

# YOUR PERSONAL WEALTH

WINTER 2021

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## WELCOME TO THE WINTER EDITION

As we head into winter, it seems that it will take more than a change of season to cool down market sentiment.

In Australia business and consumer confidence are at all-time highs, alongside other key economic indicators. It is predicted markets will see at least two years of really strong growth, after which the pressure will be on central bank interest rates. The latest ABS jobs data appears to support this optimistic view, with unemployment in April falling to 5.5%.

Recent budget announcements support efforts to get back into the workforce, with proposed increased childcare subsidies, and the removal of the \$450 per month minimum for superannuation guarantee payments. This, coupled with a number of initiatives to help get additional money into super, and home ownership initiatives, signal an election-friendly budget.

Talking employment, we're also looking at the recent APRA-led changes to income protection, with many changes due to come into effect by 1 October 2021, and how these may impact you.

Also a timely reminder of the forthcoming Census, on Tuesday 10th August, and taking a look at why this data collection is so vital to optimise outcomes for all Australians.

## INFLATION; A PASSING FAD OR HERE TO STAY?

INFLATION

Global equity markets have mostly been treading water over the last couple of months, with concerns of higher inflation. Adding to these fears, the latest US inflation numbers came in well above expectations. Markets are now waiting to see if this is just transitory, or will be sustained. The good news so far is that global bond yields, which rose sharply in the first quarter have settled for now.

On the COVID-19 front, in the US at least, a large percentage of the population has had at least one vaccination and infections and deaths are down dramatically. Many health experts believe that herd immunity is very close. The vaccine rollout is still lagging in Europe (except for the UK), but the real crisis is in emerging markets, particularly in Brazil and India.

The Australian economy is now bigger than the pre-COVID-19 level and company earnings have also surpassed December 2019 levels. However, the vaccine rollout in Australia has been much slower than in the US. This is not a great situation as it will likely delay the opening of our borders.

### RBA upgraded GDP Forecast



↑ **4.25%**  
over 2021

↑ **3.5%**  
over 2022

### Inflation



↑ **1.1%**  
Australian inflation  
reading in the first  
quarter of 2021

↑ **4.2%**  
US annual CPI the  
most since 2008.

↑ **3%**  
US core CPI measure,  
the most since 1996.

### Economy

The global economy should see a big rebound in growth this year, from the contraction of around 3.6% experienced in 2020.

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# HOW CHANGES TO INCOME PROTECTION AFFECT YOU

## Why the changes to income protection?

In response to the \$3.7 billion losses experienced in the sector in the 3 years to the end of 2020, and insurer inaction, Australian Prudential Regulation Authority (APRA) has stepped in to try and improve the sustainability of income protection policies[2]. At the end of 2019 APRA informed life insurers they had to make major changes to income protection policies starting from 31 March 2020 to 1 October 2021. One of these changes has been postponed to 1 October 2022.

## Who is APRA?

The Australian Prudential Regulation Authority (APRA), licenses banking, insurance and superannuation businesses, and supervises them to ensure that the financial promises made to their beneficiaries (e.g. policyholders) are kept. APRA's supervision aims to identify potential financial or operational weaknesses as early as possible, and ensure they are rectified before they can threaten its safety and soundness[1].

## What is income protection?

Income protection, also known as 'salary continuance insurance' or 'disability income insurance', insures one of your most important assets, your income. It's designed to pay you a benefit if you are unable to work for a period of time due to illness or injury[3].

## Initial changes

Historically, income protection policies were provided as either an:

- Indemnity value policy, where the amount you're insured for is a percentage of your salary when you make a claim; or an
- Agreed value policy, where the amount you're insured for is a

percentage of an agreed amount when you sign up for the policy. These are generally more expensive but could be useful if you have income that changes from year-to-year[4].

The first big change took effect on 31 March 2020, when new applications for Agreed Value income protection insurance were discontinued. This particularly affects self-employed, whose income can vary widely each year.

## What other changes are expected?

The following changes are to be implemented no later than 1 October 2021[5]:

- Limits on income protection payments for the first 6 months. Rules will be in place so that benefits cannot exceed 90% of earnings for the first 6 months and drop to a maximum of 70% of earnings after that. This is to encourage retraining, rehabilitation and return to work.
- Benefits will be based on the last 12 months of earnings, if you have a predominantly stable income. Previously some policies allowed you to look back 2-3 years and make the best 12 month period the basis of your claim. This look back will now be based solely on the past 12 months' income.
- Reducing the risk of longer benefit periods. This may mean stricter disability definitions for longer benefit periods.

APRA has recently announced it will postpone implementation of the **policy contract term measure to 1 October 2022** [6].

- Income protection contracts may not exceed 5 years. This means terms and conditions that used to be able to be guaranteed until age 65, now

need to be renewed and updated every 5 years, subject to an analysis of changes in your occupation and financial circumstances.

## What happens to existing policies?

If you have an existing income protection policy which includes a 'Guarantee of Renewability' in the policy wording, that is, the policy is automatically renewed each year, your policy should continue. Existing Agreed Value policies terms and conditions will generally not change, however, the premiums charged may change.

## What should I do?

Insurers are starting to develop and release new income protection policies which meet the guidelines set out by APRA.

It's important to remember these changes are all aimed at making income protection a more long-term viable proposition.

If you have been considering income protection or would like to have your existing policy reviewed, it may be useful to reach out to us and discuss the options available to you.

[1] <https://www.apra.gov.au/what-does-apra-do>

[2] <https://www.ifa.com.au/news/29441-apra-changes-to-strip-back-long-term-claim-benefits>

[3] <https://www.canstar.com.au/life-insurance/income-protection-insurance/how-does-income-protection-work/>

[4] <https://moneysmart.gov.au/how-life-insurance-works/income-protection-insurance>

[5] <https://www.apra.gov.au/final-individual-disability-income-insurance-sustainability-measures>

[6] <https://www.apra.gov.au/individual-disability-income-insurance-deferral-of-implementation-of-policy-contract-term-measure>



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The forecasts of global GDP growth have both been upgraded recently. The OECD projects that Global GDP growth will be 5.6% this year, an upward revision of more than 1% compared to its December outlook. Among advanced economies, the United States is expected to surpass its pre-COVID-19 GDP level this year, while many others are expected to return to their pre-COVID-19 levels in 2022.

Another big piece of economic data was the big miss on new jobs in the US. Markets were expecting around a million new jobs in April, but only 266,000 were created. One explanation for this is the high level of unemployment benefits and school closures forcing parents to stay home. Businesses' number one concern is the extreme difficulty attracting workers.

### Outlook

According to UBS, consensus earnings per share (EPS) revisions during the February reporting season resulted in EPS upgrades of 5% for the Australian ASX 200, reflecting a recovery to pre-COVID-19 levels. Earnings revisions in the US have been even more dramatic, where companies reported earnings 22.9% above estimates.

However, valuations are well above long-term average levels. Australian equities are trading above 17 times fiscal forecast 2022 earnings while the US market, price to earnings (PE) ratio is above 21 times.

We would expect to see inflation spikes in the 3% to 4% year-over-year range for the US in 2021. This is especially true for April to June when inflation plunged in 2020. If this was to be sustained, it would result in much higher bond yields and lower PE multiples, and hence lower stock prices. There are some additional factors causing inflation to spike in the short term, including supply chain bottlenecks.

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**The latest inflation reading in Australia showed inflation was fairly benign**

The US Fed believes, and probably the market consensus is, that the spike in inflation will be transitory, and we will soon revert to the benign inflation rates of recent years. This open question would seem to be the biggest risk to equity markets going forward. The main result of higher bond yields so far has been that value or cyclical stocks have been outperforming growth stocks for some months now.

The swing to cyclical stocks should be positive for Australian equities given the proportion of them in our market, such as banks and resources. We do not know how long these stocks will outperform, so we suggest that clients maintain a mix of growth and value/cyclical stocks.

The other major risk to US markets is the big government and taxing policies of the current administration. The expectation is that they will try to raise the corporate tax rate from 21% to 28%, which amounts to more than \$2 trillion in extra taxes over 10 years. This will result in earnings downgrades in future years, as well as be negative for employment in the longer term. Massive spending proposals on top of a booming economy are also likely to put upward pressure on interest rates in the short term.

We do not know how many of these measures will get passed, but we do not believe the markets have focused on the risk they pose to markets, especially given the above-average valuations we have right now. Given how far the market has run up and some of the risks we have set out, we would be pretty cautious right now.

## THE CENSUS AND YOU



Australia's next national Census will be held on **Tuesday 10 August 2021.**

The Census is a snapshot of who we are, what we do, and how we live, and tells the story of how we are changing. It's used to inform many things, from planning schools, healthcare, and roads, to local services for individuals, families, and communities.

### Why your participation is important

The Census provides data on important topics such as populations, rents, mortgages, incomes, religion, languages, housing, and more.

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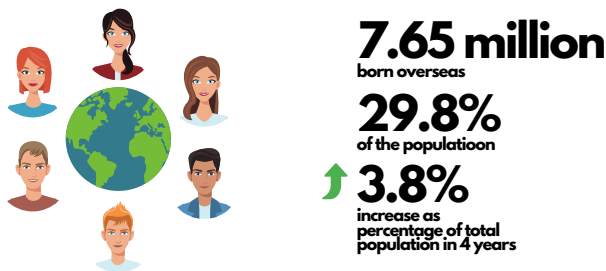
It helps governments, businesses, researchers, not-for-profit and community organisations make informed decisions.

Here are just a few of the ways the census data helps:

- the Council of the Ageing (COTA) uses Census data to help understand issues affecting older Australians,
- the Royal Flying Doctor Service uses Census population data to determine what health services are required in rural and remote areas, and
- Crime Stoppers uses Census data to deliver prevention campaigns that help keep communities safe.

### Did you know at the last census in 2016, there were 26% of Australians born overseas?

The ABS recently released new data on the size of Australia's overseas-born communities. In June 2020 these figures jumped by almost 4%:



Since the last Census, the total number of Chinese and Indian born Australians overtook New Zealand born, to now be the second and third largest overseas-born Australian populations. During this period, the proportion of Nepalese-born Australians jumped over 123%, whilst the Italian and Greek-born populations dropped by almost 10% each.

As demographer Simone Alexander [1] explains, what these figures don't tell us are details like their age, which suburbs they live in, and whether they are here temporarily or have relocated permanently. This detailed information, collected through the Census, is vital in helping to plan services for our multicultural communities.

With all the border closures and international travel restrictions due to COVID, it will be interesting to see the impact of these changes in the 2021 Census!

[1] <http://demogblog.blogspot.com/2021/05/australias-migrant-communities-in-2020.html>

## Federal Budget 2021 HIGHLIGHTS

The aim of this budget is to secure Australia's recovery and drive the unemployment rate down. It is aimed at creating jobs, guaranteeing essential services and building a more resilient and secure Australia.

It's important to note that these proposals have not yet passed into law. Many also have a proposed start date of 1 July 2022, after the next Federal election.

Call our office if you have any questions regarding how these proposals may offer you opportunities.

### Superannuation proposals



Work test for contributions removed for those under 75

Removal of \$450/month minimum for super guarantee threshold

Downsizer contributions can be made from age 60

### Tax proposals



Extended tax cuts for low to middle income earners

Depreciable business assets, instant write-off extended

Business temporary loss carry back scheme extended

### Housing proposals



10,000 additional places under New Home Guarantee

Family Home Guarantee single parent deposit reduced to 2%

First Home Super Saver cap increased to \$50,000

### Women & Care proposals



Increased childcare subsidy for second and subsequent children

\$164.8 million support for women escaping domestic violence

\$17.7 billion for Aged Care over 5 years & \$2.3 billion for mental health

**IMPORTANT:** These announcements have yet to be passed through a Senate in which the current government does not have a majority.



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