ANNUAL UPDATE 2014/15

Select Super, Pension, Investments
July 2015

THIS ANNUAL UPDATE FOR 2014/15 PROVIDES AN OVERVIEW OF FINANCIAL MARKETS, EXPLAINS OUR APPROACH TO INVESTING AND SUMMARISES KEY LEGISLATIVE CHANGES THAT MAY AFFECT YOU. YOUR ENCLOSED ANNUAL STATEMENT FOR 2014/15 DETAILS HOW WE HAVE MANAGED YOUR ACCOUNT AND THE TRANSACTIONS YOU HAVE MADE DURING THE YEAR.

Perpetual delivered another year of positive real returns for Select investors across all investment options. Pleasingly, we maintained diversification across asset classes and generated returns at a lower level of risk relative to the market. The outlook for investment remains challenging and, in an environment where income will become harder to generate from portfolios, we continue to exercise prudence when it comes to investing our clients' money.

WE MAKE SURE WE ADAPT OUR APPROACH NOT ONLY AS MARKET CONDITIONS CHANGE, BUT AS YOUR LIFE STAGES CHANGE SO WE CAN HELP YOU CREATE THE FINANCIAL FUTURE YOU WANT.

Prudent does not mean passive, and Perpetual has always invested with a strong focus on active management, in order to protect and grow wealth in real terms. The Select investment team diversifies across traditional and alternative asset classes and within each asset class, using best of breed investment managers from around the world and accessing investment opportunities that are generally not available to other investors. The team continues to work on identifying managers with a strong track record of meeting investor objectives, as well as asset classes that can deliver attractive, risk-adjusted returns with low correlation to traditional markets.

Our role is to provide you with a range of multi-sector and single sector investment options which are suitable for your own circumstances and help you reach your financial goals.

We make sure we adapt our approach not only as market conditions change, but as your life stages change so we can help you create the financial future you want.

Our highly qualified Perpetual Private financial advisers can provide personalised advice on investments, superannuation and retirement planning.

If you have any questions about your investments or would like to speak to an adviser please contact us on 1800 003 001.

Thank you for entrusting us with your investments.

MARK SMITH
Group Executive
Perpetual Private

Perpetual

WHAT HAPPENED IN FINANCIAL MARKETS?

AUSTRALIAN SHAREMARKET

With global interest rates remaining at historic lows and a steady decline in bond yields, investors continued to look to the Australian equity market for greater investment return opportunities. However, the S&P/ASX 200 Accumulation Index rose just 5.7% for the financial year ending 30 June 2015 – significantly lower than growth experienced in recent years. Valuations have become stretched, especially in sectors where investors have chased dividend yields. Whilst the big bank stocks corrected somewhat towards the end of the year, the 'yield trade' remains very much in vogue, as evidenced by the continued strong performance of Telstra and infrastructure companies.

On the economic front, growth remained subdued as the economy continues to slowly transition from a declining mining investment boom to more domestic driven activity. Employment and housing construction activity were solid, however this has yet to translate into higher consumer sentiment or stronger non-mining business investment.

INTEREST RATES

With economic growth persisting at subdued levels and the slow pace of a transition from mining investment to domestic activity, the Reserve Bank of Australia (RBA) embarked on a new round of interest rate cuts in 2015, reducing the official cash rate in February and May by 0.5% in total. Whilst the cuts raised concerns that it might fuel large increases in house prices in certain housing markets, the Reserve Bank felt that this was warranted – given the significantly lower commodity prices and an expectation that a return to trend growth might take longer than expected.

The cuts saw Australia with the lowest official cash rates on record, although they still continued to be above other countries such as the near-zero rates of the US, Japan and Europe. As a result, over the financial year, inflation has remained within the RBA's target band of between 2 and 4%.

THE AUSTRALIAN DOLLAR

The extended period of strength for the Australian dollar finally came to an end during the financial year. The Australian dollar had long benefited from its status as a AAA-rated currency, as well as the ongoing central bank policies of close to zero official policy rates and money printing programs in the major global economies.

However, the slowing Chinese economy, sharply lower commodity prices and the shift to an easing bias by the Reserve Bank of Australia combined to finally drive the Australian dollar lower this year. Despite this, the RBA noted that the Australian dollar still remains overvalued on a trade weighted basis given the size of the decline in commodity prices and that further depreciation seemed 'likely and necessary'.

ALTERNATIVE ASSETS

Alternative assets and strategies generated consistent gains for the year, against a backdrop of low interest rates and government stimulus which has seen the valuations of traditional asset classes remain elevated by historic standards. One example is direct lending strategies in Europe where banks are no longer servicing traditional clients due to regulatory or capital constraints. Investments in this area are well-secured by strong cashflows and underlying assets.

Corporate activity has remained healthy, providing opportunities both in listed and private markets as companies merge, are acquired, restructure or divest assets. Opportunities have also arisen as particular economies start to accelerate from subdued levels of growth over recent years.

PROPERTY

Australian Real Estate Investment Trusts (A-REITs) had another buoyant year posting strong returns. As bond yields and the Reserve Bank of Australia cash rate fell, investors continued to seek higher yielding assets, benefitting this asset class. A-REITs have continued to manage their balance sheets conservatively whilst IPO and transactions flows remained strong, particularly in the smaller end of the market.

Similarly, Global Real Estate Investment Trusts (G-REITs) had a strong year. Returns were driven by the same themes as those in the domestic market – falling bond yields leading investors to seek higher yielding assets. While traditional real estate assets, such as commercial and retail property, continue to dominate the sector, the last few years has seen a proliferation of REIT structures holding non-traditional property assets such as data centres and telecommunication towers.

5.7%

Return from the Australian sharemarket over the financial year

S&P/ASX 200 Accumulation Index, Source: FactSet

0.5%

Fall in the Australian cash rate (From 2.5% to 2.0% this financial year)

Source: Reserve Bank of Australia, as at 30 June 2015

High

94.58c

Low

75.90c

Australian Dollar from 1 July 2014 to 30 June 2015

Source: Reserve Bank of Australia, as at 30 June 2015

FROM THE SELECT MANAGER

Similar to last financial year, all the Select funds again produced strong returns, with investors in our Balanced options enjoying returns, in excess of our long-term average return expectations.

Favourable investment markets meant that all asset classes posted positive returns over the year. We remain committed to active value-focussed strategies and vigilant to potential risks. Our tactical asset allocation process has seen us gradually reduce exposure to riskier assets so that when markets inevitably correct, we will be able to reinvest this capital at more attractive valuations.

The Select funds' international share investments have been unhedged against currency movements for most of the year, allowing us to take advantage of the weakening Australian dollar, enhancing returns from this asset class. Indeed, more than half of the return from international shares for the year was due to currency effects. At year-end, we remain fully unhedged as risks to the Australian dollar weigh to the downside, particularly with the mining boom receding and the Reserve Bank inclined to make further rate cuts relative to the rest of the world.

The Select funds' exposure to alternative assets has continued to provide a strong source of returns with a low correlation to traditional assets, enhancing portfolio diversification. Both our defensive and growth alternatives strategies have delivered returns in excess of their 'cash plus' benchmarks for the year. With the outlook for returns in traditional markets becoming more challenging, Select investors continue to enjoy exposure to alternative assets which we expect to produce relatively attractive risk-adjusted returns.

We continue to manage Select investments in keeping with Perpetual Private's 'Protect and Grow' philosophy, focussing on real returns, preservation of capital, and growth of assets over the investment cycle.

This has been our proven method of responsibly managing our clients' wealth over the long term.

KYLE LIDBURY
Head of Investment Research

SUPERANNUATION PRODUCT AND LEGISLATIVE CHANGES

SUPERANNUATION AND AGE PENSION CHANGES

The past year has seen widespread debate about Australia's superannuation and retirement income policies regarding taxation, access and fairness.

With an ageing population and the government's finances under ongoing pressure, it has introduced legislation to tighten eligibility for the age pension as well as eligibility for payments while absent from the country.

No changes have been made to the taxation of superannuation but the recent release of the Government's Tax Discussion paper with the intention of consulting widely for the rest of year potentially means taking new taxation policies to the next election. There is strong bipartisan and community support for superannuation as the preferred method of saving for retirement and this is unlikely to change.

The increased political focus on these issues highlights the need for everyone to take control of their financial future, be engaged, and do what they can to maximise their retirement savings.

AGE PENSION ASSETS TEST

From 1 January 2017, the Government proposes to increase the level of assets an individual may have in addition to their home, in order to qualify for a full pension. If this proceeds, the maximum assets allowed outside the family home in order to receive a part-pension will decrease from $1,151,500 to $823,000 for couples and from $775,500 to $547,000 for single people.

People under age pension age who lose their pension entitlement as a result of the changes will automatically be issued with a Commonwealth Seniors Health Card or a Health Care Card which provide similar discounts and concessions to the Pension Concession Card, including discounts on Pharmaceutical Benefits Scheme prescription medicines.

The Government also proposes to increase the tapering rate for the assets test from $1.50 to $3.00 per $1,000 of assets held above the 'assets free area'. This will effectively reduce the maximum value of assets that could be held to qualify for a part-pension.

CHANGES TO RULES ALLOWING THE RELEASE OF SUPERANNUATION DUE TO A TERMINAL MEDICAL ILLNESS

For many years, unrestricted tax-free access to an individual's superannuation can only occur when it has been certified by two medical practitioners (one of whom must be a specialist) that their likely life expectancy is within one year. As originally proposed in the 2015 Federal Budget, from 1 July 2015 this period has now been widened to two years. This is a sensible and common-sense outcome and means that people in these difficult circumstances will be better able to plan their financial future with more certainty, flexibility and relief from the financial burden of treatment costs.

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MORE INFORMATION

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