INFORMED INVESTOR

August 2021

threePILLARS wealth management

CONTENTS

ECONOMIC UPDATE

INTRODUCTION

The Covid situation took a turn for the worse, as spiralling infections saw new lockdowns introduced in Australia.

The government has suggested all restrictions can be lifted once 70% of the adult population has been fully vaccinated. Until then, the outlook for economic activity levels has deteriorated.

Despite these unwelcome developments, Australian shares started the FY22 year with solid gains. Bond yields fell sharply, resulting in favourable returns from fixed income markets too.

It was a similar story offshore, with gains in both equity and fixed income markets supporting pleasing returns for most investors.

Continued over...

FURTHER INFORMATION

Julian Payne
Three Pillars Wealth Management

P: 02 4969 8402

E: julian@threepillarswealth.com.au

W: www.threepillarswealth.com.au

Capstone FINANCIAL PLANNING

ECONOMIC UPDATE
CONTINUED

AUSTRALIA

Printing at 0.5% for the June quarter and 1.6% on a rolling 12-month basis, core inflation in Australia was in line with consensus expectations. Unlike in some other countries, there was limited evidence of pricing pressures due to supply bottlenecks, leaving the inflation level well below the Reserve Bank of Australia's target range.

With that in mind, the latest data are unlikely to have changed policymakers' thinking regarding interest rate settings. Investors continue to suggest that official borrowing costs are unlikely to be raised until 2024. Officials have reiterated that inflation will need to rise above 2% on a sustainable basis before policy settings are tightened.

Australian unemployment fell to 4.9% in June, the lowest level in exactly 10 years – the last time the jobless rate was below 5% was in June 2011. Unfortunately, with new lockdowns in place across much of the country, the unemployment rate seems likely to rise again over the next few months.

NEW ZEALAND

The Reserve Bank of New Zealand surprised the market by halting its bond purchase program. Like similar 'quantitative easing' efforts in other countries, the program was designed to lower borrowing costs for households and businesses by injecting additional liquidity into financial markets.

Officials have determined that economic conditions have improved sufficiently and that additional bond purchases are not required. The end of the program came around a year earlier than expected and had not been telegraphed in previous communications. In turn, investors speculated whether the Reserve Bank might consider raising interest rates.

The decision will depend on the tone of economic data in the months ahead, but a rate hike before the end of 2021 now appears plausible.

Inflation quickened to an annual rate of 3.3% in the June quarter and house prices are more than 22% above 2020 levels. These pricing pressures could be a concern for policymakers.

US

US GDP grew at an annualised rate of 6.5% in the June quarter, which was substantially below consensus expectations. The shortfall appeared to be primarily attributable to lower government spending.

Consumer spending – a more important indicator for policymakers – was stronger than anticipated. Indeed, economic growth appears to remain on track to meet the Federal Reserve's 7% target for the full calendar year.

There was an ongoing focus on inflation. Consumer prices rose 5.4% in the year to 30 June; an acceleration from the May level and well above the official target. Nonetheless, officials continue to suggest the uptick will prove temporary, and that there is no need for policy settings to be tightened at this point.

The latest data showed that 850,000 new jobs were created in America in June; well above consensus expectations. The numbers for May were also revised higher.

Around half of US-listed firms released their earnings for the three months ending 30 June and the results were generally encouraging. Consensus forecasts suggest earnings per share among S&P 500 companies could increase by as much as 27% in the next 12 months as the economic recovery gathers pace. This is helping support sentiment towards US and global share markets.

EUROPE

The Eurozone economy grew at an annualised rate of 2.0% in the June quarter, which was above consensus forecasts. The beat was driven by stronger private and government spending. Industrial production has also rebounded strongly from 2020 lows. Germany – Europe's largest economy – suffered from some devastating floods in July. The economic impact is not expected to be too significant, perhaps 0.2%-0.3% of GDP, as the floods were mainly concentrated in areas with limited industrial density.

The UK removed all remaining social distancing restrictions during the month, on 'Freedom Day'. With more than 90% of the population vaccinated, the hospitalisation rate is more than 3x lower and the mortality rate is more than 10x lower than in the previous wave of Covid infections. This suggests vaccines significantly weaken the link between cases, hospitalisations and deaths, and offers an encouraging roadmap for countries like Australia where vaccination rates are currently much lower.

ASIA

At an annualised pace of 7.9%, GDP growth in China was slightly weaker than expected in the June quarter. The outlook for the second half of the year appears mixed, which prompted officials to reduce the amount of cash that banks must hold in reserves. Essentially this frees up more than A$200 billion of liquidity that can be lent, theoretically boosting lending and supporting economic activity levels.

The Olympics got underway as planned in Japan, but the Games are not expected to move the dial economically. Inflation is running at just 0.2% in Japan, reflecting subdued activity levels.

AUSTRALIAN DOLLAR

The deteriorating outlook for growth in Australia weighed in the AUD. The 'Aussie' depreciated by 2.1% against the US dollar, falling to 73.4 US cents, and by 3.3% against a trade-weighted basket of international currencies.

AUSTRALIAN EQUITIES

Australian equities were little changed in the first half of July as rising coronavirus cases and the return of lockdowns weighed on the market. However, improving earnings expectations following the release of generally positive financial results from US firms saw the S&P/ASX 100 Accumulation Index rally in the final week, to close July 1.2% higher – the 10th consecutive month of gains. Stronger iron ore and gold prices helped push the Materials sector 7.1% higher.

The iron ore market has continued to benefit from rising demand for steel across several industrial sectors, particularly construction.

LISTED PROPERTY

Global property securities enjoyed solid gains in July, with the FTSE EPRA/NAREIT Developed Index rising 6.1% in AUD terms.

The best performing regions included Sweden (+12.3%), Spain (+8.3%) and the UK (+7.8%). Underperformers included Hong Kong (-2.6%), Japan (-0.9%) and Australia (+0.3%).

Global real estate markets remained affected by the evolving status of Covid-19. Concerns resurfaced in the UK and US over the newer Delta strain, and more lockdowns were implemented throughout Asia. Markets seem to be looking through short-term volatility, however, towards a longer-term recovery. Locally, the A-REIT market returned 0.3%.

GLOBAL EQUITIES

The performance of major share markets was mixed.

In the US, the bellwether S&P 500 Index added a further 2.4%, rising to fresh all-time highs. The ongoing rollout of vaccines continues to support sentiment – more than 60% of American adults are now fully vaccinated, enabling restrictions to be lifted and paving the way for an improvement in company profitability.

Further progress with vaccine rollouts supported risk appetite in Europe too, and helped most major share markets in the region make positive progress.

The French, Swiss and Italian stock markets rose 1.6%, 1.5% and 1.0%, respectively. UK shares were little changed, despite the removal of all remaining virus-related restrictions in mid-July. Asian markets bucked the positive trend, performing very poorly. Hong Kong's Hang Seng dropped 9.9%, for example, while China's CSI 300 fell 7.9%.

GLOBAL AND AUSTRALIAN FIXED INCOME

Government bond yields continued to fall, as central banks in the US and Europe hosed down suggestions that quantitative easing programs could be scaled back in the months ahead. The likely timing of interest rate hikes is also being pushed back again, suggesting recent increases in yields may have been a little premature.

Ten-year yields closed the month of July 25 bps lower in the US and Germany, and 15 bps lower in the UK. The downward move was even more substantial domestically, with yields on 10-year Australian Commonwealth Government Bonds declining 35 bps over the month.

GLOBAL CREDIT

Credit spreads – the additional yields on offer from corporate bonds over and above comparable government securities, to compensate investors for higher default risk – edged higher in July. The moves were not too significant among investment grade issues, but spreads on speculative grade issues widened slightly more as investors moderated their appetite for risk.

Source: Colonial First State

INCREASING YOUR AGE PENSION ENTITLEMENTS BY RENOVATING THE FAMILY HOME

One of the quirks of Australian society, including its taxation system, is that it puts home ownership at the centre of physical, emotional and financial well-being.

There's an aura about owning your own home. It's why we talk about it at BBQs, go to open-houses when we have no intention of buying, and are amazed at how expensive property is.

The government's tax and superannuation rules may contribute to this aura. In the case of the Age Pension means tests, the family home or principal place of residence is not an assessable asset. When it comes to applying for the Age Pension, you can have a $20 million mansion, and assuming you have no other assets, or limited assets, you can still get the Age Pension.

These same rules can come in very handy if you want to access the Age Pension but can't because of the value of your assessable assets. Any money spent on repairs or renovation of a home contributes to its value. The money spent (hopefully) increases the value of your home and becomes exempt from the assets test. That investment in your house, which improves its comfort, safety and efficiency, could also help you access Age Pension entitlements by reducing your assessable assets.

Take the example of installing a solar energy system in a home. It's sustainable, helping the environment. It could also reduce your power bill throughout retirement.

If you keep going and modernise the bathroom, energy saving water devices could be installed, improving not just the comfort and value of the home, but also reducing ongoing energy bills.

Like all things in the world, there is a trade-off. The money you spend on the house improving its comfort and value isn't available to fund other aspects of retirement. So, it's always best to speak to your financial adviser before making any financial decisions.

CASE STUDY

Kevin and Helen love their home which they bought, back in the 1970s, for $34,000 and is now worth about $950,000. They have $600,000 in super, $30,000 in personal assets and $50,000 in the bank. Their assessable assets total $680,000.

While Kevin and Helen have maintained their home immaculately, it's getting tired. The kitchen and bathrooms are original and need a makeover to take them well into their retirement years.

They were planning on doing renovations in a few years, but after speaking with their financial adviser they decide to bring forward the cost to enjoy their renovations sooner and get some more Age Pension today.

The building work (including solar panels and water saving devices) cost them $72,000, leaving them with about $608,000 in assessable assets.

This reduction in assets boosted their combined Age Pension by an extra $5,616 in the first year, increased the value of their home and reduced their yearly electricity and water bills.

Source: Challenger

Note: Case study for illustrative purposes only. Age Pension entitlement increases are based on Social Security rates and thresholds effective 20 March 2021. Age Pension benefits described above will not apply to all individuals. Age Pension outcomes depend on an individual (or couple's) personal circumstances and may change over time.

HOW MUCH DO I NEED IN MY EMERGENCY FUND?

How much you need may surprise you

In these uncertain times, it pays to have money set aside to give you peace of mind that if your income drops, you still have ample funds to pay for your everyday expenses until you get back on your feet again.

A good rule of thumb is to have enough money for three months of expenses in your emergency account. The amount you set aside, however, will depend on your circumstances.

The Henderson Poverty Line, the amount of money you need to get by each week, including how much you need to keep a roof over your head, is a good place to start to figure out how much you need to cover the basics in the event of an emergency.

This is a benchmark that was first developed in 1973, which is now widely considered to be the benchmark for the disposable income Australians need to support themselves. Its figures show:

- Single people need $542.92 a week
- Couples need $726.27 a week
- A family of four needs $1019.70 a week

These figures are a guide only, and your expenses are likely to be higher, so it's worth looking at your actual expenses to figure out how much to set aside. You can do this by:

- Figuring out the amount of money you have spent by reviewing your transactions in online banking across a three-month period.
- Dividing up costs into buckets like food, rent or mortgage payments, other loan repayments, transport and car costs, health and insurance premiums and energy and phone bills.

Once you know how much you've spent on these basic expenses you can work out how much you need to save in your emergency fund. It's a good idea to add a contingency amount over and above this amount in case other expenses arise.

SAFE KEEPING

Now you've figured out how much to save in your emergency fund, it's time to decide where to store these funds. Here are some options:

- Mortgage offset account or redraw facility: storing your emergency funds in an account linked to your mortgage helps reduce the interest you pay and the time it will take to pay off your mortgage.
- High interest savings account: this is an option if you rent and can help to add to your emergency funds over time as you will earn interest on the money. Look for an account that pays extra interest if you don't make withdrawals.

WHEN TO ACCESS YOUR MONEY

Once you've saved up your emergency money, it's useful to put in place some guidelines about when to spend it.

This is important as everyone has different ideas about what constitutes an emergency, depending on their views, as well as their level of wealth. Here are some ideas:

- If you lose your job and need funds to pay for your mortgage or rent.
- If you suffer a health emergency or need urgent dental work and need money to pay for treatment.
- If your car needs urgent repairs that are not covered by car insurance.
- If a family member falls ill or suffers an accident and you need to take time off work to look after them.

If you decide to dip into your emergency savings for one of these or another reason, the idea is to spend the money on daily living expenses like food and bills. Emergency money isn't usually for play money or for entertainment purposes. You can always set aside another pot of money for this purpose.

Emergency funds are a great way to give you a sense of financial confidence and the sense you will be able to meet your obligations through life's ups and downs.

Source: BT

DOWNSIZING YOUR HOME?

Understanding the downsizer contribution

Downsizing the family home is often part of the longer-term financial plans for many older Australians.

But did you know that you could consider investing the proceeds of the sale of your family home to your super – depending on your age and circumstances – as a downsizer contribution?

WHAT IS A DOWNSIZER CONTRIBUTION?

If you're aged 65 years or older, you may be eligible to make a downsizer contribution of up to $300,000 to a complying super fund from the proceeds of the sale of your primary residence, which is owned for 10 years or more.

A downsizer contribution doesn't count towards any of the contribution caps – and can still be made even if a person has total super savings greater than $1.7 million, or if they do not meet the work test requirements. It is a once-off option and doesn't apply to the sale of any residences in the future.

Your spouse, provided they are also aged 65 years or older, can also make downsizer contributions to their own super, of up to $300,000 from the same proceeds, even if they are not an owner of the property.

To do this, the sale price is key, as your couple contributions cannot be more than the total sale price of the property.

THE BENEFITS OF THE DOWNSIZER CONTRIBUTION

No work test requirements

There is no requirement to meet a work test or work test exemption for this contribution, which makes it ideal for those aged between 67 and 74.

It is even more appealing if you are aged 75 or over, as outside of this opportunity, you can no longer make voluntary contributions.

Contribution caps don't apply

It doesn't matter how much you already have in your super – the total super savings test (must be $1.7 million or less to make after-tax contributions) doesn't apply for downsizer contributions.

May be more tax-efficient

The downsizer contribution is an after-tax contribution, so no tax is paid on the way in. And because you are over 65, it is returned tax free when you withdraw the funds in the future.

You don't have to buy a new home

The money you make from the sale doesn't have to be used to purchase a new home, and there is no need to move to something smaller or cheaper. If it involves the sale of a previous principal residence (that is now an investment property), there is actually no need to move at all.

WHO IS ELIGIBLE?

In addition to the age 65 threshold, there are a number of other important criteria to be met.

You must sell a property that is located in Australia, and you must have owned the property for at least 10 years.

When you sell that property, you need to be eligible for some form of exemption from capital gains tax (CGT) on the sale of the property under the "main residence" provision. Basically, this means the property needs to be your principal place of residence for at least some time during its ownership.

If you purchased the property before 20 September 1985 (so that CGT doesn't even apply), you still need it to have been your principal place of residence at some stage during ownership.

Keep in mind, it also doesn't matter if the exemption from CGT is a full or partial exemption, which means the property could have been an investment at some stage during your ownership of it.

WHAT A DOWNSIZER CONTRIBUTION COULD LOOK LIKE

Here are some hypothetical examples of how downsizer contributions could work in different situations.

Example 1:

Martin and Sharon are both aged in their 70s, own their home jointly and have lived in it for 25 years.

They sell their home on 1 August 2021 for $550,000 and the settlement date is 13 September 2021. They are exempt from capital gains tax (due to the home having been their primary residence).

Under the downsizer contribution measure, within 90 days, Sharon makes a downsizer contribution to her superannuation of $300,000 while Martin contributes $250,000 to his superannuation.

Though the cap on downsizer contributions is $300,000, Martin only contributed $250,000 because the combined contributions cannot exceed the sale proceeds of their home. They could have also split the contributions evenly, contributing $275,000 each.

Example 2:

Roger is aged 66, Mel is aged 63, and they live in a home purchased by Mel 20 years ago.

Mel sells the home for $900,000 on 15 July 2021 and the proceeds are exempt from capital gains due to it being their primary residence.

Roger can make a downsizer contribution of up to $300,000 within the 90-day period but as Mel is under age 65, she is unable to make a downsizer contribution.

DOES IT IMPACT THE AGED PENSION?

If you qualify, or are hoping to qualify for the Age Pension, the impact of selling an asset needs to be considered. The value of your main residence is excluded from the assets test, however if it is sold, and some of the proceeds added to your super, that value will then be assessed and may reduce your age pension benefits.

HOW DO YOU MAKE A DOWNSIZER CONTRIBUTION?

If you are eligible, you'll need to complete a downsizer contribution form and provide this together with or before your contribution, to your complying superannuation fund so it can be correctly classified. The form is available from the ATO website. You can elect to notify your super provider in advance of the contribution also.

It's important to be aware of the timing of your contribution into super. The contribution must be made within 90 days of receiving the proceeds of sale (or longer permitted period), which is usually the date of settlement.

Source: BT

ADDING MORE TO YOUR RETIREMENT SAVINGS

Is it worth it?

There's no denying that being proactive with your super may be key to increasing your retirement savings.

As an investment vehicle, super can offer significant benefits thanks to the magic of compounding interest. It also provides one of the best tax structures available.

WHY SUPER OFFERS MUCH PROMISE FOR RETIREMENT SAVING

Adding more into super is not only a good way to invest your income, it also helps your retirement savings grow so that when you do retire, your money will still be worth something.

Depending on your income and how much you can afford to contribute, adding more into your super may be a decision that could benefit you in retirement.

Why? It boils down to two key things.

MAGIC OF COMPOUND INTEREST

The first, is the magic of compounding interest – the process of earning interest on your interest and so on.

For example, if you invested $10,000 at 5 per cent per year, each year you would earn $500 in simple interest. However, when you add in the magic of compounding and allow the $500 interest earned in the first year to be added to your account balance, then repeated each year during the 5-year period, after 5 years you would have earned a total of approximately $2,762 in interest (compared to $2,500 in interest after 5 years using simple interest). This would give you a total of $12,762 after 5 years.

But that's not all.

ONE OF THE BEST TAX STRUCTURES AVAILABLE

From a tax point of view, super can be incredibly powerful.

By making extra contributions to your super fund using your pre-tax income, up to the current annual contribution cap of $27,500 (2021/22), you could benefit from those contributions being taxed at just 15 per cent. This is potentially a lot less than the personal tax you would pay on your income.

If your spouse is a low-income earner, there are tax benefits you could gain too for making a contribution to their super.

But like most good things, super is not without its drawbacks.

LIMITATIONS OF SUPER FOR RETIREMENT SAVING

Super does have some limitations as an investment vehicle. For instance, you can only make up to $27,500 in super contributions before-tax in the 2021/22 financial year (this amount includes your employer's contribution of 10 per cent of your salary) or up to $110,000 in after-tax contributions in a financial year. You may be liable for more tax if you exceed these limits.

There are also limitations on when you can access your super.

GET SUPPORT

Planning for your retirement can be a complex and a challenging area to get your head around.

So if you're keen to supercharge your retirement savings, but aren't sure how to go about it, then speaking to a financial adviser can be a good way to go.

Bottom line: Being proactive with your super will likely make a significant difference to the size of your final nest egg.

Source: BT