Firstlinks
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Contents

How much should you spend in retirement?

Graham Hand

The Australian superannuation system ensures most people retire with an account-based pension, either instead of or supplemental to the age pension. The superannuation guarantee started in 1992, and most workers will accumulate some retirement savings by the time they reach the age of 65. A superannuation pension is an attractive investment vehicle because earnings and withdrawals are tax free. People who have accumulated savings over their lifetime will hopefully accumulate enough in super to enjoy a reasonable standard of living in retirement.

Assuming a person has achieved a so-called 'Condition of Release', which generally means achieving the age of 65 (or 60 and ceasing an employment arrangement), they can move super from the accumulation phase of their working years to the pension phase of their retirement. They are then required to withdraw a minimum amount each year, depending on their age, as shown below (source: ASIC's MoneySmart website).

Age	Annual payment as a % of account balance
55-64	4%
65-74	5%
75-79	6%
80-84	7%
85-89	9%
90-94	11%
95+	14%

How much is needed for a comfortable retirement?

The obvious issue is whether taking this much out of a pension account each year means a retiree might run out of money in the account. Of course, superannuation is not the only source of wealth, and usually, people hold savings outside super as well as owning their own home.

The Association of Superannuation Funds of Australia (ASFA) produces an estimate of how much money is needed for both a modest and comfortable lifestyle in retirement. You can see their assumptions here. Crucially, the numbers assume retirees own their own home and are in good health. Home ownership is a massive issue in retirement, and the following amounts will be insufficient for people required to pay rent in major capital cities.

Budgets for various households and living standards for those aged around 65 (September quarter 2019, national)

	Modest lifestyle		Comfortable lifestyle	
	Single	Couple	Single	Couple
Total per year	$27,913	$40,194	$43,787	$61,786

A simple calculation shows the challenge for retirees in the current low rate environment. If a couple has $1 million in two pension accounts earning say 3% per annum, the income is only $30,000 a year. This is far less than the $61,786 a year required for a comfortable lifestyle if their only source of income the pension account. They will therefore need to draw down their capital to meet expenses. Moreover, the average combined superannuation balance for people aged over 15 is only about $289,000 (men $168,000, women $121,000).

Consequently, most retirees fear running out of money. Recent research by AllianzRetire+ reveals only 44% of Australian retirees feel secure in their current financial position, and two-thirds spend only on necessities, worried about unexpected costs and illness.

In a previous article, Graeme Colley of SuperConcepts ran the numbers based on the ASFA comfortable standard of $61,500 a year after tax for a retiring couple aged 57 and 59. There are many variables in calculating how long the money might last, but assuming income earned on the retirement savings is 5% per annum, and the capital is allowed to deplete to zero in the 25th year after retirement, the total amount required in today's money is $1.1 million.

How much can be withdrawn safely?

There is no simple answer to the safe withdrawal rate dilemma because it depends on many unknown factors, including the returns generated in the pension account and life longevity. If the account delivers a healthy return of, say, 10%, then drawing down 4% each year is fine. But many highly conservative retirees are restricting investments to cash which earns less than 2%. This barely covers inflation, and so the capital in the account is depleted each year.

This 4% drawdown level is a common 'rule of thumb' used in the financial planning industry as a safe drawdown rate, but it is based on a desire to spend only the fund's income and not the capital. This often means the retiree lives frugally and then leaves money in their estate, when they could have enjoyed a better lifestyle.

A group of Australian actuaries has developed a new rule to help retirees who have reached age pension eligibility decide how much they can withdraw from their savings. Their report is called, 'Spend Your Age, and a Little More, for a Happy Retirement'.

"The reality is that many people can have a better retirement if they have higher confidence that they are able to draw down a little bit more of their savings than the minimum required by the government," said Actuaries Institute President, Nicolette Rubinsztein.

"Many retirees draw a bare minimum from their account-based pensions, or their savings, after they stop work," she said. "They can't afford to pay for professional advice from a planner, and they live frugal lives because they fear outliving their savings. But the 'rule of thumb' is simple and accurate and takes into consideration a retiree's asset base and age."

They defined 'optimal' as a draw down which allows the best possible lifestyle but allowing for the fact that spending too much early in retirement means less is available later. The calculations allow for age pension eligibility.

Here is their simple 'rule of thumb' for a single retiree:

- Draw down a baseline rate, as a percentage, that is the first digit of their age.
- Add 2% if the account balance is between $250,000 and $500,000.

For example, a single retiree with a super balance of $350,000 would draw down $28,000, which is 8% of $350,000. The draw down amount would increase to 9% when the person reaches 70.

What about people with less money? The actuaries acknowledge that someone with only $40,000 might “buy a caravan and go around Australia”, knowing they can rely on the age pension. But those with more money are more likely to use it wisely for a better retirement.

The main problem with these types of calculations is that nobody knows how long they will live, and longevity continues to push out. And while nobody should aim to rely on the age pension, it is the safety net for the majority of people. For many couples who own their own house and with other assets less than $394,500, the full age pension including supplements is $1,407 per fortnight, or $36,582 a year. This may be acceptable for a modest lifestyle, but people should aspire to better.

It is, of course, possible to assume a market scenario where someone withdraws only 4% a year and runs out of money, but investing should balance the probabilities. As Michael Kitces, a leading consultant to financial advisers, writes in this article on the old 4% rule:

"The bottom line, though, is simply to recognise that even market scenarios like the tech crash in 2000 or the financial crisis of 2008 are not ones that will likely breach the 4% safe withdrawal rate, but merely examples of bad market declines for which the 4% rule was created."

The lessons behind the numbers

The lessons from these insights, notwithstanding the potential for unlimited assumptions and uncertainty, are:

1. The money required in retirement depends on personal lifestyle aspirations.
2. Life expectancy and future expenses are uncertain, and anyone who does not want to live on the age pension needs to consider saving more, spending less and working longer.
3. Owning a home is a significant risk mitigant (which also comes with the financial advantages of tax-free capital gains and exclusion of the home from the pension assets test).
4. Investing wisely and saving early allows the benefits of compound interest to build retirement balances over time. Education on financial opportunities is an important skill.

Retirement years should be a time to enjoy the rewards of a fulfilling working life, not worrying about when the money will run out.

Graham Hand is Managing Editor of the free financial newsletter Firstlinks, published by Morningstar.

Millennials struggle to invest, but property top priority

Ross Fox

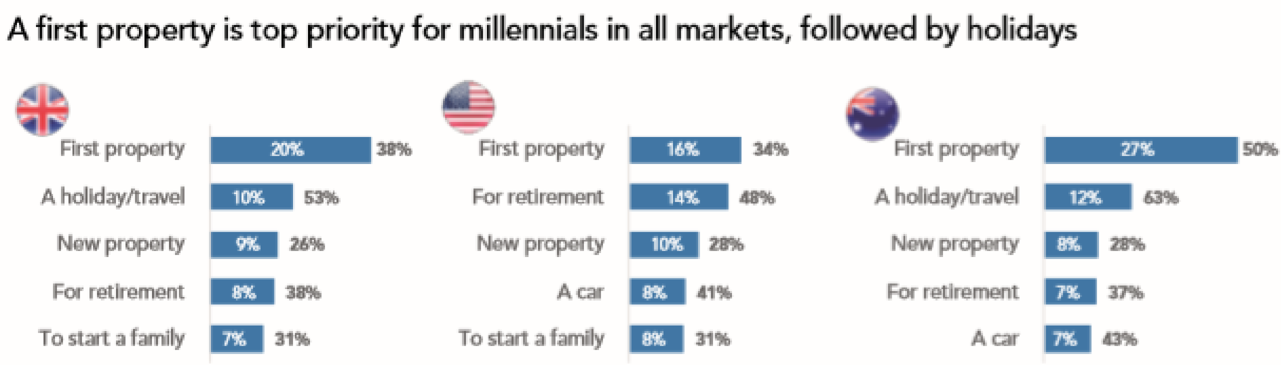
As fund managers globally scramble to diversify and future-proof their underlying client base, more attention is now being paid to the financial needs of millennials, a demographic born between 1981 and 1996, which investment firms have struggled to appeal to.

However, a recent Calastone study of 3,000 people aged between 22 and 34 across the UK, France, Germany, US, Hong Kong and Australia sheds light on some of the lifestyle habits, ambitions and general trends among millennials in what could help fund managers better target younger investors in the Australian market.

Property priority top, ability to invest bottom

Investing does not elicit much interest from millennials globally, and young people in Australia do not buck this trend. While finance may not poll particularly strongly among the Australian millennial demographic, technology is clearly important to them, with a great deal of respondents in the local market confirming they organise their personal lives online and use apps wherever possible.

The study found that while millennials in Australia may not be assiduously saving on a monthly basis, 71% do have some sort of saving, ranking the country higher than every market bar Hong Kong. Respondents in Australia said their primary motivation for saving was to fund their first property, a higher proportion in Australia than any other country in the study.



Blue bar is ranked 1st choice, other number is ranked in top 5 choices.

However, as shown below, a disproportionate number of Australians (84%) said their main reason for *not* saving was because they were unable to afford to, well above the global average of 68%. Calastone also found most Australians (71%) felt they were unlikely to receive a high-value inheritance in the next 20 years, although this is aligned with the global average.

What are the main three reasons why you do not save / invest at the moment?

	Total	UK	USA	Australia	France	Germany	Hong Kong
I cannot afford to	68%	60%	76%	84%	75%	56%	44%
I enjoy spending on other things	29%	26%	32%	31%	23%	35%	32%
I don't have the will-power	24%	29%	27%	29%	16%	20%	17%
I am not good at keeping track of my money	23%	23%	29%	30%	20%	12%	37%
Savings interest rates are too low so it doesn't make financial sense	18%	11%	17%	9%	27%	22%	27%
I don't feel the need to right now	17%	18%	17%	11%	15%	20%	29%
Don't know	*12%*	*16%*	*12%*	*4%*	*7%*	*16%*	*24%*
None of the above	*11%*	*13%*	*8%*	*7%*	*10%*	*16%*	*7%*

Millennials and money management

Although the majority of millennials globally keep their money in a savings or current bank account, there are some regional divergences in terms of how young people invest. The study found 10% of Australians invest in funds – putting it ahead of the UK and France, but a long way behind the US and Hong Kong. Most Australians said they were investing to achieve long-term capital accumulation and returns, something which is presently unavailable from many savings accounts due to the low interest rates.

Looking ahead, Australia could be quite attractive for fund managers with 76% of all millennial respondents in the local market saying they planned to invest in the future, well exceeding that of France (54%), Germany (56%) and the UK (64%), but falling short of Hong Kong (81%) and the US (77%). However, if the funds industry is to attract these assets from millennial investors in the Australian market, it needs to better understand how this generation currently purchases its goods and services.

Attracting millennials into investment funds

According to the study, 57% of Australians will buy services and products either online or via a mobile app, putting the country on a parity with the global average. Australian millennials appear to be more technically astute when it comes to banking with 64% saying that having online access to their account information was critical, compared to the global average of 56%. Furthermore, 52% confirmed they wanted access to their bank account information through an app, which was far higher than anywhere else, particularly in Germany where only 27% said the same.

A large proportion of Australian millennials (59%) – along with those in the US (also 59%) – told Calastone's survey they would willingly purchase investment products from technology companies such as Google or Apple in contrast to investors in Europe and Hong Kong who appear to be more sceptical about the idea. Among those Australians who already invest, 73% said they would buy an investment product through a technology company, well above the global average of 63%. Furthermore, 48% of Australians said they would trust a computer algorithm to invest their money, which is broadly in line with other countries.

Australia's millennials have a strong savings culture, and while Australian respondents have yet to fully embrace investment products, many young people are keen to invest in the future. However, embracing digitalisation will be crucial for asset managers if they are to win mandates in the tech-savvy local market. A failure to digitalise could impede asset managers' efforts to raise funds from millennials.

Ross Fox is Managing Director and Head of Australia and New Zealand at [Calastone](#).

Four major insights from APRA's super heatmap

Graham Hand

Large super funds have been waiting anxiously for the release of the regulator's 'heatmap', which assesses the performance of every MySuper product. While many trustees will be relieved by the good results, others will be worried and are likely to face pressure from APRA to perform or merge. The heatmap identifies 416 funds on this link.

The Excel spreadsheet looks unwieldy at first, but it includes a 'User Guide' tab and an explanation of the colours. Funds with dark red or orange for performance or fees will face more scrutiny, and white is good.

MySuper funds are supposed to be simple and low cost, and are the only funds which can accept default contributions. They are usually balanced portfolios with a growth emphasis, and hold about $800 billion of the $3 trillion in super.

APRA defines the objectives and use of its heatmap as:

"The objective of the Heatmap is to provide credible, clear and comparable insights into the outcomes provided by MySuper products in a number of key areas. The Heatmap is expected to drive improvements in outcomes

for members by holding RSE licensees publicly accountable for their performance, and in particular highlighting areas of underperformance."

APRA Deputy Chair Helen Rowell said on [the release of the report]:

"Australia's superannuation system delivers sound outcomes for most members, but APRA is determined to weed out the industry's underperforming tail ... we directly contacted the trustees of the worst performing products and asked them to provide or update action plans outlining how they will address identified weaknesses. If they are unable to make substantial improvements in good time, we will consider other options, including pressuring them to consider a merger or exit the industry.

APRA identified four major insights from its research:

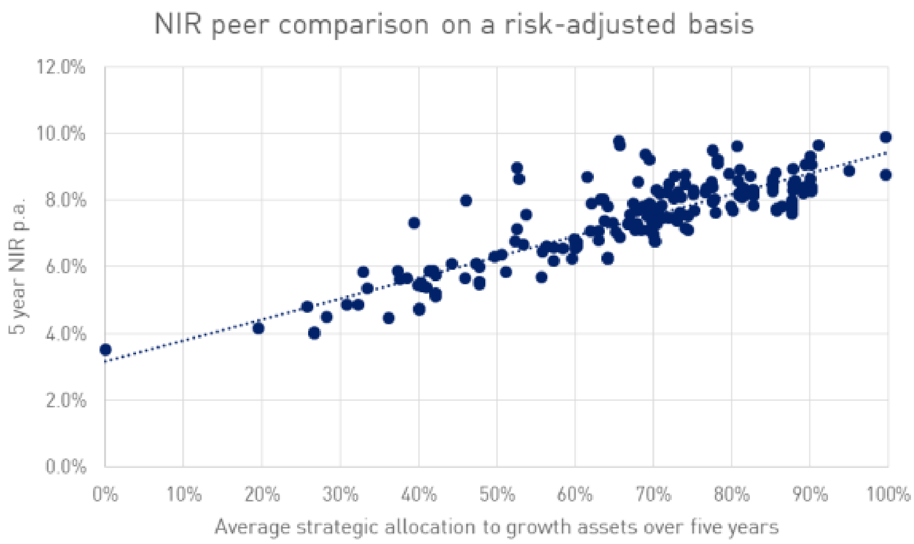
Key insight #1: significant variation of results

Although the funds were all MySuper compliant, a wide range of results were found. APRA focused on five-year performance as the longest time horizon available, although it should aim for at least 10 years. Performance over shorter periods can be affected by cyclical factors where funds with solid processes have not seen sound strategies pay off.

APRA differentiates between 'single-strategy products' with specific asset allocations, and 'lifecycle products' where the portfolio varies with the age of the member (eg, more into bonds as a member ages).

The five-year net returns on funds with over 60% allocated to growth assets ranged from 5.1% p.a. to 9.5% p.a. in single-strategy products (median 7.4%) and from 5.6% p.a. to 9.6% p.a. (median 7.9%) in lifecycle stages. Offered by many leading brands, 23 funds performed well below the industry average.

APRA makes the valid point that many other fund comparisons use a wide range of growth bands (such as 60% to 80%) in evaluating peer performance, which disadvantages funds at the lower end of the scale when markets are strong. Instead, APRA has taken the average allocation to growth assets and compared the funds with their five-year Net Investment Return (NIR), as plotted below. It shows that even allowing for risk, results vary significantly.

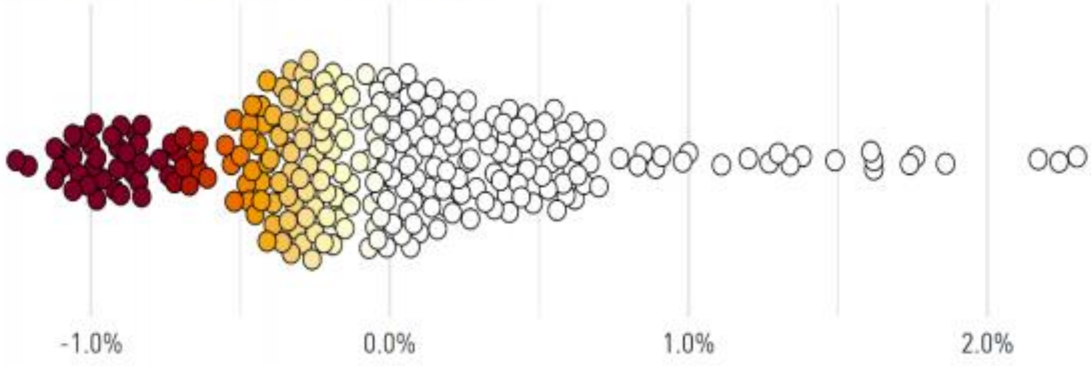


Key insight #2: underperformance in all industry segments and risk profiles

Underperformance was found in both single strategy and lifecycle stages with similar allocations to growth assets.

APRA built a Simple Reference Portfolio of passive, low-cost, liquid investments as a reference point. The figure below highlights underperforming funds and the level of underperformance. The colours are the same as used in the main heatmap, with dark red for poor results and white for acceptable (APRA deliberately avoids the endorsement implied by green).

Figure 9. Distribution of outcomes for 5-year net investment return relative to Simple Reference Portfolio p.a. (as at 30 June 2019)



Key insight #3: more single-strategy products outperformed than lifecycle products

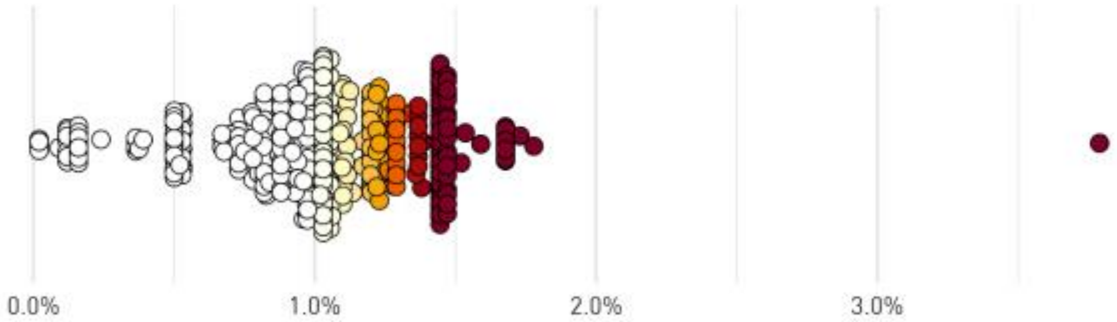
APRA reports that of the 59 single-investment strategy products, 34 (or 58%) outperformed the Simple Reference Portfolio over the five years to 30 June 2019. However, of the 204 lifecycle stage products, only 74 lifecycle stages (or 36%) outperformed.

Following the introduction of MySuper, many retail funds rushed to lifecycle solutions, putting more money into defensive assets as a person ages. This has not paid off as equity markets have rallied strongly, and now, new bond investments are rolling into funds with rates less than 1.5% and long durations. We should expect many of the lifecycle strategies to be critically reviewed by APRA, trustees and members.

Key insight #4: fee impact varies significantly based on account balance size

Figure 16 below shows the range of administration fees charged to MySuper products as a percentage of a $10,000 account balance. As a sign of the impact of expenses on low balances, 42% of funds have a fee in excess of 1%, with some over 1.5%. These are supposed to be low cost, simple options. Again, APRA uses the heatmap colours to show which fee levels are unacceptable.

Figure 16. Distribution of outcomes for administration fees for $10,000 account balance



Responses to the heatmap

No fund should only be judged by the colour in one category of either performance or fees. Some of the more expensive funds are also the top performers. There are winners and losers among both the retail and the industry funds, and peak groups advised members to consider a wider perspective.

The Financial Services Council jumped to defend retail funds, with CEO Sally Loane saying:

"The heatmap may tell you that other funds have had higher returns over five years, but if you're close to retirement you might be far more concerned with how your fund is managing the risks of a market downturn to safeguard your retirement savings. The heatmaps don't reflect that ... The heatmap doesn't tell you how your super has performed over your lifetime, it can't tell you whether your fund invests in accordance with your

ethical and philosophical beliefs, and it doesn't tell you what additional services they offer to help you manage your savings.

The media headlines have already focussed on particular examples, and their trustees will need to address the results. For example, some BT Super funds are flush with deep red colours and must face APRA's gaze, and only 15 funds scored 'white' across all categories.

The Association of Superannuation Funds of Australia (see ASFA website) has also urged caution, with CEO Martin Fahy saying:

"Let's be careful however not to jump to erroneous conclusions that may impact the entire category, or damage member outcomes with knee-jerk reactions from anti-retirement groups … achieving sound investment performance and broader member outcomes is a long-term journey, it's not measured in terms of years, it's measured in terms of decades."

APRA has finally taken a stance on the definition of 'defensive' assets. Some super funds include infrastructure and property as defensive, where in reality, they have growth characteristics rather than the portfolio protection of government bonds. APRA has decided that listed infrastructure and property should be classified at 100% growth, while unlisted are 75% growth and 25% defensive.

Other industry participants, such as SuperRatings, question why APRA is even publishing such results, arguing a regulator should be regulating not managing a public scoring system

The bottom line is the industry must accept the regular updates from an emboldened APRA, and it just became even more difficult to discharge the duties of a super trustee.

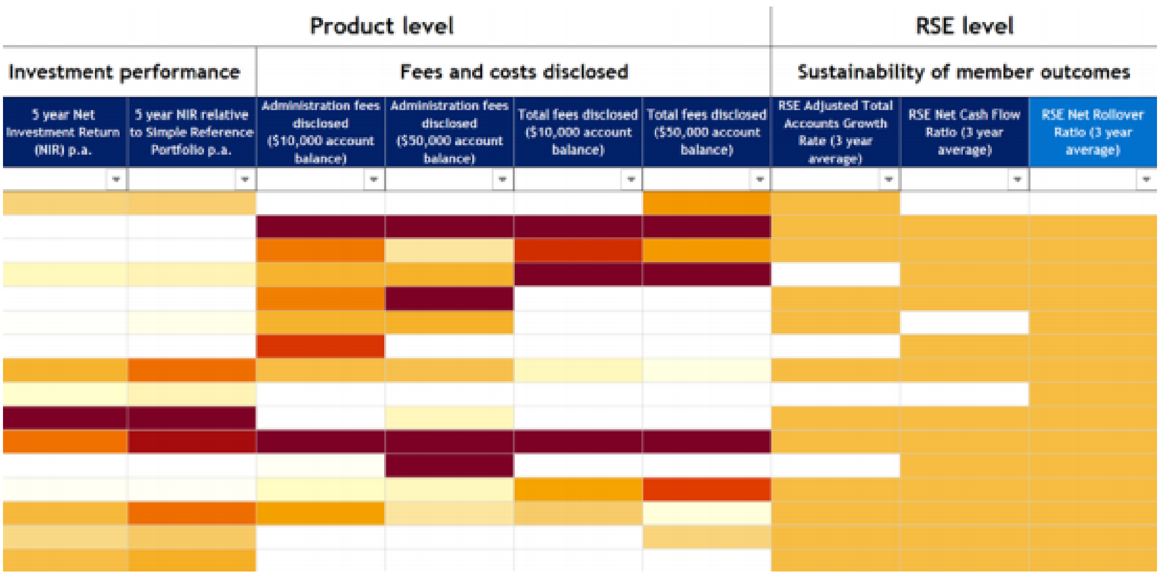
Graham Hand is Managing Editor of Firstlinks.

Checking the temperature of the APRA heatmap

Phil Graham

Around a year ago I wrote a commentary for Firstlinks "*4 reasons why investment performance comparisons are flawed*" which outlined a number of deficiencies in commonly-used comparisons of superannuation fund investment performance. The article offered suggestions aimed at raising the level of analysis and debate in this area.

The release of APRA's 'heatmap' on MySuper funds highlights the question of how to best compare funds. Here is a sample of what the heatmap looks like, with each row representing a fund, judged according to investment performance, fees and sustainability. Dark red is bad, through to white is good.

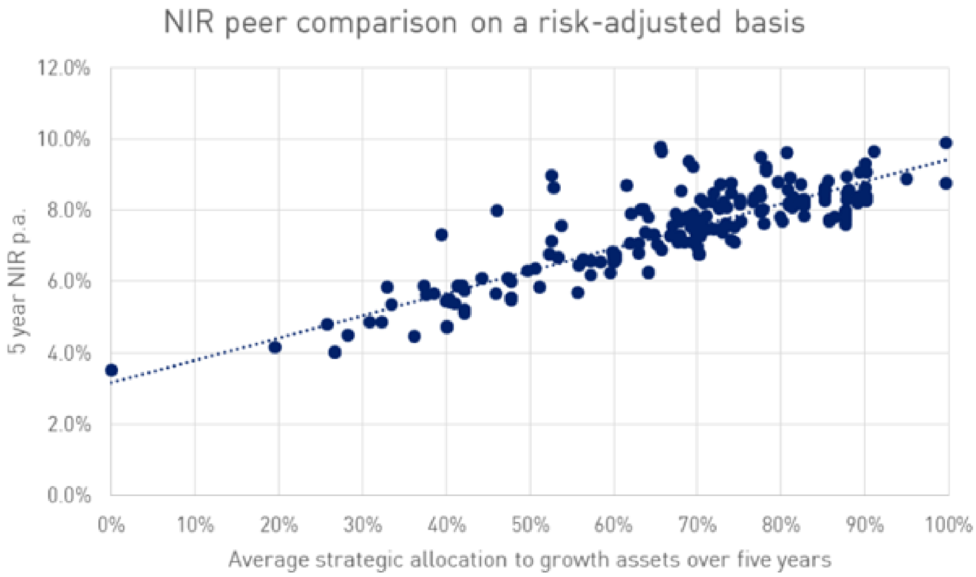


Let's take a closer look at these three areas.

1. Investment performance

Investment performance is primarily assessed over five years, with three year returns also provided in an 'Expanded View'. The three relative measures use the following approaches:

- A **risk-adjusted return assessment**, which compares a fund's net investment return to an equivalent fund on the growth/defensive spectrum, as determined by a trend calculation as shown in the chart below. This approach is the same suggestion I made a year ago and removes the bias that funds with higher growth assets enjoy when compared with a broad range of funds (for example 60-80% growth assets).



Source: APRA Information Paper, "Heatmap – MySuper products", November 2019, page 16 (left chart).

- A **Simple Reference Portfolio** (SRP), which calculates the return for a simple listed growth and defensive portfolio as shown in the first table below, and then applied to a growth/defensive asset split as calculated for each fund using a fund's growth/defensive breakdown as shown in the second table below.

Table 3. Growth and Defensive Portfolio (Asset breakdown)

Growth Portfolio	%	Defensive Portfolio	%
Australian equity	50	Australian fixed interest	40
International equity (hedged)	25	International fixed interest	40
International equity (unhedged)	25	Australian Cash	20

Table 4. Growth/Defensive Classification

SAA Asset Class	Growth / Defensive classification
Equity, Listed Property, Listed Infrastructure	100% Growth
Unlisted Property, Unlisted Infrastructure	75% Growth, 25% Defensive
Commodities, Other	50% Growth, 50% Defensive
Fixed Interest, Cash	100% Defensive

Source: APRA Information Paper, "Heatmap – MySuper products", November 2019, page 14.

- A **listed SAA** (SAA) using a fund's published strategic asset allocation for a fund, and using purely listed passive assets.

A key aspect of the returns analysis is the use of 3- and 5-year timeframes. While a lot better than the 1-year timeframe which the media often focuses on, few MySuper products would use an investment objective that short. Many would use 7- or 10-year timeframes, especially the more growth-oriented products. APRA plans to extend the period over time, test a product over a full market cycle. Lengthening the time frame should be a priority.

In terms of the measures themselves, given that a consistent framework is applied across all funds using published SAAs and using a defined growth/defensive split, they provide a reasonable approach. Importantly they should provide a better like-with-like comparison, based on the growth asset split.

That said, the devil could be in the detail; for example, it will be interesting to see how well the SRP and SAA benchmark returns reflect a fund's true position (as shown by the difference between the SRP/SAA benchmark and the fund's own benchmark return calculation).

The growth/defensive split classifies unlisted infrastructure and property as 75% growth and 25% defensive. In my experience that is arguably a higher allocation to growth than many would prescribe and will raise the performance benchmark, so some funds will no doubt argue for a greater defensive weighting for these assets. The classification of "Commodities, Other" as 50% growth/50% defensive is curious for commodities, which I believe should be 100% growth, but on average reasonable for alternatives (which includes a wide variety of products from quite defensive to very growth).

To focus attention on underperforming funds and to avoid a ranking system interpretation, the heatmap measures underperformance only (with white colour for all outperformance), down to -0.75% p.a. for the two relative measures. Given the benchmarks used and the time periods, this is fair.

2. Fees

The approach on fees is to calculate both administration fees and total fees (so also including investment management fees) at different levels of fund balances (from $10,000 to $250,000).

Administration fees start at a range of 1.0-1.4% for a $10,000 balance, which falls to 0.2%-0.4% for a $250,000 balance (so the range declines from 0.4% to 0.2%). For total fees, the range is 1.8%-2.2% for $10,000 and 1.0-1.2% for $250,000.

The focus on lower administration fees aims to maintain pressure on funds to be as efficient as possible, which is fair. However, the focus on total fees (once again) emphasises the focus on lower fees. As it is a peer relative measure, funds with higher fees will always be in a negative position. However, high investment management fees in themselves are not a bad thing if they deliver superior investment performance (shown by the net investment return), so the total fees outcome needs to be assessed alongside the net investment return measures. Indeed, some of the results show funds with the highest fees have delivered the best results after fees.

3. Sustainability

There are three so-called 'sustainability' metrics - adjusted total accounts growth rate, net cash flow ratio and the net rollover ratio. While I understand the focus on cash flow and other metrics for a fund, it is not clear to me whether these are really a measure of fund performance, or of a fund's health. Simply because a fund is in cash outflow does not make it a poor performer, rather that it is a reflection of its member base.

Should APRA have gone public?

APRA believes the MySuper heatmap provides a major enhancement to industry transparency and that it gives stakeholders credible, clear and comparable insights. This might be ambitious given the data is delivered in a spreadsheet which many retail users will find hard to navigate.

However, from the perspective of providing an improved comparison of investment performance, the heatmap approach is an improvement, through its use of a consistent methodology for all funds, by comparing funds on a like-with-like basis. There is scope for further improvement, using longer time periods, improved delineation of growth and defensive assets, and adding a measure of drawdown risk for investment performance.

From an overall perspective my concern is how the heatmap will be used. Ever on the outlook for a story, the media will focus on underperforming funds. How will members and trustees of these funds react? If they vote with their feet and exercise their right to switch funds, those funds will arguably be placed in an even worse position, potentially harming remaining members. In the extreme, fund liquidity could be compromised.

Whether APRA and the industry would be better served using the review outcome to privately pressure funds that rate poorly, rather than going public as has been the case, remains to be seen.

Phil Graham is an independent board member and investment consultant. Until August 2018 he was Deputy Chief Investment Officer with Mercer. Some of this article was written using the previous November 2019 APRA Information Paper.

Australian ETFs further widen their appeal

Ilan Israelstam

The latest BetaShares/Investment Trends 2019 Report shows Exchange Traded Fund (ETF) adoption is at record highs. The insights are based on responses from around 8,000 investors and 800 advisers, making it the most comprehensive survey on the ETF industry in Australia.

The average ETF investor is getting younger

The average age of new entrants to the ETF market (defined as those who started investing in ETFs within the last two years) is 42 years, down from 56 years more than five years ago. About 43% of these first-time investors are now in the millennial age-bracket, versus 12% more than five years ago.

Interestingly, one in four new ETF investors is female, compared to only one in 10 just five years ago.

Started investing in ETFs:	>5 years ago	2-5 years ago	**Within last 2 years**
Average age	56 years old	50 years old	**42 years old**
% who are female	11%	14%	**24%**
% who are millennials	12%	29%	**43%**
% who are retired	38%	24%	**12%**
% who invest in ETFs through an SMSF	41%	33%	**14%**
% who intend to re-invest in ETFs in the next year	54%	60%	**59%**

Source: BetaShares/Investment Trends ETF Report, 2019

SMSF usage strong, but growth in non-SMSF faster

The number of Australian investors using ETFs has grown to a record number of 455,000, up 18% from 385,000 the previous year.

The number of SMSFs using ETFs continues to rise too, up 12% since 2018 to a total of 135,000 SMSFs. However, as the industry becomes increasingly mainstream, the proportion of SMSFs to total ETF investors remained relatively flat at 30%, versus 31% in 2018.

This is due to the even stronger growth in the self-directed investors who are using ETFs outside of SMSFs, up 21% to 320,000 in 2019.

Diversification remains the primary driving factor for using ETFs, cited by 78% of current ETF investors, followed by low cost (64%) and access to overseas markets (58%).

Use by financial advisers continues to rise

Financial advisers are increasingly adopting ETFs with clients, with 58% now providing advice on ETFs, up from 53% in 2018. Since 2010, this figure has more than doubled from 27%.

Among planners who recommend ETFs, low cost was the number one driver, cited by 75% of planners, followed by diversification (61%) and the ability to bring down fees in an overall portfolio (59%).

Around a quarter of financial advisers now have their own financial services license (AFSL), up from 20% in 2018. These self-licensed advisers allocate double the share of client money to ETFs (14% of new inflows), compared to their aligned peers (7% of new inflows).

Self-licensed advisers also expect their allocation to ETFs to increase to 19% of client inflows over the next three years, compared to 11% for other advisers.

Only 22% of investors said a financial adviser was involved in their most recent decision to invest in ETFs, suggesting that there is potential to increase adviser involvement in the ETF market.

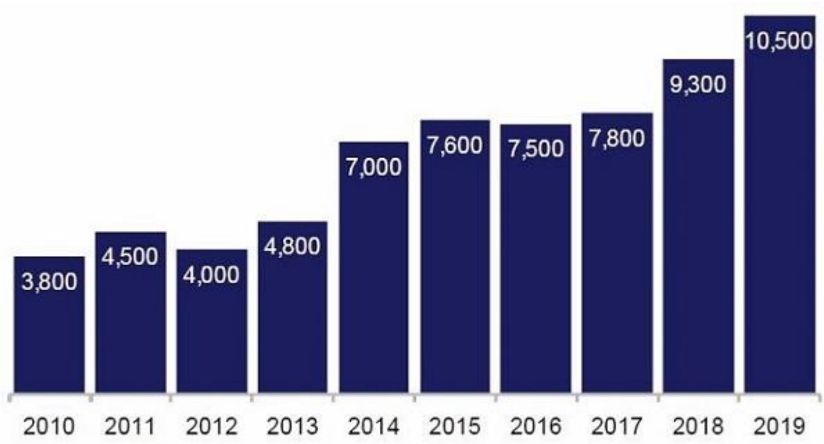
We think that, given the unprecedented regulatory scrutiny they face, advisers will increasingly make use of ETFs. As well as being transparent and low cost, ETFs can significantly decrease the time advisers spend on constructing client portfolios and assist with their compliance burden.

Investors turning to ETFs for defensive positioning

While around half of ETF investors made no significant changes to their asset allocation in the last 12 months. Of those who did, 40% made changes to increase defensive positioning in their portfolios.

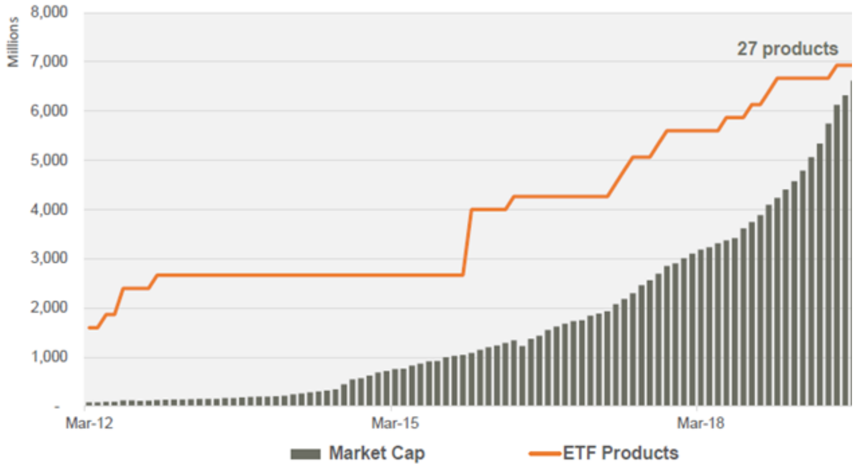
We saw significant growth in the fixed income and cash ETF category, which attracted over $2.8 billion of inflows from December 2018 to end October 2019, making it the top category for flows in the period. Since 2012, the annual

Number of financial advisers using ETFs in Australia



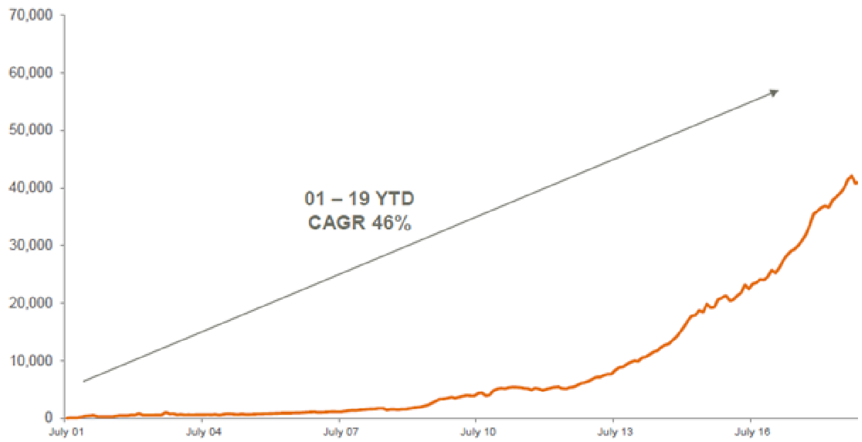
Source: BetaShares/Investment Trends ETF Report, 2019

Australian Fixed Income ETFs: 2012 – YTD 2019



Source: ASX. As at 31 October 2019.

Australian ETP Market Cap: July 2001 – October 2019 (A $M)



Source: ASX, BetaShares. CAGR: Compound Annual Growth Rate.

growth rate for fixed income ETFs in Australia has been 79.2%. The BetaShares cash, fixed income and hybrids range attracted ~$1.6 billion in net inflows to the end of October, to reach a combined $3.5 billion.

This trend reflects an increasing appreciation by investors that ETFs can be used as a convenient and cost-effective way to implement asset allocation decisions, and gain exposure to previously hard to access securities. The defensive and diversification benefits of fixed income ETFs also appeals.

Outlook for the sector

There remains plenty of scope for the industry to prosper, with over 135,000 investors planning to enter the ETF market within the next 12 months, and reinvestment amongst current ETF investors at a high 58%.

Assets in the ETF industry broke though the $50 billion barrier only in June 2019, but we expect Australian ETFs to reach more than $75 billion by the end of 2020.

**The term 'ETF' as used in this article includes both ETFs and other exchange traded products.*

Ilan Israelstam is Head of Strategy at [BetaShares](), a sponsor of Firstlinks. A summary copy of the Report can be requested [here](). This article is for general information purposes only and does not address the needs of any individual.

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A decade of Aussie shares: who delivered, who dithered?

Ashley Owen

The end of another decade is almost upon us! Each decade tends to have its dominant investment themes. The 1970s was the era of oil price spikes, US dollar collapse, high inflation and unemployment. The 1980s was Reagan/Thatcher inflation-busting recessions, Hawke/Keating reforms, the 'greed is good' boom, then the 1987 crash. The 1990s saw the Asian currency crisis, the Russian default and the 'irrational exuberance' dot-com boom. The 2000s had the 'tech wreck', the global credit/China boom then the sub-prime crash and GFC.

Nobody could have predicted any of these at the start of each decade.

How did we go in the 2010s?

The 2010s has been a decade of change and similarly unpredictable events. Many things we now take for granted were unthinkable at the start of the decade. Instagram, 'Instagram influencers' and YouTube channels as lucrative 'careers', Snapchat, Pinterest, WhatsApp, Uber, Deliveroo, Airbnb, Spotify, iPads, tablets, Kindle, bitcoin, Square, pay wave, smart watches, fitness trackers, Bluetooth, USB flash drives, GPS on smartphones, 4G, streaming, self-driving cars, drones, and even test cricket played at night with a pink ball!

We have Trump in the White House, Britain in 'Brexit' chaos, combat warfare on the streets of Hong Kong, rising nationalistic fervour and extreme right and left-wing politics across the world, the US withdrawing from the multi-lateral world and China expanding militarily and economically far beyond its borders.

For investors it has also been a decade of surprises. At the start of the 2010s decade the world looked like it was on the way to recovering from the US sub-prime crisis and global banking crisis. Ten years later, the US, Europe and Japan are still on life support in the form of unprecedented monetary and fiscal stimulus, but it has done little to stimulate economic growth or inflation. All it has done is fuel asset price bubbles and mountains of debt everywhere. The winners have been asset owners, lenders and emerging country wage earners, while the losers have been savers, renters, traditional retailers and developed country wage earners.

Two unusual features in Australian shares

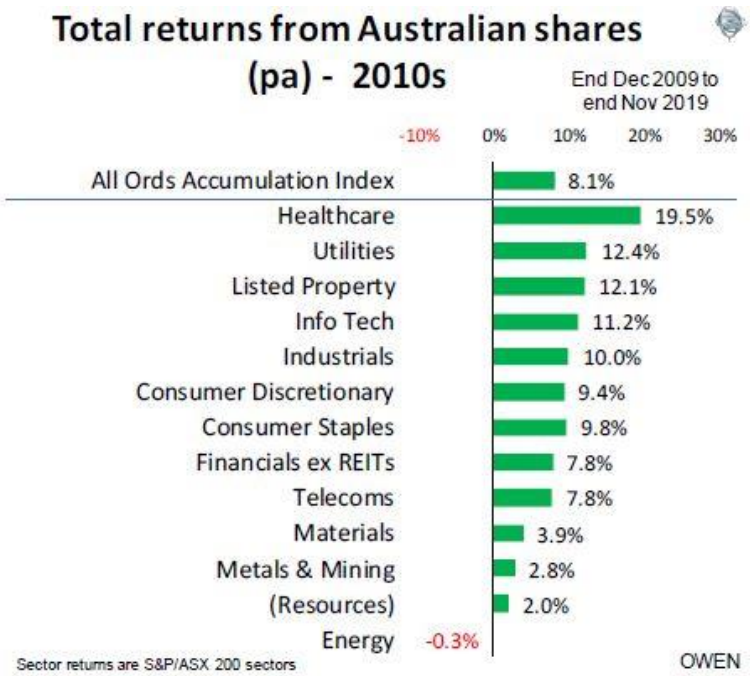
The chart below shows annualised total returns (including dividends) from the different sectors of the Australian share market since the end of 2009 to the end of November 2019 (almost a decade).

There are two unusual features.

The **first** is that the 8% total returns per year from the overall market has been well below its long term average of around 10% per year. What is surprising is that the poor results were achieved in an era of very low interest rates and inflation.

The **second** unusual feature is the wide dispersion of results between different sectors.

(The numbers expressed below for individual companies are total share price gains over the decade, not annualised, so they should be compared to the broad market share price gain of +42% for the decade. Yes, only 42% growth (or 3.6% per year) for the decade).



Healthcare

Healthcare has been the star sector for the decade. CSL is up +773% and is about to take the lead from CBA as the most valuable company on the ASX. ResMed is up +274%, Cochlear +239%, Ramsay +570%, Ansell +171%, and Sonic +99%. Despite these successes, the sector is notoriously speculative and accident-prone, with many more losers than winners. Some companies had their brief time in the sun, like Mesoblast and Primary Health care (now 'Healius'), but most of the nearly 200 healthcare stocks that were on the ASX at the start of the decade have gone nowhere (still waiting or their big breakthrough) or have run out of money and disappeared.

Utilities

Utilities stocks have also done well. Their relatively stable, regulated cash flows have benefited enormously from the great collapse in bond yields over the past decade. APA is up +214%, AusNet +90%, Spark +57%, but AGL is up only +41%.

Technology

The tech sector has had a good decade. Carsales is up +207%, Altium + 14,000%, Technology One +1,003%, Infomedia +563%, Praemium +256%, and Seek (classified as an 'industrial') +236%. The tech sector is like healthcare in having a lot more losers than winners. At the other extreme is Silex Systems down -90%, but most of the other 110 tech stocks that were listed 10 years ago have remained dormant or disappeared. Computershare, a survivor from the last tech boom in the 1990s, is up just +55% this past decade.

Listed property

The listed property sector is in the winners list for the decade but it suffered badly in the GFC. Many of the best property trusts are still well behind the rest of the market if measured at a starting point before the GFC hit.

Industrial property specialist Goodman has been the star +368%, benefiting from the shift from physical shops to online shopping. Bunnings +129% has been a rare exception of retail success despite the Amazon effect. The smartest operator in retail property is Frank Lowy (Westfield) and he sold out of the retail trust of Westfield in 2014 and out of the development arm this year.

Industrials

In industrial, transport has done well: Qantas +144%, Transurban +177%, Brambles +85%. Also building products: Amcor +145%, James Hardie +241%. Rounding out the laggards is Telstra, up just 32% in the last 10 years, but still 60% below its peak 20 years ago.

Banks and financials

CBA is up just 47% in 10 years, but the rest of the Big 4 have done nothing and AMP is down -71%. The star has been Macquarie, up +185% for the decade. Among the insurers, IAG +99% and Suncorp +54% have easily beaten the perennially accident-prone QBE -50%, which was once a top 10 stock.

Resources

Miners are driven by commodity cycles: Copper -20%, Nickel -28%, Aluminium -18%, Lead -20%, Tin -2%, Zinc -12% for the decade.

BHP's share price is down -11% (or down -5% including the free shares in spin off South32), but RIO is up 29%. Fortescue is a genuine star +119%. Gold mining heavyweight Newcrest is down -13%. Among energy are Origin -48%, Woodside -27%, Santos -42%, Worley -48%, while Oil Search is ahead +21%.

Retailers

Also struggling over the past decade were the retailers. Myer is barely surviving after being worked over by private equity, and it will probably suffer the same fate as Dick Smith. DJs has been taken over by South African Woolworths and is also on its last legs. Harvey Norman, the star of decades past, is flat over the 2010s decade. Even JB – arguably the best of the retailers – is up just +66% over 10 years. Woolworths is up +42% and Metcash down -21%. The winners have been the online players, like Domino's Pizza up +878%.

Who will be the winners and losers over the next decade?

The miners and banks are driven by macro shifts. For miners it is the big picture commodities cycles, and for the banks it is demographic cycles, regulatory cycles, competitive regimes and interest rate or credit cycles.

Each industry has its own big picture trends, like the 'Amazoning' of retailing. What determines the winners and losers is the the quality of management. This includes the ability to capitalise on opportunities, but often it is a simple as not doing dumb things like undertaking huge ego-boosting acquisitions and expansion projects at the tops of booms. It's a disease that afflicts most companies in all industries.

The winners in the next decade will be the companies run by visionaries who are supported by highly-skilled directors with real experience in running companies themselves and who add value rather than just ticking compliance boxes.

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.

Have bonds reached the end of the line?

Stephen Cooper

Bond markets typically perform well during periods of economic uncertainty. All else being equal, decelerating economic growth dampens inflationary pressures, increases the probability of interest rates being lowered and, in turn, pushes bond yields lower.

That has certainly been the case over the year or so. Economic conditions have softened – both within Australia and offshore – resulting in interest rates being cut to help support economies. Here, the Reserve Bank of Australia has lowered borrowing costs three times in 2019, reducing the official cash rate to an all-time low of 0.75%. Policymakers are continuing to debate whether further cuts are warranted.

The deteriorating economic background has been reflected in the local fixed income market. Yields on 10-year Commonwealth Government Securities – a good barometer of the overall domestic bond market – have more than halved over the past 12 months, from over 2.70% in November 2018 to around 1.20% today. Remember, there's an inverse correlation between bond yields and prices; the sharp move lower in yields has therefore resulted in favourable returns from fixed income portfolios.

That's great for investors who've had exposure to bonds, but what does it mean for the outlook going forward? Investors are increasingly questioning whether it might be time to lock in gains and remove allocations to fixed income investments. As well as record low cash rates in Australia, official interest rates are negative in Europe and Japan and are being lowered elsewhere, most notably in the US. Moreover, increasingly accommodative policy settings by global central banks – and, in some cases, the introduction of '*Quantitative Easing*' measures

– have driven yields *below zero* on more than a quarter of government bonds on issue worldwide. How much lower can they go?

Against this background, it is understandable that investors are questioning whether bonds still have a role to play in portfolios.

In our view, they certainly do. In the interests of full disclosure, First Sentier Investors currently manages more than $15 billion of Australian fixed income securities, so our view probably won't surprise too many people. But, even after putting unintended biases to one side, there remains a clear case to support ongoing allocations to defensive, income-oriented investments like bonds.

The asset class still has an important role to play in most well-balanced, diversified portfolios, even though the future return profile is less appealing than it has been in the past.

The historical reasons for holding bonds include:

1. Their low risk profile. Given very low default rates, government securities are almost guaranteed to generate positive returns if held to maturity.

Even though the overall indebtedness of most countries is increasing worldwide, the risk of default on debt issued by sovereigns in their own currency remains extremely low. This is affirmed by credit ratings, which provide an independent view of issuers' ability and willingness to repay their debt. Currently, Australian government debt is rated AAA by Moody's; the maximum possible rating and one that's only awarded to a handful of issuers worldwide. With the ability to print currency if required to meet debt repayment obligations, the likelihood of non-payment is very low.

2. A reliable source of income. Again, almost all bond issuers – including both governments and companies – are well placed to service their debt servicing obligations and make regular coupon payments to investors.

While some global bonds are now showing negative yields to maturity, Australian government bonds still offer positive and secure income for investors. Most securities make coupon payments semi-annually. Yields and potential income are higher in corporate debt markets; bonds issued by companies typically provide higher yields than government securities given their inherently higher risk profile. With interest rates so low, most companies are currently able to comfortably meet their debt repayment obligations and profitability is holding up quite well among high quality firms. Accordingly, while the risk profile of corporate debt is always evolving, credit markets continue to offer opportunities for income-based returns with a relatively low risk of capital loss.

3. A hedge against falls in equities. Allocations to fixed income securities have historically helped preserve capital during equity down markets, effectively providing a cushion against falling share prices.

Even with yields below zero in some regions, the historical negative correlation between equities and bonds during periods of equity market stress is expected to persist worldwide (for reasons outlined in the first point above). During times of elevated uncertainty, a 'flight to quality' into defensive assets with perceived capital security and plentiful liquidity would be anticipated, helping to maintain the historical relationship between equities and bonds.

There is still some scope for capital appreciation from Australian bonds too. If cash rates are lowered further in 2020 as has been talked about, government bond yields could conceivably come under further downward pressure. This would push prices higher, augmenting income from coupon payments and lifting total returns. With yields at ~1.20% instead of ~2.70%, the expected return profile of Australian bonds is clearly lower than it was a year ago. But, importantly, all of the above characteristics are likely to hold over the medium term, underlining the ongoing appeal of bonds as part of a broader asset allocation mix.

Stephen Cooper is Head of Australian Fixed Income at First Sentier Investors, a sponsor of Firstlinks. This article is for general information only and does not consider the circumstances of any individual.

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How to sell business real property into an SMSF

Jeff Song

From 1 July 2018, a new law provides that in certain circumstances, the outstanding amount of a Limited Recourse Borrowing Arrangement (LRBA) will count towards the relevant member's Total Superannuation Balance (TSB).

How will these new provisions affect the plans of SMSF members who could otherwise have benefitted from putting their business real property into their super fund?

Impact on future contributions

Let's consider an example of Bruce and his plan to sell/transfer his property to his SMSF:

- Bruce and his wife Linda have an SMSF of which they are the only members and trustees.
- Bruce is 65 and Linda is 60 and in full time employment.
- Bruce solely owns a commercial property in NSW worth $2 million and wants to sell this property to the SMSF.
- Bruce and Linda have recently reviewed and revised the investment strategy of their SMSF.
- Bruce and Linda have approximately $1 million and $500,000 respectively of liquid assets in their SMSF available to spend on this property purchase.
- To fund the shortfall for the purchase price the SMSF will borrow using an LRBA.

Assuming the property is a 'business real property' in NSW, the SMSF's purchase from Bruce may be eligible for stamp duty concession, meaning a potential saving of up to $94,800 on stamp duty. One of the requirements for this concession is that the purchase is financed by only Bruce's interest in the SMSF and an LRBA (i.e. Linda's interest of $500,000 cannot be used towards the purchase).

If the SMSF uses Bruce's interest of $1 million, and borrows under an LRBA a further $1 million to finance the purchase, any outstanding LRBA loan amount as at the next 30 June (i.e. 30 June 2020) will count towards Bruce's total superannuation balance as he has reached the age of 65.

It would also have applied if Bruce had not reached 65 but had borrowed from a related party.

Once added to Bruce's TSB, it will affect his eligibility in the following financial year (i.e. FY2020/21) for carry forward concessional contributions, non-concessional contributions cap and bring forward of the non-concessional contribution caps, spouse tax offset, and segregated asset method to calculate exempt current pension income.

Not the death of the strategy

Is the strategy of selling your business real estate into your SMSF effectively dead? Not quite.

Let's now consider a different scenario where the SMSF's purchase is structured into two separate transactions of:

- purchase by SMSF of the first 50% of the property to be segregated in the SMSF for sole benefit of Bruce (first purchase); and
- purchase by the SMSF of the other 50% of the property to be segregated in the SMSF for sole benefit of Linda (second purchase).

The first purchase will:

- only use Bruce's balance (approx. $1 million)
- be segregated in the fund for sole benefit of Bruce
- be eligible for stamp duty concession (subject to other conditions being satisfied for the concession of course)
- be transferred to the Fund Trustee(s)
- be without any use of LRBA, thereby not affecting Bruce's TSB.

The second purchase will:

- only use Linda's balance (approx. $500,000) and an LRBA loan

- be segregated in the fund for sole benefit of Linda
- not be eligible for stamp duty concession (full stamp duty on this 50% will be payable)
- be transferred to a bare trustee/holding trustee for the SMSF (LRBA)
- will not affect Bruce's TSB as this 50% secured under the LRBA doesn't support his superannuation interest (it is segregated for the sole benefit of Linda)
- will not affect Linda's TSB as she hasn't satisfied the condition of release (i.e. has not obtained the age of 65 and is still employed)

The above example is used for the purpose of demonstrating potential implications of the new laws relating to LRBAs counting towards members' TSB.

If you are considering a similar transaction, actual implementation would be complex and require legal, financial and tax advice as well as negotiation with the lender.

Jeff Song is Senior Solicitor, Division Leader Superannuation Online Services at Townsends Business & Corporate Lawyers. This article is based on an understanding of the legislation at the time of publication and individuals should seek their own financial and legal advice.

The role of retirement villages in retiree housing

Annika Bradley

In retirement, many Australians need to determine the most appropriate housing option from both an emotional and financial perspective. And the housing options of retirees cannot be ignored by the financial services industry as it works towards delivering sufficient retirement income.

While the vast majority of Australians choose to 'age in place' by remaining in their own home, retirement villages' popularity is increasing faster than any other age-specific housing option (Productivity Commission Research Paper). Prima facie, retirement villages provide a good solution, but currently the offer is complex and requires specialist advice.

Three reasons to move to a retirement village

Retirement villages house around 5% of Australians over 65 years old (approximately 184,000 people) and this housing segment has a number of advantages.

Firstly, transitioning to a retirement village can provide an opportunity to downsize and unlock home equity, and unlocking home equity can be key to sufficient retirement income. Yet according to the Producivity Commission, unlocking home equity is rarely the main driver of moving to a village and the majority of older Australians believe that their current home will not help fund their retirement.

Secondly, retirement villages meet retirees' needs to feel safe, offer a range of activities and provide the necessary building features, such as non-slip surfaces and handrails.

Thirdly, retirement villages can serve as a gateway to further care such as an aged care facility.

However, there are a number of emotional barriers to moving into age-specific accommodation. A study by the National Seniors Productive Ageing Centre in 2013 cites a 'loss of independence' and 'lack of privacy' as the two most likely factors to discourage relocation to a retirement village. Atul Gawande's book, Being Mortal, openly details the 'controlled and supervised institutional existence' that can result by moving the elderly into assisted living and aged care facilities in particular.

Financial arrangements are complex

From a financial perspective, the fee structures of retirement villages are complex and vary substantially across villages, making comparisons difficult. Further, the cost of getting it wrong can be high due to significant exit costs in some structures. A Macquarie University economist, Tim Kyng, developed the Retirement Village Cost Calculator after trying to select a retirement village for his mother. The calculator simplifies the various fees down to a single monthly cost, to help compare different options. However, when working through the calculator and the various fee structures, what appears to be a housing decision for retirement looks a lot like purchasing a complex end of life insurance product.

Despite this, legislation remains state based, standardised and comparable fee disclosure principles (think RG97) do not yet exist, and retirement villages are not 'in-scope' at the current Royal Commission into Aged Care Quality and Safety. On top of the complex contract, individuals also should consider how a transition (and possible downsizing) can affect pension entitlements and their future income stream.

In the absence of better regulation in this area, seeking professional advice is necessary. As advisers consider their value proposition, this is one area that could make a significant difference to the retirement outcomes of their clients. Examples of providers of specialist education and ongoing training are Aged Care Steps and Aged Care Gurus.

Superannuation funds should also consider the role they play as they grapple with designing appropriate post-retirement products, such as Comprehensive Income Products for Retirement (CIPRs). One concept floated was super funds owning residential aged care accommodation options, providing quality social infrastructure, while generating a return for their members. It would be age-specific accommodation provided for the member and owned by the member. The concept might prove an important pillar in unlocking home equity and underpin Australians' income streams in retirement.

The Australian Bureau of Statistics projects that by 2050, there will be over eight million Australians over 70 years old. The challenges associated with age-specific housing options, the complexity of the contracts, and unlocking home equity are not going away. As we work towards providing Australians with an income stream in retirement and embark on the upcoming independent review into retirement income, we cannot ignore this housing segment.

Annika Bradley, CIMA® is an independent member of a number of investment committees and she provides advice to other financial businesses. This article is general information and does not consider the circumstances of any person.