July 2017

PERPETUAL SELECT ANNUAL UPDATE 2016/17

SELECT SUPER, PENSION, INVESTMENTS

WELCOME TO YOUR ANNUAL UPDATE

To end the financial year, I'd like to start by thanking you for trusting Perpetual to manage your money.

I want to quickly discuss what we've seen happening in investment markets and how Perpetual has responded. Then I'll touch briefly on some superannuation law changes that may affect you – now or in the future.

Your enclosed annual statement for 2016/17 provides details of your account balances and returns, as well as any transactions you performed during the financial year.

2017 – BETTER THAN THE HEADLINES

While the newspapers have been full of stories about market volatility and political surprises (President Trump, Brexit, the recent UK election etc) FY2017 has been another year of positive returns for investors across most asset classes.

Global and Australian sharemarkets performed particularly well. Income returns from fixed income (bonds) and from term deposits and cash remained positive – but low.

Our Select multi-asset funds, built around a carefully selected mix of growth assets (shares, property and infrastructure), as well as defensive assets (bonds and corporate credit) posted returns in excess of their long-term return targets, while continuing to deliver a smoother ride compared to other funds.

These are impressive outcomes, particularly considering the low interest rate, low inflation environment we are living in. Perhaps most importantly, they are not a one-year phenomenon.

Over the past three years our Select Funds have comfortably beaten the return available from cash and along the way, easily outstripped inflation. This means Perpetual investors have enjoyed a real wealth gain.

MANAGING UNCERTAINTY

As these results indicate, it is possible for investors to navigate a volatile world – with the right philosophy. At Perpetual we have always had a consistent approach to uncertainty – to take a long-term view, focus on investment fundamentals such as value and quality – and to diversify both risks and returns.

Our Select investment portfolios are constructed to provide the benefits of diversification at every level. In addition to spreading your capital across the range of asset classes, we seek to select the best specialist managers within each asset class.

One other thing I know for certain is that no-one ever grew their wealth by not investing. We encourage all our clients to invest through market cycles – both rises and falls – via a considered and consistent strategy tuned to their individual life goals and circumstances.

SUPER CHANGES

As you no doubt have heard, the government has made a number of changes to superannuation and retirement incomes policy effective 1 July 2017. A summary of these key changes is provided on page 4.

Like many in the investment and advisory field, I'd like to see fewer changes to super rules. Yet the reality is that superannuation continues to be a very attractive way of investing to provide for retirement. If anything, the changes highlight the value of maximising your superannuation balance and reaping the tax benefits it provides – on the contributions you make, the returns you enjoy and on the retirement income it eventually pays out to you.

If you have any questions about maximising your superannuation balance, optimising your investment strategy, or would simply like to speak to one of our advisers please contact us on 1800 003 001.

Thank you once again for entrusting us with your investments.

MARK SMITH
Group Executive,
Perpetual Private

FINANCIAL YEAR 2016/17 AT A GLANCE

AUSTRALIAN SHAREMARKET

The Australian stock market delivered positive returns in FY2017 with the S&P/ASX 300 Accumulation Index rising 13.8% to 30 June, driven by broad contributions from all but two sectors. Banks grew revenue and managed expenses well, credit quality was sound, and bad and doubtful debts remained historically low resulting in earnings growth. However, with housing affordability and interest rates both at all-time lows we continue to remain watchful. Resources stocks finished the year higher, benefiting from rising commodities prices as well as better than expected cost discipline, allowing them to deleverage their balance sheets and increase their dividends. Real Estate Investment Trusts (REITs), utilities and infrastructure stocks remained highly sought-after for their attractive dividend yields, in spite of a correction earlier in the year when bond yields sold off. The weakest sector was telecommunications which is undergoing structural change as the industry transitions to the National Broadband Network (NBN), resulting in industry consolidation, increased competition and lower prices.

GLOBAL SHAREMARKET

Equity markets abroad returned positive gains over the year, despite several key geopolitical events including the US and French presidential elections, and more recently the UK general election. The major US sharemarket indices all rose to record highs as earnings accelerated to the best year-on-year growth in six years, beating market expectations. Technology stocks were the standout, with the so-called 'FANG' stocks (Facebook, Amazon, Netflix, Google) delivering share price gains of up to 58.6% over the year. European markets also performed strongly as the economic recovery continued – in the UK the FTSE 100 gained 12.4%, the German DAX was up 27.3%, and the French CAC 40 rose 20.8%. Across equity markets globally a consistent theme is valuations continuing to trade above their long-term historical averages, and value as an investment style has been underperforming its growth counterpart. However, there are always opportunities to own high quality companies trading below fair value, and as a value manager this has simply meant we have had to work much harder to identify these.

INFLATION, INTEREST RATES AND CREDIT SPREADS

The Australian economy was patchy through FY2017 with the annual rate of growth slowing to just 1.7% by the end of the March quarter. Despite some strong leading indices, a home construction boom and a rebound in commodity prices, weak consumer spending emerged as the new threat to the Australian economy. Low inflation allowed the Reserve Bank of Australia (RBA) to lower interest rates again in August to 1.5%. However, the resultant house price surge and the switch to a new RBA Governor refocused attention on the health of household balance sheets, which are laden with record levels of debt. This problem was accentuated by wage growth falling to new multi-decade lows and underemployment rising to a multi-decade high. New regulatory restrictions on investment loans and out-of-cycle rate hikes by the banks helped cool speculative excess going into 2017, and the government delivered a big-spending infrastructure budget which slugged foreigners and the big banks. Despite fears of the loss of Australia's AAA credit rating, the Australian dollar remained stubbornly high and bond markets were fairly subdued.

ALTERNATIVE ASSETS

Our alternative assets programs delivered solid returns through the year in an environment of rallying equity markets and softening bond markets. Importantly, they continue to provide diversification across our funds, providing a better downside risk protection profile relative to other funds in the marketplace.

In an environment that saw Australian and global bond exposures deliver flat returns over the last twelve months, our defensive alternatives program continued to provide a healthy income yield above cash, without the negative price experience seen in traditional fixed income markets. This has made a solid contribution to the funds and helped maintain income generation, with the underweight fixed interest position in portfolios rewarding members this year.

Our growth alternative exposures delivered strong, positive performance over the year, well in excess of our expected returns for these asset classes. We saw significant gains from both listed and unlisted infrastructure exposures, as well as our private equity managers, taking advantage of buoyant equity markets by selling private company investments at strong return multiples and returning cash to the funds.

FROM THE SELECT MANAGER

PROPERTY

Real Estate Investment Trusts (REITs) have ended a multi-year winning streak as the top performing asset class for Australian investors, with both Australian REIT and unhedged Global REIT indices delivering negative absolute returns over the financial year. Despite this, our managers delivered positive absolute returns through prudent security selection and a focus on high quality property exposure when constructing their portfolios.

As opposed to the last sell-off in REITs, current downward pressure on security prices is being driven by increased interest rate expectations as opposed to high levels of leverage and the exuberant risk being taken by REIT managers in the lead up to the GFC. Leverage in the sector remains prudent and risk-taking is still in check, however given that price appreciation to date has been almost wholly driven by declining interest rates, volatility should be expected as more central banks start to withdraw monetary stimulus from markets and economies.

FY2017 saw rallying equity markets accompanied with volatility in bond markets, as the world shrugged off geopolitical events such as Brexit and the election of President Trump, driving markets higher on the optimism of increased fiscal stimulus and strengthening economic activity. At the same time, central banks have reversed policy on interest rates, with expectations now pointing towards increasing rates in the US and stabilisation of monetary policy in the Eurozone and beyond.

Balanced funds broadly have delivered high single digit returns for Australian investors which, given the environment of ultra-low interest rates, has been a good outcome for members. Equity markets rallied strongly in the second half of 2016, despite unexpected results in elections, however the first half of 2017 has been characterised by less certainty in markets and divergence between sub-asset classes such as large-cap and small-cap companies, developed markets and emerging markets, as well as periods of negative returns for bonds.

Observers and the media have been offering weekly explanations for movements in various markets – examples include 'profit taking' in technology stocks and price reactions to surprise policy outcomes (read here 'the bank tax'). Markets are becoming increasingly noisy and the managers we employ in managing your money have been navigating these bumpy waters by sticking to what they do best: fundamental, security selection based on sound investment processes made by experienced portfolio management teams. Perpetual spends considerable time in scouring the world for the best investment managers in order to build resilient, high quality portfolios – a characteristic that is difficult to achieve by investing in indices.

While passive investing is gaining a lot of traction in markets and with investors, we continue to stand by our belief in the ability for active management to deliver superior outcomes by protecting on the downside – a characteristic that we believe leads to long-term outperformance as well as a less painful journey for members and investors.

While it may not be fashionable, this approach epitomises the 'protect and grow' investment philosophy upon which Perpetual was founded. The success of that philosophy can be seen in the fact that after 130 years, the firm is still doing what it has always done: we look after other people's money by protecting and growing their wealth over the long-term. It's a philosophy highly compatible with superannuation as a long-term investment vehicle and I hope it gives you continued assurance on our performance as custodians of your retirement savings.

KYLE LIDBURY
Head of Investment Research,
Perpetual Private

SUPERANNUATION LEGISLATIVE UPDATE

To ensure you get the right advice for your situation, please consider speaking to a financial adviser.

CHANGES TO SUPER EFFECTIVE FROM 1 JULY 2017

$1.6 MILLION SUPER TRANSFER BALANCE CAP

The total amount that can be transferred to a tax-free pension account or can be held in a tax-free pension account as at 1 July 2017 is limited to $1.6 million (excluding structured settlements or personal injury payouts and amounts in transition to retirement pension accounts).

NON-CONCESSIONAL CONTRIBUTIONS TAX

The annual non-concessional (post-tax) contributions cap is lowered to $100, 000 (previously $180,000) and is restricted to people with a total superannuation balance below $1.6 million at the end of the previous financial year.

CONCESSIONAL SUPERANNUATION CONTRIBUTIONS

The annual concessional (before-tax) superannuation contribution cap is lowered to $25,000 (previously $30,000 for those aged under 49 at the end of the previous financial year and $35,000 otherwise).

TRANSITION TO RETIREMENT (TTR) INCOME STREAMS

Investment earnings on assets in transition to retirement pensions are taxed at 15%. Prior to 1 July 2017, these were tax-free.

PROPOSED CHANGES TO SUPER

In his budget announced on 9 May 2017, Treasurer Morrison announced a number of proposed changes to superannuation. This year, there was minimal tinkering to superannuation, allowing us all to continue to digest and consider the changes announced in the 2016 budget that generally became effective from 1 July 2017.

Following is a summary of two key proposals to superannuation. It is important to note that at the time of writing, none of these proposals have been legislated, and as such may not proceed.

USING THE PROCEEDS FROM SALE OF THE FAMILY HOME TO CONTRIBUTE TO SUPER

From 1 July 2018, retirees will be allowed to contribute a portion of the proceeds from the sale of their home into superannuation. The intention is to incentivise older Australians to downsize homes that no longer meet their needs, to free up larger homes for families.

Individuals aged 65 or more will be able to make a non-concessional contribution (NCCs) of up to $300,000 from the proceeds of sale of their home, where the property has been their principal place of residence for at least 10 years.

FIRST HOME SUPER SAVER SCHEME

From 1 July 2017, the First Home Super Saver Scheme commences to give individuals the ability to boost their savings for their first home. Individuals can make voluntary pre-tax contributions of up to $15,000 a year and $30,000 in total to their super fund. NCCs can also be made.

Unlike earlier First Home Saver Accounts, this scheme allows people to build a deposit, firstly, inside superannuation, secondly, with pre-tax dollars, and thirdly, which is accessible in a shorter timeframe.

From 1 July 2018, these contributions together with deemed earnings thereon – based on the 90 day Bank Bill rate plus 3% – can be withdrawn for a deposit. These withdrawals will be taxed (excluding NCCs) at the member's marginal tax rate less a 30% tax offset.

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MORE INFORMATION

Speak to your Adviser or contact us:
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