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Investment Insight

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2017 has seen global share and property markets blasting to new heights. The potent combination of favourable economic data emerging from the US and China, together with positive expectations from President Trump's growth based rhetoric, have been irrepressible. These are matters economists, investors and commentators concern themselves with daily because they change so quickly and impact our immediate lives and financial well-being. However, there are much bigger and more powerful trends at play that should concern us more, yet don't. Although they move imperceptibly slowly and appear not to matter, they do and they will.

Will You Still Need Me, Will You Still Feed Me, When I'm 64

Readers young and old may recognise the title to this edition of Investment Insight. It was chosen as a stark reminder to us all of how life has changed over the last 60 years. It's theme is simply about ageing.

The melody was written in 1957 by a then very young Paul McCartney who had lost his mother to a fatal embolism a year earlier. The lyrics were added later to honour his father's 64th birthday and became the first song recorded for the legendary "Sgt Pepper's" album of 1967.

Mortality in the post war years was an issue confronting every adult. Medical treatments fell well short of those we take for granted today. Reaching age 65 was a milestone, celebrated by a well earned retirement often characterised by decades of physically demanding work. At that time, relatively few people lived beyond their early 80's.

Why this is important to us is because innovation, climate change, energy use, demographics and ageing determines the future of global asset prices, costs and the goods and services the world will consume. Savvy investors learn from the past, but are mindful of the bigger and more critical technological, environmental and economic trends of the future. After all, **the returns on every investment made today are totally dependant on the profits made in the future** and the industries in which they are made.

Changes Through The Decades

10 years ago **Facebook** was a fledgling company, today it commands the social media space and impacts the lives of billions. 20 years ago, in 1997 **Google** had only just registered its own domain name. Today, it is referenced every day by nearly every person on earth. 30 years ago, global stock markets fell over 20% in a single day. 40 years ago the first **Apple** computer went on sale. Today Apple is the biggest company on the planet with a market capitalisation in excess of $1 trillion. 50 years ago the digital revolution that would change the world was being formed with the introduction of transistor radios, digital calculators and the world's first ATM. 60 years ago **Toyota** sold its first car in the US. Today it sells over 10m cars and is the world's Number 1 car brand. Meanwhile music was being claimed by the youth of the world, as the platform to drive their individuality and freedom of thought and speech from their pre WWII parents.

Successful investing does not require investors to pick the right companies that might dominate the future world. Like gambling, that can be fraught with financial risk. However, recognising trends and quantum shifts in consumer needs and behaviour is one of the keys. The days of passively buying shares and "putting them in the draw" are over, lest you or your holding be left behind. Woolworths could be a case in point where a once dominant high margin company fell asleep at the wheel and then found disruptors at its doorstep. Over the last 5 years, shareholder returns and capital have evaporated. Could the credit super cycle (debt binge) of the last 20 years based on ever decreasing interest rates and fuelling Australia's financial sector face the same fate? We'll soon see.

The Generations As We Now Know Them

Children born in the 1946 - 1964 era are those we now refer to as **Baby Boomers**. Anyone enjoying a flood of memories from references to bodgies and widgies, hula hoops and yo-yo's, the British invasion or Rin Tin Tin and Pick-a-Box, is a Baby Boomer. Economically, **boomers currently command more wealth than any generation before them.**

This massive global cohort has already retired or is approaching retirement within 10 years and is currently placing unprecedented strains on limited government and healthcare resources. It can only get worse.

Quantum leaps in medical science and preventative medicine have stretched the good health and longevity expectations of Baby Boomers by decades. Affluence, education and employment opportunity has also meant boomers can afford and enjoy lifestyle comforts and experiences unimaginable by their parents. It is said 60 is the new 40 and for many "empty nesters" this throw away line is not far from reality. Most 70 somethings today enjoy active lives pursuing their respective interests including travel. There is much evidence that the commercial world is adapting to meet their needs, and of course profit from them.

Generation X (Gen X) is defined loosely by demographers as people with birth years ranging from the mid 1960s to early 1980s. The product of post sexual revolution relationships, rising divorce rates and two working parents, this cohort is dubbed the "MTV Generation" or "latchkey kids".

In most domestic situations, married or unmarried, both Gen X parents must work in order to support their modern lifestyles and often huge mortgages. Sandwiched between Boomers and Millennials, Gen X is the **smallest demographic** in number with arguably the greatest burden to bear economically. Gen Xers have at least 20 - 25 working years ahead of them, at a time where work pressures and technological change are at their highest. Typically **Gen Xers are demonstrably likely to receive a less than fair share of the economic pie at a greater than their fair share of cost**. A by product of current seniors living longer, the intergenerational transfer of wealth (homes) disproportionately favours Baby Boomers more than Gen Xers. That's a bitter pill to swallow.

Finally come the **Millennials** (Gen Y) born between the early 1980s and late 1990s. Generally born to Baby Boomers and older Gen Xers, Millennials are also referred to as "Echo Boomers" due to a major surge in birth rates in the 1980s and 1990s. By 2035, this cohort will be the **biggest by number** in the world, the workplace and in global economic influence. Raised in the egocentric information age, their outlook is "i" focused but nonetheless imprinted with the long lasting global aftermath of 9/11.

It is expected that Millennials will quickly overtake Gen Xers in most spheres of life, being better adapted to a wholly digital world and considerably less burdened by debt. Significantly, Millennials are those most likely to enjoy the 2030s intergenerational transfer of global wealth as their Boomer parents age and die over the next 10 -25 years.

If you've heard a cry from anyone saying they have been "locked out" of the housing market, it will be from a Millennial and it will be largely true.

Boomers and Gen Xers are currently well positioned on the property ladder having bought their houses cheaply (in the case of Boomers) or having already enslaved themselves to banks (in the case of Gen Xers).

The challenge ahead of Millennials, having a very different mindset on debt to Gen X, will be to either jump into the pool now, compromise on the first home they buy, or wait a few years for the likely (but uncertain) rebalance between demand and supply of housing and the prolonged effect of people already drowning in their existing debt, but kept buoyant by the lowest interest rates in Australian history. It remains a tough call.

Generational Work Ethic and Typical Behaviours

To assist all readers to get a feel for where they fit on the generational totem pole and some of their key (generalised) stereotyped work behaviours, we provide the table below. Although not exhaustive, the table clearly shows changing work preferences across the generations.

GENERATIONAL WORK ETHIC TRAITS

	Baby Boomer 1946 - 1964	Generation X 1965 - 1980	Millenials 1981 - 2000
Attire	Business	Business casual	Whatever feels comfortable
Priorities	Job security	Money	Make a difference & credit
Attitudes	Not afraid to challenge	Work-life balance	Values freedom & flexibility
Client Orientation	Face-to-face & telephone	Phone, e-mail, IM, Text	E-mail, IM, Text
Work Style	Teamwork and collaboration	Independent and techno-savvy	Entrepreneural, always connected
Career Goals	Build a long-standing career, excel at work	Build a transferable career, have a variety of skills & experiences	Build several parallel careers or a business, have several jobs simultaneously
Behaviours	Strong work ethic, competitive	To be seen as leaders	Their work matters in the world
Reference	Respect authority	Skeptical of authority	Test authority

Why Every Generation Feels Entitled

We do not wish to be disrespectful to any readers whose heritage is pre WWII. For you we reserve our highest compliment. Of all living people, only your generation has left the one after it in a better shape than you found it. Boomers most certainly have enjoyed the education and opportunity denied their parents by serious adverse global events.

As with most things in life, outcomes are not all determined by one's environment or skills and not everyone makes good choices. Although Boomers have mostly been fortunate, just as many of them are under-provisioned financially finding themselves dependant on government to live a dignified retirement. This brings us to the 21st Century global paradox of widespread discontent despite broad based social welfare.

The **"Age of Entitlement"** expression was coined well before Joe Hockey infamously popularised it in the context of Australia's increasing welfare burden. But who exactly is getting all the money?

If one were to speak to seniors, their recollection would be that they paid higher taxes and got no family payments or childcare assistance. They would suggest their wealth came by saving harder after shouldering 17% interest rates. There is very little sympathy for younger Australians, their smart phones, "smashed avocado", overseas trips et al.

On the other hand, younger people find themselves straddled with uni debts, a job market offering very little financial security and an unaffordable property market. Add to that, the prospect that in their working lifetime (to age 70), they will be forced to pay higher taxes, to meet the government's funding gap for age pension and health care costs being spent on seniors! Surely they can't both be right, can they?

In fact, **retirees today earn more income and pay less taxes than ever before**. Most retirees actually pay no income taxes at all. In November 2016, the Grattan Institute completed an extensive review of age-based tax breaks and concluded emphatically that older households were getting such generous treatment, benefits should be wound back. Not only do they enjoy potential age pension benefits, higher health fund rebates, Medicare thresholds and the Seniors Australians & Pensioners Tax Offset (SAPTO) also come straight out of the taxes of younger taxpayers often unable to purchase a home. Alarmingly, between 2004 and 2010, seniors households on average cost government (in welfare and in-kind services such as healthcare) an extra $10,000 pa bringing the total cost to $32,000 pa for every senior household.

Adding salt to the wound, the Grattan analysis also showed that younger generations (especially Gen Xers) are paying similar rates of income tax as older generations did, as well as GST. Much to the chagrin of seniors, it seems the facts do not support their recollection of events.

As far as interest rates and house prices are concerned, the much lauded "pain" endured by older Australians fails to take into consideration the proportionately lower loan/income and price ratio and the fact that the real costs of repayment were diluted by much higher inflation and much higher wage rises. Grattan concluded (again) today's mortgagees are paying higher debt servicing costs than at any time prior to 2000.

The undeniable conclusion we must form here, is that **older households just happened to be at the right place at the right time**, owning houses before the 20 year decline in interest rates and overseas buyers, lifted prices. It was yet another stroke of good luck for Baby Boomers. Yay!

Although younger Australians spending habits have not done them any favours, they do seem to be faced with the rough end of the pineapple, as the saying goes. Then again, without lauding any single taxpayer group, consider those who really do the heavy lifting taxwise in this country. The ATO recently published it's 2015 tax statistics showing the top **3% of income taxpayers** who earn over $180,000 p.a. (399,000 people) **pay a whopping 30% of the nation's total income tax** revenue. That is a lot of burden thrown on a much maligned minority that pays for other people's family tax benefits, pensions, healthcare, defence, education, roads and a lot of other stuff people take for granted. Increasing the top marginal tax rate, as successive governments have, may sound fair, but **a 49% tax rate** paid by the 3%, when most pay (and resent) a marginal of 35% or less, **should not go unrecognised**.

So Where to Now?

Governments both in Australia and overseas have got a problem. The drain on all socialised services coupled with the drag on income from an ageing population of Boomers will end up forcing their hand in time.

For now, arguments increasingly centre around class warfare and generational warfare. Brexit and Trump exemplify this. However, the problems go so much deeper than the current discussion. That there is vociferous agreement budgets need repair, does not eliminate the need that someone must bear the cost. Who, how and when are the unknowns.

We see increasing budgetary tensions compromising future economic growth. Overleveraged governments, overleveraged people and ever increasing lifestyle expectations from all generations some of the reasons we remain cautious in managing our clients' savings.

Whilst we fail to see any immediate threats to the currently favourable economic data supporting most markets, we are watchful that high asset prices leave little wriggle room for anything to go wrong.

Last Call For Simple Super

As eluded to in our December 2016 edition, the curtain falls on "simple super" on the 30th June 2017. Make no mistake, many people already know and enjoy the tax concessional power and benefits that our super system, in all of its incarnations, provide. For many, particularly those approaching retirement, **there is no better deal offered in Australia to legitimately pay no tax**, so we suggest if you have not already done so, review your options and act immediately. There will be no tomorrow.

As a final reminder, the age based tax deductible contribution cap is presently $35,000 (for over 50's) and $30,000 (for under 50's). The non concessional cap for under 65's is $180,000 ($540,000 using the bring forward rule).

From 1st July, 2017 tax deductions will be reduced and capped for all people irrespective of age, to $25,000 whilst the non concessional cap is reduced to $100,000 pa. A raft of other measures will also apply to dilute future tax benefits as well as trip up unsuspecting DIY savers.