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Quarterly

2018 SUMMER EDITION

2018: A Balancing Act

BY **Tom Stevenson**

Most of the time, investors don't need to think too much about market timing or asset allocation. The long-term trajectory of financial markets is up and the only sensible thing to do is to be fully invested and allow the odds to work in your favour.

As we enter 2018, however, it doesn't feel like 'most of the time'. Nine years into the current equity bull market and with well-known and successful investors like Jeremy Grantham and Neil Woodford muttering darkly about investment 'bubbles', every investor's new year resolution should be to look at their portfolio and understand the risks they are taking.

If you try to call the top of the equity market, one of three things will happen. You will get it just right, be too early or too late. The chance of the first is vanishingly small, so it is prudent to assume that if you try and time the market peak you will get it wrong.

The only question that matters is how you want to be wrong. Do you care more about losing what you have accumulated in recent years or watching from the side-lines as others make profits that you have consciously foregone?

Continued on page 2…

INSIDE:

Understanding the new superannuation pros… and cons **PAGE 3**

Vanguard chief: You will never see a bitcoin fund from us **PAGE 4**

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… Continued on from page 1

Whichever misjudgement you choose, it will probably be expensive especially if you are over-exposed to the equity market as most investors are. A year ago, you could have looked at the valuation of the US stock market and concluded that it was over-priced. Shares cost about 25pc more as a multiple of profits than their long-term average. If you had de-risked your equity portfolio at the beginning of 2017, you would have missed out on a 20pc rise in the S&P 500 and even more on the basis of the Dow Jones Industrials index or the Nasdaq.

Anyone bailing out of the market today risks a similar opportunity loss. In every market peak since the 1920s, returns have tended to accelerate in the six months before the market changes direction. On average, missing out on the final year of a bull market has meant leaving 20pc of gains on the table for someone else.

Being late is just as painful. Between 2000 and 2002, the same US benchmark index fell by nearly 50pc. Between the peak in 2007 and the bottom of the market in 2009, the fall was closer to 60pc. These are the exception not the rule but there are plenty of other examples of market falls of between 10pc and 20pc. Even these are worth avoiding if you can. Remember, a 50pc fall in the value of a portfolio requires a 100pc recovery simply to get back to square one.

So if like most people you feel the pain of a loss more than you enjoy the pleasure of a gain, you are probably thinking about protecting what you've got. How might you do that?

If you are really risk-averse, you may decide that the market has been driven by excessively loose central bank policy which is now reversing, that valuations have gone too far and that the market has had a fantastic run. You will swap all your investments for cash. Anyone doing this needs to understand that it comes with a significant cost. It's not just the opportunity cost, it's the fact that assets like cash with the lowest risks also guarantee the lowest returns. All the while that you are 'de-risked' you will be losing money in real terms.

The good news is that you don't need to do this. If you are prepared to accept that a portion of your portfolio will indeed go 'over the cliff' when the market inevitably turns you can still minimise your losses and maintain some exposure to any final 'melt-up' phase in the market by injecting some balance into your investments.

To see how this worked the last time an equity market bubble burst, let's jump back in time to the 1999-2003 boom and bust. In 1999, emerging market equities delivered a total return of 72pc while Japanese shares returned 67pc. A well-diversified global equity fund would have given you 31pc while the defensive assets in your balanced portfolio would have looked drearily pedestrian at 6pc for cash, 3pc for corporate bonds and a modest fall in the value of any government bonds you held.

The following year as the equity bubble burst, the emerging market equities that topped the table in 1999 were the worst performers, losing more than 25pc of their value and the Japanese shares were not far behind. Offsetting those falls, however, were cash, with a slightly higher return than the previous year and double digit returns from all types of debt: emerging market, corporate and government. In 2001, it was the same story. By 2003, however, the tables had turned with emerging market equities the top performer and government bonds at the bottom of the list.

One of the problems with how we think about our investments is that we are encouraged by the media to think it is all about equities. This is natural. Shares are more newsworthy because they bounce around more than bonds and are more closely linked to the ups and downs of corporate news. But this focus on shares encourages us to think in black and white terms about the market. If your new year's resolution is to take some risk off the table, don't overdo it and don't swap one unbalanced portfolio full of equities for another stuffed full of cash. At this uncertain point in the cycle you can't be too diversified.

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Understanding the new superannuation pros... and cons

BY **Nick Bruining**

There's a saying in the financial planning game that we'll never be out of work because the mugs in Canberra keep changing the rules.

Two sets of changes, including one lot rushed through Parliament in the dying days of 2017, have further altered the timing and nature of decisions we have to make when preparing for retirement.

There are some nasties involved, but also opportunities to better set ourselves up for retirement.

Just before it rose for the year, Parliament passed laws allowing people aged 65 or more to inject hundreds of thousands into super.

Workers can now put money into super and claim a tax deduction.

The new rules for putting the proceeds of selling a home into super take effect on July 1 this year.

Providing you've been in your primary dwelling for at least 10 years, you will be able to contribute up to $300,000 from the sale proceeds into super, irrespective of your age.

If there's two of you, that potentially means a $600,000 dump into super. Sale contracts need to change hands after that date and the money must hit the super fund within 90 days of settlement. You can't top up the amount to get it to $600,000 if the house sells for less but equally, you don't have to down-size by buying a new place. You might decide to rent instead.

Of course, once it's in super it can be converted to a completely tax-free income stream like an account-based pension.

A $600,000 combined amount would generate an income of at least $36,000 per annum for a pair of 76-year-olds, based on the minimum drawdown of 6 per cent of the account balance.

To be blunt, it's mainly of interest to someone who has pots of income in retirement and pays a decent amount in tax or, perhaps, would like to take advantage of death benefit payment rules that bypass their will and the need to go to probate when they die.

You can nominate dependants as the beneficiary of your super fund using a non-lapsing binding death benefit nomination and the super fund will pay it to the specified people.

A lot of the talk about the changes in contribution rules that took effect in July last year focused on the Feds' rather meanly cutting the concessional contribution cap from $35,000 for older workers to $25,000 annually for most workers. But we shouldn't forget the changes also included the dropping of a silly rule that effectively meant only the self-employed could claim a tax deduction for making concessional contributions into their super fund.

A concessional contribution is a contribution where someone, typically your boss, claims a tax deduction for making the super payment. It has always included the boss's 9.5 per cent compulsory super contributions and any amounts you choose to salary sacrifice.

Salary sacrifice is where you ask your employer to redirect some of your pre-taxed income to super. Up until July last year, it was really the only way an employed individual could pump money into super and get a tax break.

Now, an individual can claim a personal tax deduction for money they choose to put into super up to the new $25,000 cap. It means you no longer have to salary sacrifice to get concessional money into super.

https://thewest.com.au/business/your-money/understanding-the-new-superannuation-pros-and-cons-ng-b88717077z

Vanguard chief: You will never see a bitcoin fund from us

BY **Thomas Franck**

Vanguard CEO Tim Buckley may think highly of blockchain technology, but he isn't planning on investing in bitcoin anytime soon.

Buckley, who succeeded the firm's former chief, Bill McNabb, at the start of the year, oversees roughly $4.5 trillion in assets under management.

"You will never see a fund from Vanguard on bitcoin," Buckley told CNBC's Bob Pisani on Monday. "We tend to stay away from assets that don't have underlying economic value. They don't generate earnings or cash flows."

Digital currency bitcoin has risen and fallen dramatically over the past several months in what many investors consider a bubble-like move. Generated through a digital process called "mining," bitcoin derives much of its value from its scarcity. And given widespread appraising and volatile price moves, Buckley told investors he's steering well clear of the space.

"The bitcoin – its value is based off of scarcity – and an artificial scarcity that's out there," he explained. "It's really tough to imagine where the long-term return comes from other than speculation."

Buckley compared the lack of fundamental economic value in bitcoin to a lack of fundamental value in gold, an asset class which Vanguard also avoids.

Vanguard, based in Malvern, Pennsylvania, prides itself as one of Wall Street's most low-cost and conservative managers. Founder John Bogle's strategy of low-cost index fund investing has since swept across Wall Street.

www.cnbc.com/2018/01/22/vanguard-chief-you-will-never-see-a-bitcoin-fund-from-us.html

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