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Financial education for all Australians

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The US Presidential Election – Implications For Investors

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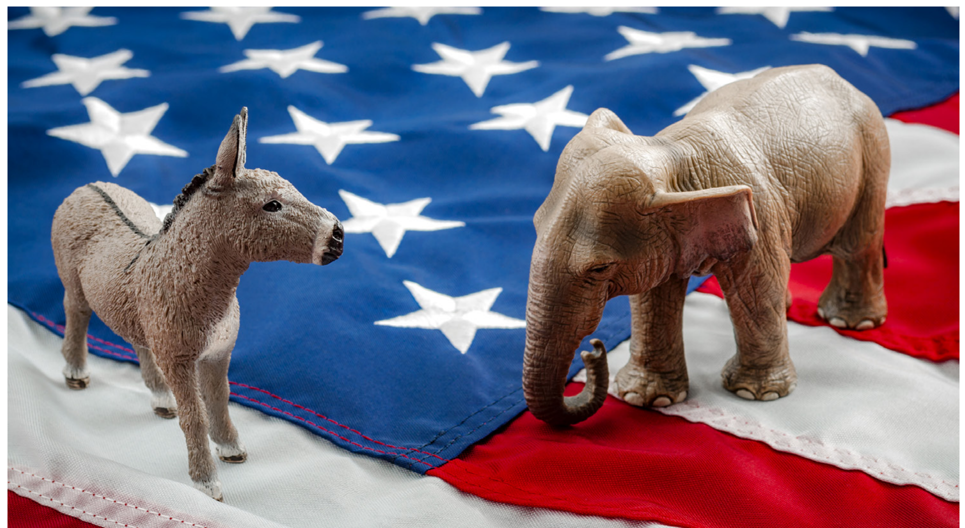
by **SHANE OLIVER**



Investor focus on the US election waned earlier this year after socialist Bernie Sanders dropped out of the Democratic primary race in favour of moderate Joe Biden. At the same time coronavirus became the main focus for markets.

However, markets may soon start to pay more attention as the election is rapidly approaching, while Joe Biden is a moderate, he is proposing higher taxes and more regulation and President Trump is not having a good run. Trump's re-election chances have fallen with a majority of surveyed Americans disapproving of his handling of the pandemic and recent civil unrest at a time when the US has plunged into its deepest recession since the 1930s. The historical record indicates incumbent presidents tend to lose when there is a recession in the two years before the election and unemployment has gone up.

Normally at this point past presidents seeking re-election have started to see an upswing in approval, but this is not evident yet for Trump. Rather, consistent with the above, according to Real Clear Politics' average of polls Trump's approval rating has fallen to 41.2% over the last two months, his disapproval rating is edging above its 2019 high, opinion polls have Biden leading Trump by around 9 points and Biden is ahead in all 6 "battleground states", the 'Predict It' betting market, which had Trump ahead of Biden up until late May, now has Biden with a 23 point lead and also now has Democrats winning the presidency, the House and the Senate. The Democrats already have control of the House and are likely to retain that, but they need three seats to then along with the Vice President, gain a majority of the Senate. A clean sweep for the Democrats would remove the Senate as a blockage to higher taxes.

However, it would be wrong to write Trump off. Polls and betting markets were not so reliable in the 2016 election, there are still four months to go to the election & ongoing civil unrest could see him garner support as a "law and order president" as Nixon did in 1968. And Trump rates more highly on the economy than Biden and this may get a boost if the economy continues to reopen and recover. A rebound in the economy is Trump's best hope

BEFORE YOU GET STARTED

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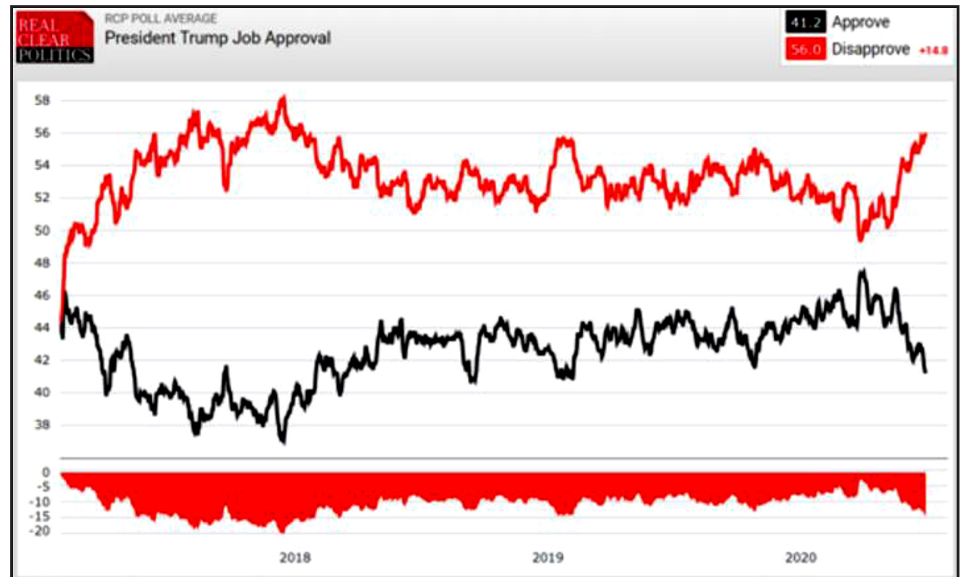
US presidential elections if recession in prior 2 yrs

President	Election year	Recession	Re-elected?
Obama	2012	No	Yes
Bush Jr	2004	No	Yes
Clinton	1996	No	Yes
Bush Snr	1992	Yes	No
Reagan	1984	No	Yes
Carter	1980	Yes	No
Ford	1976	Yes	No
Nixon	1972	No	Yes
Johnson	1964	No	Yes
Eisenhower	1956	No	Yes
Truman	1948	No	Yes
Roosevelt	1944	No	Yes
Roosevelt	1940	No	Yes
Roosevelt	1936	No	Yes
Hoover	1932	Yes	No
Coolidge	1924	Yes	Yes
Wilson	1916	No	Yes
Taft	1912	Yes	No

Source: Strategas



Source: Real Clear Politics

which partly explains why he cheered on reopening from the end of April. However, the rebound in US coronavirus cases in many states in the last few weeks puts all this at risk.

> **Biden** would likely **de-escalate tensions with Europe** and strengthen the alliance, work with international organisations like the World Trade Organisation, **work to re-establish the nuclear deal with Iran** and adopt a more diplomatic approach to dealing with **trade & other issues with China** (working with Europe and Asian allies in the process).

Key Biden policy directions versus Trump

Taxation: Biden plans to raise the corporate tax rate to 28% (reversing half of Trump's cut to 21%), return the top marginal tax rate to 39.6% (from 37%) and tax capital gains and dividends as ordinary income.

Infrastructure: Biden plans to spend $1.3trn over 10 years.

Climate policy: Biden aims for the US to reach net zero emissions by 2050 by raising the cost of fossil fuels & boosting the development of alternatives (possibly with a carbon tax).

Regulation: Biden is likely to end the era of deregulation.

Healthcare: Biden wants to strengthen Obamacare and limit drug prices.

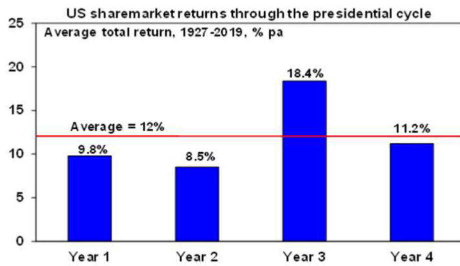
Trade and foreign policy: Biden would likely de-escalate tensions with Europe and strengthen the alliance, work with international organisations like the World Trade Organisation, work to re-establish the nuclear deal with Iran and adopt a more diplomatic approach to dealing with trade & other issues with China (working with Europe and Asian allies in the process). By contrast a re-elected Trump is likely to double down on his trade war with China and possibly elsewhere including Europe.

Budget deficit: For the near term, the budget deficit is likely to remain high whoever wins, but historically they have fallen under Democrats after rising under Republicans. That said, if the economy proves slow to recover Joe Biden may be more likely to respond with large public sector spending programs aided by ongoing Fed quantitative easing in order to deal with ongoing high levels of spare capacity and unemployment.

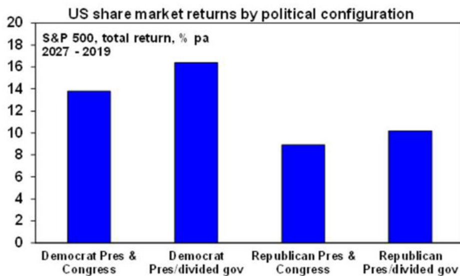
Economic impact

On their own higher corporate and top marginal tax rates, increased regulation and an increased cost of carbon which will weigh on energy companies when they are already struggling are negative for the growth outlook. For example, the rise in the corporate tax rate would knock around 6% off earnings per share for S&P 500 companies. In particular, they may reverse some of the supply side boost provided by Trump. However, as with all things economic its never as simple as that.

- First, the negative impact of tax hikes and increased regulation in the short term could be more than offset by increased infrastructure spending (particularly if some of the revenue comes from those with high saving rates).
- Second once in office Biden may dampen down his planned tax hikes, particularly if the economy is still weak as is likely.
- Third, raising taxes on top earners while a negative for incentive may



Source: Bloomberg, AMP Capital



Source: Bloomberg, AMP Capital

help reduce inequality which has been a key driver of the populist backlash of recent years and has arguably been made worse by Trump.

- Fourth, Biden's trade and foreign policy focussed more on strengthening ties with Europe and a diplomatic approach to dealing with China may substantially reduce a source of angst and uncertainty under Trump (which is likely to intensify if he is re-elected).
- Finally, more stable and predictable policy making reliant on expert advice under Biden may provide a more certain environment for business and so result in increased business investment despite a rise in the corporate tax rate. Don't forget that the uncertainty caused by Trump's trade wars offset the boost to investment from his tax cuts.

So, on balance I see no reason to expect a weaker economic and share market outlook under a Biden presidency.

Likely market reaction

Firstly, despite the heightened policy uncertainty the election year is normally an okay year for US shares.

Since 1927, the election year, or year 4 in the presidential cycle, has had an average total return of 11.2% pa, which is only just below the average return for all years. Of course, this year is complicated by the coronavirus hit to growth and so may well be weak regardless of the election.

Second, the run up to the election could see increased share market volatility if Trump's prospects look bleak for two reasons: investors may start to fret about the prospects of increased taxes and regulation under a Biden presidency, particularly if it looks like Democrats will win control of the Senate; and Trump may reason that he will have nothing to lose by seriously ramping up tensions with China (and maybe Europe) in a way that threatens the economic outlook, but with the prospect of shoring up his base and rallying Americans around the flag. However, while there may be short term jitters ahead of the election, for the reasons noted in the last section, there is no reason to expect a weaker economy and hence share market under a Biden presidency. Investors may ultimately welcome more reasoned and predictable policy making.

Third, historically US shares have done best under Democrat presidents with an average return of 14.6% pa since 1927 compared to an average return under Republican presidents of 9.8% pa. This has been evident in recent years with good average annual returns under President's Obama (14.8% pa) and Clinton (19.1% pa) versus terrible returns under President G W Bush (-0.6% pa) but strong returns under President Trump's first three years (16.3% pa).

However, the best average result has actually occurred when there has been a Democrat president and Republican control of the House, the Senate or both. This has seen an average return of 16.4% pa. By contrast the return has only averaged 8.9% pa when the Republicans controlled the presidency and Congress.

Concluding comment

The run up to the US election has the potential to drive increased share market volatility if it looks increasingly likely that Biden will win and raise taxes and regulation and the risk is probably greater if President Trump decides he has nothing to lose and so ramps up tensions with China and maybe Europe. This would weigh on global and Australian shares and the Australian dollar given Australia's exposure to China. However, this is likely to be short lived as there is no reason to expect a weaker economy and hence share market under a Biden presidency and he is likely to take a less disruptive approach to trade and foreign policy issues.

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Breaking Down The First Home Super Saver Scheme

by **JACK STANDING**

In May 2017, the federal government announced their intention to help younger Australians saved for their first home by giving them the ability to build part, or all, of their deposit inside of superannuation.

This initiative was appropriately named the First Home Super Saver Scheme.

The key aspect of the scheme is that it allows individuals to make voluntary superannuation contributions of up to $15,000 per year, and up to $30,000 in total, that can then be withdrawn from super at a later date to help facilitate the purchase of a first home. These contributions can either be made pre-tax or post-tax within the respective concessional and/or non-concessional caps of $25,000 pa and $100,000 pa respectively.

Three important things are worth noting with respect to the type of contribution that goes in:

- Concessional contribution
- Taxed at 15% on the way into super > only 85% invested
- Make up the taxable component > returns on this amount add to the taxable component balance
- Withdrawals from the taxable component are taxed at the person's marginal tax rate (MTR) less a 30% tax offset

- Non-concessional contribution
- No tax on the way into super >100% of the contribution gets invested
- Make up the tax-free component > returns on this amount add to the tax-free component balance
- Withdrawals from the tax-free component are tax-free

Importantly, while your actual balance may be subject to market forces and returns, the amount of earning that can be withdrawn are not. The earnings are calculated based on the 90-day Bank Bill rate plus 3 percent.

While the Australian Taxation Office (ATO) is generally not involved in the APRA-regulated superannuation sector, they do administer the First Home Super Saver Scheme. They have the following roles within the scheme:

1. Assess the eligibility for withdrawal
2. Calculate how much can be withdrawn
3. Provide a request to the superannuation fund to release funds
4. Ensure individuals use the proceeds they withdraw to purchase their first home

Where can this work?

The bottom line with the Scheme is that you or your children could boost the savings rate on a deposit by up to 30% compared with owning that same deposit in one's personal name. This is a direct result of swapping a personal MTR for the concessional rate in superannuation. To sweeten the deal, there is also a 15% net savings on concessional contributions when you offset tax paid on the way in against tax paid on the way out.

While many people scoff at the potential of the Scheme to assist people in saving up a deposit (particularly Sydneysiders), the reality is that the longer your time frame, the better off you will be.

Take, for example, a 3-year-old child who has a parent place $30k into a superannuation fund for them with the long-term aim of future home funding. Assuming the earnings rate is just 3.5% pa, at age 25 the child would have circa $65,000 to withdraw to help fund a home purchase. This is not even factoring in that the value of their superannuation balance would be over $130,000 at this point.

As with investing generally, the longer the timeframe, the better off you will be as the compounding effect becomes more prevalent.

The key to this one? Plan ahead!

Iron ore - the gift that keeps on giving

republished from Informedinvestor.com.au

by **GAVIN WENDT**

The essential steel-making ingredient that burst out of the blocks with the onset of the China boom during the early 2000s has defied the sceptics and generated an earnings bonanza for the mining heavyweights that dominate the industry. Iron ore is the gift that keeps on giving as far as Australian iron ore miners are concerned, with federal treasury officials cheering from the sidelines.

The graphic below highlights the volatility in iron ore prices since 2004, compared to the preceding decades. Due to the dynamics of the iron ore industry, it has historically been dominated by mining industry behemoths. The steel-making ingredient had typically been a large-capex, low-margin business - thus spawning significant barriers to entry for smaller/mid-cap miners.

Big miners have therefore become the key suppliers, possessing the large balance sheets that can fund large-scale iron ore developments. Finding an economic deposit is just the start - as developments typically require the construction of key infrastructure such as railways and ports - to enable the ore to be transported from mine-site to international customers.

With iron ore prices typically trading below US$30 per tonne for many decades leading up to the 2000s, the industry was a low-margin affair, where miners would generate returns over the medium to longer-term on their initial investments.

Of course, all of this changed with the onset of the China boom, with iron ore prices skyrocketing towards US$200 per tonne. The incumbent iron ore industry players were caught short by China's burgeoning demand, forcing them to play catch-up in terms of supply. Given the significant infrastructure challenges in the iron industry, it wasn't easy for miners to turn the supply tap on quickly. Hence, rampant demand met restricted supply - leading to rapid price escalation. Australian producers have also enjoyed a logistical advantage over their Brazilian rivals, with 12 days sailing time to China compared to around 45 days from Brazil.

Whilst such lofty price levels were sustainable due to supply eventually catching up with demand, the pricing scenario that we witness today is still highly advantageous for iron ore miners. At a current spot price of around US$100 per tonne, prices are well above the US$30 per tonne long-term average that the industry endured for many decades.

This means that iron ore miners are continuing to generate strong operating margins (the differential between the per-tonne price received and the per-tonne cost of production). Miners have also benefitted from driving down their internal costs of production through greater economies of scale as production has grown, together with enhanced operating efficiencies. Although producers are often reluctant to provide their individual mining costs, the heavyweight miners like BHP, Rio Tinto, Fortescue Metals and Vale are all producing at a cost of less than US$20 a tonne.

With this in mind, let's now turn our attention to the latest industry factors that have led to a price resurgence. Last year, Australia led worldwide iron ore production with 930 million tonnes, followed by Brazil with 480 million tonnes and prices averaging US$112 per tonne, up 21% from the US$93 per tonne average during 2018. The demand-side is therefore heavy reliant on the world's two major producing nations - Australia and Brazil - implying any supply hiccup could likely lead to a price spike. This is clearly reflected in the graphic below.

What we've witnessed during the course of 2020 is the market's dependence on its key suppliers, leading to iron ore's status as close to the best-performing commodity. As China, which buys about two-thirds of global

seaborne iron ore supplies, has sought to ramp-up industrial production via government stimulus in order to boost domestic economic growth in the wake of COVID-19, the nation's access to iron ore has been hamstrung by lower levels of output from Brazil, the world's number two supplier.

Legacy issues from tailings dam failures have impacted Vale's iron ore production capabilities, combined with escalating COVID-19 infections in the world's second-most affected country. The consequence of all of this is that iron ore prices have firmed by 7% since the end of last year, due to a combination of bullish supply and demand considerations. The big question now is how long can high prices last?

The immediate outlook remains positive, as there is evidence of slower Brazilian exports. Vessel-tracking and port data compiled by Refinitiv points to iron ore shipments of about 20.8 million tonnes during May, which represents a 28.5% fall from the 29.1 million tonnes shipped during the same month in 2019. Vale had already previously indicated a trimming of their 2020 production outlook from 340-355 million tonnes to 310-335 million tonnes on account of coronavirus disruptions.

Based on the latest development however (Vale estimates a disruption of 2.7 million tonnes per month), we could now likely see 10% of Vale's iron ore output or 2% of the total global seaborne output come to a standstill, compounding the issue in what is already a tight market.

Simultaneously, China has maintained a robust level of demand

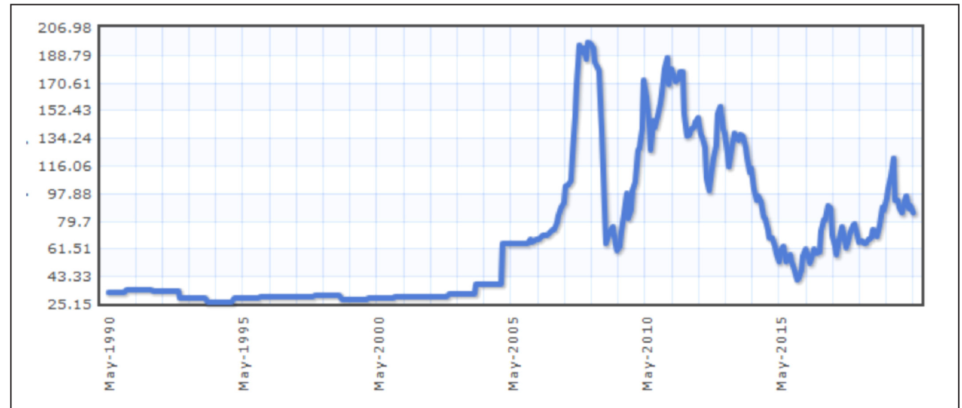

Figure 1: 30-year spot iron ore price, courtesy of Indexmundi.

Figure 2: 12-month iron ore price chart

growth, with the world's biggest steel producer registering 445.31 million tonnes of iron ore imports for the first five months of 2020, up 5.1% on the same period in 2019, according to Chinese customs data. At the same time, China's iron ore stockpiles at its ports fell to 109.5 million tonnes as of May 29, the lowest level since November 2016, according to SteelHome consultancy.

In terms of the world demand picture, the World Steel Association estimates that global steel demand will fall by 6.4% this year, but bounce back next year. The impact of the virus has been uneven, with steel demand in China expected to rise 1% this year, while tumbling by 17% in developed economies. After a fall this year to 1.65 billion tonnes, it forecasts a rebound in steel demand of 3.8% in 2021 to 1.72 billion tonnes.

The current dynamics therefore help explain why iron ore is a standout commodity, and it's likely that the outperformance will continue until Brazil supplies are assured, or until there is evidence of slowing Chinese steel demand.

The country that has most benefitted from the supply-side disruptions in Brazil and the demand-side push from China has been Australia, which is also the world's largest exporter of iron ore. China currently accounts for two-thirds

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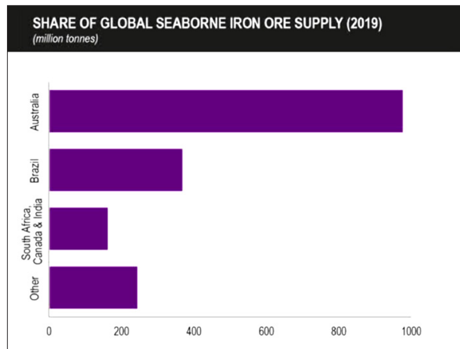

Figure 3: Courtesy of Fastmarkets, Michael Gayed

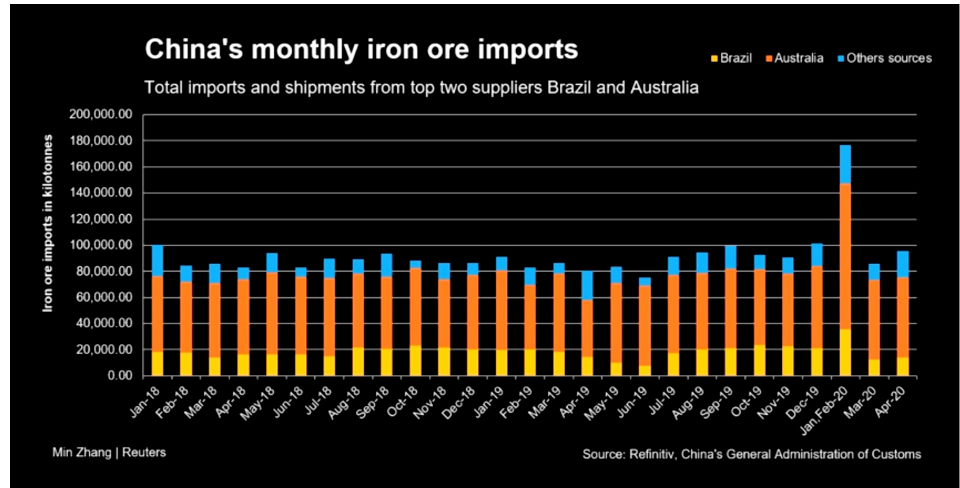

Figure 4: China monthly iron ore imports

of the world's iron ore demand and Australia is currently supplying between 60% and 70% of China's total iron ore imports.

Last year, China imported around $61 billion of iron ore from Australia, and this year Australian treasury officials forecast that this could grow to $81.5 billion, representing year-on-year growth of 33%. Iron ore has also played a major role in Australia's enhanced forecasts for overall resources and energy export earnings for 2019-20, with the government's latest March outlook data suggesting earning of A$299 billion, up A$18 billion compared to its December outlook.

Conclusion

The iron ore industry is rather unique, in that the demand-supply elements differ from most other commodities. There are very few commodities where China dominates market demand quite like iron ore, and on the supply side there are few commodities where production is dominated by a relatively few major players. When one combines these elements, it creates the potential for both price volatility, but also extended periods of price outperformance. Australia is set to maintain its position of dominance in the iron ore business, as China has no meaningful alternative sources of supply, given ongoing supply problems from Brazil.

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Top 11 Family Trust Mistakes NOT to Make

WEALTH ADVISER SERIES:
Part 3 of 3

Mistake #8 – Not being careful enough with the appointment of trustees

Setting up a trust is a serious and rather expensive undertaking. It is, therefore, important that you do not try to save crumbs in the wrong places. One of the most common false economies that can come

back to haunt investors is the fallout that can often occur due to a failure to appoint a corporate trustee.

It is true that it is cheaper to have an individual as a trustee but that leaves that individual exposed to all sorts of risks associated with the trust. This is a particularly ironic situation given that many trusts are set up with asset protection as a key goal. The risks associated with being an individual trustee can be effectively mitigated through the appointment of a corporate trustee.

Yes, it will be more expensive but the little bit of extra money that you will be spending will buy you an extra layer of protection and the resultant peace of mind.

Mistake #9 – Not determining whether it is necessary to have an 'appointor'

There are some strange and novel functions associated with a family trust and the 'appointor' certainly falls within this category. While the appointing of an appointor is not necessarily a hard and fast legal requirement many trust deeds will, for a variety of reasons, contain provisions that will allow for the creation of such a position. You need to have a look at your trust deeds to ascertain whether this is true in your case. This is because the role of appointor carries with it a significant level of power. Chief among these is the power to sack trustees! You will, therefore, want to know whether this role exists in the trust deed of any existing or to-be-created trusts that you are involved with.

Even if you do not have the role

of appointor specified in your trust deeds you will certainly do well to seek professional help to determine whether this is something that should be included in your trust deed. Some questions that such an advisor can help you to work through are:

What are some of the reasons behind nominating an appointor?

Are there circumstances that would make nominating an appointor in this case a good idea?

Who will it be?

Might it be necessary to have more than one?

Mistake #10 – Using form documents

If there is one area where 'One size fits all' most definitely does not apply it is family trusts. Families and their financial needs differ like night and day. Yet in spite of this many people believe that setting up a trust is as simple as filling in forms found on the internet or in legal software packages. This is, needless to say, a highly risky strategy (or rather lack of strategy!)

Not only can you not be totally sure that such forms really fulfil all the exacting legal requirements associated with trusts, they are also necessarily designed to serve the 'average' investor. Therefore, sadly they often deliver only average results. Here it is worth repeating the principle that 'saving' money can sometimes be a sure fire way to wasting it.

Getting advice and professional help will certainly cost you something but messing up the setting up of a family trust could very well cost you much more.

Mistake #11 – Neglecting to update your trust

A trust is not something that you can simply set up and then forget about. Circumstances change and trust deeds will therefore have to change to keep up instead of being regarded as something written in stone.

We strongly recommend that you review your trust documents to ensure that they still meet your needs. Some of the following events could trigger a review:

- Births or deaths
- Marriage or divorce
- Job changes
- Retirement
- Tax law changes
- Changes such as these represent a good opportunity to take stock.