FIDUCIAN FOCUS

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ADVICE BEATS 'ALPHA' FOR RETIREMENT INCOME

When it comes to investment returns, research is showing that financial advice beats the search for 'alpha', which measures an investment's performance compared to a certain benchmark.

Last year, *Forbes* business magazine said that people who consulted financial planners enjoyed an annual return almost 3% higher than those who didn't — even after the fees they paid for that advice.

A recent study, *Alpha Beta and Now … Gamma*, by Morningstar researchers David Blanchett and Paul Kaplan , goes further than this and talks about 'gamma' – the extra value achieved from intelligent financial decisions. These researchers say gamma has five elements:

1. dynamic withdrawal strategy
2. asset allocation that is optimised relative to liabilities
3. tax-efficient decisions
4. total wealth framework
5. guaranteed income products such as annuities

Unlike traditional alpha, which can be hard to predict, Blanchett and Kaplan have found that gamma can be achieved by anyone following an efficient financial planning strategy.

From a wider perspective, each of these gamma concepts can be thought of as the actions and services provided by financial planners.

Blanchett and Kaplan estimate a retiree can expect to generate more than 20% more in certainty-equivalent income using an income strategy that's gamma-efficient.

Among the five elements, the most important is using a dynamic withdrawal strategy. The second most important is total wealth asset allocation. The third is making tax-efficient allocation decisions.

But, two things may influence the results. First, investor attitudes about the timing of income can be important in assessing the value of intelligent financial planning. Second, gamma-generating strategies may incur more costs.

Inside this issue...

DON'T WAIT FOR THE BUDGET – THE TIME TO ACT IS NOW

With pre-Budget submissions now completed, the May 2016 Budget forms the centrepiece of the election year ahead in the battle for the hearts and minds of Australian voters.

Critically, the debate is about the continued reform of the Australian tax system, in the light of continued demographic and economic growth challenges. Treasury Secretary John Fraser in his Budget speech to the Sydney Institute in January this year made some very important points.

'Australia's Budget position never was as bad as these (developed) countries and our economy never stopped growing. But we cannot be complacent.

'Expenditure restraint played a key role in all these countries in improving their fiscal situation.

'All that said, over the longer-term, economic growth will be critical for fiscal sustainability as well as continued improvements in living standards. This will require ongoing productivity-enhancing structural reform.

'The 2015 Intergenerational Report highlighted the long-term challenges that lie before us.

'The ageing of Australia's population will weigh heavily on Australia's potential growth rate and long-term fiscal position. Demographic and broader medium-term pressures will place greater demands on government finances, making deficit and debt reduction more difficult.

'Structural reform is critical and this includes reforming competition policy and implementing the Harper Review recommendations.

'Improving productivity is a far more sustainable way to boost economic growth than relying unduly on exchange rate depreciation.

'These growth-enhancing policies also very much include tax reform. Tax is not just about raising revenue, it is also about helping to shape the economy so that we attract and deploy resources in a manner to promote long term growth. The arguments for a tax mix switch rest heavily on encouraging more jobs through a higher growth path. Tax reform is a complex issue and is very much the focus of the Government at the current time'.

So what is the 'lay of the land', given the political noise?

At this stage, the Prime Minister and Treasurer have ruled out increasing the GST rate and abolishing negative gearing.

Still on the table are possible amendments to Capital Gains Tax and Superannuation.

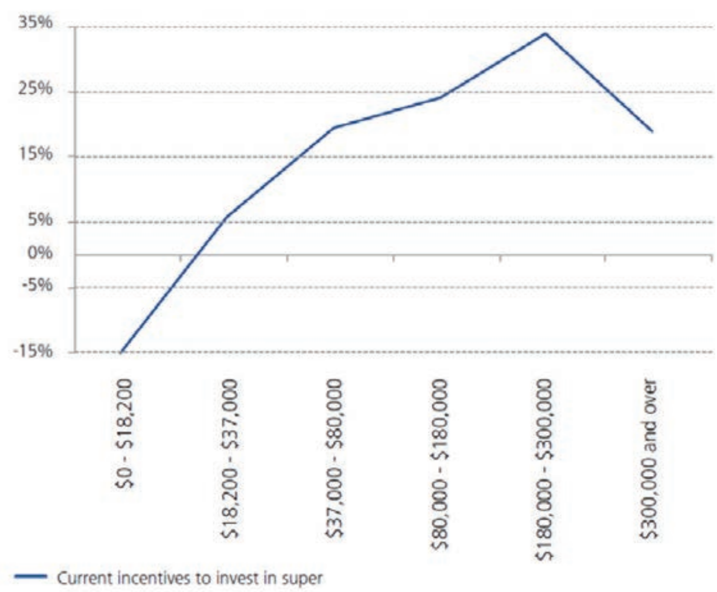
Currently, superannuation is valued at $1.8 trillion. Superannuation is:

- taxed at 15% upon entry for concessional contributions (including SGC), with an additional tax of 15% tax applying to higher income earners (>300K)
- subject to a Superannuation Guarantee increase from 9.5% to 12% by 2025
- subject to caps for contributions, but is not subject to a lifetime cap
- subject to concessional treatment of assets and income when in pension phase, with pension income received post-age 60 generally treated as tax-free
- subject to Preservation Age, which is less than the current Age Pension Age, and
- providing a possible refund of contributions tax via a possible anti-detriment payment for superannuation dependents.

Much of the media discussion has focused on superannuation tax upon entry, with little commentary on the intertwined effect on the Age Pension, national savings and substitution into non-superannuation investments.

Critically, the Prime Minister and Treasurer have been considering Deloitte's paper, *Shedding light on the debate*, which includes the argument that existing superannuation concessions, while costing less than the Age Pension, are inequitably targeted, 'with $1 in every $200 of the cost of superannuation concessions going to the bottom 20% of income earners, whereas more than half goes to the top 20%' (Murray Review).

Chart 1: Tax benefit (loss) of diverting a dollar from wages to super



Source: Deloitte Access Economics, Deloitte Shedding the light on the debate

Deloitte has proposed that superannuation be taxed at current marginal tax rates with the application of a 15% tax offset. Deloitte estimates that this will provide a reform dividend of $6 billion in 2016-17 that could then be used to lower the company rate, with little effect on the Age Pension .

In contrast, ASFA modelling by PwC of a 15% rebate notes that the rebate would increase in the reliance upon the Age Pension and higher tax rates applying for those earning between $37,000 and $300,000.

TURBULENCE IN THE CHINESE ECONOMY AND ITS IMPLICATIONS FOR THE STOCK MARKET

BY AMBER SAFT, SENIOR PRODUCT MANAGER, FRANKLIN GLOBAL EQUITY GROUP, ONE OF THE UNDERLYING MANAGERS OF THE FIDUCIAN INTERNATIONAL SHARE FUND

China concerns have been at the centre of the volatility that has engulfed financial markets so far this year. Fears about a slowing Chinese economy, falling Chinese domestic equity prices and private capital outflows as the government works to stabilise markets have been at the top of the headlines. While Chinese reserves remain at comfortable levels, they have declined over the past 18 months in the face of a weakened economy and falling commodity prices. According to the People's Bank of China, January saw foreign exchange reserves drop nearly US$100 billion to US$3.23 trillion as policymakers tried to support the Chinese currency amid private capital outflows.

We attribute much of the recent weakness in the Chinese economy to the uneven transition from an investment-led economy to a domestic consumption and services-led economy. China's policymakers are in the challenging position of having to manage this economic transition, while at the same time keeping growth fast enough to preserve political stability. However, we believe that China's policymakers have both the tools and the financial firepower to counter the recent slowdown and keep growth on track at 6%-7% a year, which in turn is sufficient to support global growth.

" China's policymakers have both the tools and the financial firepower to counter the recent slowdown and keep growth on track at 6%-7% a year"

Increasing labour costs and interest rates have put downward pressure on profits; higher wages boost consumption, which has increasingly become the anchor of Chinese growth; we estimate that consumption is now a much higher proportion of GDP than it was 2 years ago (it was 37% in 2014 according to the World Bank – see chart below) and rising.

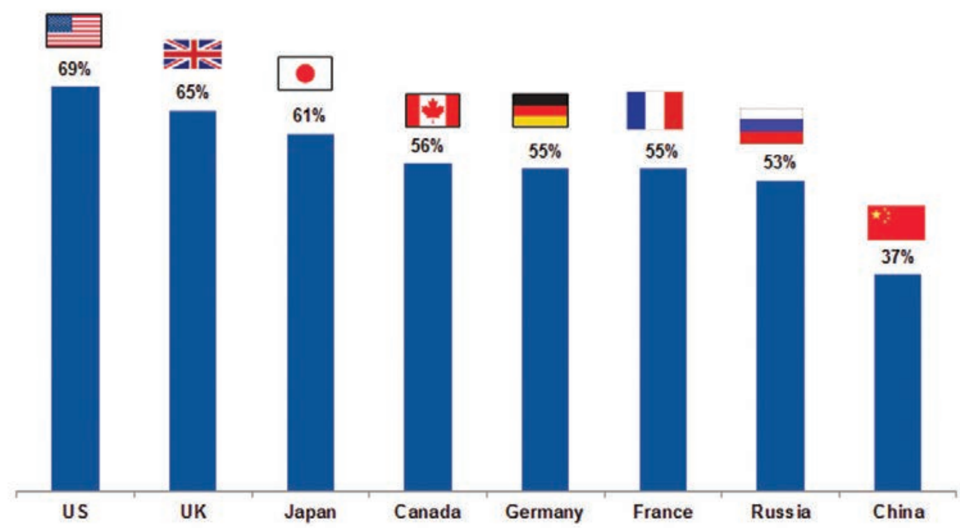
The private sector in China now contributes more to job growth than the state-owned sector, which has not been the case for the past 30 years. China's rapid urbanisation process will also necessitate development. Plans for infrastructure investment are underway as the railways sector is set to expand along with demand for broader use of water purification and environmental related projects. Such projects could somewhat offset the negative drags on growth from a contraction in manufacturing and excess capacity in the real estate sector.

Franklin Global's investment approach

We continue to focus on bottom-up individual stock selection in these volatile and unpredictable markets. In fact, despite China's economic deceleration, we have identified and invested in growth companies in China with sustainable business models, best-in-class management teams and strong returns on capital. For instance, we hold a position in TAL Education Group, an after-school tutoring services company, which grew revenues 43% and enrolments 56% in their most recent quarterly release across 301 centres in 24 key Chinese cities. Given China's competitive, examination-based education system, our analysis indicates that parents will continue to spend substantial sums on preparing their children for the future. Although China's transition may make for turbulent and headline-driven markets in the short term, we remain consistent in our belief that company fundamentals will matter over the longer term and continue to invest accordingly.

International Comparison of Consumption as a % of GDP

Statistics for the Year 2014



Source: The World Bank, Household Final Consumption Expenditure as a % of GDP

FIDUCIAN IN THE COMMUNITY

FIDUCIAN HELPS FLOAT THE BOATS

Fiducian has just signed up to sponsor two rowing sculls for Newcastle Grammar School's rowing team.

This includes sponsorship for five years and naming rights for the two sculls.

The double will be named *Fiducian Newcastle* and the single will be *Fiducian Hunter.*

Fiducian's MD, Indy Singh, says he's thrilled that the company is able to help with this project.

VISION BEYOND AUS CLOSE TO 20,000 EYE SURGERIES

Vision Beyond AUS (VBA) helps restore sight to some of the world's most disadvantaged people, through performing free clinical consultations and eye assessments, cataract surgery, provision of glasses and the administration of any other necessary eye care. To date, VBA has conducted 60,000 eye tests and performed 16,852 eye surgeries.

If you would like to donate, please visit www.visionbeyondaus.org.au

BURGEONING WRITER TAKES OUT AWARD

Thomas Burge – son of Fiducian investments manager Conrad Burge – receives his medal for the highest score in Year 6 English for the International Competitions and Assessments for Schools (ICAS).

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