Your Fund Update

StatePlus

Formerly State Super Financial Services

Half Year ending 31 December 2016

Our focus is on improving your financial wellbeing. So we want to smooth the journey for you by delivering investment returns at appropriate levels of risk.

The year that was and the year ahead

As we kick off 2017, one of the things that strikes me most is just how important it is to keep focused on our long-term goals. At the start of 2016, few could have predicted what a dramatic year it would be, with key political events driving investment markets around the world. Brexit, Trump and at home, our own Australian federal elections, all ended with surprise outcomes.

What comes to the fore at times like this is the value of having a diversified portfolio. We've often said that diversification is the most important component of achieving your long-term financial goals, while minimising risk. This continues to be true today.

Markets don't like uncertainty and typically react to political events, which results in volatility. We certainly saw plenty of ups and downs last year in investment markets. At StatePlus our focus is on improving your financial wellbeing. So we want to smooth the journey for you by delivering investment returns at appropriate levels of risk. We structure portfolios in a way that ensures some of your assets are in stable investments that are less affected by market volatility.

Ongoing changes to super

For many Australians, superannuation is the number one source of income in retirement. The ongoing recent changes have caused some uncertainty among retirees and pre-retirees. In this edition we take a detailed look at some of the changes that have been passed as legislation and that will take effect on 1 July 2017.

Some of you who receive the Age Pension may also be affected by Centrelink changes to the asset test thresholds and taper rate from 1 January 2017.

If you're concerned about how these changes affect you, I'd encourage you to speak to your financial planner.

Enjoy a fulfilling retirement

So whether it's navigating changes in superannuation legislation, or staying on track with your long-term goals, I'd like to reassure you that my team and I at StatePlus are focused on providing you the retirement outcomes you want.

We're here to help keep your finances on track so that you can enjoy a fulfilling retirement. We know that an ongoing relationship with a professional financial planner has a positive impact on the lives of our clients. So as always, if there's anything we can do, just give us a call.

We hope this edition of Your Fund Update will help keep you up-to-date with your investments, and what's happening in global and domestic markets.

I wish each and every one of you a healthy and successful 2017.

Graeme Arnott
Chief Executive Officer

Contents

Market update – the year in review

2016 was a year of unexpected political events around the globe, but investment markets showed surprising resilience. Shares had a good year, while bond yields rose. Looking forward, investment returns are expected to be lower, which once again reinforces how important it is for investors to stay well diversified.

Shares

2016 turned out to be a very good year for investors in shares, despite a rocky start. January and February were volatile, due to concerns about economic fragility in China and uncertainty about whether interest rates in the US would rise too quickly and cause a slowdown.

The best performing sectors were those linked to surging commodity prices.

Mid-February marked the bottom for most markets, at which point the S&P/ASX 300 index was down 8.9% for the year and the MSCI World index down 12.5%. The subsequent recovery was remarkable both for its magnitude and its resilience to unexpected political outcomes. Australian shares ended up returning 11.8% for 2016, and international shares 8.9%.

The best-performing sectors were those linked to surging commodity prices. Energy and mining companies were strong, but are still lagging over longer-time horizons. The more defensive consumer and healthcare related companies, which led the indexes in recent years, began to underperform as investors gained confidence in the earnings outlook for cyclical stocks.

In 2017 we're expecting the political surprises to keep coming, with elections in Europe, the UK leaving the European Union and an incoming US president known for unpredictability and unconventionality.

In this kind of environment, active management and diversification will be critical.

For now at least, the markets seem willing to look on the bright side, and last year's strong returns mean valuations on average are somewhat elevated. In this kind of environment, active management and diversification will be critical.

Fixed Interest and Cash

For fixed interest investors it was a year of two halves. Returns were strong in the first half of the year, as bond yields fell around the world after the UK's shock Brexit referendum. From July through to December though, economic news steadily improved and the market started contemplating a return to more normal levels of inflation and interest rates.

This saw yields on most government bonds rise and fixed interest portfolios deliver small negative returns.

The market is now expecting the Reserve Bank to keep interest rates on hold throughout 2017.

The Reserve Bank made two cuts to the Australian cash rate, dropping it to 1.5% as inflation surprised on the downside. The recovery in commodity prices and better outlook for global growth in the second half of the year shifted expectations, and the market is now anticipating the Reserve Bank to keep interest rates on hold throughout 2017 and begin raising them in early 2018.

At the start of the year the US Federal Reserve was expected to raise interest rates two or three times, but ended up doing so only once, in December. Central Banks in Japan and Europe continued to stimulate their weak economies through negative cash rates and quantitative easing (buying bonds to keep borrowing costs low).

Property and Infrastructure

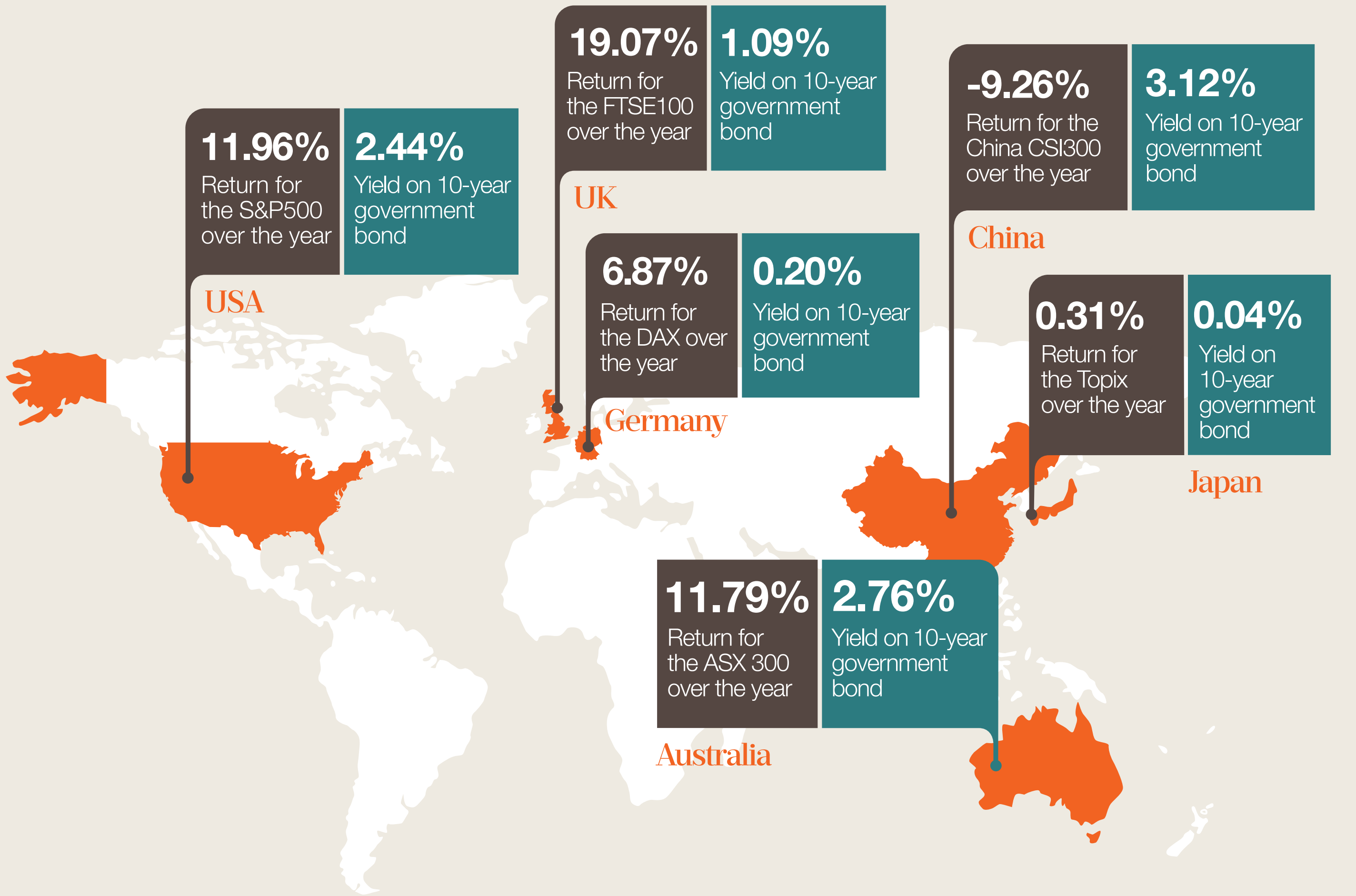
During the recent long era of low interest rates, investors looking for stable income bid up listed property and infrastructure investments. As yields on fixed interest investments began to rise mid-year, prices for these traditionally defensive 'growth' assets fell.

In 2016 we started building a portfolio of unlisted infrastructure.

For some time now we have invested in property through unlisted funds, where returns are more stable than listed markets. In 2016 we started building a portfolio of unlisted infrastructure, which has similar characteristics to direct property and provides welcome diversification.

Investment market performance from around the globe

31 December 2015 – 31 December 2016



Source: FactSet

The Australian dollar

In US dollar terms, the Australian dollar traded in a wide range, but finished 2016 almost exactly where it started. The British Pound fell significantly against all currencies following the Brexit vote, and dropped 18.7% against the Australian dollar.

Holding some unhedged international assets continues to provide diversification for portfolios. Our dollar tends to weaken when investors are concerned about global growth, so having foreign currency in portfolios provides a boost when growth assets are experiencing more volatility.

Australian dollar vs US dollar

US $0.7276	US $0.7241
31 December 2015	31 December 2016

Annual returns on commodities

One year investment return
(31 December 2015 to 31 December 2016)

Gold	Oil	Copper	Iron ore
8.46%	45.03%	16.99%	101.49%

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.

How changes to super laws will affect you

The Federal Government recently legislated a number of changes to super. Most of the changes start from 1 July 2017 and will affect just about everyone. Here we discuss the changes according to age, income and how much you have in your super.

If you're still working

Pre-tax contribution cap has lowered to $25,000

What's changed

The maximum amount you'll be able contribute to super annually from your pre-tax income will be $25,000. The current rate is $30,000 for people under 50 and $35,000 for people 50 or older. This total includes all mandatory employer contributions, salary sacrifice and personal contributions for which you claim a tax deduction.

What it means to you

If you put more than $25,000 into super in a year, you'll start paying your marginal tax rate on any other amounts you contribute (not the 15% concessional tax rate), plus an interest penalty.

After-tax contribution cap has lowered to $100,000

What's changed

Currently you can contribute up to $180,000 in after-tax money to your super per year. This will drop to $100,000 and will only be an option if you have less than $1.6 million in super.

What it means to you

If you're putting your after-tax income into super, the maximum amount you can contribute in this way each year has dropped by $80,000.

If you're under 65 at the start of the financial year the amount you can contribute depends on your super balance: if your balance is less than $1.4 million, you can contribute up to three years' worth of the cap at once; if your balance is between $1.4 million and $1.5 million, you can contribute up to two years' worth of the cap; if your balance is between $1.5 million and $1.6 million you are limited to just one year's worth of cap.

Claiming personal contributions as a tax deduction

What's changed

You'll be able to claim up to $25,000 in personal super contributions (those you make from your after-tax income) as a tax deduction. If you're aged between 65 and 74 you'll have to pass a work test to claim the deduction. This isn't available for contributions to untaxed funds and Commonwealth public sector defined benefit funds.

What it means to you

This makes personal contributions much more attractive, as the more you contribute the less tax you'll pay. Remember though that these contributions will count towards your $25,000 concessional contributions cap, so keep an eye on your total of these personal contributions, as well as employer and salary sacrifice contributions.

If you earn more than $250,000 a year

What's changed

High income earners currently pay an extra 15% tax on any concessional contributions that push their income over $300,000. From 1 July 2017 this threshold will fall to $250,000.

What it means to you

If you're a high income earner you'll pay more tax. Let's say you have an income of $240,000 and make concessional contributions of $25,000 (a total income of $265,000). You'll pay an additional 15% tax (30% in total) on contributions of $15,000, which is the amount of your contribution above $250,000.

You could also find yourself in this situation if you're not on such a high salary, but you receive a lump sum that puts your total income for the year over $250,000. This could happen for example if you receive a redundancy payout, or sell an investment property.

If you don't contribute for a few years

What's changed

From 1 July 2018, you can make 'catch-up' contributions at the concessional tax rate of 15% if you:

- haven't made contributions for up to five years
- have less than $500,000 in super
- have unused concessional cap amounts.

What it means to you

If you haven't been paying attention to your super, this will provide an opportunity to top it up at the lowest tax rate.

If you earn less than $37,000 a year

What's changed

The Government has offered the Low Income Superannuation Contribution payment for some years now to people who earn less than $37,000 a year. The payment is a boost to your super of up to $500, and is, in effect, a refund of the 15% tax you paid on your concessional contributions. The Government has renamed the payment to Low Income Superannuation Tax Offset (LISTO).

They've also increased the lower threshold for tax offsets for spouse contributions from $10,800 to $37,000.

What it means to you

If you're eligible for LISC you're eligible for LISTO; only the name has changed.

For the spouse contributions tax offset, the change to the threshold means that if:

- your partner earns less than $40,000, and
- you make a spouse contribution to their super of up to $3,000

then you're eligible for an 18% tax offset of the contribution of up to $540.

Max and Lara, full-time and part-time working couple

Max works full-time and earns $100,000 a year. Lara is flat out being a mother and working two days a week, earning $32,000 a year. As her income is below $37,000, Lara qualifies for the Low Income Superannuation Tax Offset, and Max can contribute up to $3,000 to her super to earn a tax offset of $540.

They decide to sell their investment property, making a profit of $600,000. They could choose to make a non-concessional contribution of up to $300,000 each to put the entire $600,000 into super.

To ensure that they're optimising their opportunity to build their super, they can also make a combination of salary sacrifice contributions and personal contributions for which they claim a tax deduction. The key is making sure that these contributions don't exceed $25,000 when combined with their employer's super guarantee.

How changes to super laws will affect you
(Cont.)

If you're transitioning to retirement

Changes to transition to retirement income stream tax exemptions

What's changed

Earnings on the assets supporting your transition to retirement income stream have historically been tax-free.

As of 1 July 2017, these earnings will generally be taxed at up to 15%, regardless of when you started the account.

What it means to you

The tax effectiveness of your transition to retirement income stream will be reduced, so you should ask your financial planner whether it will still be relevant to you.

If you have a retirement pension

What's changed

The ATO is introducing a $1.6 million cap on the amount of super you can transfer into a tax-free retirement account.

This will also affect defined benefit pensions. When you start a defined benefit pension, the ATO multiplies your annualised payment by 16 to produce a notional capital value. If your annual income is $100,000 or more then you reach the $1.6 million 'transfer balance cap'.

What it means to you

If the starting balance (or the current value on 1 July 2017) of your tax-free retirement pension account (across all super funds) plus the capitalised value of your defined benefit pension is over $1.6 million, then you'll have to pay tax on the excess.

You'll need to either:

- transfer the excess from your tax-free retirement account back into an accumulation superannuation account, or
- withdraw the excess amount from your retirement account.

If your defined benefit pension alone puts you over the cap, you won't be able to have a tax-free retirement account, and defined benefit pension payments over $100,000 will be taxed accordingly.

If you're concerned about how these changes to super laws affect you, please speak to your planner.

John, retired on a defined benefit pension

John is about to start a defined benefit pension that pays $65,000 annually (making it worth $1,040,000). He also has an account-based pension of $600,000. As his total would be $40,000 over $1.6 million, if he does not move at least $40,000 back into an accumulation account he'll have to pay tax on it.

Investing in unlisted infrastructure

At StatePlus we're always looking for better ways to invest your money. We're now investing in unlisted infrastructure. These are assets held privately rather than listed on a sharemarket.

If you're invested in the Capital Stable, Moderate and Balanced options you will have exposure to these unlisted infrastructure assets as part of your diversified portfolio.

Why are we investing in unlisted infrastructure?

Infrastructure assets typically offer the following attractive investment characteristics:

- stable, predictable cash flows which can also protect against inflation
- diversification through differentiation from traditional asset classes (i.e. stocks and bonds)
- as these assets provide essential services, the demand for them remains relatively stable, so they are less sensitive to economic cycles
- unlisted infrastructure is not valued daily (unlike shares and bonds), so valuations remain relatively stable.

As with any investment, investing in unlisted infrastructure carries a certain amount of risk, which is balanced with the diversification benefits it offers for the StatePlus portfolio.

As these assets provide essential services, the demand for them remains relatively stable, so they are less sensitive to economic cycles.

Investing in renewable energy

A recent StatePlus unlisted infrastructure investment is in the *Powering Australian Renewables Fund* (PARF). PARF is a renewable energy investment vehicle that is partnering with existing alternative energy experts. It is an investment managed by wholesale funds manager QIC Limited.

PARF aims to build 1,000 megawatts of renewable power generation, through large-scale projects that use proven renewable energy technologies. The first assets are solar farms at Broken Hill and Nyngan, in outback NSW.

Once fully invested, PARF will own approximately 10% of Australia's renewable energy capacity and will generate over 3,000 gigawatt hours of electricity. This generation will abate around 2.7 million tonnes of greenhouse gas emissions per annum, or provide power to approximately 530,000 homes. It is equivalent to removing about 800,000 cars from the road.

Investing in the Port of Melbourne

The Port of Melbourne is the largest container port in Australia, and more than a third of Australia's total import and export container trade goes through it. The port is centrally located near Melbourne and well-connected by rail and road infrastructure. By providing a critical trade gateway into and out of Victoria, the port provides an essential service to the Melbourne region.

Steady population and productivity growth have made Victoria the second-most populous state in Australia behind NSW. Container trade at the Port of Melbourne has matched this progress, even through difficult periods such as the Global Financial Crisis.

New year? New idea

The start of a new year is always a good time to take stock and think about what you could do differently. New Year's resolutions aside, there are a few changes we can all consider that will make our lives that little bit more enjoyable, whether you're retired or are contemplating retirement.

Extensive research[1] has shown that the more active we are in life, the healthier we are, both physically and mentally. This applies whether you're retired, working part-time or 40+ hours a week. Keeping an active body and mind, and staying in touch with your social network are key to good health.

So, is 2017 the year in which you shake things up a bit? If so, where should you start?

1. Exercise with others

Sometimes getting over the reluctance to exercise can be harder than the exercise itself. One way to ensure that you get out of the house and get your heart rate up, is to exercise with friends.

Peer pressure is one of the strongest forces in the universe: if you know that other people are relying on you go walking at 6am, or do aqua-aerobics at 2pm, you're far more likely to do it.

2. Exercise your mind as well as your body

If we stop exercising our muscles they lose definition and we become weaker. Like our muscles, our brain needs to be used continually to keep it in shape, so exercising your mind is just as important.

Whether it's reading books, playing board games, listening to music or studying a topic of interest, all of these things help to keep your brain in constant activity.

This not only keeps your mind 'plastic' and able to adapt, but it gives you something to think about and talk about. That's an important component of the third element of an active lifestyle: your social life.

3. Make that 'we must catch-up' happen

In the years we spend building a career or raising a family, we often find that we've lost contact with family and friends. This is especially true if they've moved to another city or suburb and aren't close by anymore.

When we no longer have to work five or six days a week, we have more opportunities to spend time with the people we love. Humans are social creatures and generally thrive on contact with other people, so making plans to see friends and enjoy society is a big part of an active life.

Those of us who have grandchildren can be certain that our own children will be deeply grateful for even an hour of respite, especially when the grandchildren are very young.

[1] Australian Government Department of Health website, Education and Prevention, Australia's Physical Activity and Sedentary Behaviour Guidelines

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.

www stateplus.com.au | call 1800 620 305 | face to face

Connect with us

Important information

State Super Financial Services Australia Limited trading as StatePlus (ABN 86 003 742 756 | AFSL 238430) is wholly owned by FSS Trustee Corporation (ABN 11 118 202 672 and AFSL 293340) as trustee of the First State Superannuation Scheme (ABN 53 226 460 365). This information is of a general nature only and is not specific to your personal circumstances or needs. Before making any decisions based on this information you should consider its appropriateness to you. Every effort has been made to ensure the information contained in it is accurate. We strongly recommend that you consult a financial planner before taking action based on this information. Past performance is not an indicator of future performance.

Neither the SAS Trustee Corporation nor the New South Wales Government take any responsibility for this information or the services offered by StatePlus, and nor do they, FSS Trustee Corporation or StatePlus guarantee the performance of any product provided by StatePlus. All information is correct as of 31 December 2016.