July 2014

As consumers and investors took stock at the end of the financial year, they decided things were not as bad as they feared after the release of the May budget. Signs of a turnaround in sentiment emerged after new research revealed consumer confidence rose 6 per cent in June.

However, the ANZ-Roy Morgan consumer confidence index remains 10 per cent below levels at the end of April, igniting concerns business confidence could also be affected.

Elsewhere, speculation is growing that low interest rates will continue in the United States after freezing weather triggered a shock 2.9 per cent fall in first quarter economic growth. The US dollar was sold down, pushing the Australian dollar above US94c.

As a result, the US Federal Reserve is not expected to increase the benchmark interest rate until the second half of next year. Locally, the Reserve Bank of Australia is tipped to raise the official cash rate as early as April next year.

The Reserve Bank acknowledged the dollar is still high by ''historical standards". A rebound in the US currency could reverse the Aussie dollar's rise, but this is considered unlikely while US interest rates remain low.

Robust Chinese data also provided support for the strong local currency, after the HSBC/Markit Flash China Manufacturing Purchasing Managers' Index increased to 50.8 in June from 49.4 in May. The Aussie dollar finished the year near its 2014 high.

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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.

When China's answer to Twitter – Weibo – floated on the New York Nasdaq exchange recently, the shares jumped almost 20 per cent on debut.

It was not just short-term profits that had investors excited. The company offered the chance to tap into China's rapidly growing consumer technology market and more than one billion eager consumers.

Weibo is just one of the many new companies being listed around the world. Later this year China's ebay equivalent, the Alibaba Group is also being listed in the US. But unless you are willing to step outside Australia to invest, you inevitably miss out on such opportunities.

At the heart of every investment strategy is the need to diversify in order to spread your risk across a variety of asset classes, markets and regions.

Spreading your net

Having a mix of just Australian shares means you may be missing out on global opportunities to further diversify your risk. Given that the local market represents less than 2 per cent of global market capitalisation, you may be overlooking 98 per cent of sharemarket opportunities.

What's more, since the Australian market is dominated by banks and resources, you may be missing out on a whole range of major global technology and consumer companies.

Aside from the likes of Weibo and the Alibaba Group, Australian investors lack direct access to other major global brands such as Apple, IBM, McDonalds and Samsung. None of these companies are listed on the local market. This is not a recommendation to buy or sell any of the companies mentioned in this article, rather, they have been provided for illustrative purposes only.

Admittedly, your superannuation fund may provide exposure to international shares. But if you have a self-managed superannuation fund, be careful your investment exposure provides adequate diversification, as evidence suggests many take an Australian centric approach. Of course, you may also have exposure to overseas markets through Australian companies with offshore operations.

Emerging markets

Ignoring overseas markets is not just about missing out on global brands, it also means missing out on the economic potential emerging in other parts of the world. Australia is viewed as a mature market so the opportunity for growth is more limited than in developing economies.

In particular, you might want to look at investing in the latest group of countries that are tipped to grow rapidly over the next 20 years, the so-called MINT economies of Mexico, Indonesia, Nigeria and Turkey. These latest countries are quickly catching up with the BRICs nations (Brazil, Russia, India and China) that were the global market darlings in recent times.

How to invest offshore

There are three key ways to invest overseas – directly, through listed or unlisted index funds, or through actively managed international funds.

While a number of Australian brokers offer direct investing in offshore companies, you need to do your research before investing. Not only do you have share price risk to handle but you also run a currency risk.

Investing in an index fund that mirrors an overseas market can be an option although your investment will be a passive investment, only moving in tandem with the index it represents.

For many, an active international managed fund is the most appealing option. While you may have less control investing through a managed fund, you do benefit from the expertise of the fund managers and the potential to outperform passive index returns. Also, managed funds allow you to target specific markets, countries or industries.

Importantly, many managed funds are offered in hedged and unhedged versions. Hedged funds use a variety of strategies to manage the risk that exchange rates will move against you.

Recognising the importance of diversifying your investments beyond Australian shores is only half the story. You then need to work out what global investments best suit your risk profile.

This is where professional advice can help find the right global solution for you.

Imagine winning the lottery or great Aunt Sally leaving you all her worldly goods. What would you do? It might all sound wonderful but, interestingly, windfalls like these can present as many problems as they solve.

Among a suite of possibilities, the classic choice of what you should do with a windfall is to either pay off your mortgage or put the money into super. But given that a lottery win or an inheritance is likely to be a post-tax sum, the mortgage route may often prove more effective, despite the appeal of superannuation's favourable tax treatment. In most cases, however, the decision will depend on your personal circumstances.

Can investments earn enough?

A key factor in favour of paying off the home loan is that it is a non-deductible debt; there are no tax advantages or offsets to help service your borrowings. With mortgage rates around the 7 per cent mark you would need to earn at least that amount after tax from your investments to decide against paying off your mortgage.

Admittedly, earnings on your investments in super only attract a maximum 15 per cent tax in the accumulation phase and are tax-free in the pension phase, but you would still need to earn at least an 8.25 per cent return to make it a better option than paying off your mortgage.

A taxing question

Mind you, if Aunt Sally has left you her holiday home or some other asset with a capital gains tax (CGT) liability, when you sell it, then contributions to super might be a way to offset that liability. For this to be the case, you first must be eligible to claim a deduction. This requires you to have no more than 10 per cent of your income derived from employment in the financial year you wish to claim the tax deduction.

For example, if your capital gain was $200,000 and your CGT liability was on 50 per cent of that (i.e. $100,000)[1], you could further reduce this liability by making a $25,000 contribution to super (if you are under age 60; otherwise $35,000). This could bring the sum on which CGT is payable down to $75,000. These are all issues you need to discuss with us (and your tax accountant) to ensure your needs and personal circumstances are fully considered. For example, exceeding contribution limits may incur a large tax penalty.

If you are someone who is used to having a mortgage and building an effective family budget around that, consider taking two steps: pay off the mortgage first, and then redraw funds to purchase an investment. If you use that approach, the interest on your loan becomes tax deductible.

Of course, if you don't have a mortgage, consider putting the money into super as a non-concessional contribution. That way you would benefit from the 15 per cent tax on investment earnings rather than paying your full marginal tax rate which could be as high as 46.5 per cent.

Calculating your options

According to the Government website Moneysmart.gov.au, somebody aged 50, earning $100,000 a year, would be better off paying down their mortgage if they received a $300,000 windfall, in comparison to making super contributions. The assumptions behind this are the person has a $300,000 mortgage with 15 years to run at 7 per cent. It also assumes a 3.5 per cent inflation rate and a 7 per cent return on super investments. According to the website, the difference once the person turns age 65 would be $256,370. And if you had been 40 at the time of the windfall, you would have been $348,676 better off. It is important to remember however, if superannuation returns were more than 7 per cent, this would reduce the benefit of paying off the mortgage first.

There are so many variables to consider, it is important that you do your homework well and seek professional advice to match your decision with your personal circumstances. A windfall might be money received without effort on your part but effort and planning are what you need to get the best from your gift of good fortune.

1 Assumes the property was held for more than 12 months