QUARTERLY INSIGHT

InterPrac Financial Planning Newsletter Edition 4 2022

Summer update

Summer is here, Christmas is just around the corner and some of us are already looking ahead to the New Year.

It's not all fun and overindulging though: Spare a thought for those that have been affected or continue to be affected by floods. Interest rates continue their upward trajectory with the end not yet in sight, while electricity and general household bills are rising.

With this as a backdrop, many people are anxious about their financial future. If worrying about whether you can afford to retire is keeping you awake at night, we have included some recent research that may help guide your planning.

Christmas is a time to gather the family, have a meal together and exchange gifts. For a different take on the traditional season of giving, we look at gifting shares to children – a gift that will keep on giving financially but also in terms of investment education.

The new year also brings the possibility of a fresh start and a time to set goals for the year ahead. We provide some tips to help you achieve your resolutions in 2023.

We hope that the fruit cake rises to the occasion.

Look out for each other, stay safe and contact us if you have any concerns or questions.

Wishing you and your families a happy, festive season and best wishes for 2023!

Outlook for 2023: positioning

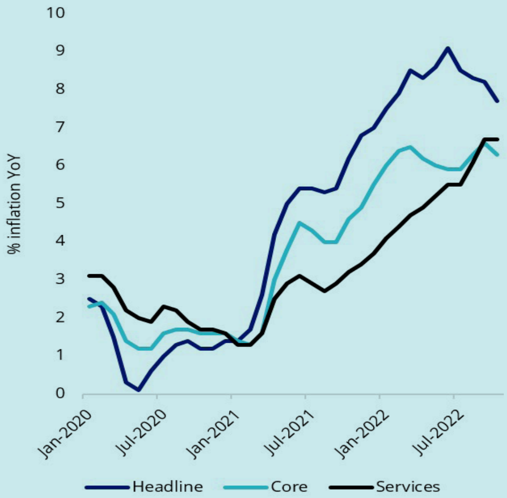
What a year 2022 has been. From skyrocketing inflation and heightened geo-political tensions to global talent shortages and an energy crisis. But as the year draws to a close, and fears of a global recession mount, investors are wondering what 2023 might have in store and how they should be positioning their portfolios.

Australia on balance, is much better positioned than most countries to deal with economic challenges in 2023. Wage growth has been relatively modest, and, the return of migration over the next 12 months will likely ease the labor market tightness.

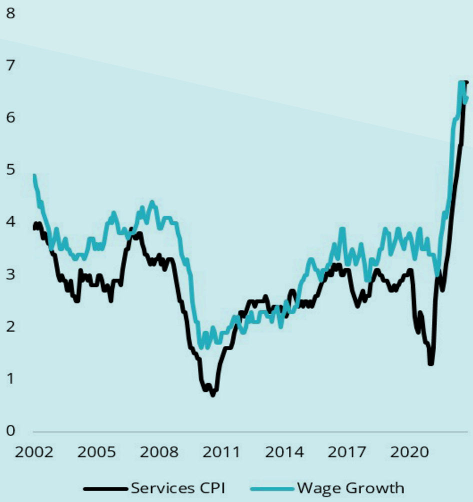
In the US, the picture is somewhat different, Fed Chair Powell has reiterated that there is "more pain to come" and cautioned that monetary policy is likely to stay restrictive for some time until real signs of progress emerge on inflation, despite the US Funds Rate already jumping to 2008 levels with another 1% increase forecast by the futures market in 2023. Of most concern to the Fed is high services inflation. Here is why.

The latest CPI print showed that services inflation remains sticky despite core and headline inflation showing early signs of cooling. Services inflation contributes 60% to total CPI and high accelerating YoY growth is due to high wage growth and record low unemployment.

US CPI YoY



US Services CPI versus wage growth



Source: US CPI YoY - US Bureau of Labor Statistics. US Services CPI vs wage growth - Bloomberg, Federal Reserve Bank of Atlanta.

Inflation and Unemployment

Another relationship to observe is the relationship between wage growth and unemployment as shown below. Labour market retrenchment is needed to slow spending and lower wage growth. The challenge for the Fed is that every time the US unemployment rate has increased by more than 0.50% it has triggered a recession.

US wage growth versus unemployment

Source: Bloomberg, Federal Reserve Bank of Atlanta

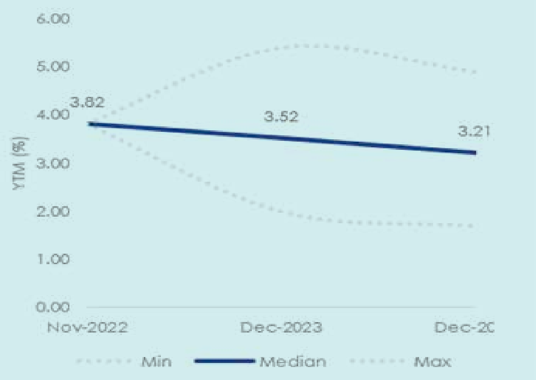
for slowing economic growth

2023 Positioning Quality

Based on the current inversion of the curve, as reflected by the 10- and 2-year yields, a US recession is priced in as a likely scenario in late 2023 given the rapid succession of central bank policy rate hikes and hawkish tone from the Fed. A slowing economy with falling inflation could see a return back to quality.

The US treasury 10-year bond yield is likely at the peak. The interest rate curve has priced for a Fed that is expected to cut the Funds Rate in H2 2023 as the economy slows.

US Treasury 10 Yr Government Yield broker consensus



Source: Bloomberg

1. Government bond yields expected to fall

Analysts forecast US treasury yields to fall in 2023 and 2024 as the global economy slows in the face of higher interest rates. The Futures market also expect the Fed Funds Rate to be cut in H2 2023. Falling yields would be a tailwind for quality companies. Quality companies typically trade at a valuation premium relative to the benchmark (i.e price to earnings) which means that prices are more sensitive to interest rate movements.

Quality performance relative to MSCI World versus US 10 Yr Government Bond Yield

Source: Bloomberg. Quality is MSCI World Quality Index's relative performance compared to MSCI World Index. You cannot invest in an index. Past performance is not a reliable indicator of future performance.

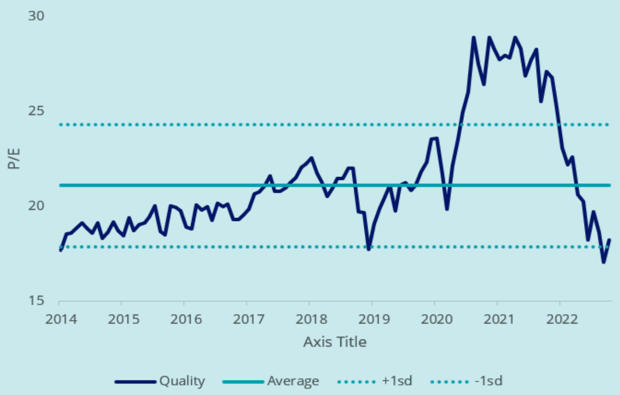
2. Stable earnings

Quality companies typically outperform in a late cycle environment as they are rewarded for their ability to generate sustainable earnings amid a backdrop of stagnate economic growth.

3. Valuations attractive

Quality companies are trading at one standard deviation below the price to earnings 9 year average.

MSCI World Quality Price to Earnings



Source: Bloomberg, MSCI. Quality is MSCI World Quality. You cannot invest in an index.

Quality was the standout factor between the GFC and emergence of COVID-19 during an era of falling inflation and stagnate economic growth. The stage is set for a repeat of this environment in 2023.

How much super do you need to retire?

Working out how much you need to save for retirement is a question that keeps many pre-retirees awake at night. Recent market volatility and fluctuating superannuation balances have only added to the uncertainty.

So it's timely that new research shows you may need less than you fear. For most people, it will certainly be less than the figure of $1 million or more that is often bandied around.

For most people, the amount you need to save will depend on how much you wish to spend in retirement to maintain your current standard of living. When Super Consumers Australia (SCA) recently set about designing retirement savings targets they started by looking at what pre-retirees aged 55 to 59 actually spend now.

Retirement savings targets

SCA estimated retirement savings targets for three levels of spending – low, medium and high - for recently retired singles and couples aged 65 to 69.

Significantly, only so-called high spending couples who want to spend at least $75,000 a year would need to save more than $1 million. A couple hoping to spend a medium-level $56,000 a year would need to save $352,000. High spending singles would need $743,000 to cover spending of $51,000 a year, and $258,000 for medium annual spending of $38,000.[i]

While these savings targets are based on what people actually spend, there is a buffer built in to provide confidence that your savings can weather periods of market volatility and won't run out before you reach age 90.

They assume you own your home outright and will be eligible for the Age Pension, which is reflected in the relatively low savings targets for all but wealthier retirees.*

Retirement planning rules of thumb

The SCA research is the latest attempt at a retirement planning 'rule of thumb'. Rules of thumb are popular shortcuts that give a best estimate of what tends to work for most people, based on practical experience and population averages.

These tend to fall into two camps:

- **A target replacement rate for retirement income.** This approach assumes most people want to continue the standard of living they are used to, so it takes pre-retirement income as a starting point. A target replacement range of 65-75 per cent of pre-retirement income is generally deemed appropriate for most Australians.[ii]
- **Budget standards.** This approach estimates the cost of a basket of goods and services likely to provide a given standard of living in retirement. The best-known example in Australia is the Association of Superannuation Funds of Australia (ASFA) Retirement Standard which provides 'modest' and 'comfortable' budget estimates.[iii]

SCA sits somewhere between the two, offering three levels of spending to ASFA's two, based on pre-retirement spending rather than a basket of goods. Interestingly, the results are similar with ASFAs 'comfortable' budget falling between SCA's medium and high targets.

ASFA estimates a single retiree will need to save $545,000 to live comfortably on annual income of $46,494 a year, while retired couples will need $640,000 to generate annual income of $65,445. This also assumes you are a homeowner and will be eligible for the Age Pension.

Limitations of shortcuts

The big unknown is how long you will live. If you're healthy and have good genes, you might expect to live well into your 90s which may require a bigger nest egg. Luckily, it's never too late to give your super a boost. You could:

- Salary sacrifice some of your pre-tax income or make a personal super contribution and claim a tax deduction but stay within the annual concessional contributions cap of $27,500.
- Make an after-tax super contribution of up to the annual limit of $110,000, or up to $330,000 using the bring-forward rule.
- Downsize your home and put up to $300,000 of the proceeds into your super fund.

Thanks to rules that came into force on July 1, you may be able to add to your super up to age 75 even if you're no longer working.

While retirement planning rules of thumb are a useful starting point, they are no substitute for a personal plan. If you would like to discuss your retirement income strategy, give us a call.

* Assumptions also include average annual inflation of 2.5% in future, which is the average rate over the past 20 years, and average annual returns net of fees and taxes of 5.6% in retirement phase and 5% in accumulation phase.

i *CONSULTATIVE REPORT: Retirement Spending Levels and Savings Targets*, Super Consumers Australia

ii *2020 Retirement Income Review*, The Treasury

iii Association of Superannuation Funds of Australia (ASFA) Retirement Standard

A gift that keeps on giving – buying shares for kids

Many parents and grandparents worry about how to help the children in their lives achieve financial independence. But the value of long-term investment can seem like a dry and complicated idea for kids to get their heads around.

In fact, many young people would like to know more about money, according to a Young People and Money survey by the Australian Securities and Investments Commission MoneySmart website. The survey found more than half of the 15-21-year-olds surveyed were interested in learning how to invest, different types of investments and possible risks and returns. What's more, almost all those young people with at least one investment were interested enough to regularly check performance.

One way to introduce investment to children may be to begin a share portfolio on their behalf. The child can follow the progress of the companies they are investing in, understand how the market can fluctuate over the short- and long-term, as well as learn to deal with some of the paperwork required, such as filing tax returns.

How to begin

Setting up a share portfolio doesn't need to be onerous. It's possible to start with a minimum investment of around $500, using one of the online share trading platforms. Then you could consider topping it up every year or so with a further investment.

Deciding on which shares to buy comes down to the amount you have available to invest and perhaps your child's interests.

If the initial investment is relatively small, an exchange traded fund (ETF) may be a useful way of accessing the hundreds of companies, bonds, commodity or theme the fund invests in, providing a more diversified portfolio.

ETFs are available in Australian and international shares; different sectors of the share market, such as mining; precious metals and commodities, such as gold; foreign and crypto currencies; and fixed interest investments, such as bonds. You can also invest in themes such as sustainability or market sectors such as video games that may appeal to young people.

Alternatively, buying shares in one company that your child strongly identifies with – like a popular pizza delivery firm, a surf brand or a toy manufacturer – may help keep them interested and excited about market movements.

Should you buy in your name or theirs

Since children cannot own shares in their own right, you may consider buying in your name with a plan to transfer the portfolio to the child when they turn 18. But be aware that you will pay capital gains tax (CGT) on any profits made and the investments will be assessable in your annual income tax return.

On the other hand, you could buy the shares in trust for the child. While you are considered the legal owner the child is the beneficial owner. That way, when the child turns 18, you can transfer the shares to their name without paying CGT. Your online trading platform will have easy steps to follow to set up an account in trust for a minor.

There is also some annual tax paperwork to consider.

You can apply for a tax file number (TFN) for the child and quote that when buying the shares. If you don't quote a TFN, pay as you go tax will be withheld at 47 per cent from the unfranked amount of the dividend income. Be aware that if the shares earn more than $416 in a year, you will need to lodge a tax return for the child.

Taking it slowly

If you are not quite ready to invest cash but are keen to help your children to understand share investment, you could consider playing it safe by playing a sharemarket game, run by the ASX .

Participants invest $50,000 in virtual cash in the S&P/ASX200, a range of ETFs and a selection of companies. You can take part as an individual or a group and there is a chance to win prizes.

Another option, for children able to work independently, is the federal government money managed website. This is pitched at teens and provides a thorough grounding in savings and investment principles.

Call us if you would like to discuss how best to establish a share portfolio for your child, grandchild or a special young person in your life.

Strategies for successful new years' resolutions

A brand new year presents a clean slate to do things a little differently, break habits you don't want to hang on to and change things for the better. Unfortunately, our good intentions are often just that, without a strategy in place to achieve our resolutions.

An online survey conducted by Strava (a digital platform for exercisers) revealed that resolutions generally don't make it through the first month of the new year, labelling January 19 "Quitters day".[i]

The main contributing factor to the amount of people who become a 'quitter' is that resolutions are often formed without a strategy. A strategy has clear directions, timelines and consideration of resources needed, which is why they are much more likely to be acted upon.

Now is a great time to think about what you want to achieve over the coming year and develop a road map.

Reflect on your goals

Think about what you want to achieve during 2023. Really want to achieve. Not only does this strengthen your vision, but your chance at success also becomes much more likely.

Many of us share similar goals. According to the website Envision Experience, the most common self-improvement goals people strive for are to improve their health and fitness, find their life purpose, acquire more skills for success, strengthen relationships, challenge themselves and improve their self-esteem and positivity.[ii]

While these goals may resonate for you, you need to set goals that are meaningful to you, not simply reflect what others want to change in their lives. Simply writing down "earn more money" or "lose weight" will make your goals more like resolutions, grandiose statements that have little direction and no intent. How will you see your goals through or even attempt to be accountable when you haven't created a finish line?

Think of the 'why'

Before creating your plan, think about why you want to achieve these goals. Your why will be the reason you get up early in the morning for the gym, or the late nights you'll spend studying. It is the core motivation that will enable you to keep focused while working towards your goals.

Creating your strategy

Once you have clear idea of what you'd like to achieve and more importantly why, it's time to develop your strategy for succeeding. Start by transforming your new year's goals into SMART goals – Specific, Measurable, Assignable, Realistic and Time-related. SMART goals were introduced in 1981 via a paper by George T. Doran in the Management Review journal and has been a popular feature for goal setting be it small or life changing.[iii]

The SMART criteria will help you define and strengthen your goals and form a framework for your strategy, recognising the resources you need and any potential challenges.

Say for instance you want to improve your fitness. By thinking *'Specifically'*, you narrow down the focus to committing to a running routine. To make the goal *'Measurable'*, you decide you want to be able to run 5km by mid-year. The person *'Assignable'* is you. By being *'Realistic'*, you plan for what results can be realistically achieved – for instance, using the Couch to 5k app three times a week to build up your cardiovascular endurance. The *'Time'*-related aspect of the goal is the date you have set yourself to achieve this (in this example, mid-year).

Once you're off and running, don't forget to set aside time to check in, to review your progress and reassess your initial strategy, so that you continue working towards success.

Managing multiple goals

As with resolutions, we can overextend ourselves with our goals. This doesn't mean you have to pick just one goal but be realistic about how many you can manage. Someone who knows all about goals is Warren Buffett, who recommends writing a list of goals and narrowing it down to five.[iv] His theory is that all other goals are in fact distractions that will prevent you from achieving what matters to you most.

If you're striving towards more than one goal, it's a good idea to stagger them. You don't want to plan to train for a marathon, take on that big project at work and agree to volunteer for an event only to create competing pressures on your resources and time required to achieve them. Consider how your goals fit together or if they take time away from the other, and plan accordingly.

And last but by no means least, if you want to avoid being a quitter in the new year, all strategies benefit from having a mentor or a coach to keep you focussed and accountable to the goals you have set for yourself. We can work with you to help you achieve your version of success in 2023.

i https://www.strava.com/clubs/261951/posts/7872836

ii https://www.envisionexperience.com/blog/the-6-most-common-self-improvement-goals-and-how-to-achieve-them

iii https://www.projectsmart.co.uk/brief-history-of-smart-goals.php

iv https://www.cnbc.com/2017/06/23/berkshire-hathaways-warren-buffett-shares-his-top-rule-for-success.html

Boiled Fruit Cake

Ingredients

500g Sunbeam mixed fruit

½ cup sherry or brandy

1 cup water

125g butter

2 tablespoons golden syrup

1 cup dark brown sugar

1 teaspoon bicarbonate of soda

1 tablespoon boiling water

2 x 70g eggs

1 cup self-raising flour

1 cup plain flour

½ teaspoon mixed spice

¼ teaspoon nutmeg

¼ teaspoon cinnamon

1 teaspoon vanilla essence

Blanched almonds for decoration

Method

1. Soak fruit overnight in sherry or brandy.
2. Place soaked fruit, water, butter, golden syrup and sugar in a saucepan. Slowly bring to the boil. Remove from heat and add bicarbonate of soda mixed with 1 tablespoon boiling water. Cool for 15 minutes.
3. Add lightly beaten eggs mixing thoroughly. Fold in sifted flours, spices and vanilla essence.
4. Place in a 20cm square cake tin. Decorate with almonds. Bake at 160˚C for 1 ¼ to 1 ½ hours. Cool in tin

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InterPrac Financial Planning Pty Ltd

ABN 14 076 093 680

Australian Financial Services Licence Number 246638, Level 8, 525 Flinders Street Melbourne VIC 3000