

Right Prediction...Wrong line...Shorter Timeframe

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'It's tough to make predictions, especially about the future.' – Yogi Berra

When you're in the predicting business, you really do appreciate the irony in that quote.

However, there are times when some predictions are far easier to make than others.

A little over 12 months ago, I wrote:

'In my home state of Queensland, the government — with a serious spending problem — is planning to raid the Government Employees' Superannuation Fund.'

'For the uninitiated, a Defined Benefit Fund pays its members a guaranteed multiple (based on years of service) of their final average salary.'

'The government must guarantee the \$1 million is there to pay them. That example is simple enough. Now add into the mix thousands of employees.'

'Enter the actuaries...the number crunchers. They put all the variables into their models — including a guesstimate on future earnings.'

'The Queensland government has identified an apparent surplus of \$11 billion in the Government Employees fund...which, under current assumptions, is expected to last for 10 years.'

'Well, the answer to that depends on whether the actuaries dial the future performance numbers up or down.'

'If the actuaries plug an earning rate of 7% per annum into their forecasting model, then there's \$11 billion ripe for picking.'

'However, if you adopt a more conservative 3% per annum return (which is probably more in line with the low growth, low return environment we're in), the surplus disappears.'

'Call me silly, but I'm thinking our Treasurer, Curtis (Money) Pitt will opt to go with the 7% rate, netting him a big fat cheque for \$11 billion.'

'Guess what's going to happen in a few years' time?'

'OK, you guessed it.'

'The Courier Mail (the local rag in Brisbane) line is going to be 'Government Define Benefit fund in the red'. Queenslanders will be in for a shock.'

'No crystal ball needed for making this prediction. It is a sad repeat of what politicians all around the world are doing.'

'They are perennial over-promisers, under deliverers, and raiders of any money box, drawer or pantry to compensate for their poor planning.'

'It saddens me that, as a society, we do not possess foresight that extends beyond the next offering of political silver pieces.'

'While I lament a lack of leadership in the political realm, it's also a sad reflection on our community. We have allowed ourselves to be misled.'

Front-page article in *The Australian* on 18 July 2017:

'Raided Queensland public service super fund risks deficit'

Right prediction: But it was an easy one to make...the words 'inept' and 'treasurer' go together like 'horse' and 'carriage'.

Wrong line: *The Courier Mail* didn't break the story.

Shorter timeframe: I thought it'd take a few years, not 12 months, for the risk to be identified.

This is an extract from that article:

'The Queensland public service superannuation scheme that was stripped of \$4 billion last year by the Palaszczuk government

'At the time, Mr Pitt argued the scheme was heavily in surplus.

'The scheme has an "actuarial surplus" of \$6.17bn in excess funds as at June 30, 2016 if all costs and member's benefits were

'The "actuarial surplus" is based on a projected 5 per cent annual return on the scheme's investment into the future.

'But on the more stringent Australian "accounting basis" — using a projected 1.9 per cent return on investment — the scheme w

Was the fund in surplus or not? Well, that depends on what future rate of return you use.

The more optimistic the rate, the better the projected outcome. But is that forecast rate correct? When you're a treasurer in need of

In principle, think of the problem confronting defined benefit funds as that facing a pending retiree with \$1 million. The prospective re

One planner projects a return of 7% per annum (delivering \$70,000) and declares there's a 'surplus' of retirement income.

Another planner projects 2% per annum (returning \$20,000). You require a capital base of \$2.5 million at 2% to achieve a return of \$

The reality is that no one knows what future returns are likely to be. But common sense dictates it's better to err on the side of caution

But the shortfall confronting Queensland taxpayers is not unique.

Defined benefit funds the world over are in trouble.

Bloomberg published this article on 21 June 2017:



Source: Bloomberg

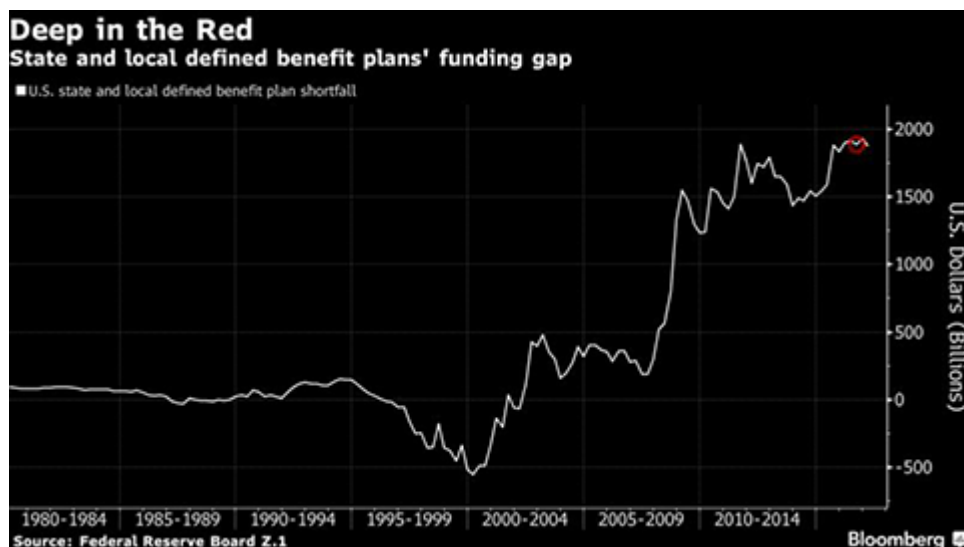
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Even if the bean counters use an overly-optimistic outlook for returns, they still cannot turn a chronic deficit into a surplus. From Blo

'A "best case" scenario of a cumulative 25% investment return during the 2017-2019 period will not offer a respite for chronically

How bad is the shortfall in US state and local government pension plans?

US\$2 trillion.



Source: Bloomberg

[\[Click to enlarge\]](#)

Take a close look at this chart, and you'll see it tells a tale. Prior to 1995, the funds were neither in surplus nor deficit. There was surplu

After 1995, the funds actually went into surplus...peaking at US\$500 billion in 1999.

How was this achieved? Competitive pressures meant the funds — to keep up with the Joneses — gradually increased their weighti

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In the early 2000s (when the tech bubble burst), there was a US\$1 trillion turnaround in fortunes — a US\$500 billion surplus transfo

The high returns achieved in the boom of 2003 to 2007 held the situation steady. But they did not make any substantive inroads into

The 2008/09 crisis then sent the deficit soaring...another US\$1 trillion gap opened up.

Even the Dow's record-breaking performance over the past eight years has not changed the trend.

What happens when the next crisis hits? (And it will...with a vengeance.)

In Europe, Deutsche Welle ran this line on 1 July 2017:

Severe deficiencies: The German pension system does not work

German Economic News , Michael Bernegger Released: 01.07.17 22:46 Clock

The German pensions system is not viable due to considerable structural deficiencies.

[\[Click to enlarge\]](#)

To quote the article (emphasis mine):

*'The core problem of the German economy and society is miserable demography. A positive development, namely the increasing **sustainably financed, because the ratio of contributors and receivers will drastically deteriorate.***

American economist Herb Stein famously said that *'If something cannot go on forever, it will stop.'*

The next crisis — delivering massive losses to portfolios weighted heavily in shares — is likely to be the tipping point of this pension

Something must give.

Benefits must be reduced **OR** taxpayers must be asked to pay more to fund the deficits **OR** a combination of both.

That's NOT a prediction; it's a statement of mathematical fact.

Whatever the solution to this problem is, the outcome will be deflationary.

Members receiving lower benefits will have less spending power. Taxpayers with less after-tax income will have less spending power.

In pushing interest rates so low to stimulate growth (via more debt accumulation), the central bankers have starved pension funds of

There are no free lunches. At some point the markets are going to remind investors of the price to be paid for chasing higher returns.

With pension funds highly exposed to market forces, what we have is a disaster of biblical proportions lying in wait.

On a global basis, hundreds of millions of lives are going to be impacted by the cumulative decisions of inept central bankers and tre

The cruel twist is that the pension plans of these incompetents running the show are not under threat.

Regards,

Vern Gowdie,
Editor, *Markets %26 Money*

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Vern Gowdie Editor at Markets & Money

Vern Gowdie has been involved in **financial planning** since 1986.

In 1999, *Personal Investor* magazine ranked Vern as one of Australia's Top 50 financial planners.

His previous firm, Gowdie Financial Planning was recognized in 2004, 2005, 2006 & 2007, by *Independent Financial Adviser (IFA)*

He has been writing his 'Big Picture' column for regional newspapers since 2005 and has been a commentator on financial matters

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Vern is is Founder and Chairman of the [Gowdie Family Wealth](#) advisory service, a monthly newsletter with a clear aim: to help you

To have Vern's enlightening market critique and commentary delivered straight to your inbox, [take out a free subion to Markets and](#)

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