The Key

Autumn 2015

Issue 46 of the latest market insights from Financial Services Partners includes:

- Plummeting oil price good news for consumers
- Futuristic technology helps you keep track of your activity
- Thinking outside the investment square
- Adding insurance to your super has several benefits

Welcome to the Autumn 2015 edition of The Key. We hope that you enjoy reading our quarterly newsletters this year. This edition we focus on the price of oil which is topical at the moment, alternative investments and the benefits of adding insurance to your super. We hope you find these topics interesting. If you have any questions once reading our articles we would be happy to discuss these with you so please give our office a call. We have also enjoyed researching our lifestyle article which this quarter looks at the new craze of electronic fitness gadgets.

From all of us, welcome to the first edition of The Key for 2015, we look forward to bringing you more newsletters with interesting and informative articles.

Plummeting oil price good news for consumers

On 26 January, the Brent oil price fell to US$46 a barrel. This represents a fall of almost 60% from the average seen in June and was its lowest level in six years. This continuing slide in oil prices, though a negative for energy producers, is likely to be positive for consumers and growth over the year ahead.

Several factors at play

There are a number of reasons for this fall in global oil prices. While some analysts point to a slowdown in the Chinese economy and softer growth throughout Europe, the full picture, however, is a little more complex.

A significant factor this time has been increased oil supply. In particular, the increased supply of shale oil in the US is a huge factor. Shale oil is a high quality crude oil embedded between layers of shale rock, impermeable mudstone or siltstone. As a significant producer of shale oil, the US has greatly increased its supply over recent years. This has seen a large decrease in US demand for foreign oil which has impacted global prices.

In addition, as the governments of major suppliers in the Middle East, such as Libya and Iran continue to stabilise, production levels there have also increased. At the same time, high prices also made it economical to extract oil in ways that were previously prohibitive, such as in the tar sands of Canada.

When you add the massive output generated by Russia, Nigeria, Venezuela, Saudi Arabia and Algeria it is easy to see why there is currently a global excess supply of oil relative to demand.

As the global economy continues to struggle to recover, Organization of Petroleum Exporting Countries' (OPEC) decision not to cut production exacerbated already softening prices.

Global economy set for more growth

Declining oil prices should be generally positive for the global economy, as declines will exert downward pressure on inflation and allow Central Banks to focus on supporting growth. A low interest rate, low oil price environment is likely to boost consumer confidence and consumption and contribute to higher global economic growth in 2015.

Developed economies – which are large energy consumers – are likely to benefit far more than energy-producing countries that are constrained by falls in investment levels and lower profits in the energy and resources sector.

While on balance the fall in oil prices should be positive for global growth, there are losers. Global energy companies suffer from the fall in prices. This has been significant in the US, where energy companies have comprised about 20% of high yield debt issuance as companies – attracted by cheap debt and high oil prices – borrowed to significantly increase production.

There are legitimate concerns that we will now see a large rise in defaults in this space, which has seen the price of debt for these companies rise significantly in the past six months.

Similarly, Australian energy companies including Santos, Woodside Petroleum and Oil Search Limited have already suffered a fall in share price, as markets fear narrowing profit margins.

However, the Australian energy sector has survived dramatic oil price collapses before and companies in this sector have proven their resilience during similar periods of price uncertainty.

Based on the expectation of accelerated global growth in 2015, growth assets should perform favourably. In particular, developed share markets are expected to deliver strong returns as global activity picks up, with US and Japanese share markets poised to directly benefit the most from falling oil prices.

Good news for consumers

Consumers also stand to gain. According to some analysts, if the oil price stays near US$50 a barrel, the average Australian family will save about $15 a week at the pump alone, based on an average price of $1.13 a litre. This equates to roughly $750 a year, which is worth more to the average family than another quarter-point cut in mortgage rates. If the oil price fell to US$40 a barrel, there would be even greater savings.

If consumers put these savings on petrol back into the economy, we can expect business sentiment to improve, more jobs growth and a generally healthier economy.

A financial adviser is always very well briefed on current trends and opportunities and is ready to discuss any questions and concerns you may have.

Futuristic technology helps you keep track of your activity

Fitness trackers – electronic gadgets generally worn on the wrist like bracelets – are the must-have digital fashion accessory *du jour*. While these devices have been on the market for the best part of a decade – monitoring heart rate, steps taken and sleep patterns – it's only in the last couple of years that they have reached almost futuristic levels of sophistication.

US company Whistle has even developed a fitness tracker for dogs. The US$100 dog collar features Bluetooth to connect it to your smartphone and Wi-Fi to track location, all the time collecting data that lets you track your best mate's activity over a chosen period of time.

Fitbit is the best-known and biggest-selling variety of these trackers. The latest Fitbits have morphed into wristwatch form and use GPS to track exact levels of physical activity in any given location at a specific time.

They also track food intake and weight, all the while transferring the information to other devices such as smartphones or notebooks via the Fitbit app. They have enough memory to record up to 30 days of activity – more than enough for the average person to get an idea of how healthy a lifestyle they're living.

One of the benefits of technology like Fitbit is that it can alert you to a potential health problem much faster than an annual visit to your GP. However, it's still essential to have a good health insurance policy in place, especially if you have dependents, so that you have some financial peace of mind if something unforeseen happens.

Thinking outside the investment square

Alternative assets may appeal to investors seeking greater portfolio diversity than that available to them in traditional asset classes. These alternative asset segments can provide higher returns, particularly in the short term, but they also carry different risk profiles.

What are alternative assets?

Investors traditionally allocate their portfolios almost entirely to a mix of cash, liquid bonds, listed shares and listed property. Alternative assets cover a wide range of investments and strategies in areas such as hedge funds, physical commodities and private equity, which are generally not available through listed stocks.

Examples include buyouts, venture capital, distressed debt, real assets such as real estate, infrastructure, insurance-linked assets, and shipping and trade finance.

Diversifying your portfolio

The main aim of investing in alternative assets should be to diversify your portfolio by reducing the reliance on equities as the primary driver of returns above inflation.

Having a diverse portfolio spreads the risk, which can be especially important when markets become volatile or when traditional bonds or shares do not perform as expected. By blending alternative and traditional assets, your portfolio can potentially deliver a smoother return with less volatility.

This approach differs to that taken by traditional investment funds, which are often constrained by having to allocate particular amounts to a market sector irrespective of valuations or volatility.

However, investors should beware that while alternatives target absolute returns, some can take on a similar level of risk to equities. It is also worth noting that risk may vary substantially between the different investment areas.

Like traditional growth assets, growth alternatives tend to require an investment horizon of at least five years. Investing at the appropriate time is important, as some strategies have less certain liquidity characteristics and leverage the physical assets by using derivatives as insurance for price fluctuations.

Hedging your investments

Hedge funds frequently run far more active or concentrated exposures to a small number of stocks or bonds. They may invest primarily in the same listed stock and bond markets as traditional asset managers, but they do not have to track the corresponding indices or benchmarks.

They can also vary their exposure to market segments by going 'short' in derivatives such as futures, where they are betting that a particular currency, stock market index or market segment will go down. Trading currencies and commodities and their derivative equivalents may make for a bumpy ride, so it's best to be sure these investments are suitable for your risk profile.

Most importantly, you should consider who the fund manager is because this segment of the market is particularly dependent on manager skill for outperformance.

However, bear in mind that past performance is not reflective of future returns, therefore it's important to think about how the fund fits in with your overall investment goals. Hedge funds are generally not bound by the same rules as traditional funds, so their performances can vary widely.

Other strategies

Alternative investments may also include real estate investments that hold equity or debt financing on a portfolio of property assets.

Investment structures can also vary extensively. They can involve high-yield or illiquid credit investments comprising capital for investment in debt securities that experience higher risks of default than investment-grade corporate or government bonds. Such positions can be illiquid and exposure to risk can be high.

Alternative portfolios may also include physical commodities, where funds invest in mostly physical commodity assets, but use derivatives to hedge against price movement. Of course, this carries its own risks and rewards.

Talk to an expert

Having multiple sources of return in a diverse portfolio can be highly advantageous. However, the challenge is in finding a suitable investment that is likely to perform in line with expectations.

As with all investment strategies, it is important to talk to a financial adviser who can help you clarify your overall financial goals, tolerance to risk and timeframe concerning alternatives, then align your strategy accordingly.

Adding insurance to your super has several benefits

Australian consumers have never had more choice when it comes to super funds and insurance policies. They also have plenty of options when it comes to the amount and types of insurance cover they want and the methods of payment.

However, recent research revealed at last November's Association of Superannuation Funds of Australia (ASFA) conference in Melbourne, found that the majority of fund survey respondents believed most fund members didn't know what insurance cover was included in their super accounts, and whether it was appropriate for their needs.

Additionally, about 73 per cent of respondents said their super fund members didn't understand insurance in relation to super.

Almost all super funds can arrange life, disability and income protection insurance for their members, and many super accounts have elements of these insurance types embedded into their fee structures. This means many people already have some sort of cover without even knowing it.

These types of insurance not only provide some security for you and your family in the event of death, illness or injury, but having your insurance in super also helps to consolidate what may otherwise be several expenses under the one superannuation account.

Super funds typically offer life insurance, otherwise known as death cover, where your beneficiaries receive the benefit if you die.

They may also offer total and permanent disability (TPD) cover (where you receive a benefit or periodic payment if you become permanently incapacitated and can no longer work) and income protection (where you receive an income stream if you are forced off work through temporary disability or illness).

Your super fund's product disclosure statement (PDS) usually details the insurer and the cover available, and you can also get these details by contacting your super fund.

Talk to an adviser

Before taking any action, talk to a financial adviser – preferably a superannuation expert – about what is best for your circumstances and whether your current policy has the cover you need.

> Ask as many questions as you can think of. If your existing super policy doesn't cover all your essentials you can either purchase more cover or shop around for a super fund that better suits your investment and insurance profile.

First, you need to consider what sort of insurance you need, taking into account your current debt levels, your children's future education costs and how much money your family would need to live comfortably in the event of your death or permanent disability. If you don't have dependents, you still need to think about how much you would need to live on following illness or injury.

It's always good to have a financial adviser check the fine print of any policy, and to advise you on the different types of cover and when it does or doesn't apply. That way you know exactly what you're getting.

For example, each insurer has different definitions of what they consider to be totally and permanently disabled. Being off work for a year is not considered 'permanently disabled'. You should also be wary of policies offering disability cover without medical checks, as they generally offer limited cover.

> You also need to be aware that your insurance cover may be affected if the circumstances of your policy or employment change.

For example, if your employer is contributing to your super fund and you change jobs, the insurance cover may stop when your former employer's contributions stop.

Finally, you should consider consolidating your super into one policy to avoid paying unnecessary fees and possibly insurance premiums across more than one fund.

Cost savings and peace of mind

Taking out life, total and permanent disability and income protection insurance through your super account has several benefits. Super fund insurance policies are often cheaper than those offered by other financial institutions because their sheer size allows them to purchase policies in bulk.

Additionally, since you pay the fees from your super account, you should generally be able to get the protection you need, even if money is tight at any given time. Also, you may be able to fund premiums for life and total permanent disability insurance with your pre-tax income, if you take out this insurance in super.

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