FIDUCIAN FOCUS

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WHO MOVED MY CHEESE?

CHANGES TO SUPER AHEAD

Federal Parliament recently passed legislation that will affect superannuation from 1 July 2017.

Superannuation is all about tax and how you save for retirement – it can reduce tax on the income you receive now, has lower tax on your retirement savings, and generally nil tax when you retire. While the Government is legislating that super is not for estate planning, super will also – for many – be the largest asset (outside their home) that they wish to pass to their children and grandchildren.

The Government is targeting superannuation contributions, through reduced and new caps, from 1 July 2017. Here are some of the key changes that you may wish to discuss with your planner.

Deductible or concessional contributions

While there is a 'catch-up' provision, the 2017 concessional contributions' cap will reduce to a flat rate of $25,000, limiting the amount that can be paid into superannuation from super guarantee, salary sacrifice and personal deductible contributions.

For some defined-benefit scheme members, a notional formula will capture the full value of your employer's contribution within the lowered concessional cap. From July 2017, many members will no longer be able to make additional concessional contributions because the current partial calculation will not apply.

For a high-income earner, self-employed person or those looking to offset capital gains, making a concessional contribution of up to $35,000 this financial year makes sense.

Rather than tax being paid at your marginal tax rate, tax is paid at 15% and earnings are taxed at no more than 15%, providing an immediate tax-saving and increasing the amount invested for retirement.

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WHO MOVED MY CHEESE?
CHANGES TO SUPER AHEAD CONTINUED

John, age 50, maximum salary sacrifice

Income tax	2016-17	2017-18
Gross salary	95,000	95,000
Less max salary sacrifice	(25,975)	(15,975)
Taxable income	**69,025**	**79,025**
Less income tax + Medicare levy[1]	(15,361)	(18,811)
Net income	**53,664**	**60,214**

Superannuation	2016-17	2017-18	
Total concessional contribution	35,000	25,000	
Less contributions tax	(5,250)	(3,750)	
Net contribution to superannuation	**29,750**	**21,250**	
Investment return[2]	2082.50	1,487.50	
Less tax on earnings[3]	(208.25)	(148.75)	
Net gain in super	**31,624.25**	**22,588.75**	**$9,035 no longer within super**
Total tax paid[4]	**20,819.25**	**22,709.75**	**$1,890.50 in additional tax**

If John was earning between $250,000 and $300,000, additional tax of 15% will apply on taxable concessional contributions above the $250,000 threshold from 1 July 2017.

Non-concessional contributions

The controversial lifetime non-concessional cap has been replaced with a reduction in the annual non-concessional contributions cap to $100,000, subject to a new $1.6 million superannuation balance cap.

For all intents and purposes, 2016-17 will be the last financial year during which up to $540,000 can be contributed via non-concessional contributions. These contributions, in our experience, arise from a windfall, such as an inheritance or from downsizing a home, or from contributing a large asset into superannuation.

In July 2017, the maximum non-concessional contribution available will reduce to $300,000 (for three financial years) unless a large non-concessional contribution was made in 2015-16 or 2016-17. Even if you intend to leave excess funds in accumulation mode, you will not be permitted to make a non-concessional contribution once your superannuation balance exceeds $1.6 million.

Whether the windfall should be contributed or retained outside superannuation requires careful consideration of your overall financial position with your financial planner.

Maximising arrangements

The $1.6 million transfer balance cap (TBC) will measure all retirement income streams, including reversionary and defined-benefit income streams from 30 June 2017. In general, excess funds must be removed from retirement mode or upon the death of an individual, which will affect tax and asset growth.

As the TBC is individual and does not take into account growth nor losses, you should review your family arrangements to maximise the potential pension tax exemptions.

For those close to the $1.6 million cap, investigation and analysis of investment strategy and capital gains tax will need to be completed before 30 June 2017.

The changes in superannuation will affect the amount that can be contributed and withdrawn from superannuation from July 2017. By anticipating and adapting to the changes, your financial outcomes can be enhanced. For assistance with navigating these changes, please contact your Fiducian planner.

[1] The impact of available personal tax offsets and other tax deductions has been excluded from this case study.

[2] Assumes investment returns at 7%. Investment returns depend on investments selected, and are not guaranteed. The case study does not take into account John's existing superannuation balance.

[3] Investment returns are taxed at a maximum of 15%. However, the overall tax rate is often lower due to offsets such as dividend imputation credits that reduce tax payable. For this case study, we have adopted an average tax rate of 10% on super fund earnings. Investment returns on a super pension account are tax-free.

[4] This is the total of income tax, super contributions tax and tax on investment earnings.

MICROCAP STOCKS
SHOULD BE IN AUSTRALIAN EQUITIES EXPOSURES

Tony Waters, Microcap Portfolio Manager, Ausbil Investment Management Limited, an underlying manager for the Fiducian Australian Smaller Company Shares Fund

In November 2016, 1,935 companies were listed on the Australian Securities Exchange (ASX). Yet of the total $1.6 trillion value on the ASX, 90% sits within the top 300 companies represented by the ASX300. Therefore 84% of ASX-listed companies represent only 10% of the value of the market. This is the world of microcap investing.

While the definition of microcaps can vary greatly across different microcap managers, the fact remains that there is a vast ocean of companies beyond the concentration of where most institutional money is invested and beyond the radar of most investment managers. On this basis alone, microcaps should be considered to be part of everyone's equities mix.

However, microcaps are a great place to look to generate superior returns in an investment portfolio for a number of reasons.

"Microcaps are a great place to look to generate superior returns in an investment portfolio"

1. Business models are varied

Unlike the large-cap universe, where four banks and one large diversified miner (BHP Billiton) make up one-third of the market, there is plenty of diversity across microcaps, some of which represent truly unique businesses. One of the ironies in the market is that the current trend towards passive or index investing on the ASX provides a very unbalanced sector exposure to the Australian equities market. Therefore, an active manager in the large-cap space will take on substantial business risk if they attempt to provide diversity across the portfolio by being underweight the largest five stocks in the market. However, a microcap manager is least likely to face these pressures.

2. More exposure to growth

It goes without saying that the small end of the market should provide greater exposure to growth companies. Microcap companies on average will be earlier in their business life cycle.

3. Founders tend to be emotionally interested

Management are more likely to be significant shareholders in a business and therefore arguably have more incentive to work on behalf of shareholders because they may be significant shareholders themselves. This incentive is not just monetary but also usually includes a significant emotional attachment to a business they helped create and are therefore more likely to look after.

4. Management may be more accessible

Given less ability to attract market attention, management tend to be far more amenable to giving their time to potential investors. This can often be very different to the managed PR exercise that often takes place through the investor relations team of large-cap companies. It is what they don't tell you that in hindsight will tend to be more important.

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Monthly Median Manager Absolute Return

Sources: Ausbil Investment Management Ltd

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MICROCAP STOCKS SHOULD BE IN AUSTRALIAN EQUITIES EXPOSURES CONTINUED

5. Institutional ownership tends to be lower

The return on an investment is made up of three components. Dividends, earnings per share growth and the change in the multiple paid on those earnings. It is this third component that often has the biggest impact on short- to medium-term performance in a stock price. By definition, the more demand from institutional investors as a business grows, the more likely a company will trade on a higher multiple of that company's earnings. By being a microcap investor, we get in at the basement level as this process gets under way.

6. Broker incentives create inefficiency

In a world where broker commissions as a percentage of the value of trades is trending down, brokers have a greater incentive to focus on companies that require capital raisings and/or have high turnover in the market. This takes broker focus and support away from microcap stocks that can grow organically through reinvestment of cashflow in their businesses. These are exactly the sort of stocks that can create superior returns for shareholders but are ignored often by stockbrokers.

7. Market inefficiency can be greater

There are more mispriced stocks among microcaps, creating more opportunity and therefore ability to capture alpha. In other words, microcap managers have more opportunities to beat the market over the long-term.

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