A window into topping up super in retirement

There are restrictions on contributions as retirement age looms

MEG HEFFRON

From July this year there are some important changes that extend the ability for certain people over 65 to make contributions to superannuation.

In a nutshell, the rules in the current financial year only allow superannuation contributions for someone over 65 if:

- The contributions are legally compulsory (such as those required by an award or the Superannuation Guarantee rules); or
- The member is under 75 (or more technically, has not yet passed the 28th day of the month after their 75th birthday) and has met a "work test". The work test is, broadly speaking, completing 40 hours of paid work over no more than 30 consecutive days at any time in the financial year and before the contribution is made.

From July 1 some people will have one extra financial year in which contributions can be made — the year after they last meet the work test.

They must meet an important condition: their total superannuation balance (the measure of all of the money they have in superannuation funds) must be less than $300,000 at a particular point in time. For example:

1. Mary is going to retire in May 2020, aged 67 (she will meet the work test in 2019-20 but will not work at all in 2020-21).

2. She needs to confirm that her total superannuation balance is under $300,000 at the end of that year (June 30, 2020, in this case), and if so;

3. Member and employer contributions will be allowed for Mary in the 2020-21 year even though she will be turning 68 and will not have worked during that year.

The new rules give Mary an extra year (2020-21) for contributions. Had nothing changed, her last year would have been 2019-20.

While the new rules don't start until next financial year, some people should think about them right now. That's because some individuals could give themselves a chance to have super contributions this year and next year by making sure they meet the work test now.

For example, Colin retired several years ago and is now 71. He has come into some money and would like to put it into superannuation. If he gets some part-time work now and meets the work test, not only can he make superannuation contributions in 2018-19 (this year), but he can also make them next year. To make contributions next year (2019-20), he will have to make sure his total superannuation balance is less than $300,000 at June 30 this year but, importantly, he will no longer have to meet the work test in 2019-20.

There are some problems this change doesn't solve.

Those who cease work entirely well before age 65 will effectively receive no benefit from this change. It is not a blanket exemption for one year after the last year in which contributions were possible. Even in the example above, Colin needed to go back to work and meet the work test one last time in 2018-19.

It doesn't allow contributions at times when they are not allowed regardless of whether the person has met the work test — voluntary contributions are illegal after 75 and this remains the case.

The exemption is also only available in one financial year. This means that it isn't possible for someone to use the exemption in one year, then meet the work test in the next and use the exemption again the year after.

How does the exemption interact with the "bring forward" rules where you can make a cumulative contribution?

The "bring forward" rules allow people to contribute up to two or three years' personal contributions in a single year (effectively "bringing forward" one or more years' contribution limits). Currently, the year in which an individual turns 65 is the last year in which they can initiate a bring-forward period and this will not change as part of the exemption.

Overall, the feature that limits the value of this opportunity is the $300,000 cap on members' total superannuation balances. However, it does present some new opportunities for those with balances below this threshold.

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Bond ETFs' range of risks, rewards

Low-cost index investing as opened a new sector of interest

ELIZABETH MORAN

Exchange-traded funds have been one of the ASX growth stories in recent years as investors aim to mimic Warren Buffett's low-cost index investing strategy.

Simply, ETFs track a benchmark basket of investments. There's no minimum needed to invest and fees are very low, theoretically providing a diversified portfolio with little need to trade and more stable returns than holding a smaller number of direct investments over the longer term.

For fixed-income investors, the ETF market has also created a new route into the bond market. Up until very recently, the bond sector was dominated by either the direct ownership of bonds or the ownership of actively managed bond funds. Now, bond-based ETFs are creating a new sector of interest.

ASX-listed fixed-income ETFs grew strongly in 2018 with $1.3 billion in net inflows, ranking third after international and Australian equity ETFs. The total value of fixed-income ETFs is more than $5.5bn across 25 ETFs.

For investors thinking about investing or wanting to review fixed-income ETF investments, here are a few key considerations.

Underlying investments

It is important to understand what you are investing in — there are sub-sectors in the market with a range of risk and reward characteristics. The lowest risk is cash and at the other end of the scale are global high-yield bond ETFs.

Most bond ETFs will have an allocation to government bonds, as federal and state governments have been big bond issuers. So, many of the funds are very low-risk but also have very low returns. To put the return into perspective, the 10-year government bond rate is around 2.15 per cent a year.

So, you should understand the percentage allocation to these assets when comparing fixed-income ETFs. Some ETFs only invest in government bonds, so returns may even be lower than term deposits.

In fact, the largest fixed-income ETF is a BetaShares Australian High Interest Cash ETF with $1.3bn in net assets. The fund aims to provide regular income distributions that exceed the 30-day bank bill swap rate after fees and expenses and invests in bank deposits. Investors don't need to open a bank account or lock up capital and are paid monthly. It's a simple strategy, even though it doesn't actually track an existing index. The fund started in March 2012 and has returned 2.89 per cent a year since inception.

Assessing yields

When trying to assess performance, don't make the rookie error of just reviewing the running yield, which is the annual dollar interest payment divided by its market price. Many running yields are attractive, showing 3.5 per cent or more, but if you are investing for the longer term, you will need to look at the yield to maturity, which is probably lower. This is the return if all the bonds are held until their maturity dates.

Only three Australian dollar fixed-income ETFs have a yield to maturity of more than 3 per cent — Investment Grade Corporate Bond ETF, VanEck Vectors Australian Corporate Bond Plus ETF and the Vanguard Australian Corporate Fixed Interest Index Fund. Quoted yields to maturity were 3.58 per cent, 3.2 per cent and 3 per cent, respectively.

An important factor in assessing various options, especially when interest rates are low, is the weighted average term to maturity. A longer-dated portfolio will be higher-risk, as it's harder to determine what will happen to companies over a longer term, and should pay higher returns to compensate. The Investment Grade Corporate Bond ETF, launched last year has an average term of 7.4 years compared to VanEck at 5.1 years and Vanguard at 4.2 years.

The three ETFs reference different benchmarks. I'd suggest you do your homework and check the composition of the benchmark and individual holdings in the ETFs, which may also help explain the different yields.

Corporate bond ETFs

The largest two ETFs that include an allocation to corporate bonds and reference the same underlying benchmark, the Bloomberg AusBond Composite 0+ Year Index, are the iShares Core Composite Bond ETF and the Vanguard Australian Fixed Interest Index. There is little to separate the two, with Vanguard edging out its rival, showing a higher yield to maturity and running yield.

If these yields seem low, there are two high-yield global fixed-income ETFs that may be more interesting. Both are issued by iShares and track different high-yield indices. The running yields and yields to maturity are above 5 per cent. The funds are relatively small with a combined net asset value of less than $40m and a small number of holdings of just 13 and 23 bonds. Ideally in the high-yield space you would want better diversification, whereas I'd be much happier with smaller numbers of investment-grade bonds.

On that note, a newcomer, the BetaShares Australian Bank Senior Floating Rate Bond ETF, which has 96.5 per cent invested in 14 low-risk senior bank bonds, has been doing well. Launched in 2017 it has $392.4m in net assets with a yield to maturity of 2.78 per cent a year. The remaining 3.5 per cent is invested in high-yield equities.

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MARKETS P28

ETFs have been one of the ASX growth stories in recent years

AAP

Fixed income ETFs – Australian dollar	*ASX code*
Investment Grade Corporate Bond	CRED
VanEck Vectors Australian Floating Rate	FLOT
BetaShares Australian Bank Senior Floating Rate Bond	QPON
iShares Core Cash	BILL
iShares Enhanced Cash	ISEC
UBS IQ Cash	MONY
VanEck Vectors Australian Corporate Bond Plus	PLUS
Australian High Interest Cash	AAA
iShares Core Composite Bond	IAF
iShares Government Inflation	ILB
iShares Treasury	IGB
Russell Australian Government Bond	RGB
Russell Australian Semi-Government Bond	RSM
Russell Australian Select Corporate Bond	RCB
SPDR S&P/ASX Australian Bond Fund	BOND
SPDR S&P/ASX Australian Government Bond Fund	GOVT
Vanguard Australian Corporate Fixed Interest Index Fund	VACF
Vanguard Australian Fixed Interest Index	VAF
Vanguard Australian Government Bond Index	VGB
Fixed income – Global	
iShares Global High Yield Bond ($A Hedged)	IHHY
iShares Core Global Corporate Bond ($A Hedged)	IHCB
iShares JP Morgan $US Emerging Markets Bond ($A Hedged)	IHEB
Vanguard Global Aggregate Bond Index (Hedged)	VBND
Vanguard International Credit Securities Index (Hedged)	VCF
Vanguard International Fixed Interest Index (Hedged)	VIF

Source: Bloomberg

Lessons from the reporting season: be prepared for opportunities from volatility

ROGER MONTGOMERY

Now that our half-year reporting season is over, it has painted a mixed picture about the outlook for Australia. But it has also left me reasonably optimistic that we will see a few more bouts of volatility this year, which will provide some opportunities to find some value among quality businesses.

Let me explain.

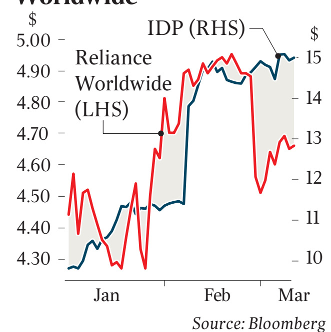
In aggregate, results were marginally weaker than expected, but remember these results are looking backwards all the way to July 1, 2018. The material drops in retail foot traffic and spending, construction and home sales all occurred towards the very end of the half year. That weakening just before Christmas, which also continued in January, saw companies offer very weak guidance for the remaining five months of the year, and in some cases for 2020.

Companies that downgraded guidance included Woolworths, Westfield, Scentre Group and Coles. Companies that upgraded included Ansell, Computershare, Corporate Travel Management and Jumbo Interactive, but more companies downgraded guidance than upgraded for the first time in three or four years.

Last year, earnings for the top 100 companies grew by almost 7 per cent, but following recent downgrades, earnings are now expected to grow by 2.5-3.5 per cent. Importantly, most of that growth will be generated by resources stocks. Take resources and financial stocks out of the picture and industrial earnings are expected to decline by 3-4 per cent.

When earnings are going backwards, institutional investors pressure companies to reduce costs and delay research and development or, indeed, to delay reinvestment of any description. But management invariably discovers that cutting costs can take time, and R&D is necessary for future growth.

IDP and Reliance Worldwide



Source: Bloomberg

Consequently, an impatient market often overreacts to the failure to meet short-term expectations, producing share price volatility, which provides an opportunity for longer-term value investors. And given the industrials index excluding financials is trading on almost 20 times earnings, volatility could be triggered at any moment.

This weakening aggregate earnings picture is at odds with the near 10 per cent rally in the market in January and February. I suspect the massive Chinese stimulus and the US Federal Reserve's decision to ease off the gas with respect to rate hikes may have had a lot to do with recent market strength.

One positive note out of reporting season was the decision by some companies, including Flight Centre and Wesfarmers, to pay large dividends. This may have been motivated by concerns a Labor election victory will reduce the value of franking credits to investors.

What was surprising was that more companies didn't follow Wesfarmers' and Flight Centre's lead. Given the surplus franking credits held by Harvey Norman and JB Hi-Fi, I suspect the deteriorating business outlook may have usurped the desire to be more generous.

The recent rally in the market has stretched valuations again and, while we invested a reasonable amount of cash during the December-quarter sell-off, we ceased investing as the market rallied. If the rally continues we may end up trimming some holdings.

Two key themes emerged during reporting season:

- There is a group of smaller companies doing well overseas. If you believe that the Australian economy will slow, putting pressure on the dollar, these companies are worth investigating as they benefit from repatriating foreign earnings. This group of companies include IDP Education, Reliance Worldwide (both owned by The Montgomery Fund), as well as Bellamy's, a2 Milk, Appen and WiseTech Global. The prices currently required to invest prohibit sensible value investors from participating in this latter group.
- A group of companies is only just entering a period of difficulty. These are exposed directly to house sales — think Villaworld and AVJennings — and indirectly through the sale of goods that are used to furnish and finish a home — think Bunnings, Metcash, Adairs, Beacon Lighting, Harvey Norman, Nick Scali and JB Hi-Fi-owned The Good Guys.

This year should be an interesting one and, with opportunities for value likely to be presented at any moment, investors will benefit from being prepared.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund.

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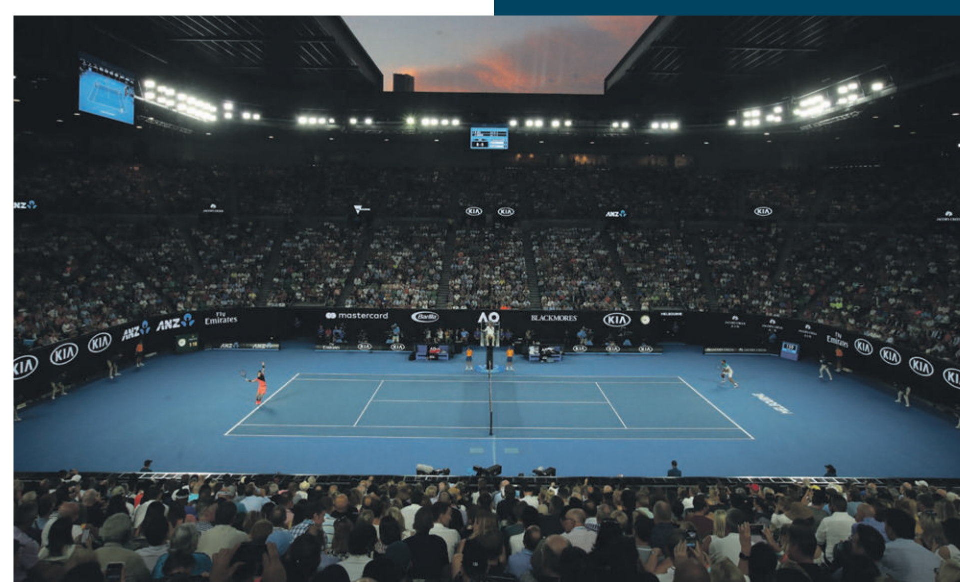

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