INVESTMENT SOLUTIONS

Summer 2015

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PKF Wealth

Welcome

In this edition of Investment Solutions, we take a look at the Australian property market and how things could be shaping up for the years ahead.

With interest rates at historically low levels, we discuss different options to position your portfolio and maximise returns.

In our economic outlook, we hear from prominent economists to understand if Australia is heading into recession.

Planning a holiday? We share 5 ideas that can help you get there without all the financial stress.

Until next time – happy reading.

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Economic outlook

Health check for Australia – how are we doing?

Economic growth of a meagre 0.2% last quarter, more than 770,000 Australians unemployed, paltry wages growth and a flailing sharemarket – is Australia going to be OK or could we be heading for a recession?

That's the question being asked by some economic commentators as Australia's transition from the mining boom of the 2000s to a broader-based economy grinds on.

While there are doomsayers predicting the worst for the economy, most economists are not tipping a recession in the near future. Westpac's Chief Economist Bill Evans, for example, believes Australia's economic growth is likely to continue to remain stubbornly low in 2016, but does not predict negative growth.

Mr Evans says the latest economic indicators appear to suggest that the economy may grow slower than the 3.0% growth rate currently predicted by the Reserve Bank of Australia, but he says it is more likely to be around 2.5% to 2.75% than negative growth. As you can see from the chart below, while this is positive, it is still well below long term trend GDP growth of close to 3.5%.

The latest Business Outlook by Deloitte Access Economics also points to below trend growth in Australia over the next two years.

"The negatives facing Australia are big and growing: China is throwing the kitchen sink at its slowdown, but that hasn't been enough to halt the slide in global commodity prices," the report says.

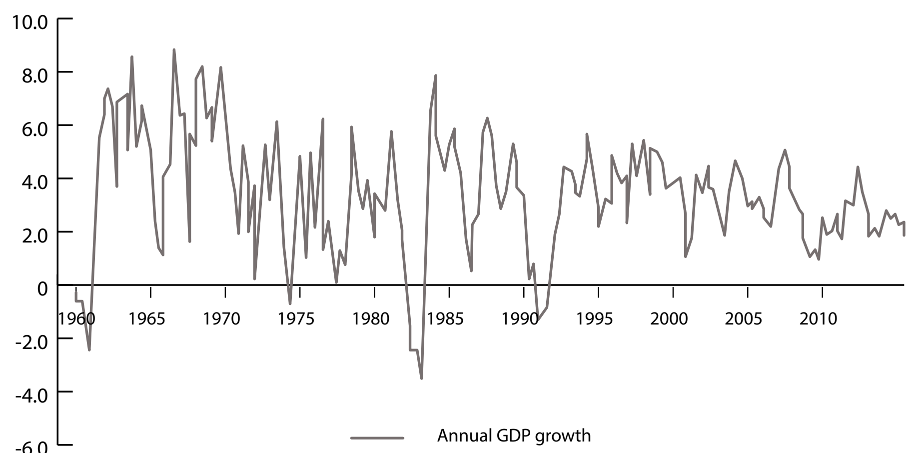
"Yet the positives are big and growing too. The Australian dollar's fall is already throwing its lovin' arms around the Australian economic outlook. And there's plenty of good news still to come, as it takes two years for a lower Australian dollar to have its maximum positive impact on the economy. Ditto interest rates, whose 'lower for longer' profile will keep generating good news."

BT Financial Group Chief Economist Chris Caton says Australia's economy is still suffering from "the bust phase of the mining capital and commodity price boom".

"That's taken growth out of the economy and we haven't been able to replace it yet," he says.

"We've cut interest rates and that's helped. Residential construction is up 10% over the year. The exchange rate has come down and that's helped. Exports of tourism and educational services are growing rapidly but it's just not enough."

Taking these factors into account, Mr Caton has forecast that the Australian sharemarket (as measured by the ASX 200) will finish the year between 5300 and 5500 and the Australian dollar will finish the year at about 72 cents.



Source: Australian Bureau of Statistics - Seasonally adjusted GDP Growth (annual)

Safe as houses – Investing in property

Australia's property market has enjoyed very strong returns in recent years. So where is the market headed in the years ahead?

If you live in Sydney or Melbourne at the moment, you could be excused for believing that property prices always go up.

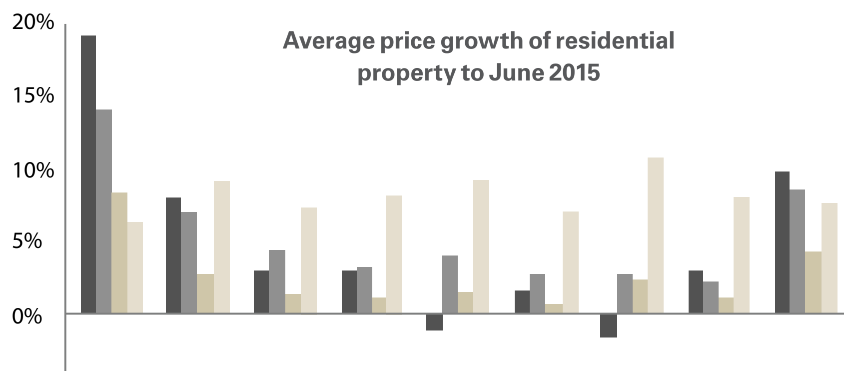
It's at times like these that it pays to remind yourself that all property markets are subject to market cycles.

In Sydney, for example, the overall residential property market rose 48% in the three years to June 2015, according to Australian Bureau of Statistics data. However, Sydney has been the poorest performing capital city in Australia if you look over a 10-year period, as you can see from the graph below.

That's because while Perth and Darwin were skyrocketing thanks to the mining boom, the Sydney market was dormant. In the eight years prior to June 2012, Sydney's residential property prices rose an average of only 2% per year.

The message from all of this, according to BT Technical Services Manager Bryan Ashenden, is that property investors need to have a long- term investment outlook.

"In general, property is an investment that favours the patient," Mr Ashenden says.



	Sydney	Melbourne	Brisbane	Adelaide	Perth	Hobart	Darwin	Canberra	Weighted Average
1 year	18.89%	7.76%	2.90%	2.75%	-1.22%	1.54%	-1.83%	2.81%	9.79%
3 year pa	13.89%	6.75%	4.41%	2.89%	3.94%	2.48%	2.85%	2.20%	8.38%
5 year pa	8.12%	2.61%	1.22%	0.72%	1.24%	0.40%	2.22%	0.89%	4.15%
10 year pa	6.13%	9.01%	7.41%	8.01%	9.12%	6.90%	10.60%	7.92%	7.57%

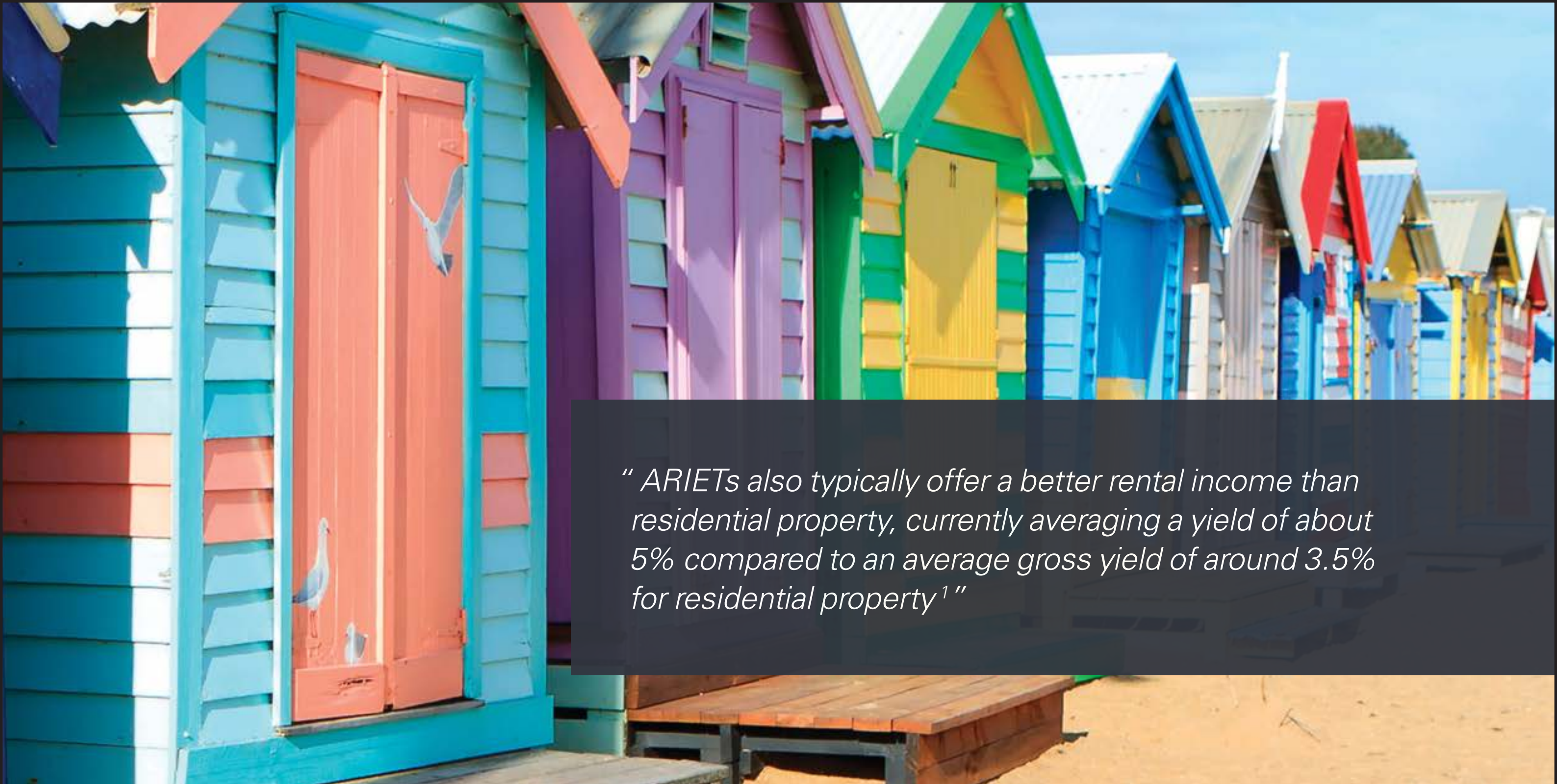
"Your success comes down to what point in the cycle that you get into a market and your ability to ride out the inevitable falls or flat spots."

The difficult thing is to pick the right time in the cycle. At the moment, there is a widespread belief that the Sydney and Melbourne market is overheated and is likely to pull back or soften over the next five years. Recent reports from investment banks such as Morgan Stanley, Macquarie and Credit Suisse have pointed to a cooling in both Sydney and Melbourne over the next two to three years.

Market researchers BIS Shrapnel share that belief. In the recently released Property Prospects 2015-2018 report, the group forecast falls across most capital cities over the next two to three years.

While the group predicts continued growth for Sydney and Melbourne this financial year, they have tipped falls of around 4% per year in the following two financial years for both cities. Perth, Adelaide, Hobart, Canberra and Darwin are all set for continued sluggish growth, according to BIS Shrapnel, while Queensland is predicted to shine. The group expects Brisbane, Gold Coast and Sunshine Coast all to record price growth of around 11-12% over the next three years.

Property research specialists SQM



Research are less bearish in their outlook for 2016 than BIS Shrapnel, particularly in relation to the Adelaide and Hobart which they expect will show growth in 2016.

In its recently released "Housing boom and bust" report, SQM Research predicts Melbourne will take over from Sydney with price increases in the range of 8 to 13 per cent while Perth and Darwin prices will continue to languish.

At the heart of issues for Australian residential property is affordability. Australia's median house price is now 6.4 times the median income of Australian households, according to the Demographia International Housing Affordability Survey 2015. Sydney came in at 9.8 times household income. This is significantly higher than the US at 3.6 times and the UK at 4.7 times median household income. The questions many observers are asking is how sustainable is the growth in the Australian market considering that key measure.

The high price of our residential property is also a challenge for property investors as a single property will often make up a very high proportion of their total investment portfolio. That makes it very difficult to have a diversified investment portfolio.

If that individual property, suburb or state doesn't grow, then your investment return could be flat or even worse, result in a loss.

Adding commercial property to your portfolio can add diversification. It can also be a good alternative for investors not keen on making the significant outlay required for residential property. Australian Real Estate Investment Trusts (AREITs) listed in the ASX give you access to commercial property such as shopping centres, office blocks and factories with only a small investment.

As you can see from the table below, AREITs have performed very strongly over the five years to 30 June 2015, increasing in price by around 11.50% per annum.

Performance to June 30 2015	**1 year**	**3 years**	**5 years**	**10 years**
AREITs	15.69%	16.58%	11.50%	-3.99%
Residential property	9.79%	8.38%	4.15%	7.57%

AREIT - SPDR S&P/ASX 200 Listed Property Fund Exchange Traded Fund (ETF) price movement (excluding distributions.

Residential property – weighted average of eight Australian cities – Australian Bureau of Statistics

Before plunging into AREIT investments it is important to seek advice. So why not contact us today to find how AREITs can form part of your investment portfolio.

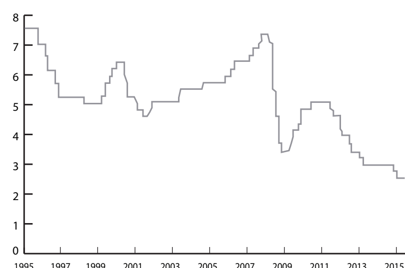
1. Gross yield of Australian residential property October 2015 – RP Data-Rismark. AREIT yield - SPDR S&P/ASX 200 Listed Property Fund Exchange Traded Fund (ETF)

Investing in a low rate environment

"Lower for longer" has been a common theme running through interest rate markets for the past few years. So how should investors be positioning their portfolios in this environment?

Official interest rates in the US have been at zero for more than nine years now and Australian official rates have remained at historically low levels for the past eight years, as you can see from the chart below. And many market observers believe interest rates will remain at very low levels around the world for some time to come.

Official interest rates 1995 - 2015



Source: Reserve Bank of Australia

So, investors with a longer-term horizon may consider increasing allocations to shares and property to take advantage of higher income and greater potential for long-term capital growth.

So should you be adjusting your portfolio to a low rate environment?

BT Technical Services Manager Bryan Ashenden cautions against investors making significant changes.

"Provided you already have a well diversified portfolio that is appropriate for your attitude to risk, then your best policy is to stick to your long-term strategy," he says.

However, Mr Ashenden recommends investors discuss the issue with their financial adviser and asking whether a tilt to certain assets in their portfolio may be appropriate.

For instance, low interest rates mean low return for cash and term deposits so the more conservative or income-oriented investors may consider increasing their allocations to fixed interest to increase their income return over the medium term. And for your money that is in cash, make sure it is earning the best rate in the market. That means not being afraid to change banks where necessary.

Low interest rates tend to be supportive of growth assets such as shares and property, as interest expenses often make up a significant portion of costs borne by businesses and investors. So, investors with a longer-term horizon may consider increasing allocations to shares and property to take advantage of higher income and greater potential for long-term capital growth.

In general, the aim of lowering interest rates by banks is to encourage individuals and businesses to invest and spend and therefore increase economic growth. The prospects of growth in an the economy is ultimately what drives sharemarkets. So, if central banks are successful in their attempts to increase spending and investment, it is generally good news for the sharemarket.

But Mr Ashenden cautions that the direction of interest rates rather than their absolute value can have a more significant bearing on growth assets.

"Rising interest rates can have a detrimental effect on shares and property as businesses and investors adjust to higher costs of doing business," he says.

To ensure your investments are working hard for you during this low interest rate period, please speak to us today.

Daydreaming about your next holiday

Travel has evolved significantly over the past 20 years, with many travellers looking for something with more adventure such as walking treks in New Zealand, cooking experiences in Tuscany, cruising on the Mekong River, or travelling through Australia's beautiful outback.

With all this extra adventure, the need to prepare financially has become even more important. The last thing you want when you come home from a life-changing trip is have a large debt hanging over your head. And you certainly don't want to be worried about money while you are away from home.

Here are 5 ideas on how to make savings part of your journey.

1. Start up a dream list or spreadsheet

While you are daydreaming about your trip and imagining your travel experiences, jot each of them down and add your estimation of the cost next to each dream item.

Keep adding to this list as your planning evolves, making sure you add in big ticket items such as flights, tours, petrol, eating out, accommodation and shopping.

If you find your expenses are getting out of your reach, divide them into "needs" and "wants".

2. Set up a dedicated savings account

Look for a savings account that is easy to use and has a competitive interest rate and conditions that suit you.

Adding money to this account as often as you can will make you feel more positive about preparation for the trip and reduce financial anxieties.

3. Consider a garage sale

Garage sales are a great way to pare down possessions, create space in your home and add to your travel adventure fund. Selling unwanted items on eBay or Gumtree can be equally effective. Any extra income you can earn may mean you can make a special purchase on your trip or perhaps fund an accommodation upgrade or a side tour for your efforts.

4. Prepay as much as possible

Pay for accommodation and day tours before you go. You'll have more time to scout for the best deals before you leave and then have more time to focus on enjoying yourself while you're away. Use rewards program points to pay for flights or accommodation

5. Consider swapping your credit card for a debit card

Credit cards can carry additional expenses and provide a temptation you don't need. Debit cards remove that temptation as you can only spend what you have. Another alternative is a specialist travel card which allows you to purchase spending money in different currencies before you leave.

If you need help getting your finances organised for your trip, please speak to us today.

Disclaimer
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