Your Fund Update

Formerly State Super Financial Services

Financial Year ending 30 June 2017

Remember Hem and Haw in the phenomenal little bestseller 'Who Moved My Cheese?' After almost two decades, the late Dr Spencer Johnson's insights still ring true. We all need to find our way in the maze of life and succeed in changing times.

Welcome to this edition of *Your Fund Update*. This time last year, I had just started with StatePlus and I was sharing my first CEO message with you. Who could have imagined some of the unexpected events we've seen since then? Brexit, Donald Trump's election, tensions on the Korean Peninsula, and at home, one of the closest federal election results in recent history. There's no doubt this past financial year has presented challenges but it has also shown how investors have gone from being spooked by uncertainty to being resilient.

Strong markets despite political uncertainty

Surprisingly, the year's geopolitical turbulence was not reflected in financial markets. Not only did they experience little volatility, but all major share markets returned strong, double-digit percentage gains. Locally, the ASX 300 returned almost 14% for the year. In our market update on the following pages, we discuss the financial year that was and give our thoughts on the year ahead.

Changes to super and disclosure rules

The Federal Government recently legislated a number of changes to super. Most of the changes started from 1 July 2017 and will affect just about everyone. As part of the Stronger Super reforms, all super funds must also change how they disclose fees and costs. We explain what the changes are and how they might affect you, so do take a moment to read these.

Staying in control online

You've told us that being able to manage your finances how and when it suits you is important. Look out for more communications from us about the upcoming launch of our new, secure StatePlus website that will offer exciting changes to the way you manage your investments and account.

Success in changing times

My daughter's final stretch in her degree reminds me just how quickly time flies. She's just about to complete her degree and is in the final stages of becoming a secondary school teacher. I'm really proud and excited to support her in this new phase of her life as she embarks on the education of our youth, and faces new challenges.

So back to the story of *Who Moved My Cheese*, where the protagonist Hem resists change while Haw learns to adapt when he sees that changing can lead to something better. We can never tell what's round the corner. In the current environment of change, financial advice is more important than ever to achieving your goals in retirement. Our planners are here to help, and will work with you to help you understand and succeed in the current environment of change.

I hope you enjoy this edition of *Your Fund Update* and I wish you all the very best for a successful financial year ahead.

Graeme Arnott

Chief Executive Officer

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Market update – the year in review

Strong performance from share markets drove above-average returns for growth-oriented portfolios, while more defensive portfolios experienced weaker returns in fixed income. Volatility was quite low despite a tumultuous year of political events, but we expect volatility to rise and returns to be lower in 2018, so it's important to stick to a long-term plan and rebalance at the right time.

Shares

Global share markets performed strongly, with all major markets delivering double-digit percentage gains. There was a notable lack of volatility, and returns were solid thanks to better-than-expected economic growth, fading political risks and favourable conditions supporting the outlook for profits around the world.

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The year was dominated by the election of Donald Trump as US president. His victory captured the attention of the world, and created a surge in equity markets. This momentum in late 2016 soon faded though, as promised reforms (especially on tax, healthcare, and infrastructure) became bogged down, and commodity prices fell, especially oil. In combination, these factors saw the 'Trump Trade' begin to unwind.

Despite this, global equity markets remained strong, underpinned by generally improved corporate performance. The MSCI World Index gained 18.9% in local currency terms, and the US S&P 500 finished the year close to record highs, returning 17.9%.

Other major global share markets also finished strongly, including the UK FTSE 100 (up 16.9%), the Chinese CSI 300 (up 18.8%), and the Japanese TOPIX (up 32.2%). Australian equities were more subdued, but the S&P/ASX 300 still returned 13.8%.

We think it's unlikely that shares will deliver similar returns over the next year.

In Australia a range of factors made the second half of the financial year a bit weaker, including weak growth, a new bank levy announced in the May budget, sub-par retail sector results and weaknesses in commodities, particularly iron ore.

We think it's unlikely that shares will deliver similar returns over the next year. Optimism for economic and earnings growth are largely reflected in prices worldwide and the market is likely to become more volatile.

Fixed interest and cash

As the unemployment rate in the US falls and wage growth shows signs of life, the Federal Reserve has been removing its policy stimulus. They raised rates three times over the year, and in a few months' time are expected to begin selling assets they bought to support markets after the global financial crisis.

If any economic weakness emerges, bonds will probably perform well and so can still play a valuable role in a diversified portfolio.

We expect that bonds will likely be challenged over the next 12 months, as central banks globally continue to normalise settings, reducing the extraordinary levels of stimulus they've provided over recent years. If any economic weakness emerges though, bonds will probably perform well and so can still play a valuable role in a diversified portfolio.

The Australian dollar

The Australian dollar spent the year between 72 cents and 77 cents against the US dollar. The range was a bit wider versus the British pound and the Euro, and our dollar rose nearly 13% against the Japanese yen.

A weaker dollar tends to have a positive impact on economic growth and inflation, so the Reserve Bank would probably prefer to see it go a bit lower from here.

Many had forecast a weak Australian dollar due to exposure to China's economic slowdown, elevated house prices and sensitivity to the US rate cycle, so the relative stability was surprising. A weaker dollar tends to have a positive impact on economic growth and inflation, so the Reserve Bank would probably prefer to see it go a bit lower from here.

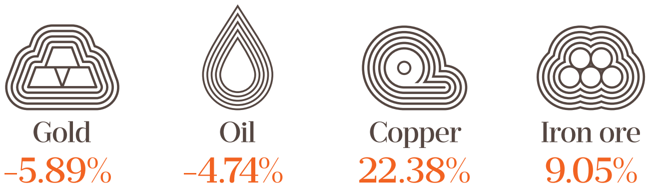
Australian dollar vs US dollar

US$0.7446	US$0.7670
30 June 2016	30 June 2017

Source: FactSet

Annual returns on commodities

One year investment return (30 June 2016 to 30 June 2017)

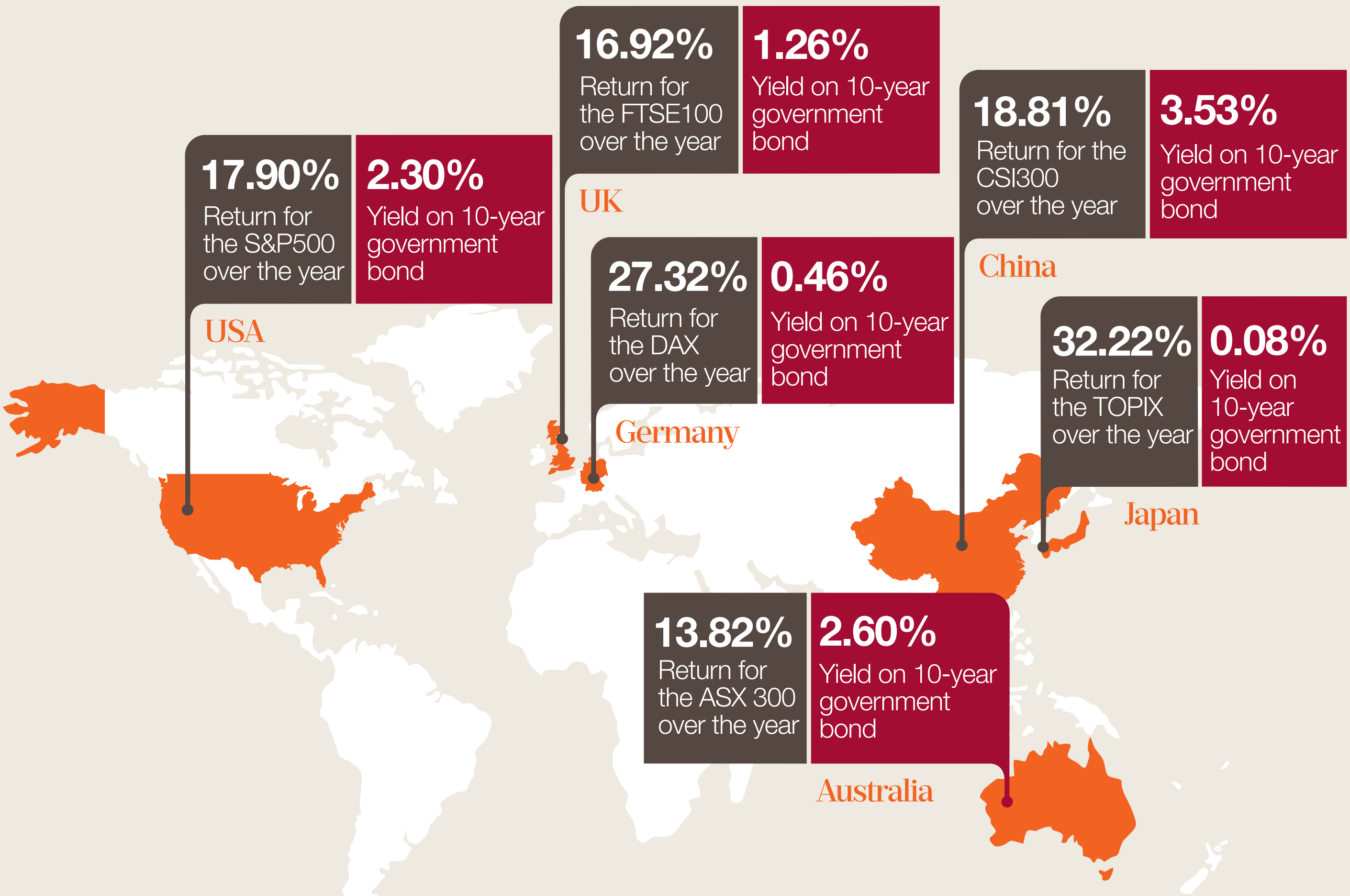


Source: FactSet

Your financial planner can help ensure that your portfolio is positioned correctly for your needs. If you have any questions, please contact your planner.

Investment market performance from around the globe

30 June 2016 – 30 June 2017



Source: FactSet

The new super rules – know your new limits

Changes to the superannuation and pension system that came into effect on 1 July 2017 have imposed some new limits and opened up some new possibilities. Here we highlight some of the key changes that many of you have asked us about.

New caps on contributions

Concessional cap now $25,000

As of 1 July 2017 the concessional contributions cap went down to $25,000 for everyone. It was previously $30,000 for people under 50 and $35,000 for those aged 50 or more.

This means that $25,000 is now the maximum amount of pre-tax income you can put into super in a year and only pay 15% tax.

Anything you contribute above this amount is taxed at your marginal tax rate (less a 15% non-refundable tax offset), plus an excess concessional contributions charge. So if you're making personal contributions or salary sacrificing, you should pay close attention to how much you're contributing.

Non-concessional cap now $100,000

The maximum amount you can contribute in after-tax money has also gone down, from $180,000 to $100,000.

In addition, individuals with a total superannuation balance equal to or greater than $1.6 million (as at 30 June of the preceding financial year) will have a non-concessional contributions cap of nil. If this applies to you, it means you won't be eligible to make non-concessional contributions without exceeding your non-concessional contributions cap. However, you can continue to make concessional contributions, subject to the concessional contributions limit of $25,000 p.a.

The above is not to be confused with the $1.6 million transfer balance cap rule (see 'Transfer balance cap of $1.6 million' on the following page).

Under the bring-forward provisions, this means that you can bring forward the next two years' worth of the non-concessional contributions cap, contributing a total of up to $300,000 in non-concessional contributions over three years.

There are also new restrictions on using the bring-forward provisions if your total superannuation balance is above $1.4 million, and transitional provisions if you triggered the bring-forward rule in the 2015-16 or 2016-17 financial years and have not fully used your bring-forward amount before 1 July 2017.

Transfer balance cap of $1.6 million

The term 'transfer balance cap' means the amount you can transfer into retirement phase accounts. There's no limit on the amount of money you can have in your accumulation super accounts, but as mentioned on the previous page, there are now tighter restrictions on making contributions to boost your super.

As of 1 July 2017, the maximum amount you can transfer into eligible retirement phase income stream accounts in your lifetime is $1.6 million. This is called the transfer balance cap and will be indexed periodically in increments of $100,000 in line with inflation.

The cap applies to the total amount of superannuation that you have transferred into the retirement phase, across all income stream accounts from all providers you hold these amounts in.

Claiming voluntary contributions as a tax deduction

From 1 July 2017, personal super contributions made from your after-tax salary can generally be claimed as a tax deduction. If you're aged 65 to 74, you'll still need to satisfy the annual work test to be eligible to claim a tax deduction on your personal contributions. These contributions count towards your $25,000 concessional cap though, so while this makes personal contributions more tax-effective, you won't be able to claim any amounts that take you over a total annual contribution of $25,000.

Spouse contributions and tax offset

The new super rules that came into effect on 1 July 2017 changed the thresholds concerning your spouse's annual income in order for you to receive a tax offset for any after-tax contributions you make to your spouse's super. The tax offset is 18% of the amount of the contribution, subject to the following thresholds and rules.

If your spouse's annual income is $37,000 or less, the offset will apply to all spouse contributions, up to $3,000. This means the maximum offset you can receive in a year is $540 (18% x $3,000). For every $1 that your spouse's income exceeds $37,000, the $3,000 cap is reduced by $1. The tax offset cuts off when your spouse's income reaches $40,000.

In addition, from 1 July 2017, the tax offset will not be available if the spouse receiving the contribution exceeds the non-concessional contributions cap or has a total super balance greater than $1.6 million (indexed).

The increased thresholds have made this tax offset available to a lot more people, so take a moment to check whether you can now take advantage of spouse contributions.

The overall effect of these changes

While the Federal Government often tinkers with the rules, superannuation remains one of the most effective ways to save for and live in retirement. While the increased spouse contribution thresholds may help the balances of some low-income earners, the newly-reduced caps place tighter restrictions on the amount of funds you can put into the tax-effective superannuation environment.

As always, we recommend that you consult your financial planner before making decisions about your super. It's important to understand all the implications before making investment decisions.

Changes to the way we communicate with you

This applies to investors in **Allocated Pension, Personal Retirement Plan, Flexible Income Plan and Tailored Super Plan.**

Recent changes to superannuation rules, fee and cost disclosure and return objectives may have an impact on your account. **From now on, we will publish all important information and changes to your superannuation or pension product ('Important Changes') online**. We will notify you by your chosen method of communication (e.g. email or by post) when we have published Important Changes online.

If you'd prefer to receive paper copies of Important Changes free of charge, you can update your preferences by calling us on 1800 620 305.

Your preferences will apply to all notifications about Important Changes following your election. If you update your preferences within seven days of receiving this newsletter, we will send you a paper copy of any Important Changes that were published during those seven days.

Please note: We have published notices containing more details on the changes summarised here.
Go to **stateplus.com.au/notices** to see these.

Important updates on your fees, costs and investments

Changes to how we disclose our fees

*As part of the Government's Stronger Super reforms, all superannuation funds and investment product providers must change how they disclose fees and costs. Here we summarise some of these changes and how they affect you. We've provided a detailed explanation of the changes to our fee and costs disclosure, and changes to return objectives, online at **stateplus.com.au/notices***

New regulations have been introduced that require all super funds to change how they disclose investment fees, performance fees and costs.

We now need to disclose a broader range of costs.

We've always factored in all costs in our unit pricing calculations, so the return on your investment has always reflected the fees and costs we've incurred.

So what are the changes?

A superannuation fund has two main types of fees and charges:

- Fees charged by the fund
- Costs incurred by the fund.

Investment and performance fees

The main fee we charge is the Investment Fee which covers all of the investment and administration services we provide. The Investment Fee consists of:

- the **management** fee we charge to invest and administer your super
- **performance-related fees** that we pay to investment managers if they meet certain performance-related hurdles
- **Government costs and levies**.

These amounts have always been shown on your annual statement, and that doesn't change.

Costs incurred in managing portfolios

These are essentially the costs of managing the assets of particular investment options.

Indirect costs

These are costs that are borne by the fund. They reduce investment returns to investors but aren't charged as a fee. Examples include securities lending costs, certain transaction costs (such as brokerage), the costs of administering a fund in which we invest, and certain over-the-counter derivative costs.

The total amount of these costs divided by the total assets of the fund can be expressed as an Indirect Cost Ratio (ICR). By multiplying the ICR by your average account balance you can calculate the estimated indirect costs of your investment.

Transaction and operational costs

To invest its assets, the fund incurs transaction and operational costs. Some are explicit costs charged by third parties such as brokers to buy and sell securities, while others are implicit costs (for instance bid offer spreads on fixed income securities).

Transaction and operational costs are generally either deducted from the assets held by the fund when they are incurred or reflected in the unit price of the fund, and are not explicitly charged by the fund as a fee.

Borrowing costs

For some assets, we may enter into borrowing arrangements and incur costs such as interest payments and loan fees. These costs can change and are generally deducted from the assets held by the fund rather than being explicitly charged by the fund as a fee.

What this means to you

We're not charging any new fees, simply disclosing more clearly what your investment costs each year. From next year your statements will show more information on fees and costs.

For more information on fees and costs including:

- borrowing costs
- transaction fees
- indirect costs

please go to **stateplus.com.au/notices**

Investment Fee and Estimated ICR amounts

As a result of the new regulations and changes in the underlying investments and our arrangements with investment managers, the total fees and costs that were disclosed in the Product Disclosure Statements have changed.

The following table shows an estimate of the total fees, costs and total estimated corresponding dollar amounts for the 12 months to 30 June 2017. The total fees and costs will change from year to year as fees and expenses change.

For example, if you were invested in the Tailored Super Plan Moderate Fund, you would have paid $375 in the last financial year for every $50,000 you had in the fund.

Fees and Costs for the Tailored Super Plan and Flexible Income Plan

Investment option	Investment Fee %			Indirect cost ratio (estimated) %	Total Estimated investment fees and indirect costs expressed as $ per $50,000
	Management fees %	Performance related fees (estimated) %	Government costs & levies (estimated) %		
Cash Fund	0.39% p.a.	N/A	0.01%	0.00%	$200
Fixed Interest Fund	0.50% p.a	N/A	0.01%	0.06%	$285
Capital Stable Fund	0.57% p.a.	0.02%	0.01%	0.06%	$330
Moderate Fund	0.61% p.a.	0.03%	0.01%	0.10%	$375
Balanced Fund	0.70% p.a	0.03%	0.01%	0.12%	$430
Growth Fund	0.77% p.a.	0.02%	0.01%	0.15%	$475
Australian Equities Fund	0.77% p.a.	N/A	0.01%	0.15%	$465
International Equities Fund	0.77% p.a	N/A	0.01%	0.12%	$450
Fixed Term Fund	0.50% p.a	N/A	0.01%	0.02%	$265

Changes to return objectives

We've recently changed the return objectives for the Personal Retirement Plan and Allocated Pension Fund to reflect how we charge fees.

Previously, the return objectives for each investment option across these products were calculated after investment fees only.

What's changed?

We've made two changes:

- factoring in the fees we charge into the investment return
- stating that the return objectives are gross of tax, that is before tax on earnings, and adding the value of franking credits back in.

The change to the treatment of tax gives consistency between tax structures (investments, superannuation and pension) because the return objectives don't need to factor in the differing tax amounts that apply.

What this means to you

These changes mean that the return objectives for the investment options in both of these products are now lower.

Go to **stateplus.com.au/notices** for more information about changes to the return objectives, as well as the other changes summarised above. Please call 1800 620 305 if you'd like us to send you a printed copy of this information free of charge.

We've closed some funds

We've recently closed two funds:

- the *Growth Plus Fund* in the Investment Fund – Class A, effective 15 May 2017
- the *Fixed Payment Fund* in the Flexible Income Plan and Allocated Pension Fund, effective 1 July 2017.

We've written to affected investors. The funds have either been returned to investors or re-invested in another option.

These changes are reflected in our latest Product Disclosure Statements (see **stateplus.com.au/pds**).

Top tips for staying active in retirement

Lying in a hammock all day might sound attractive. The reality is that an active retirement is much better for mind and body.

1. Active mind, active body

While we're busy working, we often don't recognise that our work environment is a social and stimulating place.

We interact with people constantly and are faced with challenges daily. While we might call these things 'stress', in fact, it's often your job that's keeping you active, both mentally and physically.

When we retire we need to create a new environment that provides the same level of stimulus as our work environment did. While it's likely to be a completely different *type* of stimulus, what counts is keeping an active body and active mind[1].

2. So, look on the bright side

Retiring from your career doesn't mean retiring from work completely, nor does it mean retiring from society.

On the contrary, it's an opportunity to do the things you haven't previously had time for. The key is creating a structure and a purpose to your days, finding time to exercise, eating well and starting a new phase of your life.

3. Age is a relative thing

With life expectancies increasing, many of us could well be spending as much as a third of our lives in retirement. Viewed in that context, lying in a hammock is going to get pretty boring pretty quickly.

So if you're retired, or looking to retire soon, take some time to visualise what your days will be like. What will you do? Who will you socialise with? What activities do you have planned?

1. Department of Health & Human Services, State Government of Victoria website: Healthy ageing - stay mentally active

Let us know what you think

We'd love to hear from you about Your Fund Update, so please give us a call or go to **stateplus.com.au/contact** to send us your feedback.

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