Investment Solutions

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Welcome

In this edition of Investment Solutions magazine we take a look at end of financial year strategies.

BT Financial Group Investment Specialist, Riccardo Briganti, provides us with a market update on local and international markets.

Finally, we share insights on sustainable and impact investing.

Until next time – happy reading.

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Market update

US growth has supported investment market recovery over the quarter, though the prospect of further US rate increases means recovery is tentative.

The US Federal Reserve (Fed) increased the fed funds rate by 25 basis points to 1.75%-2.0% at its June meeting. This is the seventh interest rate increase in the current tightening cycle that started in December 2015. The Fed is taking a very gradual approach to normalising interest rates consistent with economic developments and unfolding risks that may impact economic growth. Tightening was put on hold for a year after the initial increase in 2015 and again in the second half of 2017 when growth faltered and inflation pressures were largely absent.

The current phase of rate rises is being perceived differently by market participants. Wage and inflation pressures are becoming more prominent concerns in the US as the unemployment rate continues to trend lower and capacity constraints are becoming apparent after four years of uninterrupted economic growth. Current market expectations are that the Fed will increase rates at least two more times this year. This would still leave US official rates significantly below previous highs.

The impact of US inflation and interest rate fears can be clearly seen in the sharp falls in share markets earlier this year. There is, however, a continuing tug of war between these fears and the fact that higher inflation and interest rates are being driven by improved growth. Global shares have rebounded from March quarter weakness but the recovery remains tentative and volatile. The MSCI Developed Markets index will have posted three consecutive months of positive returns by the end of June following significant declines in February and March. As always, other developments have also influenced market behaviour with renewed concerns about the stability of the European Union following Italian elections being the major negative. In contrast, perceptions of risks associated with North Korean nuclear capabilities have significantly eased as the US and North Korea have made it to the negotiating table.

The major Australian development was the release of March quarter GDP results showing a seasonally adjusted 1% increase in the quarter and 3.1% growth compared to a year earlier. While the headline result was strong, the component parts did not suggest growth would be sustained at this higher level. In particular, the increase in inventories and the strength of government consumption expenditure in the March quarter are unlikely to be repeated. As such, the GDP result is not expected to prompt a reaction from the Reserve Bank of Australia (RBA), who have kept official rates unchanged at 1.5% for the past two years. Wages growth in Australia remains stuck at around 2% with consumer price inflation similarly subdued. As a result, most expect the RBA will keep rates unchanged through 2018.

The Australian sharemarket has matched the US market's rebound since the end of March, although has been slightly more subdued over the past couple of months with the Resources sector posting strong returns while the remainder of the market has been held back by financial stocks and weakness in Telstra.

New financial year super strategies

The start of the financial year is a good time to think about how you could build your super and start saving for retirement. Here are some options to consider to help your super work harder for you.

Tax-deductible super contributions

You may be eligible to claim a tax deduction for your personal super contributions. By doing this, you may be able to pay less tax while saving more for your future. Your eligibility can be affected by your age, sources of income and the level of salary sacrifice and certain other employer contributions made for you. To claim a deduction, you must give a notice to the Trustee of your super fund and have it acknowledged.

Keep in mind that personal deductible contributions count towards your annual before-tax contributions cap. The current before-tax contributions cap is $25,000 per financial year. Any contributions made above these limits will attract additional tax.

Salary sacrifice to top up your super

Salary sacrifice is an arrangement where part of your before-tax wage or salary is paid into your super account instead of being received as take-home pay. It could be an effective way to boost your super and help you with saving for retirement. There may be tax advantages for you, depending on how much you earn.

To get started, do a budget to work out how much you can afford to invest from each pay packet. You may also consider talking to your employer to find out if they can set up salary sacrifice arrangements for you.

Keep in mind that salary sacrifice contributions count towards your annual before-tax contributions cap of $25,000 per financial year. Personal deductible contributions and contributions made by your employer also count towards your annual before-tax contributions cap.

Consider a one-off contribution

After-tax super contributions are made from money you have already paid income tax on and won't be claiming a tax deduction on. For example if you work for an employer, making a contribution to super directly from your bank account is considered an after-tax contribution.

Investment earnings within your super accumulation account are taxed at up to 15%, compared to your marginal tax rate which applies to investments you may hold outside of super. Please note that depending on your income level, your marginal tax rate may be less than 15%.

The annual limit for after-tax contributions is currently $100,000 if your total superannuation balance is below $1.6 million at the start of the financial year. In certain circumstances, you may be able to bring forward three years of after-tax contributions into one year, contributing up to $300,000, if you haven't triggered the rule in the previous two years and your total superannuation balance is below $1.4 million at the start of the financial year. You may still be able to contribute part of the bring-forward if your total superannuation balance is between $1.4 million and $1.5 million at the start of the financial year.

Downsizer contributions

From 1 July 2018, if you are planning on downsizing your family home of ten years or more and are aged 65or over, you may be able to contribute up to $300,000 from the sale proceeds to superannuation as a downsizer contribution. If you have a spouse, they could also contribute up to $300,000 to their superannuation from these proceeds. Downsizer contributions do not count towards your before or after-tax contribution caps or caps on contributions for total superannuation balance. You can find out more about whether you might be eligible at ato.gov.au.

Be aware of annual limits

As annual limits apply to the amount you can add to your super each year, it is important to consider how much you have already added to your account (or accounts) during the financial year to know which strategies can work for you. Visit ato.gov.au for the latest information on super contributions.

The rise of sustainable and impact investing

There is no doubt that interest in responsible investments is growing. Not only in Australia but globally, investors are increasingly interested in how a company makes its money not simply how much it makes.

Whilst some investors may focus on the longer-term viability of a company and its behaviour, others may hold particular values they want their investments to mirror. How these two strategies play out in the investments context can be different.

This is not a new idea

Today, many investment managers, including BT, use environmental, social and corporate governance (known collectively as ESG) knowledge and data. It can help to inform the analysis of risk, innovation, operating performance, competitive and strategic positioning, and quality of management, corporate culture and governance and to enhance financial valuation, portfolio construction, engagement and voting practices.

Examples may include a company's interactions with the environment, such as water and air pollution, social factors like employee diversity or safety standards, along with the company's governance structure, such as how the board is composed and compensation structures. This approach seeks to add value or manage risks through broader, more comprehensive investment analysis, decision-making and engagement with companies.

This approach is providing measurable results

Investor-led initiatives have resulted in change at some of the world's biggest companies. For example last year, investors successfully influenced oil and gas company, Exxon, to be more open about the effects of climate change on its business, by improving is disclosure of climate-related risk.

In December, engagement provider Hermes EOS, who advocates for change in global companies on behalf of investors, released its key themes for engagement in 2018, which included climate change, diversity, remuneration and human rights. Focusing on ESG issues allows investors to make a positive impact, or at least encourage the companies they invest in to make these changes.

There are opportunities for everyone

For retail investors, navigating the world of responsible investment can be complex, terms like ethical, sustainable and impact investing are often used interchangeably by investors seeking to ensure that their money is invested in companies or funds that mirror their values and beliefs. In reality, these terms each related to a specific type of responsible investing – depending on what the investment is trying to achieve.

Arguably, the most well-known responsible investment strategy amongst retail investors is ethical investing. This strategy's primary purpose is to exclude certain industry sectors, companies, practices or even, at times, and countries that meet specific criteria from a fund or portfolio, based largely on the client's preference not to be invested in these activities. Traditional ethical investment

strategies seek to avoid issues like tobacco, weapons, gambling, and pornography, however, investors are increasingly interested in strategies that avoid sectors linked to climate change or human rights abuses.

Sustainable investing, in contrast, is a type of responsible investing that considers ESG issues in an investment, alongside standard financial measures when assessing a company's performance. This might include how a company approaches employee relations, executive remuneration and anti-money laundering legislation, how it manages strategic issues such as climate change, or how it manages corruption.

Sustainable investing as an approach that explores further to reveal broader risks and help to identify greater opportunities. It naturally lends itself to longer-term investment horizons and strategies. The attractive consequence of this approach is that as more investors use a sustainable strategy in their investment decision-making, more and more companies will be encouraged to behave sustainably and address ESG concerns and opportunities in their business.

You may also have heard about the rapidly developing field of impact investing. Impact investments preference the social or environmental purpose of an investment over or alongside its financial results. An impact investment should be aligned to creating a positive social or environmental impact, it cannot simply be a bi-product of business-as-usual behaviours. Impact investments may target a specific social or environmental issue (think homelessness or renewable energy) or may be more broadly themed, for example focusing on businesses that have a measurable social impact across a range of areas (for example diversity, job creation or medical research). Whilst there are currently few opportunities to access impact investments for most retail investors, many people are attracted to the idea of investments that aim to deliver a positive outcome as an alternative, or complement to traditional.

What can retail investors do today?

While specific impact investments may be difficult to access for many investors, more traditional investments can still be used to make an impact. We know that that there are often factors outside of the standard measures of business and financial performance that can influence the viability of of a company from an investing perspective. Considering responsible investment strategies, allocating a portion of your funds to a dedicated sustainable or ethical option, or even personally investing in those companies known for involvement in social or environmental projects are all possibilities to consider and discuss with your financial advisors.

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