one thing we all agreed on. Prices for many listed and unlisted companies have reached insane levels.

I listed the worst offenders:

- Wisetech, on the same market cap as Qantas of $8.5 billion but earning 2% of Qantas's revenue.
- At 60 times earnings, Appen must have the smartest AI shareholders in the world because Appen's US-based and private equity-owned competitor, Lionbridge, wants to list here too.

- The printed circuit board (PCB) software designer, Altium, is on a PE of 57 times, putting it on the same market cap as JB Hi-Fi, Metcash or Air New Zealand. But while the latter three each earn revenue of between $4 billion and $14 billion, Altium earns $177 million.

- After 12 years of operations, Xero has finally achieved cashflow break-even. In 2021 it is expected to earn a little over $20 million in profit too. It just has to be worth over $8.5 billion or 370 times forecast profits!

This will end badly, but when?

At that table, a lot of fundie experience with stock market corrections agreed that this ends badly. What we could not agree on, however, was how it ends, nor when.

But perhaps that latter question has an answer and in this article I'll highlight a possible stumbling block for a continuation of heady valuations of profitless tech companies.

The calendar year 2019 is shaping up to be the busiest for new tech stock listings since 2000. I was working at Merrill Lynch in 1999 when analysts were concocting new ratios to justify billion dollar market valuations for companies (nay 'projects') with no revenue. Analysts told investors that the ability of these companies to transform e-commerce, for example, meant that almost 'any price' should be paid to acquire a piece of the action.

So far this year, 25 tech companies have IPO'd in the US raising US$19 billion. At the time of writing, the average gain on listing has been 34% according to Dealogic. The picture was a little different in 1999, when the first day gain for IPOs on the Nasdaq was closer to 90%. Perhaps conditions aren't as crazy now.

But does that really matter? That would be like suggesting one patient in the asylum is slightly less insane than another. Neither of them should fly a passenger jet nor should they be put near an equity portfolio.

Most new listings are questionable quality

Of the 25 companies that have IPO'd this year, less than half can be classed as 'major tech companies'. They are: Beyond Meat, which is up over 500% since listing, Zoom Video (+170%), PagerDuty (+120%), CrowdStrike (+110%), Pinterest (+45%), Chewy (+47%), Fiverr (+30%), Slack (+27%), Fastly (+10%) and Uber and Lyft (both negative).

Share price performance, however, doesn't really matter. It cannot tell you what will happen next.

Aneet Chachra, is a Portfolio Manager at Janus Henderson Group. Chachra studied the history of 220 US technology IPOs from January 1, 2010 to March 31, 2018, focussing only on those with a 12-month trading history. Chachra observed:

"Statistically, if you can get into a tech IPO at the deal price, you are going to do well."

Presumably he was referring to the final funding round deal price before IPO. Pitchbook's 2018 study reaches a similar conclusion. Pre-IPO investors do better from the IPO 'step-up' than investors who buy on the first day of public trading.

This makes sense. PE investors will want to price their IPO so that all existing shareholders make money at the time of listing, and they will time the IPO to give their investors the best chance of achieving that outcome. In a 10-year bull market fueled by historically low rates that caused investors to spurn cash and migrate to anything and everything that might go up, including private equity, the study's findings should not be surprising.

Two glaring issues for investors

The **first** is that if 10 years of declining interest rates has encouraged or forced high-net-worth and ultra-high-net worth investors to buy private equity and invest pre-IPO, who will be left to buy these stocks after they list?

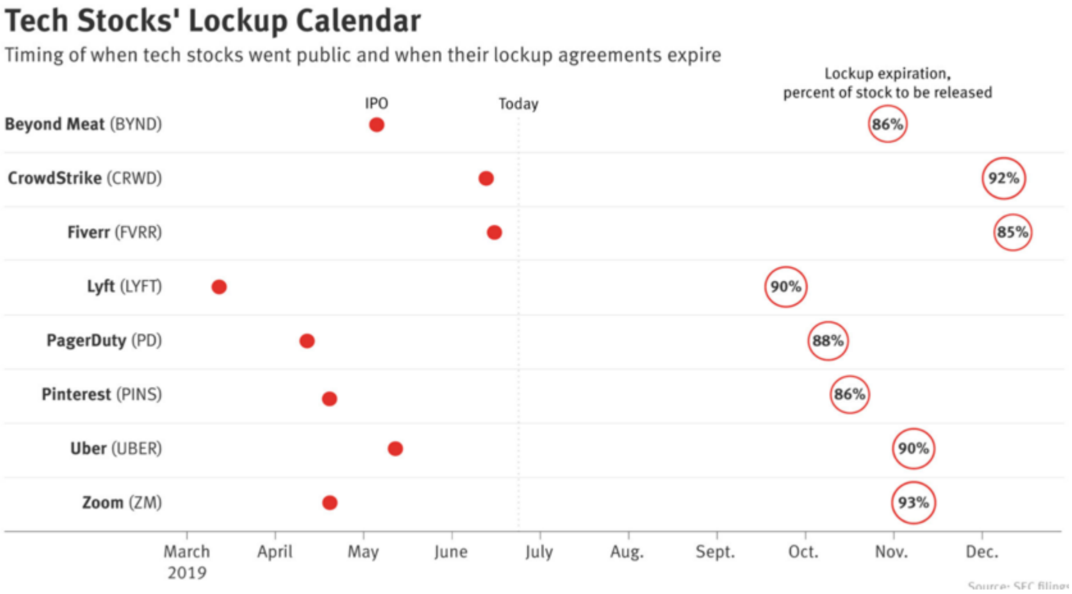
Chachra's and Pitchbook's findings may reflect the fact that the exponential growth in the number of private equity firms globally since 2009 has attracted most of the money of high-net-worth investors leaving only 'Mom & Pop' investors to pick up the scraps.

Second, of the largest tech stocks that have listed this year, only 10% to 15% of their scrip has been available to trade. A 180-day lock up (escrow) period for founders and backers means 85-90% of scrip is still waiting to be sold.

This overhang could easily become selling pressure if PE investors who have been locked in for a decade, such as with Uber, decide they want out. It's the marginal seller that determines the price for everyone. If the Uber investors who bought in 2010 at much lower prices decide they want to sell, their trading will impact the market capitalisation for everyone.

And this transmission mechanism is perhaps another explanation for the poor post-IPO performance of the average tech float.

Beyond Meat will see an additional 86% of its scrip released for possible sale in November 2019. CrowdStrike will see 92% of its scrip released in December, Fiverr (85% in December), Lyft (90% September), PagerDuty (88% October), Pinterest (86% October), Uber (90% November) and Zoom (93% November). And a record number of IPOs this year will ensure the pressure doesn't let up until next year.



Tech IPO investors in Australia won't be immune from the impact of the 2019 US private equity exit.

Roger Montgomery is Chairman and Chief Investment Officer at [Montgomery Investment Management](). This article is for general information only and does not consider the circumstances of any individual.

Picking the winners, avoiding the losers

Dawn Kanelleas

There are many high-quality small companies operating across all areas of the Australian economy. Some of these companies will one day grow into large, mature businesses.

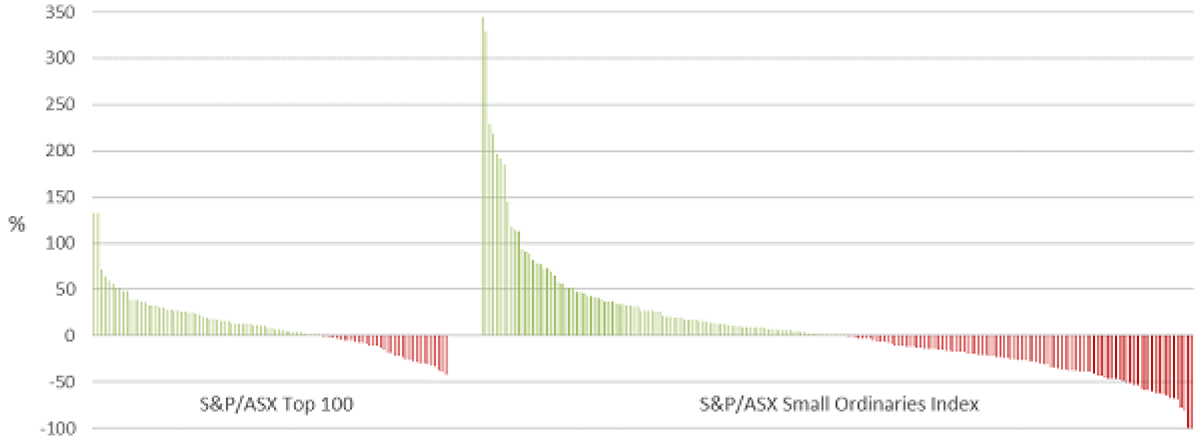
Identifying these stocks at the beginning of their journey provides investors with the potential for significant capital growth along the way. As small companies flourish, revenue and earnings growth are typically expanding at their fastest point in the company's lifecycle. It is growth that larger, more mature companies would find difficult to replicate.

On the flip side there are, of course, many poor-quality companies in the S&P/ASX Small Ordinaries index. Some will spend years floundering, or fall victim to unfavourable market conditions or poor management decisions. Investing in these companies can result in significant (or total) capital loss.

Therefore, especially in small caps, the key is picking the winners and avoiding the losers.

Dispersion and amplification of returns

One-year share price performance – S&P/ASX 100 Index vs S&P/ASX Small Ordinaries Index

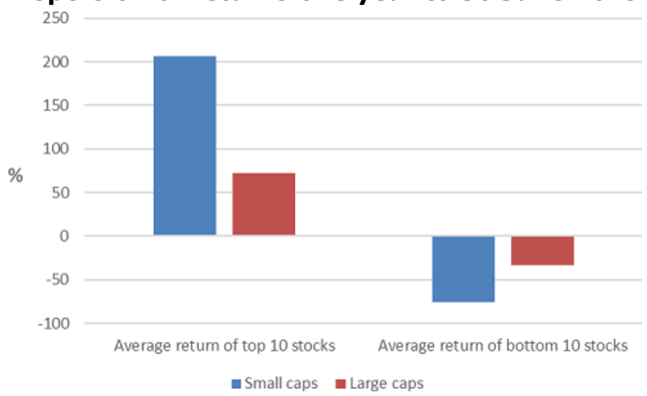


Company total returns of index constituents for 30 June 2018 to 30 June 2019 shown. Source: Bloomberg, 12 months ending 30 June 2019.

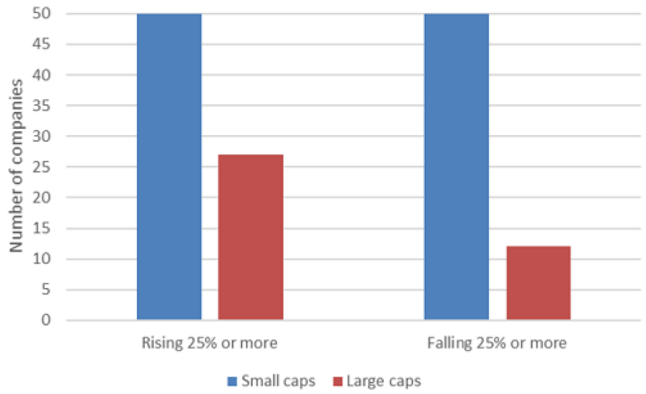
The chart above shows the one-year returns of companies in the S&P/ASX100 Index and the S&P/ASX Small Ordinaries Index. Return dispersion and amplification in the small caps universe is higher than in the large caps universe. Note the number of small company stocks which performed extremely well and the number that performed extremely poorly.

Out of 200 stocks in the S&P/ASX Small Ordinaries Index, 50 stocks – or one in four – lost 25% or more, including two that went into liquidation. In contrast, only 12 stocks in the S&P/ASX 100 lost 25% or more over the course of the year.

Dispersion of returns one year to 30 June 2019



Amplification of returns one year to 30 June 2019



Source Bloomberg, CFSGAM. At 30 June 2019. Small caps is S&P/ASX Small Ordinaries index. Large caps is S&P/ASX 100 index.

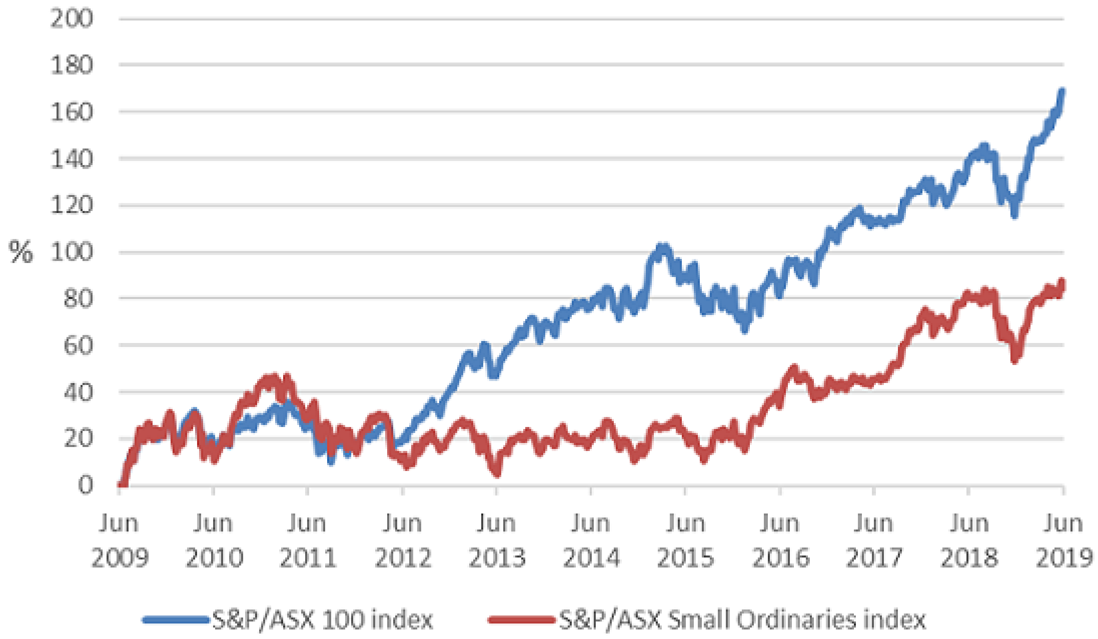
The amplification and dispersion of returns underlines the critical importance of careful stock selection in small cap investing and the importance of focusing on downside risk.

Given the inherent risks in individual stock selection, why not diversify and mitigate this risk by simply owning the index?

The importance of being active

In addition to the wide divergence of returns, history shows that the larger cap S&P/ASX 100 index regularly outperforms the S&P/ASX Small Ordinaries index and with less volatility. The chart below shows how the small cap index has underperformed the large cap counterpart in the last decade.

S&P/ASX Small Ordinaries Index returns vs S&P/ASX 100 Index returns, 10 years to 30 June 2019



Source Bloomberg, CFSGAM. Cumulative total returns 30 June 2009 to 30 June 2019.

In the S&P/ASX Small Ordinaries index, the negative returns from numerous low-quality companies often erode the value created from more successful businesses. Attempts to mitigate risk by diversifying across the index, for example, via passive investments or low active share, are often not the optimal strategy for investors with regards to the risk/reward outcome.

However, the comparison of returns from the S&P/ASX 100 index and S&P/ASX Small Ordinaries index is too simplistic. The index returns ignore the impact of 'alpha generation' that active managers can produce, which can be particularly significant in small caps.

Most stocks in the large cap S&P/ASX 100 index are extensively researched by the professional investment community. They are mostly well known, mature companies with a large shareholder base. Investors like to hold large, mature companies because they are generally considered more predictable and less risky than their small cap counterparts.

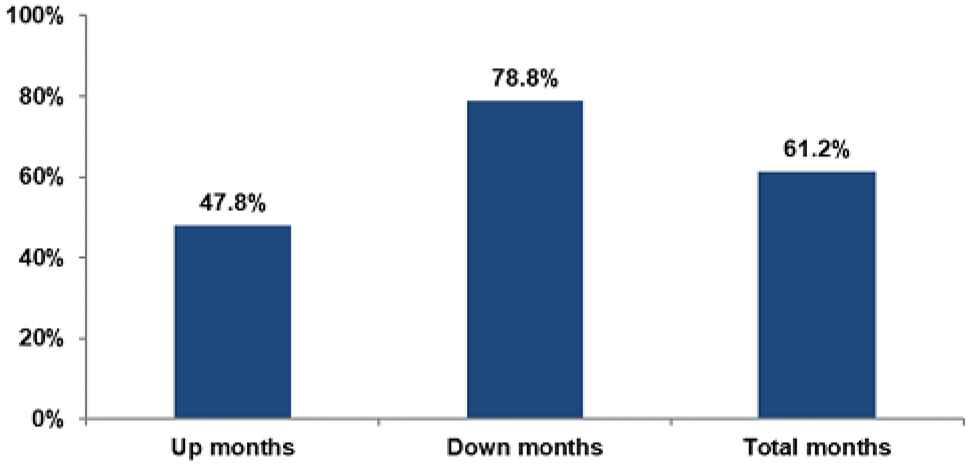
In contrast, small companies tend to be less well researched and understood. This provides the opportunity for skilled small cap managers to identify companies that have the potential to be future leaders, and companies that have the propensity to fail. By picking the winners and avoiding the losers, there is potential for significant alpha generation.

Capital preservation is key

To help avoid the losers, small company fund managers should have a strong focus on downside risk and be invested in a concentrated group of quality stocks, which collectively have a better return profile than the index. In aggregate, a risk-aware small cap fund is likely to have a larger allocation towards investments that have a clearly-defined, articulated investment strategy, supported by a strong capital position and a proven and capable management team. The long-term outcome of such strategies is typically a strong return on capital and free cash flow generation.

To show what is possible in this space, the chart below shows the percentage of months the CFS Wholesale Small Companies Fund has performed in rising markets, falling markets, and all markets over a period of 10 years.

Active asset selection, percentage of months outperforming (net)



Source: CFSGAM. The chart shows the percentage of months the CFS Wholesale Small Companies Fund has outperformed its benchmark (S&P/ASX Small Ordinaries Index). Net returns shown after fees and taxes, between 30 June 2009 to 30 June 2019. Past performance is not an indication of future performance.

The chart shows the Fund is more likely to outperform in down months (78.8% of the time over 10 years), due to the resilience of higher-quality companies during falling markets. It also demonstrates a propensity to avoid the biggest losers when times are bad.

During rising markets, the Fund outperforms less frequently. It does not chase returns or invest in the 'next big thing'. Performance over multiple investment market cycles has proven the effectiveness of a focus on quality to pick the winners and avoid the losers.

Dawn Kanelleas is Senior Portfolio Manager, Australian Equities Small Companies, at Colonial First State Global Asset Management, a sponsor of Cuffelinks. This article is for educational purposes and is not a substitute for tailored financial advice.

For more articles and papers from CFSGAM, please click here.

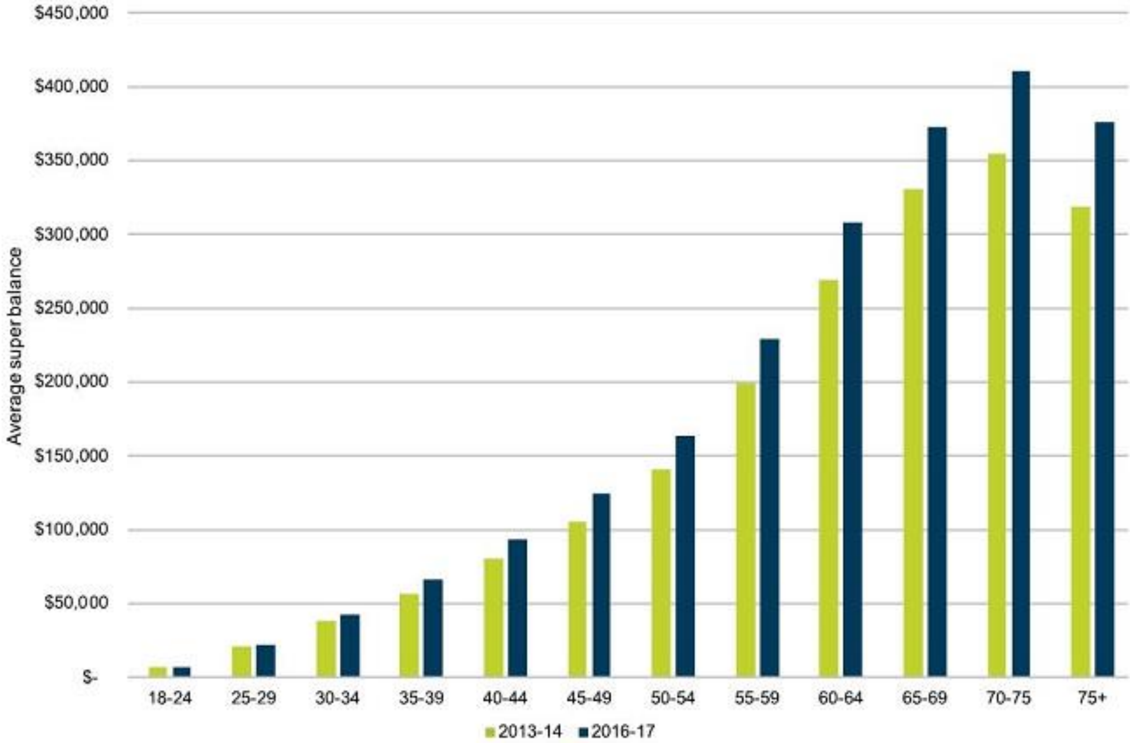
Super is delivering for people about to retire

Jeremy Cooper

Contrary to many opinions, super is reducing reliance on the age pension for the large majority of people entering retirement. At the end of December 2018, only 45% of 66-year-olds were accessing the age pension, and only 25% of 66-year-olds were drawing a full age pension.

The average consolidated super balance for Australians aged 60-64 (i.e. those approaching retirement) is now over $300,000. This is far from where the super system peaks, as average balances continue to rise across all age groups as the system matures.

Average consolidated super account balance, by age



Source: Taxation statistics, ATO

The success of super is widespread

The average retirement phase member balance across all large APRA funds at June 2018 was $281,253. These are not consolidated balances, but it is far less likely for a member to have multiple account-based pensions than it is to have multiple accounts in the accumulation phase.

This figure is an average of balances spread across all age cohorts in retirement and will include older retirees who have either spent the bulk of their super or never had much in the first place (only one in five people aged over 75 has a super balance).

Super balances at the household level

Most people enter retirement as a couple, so considering the combined super balances of a couple household in the 60-64 age group is a better measure of how well people are financially prepared for retirement.

The majority of people in the 60-64 age group are part of a couple. The combined super balance of a couple-household will be higher than the average male balance in this age group of $336,360. The average female balance is $278,000, but simply adding these averages together would be misrepresenting the likely true picture. Broken work patterns and part-time work need to be factored in.

This means that a typical couple-household will probably be starting retirement today with more than $400,000 in super.

Who is getting the age pension?

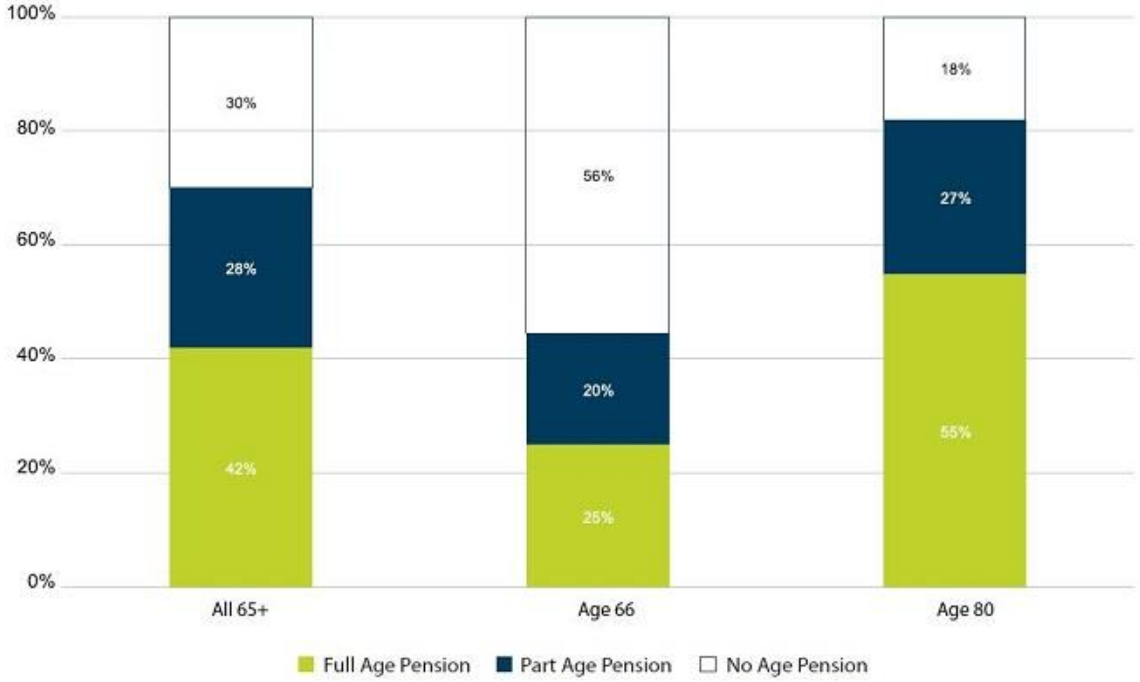
These averages are significant in that they are all above the lower threshold for the age pension assets test of $258,500. This means that the average member in the retirement phase does not get the full age pension.

In 2018, only 42% of age-eligible retirees were on the full age pension. This is an overall average and includes retirees in their 90s who have never had super.

Recent retirees are much less likely to be on the full age pension, with the typical super balance at retirement for a household over $400,000, and most owning their own home. As stated above, Department of Social Services (DSS) data reveal that the majority of new retirees are not accessing any age pension and only 25% of 66-year-olds were accessing a full age pension.

The apparent success of super in building savings at retirement means most people can expect to spend longer in retirement before they receive any age pension.

Age pension access at selected ages, as at December 2018



Source: Calculations based on ABS and supplied DSS data.

Retirees will need access to secure and reliable income

The next phase for large APRA funds will be to make it easier for their members to convert an appropriate part of their super into secure, lifetime income to compensate for their delayed and reduced access to the age pension.

Jeremy Cooper is Chairman, Retirement Income, at [Challenger](). The full research report by Challenger can be accessed [here]().

Why has gold moved beyond $2000/oz?

Jordan Eliseo

In more than 20 years in financial markets, we have never seen an asset class divide opinion quite like gold does. Some investors think it's the ultimate form of money and safe-haven asset, while others see it as a barbarous relic of a bygone era.

Irrespective of how one personally views gold, there should be no doubt that the recent rally beyond US$1,400 per ounce and A$2,000 per ounce has reignited interest in gold.

This article touches on the reasons behind the latest move in the yellow metal, as well as its characteristics as an investment and the key benefits it can bring to a portfolio.

Why the recent rally?

The gold price has risen by over US$100 per ounce and A$200 per ounce since late April 2019, driven by a number of factors which include:

- A plunge in global bond yields, with the market value of debt trading with a negative yield currently sitting at approximately US$12 trillion.
- Expectations of monetary easing by the US Federal Reserve, possibly as early as July 2019.
- Escalating geopolitical tensions in the Middle East.
- Continued concerns regarding a US-China trade-war.

Australian dollar investors have also received a boost from the declining local currency, with the cash rate now down to an unprecedented 1% after two recent rate cuts.

Gold as an investment

To help understand gold and look at the role it can play in your portfolio, it first helps to characterise what kind of investment it is.

To that end, we broadly agree with the comment from John Pearce of UniSuper, who was quoted recently in Cuffelinks, saying he thought *"of gold as a currency".*

What are the characteristics of this currency?

- It is highly liquid: Turnover in the gold market is typically in excess of US$100 billion per day.
- It is easily accessible: Gold can be bought from as little as $50 per investment through The Perth Mint depository, while listed products, such as our ASX-listed PMGOLD, allow investors to buy and sell gold via their stockbroking account.
- Central banks still use it: Central banks own more than 30,000 tonnes of gold as part of their foreign exchange reserves. In 2018, they added over 600 tonnes to their holdings, the fastest pace of gold accumulation since the late 1960s.
- It has no credit risk: Unlike most investments, there is no liability attached to gold. Gold is purely an asset.
- Gold can be volatile: Like equities, the price of gold can be volatile on a short-term basis.
- It has delivered strong-long term returns: Despite the lack of income, the price of gold has risen by approximately 9% per annum over the last 48 years.

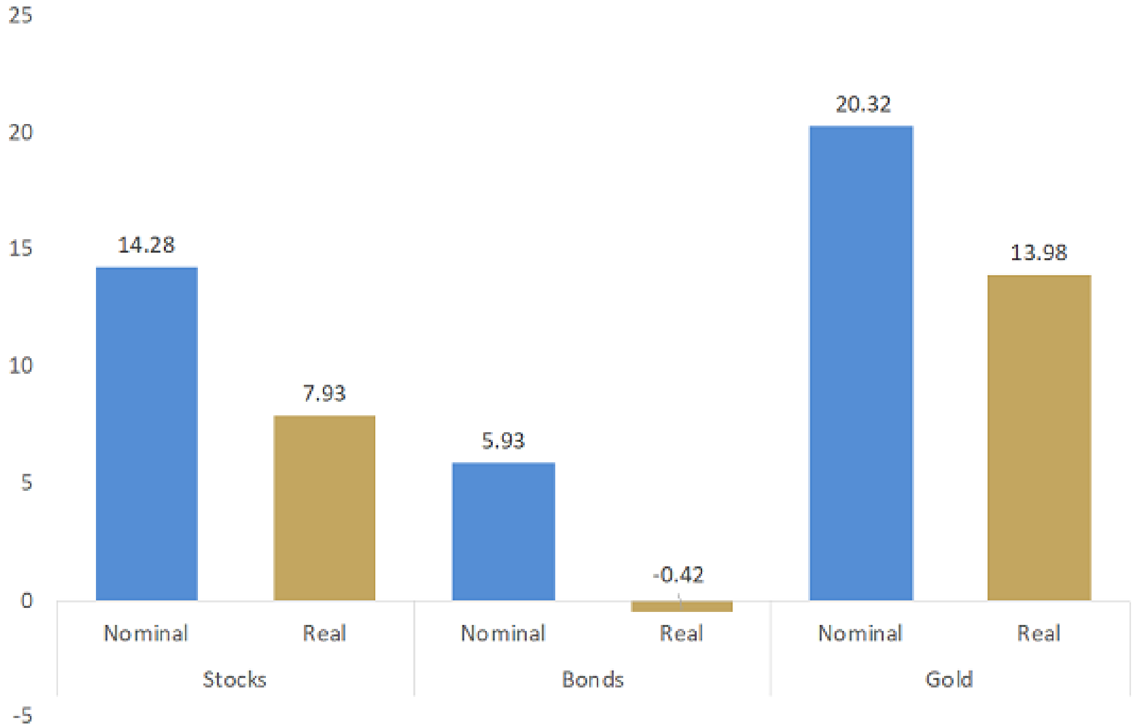
Key benefits for investors

Consider two benefits gold can bring to a self-directed investor's portfolio.

First, gold tends to be the best-performing asset class in years when real cash interest rates, which factor in inflation, are low. This is highly relevant today, not only because markets expect that the RBA will cut the cash rate to just 0.75% in the next year, but also because Australian 10-year government bonds currently yield just 1.30%.

The chart below covers 1971 to 2019 inclusive and shows the average nominal and real return for Australian stocks, Australians bonds and gold during years where real cash interest rates were below 2%.

Australian asset class returns when real cash interest rates were below 2%



Source: The Perth Mint, Australian Bureau of Statistics

Gold performs well during periods when real cash interest rates are low for two key reasons:

1. Low or even negative real cash interest rates are typically only implemented as a form of monetary stimulus when the economy is weak or softening. In such environments, it's natural that investors adopt a more defensive approach by seeking out safe haven assets such as gold.

2. If the real interest rate from cash or short-term bonds is low, or even negative, then the opportunity cost of investing in gold is significantly reduced.

Second, gold can be a hedge against severe declines in equity markets.

This was made clear in a 2015 paper titled "*Good Strategies for Tough Times*", published by AQR. The paper looked at the 10 worst calendar quarters for global equity markets, with the results for various asset classes and strategies seen in the table below.

Asset class returns when global equities suffer their largest quarterly falls

Global Equities	Global Fixed Income	Hedge Funds	Global 60/40 Fund	Gold (USD)
-19.10%	3.90%	-5.90%	-10.30%	4.20%

Source: AQR Capital Management, Good strategies for tough times, Q3 2015

The table below looks at the same 10 calendar quarters AQR studied, and shows the average returns for Australian equities, Australian bonds and gold priced in Australian dollars.

Australian asset class returns when global equities suffer their largest quarterly falls

Australian Equities	Australian Cash	Australian Bonds	Gold (AUD)
-12.17%	1.72%	5.94%	9.07%

Source: The Perth Mint

In the five worst calendar years for Australian equities since the early 1970s, the gold price recorded an average annual increase of almost 40%.

Gold on the radar

The key takeaway is that while gold is not guaranteed to rise in price every time markets fall, since the 1970s, no other single asset class has outperformed gold during the most significant equity market declines.

Given the current economic, monetary and market environment, we think these attributes should put gold on the radar for investors focused on wealth preservation.

Jordan Eliseo is a Senior Investment Manager at [The Perth Mint](). The information in this article is for general information only and should not be taken as constituting professional advice from The Perth Mint. The Perth Mint is not a financial adviser. You should consider seeking independent financial advice to check how the information in this article relates to your unique circumstances.

Preparation for PAYG employees at tax time

Mardi Heinrich

It's time to get your tax return sorted and crucially to ensure you pay the right amount of tax.

The first question is whether you do your own return or not. Where a taxpayer lodges their tax return via a tax agent, an extension of time to lodge and pay may be available. This though is only the case if your previous returns are all in order. No time extension will be given if there are outstanding prior year returns.

Ordinarily, taxpayers are required to lodge their tax returns by 31 October following the 30 June year end, so PAYG employees should consider whether a lodgement extension is desirable in their particular circumstances.

The deferred lodgement due dates available for clients of tax agents are:

- 31 March 2020 if the taxpayer's last lodged tax return resulted in a tax liability of $20,000 or more; or
- 15 May 2020.

Not only do you gain more time, but crucially professional expertise. Qualified tax agents have experience in dealing with the ATO. As outlined in the ATO's Compliance Programme, they are aware of the audit focus areas. Tax agents are also aware of any current ATO questionnaires or notices and ATO data matching activity, and the impact that these have on the taxpayer. All taxpayers should seriously consider whether going it alone is a false economy.

But for those who have reasonably straightforward tax affairs and choose to do their own tax return, what are the main points that you need to be aware of?

Firstly, don't be late!

Missing that 31 October deadline can give rise to late lodgement penalties. The second key item to note is the tax payment due date is three weeks after lodgement, i.e. 21 November 2019. Paying your tax liability late is likely to give rise to interest charges being imposed by the ATO.

Most taxpayers lodge their tax return online via myTax by linking a myGov account with the ATO. It is not mandatory but it can help streamline the process. If you are expecting a tax refund, lodging online should expedite receiving the money. The ATO usually issues tax refunds within 12 business days where the tax return is lodged online, or 50 business days where a paper return is lodged.

A change to note this year is that many employers will have reported through Single Touch Payroll (STP), which refers to direct payroll reporting to the ATO on a real-time basis. If your employer reported through STP in the 2018/19 tax year, you will not receive a PAYG payment summary. Instead, this information will be included in an employment income statement that should be readily available for you to access via your myGov account after 15 August 2019 once your employer has finalised their STP report for the year.

How can PAYG employees maximise the amount they get back in tax?

First, you no longer need to 'salary sacrifice' super contributions in order to reap tax savings. From 1 July 2017, all individuals under 75 years (including those aged 65 to 74 years who meet the work test) are eligible to claim a tax deduction for personal super contributions made into an eligible super fund. In order to claim a deduction, taxpayers need to provide their super fund with a 'notice of intent to claim' on or before the day the 2019 tax return is lodged or 30 June 2020, whichever is earlier. Trap: taxpayers should observe the concessional contributions cap (currently $25,000) and limit their deductible contributions to the cap amount if they want to avoid paying excess concessional contributions tax.

Second, make a payment of interest in advance on your investment portfolio. You need to ensure you don't breach pre-payment rules, so payment of interest before 30 June 2019 would need to be for interest relating to the period prior to 30 June 2020.

Third, if you have a rental property, claim appropriate capital works and capital allowances (depreciation) deductions. Be aware that the rules changed from 1 July 2017. Capital allowance deductions can generally no longer be claimed for previously used plant and equipment (second hand assets) acquired after 9 May 2017, or second hand assets acquired before 1 July 2017 but not used to earn income in the year ended 30 June 2017. Investors who purchase *new* plant and equipment will continue to be able to claim depreciation expenses on these assets. Tip: engage a quantity surveyor to make an assessment and prepare a depreciation report to outline amounts to be claimed in your tax return each year. The cost of having a depreciation report prepared is also deductible.

Fourth, review un-reimbursed work-related expenses to determine the extent to which they are deductible and ensure you have retained sufficient substantiation. For example, if an employee uses their vehicle for work-related purposes then, at a minimum, they should record the kilometres travelled for work-related purposes. Trap: it is important to note that home to work travel is considered to be private travel and not work-related travel.

Fifth, ensure you have picked up all donations made during the year to deductible gift recipients. Taxpayers may make donations over the course of the year but often forget to claim them because they forget to keep a record. With increased use of electronic receipting via email, the ability to locate the receipts in the digital world has become easier.

Sixth, ensure you have adequate private hospital insurance coverage with an Australian registered health fund so that you are not liable for the Medicare Levy Surcharge (MLS). Having 'extras' or 'ancillary' cover only will not be sufficient. At present, the MLS will apply where a taxpayer's 'income for surcharge purposes' is above $90,000 (singles) or $180,000 (families). Tip: it is now optional for your health insurer to send to you a private health insurance statement, so you may need to request a statement from your health insurer to complete your tax return if one is not automatically provided.

So, start collating all your information. Back up that digital file if you keep everything on your computer or bring out the shoe box. It's never too early to be prepared.

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The next generation and investment bonds

Catherine Van Der Veen

Australian parents and grandparents are overwhelmingly concerned for the next generation's financial future, with 96% fearing their children and grandchildren either will not be financially secure, able to afford a property or secure a good education in the years ahead.

Generation Life's *Saving for the Next Generation* report surveyed over 1,000 grandparents and parents and found that over half of respondents worry their grandchildren and children won't be able to afford to buy a property or live comfortably (52%) when they reach adulthood. Parents are also concerned a good education is unaffordable for their children, a concern shared by grandparents.

Despite considering the financial well-being of the next generation a top priority, more than half of parents (53%) are not currently saving to support their children financially and two-thirds wished they had started earlier (10 years on average).

Only 15% of grandparents admitted they are saving for their grandchildren's future, with half believing they should have started at least 12 years earlier.

A child's financial future is a broader family effort

There has been a structural shift over the last 20 years. The price of housing and education has accelerated so much that the average family has to consider how they will assist their children with these two large and expensive milestones. The median cost of a house in Sydney and Melbourne has gone past the million-dollar mark and a private school education can come close to half a million dollars.

Most parents are concerned they are not saving enough for their children's future. Mothers are more likely to save for their children's higher education or school fees, while fathers are more likely to save to transfer wealth. Nearly all respondents revealed that they want to pass on good financial knowledge to their kids as they believed they had a sound level of financial understanding.

Of the respondents that are currently saving for a child's financial future, the majority of grandparents and parents are using cash and term deposits, followed by managed funds and property investments.

Deposit accounts are well understood, they are widely available and they are visible, next to people's everyday financials. They are also simple. People generally use deposit accounts in two ways: they set up an account in their child's name, or they set up a separate account in their own name and 'ring-fence' it for future spending.

Allowing time for investment bonds to work

When thinking about securing your child or grandchild's financial future, including big purchases such as houses or education, you have time for investment returns to work hard. That's where investment bonds can assist. They provide a wide range of investment options, with the advantage of a 30% tax rate for those on higher personal marginal tax rates. These benefits, compounded over time, can make thousands of dollars of difference.

Investment bonds have been around for almost 40 years. They were a more popular long-term savings vehicle until superannuation was introduced. However, investment bonds avoid the constant changes to superannuation that frustrate savers, with liquid and flexible alternatives and potential tax efficiencies.

Investment bonds can help in saving for retirement as there are no restrictions such as contribution caps, age limits or 'work tests'. You can also access your funds before retirement age, with no restriction on how much you can access.

Three tips for parents and grandparents to save for the next generation are:

1. **Start now.** Saving early is the best way to harness the benefits of compounding. Starting small and saving regularly can turn $100 a week into more than $50,000 over 18 years. It's best to save in a fund that provides good long-term returns in a tax-effective environment with low fees.

2. **Share your knowledge.** Talking about saving with your children and grandchildren is a great way to educate them with good money habits that last a lifetime. Allow them to participate in family budgeting and spending. When they start earning their own income, use it as an opportunity to help them save and invest for themselves, choosing products that are suited to their needs.

3. **Invest in growth assets**. With house prices and school fees rising faster than inflation, savings must keep pace. Investing in growth assets like shares and property are a better choice than cash over time. For example, a balanced index fund through an investment bond is a good way to set and forget, keeping fees low.

Catherine van der Veen is CEO of Generation Life, a leading provider of investment bonds. This article is for general information only and does not consider the circumstances of any investor.