Newsletter

September 2016

Introduction

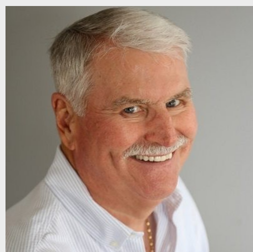
Welcome to our newsletter for September 2016. This newsletter combines the articles that we have published on our site since we last published a discrete newsletter. We provide the newsletter in this format so that you have a single, portable document that you can read at your leisure.

In this newsletter, we discuss how good advice can be boring – a constant challenge for us when it comes to preparing these articles! We also comment on Australia's extraordinary run – 25 years of uninterrupted economic growth – which has nevertheless still left many Australians looking forward to nothing more than the age pension in retirement. We also discuss the changes to the changes to the super rules announced in May… have a read; you will see what we mean. Finally, we finished the month of September with a discussion of how to make hay while the sun shines – or what to do while interest rates are low, which is the financial equivalent.

Please feel free to share this newsletter with anyone you think would find it helpful. And please also free to get in touch with us if there is anything that you would like to discuss about its contents.

Did You Know… the month of September

September has been in important month in Australian history. In September 1956, TV was first broadcast and in 1983 Prime Minister Bob Hawke swore at everyone when Australia won the Americas Cup – a trophy that America had been so good at winning that they called it the Americas Cup. In 2000, Sydney hosted the Olympic Games with Kathy Freeman winning her iconic 400 metre gold medal on a rainy September 25.



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Some Good Advice That's Boring

The problem with saving is that spending is so bloody easy. Make it harder to spend and watch your savings skyrocket.

'Save first, spend what's left.' This is great advice. It's also the opposite to what most people do, which is 'spend first, save what's left.'

The second strategy has an obvious problem: what happens if there is nothing left after spending?

The answer, of course, is that nothing gets saved. And if nothing gets saved, nothing of any value gets bought. No home, no decent holiday, no seed money for your own business (the best way to become wealthy, by the way).

Which is why financially successful people save first, and spend what's left. The good news is that modern technology gives us all a very easy way to do just that. We call this strategy 'set and forget.' It is nothing more sophisticated – and nothing more difficult – than setting up a system of direct debits. And then forgetting about them.

Direct debit is a really convenient way of ensuring you pay all your essential bills. When you organise for bills to be paid by direct debit, all you have to do is make sure you have enough money in your account on the day the payment is due. If this is a challenge, then try to organise the direct debits for the day after pay day. This gives you much less time to go spending before the bills are due.

(There is one word of warning when it comes to direct debit: make sure you actually check the bills that you are paying each month. You want to make sure prices have not risen without you realising, and that you are only being charged what you actually wanted. Hello, mobile phone company...)

The 'trick' then becomes to treat your savings plan like a normal bill that has to be paid regularly. A direct debit that has to be made each payday. Rent? Tick. Phone? Tick. *Savings*? Tick.

Let's say you arrange for an extra $200 to be transferred each fortnight into a savings account that is hard to access (or, at least, that is hard to access at 1am on Sunday morning). By the end of the year, you would have saved $5,200 plus any interest that you might be able to pick up.

All you have to do is keep getting paid and the saving occurs automatically. You set, and then forget.

The next step is also a simple one: make your savings hard to spend. This basically means making them hard to get to. A simple way to do this is to create a dedicated savings account with another bank. If you bank with the NAB, get a savings account with Westpac. If you bank with Westpac, get a savings account with the ANZ. Make this your one and only account with that bank. Go for the highest interest-earning account you can get (this will depend on how much you already have saved).

Then – and this is really important – get rid of any plastic card that comes attached to the new account. Make the money in that account hard to spend. Make it so that you have to transfer the money somewhere else before you can spend it. This will means transferring money from one bank to another, which usually takes at least 24 hours. Bye bye impulse spending.

Some people take the idea a step further and don't even set up internet and phone banking for the new savings account. The only way to get money out of this kind of account is to physically go into a branch during business hours. And branches are not open on weekends. Certainly not at 1am every Sunday morning.

This is just one way to go about forcing yourself to save. There are various others. But they all have one thing in common: you have to automate the saving – and then make it hard to access those savings.

That is the simplest way to save first, and only spend what's left. Save without thinking.

25 Years of Economic Growth.

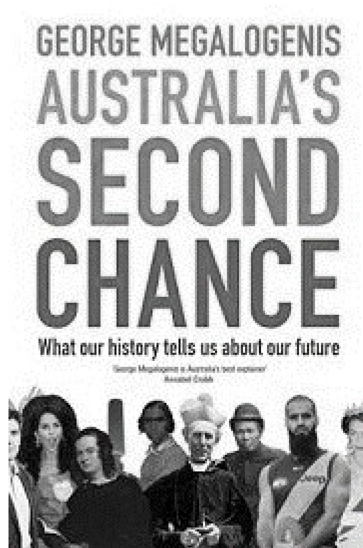
Australia's economy is the strongest in the world. It makes sense to buy a piece of it.

And now for some good economic news. As of September 2016, Australia has enjoyed 25 years without an economic recession. No other developed country has achieved this. It is historically unique.

It also means that people who have owned part of the Australian economy – also known as 'investors' – have done very well indeed.

This is easily the longest period of sustained economic growth Australia has ever had. Recessions are defined as two quarters (ie six months) of negative economic growth. They have actually been quite common over the years, and many people saw them as necessary corrections when the economy either grew too fast or relied too much on certain types of economic activity. In 1990, during our most recent recession, the Treasurer Paul Keating described it as the 'recession we had to have.' Whatever your politics, he was probably right.

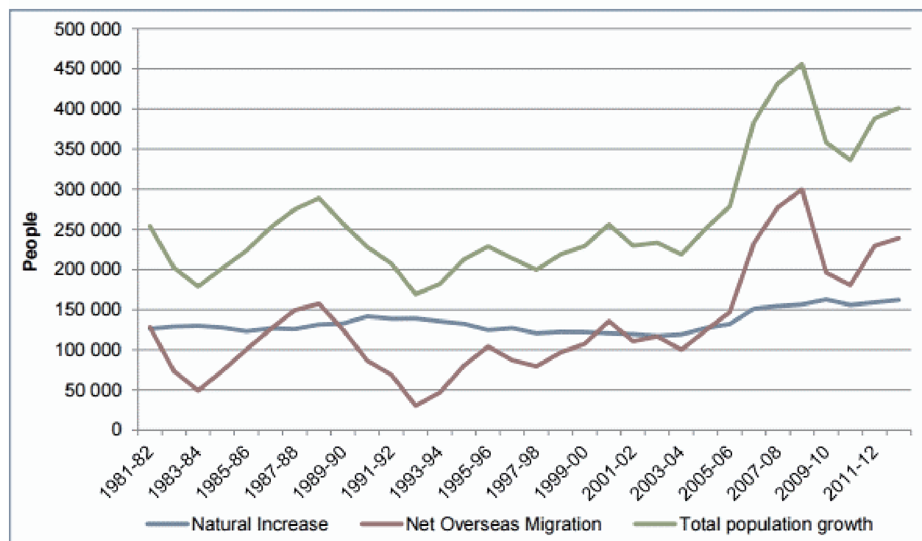
Prior to 1990, Australia experienced recessions in 1981, 1974, 1961 and 1952. There was no recession in the 1940s – wars tend to be good for economic activity, which is kind of weird. The 1930s also had a reasonably significant recession: you might have heard of the Great Depression. So, roughly every decade we have had a recession. Until the 1990s.



There are lots of different reasons why the Australian economy is so strong by world standards. One that often goes unnoticed is the impact of migration on economic activity. In a wonderful book titled 'Australia's Second Chance,' journalist George Megalogenis explores Australia's economic history since European settlement. He draws a direct correlation between the economic impact of sustained immigration and the relative strength of the Australian economy. When migration is strong, so is the economy. If you can find yourself a copy, have a read of this excellent book. Or, if you are short of time, have a listen to George speaking in this podcast with the ABC's Richard Fidler:

STREAM AUDIO

You can see the impact of migration very easily in the following graph, provided by Australia's Immigration Department. The graph shows net overseas migration (people coming in minus people going out) since the early 1980s. The 1980s – the period leading in to the 1990 recession – had relatively low levels of migration (and subsequent population growth). Migration then rose steadily through the 1990s, and spiked in the late 2000s – when pretty much everywhere else in the world was enduring the Global Financial Crisis. Put very simply, all those new arrivals boosted Australia's economy in a way that no other country enjoyed. In fact, the recessions in other countries were probably made worse by all those people leaving to come to Australia. Their loss was our gain, quite literally.



Source: Australian Bureau of Statistics

At the moment, more than 25% of Australians were born somewhere else. This figure is expected to rise in the next 30 years. Australia is and will remain a 'destination country.' Our political stability, our economic stability and even our climate make this a place that people want to be. This means that we can look forward to large numbers of new arrivals for some time to come. And we can look forward to the economic development that will come with it.

While it would be optimistic to think that we will have another 25 years without a single recession, it is not optimistic to expect that Australia's economy will do at least as well as anyone else's over that period. That would just be realistic.

So, what should you do about this? Put simply: try to own at least a piece of the Australian economy. This is what you do when you invest in what we like to call 'representative assets' – assets that will perform in rough concert with the general economy. Think of things like stand alone houses in suburbs where people already want to live, or a broad-based investment in Australian shares. These are the things that will appreciate in value if the economy continues to grow. They will ride the wave of normal economic growth.

The key to buying representative assets is to take a long-term view. Our economy has excelled over the long-term – it has not been a short term standout. Other countries have flown higher for shorter periods of time (think Ireland in the mid-80s). We tend to grow by less each year. But we do it every year. Our economy wins the marathon, not the sprint.

Your investments should take the same approach. So, why not talk to us about how you can make a representative investment and participate in the good news story that is Australia's long-term stability? Don't be sitting there in 25 years thinking 'I wish I had…'

Is the full aged pension going to be as good as it gets?

Research shows that the aged pension is all many people have to look forward to, unless they act now…

Are you planning to live on the age pension when you retire? Or would you like to do a little better than that?

We came across some research recently that demonstrates that it is likely that most people aged in their 30s today will have nothing more than the aged pension to live on when they reach their 70s. It is sobering stuff. You can read the article yourself here:

VIEW ARTICLE

The article contains a lot of assumptions and a lot of analyses. But the simple 'take out' is this: based on what they are doing now, most people will have nothing other than the aged pension to live on once they reach their 70s. There are two main reasons for this.

The first is that modern life means people do most of their milestone things later in life: they become qualified later, start full time work later, find a partner later, have kids later, buy homes later, etc. This means that there is simply less time to earn enough to meet the largest financial expenses (buying a home and raising kids). As a result, buying a home and raising kids take up more of a person's income than has been the case in previous generations. This is made especially the case because housing is much more expensive these days.

The second is that most people finish work in their early 60s. For today's twenty and thirty somethings, the age pension will not commence until they reach the age of 67. This means that the first few years of retirement will be self-funded, which seriously depletes the wealth available for the rest of the retirement. Remember, the average 61 year old has another 25 years or so to live. Their wealth has to last well after they finish working. Spending a big chunk in the first six years of retirement is not a great way to go.

The problem for many people is that they only do two things to create wealth. Those two things are good to do, but they are not enough. The first thing most people do is buy a home. A home gives you somewhere to live, but the wealth stored in a home does not really contribute anything else to your lifestyle.

The second thing most people do is rely solely on their employer to make super contributions on their behalf. Almost all working Australians receive 9.5% of their wages or salary as a compulsory superannuation contribution. This is again good – but again not good enough: this level of contribution will give you a good few years straight after you retire, but it won't stretch across 25 years in any meaningful way.

You need to do a third, fourth or even fifth thing to create wealth if you want your retirement to be a comfortable one. The list of things you might do is long: you could aim to buy one or more investment properties; you could borrow to invest in a simple index-tracking ETF, using the benefits of dollar cost averaging to invest a small amount regularly; or you could simply sacrifice a little bit more income into superannuation each month – maybe financing it with an extra couple of hours' overtime if possible. Interestingly, if you do this early in your life, and then let the extra super compound over 20 or 30 years, you will find that the little bit that you sacrifice will make an outsized contribution to your wellbeing.

One of the unexpected things about wealth creation is that there is no one thing that everyone has to do. There are plenty of ways to create wealth, and anyone who tells you that there is only one way to go is trying to sell you that way. What matters is that you do at least one intelligent thing. And that you avoid the lure of a quick buck and instead prefer lower-risk, proven strategies that understand that time is the best asset that you have.

So, why not come in to see us to discuss how we can help you ensure that the age pension is not 'as good as it gets' for you?

Flip-Flopping on Super

They changed the rules on non-concessional contributions. Then they changed them back. Sort of. But they did make them better. Than the new rules. Not the old ones.

If you have been trying to follow the Federal government's changes to superannuation over the last few months, we would forgive you for having a headache. There has been an awful lot of flip-flopping. (Flip flop is the American term for what we call thongs. But if you google 'thongs" looking for a photo to go with your newsletter, you get an entirely different set of images…)

One of the most contentious areas of change concerns non-concessional contributions into super. A non-concessional contribution is one that is not taxed as it enters the fund. Consistent with that, the member who makes the contribution does not get a tax deduction for the contribution (hence the term 'non-concessional).' In contrast, concessional contributions do provide a tax benefit for the person making them. For example, the money that employers contribute into super under the Superannuation Guarantee Charge is a concessional contribution because the employer gets a tax deduction for the contribution. The contribution is then taxed in the hands of the super fund. This is a general principle: if contributions are taxed as they arrive in a fund, the person making the contribution can usually claim a tax deduction for them.

So, if there is no immediate tax benefit, why would you make a non-concessional contribution? The main reason is that a super fund is a lower-tax environment in which to invest the money used to make the contribution. Earnings within a super fund are taxed at just 15% on income (rent, dividends or interest) and just 10% on capital gains for assets held for more than 12 months. And that is while the fund is in accumulation mode. Once the fund commences paying a pension (which in most cases means when the member turns 60), earnings are not taxed at all. From the point of view of tax, super is super.

Imagine you inherit $300,000. You have a well-paid job and pay marginal income tax at a rate of 37%. If you invest the $300,000 in your own name, then the earnings on the investment will be taxed at (at least) 37%. Let's say you bought shares and they provided a 4% dividend yield. That's $12,000 of dividends a year. This would give rise to tax of $4,440 a year at a rate of 37%. If the shares also rose in value by 10% and you sold them after 366 days (that is, just over a year), then half of the $30,000 capital gain would be taxed at your marginal tax rate. This would be another $5,550. Total tax is $9,990.

Now let's imagine you establish a self-managed super fund and make a non-concessional contribution of $300,000 into it. The SMSF makes the exact same investment. The $12,000 in dividends give rise to tax of just $1,800 (tax rate is 15%). The capital gains are taxed at 10% – which is another $3,000. The total tax is now $4,800. This is less than half what you would pay in your own hands.

Now let's say that you establish the SMSF and start paying a private 'pension' to yourself out of it. You can do this most efficiently if you have already turned 60 – and you don't even need to have retired to start taking a pension from your fund. Again, the SMSF makes the exact same investments. However, now there is absolutely no tax paid at all on either the dividends or the capital gains. Making the non-concessional contribution saves you almost $10,000 a year in tax, in this example.

The May 2016 Budget

In May 2016, Treasurer Morrison announced what many saw as a substantial change to non-concessional contributions. Under the rules that applied before the Budget, a member could essentially contribute $540,000 in non-concessional contributions into a super fund every three years. They could do this until they turned 65. There was no absolute limit: as long as the person did not exceed $540,000 in the three year period, they could repeat this every three years until they turned 65.

This was changed on Budget night. From that night, the Treasurer proposed a lifetime limit on non-concessional contributions of $500,000 – and non-concessional contributions that had already been made were included in the limit. This is why many people argued that the changes were 'retrospective.'

This met with a lot of resistance, especially within the Coalition. And then the Coalition barely won the election. To cut a long story short, last week the Government announced a change to its most recent change. That is, the Government flip-flopped. They announced that there would now be an annual limit of $100,000 of non-concessional contributions per member. This would again be allowed to be smoothed over three years, such that the limit is effectively $300,000 per member per three years. And the changes take effect on 1 July 2017, meaning that the limit for the current financial year is now back to $180,000.

These contributions can only be made while the member's super balance is less than $1.6 million. Once this limit is reached, no more non-concessional contributions can be made.

This limit of $1.6 million is about twice the threshold for the aged pension assets test. $1.6 million is becoming something of a marker. It is also the limit on the superannuation assets which can be dedicated towards a superannuation pension such that the fund does not pay tax on its earnings.

From the overall policy perspective it looks like the Government is saying that it will offer maximum encouragement to people to acquire superannuation assets, until those assets reach a level that is twice the assets threshold for the aged pension ($1.6 million). Super benefits of this size will mean that the member stays away from the aged pension – which is why the Government encourages super in the first place. But once the super assets rise to the level where the aged pension is off the table, the tax incentives fall away.

That said, most people have much less than $1.6 million in super. This means that non-concessional contributions remain a very good idea for most people. This is especially the case if you receive a lump sum amount, such as an inheritance or the sale of an asset such as your family home. So, if you are thinking about making a non-concessional contribution, make sure that you come to see us and we can show you whether and how you can invest that money in the most tax-effective manner possible.

What will you do now that interest rates are so low?

Why not make some hay while the sun is shining?

So, what are you doing with all that interest you're saving?

In case you haven't noticed, interest rates are at an historic low right now. In August, the RBA voted to drop the official target cash rate to just 1.5%. This followed a reduction in May from 2.0% to 1.75%. Home loan rates are about 3 percentage points higher than this. If you have taken out a loan in the last 25 years, then you have never met interest rates lower than they are today. Open this window and have a look at the included graph to see what we mean:

[AUSTRALIA'S OFFICIAL TARGET CASH RATE SINCE 1990](#)

These low rates represent great news for borrowers. And the news might get even better:

[WHAT ECONOMISTS ARE SAYING ABOUT TODAY'S RBA RATE CUT](#)

The average home loan in Australia is a tick over $350,000. If interest rates fall by 0.25%, this equates to a reduction in annual interest of $875. Given the two falls so far this year, the average home loan borrower is paying $1,750 less in interest than they were this time last year.

If you are a borrower, this is a good time to stop and think about how you are managing that extra interest you are saving. Are you saving your saving, or are you spending your saving?

Our advice is that you should almost always save it. Don't let the extra amount find its way into consolidated revenue from where it is spent along with all your other dollars. Before the interest rates were reduced, you were probably coping with the amount you had available for spending. You will keep coping with this much. Don't let your spending creep up. If you do increase your spending,

what will you do when interest rates rise again? And they will rise again – that is what happens when things are at historic lows. When interest rates rise again, it will be very difficult to cut your spending back.

So, save your saving. There are various ways to do this, but a couple are particularly clever. Let's look at those two.

The first is the simplest: simply maintain the previous level of monthly payments to your bank. Act as if interest rates have not changed at all. This is the easiest because you don't have to change anything.

If you owed $350,000 in April and your loan still had 20 years to run, then your monthly payment to the bank was about $2,290. After the two interest rate drops, if you kept up the same level of monthly payments, then you shortened the time left on your loan to 18 years. That's a 10% cut. Ignoring inflation, if you then kept saving the $2,290 for the next two years, you would save an additional $55,000. That is serious money.

Another alternative, which is a bit more fiddly, is to save the saving through your super fund. You can get a bit of a tax advantage here, because you can usually contribute into your super fund using pre-tax dollars, whereas money repaid on a home loan is paid after tax. So, if you pay tax at 37%, then the $1,750 in interest that you were previously paying required you to earn $2,770 before tax. You paid $1,020 in tax, and then paid the bank its interest.

Now that the bank does not want that $1,750, you can contribute the pre-tax $2,770 into your super fund without affecting your own personal spending. You avoid paying $1,020 tax yourself, and the super fund only pays $416 in tax. This means that you will end up with an extra $2,354 in your super fund. This is the same as investing the $1,750 and getting an immediate 35% return.

The alternative that you choose will depend on a range of circumstances, including your age. You can typically remove money from your super fund tax free once you turn 60. This means that saving into super makes more sense the closer you are to that age. You get to save larger amounts of money into super due to the tax benefits, and you can then withdraw a lump sum at or after age 60 and repay more of your debt than you could have making straight repayments.

If you are unsure what to do with the interest you are saving, why not give us a call? We will be all too happy to help you make the most of the interest you are saving, leaving you well-placed for when interest rates rise again.

The Legal Stuff

General Advice and Tax Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

Please arrange an appointment to seek personal financial and/or taxation advice prior to acting on anything you see on this website.

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