

financially speaking

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Why China's property market matters

A credit-fuelled property bubble enabled China to maintain its incredible run of growth through the global financial crisis (GFC). However, now China has to deal with a massive excess supply of property that is causing construction activity to contract along with a range of other linked sectors in the Chinese economy, as millions of homes lie vacant.

Background to China's property bubble

In 2007, China was constructing around 1.5 billion square metres of gross residential floor space per year (or approximately 15 million housing units)¹. This was to support urbanisation, replace old housing stock and to meet the investment needs of Chinese households. During the GFC, the economy received a huge credit stimulus and property market restrictions were loosened considerably, generating a boom in construction activity. Despite a recent slowdown in urbanisation, China maintained its high construction rate, resulting in massive excess supply of housing.

¹ National Bureau of Statistics of China (NBS)

Inside this edition

- Why China's property market matters
- Trauma fills the gaps
- Insurance through super – with choice comes complexity
- Control your retirement income
- Are your estate affairs in order
- Four tips on what to do with a windfall



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A serious geographic mismatch also developed between housing supply and demand. Although urbanisation generated strong housing demand in Tier 1 and 2 cities, a disproportionate share of property development was concentrated in smaller cities. Subsequently, Tier 1 cities such as Beijing and Shanghai generally suffer from housing shortages, while Tier 3 and 4 cities hold most of the excess supply.

Moreover, unfavourable demographics are putting downward pressure on property demand. China's working age population (aged 15-59) peaked in 2012 and is currently declining by several million people each year, while the main property buying demographic, the population aged 25-49, is expected to peak in 2015 and decline thereafter.

According to the China Household Finance Survey, 22 per cent of urban housing in China is vacant. Meanwhile, vacant floor space on developers' books has increased by over five times since 2007².

What does this mean for China?

A build-up of unoccupied properties held by investors and developers will ultimately lead to a major contraction of construction activity and linked sectors in the economy. Indeed this process is already underway. National house prices have fallen 5 per cent in the past year and urban housing completions are down 15 per cent so far in 2015. Electricity consumption, steel and cement production and rail freight traffic have also all slowed significantly (or are contracting)³.

A property fire sale could result, leaving many developers insolvent. In addition, China's property industry is highly leveraged and closely linked to the shadow banking system, creating potential financial system risks.

With real estate accounting for more than half of household wealth in China, if prices fall dramatically, household consumption would likely follow suit. Household debt, around half of which is mortgage-related, has risen considerably from around 8 per cent of GDP in 2000 to around 38 per cent in 2014⁴ but remains low by international standards. Interest rate liberalisation, capital account opening, and the availability of alternative investments (eg wealth management products) could also undermine property market fundamentals.

China's residential property sector may need to contract by as much as 50 per cent to work off the excess supply. With real estate and related industries accounting for 20-25 per cent of GDP, the bursting of the property bubble would cause a major slowdown in the economy and perhaps even a recession.



² NBS

³ NBS

⁴ McKinsey (2015) "Debt and not much deleveraging"



Implications for global markets

China is a key driver of global growth having contributed one quarter of global economic growth since 2010, despite only representing around 12 per cent of global GDP. China is by far the largest consumer of commodities and accounts for around half of the world's consumption of iron ore, cement, coal and steel. Should China's economy continue to slow or face a hard landing, the global repercussions are likely to be significant.

Commodity export countries such as Brazil, Russia, Australia and Canada are vulnerable to a slowdown in China and have already experienced material depreciations in their currencies against the US dollar. In some cases these economies may also be exposed to the unwinding of commodities-linked domestic credit booms. Other economies with major trade linkages to China, particularly the emerging markets

in Asia and Japan, would also be adversely affected.

Although relatively nascent, financial linkages between Chinese banks and Hong Kong or Singapore could provide channels for the international transmission of a Chinese financial shock. Foreign currency lending to Chinese corporates has grown at a rapid pace, and has been focused on the property sector. If China experiences a recession and defaults spread across borders, an emerging markets credit crunch is not out of the question. Meanwhile, property markets in Canada, Australia, the UK and Hong Kong could be hit as investors pull out of international assets.

Fortunately, the Chinese authorities appear to be taking steps to manage the housing market correction and slow credit growth. China has room for

additional fiscal and monetary stimulus and could nationalise a portion of its domestic debt. The country's huge foreign exchange reserves and current account surplus make China highly resilient to external financial shocks. However, if the returns on incremental spending and investment are sufficiently low, or if the private sector cuts expenditure, the government may not be able to prevent a sharp slowdown or a recession.

While there are a number of reasons to be optimistic about China's long-term economic future, there are short-to-medium term challenges if China's property bubble is set to burst and the economic ramifications will be widespread, warranting a cautious approach by investors.

Source: Magellan

Speak to your financial planner to discuss your investment options.



Trauma fills the gaps

Heart disease and stroke continue to be the two most common causes of death⁵ in Australia for people over the age of 45 and accounted for over 30,000 Australian fatalities in 2012. Incredibly, thousands of Australians are underinsured or have no insurance in place to cover the expenses should they suffer a debilitating illness.

According to the *Cost of Cancer in NSW*⁶ report, the total expected lifetime economic cost of cancer – taking into account both the financial cost and the burden of disease (lost productivity, burden on healthcare system) – is almost \$1m per person. Certainly for an individual being treated for cancer, out of pocket costs in excess of \$100,000 are not uncommon. Many financial planners use a rule of thumb for calculating an appropriate sum insured which at minimum should allow for the removal of debt and the provision of one year's income, but this is merely a starting point.

These initial figures should be considered along with the financial cost to the individual and family, and importantly the 'true cost' of the disease.

You can rely on trauma insurance

Trauma insurance can cover between 10 to 50 medical events and will pay in the event you suffer a defined health trauma, regardless of your work status. It pays a lump sum to help cope and recover from serious health conditions such as cancer, strokes and heart attacks. Some insurers also offer partial payments for less serious conditions.

Medical advances have meant that our chances of surviving traumatic events are much better than in the past. However, the cost of treatment can sometimes be beyond your normal means. Without trauma cover, you may need to dip into your children's education fund or your retirement savings; or you might even have to increase your mortgage to pay for expensive treatment.

The difference to income protection

Importantly, a trauma payment is not dependent on you being unfit to work (unlike income protection, where you need a doctor to certify your ongoing health). The diagnosis of a traumatic condition might mean that you physically could go to work, but would prefer to spend time with your family and reduce any work-related stress while you recover and consider how your future will be affected.

To make sure you don't increase the statistics, check your policy documents to see which level of cover you hold, and speak to your financial planner if you are unsure. They can help you determine what cover you already have, what changes or additions may be appropriate and how to make them.

Source: Zurich

Speak to your financial planner to find out more about trauma insurance.

⁵ Leading Causes of Death, Australian Institute of Health and Welfare, www.aihw.gov.au/deaths/leading-causes-of-death.

⁶ Cost of Cancer in NSW, Access Economics Pty Limited for The Cancer Council NSW, 2007.

Insurance through super – with choice comes complexity

Recent changes to superannuation legislation present exciting opportunities when it comes to ways of funding life insurance. With choice, however, comes complexity and the challenge is to isolate the benefits offered by the various funding alternatives.

Behind the scenes

The story behind widening the choice for consumers involves two key factors.

Firstly, recent changes to the superannuation regulations introduced a new obligation for super fund trustees to respond to requests from members to roll over funds to another super fund within specific timeframes. This measure was introduced by the Government to give consumers freedom of choice as to the location and spread of their superannuation money.

The **second factor** is the use of contributions tax rebates. Superannuation funds generally receive a tax deduction for life insurance premiums. Many super funds are now passing that benefit on to the contributing member, allowing the member to reduce the cost of their life insurance cover.

The combination of these two features may provide you with the opportunity to reduce your costs. If your life insurance needs are not being met by your existing superannuation fund, you can access more suitable life insurance cover via another super fund. It is now possible to fund the life insurance by a rollover from your existing fund. The amount rolled over may also be reduced by a 15 per cent tax rebate, delivering a substantial reduction in the cost of your new life insurance arrangements.

The way forward

The broadening of insurance payment options now gives you a substantial opportunity to ensure that your life insurance arrangements are completed on the most cost effective basis.

If you are eligible for this rebate, and a rollover provides a definitive advantage, all that's left is to make sure you are comfortable dipping into retirement savings to pay for peace of mind today.

Source: TAL

But there are considerations...

Before you commit to going down this new path, you should ensure that this option is best suited to your circumstances. You should consider the following three points:

- Erosion of retirement savings. There is no free lunch. The use of accumulated balances in your existing superannuation fund to finance your life insurance needs will reduce retirement savings.
- You may be able to fund the contributions to your life insurance superannuation fund by contributions from your employer under a salary sacrifice arrangement. In this case, as you receive the tax benefit via the salary sacrifice arrangement, you will not be eligible to receive a contributions tax rebate.
- If you are self-employed, the funding of life insurance needs via a tax deductible personal contribution into super fund may be more efficient. In this case, as you would receive the benefit of a tax deduction for your superannuation contributions, you would not be eligible for the contributions tax rebate.
- If you have a self-managed superannuation fund (SMSF), the optimum insurance solution may be to continue the traditional financing structure. Under this structure, the trustee of the SMSF owns the life insurance policy, and can access the benefit of any tax deduction associated with the premium. Introducing the complexity of a rollover arrangement may not deliver any additional benefit.

For more information about insurance through super, speak to your financial planner.

Control your retirement income

When you retire, there are different financial factors to consider because you are no longer receiving income from employment. Adverse market movements can have a greater impact on your savings in retirement because you're not replenishing your savings with a regular pay cheque. Additionally, when you're employed your income generally increases to keep pace with inflation. However, in retirement, inflation can erode the purchasing power of your savings.

At the same time, thanks to medical advancements and healthier lifestyles, you could enjoy a retirement period upwards of 30 years. This is a long time to make your savings last. Therefore, the decisions you make about investing your retirement funds are critical for making sure those funds last as long as you do.

Fortunately, there is a way to guarantee a level of secure, regular income throughout your retirement. An annuity pays you a guaranteed secure income that can keep pace with inflation, if you choose. The income is generally tax free if you're over 60 and investing your superannuation money. Some annuities may also help you access or increase your seniors benefits like the age pension and the Commonwealth Seniors Health Card.

An annuity is a secure investment that provides you with a series of regular payments, either for a chosen term or for your lifetime, in return for a lump-sum investment. It can be used with other retirement investments, like account-based pensions, to set you up with a dependable income that can last throughout your retirement.

Term annuities have fixed start and end dates that are typically chosen by you. The minimum term is one year and maximum term is 50 years. Annuity payments are for the duration of the term and stop at the end of the term.

Lifetime annuities provide regular payments for the rest of your life. If you choose, the payments may continue for the lifetime of a second person after you pass away. Lifetime annuities can help alleviate the worry that you will outlive your retirement savings.

An annuity works like a pay cheque in retirement. You invest some of your savings with a financial institution who then holds your money while paying you guaranteed regular payments. This income is generally tax free if you are over 60 years of age and are investing your superannuation money. The payments can be made monthly, quarterly, half yearly or yearly.

It is important to note that annuities are designed to be held to term. If you would like to withdraw your annuity, in most cases you will receive a return of your investment but you may receive back less than you invested originally and less than you would have received had you held the annuity for its agreed term.

Source: Challenger

To find out more about how an annuity can help you in retirement, speak to your financial planner.



Are your estate affairs in order?

Completing a thorough estate planning review is crucial for your peace of mind as well as the comfort and wellbeing of loved ones. It is also much more than just making a Will. Depending on your current financial and family situation, you might also need to review your superannuation nominations, discretionary trust deeds, any company documentation and powers of attorney.

Death is not something we like to think about but a little planning can save a lot of heartache for loved ones left behind. Here are some important areas to consider with examples and possible solutions.

Allocation of your super

In most super funds, the trustee decides who gets your super when you die. Legislation requires the fund to pay your dependants or your estate.

Example

Mary, a divorcee wants to leave money to her children from a first marriage but not to her ex-spouse. She cannot be sure that the trustees of her super fund will not apportion part of her superannuation death benefit to her former partner.

Possible solution

Most super funds allow you to make a Binding Death Benefit Nomination that will provide directions to the superannuation fund trustee as to how your death benefit is to be paid. This ensures your super is paid in line with your wishes. Talk to your financial planner to ensure your super benefit nominations are in order.

Providing money for your dependants quickly

Upon death, your Will needs to be located and, depending on your assets, may need to be proven by the courts in a process called 'obtaining probate'. This process can take many weeks and in the meantime, your estate assets may be frozen.

Example

David, the principal income-earner dies. David's family know that he has recently created a Will, however, they are unable to find it and other documents that are needed for both the funeral and to produce for the courts. This is a common situation that causes great distress. In addition, an estranged child challenges the contents of the Will and delays distribution of assets. In the short term, the surviving spouse may have insufficient money to live on, as well as a high level of stress at a time when they are least able to cope with it.

Possible solution

Ensure you have all the necessary records in a safe place. Always tell the executor of your estate where to find this information in the event of your death. To ensure your spouse is protected, it may be beneficial to hold some funds in joint names with your spouse that can be accessed quickly if you were to die suddenly.

Has something in your life changed recently?

Regularly reviewing and updating your Will helps to reduce or even eliminate problems that may arise as a result of changes to your personal circumstances which can affect your Will and even invalidate it.

There are many events that can trigger a need to review your Will, such as:

- **marriage** – which may revoke your current Will
- **divorce** – which does not revoke your current Will but does revoke any gifts made under a Will to the ex-spouse
- **a change in the family**, such as birth, death and marriage
- **a change in a relationship**, such as children entering or leaving de-facto arrangements
- **the death of a person** who plays a key role in the estate plan such as an executor or trustee.

Tax and super legislation is complex. Professional advice can help ensure your beneficiaries receive their entitlements in the most tax-effective manner.

An estate planning specialist can help you minimise the stress on your family and ensure your estate and wishes are well protected.

Source: IOOF

Speak to your financial planner to discuss your estate planning solutions.



Four tips on what to do with a windfall

We've all had those 'what if' moments, where thinking big gives us a rush of adrenaline. But seriously, before you rush off on that long dreamed of holiday, what should you do if you were lucky enough to land a windfall? Here are four practical options to consider:

1. Pay off debt

Paying off debt is one of the most financially sensible things you could do. In today's debt-fuelled world, it's wise to pay off loans which charge you the highest rates of interest, such as credit cards, car or personal loans, store cards or short term loans, before you think of doing anything else with your cash.

Only then should you consider paying off your mortgage, in full or in part, because your mortgage is likely to be charging you the lowest interest rates. Apart from the savings you'll make from lower interest payments, getting rid of debt could also eliminate financial stress and allow you to focus on smarter financial decisions for your future.

2. Build up your super balance

You should consider taking advantage of non-concessional contributions and build more of your wealth within super, rather than having it all invested in your own name in the bank. Non-concessional contributions refer to after-tax amounts which are indexed each year.

From 1 July 2015, you can contribute \$180,000. But if you are 64 years old or less anytime in the financial year and you make a non-concessional contribution, it would trigger a 'bring-forward' provision, and you could contribute up to \$540,000. This would result in a significant tax saving on your investment earnings, but it would depend on your personal income levels. Keep in mind, though, that the downside of building up your super is that you cannot access the money until you stop working or retire.

3. Diversify your investments

Keeping large sums of money in the bank at current term deposit interest rates may not be the best investment in the long term. You could work out what large capital expenses you may have over the next three years and leave this sum in the bank, but the remainder should be invested in a more growth-oriented manner, depending on your appetite for risk.

If you have already purchased an investment property, you could consider building up investments in Australian shares, international shares and other asset classes to diversify your investment portfolio.

You could also look at a managed fund that is appropriately diversified across a number of asset classes, but a good

portion should be in Australian shares to deliver the growth that can be achieved over the long term with this asset class.

4. Seek professional help

You should seek professional help about your current situation. It doesn't matter what stage of life you're at, how much money you have, or how much advice you need, it could be beneficial for you to sit down with a professional and work out your short and long term financial goals and aspirations.

Source: Colonial First State

For more on how to manage a windfall, speak to your financial planner.



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