

INSIDE

DECEMBER 2018

FINANCIAL MATTERS AFFECTING YOUR LIFESTYLE



Christmas Cash

Understanding how and why we are likely to spend money around Christmas time makes it easier for us to manage that spending.

In interesting piece of research¹ commissioned by the Commonwealth Bank a few years ago with 1060 participants offered insight into how, where and when Australians collectively spend over \$16 billion during the Christmas period.

It will come as no surprise that the bulk of our spending is on Christmas gifts. We generously hand over \$7.8 billion for presents. Another \$3.7 billion is spent on holidays – hotels, airfares etc. – by 3.2 million of us who go away for a break. The balance of spending then comes from Boxing Day sales (\$2.2 billion), entertaining friends and family (the average entertainer will spend \$294 preparing), and extra spent on eating in and eating out.

Around 70 per cent of gift-related spending was at bricks and mortar stores, with the rest online. That's a whopping \$2.3 billion going to online retailers. But tellingly we split the timing of this spending. The bulk of our online purchasing is concentrated into a period two to three weeks prior to Christmas Day. Bricks and mortar retailers, on the other hand, bear the brunt of our last-minute panic shopping just three to five days before Christmas.

Admittedly the numbers vary according to who you speak to, but if anything the Commonwealth Bank's research figures are modest.

It all points to the fact that a momentous amount of cash flows out of our savings in December each year. Such a spending event has the ability to send us into the new year in poor financial shape and to knock the wind out of our sails in terms of investment and wealth planning. But it doesn't have to.

Some of the most valuable outcomes of the pre-Christmas research is around the timing of the spending.

Planning and budgeting is essential. Exploiting the calmer periods at shopping centres weeks before Christmas, as well as shopping online from the comfort of your own home via online retailers, is a major secret to success. That includes putting aside a specific amount for gifts then breaking that amount down into expenditure on each person.

Entertainment and food costs, whether within your home or in cafes, cinemas and restaurants etc., are more difficult to control.

Experts recommend the early planning of Christmas events with family and friends, ensuring each guest brings something helpful in terms of food and drink. This removes a potentially cumbersome financial burden, makes the gathering more of a communal event and helps to alleviate stress for the hosts.

Perhaps the greatest tip is to relax and enjoy yourself. If something seems unnecessary – an expensive cocktail party or a social gathering with people you don't know very well – say no and instead put that money towards a holiday for you and your family.

The secret comes from knowing how much you have in your budget and from never blowing that budget.

1 <https://www.commbank.com.au/blog/australians-to-spend-big-this-christmas.html>
2 <http://www.smh.com.au/business/retail/18b-in-christmas-spending-20131213-2zauy.html>

3 <http://www.theguardian.com/world/2013/dec/23/australians-spending-1bn-a-day-in-final-rush-before-christmas-retailers-say>



EDUCATION: THE GIFT THAT KEEPS ON GIVING

Few gifts are as valuable as an education. But if your intention is to pay for the schooling of your grandchildren or great-grandchildren, you should be aware of the pros and cons of the various options.

One of the most enjoyable aspects of retirement is the fact that you have time to be a part of the life of your grandkids and/or great-grandkids. Passing on knowledge, helping them achieve goals and simply being there when they need you is a highly rewarding experience that is difficult to match. But some retirees wish to take their legacy further by investing in a child's education. There are many choices, each with its benefits and drawbacks.

Gifting and social security

Gifting may impact your eligibility for Centrelink Benefits so you need to be across the rules. Right now you can gift up to \$10,000 annually, up to a maximum of \$30,000 over five consecutive years, without your pension being affected. However, there are plenty of private schools whose fees will not be covered by such an amount.

Of course, you are able to gift a greater sum, but anything over \$10,000 per year or \$30,000 every five years will still be counted for five years under the assets test, and deemed for five years under the income test when calculating your Centrelink Pension.

Tax implications

If the money is held in the child's name or held by someone else solely to benefit the child then the income and interest from the fund, in whatever form it might take, is then generally taxable to the child (after the first \$416, which is tax-free) and can be taxed at up to 68%. This extremely high tax rate is to dissuade parents and others from sheltering income from their own tax rates by holding assets in their children's names.

Trusts

A trust is an arrangement where one party (e.g. a grandparent) holds assets for another party (e.g. grandchildren).

One benefit of a trust is that you can create specific instructions as to how it is managed and for what purposes its assets can be used, including specifying the timing of the trust's outgoings as the grandchildren go through various stages of school and university. The disadvantages include the additional cost to set up and maintain such an arrangement.

An amount saved for education may not justify the formation of a formal trust, but instead you may consider holding funds for the child's benefit in an informal trust arrangement, where the assets are legally owned in your name or the child's parents' names.

The tax treatment of trust income can be complex and will depend on the type of trust and whether the assets are being held solely to benefit the child.

Insurance bonds

Insurance bonds, essentially packaged investment vehicles that are offered by insurance companies, are often invested across a range of managed funds that suit various risk profiles.

Money is usually invested for a 10 year period, meaning some forward planning is required. But after that period any income and capital gain typically does not need to be declared and tax on investment earnings is paid, at a rate of 30%, within the bond by the insurance company.

A lump sum is invested up front and further contributions can be made, but tax penalties can apply where contributions during a year exceed 125% of the previous year's investment. Depending on your specific situation, you may or may not be able to access the funds tax-free prior to their 10 year maturity.

Education funds

Education funds or Education Savings Plans (ESPs) are similar to insurance bonds but with stricter rules. ESPs are designed for saving towards tertiary education, as the earnings on investments can be used to pay education expenses of the nominated child. These funds have been granted special tax status by the Federal Government as they encourage education, but the flipside is that they are more restrictive and offer less options and tighter guidelines for use of the funds.

Earnings used for education expenses are taxed as income for the student (income up to \$20,542 is usually tax-free for students over 18). However, high tax rates apply to children under 18 where education expenses, along with certain other assessable income of the student, exceeds \$416.

Otherwise they follow similar rules to insurance bonds, including an original lump sum, additions each year of no more than 125% of the previous year and a maturity period. But do be careful with the small print.

There are numerous options when giving the gift of education, just be sure that they match your own specific circumstances. If they do, then it could be the greatest gift you will ever give.

Next steps

- Go over your options with us - there is no one-size-fits-all approach.
- Discuss the options with the parent of the child. It is important to ensure your generosity will not create personal or financial (especially tax) issues for them.
- As with any other investment, re-visit it regularly and discuss its performance with us.

MARKET UPDATE

Summary: Financial Markets in November

- Strong local economic data prevented Aussie bond yields from rallying (yields lower) with the global move.
- November was a tough month for credit globally, across both cash and synthetics
- AUD outperformed all G10 currencies with the exception of NZD in November.
- Oil and iron ore prices fell in the month
- The US Dow Jones rose by 1.7% but the Australian ASX200 fell by 2.8%.

Money Markets (Cash)

The Australian data in November was largely strong. The labour force was most noteworthy, where for a second consecutive month the unemployment rate printed at 5.0%, but this time complemented with +32.8K jobs and a small rise in the participation rate to 64.6%. Consumer confidence rose to 104.3 points despite a fall in business confidence to +4 points (Business Conditions remain strong at +12 points, despite a small fall).

There was very little change in the market pricing of the next move in the official cash rate by the RBA, remained basically unchanged over the course of November.

Australian and Global Fixed Interest

The sentiment in equity markets continues to swing rapidly. Bonds have been more insulated, but not immune. After a constructive tone in the first 10 days of November, there was a distinct risk-off tone in the latter part of the month. Equities remain volatile but there has also been a clear widening in credit spreads on corporate paper over November. This was particularly true in the US, but Australian bank paper also moved wider late in the month following primary issuance well back from secondary markets.

US 10Y yields have rallied (yields lower) 11bp to 3.02% over November. Australian rates underperformed the US and the Australian 3Y has sold-off 3bp (yields higher) to 2.01% while the 10Y has rallied 3.5bp to 2.59%.

The Australian data in November was generally good. Most notably the Labour Force data which showed 5.0% unemployment but there was also the wages data which showed a three year high in wages growth of 2.3%. Construction Work Done was weaker (-2.8% on the quarter), but CAPEX showed strong intentions for the 2018/19 financial year despite that. Expectations for GDP (scheduled for 5 December) are generally firm as November draws to a close.

The stronger domestic data set against the backdrop of a US rally (lower yields) served to flatten the Australian curve and saw Aussie bonds underperform the US. The 3Y/10Y futures spread flattened 6.5bp to 52bp. The Aus-US 10Y spread has dis-inverted to -44bp at month-end.

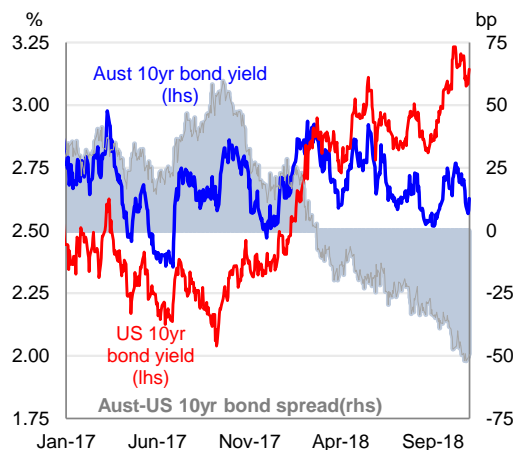
The US rally (lower yields) was not driven by the data, which was broadly strong, but instead by a re-emergence of a fear that the FOMC would tighten rates too aggressively. Various FOMC speakers (including Fed Chair Powell) weighed

in on the topic late in the month and the FOMC minutes confirmed that the FOMC would be monitoring developments closely as they moved closer to the neutral band for rates.

There was also a rash of headlines regarding the Trump-Xi meeting scheduled to take place in the periphery of the G20 meeting. The meeting itself is in December – but the anticipation of it dominated much of the second half of November. There seemed nearly daily alternation between “the US will impose more sanctions” and “we’re confident of a deal”.

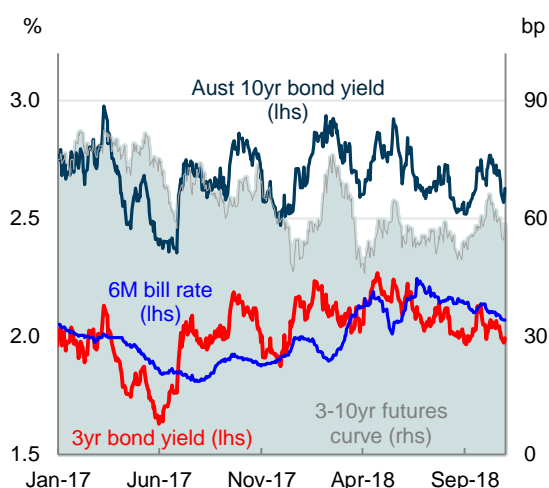
The contours of the approaching (final?) showdown in BREXIT also became clearer over November. PM May negotiated an agreement with the EU and has set the date for the vote in the House of Commons as 11 December. Her prospects at present do not look strong.

Chart 1: Australian vs US 10Y bond yield



Source: Bloomberg, CBA

Chart 2 – Main Australian Yields



Source: Bloomberg, CBA

Global Credit Markets (Cash)

November was a tough month for credit globally, across both cash and synthetics. Geopolitical risks and monetary policy expectations waxed and waned through the month. Toward the end of the month the Fed took on a slightly more dovish tone, sparking a modest rally in stocks and synthetics. Bonds and cash credit were a little more measured in their response, the latter being impacted by pent up primary issuance coming to market. For much of the month US vs China trade tensions represented a headwind, although the actual influence on cash spreads was muted.

Outside of trade and the Fed, the next theme of significance remains Brexit uncertainty. While progress has been made, it remains to be seen whether UK parliament will vote in support of the prevailing deal. A growing theme is concern around the level of lower-quality corporate bonds outstanding. With accommodative monetary policy and cheap debt obvert recent years, companies globally have gouged themselves, none more so than US corporates. As markets begin to grapple with the prospect of a US recession in coming years, this refinancing challenge represents a systemic risk.

Offshore credit spreads continued to widen with US\$ and EUR Corporate spreads both +21 bps wider on the month. Financials offshore also widened by similar magnitude. After holding back as much as possible in the face of heightened market volatility, issuers finally relented and engaged in primary activity over the latter half of the month. This supply fuelled further widening.

Synthetics were more volatile through November on the back of the broader risk off tone across risk assets in general.

Equity Markets

November was another month of increased volatility on global sharemarkets. Focal points were the US-China trade dispute; the outlook for US monetary policy; and the implications of plunging oil prices. In Europe, UK Brexit talks and the Italy-European Commission budget talks dominated.

After finishing October positively, global sharemarkets picked up where they left off in the early days of November. The US Dow Jones only fell once in the first six days, gaining 4.2 per cent over the period. The Australian ASX 200 also lifted, but by a more modest 1.7 per cent. On November 1, US President Trump said he had a "long and very good conversation" with Chinese President Xi Jinping. Data on November 2 showed a solid 250,000 lift in US jobs for October, but Apple reported that holiday sales could miss analyst forecasts.

In the second week of November the US Dow Jones outperformed, up 2.8 per cent, but gains for the Nasdaq and other global sharemarkets were closer to 1 per cent. US sharemarkets posted gains of 2.1-2.6 per cent on November 7 after results in mid-term elections met expectations. The Dow Jones lifted 545 points or 2.1 per cent. Democrats won control of the House of Representatives while Republicans retained control of the Senate. The US Federal Reserve left interest rates steady as expected on November 9.

During the third week of November global sharemarkets retreated. US shares fell by around 2 per cent while Australian shares fell by around 3 per cent. In fact the Dow Jones fell for four straight days to November 14, losing 4.3 per cent. On November 12 the US Dow Jones lost 602 points (2.3 per cent) with the Nasdaq down 2.8 per cent after two suppliers cut forecasts for sales of Apple iPhone shipments.

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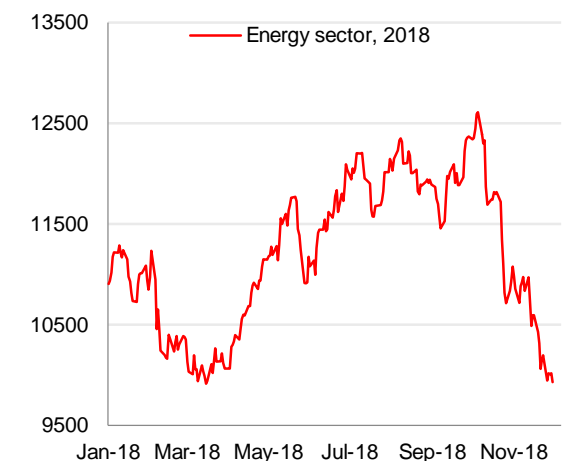
There were more declines for global sharemarkets ahead of the US Thanksgiving Day holiday. The US Dow Jones lost over 1,100 points in the four trading sessions to November 23. Big falls in oil prices drove share prices lower on the energy sectors of major bourses and Apple remained under pressure on worries about softness for iPhone demand.

In the final week of November, optimism about US-China trade talks boosted investor sentiment together with comments from Federal Reserve chair, Jerome Powell, who suggested that the central bank was drawing closer to a pause in the rate-hiking cycle. The Dow Jones rose 1,250 points or 5.1 per cent in the week to November 30.

In November, the US Dow Jones rose by 1.7 percent and the S&P 500 lifted 1.8 per cent and the US Nasdaq Composite edged up 0.3 per cent. In Asia, Japan's Nikkei rebounded by 2.0 per cent but the Australian ASX200 fell by 2.8 per cent. In Europe, the German Dax lost 1.7 per cent and the London FTSE declined by 2.1 per cent.

In November, just four of the 22 sub-industry sectors in Australia posted gains. The Transport sector rose the most (up 2.9 per cent) from Household & personal products (up 2.2 per cent), but Energy fell 10.4 per cent and Consumer Durable & Apparel fell 10.7 per cent. The MidCap50 underperformed, down by 4.8 per cent while the Small Ordinaries fell 0.4 per cent.

Chart 3- Energy sector tracks oil price



Source: IRESS, CommSec

Australian Dollar

Australia's trade-weighted index rose by 2.3% in November. AUD outperformed all G10 currencies with the exception of NZD.

AUD/USD received a commodity related boost early November following a spike in Australia's Terms of Trade.

It wasn't all good news however. Housing finance data showed a 4.2%/mth fall in owner-occupied lending, raising broader economic concerns. While the RBA's Monetary Policy Statement emphasised falling house prices, it did not present a meaningful threat to the economy, the sharp fall in owner-occupied finance (seeming to lag the more dramatic downtrend already seen in investment lending) rattled markets. In a surprise move only a few days later, RBA Deputy Governor Guy Debelle seemed to feed such concerns stating *"If a negative shock were to hit the Australian economy, particularly one that caused a sizeable rise in unemployment, then the risk on the household balance sheet would magnify the adverse effect of that shock"*.

Markets might have stewed on those RBA housing comments for longer were it not for November's employment report seeming to refute RBA Deputy Governor Debelle's concerns. Rising 32.8k (7.8k previous), and dominated by full-time employment gains (42.3k), the release pushed AUD/USD to its month-high of 0.7338. Thereafter, the ebb-and-flow of US-China trade tensions, combined with significant falls in US technology stocks, to contain further gains.

Table 1 – Australian dollar

	AUSTRALIAN DOLLAR		
	End Oct	End Nov	M/M %
	31-Oct-18	30-Nov-18	Change
AUD-USD	0.7073	0.7306	3.3
AUD-JPY	79.89	82.98	3.9
AUD-EUR	0.6253	0.6457	3.3
AUD-GBP	0.5541	0.5730	3.4
AUD-CHF	0.7133	0.7288	2.2
AUD-CAD	0.9306	0.9716	4.4
AUD-NZD	1.0854	1.0636	-2.0
TWI	61.9	63.3	2.3
Month High		0.7344	29-Nov-18
Month Low		0.7072	01-Nov-18

Source: Bloomberg, CBA

Commodities

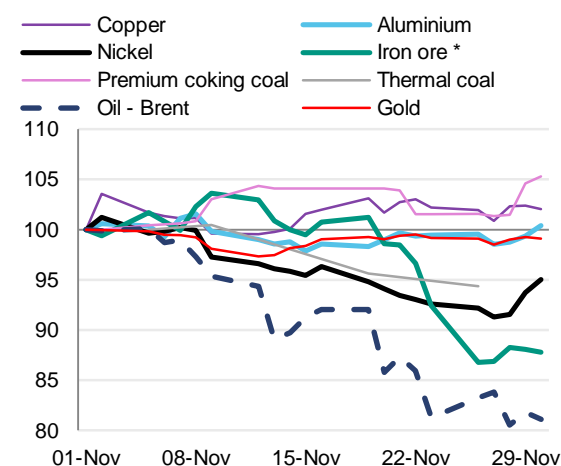
Commodity prices finished mostly lower in November, with a number of key commodities like oil and iron ore recording significant falls. Commodity-specific factors were mostly at play, but a slightly stronger US dollar and rising US-China trade tensions weighed on commodity prices generally.

Oil prices fell sharply last month as oversupply concerns accelerated. The catalyst was the surprise US decision to grant waivers to eight countries that import oil from Iran in early November, nullifying the impact of the US sanctions. The market had to adjust quickly to ~1.5% of global oil supply staying in the market. The situation was made worse by OPEC and Russia's

decision to ramp up output in May to compensate for falling Venezuelan and Angolan oil production, as well as prepare for US sanctions against Iran. Elevated OPEC and allied oil production alongside less severe US sanctions on Iran help explain the dramatic fall in oil prices. The surplus fears driving the plunge in oil price though can be alleviated if OPEC and allied producers decide to cut back production next year to help balance global oil markets. The agreement between Saudi Arabia and Russia over the weekend at the G20 summit to extend the oil market pact into 2019 suggests an output cut is coming. However, the size of cuts remains an unknown.

Iron ore prices fell last month as lower steel prices in China weighed on steel mill margins and iron ore demand. The decline in steel prices reflect both stronger supply and weaker demand. Steel supply has proven stronger than expected after China's cuts to steel production in northern China during the heating season (mid-November to mid-March) were more tame than expected. Chinese policymakers have chosen a more differentiated approach to curtailing steel (and other industrial) output instead of blanket reduction in steel production. The differentiated approach means that steel mills that already adhere to emission standards will likely be allowed to continue producing. On the demand side, a slowing manufacturing sector has weighed on end-user steel demand and prices. Weaker steel margins have also increased China's preference for lower-grade iron ore. While that will increase emissions and reduce productivity, those are the costs willing to be endured to protect steel margins.

Chart 4: Commodity price performance in November



Source: The Steel Index, Metals Bulletin, LME, COMEX, ICE, Bloomberg, CBA estimates

Australian house prices

Taken from the CBA Global Markets Research report, 'CoreLogic Dwelling Prices – November 2018'; first published 3 December 2018.

The national housing market continues to deflate. But it's very much a Sydney, Melbourne and Perth story. Dwelling prices are still rising in Brisbane, Adelaide, Hobart and Canberra. The size of Sydney and Melbourne relative to the other capital cities means that the national figures are heavily influenced by Australia's two most populous cities.

CoreLogic report that dwelling prices dropped by a solid 1.4% in Sydney and 1.0% in Melbourne over November. Houses in both capital cities fell by more than units. The moves aren't surprising given what the leading indicators of property prices have suggested. That is, monthly lending to owner-occupiers and investors has declined, auction clearance rates are at levels commensurate with prices deflating, foreign residential demand has waned and the house price expectations index from the WBC/MI Consumer Sentiment survey has been falling.

Sydney dwelling prices are now down from their July 2017 peak by 9.5%. Prices in Melbourne sit 5.8% down on their November 2017 peak. See table 2 for details. The fall in prices has been met with a rise in yields. That is, dwelling rents are outperforming values in Sydney and Melbourne. At the national level, prices in the upper quartile have driven the overall fall. Prices in the bottom quartile are higher. Stamp duty exceptions for first home buyers in a number of states is supporting the lower end of the market.

Turnover has declined markedly in Sydney and Melbourne as prices have adjusted downwards. This means lower stamp duty receipts for the NSW and Victorian state governments.

To date, the RBA has remained relaxed about the fall in dwelling prices because the broader economy has performed relatively well - economic growth has lifted and the unemployment rate has declined. And wages growth is also slowly accelerating.

As long as the downturn in the housing market remains divorced from the broader economy the RBA will continue to signal that rates are more likely to go up than down. But the risk of a negative wealth effect impacting consumer spending is rising the longer the downturn in dwelling prices persists. The monthly reads on retail sales and the quarterly national accounts data on household expenditure will warrant close monitoring for any sign that a negative wealth effect is materialising.

Table 2: CoreLogic Median Dwelling (Houses and Apartments) Prices – October 2018

	Sydney	Melbourne	Brisbane
%chg mth	-1.4	-1.0	0.1
% ann chg	-8.1	-5.8	0.3
% chg from peak (peak)	-9.5 (July 17)	-5.8 (Nov 17)	na

	Adelaide	Perth	Hobart
%chg mth	0.1	-0.7	0.7
% ann chg	1.4	-4.2	9.3
% chg from peak (peak)	na	-14.8 (June 14)	na

	Darwin	Canberra	Capital cities
%chg mth	0.7	0.6	-0.9
% ann chg	-0.8	4.0	-5.3
% chg from peak (peak)	-23.1 (May 14)	na	-5.5 (Sep 17)

Chart 5 – Annual Dwelling Price Change

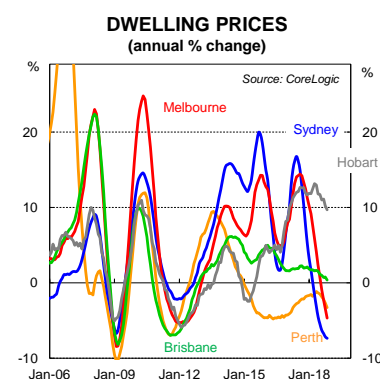
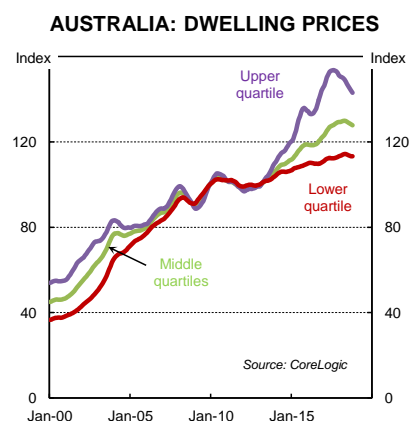


Chart 6 – Dwelling prices by quartiles



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This information was first made available to CBA clients on 3 December 2018 in a CBA Global Markets Research report publication titled, 'November Month in Review'.

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