Cuffelinks
Connecting investors with ideas

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Workers over 60 facing rude shock from Budget

Olivia Long

Few in the industry saw it coming. There was a general consensus that a looming election would temper any changes to superannuation in the Federal Government's 2016 Budget. We got it badly wrong. The Government decided superannuation was up for grabs, and proposed the most wide-ranging changes to the system since 2007. With Labor also embracing change, those 2013 commitments by both political parties to leave superannuation intact have joined the growing scrap heap of broken promises.

For advisers, it has meant a frantic reading of the Budget papers to come to grips with the enormity of the possible changes, and advising clients accordingly. Make no mistake. Reducing the before-tax contributions cap to $25,000, setting a lifetime after-tax contributions cap at $500,000, and placing a $1.6 million cap on the total amount that can be transferred into a tax-free retirement account have moved the goal posts – to the wing.

While each of these changes has received extensive exposure, another significant implication has slipped under the radar. It will affect far more people than the Government expects.

What were the main benefits of TTRs?

The Government's plans to alter the transition to retirement (TTR) rules that were introduced in 2005. Before Treasurer Scott Morrison announced the changes, TTR was considered an excellent strategy for those coming to the end of their working lives and easing their way out of the workforce.

The main benefits were:

- Pay less tax: the TTR pension environment was tax exempt, meaning all income earned and capital gains were tax-free
- Ease into retirement: taking a TTR pension from your super fund could supplement your employment income by topping up your bank account while you reduced your work hours.

The new proposal is to tax the earnings on the assets that support the TTR at 15%. The number of trustees affected is significant with the latest ATO statistics showing that the greatest number of SMSF members are in the TTR age bracket of 55 to 64. About 250,000 SMSF members would have become eligible to benefit from the old TTR rules.

What's the big change now?

Prior to 3 May 2016, many 'retirees' had a plan to leave their superannuation in an accumulation account until they reached the age of 60. Often, they did not start a TTR pension at age 55 (or 56 based on their preservation age) because pension payments would be taxed at their marginal rate less 15%, notwithstanding the tax on earnings in their pension fund would fall to zero. However, on reaching the age of 60, the tax on their pension earnings would also cease, and so the accumulation fund would be switched to a pension fund.

Now, on reaching the age of 60, there are two scenarios possible:

<u>Scenario 1: Continue some form of employment</u>

If a TTR pension is commenced, the earnings on the <u>entire fund</u> will be taxed at 15% until the age of 65, not 60. The $1.6 million limit on tax-free earnings is irrelevant.

Scenario 2: Cease employment

For the earnings in the pension fund to be exempt from tax (on balances up to $1.6 million), the retiree needs to meet a 'condition of release', usually ceasing employment.

This change is not a consequence of the much-publicised $1.6 million, but the new TTR rules. Many people expect to continue some form of work after reaching the age of 60, and now their ENTIRE earnings on their super fund will be taxed at 15%, not only the amount above $1.6 million. This will continue until reaching another 'condition of release' – the age of 65.

That's five years of tax at 15% on all earnings in super which was previously exempt.

To my mind, the Government was strongly influenced by a Productivity Commission report that found TTR strategies were increasingly being used to minimise tax and were not genuinely supporting people wanting to ease their way out of the workforce with many still working the same hours.

But under the new regime, which takes effect from 1 July 2017, no longer will the TTR environment enjoy the tax-free status it has to date. All earnings within the TTR pension will be taxed at 15%. In addition, individuals will no longer be allowed to treat certain superannuation income stream payments as lump sums for tax minimisation purposes, with the Government's rationale being to ensure that access to TTR income streams is primarily for the aim of substituting work income rather than tax minimisation.

The tax-free lifetime cap

In December 2015, the ATO released a private binding ruling which allowed members who are drawing a TTR income stream to take their minimum pension requirement out of their fund as a lump sum instead of as a pension payment. This ruling gave members who were between the age of 55 and 59 an advantage in the tax stakes.

The ATO stated that a member could elect to have this minimum pension amount count towards their tax-free lifetime cap. At present the tax-free lifetime cap is $195,000 which meant that members could pull out at least $195,000 out of their fund tax free even if they were under the age of 60! If a member had a tax-free component to their pension this would be even more.

The removal of the tax-free lifetime limit paired with a reduction in the concessional contribution cap and removal of the tax exempt status in the fund will probably mean the end for TTRs. To complicate matters, if we throw in the $500,000 non-concessional lifetime cap, any money we don't need is going to be tough to get back in.

More questions and doubts

One final question we have relates to the $1.6 million income stream cap. Is a TTR income stream arrangement going to form part of this cap even though it isn't receiving the pension exemption? Do we really want to be switching one on pre-retirement knowing that the cap is going to be indexed and we might be inhibiting ourselves from commencing a larger pension later on?

It seems to me that the Government has thrown the baby out with the bathwater in this latest 'reform'. By all means police the system to ensure it is being used as the policymakers intended, but to punish the bulk of trustees who were using TTR to manage the enormous lifestyle change from full-time work to retirement seems overkill.

There are already suggestions that some of the measures won't stand the test of time, irrespective of which party wins the election. With this mind I am just hoping that no politician promises no changes to superannuation during the course of this election campaign. After the 2016 budget, we need some change. Urgently.

Olivia Long is Chief Executive Officer at SuperGuardian. This article is for educational purposes only and does not consider the circumstances of any individual. It is based on an understanding of announcements in the 2016 Budget which may change during the legislation process.

SMSF assets do not need segregating under new rules

Doug McBirnie

The Turnbull Government's first Budget has aimed its sights squarely at the superannuation accounts of wealthier Australians, but SMSFs may be well-placed to take advantage of the proposed changes. Retirees have the ability to plan and manage their tax settings in a single vehicle.

How much income does it provide?

Changes proposed to take effect from 1 July 2017 limit the amount that can be held in the tax-free pension phase to $1.6 million. Analysis of Accurium's database of SMSF trustees preparing for retirement suggests this will impact around a fifth of trustees over 65.

This begs the question of what level of spending in retirement is sustainable for someone with $1.6 million in savings. Around a quarter of SMSF trustees using our services have indicated a desired annual budget in retirement of over $100,000.

Our research shows that superannuation savings of $1.6 million would be sufficient to give a 65-year-old male 55% confidence of spending $100,000 p.a. without outliving his savings. This assumes an asset allocation in line with the average SMSF and average Australian life expectancies. Due to their longer life expectancy, for 65-year-old females, the confidence level drops to 47%. These calculations allow for tax and age pension entitlements.

Many retirees will think a one in two chance of outliving their savings and falling back on the age pension is too great a risk. Retirees looking for greater confidence, say reducing that risk to only a one in 20 chance, would need an annual spending level of only $65,000.

Retirement spending level supported by $1.6 million in savings^

	Annual spending level, indexed with inflation	Probability of lasting for life	Annual spending level, indexed with inflation	Probability of lasting for life
65-year-old male	$100,000	55%	$65,000	95%
65-year-old female	$100,000	47%	$64,000	95%

^ Using methodology in Accurium's SMSF Retirement Insights Volume 3 – Bridging the prosperity gap.

Transfer cap is not a limit on superannuation or saving

On a practical note, the $1.6 million cap on the amount that can be used to commence a pension does not restrict the amount retirees can hold in superannuation. It is just a limit on assets that will preserve a tax-free status. The excess can continue to be held in an accumulation account with earnings taxed at a concessional rate of 15%. For most people this remains an effective and relatively simple tax-efficient structure.

Some commentators have raised concerns about the complexities such as capital gains tax impacts of complying with the cap, particularly for those already in pension phase. However, this is where the flexibility of an SMSF means there is no need to sell or transfer particular assets in order to comply with the new limit. A member of an SMSF can have both accumulation and pension accounts supported by the same unsegregated pool of assets.

SMSF trustees moving into pension phase will need to commence a pension with an amount within the cap, leaving the rest in accumulation. There is no need to identify which of the SMSF's assets are supporting the pension. For those already in pension phase, excess amounts can be rolled back to accumulation without the assets needing to be sold or allocated specifically, provided they are accounted for appropriately. In order to continue to receive tax-fee earnings, the SMSF will need an actuarial certificate providing the split of the SMSF's income between tax-free and taxed at 15%.

This will provide flexibility in terms of withdrawals. Retirees who have balances in excess of the cap may want to keep additional withdrawals from the pension account to a minimum. They can continue to draw on their accumulation assets in the form of lump sums if additional cashflow (above the minimum) is needed.

While the introduction of this cap will potentially limit the tax concessions, a retiree with $2 million in superannuation is likely to pay around $3,000 a year more in tax, although they will still be able to use the franking credits from the whole portfolio.

The added complexity of the proposed changes will make retirement planning more difficult, although SMSF flexibility should continue to make them a popular option. Advisers and accountants will have many opportunities to help their clients, and asset 'location' may become almost as important as asset allocation for many SMSF trustees and advisers alike.

Doug McBirnie and is a Senior Actuary at Accurium. This is general information only and is not intended to be financial product advice. It is based on Accurium's understanding of the 2016-17 Federal Budget Report and current taxation laws. No warranty is given on the information provided and Accurium is not liable for any loss arising from the use of this information.

Zip your wallet against economic forecasts

Roger Montgomery

The rise of macroeconomics, to such an extent that it dominates the national and global narrative, can only be described as stunning. It might be news to many that there is in fact no 'Nobel Prize in Economics' even though a Nobel Prize in Economics is awarded annually.

There is a 'Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel' but it was invented by the Swedish Central Bank almost three quarters of a century after Alfred Nobel's death. According to the New York Times, the prize is "an annoyance to the recipients of the five actual Nobel Prizes, those scholars from excluded scientific disciplines such as astronomy, and a living descendant of the donor, Peter Nobel, who has denounced it as a 'PR coup by economists'."

From leading commercial radio news breaks to the 'vox pop' responses constituents give when asked what is their greatest election issue, macroeconomics cannot be escaped. But that which provides fodder for TV and radio content producers and consumers provides little else.

Macroeconomics is useless, microeconomics is useful

While I believe macroeconomics is just about useless in explaining future returns, microeconomics is vital. Indeed, when explaining the success of Berkshire Hathaway in October 2003, Charles T. Munger noted,

"Year after year, in a kind of grind-ahead fashion, with very few failures, it eventually drew some attention, indicating that Warren and I knew something useful about microeconomics." (Herb Kay Undergraduate Lecture at the University of California).

A doctor, a physicist, a biologist, a chemist, an engineer and an auto mechanic can identify a problem and fix it. And yet despite the self-proclaimed wisdom of the world's best economists and central bankers, we remain mired low or no growth since the Great Recession of 2007-2009.

A senior Coalition Minister recently described to me the business and economic measures that were applied to decide that a restructure was necessary of a department responsible for social services. You won't get any argument from me on that score. However, viewing everything through the lens of economic rationalism might not serve the needs of everyone in the community.

Economics as a dark art rather than a science

Macroeconomics is not a hard science, like mathematics or physics. It is a soft science and its analysis, and application to the pursuit of profits in financial markets, is more a dark art than it is a robust tool that can be relied upon to produce predictable outcomes.

Take the relationship between consumption and interest rates. Monetary policy levers have always been relied upon to crank up or turn down consumption and investment. Anyone who studied Economics 101 was taught that reducing the cost of money increased its demand, which would translate to consumption. By extension, the lower rates go, the more stimulus is provided. Yet today, we are discovering the exact opposite is true. The lower rates go, the more cash savers are required to have stored to fund their future spending. As rates fall, spending declines and savings increases. In Denmark where rates are negative, consumption as a percentage of GDP has declined and saving has increased.

When Charles Munger addressed the economics undergrads in 2003, he described one of the major problems with economics was the 'fatal unconnectedness'. This term is first attributed to an English mathematician and process philosopher, Alfred North Whitehead. He spoke of its proliferation in academic disciplines where each professor didn't know the models of the other disciplines, much less try to synthesize those disciplines with his own.

The New York Times articulated it slightly differently when in February 2015, Orlando Patterson wrote,

"It's not the statistical models used by economists that are the problem, but the rejection of qualitative methods, other fields and viewpoints. The gulf between the economic view of the world and that of the lived experiences of the general population is often vast. For example, in June 2009, the National Bureau of Economic Research declared that the United States was no longer in a recession, in stark contrast with the felt, economic experience of 88 percent of Americans the following year."

Years ago I frequently presented the argument that even if the Angel Gabriel sat on the end of my bed one evening and told me what the GDP number would be in a year's time, there would be little chance you could apply any certainty to the prospect of profiting from that information.

You might also recall this Cuffelinks article by my friend Ashley Owen who explained the zero correlation between annual GDP growth and stock market returns.

Harden your head and heart to economic influences

Given that even when armed with the correct figure in advance of its release, we are unlikely to profit from the information macroeconomics gives us, why are we mesmerised by it?

For many financial advisers and institutions, their clients demand it, and it makes them look wise if not omniscient. What could be more convincing than a bank or broker wheeling out their 'economissed' to demonstrate that the stewards of the client's life savings are across the issues facing the national and global economy as well as their likely impact on those savings?

Of course, I am not the first to point out that economics fails to add value but no amount of argument will convince their supporters otherwise. Faith of course comes from the heart not the head so there is little point in cerebral warfare.

For those of you who aren't convinced, I ask you to commence the longest journey in the world - the one from the head to the heart – and consider managing your portfolio without reference to macroeconomics. Indeed, if someone tells you that you should be doing X or Y because GDP, unemployment or inflation will be A, B or C, zip up your wallet.

Roger Montgomery is the Founder and Chief Investment Officer at The Montgomery Fund, and author of the bestseller 'Value.able'. This article is for general educational purposes and does not consider the specific needs of any individual.

Fear factor should start the hunting season

Peter Thornhill

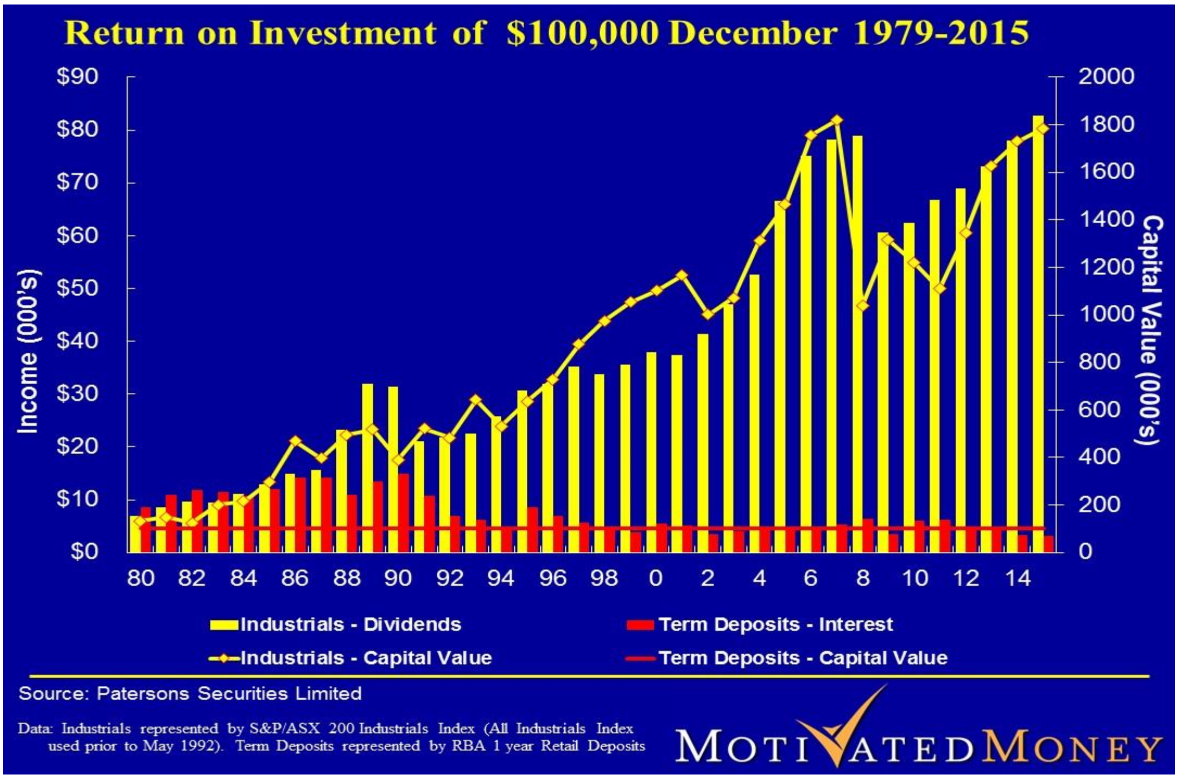
As he sighed wistfully he thought, “It seems like only yesterday, but here’s another GFC so soon. Will it be the same as the last or different?”

I can say, with considerable conviction, that the next one won’t be different. The drivers are the same: moral hazard ramped up by thoughtless governments and fear. Fear is based on ignorance. Knowledge is power.

One would have thought that with the GFC still fresh in people’s minds we would not be reacting in the same way. It never ceases to amaze me that this sort of thing happens again and again yet still we never learn. To paraphrase George Santayana: “If we don’t learn from the past we are doomed to repeat it.”

Stock markets reflect human endeavour

Below is the pattern of stock movements and dividends paid superimposed on a term deposit and the subsequent interest payments over the last 35 years.



The GFC saw a drop of 50% in share prices, similar to the market correction of 1987. Although the GFC looks more substantial, it is only because the same drop of 50% was applied to an index that had grown steadily over the intervening 21 years since 1987.

Throughout all this, $100,000 invested in Australian industrial companies in 1980 now generates an income of about $80,000 a year and has a capital value of about $1.8 million. A term deposit is still worth $100,000 and delivers income of about $3,000 a year.

At the time of the GFC and during the seven years since, I have reminded audiences that we would recover from the GFC as we have from all previous falls throughout history. This would then be followed by another correction as greed, stupidity, speculative activity and misguided government intervention once again drove the prices up.

My rationale is that the stock markets of the world ultimately reflect the profitable endeavours of the human race (the unprofitable endeavours inevitably fail). For markets to collapse totally requires that all human endeavour comes to an end and I find this rather hard to imagine. However, I am surprised at the speed with which we have forgotten or, perhaps, never learned this lesson.

I will admit to one aspect of current conditions that we haven't experienced for some time is low interest rates. It has been roughly 5000 years since we have had rates at the present levels! This is courtesy of misguided governments who, wishing to appear in control, have driven them down in an attempt to improve balance sheets resulting from our appalling financial behaviour. They are incapable of allowing us to suffer the consequences and this has led to the rise in moral hazard over recent decades.

Headlines ignore strength of company balance sheets

Here in Australia company balance sheets are generally in much better shape than they were prior to the GFC and it is clear that fear not fundamentals are driving the present gyrations. If I may quote a few headlines from recent media:

*Market bounces back but **fears** China will drag down the world*

***Fear** indexes surge to highest since GFC as China slide spooks markets*

*The day began with investors **fearing** the worst as the market fell to a fresh two-year low of 4929 in early trade.*

***Fear** driving sideshow but no need to panic here*

*$A drops to six-year low as '**fear** takes over' in global markets*

*Chinese **fears** spark region-wide rout*

And so it goes on, ad nauseam!

Check the preponderance of comments relating to China amongst the above. I guess it makes a change from the 'European crisis' or 'Middle Eastern crisis. Recently, an article in *The Australian* newspaper titled 'Stock shock leaves a trail of victims' caught my eye. The example given was a white collar worker in Beijing who had sold his house in March 2015 to INVEST (my emphasis) in the Chinese equities market.

Predictably, he has seen his 'fortune' eliminated in a few months. He told the journalist that he knew the risks when he joined with friends to invest nearly 2 million yuan in the volatile market but was still angry with the consequences. He is now worried that his decision to invest in equities could have long-lasting consequences. "I am old enough to get married and you know here that girls prefer guys who own their own houses," he said. "I didn't tell my Mum that I sold the house; she would be too mad."

What right did this lunatic have to feel angry I ask myself? I feel angry with the journalist who included the word 'invest' in the article to describe the stupid speculation that this young man indulged in.

The saddest footnote to all this pathetic reporting was an article titled: "Global market rout means surge in fear indexes." With a sharp correction on Wall Street earlier in the week the US 'fear index', otherwise known as the Chicago Board Volatility Index, surged as much as 90% to levels not seen since the height of the GFC. Fear has now become a tradeable commodity.

It's irrelevant for investing

None of it has anything to do with investors or investing. I suggest that the only appropriate action taken by investors should be to top up or add holdings to their portfolio. I am on record, when asked in an interview after the GFC, what was on my wish list for coming weeks, I responded with, "Another GFC please". The interviewer was clearly nonplussed and asked why. My response was, "I would like to buy some more CBA at $26.00 and more Wesfarmers at $13.50!"

As this irrational process of rise and fall continues I ask people to heed the words of that famous Australian philosopher, Chopper Read, and "Toughen up, princess". As the human race appears incapable of recalling the past, consider again the chart above and merely be prepared to take advantage of the 'fear factor', step up to the mark, lock and load and wait 'til you see the whites of their eyes.

Peter Thornhill is a financial commentator, public speaker and Principal of [Motivated Money](). This article is general in nature only and formal financial advice should be sought before acting in any of the areas discussed. Cuffelinks attended the Australian Shareholders Association conference in Sydney this week at which Peter presented some of these views.

The value of wealth management for Australian banks

Hugh Dive

The arguments over the vertical integration of wealth management across advice, administration and asset management continue as a political and economic issue. After poring over bank results recently and seeing how involved the banks are in the business of managing Australia's investments, this article looks at the funds management landscape in Australia, and in particular the dominance by the largest players.

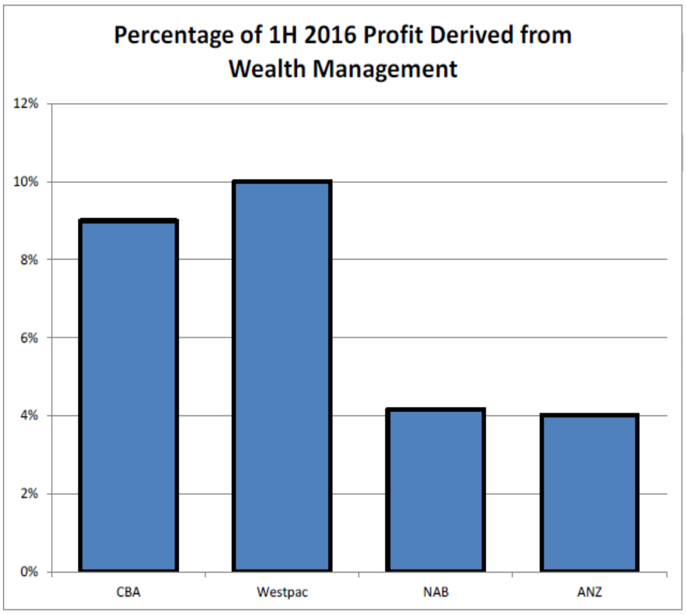
Influence of the major institutions

The wealth management businesses of the major banks (plus AMP) include funds management, life insurance, general insurance, investment administration platforms and financial advice. The businesses are attractive for the banks due to the government mandated growth from rising compulsory superannuation contributions and because wealth management earnings carry a low capital charge. This attraction has increased with the $19 billion of capital raised in 2015 to meet Australian Prudential Regulation Authority's (APRA) tougher stance on capital adequacy.

Changes to capital requirements make funds management earnings more attractive and increase the cost of lending to business and home loans. When a bank makes a standard home loan with a 70% loan to value ratio (LVR), APRA requires that the bank holds approximately $2.25 in capital for every $100 lent. This rises to $5 for every $100 for a loan to a business due to a higher risk weighting. Mathematically, when a bank is required to quarantine more capital to conduct activities, their return on equity (ROE) declines. Faced with higher capital requirements from regulators globally, earnings from wealth management can boost the bank's ROE.

About 10% of bank profits come from wealth management

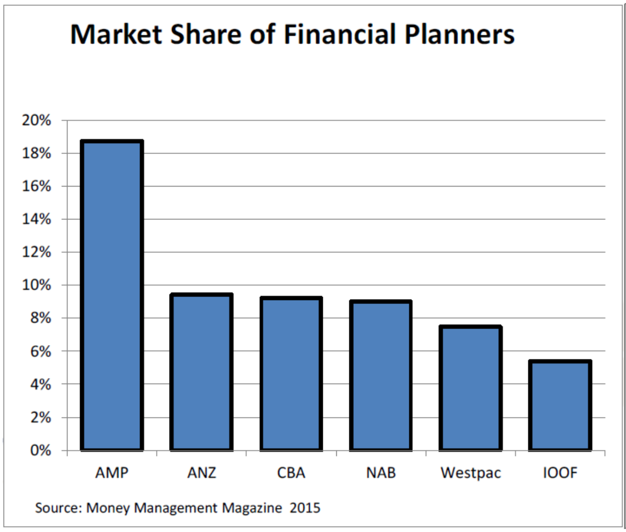
In the 2015 financial year, the four major trading banks in aggregate earned $30 billion, representing an increase of 5% on 2014. In 2015, approximately 10% of bank profits or $2.7 billion were attributable to wealth management, with CBA (Colonial First State) and Westpac (BT) gaining a higher percentage than the Melbourne-based banks. In the Aurora Dividend Income Fund, we have our exposure to wealth management indirectly via positions in the banks, rather than in listed wealth managers such as Perpetual or AMP. This results in buying $1 of wealth management earnings on a price to earnings (PE) of 13 times rather than 16 times!

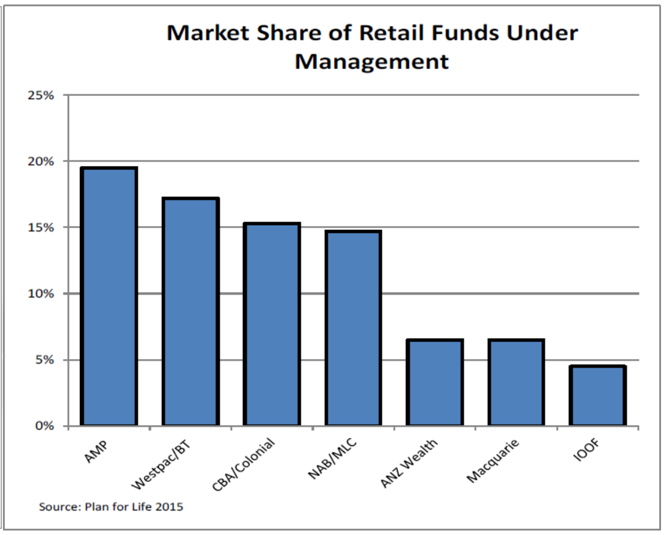


Vertical integration clips the ticket at three stages

Essentially, the wealth management industry comprises a value chain of advice (financial advisers), portfolio administration (platforms) and manufacturing (funds management). The major financial institutions have captured a dominant market share in these three links via acquisitions and technology expenditure. From the below chart on the left, the four major banks plus AMP and IOOF have financial relationships with 60% of the financial planners in Australia. Their market share has been increasing with acquisitions (Count acquired by CBA for example) and heightened compliance requirements in favour of the large institutions over smaller practices.

Investment platforms are the 'middle man' in the process, connecting the fund manager to the adviser and providing administration services and tax reporting for a client's portfolio of managed funds, shares and cash. Platforms generally charge around 0.3-0.6% of funds under management annually. Whilst this may not sound glamorous, it has been a lucrative path to capturing over 85% of this market.





Finally, the major financial institutions have also been successful in actually managing the money. The above chart on the right demonstrates the dominance that the large institutions enjoy in 'manufacturing' the investment products or funds for sale to retail investors. Currently the major banks plus AMP manage almost 80% of the retail funds under management.

Negatives for the banks

Whilst this sounds like a solid way to supplement bank profits in an environment of relatively anaemic credit growth and rising bad debts, the ownership of wealth management businesses by the banks do pose some risks.

Aside from the volatility in investment returns, wealth management businesses have the potential to deliver adverse headlines. Over the last year, both CBA and Macquarie Bank have received 'enforceable undertakings' from ASIC and face political enquiries related to allegedly fraudulent behavior and bad financial advice from the banks financial planners.

Indeed, in 2015 CBA spent $522 million in advertising building its banking brands. A portion of the goodwill generated is no doubt dissipated by headlines detailing ASIC probes into the bank's financial planning or insurance divisions. The banks are clearly concerned that negative activities occurring in wealth management do not spill over to damage their core banking brands that generate the bulk of their profits.

Our view as an investor and a boutique manager

The major financial players have not built these vertically integrated wealth platforms (advice, investment accounting and funds management) to see large amounts of value being 'leaked'' to service providers outside the network. This naturally creates strong incentives to recommend the house products over independent providers, or favour house products over external products with similar or even slightly superior characteristics.

As an investor in the major banks, we would prefer that they keep as much of the value in-house to boost payments to shareholders. However, as the fund manager of an independent boutique investment firm, I have a strong personal incentive to see funds being leaked out of the control of the major players.

Hugh Dive is Senior Portfolio Manager at Aurora Funds Management. This article is general information and does not address the personal circumstances of any individual.

Rules can change, but the final score still matters most

Tony Hansen

Amid the furore over the potential changes to superannuation rules announced in the Budget, investors should not turn away from the continuing taxation benefits. Super is still the best place to save for retirement for the majority of people.

I am reminded of events during the GFC. It was as if some investors had a view on how the game SHOULD be played, rather than how it WILL be played. There is no point sulking over the rights and wrongs of retrospectivity, but rather, focus on the remaining advantages.

As the GFC was unfolding, some bearish friends seemed certain the whole financial system would collapse and probably never fully recover, especially after the fall of Lehman Brothers. The problem in their case was that more than anything, they *wanted* the system to collapse because it *deserved* to collapse.

Their only question was timing. Inevitably, I'd pipe up, "But don't you think governments might take some action to prevent the complete destruction of the global economy?", to which the reply was usually, "Investors should have known the risks and they will have to pay the costs."

(My preference was that the destructive impact of the GFC should have been more widespread. The buying opportunities would have been even better and the lessons imparted would have been better learned. It would have been a lot longer before they were repeated.)

However, the job of an investor is to discount probabilities. The likelihood that the governments of the major economies of the world standing idly by seemed fanciful, so I steadily deployed capital into the ongoing destruction of the markets. I finally ran out of available funds in February 2009, which was only a month before the market eventually bottomed.

Understanding the rules

It is critical to operate within the rules of the system to achieve the best results, even if you don't agree with the rules. For example, you may think that negative gearing is a foolish system that causes more harm than good and distorts the market. But while the system exists, if you intend to own investment property, you need to understand the system and structure your financial affairs to create the greatest long-term benefit. As Kerry Packer famously said, "Of course I am minimising my tax - if anybody in this country doesn't minimise their tax they want their heads read". If the rules on negative gearing change and the benefits disappear, then you must find the most advantageous setup available under the new regime.

Another under-exploited opportunity is when couples find themselves in different tax brackets. Investment earnings should be in the lower-earning spouse's name, and opportunities such as superannuation spouse contributions' should be thoroughly investigated.

Superannuation remains a place where people can exploit the rules of the game, provided there is a willingness to lock precious capital away and notwithstanding the ever-changing rules of the system.

Consider the taxpayer in the 37% tax bracket who expects to be in that bracket for the rest of their working life and then retire in 20 years' time. The table below shows the different path of $10,000 saved inside and outside of superannuation. For simplicity, the investor will make 10% per annum, equal parts earnings and capital growth with the after-tax earnings reinvested.

The capital saved out of ordinary income begins life as $6,300 (after paying 37% tax on $10,000 income). The capital contributed pre-tax to superannuation begins its life as $8,500 (after paying the 15% contributions tax). The immediate disadvantage of ordinary savings leaves the saver with only 74.1 cents ($6300/$8,500) for every superannuation dollar.

The pernicious effect of the higher tax rate widens the advantage by roughly 0.7c per dollar every year, culminating in the amount saved out of ordinary earnings being worth only 60.5% of the same amount saved behind the shield of superannuation. That is, in this 20-year example with the same earnings rate, the investor has $30,191 outside super while they have $49,871 inside super, making the non-super investment only 60% of the super balance.

SAVING OUTSIDE SUPERANNUATION					SAVING INSIDE SUPERANNUATION				
	37% Tax Rate	Earnings	After -Tax	Capital Gain	Super annuation	Earnings	After-Tax	Capital Gain	Ratio
Year0	**$6,300**	$315	$198	$315	**$8,500**	$425	$361	$425	74.1%
Year1	$6,813	$341	$215	$341	$9,286	$464	$395	$464	73.4%
Year2	$7,369	$368	$232	$368	$10,145	$507	$431	$507	72.6%
Year3	$7,969	$398	$251	$398	$11,084	$554	$471	$554	71.9%
Year4	$8,619	$431	$271	$431	$12,109	$605	$515	$605	71.2%
Year5	$9,321	$466	$294	$466	$13,229	$661	$562	$661	70.5%
Year6	$10,081	$504	$318	$504	$14,453	$723	$614	$723	69.8%
Year7	$10,903	$545	$343	$545	$15,790	$789	$671	$789	69.0%
Year8	$11,791	$590	$371	$590	$17,250	$863	$733	$863	68.4%
Year9	$12,752	$638	$402	$638	$18,846	$942	$801	$942	67.7%
Year10	$13,791	$690	$434	$690	$20,589	$1,029	$875	$1,029	67.0%
Year11	$14,915	$746	$470	$746	$22,493	$1,125	$956	$1,125	66.3%
Year12	$16,131	$807	$508	$807	$24,574	$1,229	$1,044	$1,229	65.6%
Year13	$17,446	$872	$550	$872	$26,847	$1,342	$1,141	$1,342	65.0%
Year14	$18,867	$943	$594	$943	$29,330	$1,467	$1,247	$1,467	64.3%
Year15	$20,405	$1,020	$643	$1,020	$32,044	$1,602	$1,362	$1,602	63.7%
Year16	$22,068	$1,103	$695	$1,103	$35,008	$1,750	$1,488	$1,750	63.0%
Year17	$23,867	$1,193	$752	$1,193	$38,246	$1,912	$1,625	$1,912	62.4%
Year18	$25,812	$1,291	$813	$1,291	$41,784	$2,089	$1,776	$2,089	61.8%
Year19	$27,915	$1,396	$879	$1,396	$45,648	$2,282	$1,940	$2,282	61.2%
Year20	**$30,191**	$1,510	$951	$1,510	**$49,871**	$2,494	$2,120	$2,494	60.5%

The Government still wants people to fund their own retirement

If you are nervous about potential changes to the superannuation system, remember that the Government wants you to fund your own retirement. They may poke around to extract additional tax revenues from the enormous superannuation savings pool, but it remains the place where the average saver is likely to generate the best return on an after-tax basis.

Know the rules of the game and exploit them to your greatest advantage.

Tony Hansen is Chief Investment Officer at Eternal Growth Partners. This article is for general educational purposes and does not address the investment needs of any individual.