

QUARTERLY NEWSLETTER – July 2016



Major Indices

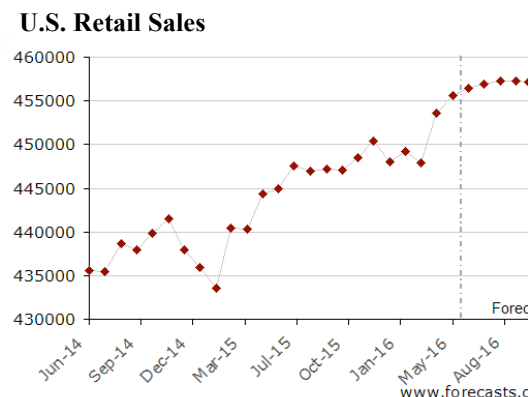
	Currency (AUD)	Interest Rate (%)	Share Index	*PE ratio (historical earnings)	Min daily wage (USD)	GDP Forecast (2017) IMF	Population (million)	Public Debt as a % GDP
Australia	1.00	1.75	All Ords – 5,340	16.7 (All Ords)	136	3.0	24.2	27.5
USA (Dollar)	0.75	0.50	S&P 500– 2,098	19.07	58	2.5	323	93.6
Japan (Yen)	77	-0.1	Nikkei 225 – 15,679	12.99	85	-0.1	127 (stagnant)	261
China (Yuan)	4.97	4.35	CSI 300 -3,158 Hang Seng 20,794	China-7.72 Hong Kong-11.65	9.60	6.2	1,375	17.7
India (Rupee)	50	6.50	BSE 200– 3,521	20.27	3.40	7.5	1,287	54.2
Europe (Euro)	0.67	0.00	DJ Stoxx 50 2,864	16.06	56	1.6 (Germany)	739 (stagnant)	86 (Germany)
UK (pound)	0.56	0.50	FTSE 100 – 6,504	18.75	80	2.2	65 (stagnant)	104
Global	N/A			16.78		3.5	7,373	

*PE ratios (based on historical earnings),

10 Yr Bond Rate – 1.45% US 30 Yr Bond Rate – 2.26% Source: Bloomberg NB: Fastest growing population is by far Africa.

Commodities

Oil –Nymex (WTI) (USD/barrel)	49	Iron Ore (\$/tonne) spot price	55
Natural Gas (\$per million mbtu)	2.92	Copper (USD/pound)	2.19
Lithium (LCE) (\$/tonne) -China	13,000	Nickel (USD/pound)	4.26
Uranium (USD/pound)	27	Zinc (USD/pound)	0.96
Gold (USD/ounce)	1,336	Aluminum (USD/pound)	0.74
Wheat (cents/bushel)	442	Corn (cents/bushel)	373
Baltic Dry Index(BDI) +	609 (slight increase, recovering)	Dow Jones Transport Index(DJT)	7,485 (flat)
US retail sales forecasts (million USD per month)	July(f) 457	Aug(f) 457	Sept(f) 457
Chinese PMI manufacturing	April (Caixin) 49.4	May (Caixin) 49.2	June (Caixin) 48.6



Commentary – Past 3 months

The past 3 months for most share markets was again volatile. The UK “Brexit” drama caused massive 2 day falls especially in UK and European markets. However within a week markets had recovered most of their losses.

Overall the quarter was mixed for global stock markets as the commodity exporters moved up along with a recovery in oil prices. The US moved sideways, and the UK and Europe moved slightly up over the quarter despite the Brexit dramas at the end of the quarter.

India did well, but China was slightly down still weighed down by concerns over rising non-performing loans in the banking sector due to the slowdown. Japan fell as its currency rose. Australia rose helped by an improved GDP figure. Australian commercial property had another strong quarter, and has had a strong year up almost 20%, as Australian investors look for stability and yield.

Global share market Prices to Earnings (PE) ratios are at fair value now with the PE for the Global 100 at 16.78. The US PE is now at 19.07 and looking expensive relative to most other countries, especially as earnings are flat.

Asia is on a PE of 11.07 is looking cheap, and China with a PE of 7.72 is priced as if they are in a global financial crisis. This can be explained by some recent reports that non-performing loans in China are as high as 22%. So China is priced already for a banking crisis. Hong Kong looks very cheap with PEs of 11.65, but will be affected by China.

India is at last looking reasonable on a PE of 20.27, given their 7.5% growth rate.

US employment fell by 0.2% to 4.7%, and **Australia** fell by 0.1% to 5.7% unemployed. Both countries have high underemployment rates, suggesting their jobs markets are not as strong as the statistics would suggest.

USA economy is perhaps the strongest western economy right now even if it is only growing around 2.4%pa. The strong US dollar is hurting US profits. 2016 will see a new US President, perhaps Donald Trump or Hillary Clinton.

Europe is keeping out of recession thanks to the weakened Euro making them more competitive, however growth is still very weak, and the population is stagnant. The Brexit and possibility of other Euro nations leaving is creating negative sentiment, which will likely slow Euro growth further.

Chinese manufacturing and exports remains somewhat weak, but services and consumption are doing quite well. Chinese property has started to stabilize despite it's over supply. China is launching the Asian Infrastructure Bank and a Silk Road railway from China to Europe. The main concern for now is the bad loans and how to fix this major banking problem. This is the reason why China is so cheap (PE 7.7), and unlikely to fully recover until the bad loans are purged from the system. The government will likely have to recapitalize (bail out) the banks similar to the US in the GFC. Expect a bad year ahead and GDP downgrades, and a banking shakeup.

India is the strongest growth area in Asia right now and is forecast to grow 7.5% for 2016 and 2017 by the IMF. The “make in India” Modi project should start to show results, along with generally lower oil prices. However persistently high interest rates in India are stalling growth to some degree, and 2016/17 should see Indian interest rates decline further, which should help growth. Emerging Market and the Frontier countries have made some recovery in the past 3 months on the back of rising commodity prices, but still remain vulnerable if oil and commodity prices were to fall back.

Global GDP is forecast by the IMF for 2017 at 3.5%. The US is still looking quite strong. China is forecast to further slow from 6.8% growth to 6.2% growth in 2016. Oil for now has stabilized around USD 50 per barrel, so helping the oil producing nations and the global economy.

Interest Rates remained the same in most of the developed world over the past quarter. The exception was Australia dropping from 2.0% to 1.75%, and India dropping from 6.75% to 6.5%

US long term bonds rates fell sharply over the quarter due to expectations the US Federal Reserve will not increase rates at all in 2016. Also, due to a flight to safety during Brexit.

Inflation has still been mild in most countries and currently not a concern.

Currencies over the quarter were summarized by a very strong rise in the Japanese Yen, and a slight fall in the UK pound due to Brexit. The Aussie dollar was flat against the US dollar and Euro.

Commodities

The past quarter was a strong recovery for oil and commodities.

Oil moved up strongly this past quarter from USD 37 to USD 49 as oversupply worries faded.

Natural Gas had a massive rally from USD 1.95 to USD 2.94, following oil's lead.

Lithium Carbonate Equivalent (LCE) prices have tripled in 2016, with China LCE contracts rising from around USD 6,000 a tonne to over USD 20,000 a tonne, or USD 13,000 a tonne for large contract buyers. This has been driven by booming electric vehicle (EV) sales, especially in China. You can read more about this in my Seeking Alpha articles linked later in the newsletter.

Copper was unchanged at \$2.19 per pound, after a 5 year decline from the 2011 peak when China's construction peaked. The other base metals were all about the same, except Nickel which did well.

Iron Ore prices were sideways at \$55 a tonne.

Uranium went sideways to at USD 27 per pound.

Gold rose significantly to reach \$1,336 per ounce.

Soft commodities were little changed with wheat slightly down and corn slightly up.

Australian Resources Price Earnings Ratio is still fair at 15.1; however the energy sector (especially oil) is facing very serious competition from renewable energy and electric vehicles.

Commentary – Forecast next 6 months

Leading indicators are fairly neutral, with US slightly positive and China slightly negative.

Dow Jones Transport Index (DJT) is another leading indicator. This index tells us how the US transport companies such as shipping, rail and air are doing. It is a good early indicator if the USA economy is slowing. In 2007, the DJT peaked in July. This was about 6 months before the GFC began. It peaked at 9,217 last Dec 29, 2014, basically 1 year ago, and today is at 7,485 slightly down from last quarter but flat over the past year. A neutral sign for the US.

US Retail sales are forecasted to rise. An overall positive sign.

The Baltic Shipping Index (BDI) – (the cost to ship raw materials such as coal & iron ore) bottomed mid February at 219 with the low oil price, and has since recovered to end the quarter at 609. Still low, but recovering. Overall, a slightly positive sign.

The HSBC Caixin Chinese Manufacturing PMI index – It has fallen slightly over the quarter from 49.4 (April) to 48.6 (June) showing China's manufacturing sector is still struggling. The PMI Services Index has been rising. Overall, a neutral or slightly negative sign for China.

A summary of the above leading indicators right now is to expect "China to remain weak for awhile". The US looks slightly positive, and commodities slightly improving.

It looks likely investors in Australia will continue to invest in commercial property due to its yield and perceived safety. Currently it is still fair valued on a PE of 15.89.

Ideas

- Growth and Aggressive investors could buy into the disruptive technology areas such as electric vehicles, lithium miners, solar/wind energy, energy storage and IT areas such as 3D printing, cloud, big data, and robotics.
- Moderate risk investors should remain around 40-50% in safe areas, and have some exposure to commercial real estate.
- All Investors should still keep at least some money in cash or safe fixed interest
- Sell Australian residential property unless it's your home.
- Invest in countries with good demographics, jobs growth, low debt and positive GDP
- Avoid oil exporting countries and be cautious with commodity reliant Emerging Markets.
- Buy direct property in countries that are benefitting from Globalization and where property is still cheap. Eg: Philippines (household debt/GDP is a very low 6%), Thailand, Indonesia, Malaysia, Vietnam, Mexico, Myanmar, Cambodia, Laos.....
- Avoid Euro/UK/Japanese currency. AUD likely to fall further (see link below)
<http://www.news.com.au/finance/superannuation/australian-dollar-could-drop-to-40-us-cents-if-we-dont-stop-our-lavish-spending/news-story/431ffffa9eab5c1fe27cc2b3cf6f89b8>

A view of the green future with Professor Tony Seba

I strongly suggest you watch this 29 minute video.

<https://www.youtube.com/watch?v=CnAYeVOUIOQ>

My latest Seeking Alpha articles

<http://seekingalpha.com/article/3984654-lithium-boom-analysis-future-demand-vs-supply>

<http://seekingalpha.com/article/3983653-galaxy-resources-excellent-way-invest-lithium-miners>

<http://seekingalpha.com/article/3983030-electric-vehicles-will-affordable-popular-2020-ev-portfolio-consider>

<http://seekingalpha.com/article/3981579-top-5-lithium-miners-consider>

<http://seekingalpha.com/article/3981266-lithium-americas-well-valued-near-term-lithium-producer>

<http://seekingalpha.com/article/3980092-companies-buy-ahead-imminent-affordable-global-satellite-internet>

<http://seekingalpha.com/article/3979652-orocobre-leading-lithium-pure-play-miners-lithium-boom>

<http://seekingalpha.com/article/3979187-fortune-minerals-make-investors-fortune>

<http://seekingalpha.com/article/3978337-lithium-boom-may-just-begun-20-year-bull-run>

<http://seekingalpha.com/article/3976986-lithium-ion-battery-trifecta-selecting-best-lithium-cobalt-graphite-miners>

<http://seekingalpha.com/article/3975293-chinas-byd-great-buy>

<http://seekingalpha.com/article/3974912-graphite-miners-next-boom>

<http://seekingalpha.com/article/3973510-positioning-potential-trump-presidency>

<http://seekingalpha.com/article/3970111-cobalt-miners-set-boom>

<http://seekingalpha.com/article/3968738-junior-lithium-miners-high-risk-high-reward>

<http://seekingalpha.com/article/3963851-lithium-miners-booming-lithium-spot-prices-rise-lithium-companies-buy>

My articles are always posted on the HNW website, so you can also find them there and keep up to date if you wish. <http://www.hnwfinancialadvising.com.au/hnw-articles.html>

Australian May 3, 2016 Federal Budget Update - Summary of changes by CFS

This year's Federal Budget includes the most significant changes to Australia's superannuation system since 2007, plus tax initiatives to support low income earners and small businesses.

On Tuesday 3 May, Federal Treasurer Scott Morrison handed down the Federal Budget for the 2016–17 financial year. The Budget measures are designed to aid Australia's transition from a mining-led economy to a stronger, more diversified economy that encourages innovation and supports job growth.

Although the Budget offers tax breaks to support low income earners and small businesses, far-reaching changes to superannuation rules are likely to impact the retirement strategies of many Australians.

Key Budget announcements include:

- reduced caps on concessional and non-concessional super contributions
- tax offsets for low income earners and those with low super balances
- reduced tax concessions on super contributions for high income earners
- a reduced company tax rate for small and medium businesses.

Superannuation changes

Contribution caps reduced

From 1 July 2017, the cap on concessional contributions will reduce to \$25,000 a year for everyone, regardless of age. Currently the concessional contributions cap is \$30,000 under age 50 and \$35,000 for ages 50 and over.

Individuals with super balances under \$500,000 who don't reach their concessional cap in a given year will be able to carry forward their unused cap amounts on a rolling basis over five consecutive years.

A lifetime cap of \$500,000 for non-concessional contributions has been introduced, effective immediately. This replaces the existing annual cap of \$180,000 (or \$540,000 every three years under the bring-forward rule).

The lifetime cap takes into account all non-concessional contributions made from 1 July 2007. Contributions made after the Budget announcement that exceed the cap (taking into account all previous non-concessional contributions) will need to be removed or will be subject to the current penalty tax arrangements. However, there will be no penalties if the cap has been reached or exceeded prior to the Budget announcement (7.30pm AEST, 3 May 2016).

Contribution eligibility requirements updated

The current work test that applies for people making voluntary contributions between age 65 and 74 will be removed as of 1 July 2017. This will make it easier for older Australians to contribute to super.

Individuals will also be able to make contributions for a spouse aged under 75 without requiring the spouse to satisfy a work test.

Tax exemption on TTR pensions removed

The tax exempt status of income from assets supporting transition to retirement (TTR) income streams will be removed from 1 July 2017, with earnings to be taxed at 15%. This change will apply regardless of when the TTR income stream commenced.

Further, individuals will no longer be able to treat certain income stream payments as lump sums for tax purposes, which currently makes them tax-free up to the low rate cap of \$195,000.

Transfer balance cap introduced

On 1 July 2017, a transfer balance cap of \$1.6 million will be introduced to restrict the total amount of super that an individual that can be transferred from the accumulation phase to the pension phase. If an individual accumulates more than \$1.6 million, they will be able to maintain the excess in the accumulation phase (where earnings will be taxed at 15%).

Those already in the pension phase on 1 July 2017 and whose balances exceed \$1.6 million will need to either withdraw the excess or transfer it back into the accumulation phase.

Individuals who breach the cap will be subject to a tax on both the excess amount and the earnings on the excess amount — similar to the tax treatment for excess non-concessional contributions.

Threshold reduced for additional contributions tax

Division 293 tax — an additional 15% contributions tax payable by high income earners with earnings over \$300,000 — will also apply to those with incomes above \$250,000 from 1 July 2017.

For Division 293 purposes, the definition of 'income' includes:

- taxable income (including the net amount on which family trust distribution tax has been paid)
- reportable fringe benefits
- total net investment loss (including net financial investment loss and net rental property loss)
- low tax contributions (non-excessive concessional contributions) including super guarantee, salary sacrifice and personal concessional contributions.

Division 293 tax will apply to any low tax contributions that exceed the \$250,000 threshold, assuming they form the top slice of income.

The following table compares the tax concessions applicable on concessional contributions at various marginal tax rates.

Marginal tax rate*	Contributions tax	Tax concession
21%	15%	6%
34.5%	15%	19.5%
39%	15%	24%

49%	15%	34%
49%	30%**	19%

*Including Medicare Levy and Temporary Budget Repair Levy

**Includes additional 15% contributions tax (Division 293)

Low income superannuation offset introduced

A Low Income Superannuation Tax Offset (LISTO) will be introduced to reduce the tax on contributions for low income earners. The LISTO will replace the Low Income Superannuation Contribution (LISC) scheme when it is abolished on 1 July 2017.

The LISTO will provide a non-refundable tax offset to super funds, based on the tax paid on concessional contributions up to a cap of \$500. The LISTO will apply to members with adjusted taxable income up to \$37,000 that have had a concessional contribution made on their behalf.

The ATO will determine a person's eligibility for the LISTO and advise their super fund annually. The fund will contribute the LISTO to the member's account.

Access increased to tax offset for spouses

The current spouse super tax offset will be available to more people when the spouse income threshold changes on 1 July 2017. The threshold will increase from \$10,800 to \$37,000.

A contributing spouse will be eligible for an 18% offset worth up to \$540 for contributions made to an eligible spouse's super account.

Deductions for personal contributions extended

As of 1 July 2017, Australians under 75 will be able to claim an income tax deduction for any personal contributions made to a complying super fund up to their concessional cap. This effectively allows anyone, regardless of their employment circumstances, to claim a deduction for their personal contributions up to the value of the cap.

Individuals will need to notify their super fund or retirement savings provider of their intention to claim the deduction, before lodging their tax return.

These amounts will count towards the concessional contributions cap and will be subject to 15% contributions tax. Individuals can choose how much of their contributions to deduct — however, if they end up exceeding their concessional cap the deduction claimed on the excess contributions will have no effect, as these amounts will be included in the member's assessable income.

Members of certain prescribed funds would not be entitled to deduct contributions to those schemes. These include all untaxed funds, all Commonwealth defined benefit schemes, and any state, territory or corporate defined benefit schemes that choose to be prescribed.

Anti-detriment payments removed

Anti-detriment provisions will be abolished from 1 July 2017, effectively removing the ability of super funds to increase lump sum death benefits when paid to eligible beneficiaries.

The anti-detriment provisions currently allow a fund to claim a corresponding tax deduction where it is able to increase the amount of a member's death benefit to compensate for the tax paid on contributions.

Tax exemptions extended on retirement products

The tax exemption on earnings in the retirement phase will be extended to products such as deferred lifetime annuities and group self-annuitisation products.

This initiative aims to allow providers to offer a wider range of retirement income products. This will provide more flexibility and choice for retirees and help them to better manage consumption and risk in retirement.

The Government also says it will consult on how these new products are treated under the age pension means test.

Changes to defined benefit schemes

From 1 July 2017, the cap on concessional contributions will reduce to \$25,000. Individuals with super balances under \$500,000 who don't reach their concessional cap in a given year will be able to carry forward their unused cap amounts on a rolling basis over five consecutive years.

The Government will include notional (estimated) and actual employer contributions in the concessional contribution cap for members of an unfunded defined benefit schemes and constitutionally protected funds. For individuals who were members of a funded defined benefit scheme as at 12 May 2009, the existing grandfathering arrangements will continue.

A lifetime cap of \$500,000 for non-concessional contributions has been introduced, effective immediately. Non-concessional contributions made into defined benefit accounts and constitutionally protected funds will be included in an individual's lifetime cap.

If a member of a defined benefit fund exceeds their lifetime cap, ongoing contributions to the defined benefit account can continue but the member will be required to remove, on an annual basis, an equivalent amount (including proxy earnings) from any accumulation account they hold. To broadly replicate the effect of the proposed \$1.6 million transfer balance cap, the government has announced that pension payments over \$100,000 a year paid to members of unfunded defined benefit schemes and constitutionally protected funds providing defined benefit pensions will continue to be taxed at full marginal rates. However, the 10% tax offset will be capped at \$10,000 from 1 July 2017.

For members of funded defined benefit schemes, 50% of pension amounts over \$100,000 per year will now be taxed at the individual's marginal tax rate.

Super objective to be enshrined in law

The objective of superannuation is to provide income in retirement to substitute or supplement the age pension. The government says it will embed this objective in a standalone Act, with an accountability mechanism to ensure that new superannuation legislation is considered in the context of the objective.

Tax changes

Company tax rate reduced

Starting from 1 July 2016, the company tax rate will be reduced to 25% over 10 years. Currently, small companies with aggregated turnover less than \$2 million pay tax at a rate of 28.5%. Franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution.

Financial year	Companies with turnover below	Applicable tax rate
2016-17	\$10 million	27.5%
2017-18	\$25 million	27.5%
2018-19	\$50 million	27.5%
2019-20	\$100 million	27.5%
2020-21	\$250 million	27.5%
2021-22	\$500 million	27.5%
2022-23	\$1 billion	27.5%
2024-25	All companies	27%
2025-26	All companies	26%
2026-27	All companies	25%

Small business turnover threshold increased

The small business entity turnover threshold will be increased from \$2 million to \$10 million so that more businesses can access certain existing income tax concessions. These include:

- simplified depreciation rules, including immediate tax deductibility for asset purchases costing less than \$20,000 until 30 June 2017 and then less than \$1,000
- simplified trading stock rules, giving businesses the option to avoid an end-of-year stocktake if the value of the stock has changed by less than \$5,000
- a simplified method of paying PAYG installments calculated by the ATO, which removes the risk of under- or over-estimating PAYG installments and the resulting penalties that may be applied

- the option to account for GST on a cash basis and pay GST installments as calculated by the ATO
- other tax concessions currently available to small businesses, such as the Fringe Benefits Tax concessions (from 1 April 2017, the beginning of the next fringe benefit tax year).

Small business tax discount increased

The unincorporated small business tax discount will be increased in phases over 10 years from the current 5% to 16%. The following table indicates when the discount rates will apply.

Financial year	Discount rate
2016-17	8%
2017-18 to 2024-25	10%
2025-26	13%
2026-27+	16%

Personal income tax reduced

From 1 July 2016, the 32.5% personal income tax threshold will increase from \$80,000 to \$87,000. This measure will reduce the marginal rate of tax on income between \$80,000 and \$87,000 from 37% to 32.5%. For example, a taxpayer earning \$87,000 will save \$315 per year as a result.

This will ensure the average full-time wage earner will not move into the second highest tax bracket in the next three years.

Current tax rates 2015–16	
Taxable Income (\$)	Tax Payable (\$)*
\$0 - \$18,200	0%
\$18,201 - \$37,000	19% over \$18,200
\$37,001 - \$80,000	\$3,572 + 32.5% over \$37,000
\$80,000 - \$180,000	\$17,547 + 37% over \$80,000
\$180,000+	\$54,547 + 45% over \$180,000

*Excludes Medicare Levy and Temporary Budget Repair Levy

Proposed tax rates 2016–17	
Taxable Income (\$)	Tax Payable (\$)*
\$0 - \$18,200	0%
\$18,201 - \$37,000	19% over \$18,200
\$37,001 - \$87,000	\$3,572 + 32.5% over \$37,000
\$87,000 - \$180,000	\$19,822 + 37% over \$87,000
\$180,000+	\$54,232 + 45% over \$180,000

*Excludes Medicare Levy and Temporary Budget Repair Levy

Social security changes

Payments simplified and savings introduced

Means testing arrangements for students and other payment recipients will be simplified from 1 January 2017. The changes include aligning the:

- assets test for all Youth Allowance and Austudy recipients, including those partnered to a Social Security or Veterans' Affairs income support recipient
- means test rules used to assess interests in trusts and private companies for all student payment recipients, including independent Youth Allowance and ABSTUDY recipients
- social security benefit and ABSTUDY income test treatment of gift payments from immediate family members with existing pension rules

- Family Tax Benefit (FTB) income test and youth Parental Income Test, and authorizing the use of FTB income details for the youth Parental Income Test low tax contributions (non-excessive concessional contributions) including super guarantee, salary sacrifice and personal concessional contributions.

A range of social security measures aimed at savings to fund the National Disability Insurance Scheme are also proposed. These include:

- New welfare recipients from 20 September 2016 will not be eligible for carbon tax compensation.
- Backdating provisions for new Carer Allowance claims will be aligned with other social security payments. From 1 January 2017, Carer Allowance will be payable to eligible applicants from the date of the claim, or the date they first contact the Department of Human Services.
- Increased reviews of Disability Support Pension recipients by assessing their capacity to work.

To find out more please contact an adviser at contactus@hnwfinancialadvising.com.au.

NB: High Net Worth Financial Advising attempts to enhance overall return for clients by investing in undervalued regions of the world and undervalued asset classes, that have positive growth stories.

NB: The contents of this newsletter does not constitute personal advice and is general in nature, please see your adviser for personal advice suitable to your own needs and objectives.