Kennedy Partners: Have you considered a Protected Equity Loan?

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What is a Protected Equity Loan?

- A protected equity loan enables you to make a geared investment into shares without being liable for any shortfall between the amount borrowed and the value of the shares you have bought.
- In a falling market you don't lose your capital, yet you retain the benefits of any increase in the value of the shares and any dividends received during the term of the loan.
- This is achievable because the loan is protected by put options which provide insurance against falling share prices.

Why we believe it is the right time to consider a Protected Equity Loan:

- The continued lowering of interest rate expectations has two benefits for the strategy:
  - Increases the investment case and attractiveness on large cap high yielding Australian shares.
  - Reduces the cost of the loan

- The re-election of the LNP Coalition has removed the tax/regulatory uncertainty.

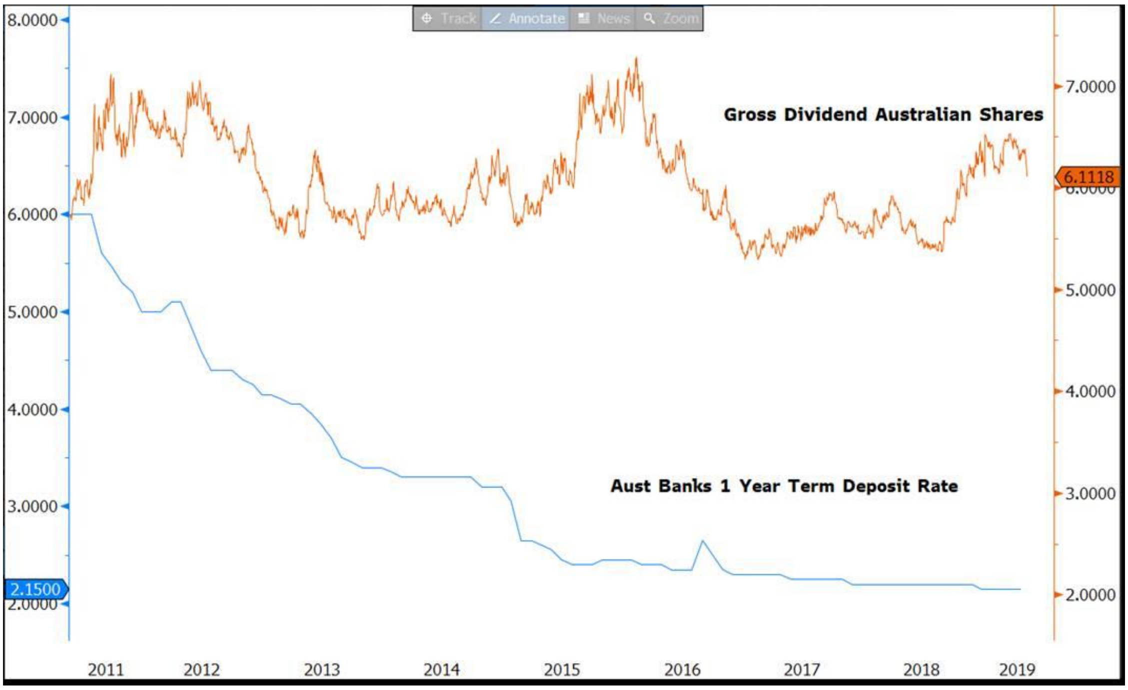
The Investment Case

The grossed-up dividend yield (including franking credits) of the ASX 200 Index is currently 6.33% and has averaged around 6% for the last 8 years. This large equity yield premium over cash rates is no short-term aberration as you can from Figure 1. Given the RBA minutes released on Wednesday cash rates are expected to go even lower.

"Governor Lowe went on to repeat the message from the minutes that the RBA's forecasts already built in two 25 bp rate cuts, without which "the forecast for unemployment would have been higher". All this supports the view that the RBA will cut the cash rate by 25bp to 1.25% in June, and to expect a follow-up cut to 1% in August, with the exact timing depending on the flow of data."

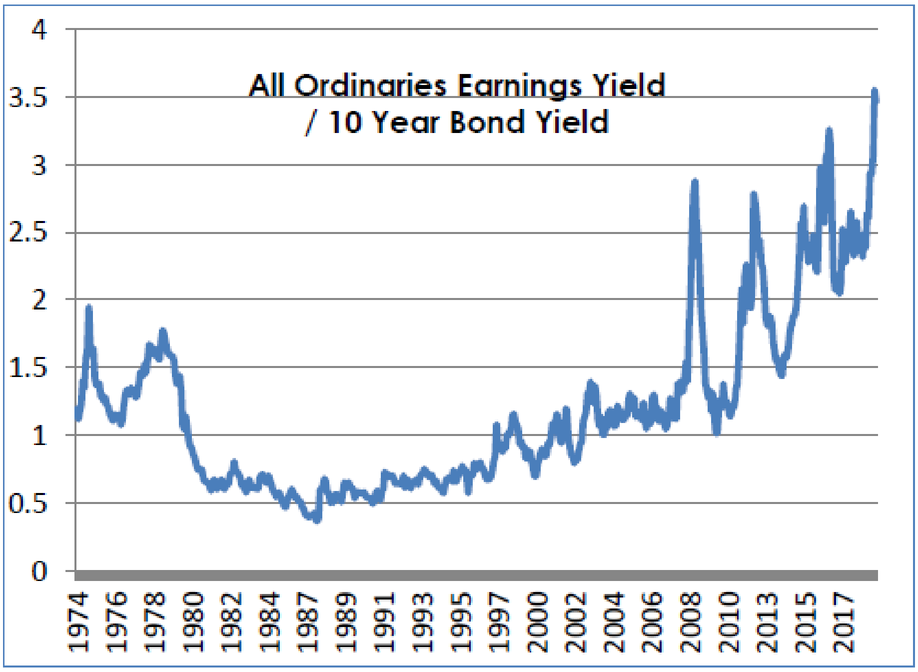
As an investor searching for earnings and yield the Australian Equity market is looking an increasingly attractive asset class. Valuations in general are in the fair range, but in a world with low interest rates for longer we could easily see a rally in equities as investors search for yield. (i.e. shares will rally until the dividends yields fall to a level the reflects the perceived risk premia over bonds).

Figure 1: Australia Equity Yields Stable in Face of Falling Deposit Rates



Source: Kennedy Partners, Bloomberg

Figure 2: All Ordinaries Yield vs. Bond Yield is highest in 50 years



Source: FactSet, UBS estimate, IRESS

Tax Clarity with the Re-Election the LNP Coalition

With the Morrison LNP Coalition returned to power on the weekend, it removes two key uncertainties

Franking credit refunds: The backlash against the Labor Party's proposed restrictions on franking credit refunds means this feature of the tax system will remain an important investment opportunity for income-seeking investors. The preservation of these tax advantages naturally favours investments that offer high levels of franking credits, such as high-yielding Australian shares.

Capital Gains Tax Concessions. Labor proposed to halve the capital gains discount from 50% to 25% for assets purchased after 1 January 2020 (and held for longer than 12 months). With this proposal eliminated, another important source of risk is removed for long-term investors seeking to benefit from solid capital returns over time.

Protected Equity Loans – Benefit

• Achieve a high level of gearing with limited downside risk

• Receive all dividends and franking credits

• No risk of margin calls or any further payments after the initial interest payment

• Get exposure to $1m worth of shares for as little as $164,000 or $51,000 after- tax*

• Interest only

• No margin calls

• SMSF friendly

*For an investor on a 47% marginal tax rate. You will need to obtain you own tax advice in relation to your individual circumstances

Your Kennedy Partners advisers have more than 50 years combined experience in assisting wealthy individuals and their families to manage and protect their wealth. Please contact your adviser if you would like to learn more:

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