FINPAC Financial Group

Wealth creation & protection

Outlook

Financial Update & Outlook

Spring 2017

Hello and welcome to the Spring edition of Outlook.

Share markets continued to rise steadily during the September quarter with the MSCI AC World Index returning 5.2% in USD terms. Global economic conditions and employment growth continued to improve prompting discussion that monetary policies are now at their most accommodative point and at some stage will begin to gradually tighten. Of significant importance to Australian investors, the MSCI China index continued to rally, increasing by 14.7% in local currency terms.

Expectations of global growth remain on track with the International Monetary Fund (IMF) maintaining world output growth expectations of 3.5% and 3.6% in 2017 and 2018 respectively during its July update.

Growth in the US rebounded strongly with GDP increasing by 0.8% during the June quarter. This resulted from stronger household consumption, business investment and federal government spending.

Economic conditions across Europe remained positive with June quarter GDP growth of 0.6% in Germany, 0.5% in France and 0.3% in the UK.

Across Asia, strengthening international trade and accommodative policies have supported economic growth and business investment. Chinese GDP increased by 6.9% in the June quarter driven by an improving services sector, property construction and infrastructure spending.

Australian GDP growth strengthened to 0.8% during the June quarter supported by rising household consumption and a broad based improvement in employment. However, the unemployment rate of 5.6% remains 0.5-0.8% above the Reserve Bank of Australia's (RBA) estimate of full employment.

There are signs of easing in the housing market and the residential construction pipeline appears to have peaked, but the level of construction work is expected to remain strong for some time.

The RBA left cash rates unchanged at 1.5% during the quarter. Fixed Interest Australian bonds recorded a moderately negative performance for the three months to September, with the Bloomberg AusBond Composite Bond Index returning -0.1%. The performance reflected a rise in yields, with the 10-year government bond beginning the period with a yield of 2.6% and finishing at 2.8%.

Many equity investors will by now have forgotten the bear market that followed the market crash of 2007 and even the subsequent Global Financial Crisis (GFC). This is because the current bull market, which commenced in the first quarter of 2009, has subsequently enjoyed fairly relentless positive momentum.

In Australia the duration of the current bull market is the longest since the bull market that ended in 1960 and this has lulled investors into a false sense of security, with market strategists generally positive about the direction of the market.

The current bull market has been unusual in a second regard, in that there has been hardly any earnings growth for the market , and certainly not when measured in real terms. Many companies have of course enjoyed some earnings growth but that has largely been offset by declines elsewhere, notably resources.

Remember if you have any questions please contact the relevant advisor listed below. Alternatively, if you have any feedback on our updates or articles you would like covered please give me a call or send an email to **gricks@finpac.com.au.**

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what drives Australian sharemarket relative under-performance?

We are often asked why the Australian sharemarket has struggled to match the performance of its global peers in recent years. We do have to emphasise though the degree of under-performance does depend on how returns are measured.

On a pure price basis (i.e. before dividends), the S&P/ASX 200 Index since the end of 2012 has produced annualised gains of only 4.3% p.a. to the end of September, compared with 10.1% p.a. for the MSCI All-Country World Index on a local currency basis.

Allowing for the fact Australian companies pay higher dividends, the difference in total returns is not as great, with total returns for the local market of 9.1% p.a. compared to 12.3% p.a. for the global benchmark.

Allowing further for franking credits on Australian dividends would further narrow this gap on a comparable gross or "pre-tax" basis.

Over this period, the $A has fallen from $US1.03 to US78c. Accordingly, in $A terms, the MSCI All-Country Index has delivered stronger total return gains over this period of 16.6% p.a.

First and foremost, the major reason for the difference is the local market's relatively large exposure to mining companies, and hence sensitivity to the price of Australian exports (i.e. commodity prices).

The Australian market tended to broadly track global performance over the 1970s to 1990s, when the terms of trade (price of Australian exports relative to imports) was also relatively stable. Australia then enjoyed a strong period of out-performance when the terms of trade surged during the commodities boom, though part of this out-performance has since been unwound.

A second factor that appears to help explain Australian relative performance is the popularity of the global technology sector, especially given Australia's relatively low weight to this sector.

Australia also tended to under-perform in the late 1990s, even though the terms of trade were broadly stable, which coincided with the strong price performance of the global technology sector.

Against this backdrop, it begs the question how the Australian market is likely to perform over the next year or so. The answer would seem relatively straight forward, if you expect commodity prices to continue to edge down rather than up and for the global tech sector to continue to outperform (as we do) – then it would suggest the Australian market is also likely to under-perform relative to global stock markets.

While many theories have been put forward to explain our relatively poor returns two factors tend to dominate: trends in export commodity prices and the health of the global technology sector. On this basis, it seems likely our market could struggle against global peers for some time yet.

30th anniversary of the 1987 crash

Some 30 years ago 20th October became known as **BLACK TUESDAY** as the world experienced a major sharemarket crash. The Dow Jones fell 23% in that one day, roughly the same as over two days in the crash of 1929.

The Australian market lost 25% the next day. Locally it signalled the end of a speculative boom caused by actions of corporate raiders such as Alan Bond, Robert Homes a Court, Ron Brierley, John Spalvins, Bruce Judge and Christopher Skase.

Companies involved were Bond Corp., Bell Group, Ariadne, Adelaide Steamship, Quintex. All these companies crumbled under massive debt levels.

So, what is the difference today following the recent long bull run?

Admittedly the US market is now more expensive than it was in 1987 but the earnings yield on shares is also around 2% above bond yields.

A correction in the US market could happen but US shares still represent excellent value compared to risk-free bonds.

northern australia insurance inquiry kicks off

The Australian Competition and Consumer Commission (ACCC) today released its issues paper for its inquiry into the supply of residential building, contents and strata insurance in northern Australia.

The ACCC is investigating why insurance premiums have increased substantially in northern Australia over the past few years.

The ACCC will use compulsory information gathering powers to access information directly from insurers. They are also seeking consumer and industry input on price, policy coverage, and any barriers to consumers getting a better deal.

Insurers' profitability in the north will be investigated under the inquiry.

The watchdog will hold a series of public forums around northern Australia to let consumers share their concerns.

Townsville will host the first forum on November 15 at the Hotel Grand Chancellor.

The Federal Government called for the enquiry back in May.

Northern Australia will include the Northern Territory, parts of Queensland and Western Australia north of the Tropic of Capricorn and some areas south of it, including Carnarvon WA and Gladstone Qld.

Submissions are due 21 December 2017.

small business is not immune to cyber threats

You might think that if you run a small business, you're mostly safe from cyber crime or ransom-ware attacks. ***After all, why would a hacker bother to target you when there are bigger fish to fry?***

These days, though, no one is safe. Cyber attacks are increasing among companies of all sizes. It is however, worth taking a moment to think about your company's security measures and consider your insurance needs.

Small businesses are vulnerable. If you still think cyber security is only a concern for larger corporations, you need to update your thinking. The latest data shows that **small businesses are just as vulnerable to data breach incidents as larger ones.**

The Australian Cyber Security Centre (ACSC) recently reported that about **90 per cent** of small organisations experienced a cyber threat or data breach in 2016 of which 58 per cent were successful. This is a sharp increase from prior years' data.

There can be a variety of costs that can impact a business due to a cyber attack, including:

- IT forensic costs
- Customer notification costs
- Increased costs of working
- Legal defence costs
- Ransom costs

Some customers might abandon your business if they're worried about security, and others might demand concessions from you that cost money. All this will impact the brand reputation of the company, which is difficult to recover from after an attack.

Getting protection against potential losses is a combination of internal safeguards and insurance. Businesses should consider how a cyber insurance policy can complement the business risk management initiatives. As part of a cyber insurance policy, insurers provide an incident response solution to assist business to recover quickly from a cyber attack

We can help develop a cyber business solution for your business – it is generally as simple as an add on to your existing business insurance.

is trauma insurance worth it?

Trauma or critical illness insurance is designed to pay you a chunk of money if something goes wrong. Trauma insurance, also known as critical illness insurance, is designed to step in if critical illness strikes.

The most common claims are for cancer, heart attack, coronary bypass, and stroke – or the "Big 4" as they are referred to in the industry. And most policies also cover an enormous list of other bad things that you really don't want.

Modern medicine means that these diagnoses are not necessarily a death sentence. With the advances in medical care and treatment, if diagnosed early enough, a person can often eventually return to a similar lifestyle they enjoyed prior to the condition arising.

There's more to critical illness than medical bills which for most, the majority is covered by either the public system or your private health insurance. Although you may not be out of pocket a significant amount for medical expenses, **the strain it can put on other areas of the budget and the family can be enormous,** particularly if treatment is a long-term process.

Some examples:

- If you do have income protection insurance, this will only cover a portion of your income, and there may be several weeks before it kicks in. Trauma insurance may pay a lump sum at the time of diagnosis or injury, without the same waiting period.

- Your partner may have to give up their work to look after you. Trauma insurance may provide money for your partner to afford to take leave without pay to care for you while you are both off work.

- If you need to travel to a larger city for treatment, you may get accommodation and travel allowances from the government, but your partner and children may not be eligible for these allowances – especially if you are in hospital. Trauma insurance may be useful if you use the money to cover accommodation and travel for your partner and children.

- There may be a specific treatment or rehabilitation program which is available only overseas and is not covered by Medicare or your health insurance policy. Trauma insurance may cover this as well.

I believe that the most important reason for Trauma Insurance is the immediate availability of funds so that all the family is able to cease work and participate in the fight to return to good health.