# Winter 2014

Consumers and investors appear to be suffering a case of post-budget jitters as they survey the impact of the Federal Government's proposed cuts on their finances.

Everyone has had time to digest the finer details and better understand how the changes apply to them.

After weeks of gloomy headlines, Dun and Bradstreet released new research showing financial stress is on the rise. Its quarterly Consumer Financial Stress Index revealed stress levels had increased to 18.7 points in April from 13 in January. While confidence was low in the Sunshine State, New South Wales was more optimistic with strong jobs and population growth and a robust construction sector.

Meanwhile, the Aussie dollar climbed to a high of 92.49 US cents in May in response to positive trading on the European stock markets. European Central Bank president Mario Draghi said the bank was wary of inflation undermining its medium-term targets. Europe's sluggish growth was in contrast to Japan amid concerns its economy was at risk of too much growth. In Australia, inflation rose to 2.8 per cent in April, well within the Reserve Bank of Australia's target band and providing assurance the official cash rate of 2.5 per cent was at the right level.

The Australian share market treaded water in the absence of direction from the United States, which awaited data such as house prices for the March quarter and consumer confidence and manufacturing figures for May.

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# High-frequency trading on regulators' radar

**High-frequency trading is one of the biggest developments on global share markets since tickertape machines were replaced by computers. While traders and regulators argue the merits of the trend, the challenge for private investors is to understand what it means for them.**

High-frequency trading – or HFT for short - uses powerful computer algorithms and high-speed cable networks plugged directly into exchanges' computer systems to exploit small price differences.

Critics say this has the potential to manipulate the market while supporters say it results in greater market liquidity and lower fees. The truth probably lies somewhere in between.

On any given day HFT accounts for more than half the turnover on the New York Stock Exchange. There are no reliable figures for the Australian market but it is estimated to be much less than that.

### High speed, high volume, low margin

High frequency traders make money by moving millions of shares a minute, aiming to earn a fraction of a cent on each share traded. The sheer volume and speed of the trades, executed in milliseconds, is why ordinary investors can be left flat-footed when computers malfunction or the algorithms are faulty.

This is what happened during the so-called 'flash crash' of May 2010 when the US sharemarket plunged 10 per cent in minutes, bringing a shadowy corner of the market into the open.

Controversy around high-frequency trading has simmered ever since but it recently reignited following the release of the book *Flash Boys* by Michael Lewis. He claims high-frequency traders have rigged the market at the expense of investors.

The head of the Australian Securities Exchange, Elmer Funke Kupper says regulatory settings and structural differences between Australia and the US mean that concerns about the practice are not relevant here.

But not everyone is convinced. Industry Super Australia has accused high-frequency traders of skimming $2 billion a year from local investors.

### Increased regulation

Regulators have begun to respond to the trend but a comprehensive and co-ordinated response will take time. The US Securities and Exchange Commission is investigating the practice amid accusations that it is little more than insider trading.

Closer to home, the Australian Securities and Investments Commission (ASIC) is concerned that high-frequency trading has the potential to undermine trust and confidence in the market.

ASIC has threatened to introduce a pause on trades for half a second before being executed. This has been introduced successfully in the US by the IEX exchange in an effort to remove the speed advantage exploited by high-frequency traders.

ASIC also has its eye on so called "front running", where high-speed traders test the market to see what price buyers and sellers will accept then jump in ahead of them with large transactions.

### The human touch

The one advantage mere mortals have over computers is judgement. If a company's share price plummets then rebounds faster than a bungee jumper, the cause is more likely to be a computer glitch in a remote trading room than any fundamental problem with the company.

Extreme volatility is a feature of modern financial markets and is probably here to stay. But the challenge for investors is the same today as it was decades ago.

If you focus on the fundamental value of an investment, diversify your holdings and ignore the swings and roundabouts of daily price movements, you will reap the rewards in the long run.

Along the way you may even profit from market fluctuations by picking up quality stocks that have been dumped by traders who focus on price not value.

*If you would like to discuss any of these issues in light of your investments, don't hesitate to contact us.*

# Small sacrifice
## to set you on the road to retirement

**Increasing discussion around raising the pension age, changes to age pension eligibility and higher taxes make it more important than ever for people to plan ahead for a financially secure retirement.**

Finding extra cash for savings at the end of the month can be a tall order. But if you follow the adage that you won't miss what you never had, then salary sacrifice can be a tax effective way to save for retirement.

It is done by entering into a written agreement with your employer to 'sacrifice' part of your pre-tax salary into your superannuation fund. In exchange, your contribution is taxed at the concessional rate of 15 per cent instead of your marginal tax rate.[i]

### Tax savings

Depending on your marginal tax rate, the tax savings can be significant. For example, the difference between the top marginal tax rate of 45 per cent* and the 15 per cent concessional rate is 30 per cent.

However, the government's generosity does have limits. If you earn more than $300,000 a year you can make the same concessional contributions but the tax rate rises from 15 per cent to 30 per cent.

And no matter how much you earn, all concessional super contributions including salary sacrifice and your employer's 9.25 per cent super guarantee payments are capped depending on your age.

Up until 30 June 2014 the maximum concessional contribution is $25,000 a year up to age 60. The caps rise to $35,000 for people aged 60 and over.

From 1 July 2014 anyone aged 50 and over will also be able to contribute up to $35,000 a year at the concessional rate of 15 per cent.

You can also make additional contributions to super from your after tax income. These are called non-concessional contributions and are currently capped at $150,000 a year.

The non-concessional cap is expected to rise to $180,000 a year after 1 July 2014, with a maximum of $540,000 allowable over three years under what is known as the bring-forward rule.

That means that anyone considering making a large non-concessional contribution using the bring-forward rule may be better holding off until after June 2014.

### Avoid penalties

It is important to keep track of all your super contributions because the Australian Taxation Office may charge a penalty if the caps are breached.[ii]

The harsh penalty regime of previous years has been softened recently in recognition of the fact that most breaches are accidental. Even so, any excess concessional contributions may be taxed at your marginal tax rate.

Under changes announced in the Budget, if you inadvertantly breach the non-concessional contribution cap you can withdraw the excess and earnings will be taxed at your marginal rate.

If you leave the excess contributions in your fund they will be taxed at the top marginal rate.

Contributing additional amounts to superannuation can be a tax effective way to boost your retirement nest egg, as the table below illustrates. But like most things to do with superannuation and tax it can be complicated and there are rules.

**Please contact us to discuss how salary sacrifice could help you achieve your retirement goals.**

### CASE STUDY: A super boost

Crystal earns $90,000 before tax, excluding her employer's super contribution.

As the table shows, if Crystal decides to redirect $10,000 of her pay into salary sacrifice super contributions, she will save $2,350 in tax, with the extra money going into her super fund.

| | Does nothing | Salary sacrifices $10,000 |
|---|---|---|
| Take-home pay | $67,403 | $61,253 |
| Tax | $22,597 | $18,747 |
| Extra money into super | $0 | $8,500 |
| Net benefit | $67,403 | $69,753 ($2,350 better off) |

Source: MoneySmart
Assumptions: Estimates are based on 2013/2014 income tax rates and a Medicare Levy of 1.5%. *Excludes the 1.5 per cent Medicare Levy and the 2 per cent deficit levy announced in the May budget.

[i] https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/super-contributions/
[ii] https://www.ato.gov.au/Individuals/Super/In-detail/Contributions/Super-contributions

# START-UPS TAP THE CROWD FOR FUNDS

Innovations made possible through crowd funding may be the type of investments established lenders run a mile from, but many would have paused to look over their shoulders this year when Facebook paid US$2 billion for a gaming accessory originally bankrolled by a group of online philanthropists.

From humble beginnings Oculus Rift, the virtual reality headset invented by California-based Oculus VR, now sits in the social media titan's pipeline. Its prototype was developed using $2.4 million donated by 9500 backers on the crowd funding platform Kickstarter in 2012.

But what traditional investors would have seen as a stellar return in super quick time – less than 18 months – enraged original donors who missed out on the US$2 billion windfall.

The seven biggest donors each shelled out $5000. But the most they received on their 'investment' was an airline ticket to Irvine to tour the Oculus lab, so long as they lived in the US, a meeting with the inventors and a show-bag of goodies.

**Social media matchmakers**

Modern crowd funding is said to have been pioneered by rock group Marillion in 1997 when it took to the internet, which was still in its infancy, to raise US$60,000 for an America tour.

Nowadays, social media and viral marketing have vastly narrowed the gap between creators of quirky ideas and funders. It is estimated that more than US$5 billion was raised globally last year alone.

Essentially, crowd funding allows innovators to raise money from the online community, with no questions asked and no reward guaranteed.

Down under, this seed capital market is not yet regulated by the Australian Securities and Investments Commission (ASIC). And until the government digests the long-awaited report on the sector from its Corporations and Markets Advisory Committee, the regulator's advice is that anyone who is tempted to hand over money should consider it as a gift or donation, rather than as an equity stake in a project that will deliver tangible dividends.

In fact, ASIC warns some projects that successfully raise funds may never see the light of day. Even worse, some may be nothing more than scams.

**Sussing out scammers**

The phantom Kobe beef jerky business was one such fraud uncovered by Kickstarter. Following a tip-off, online checks of Kobe Red's owners revealed they were scammers and Kickstarter was able to block more than US$120,000 of donations just in time.

Part of the problem for anyone thinking of stumping up cash is that potential fund recipient's bona fides and tax liabilities are generally not checked by the platform matchmaker. In fact, crowd funders such as Australia's own Pozible explicitly refuse to take this responsibility.

What's more, crowd funders do not insist that initiators develop a concept through to fruition or even deliver it on time.

Funders of animated film Anomalisa were still waiting a year after the promised release date for a glimpse of US screenwriter Charlie Kaufman's project. The filmmakers, who in 2012 received more than US$400,000 via Kickstarter, kept postponing the launch saying the project had become bigger than Ben Hur.

**A work in progress**

Yet it is likely that as crowd funding gathers momentum some platforms will be able to offer greater legitimacy.

For example, Pozible has recently partnered with charity GiveNow so that donations to charitable projects will now be tax deductible.

While crowd funding success stories are likely to continue to grab headlines, Australians would be well-advised not to hand over any money they can't afford to lose. Until stricter safeguards are in place, crowd funding is best viewed as personal philanthropy rather than as a hard-nosed investment.