Financial Focus

Spring 2020

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Welcome to Financial Focus.

As the coronavirus continues to redefine our world, many of us are considering what our future 'normal' might look like. In this edition of Financial Focus, we look at how to better weather the highs and lows, with a long term view to building wealth and achieving your goals. If you would like need more information or to review your financial plans, please feel free to contact me

Building wealth in your 40s

While you may not be as invincible in your 40s as you are in your 20s – and possibly have a few extra responsibilities like kids and a mortgage – you're probably in a more stable financial position than you've ever been.

So how can you continue to build this momentum to set yourself up for a successful future?

Generate passive income and build long-term wealth

Wouldn't you love to wake up knowing that a flood of cash seeped into your bank account?

If you can afford to put some money away for a lengthy period, and are able to take on more risk to seek better long-term returns, investing in growth assets like shares and property can generate a passive income while building your wealth over time. A passive income is money earned without you having to work. It's the best kind!

Shares

According to analysis by Credit Suisse, Australian shares have given their investors an average annual return of 6.7% per year since 1900. That makes Australia the second best performing share market in the world over 120 years.[1]

Generally speaking, shares outperform many other investments over the long term, meaning your chance of a negative return gets lower the longer you invest.

There's also the benefit of dividends. If you invest in companies that pay dividends, you'll benefit from the part of the company's profits paid to shareholders (generally twice a year).

Note: as we've seen during COVID-19, companies can cut dividends when times are tough. But they tend to increase them when profits recover.

Property

Owning an investment property is another way to generate a passive income stream – by tenants paying you rent.

Like shares, Australian residential property has delivered strong long-term returns. In fact, in the past 20 years to December 2017, it returned 10.2% pa.[2]

While less volatile than shares, residential property values change depending on supply and demand in the market. There are also high costs involved to buy and maintain one and it's difficult to get your money out quickly – if you need to pay for an expense, you can't sell off one bedroom.

Gain control of your debt

While many people understand the benefits of supplementing work-earned income with passive income, one thing holds them back.

For many people in their 40s, debt is an overbearing burden that never seems to lighten. Whether it's the mortgage repayments or mounting credit card bills, debt is one of the big obstacles to investing for your future.

So if this is the case, you may need a debt management plan – one that's realistic to follow.

Set priorities

If you have more than one outstanding debt, consider working out how much you can repay on each, based on the minimum repayment owing.

Alternatively, if you're able to repay more than the minimum, look at prioritising your debts. You'll need to think about the type of debt you have – an investment loan or personal debt – and how much is owing.

If you only have personal debt, you could prioritise repaying debts with the highest interest rate first, given these will be costing you the most.

At the end of the day, the approach you take is personal but it's important to have a plan and stick to it. And that could mean making other changes.

Keep track of expenses and income

Having a clear picture about what you earn versus what you spend can highlight areas where you may be able to save.

Whatever income you're able to save can then be allocated towards your debt. There are budget planners and phone apps you can use to track your spending. Alternatively, you can simply download your bank statements and keep a record of your receipts.

Make sure to include everything from your household necessities like rent or mortgage, utilities, kids' education, what you spend on entertainment, etc.

Invest in your retirement

If you've still got a long way to go before retirement, it's worth keeping track of your super's performance. This may lead you to reconsider your investment approach.

There are also retirement calculators you can use to see if you'll have enough saved to maintain your standard of living in retirement.

If you find you need to make financial adjustments to increase your retirement savings, one option could be to contribute more to your super on a regular basis using your before-tax or after-tax income – there are tax benefits that come with this too.

For example, if you contribute some of your after-tax income or savings into super, you may be eligible to claim a tax deduction. This means you'll reduce your taxable income for the financial year and potentially pay less tax, while adding to your super balance. It's a win-win!

And you don't have to wait until your mortgage is paid off to add more to your super either. Even small, regular contributions could make a big difference to your retirement savings.

Seek professional help

Getting independent advice from a financial adviser can help you design a financial plan that leads to passive income – super, shares, or property – that protects your lifestyle when you're not working.

An often underrated element of advice is that it helps people do common-sense things – like investing long-term, cutting debt, and putting away cash now to make life easier later on.

[1] Credit Suisse: www.livewiremarkets.com/wires/australian-sharemarket-wins-gold

[2] ASX: www.asx.com.au/documents/research/russell-asx-long-term-investing-report-2018.pdf

Financial lessons from COVID-19

The reality is, none of us can predict the future – not even experts. It's equally true that good news is rarely perfectly predicted either.

So, it could be said that the secret to life as an investor is not to predict the future, but to prepare for its ups and downs.

Here's five financial lessons that are helping people get through the COVID-19 crisis.

1. Keep a long-term perspective when investing

Sharemarkets get disrupted all the time, from the 1987 Stock Market Crash, the bursting of the Tech Bubble in 2000, to the Global Financial Crisis in 2007 and COVID-19 today. Each trigger is different and the recovery time varies too.

But investing with a long-term approach puts time on your side. For instance, when investing in shares, your chance of a negative return gets lower the longer you invest.

The other benefit of long-term investing in growth assets like shares is that it is more likely to pay off.

Analysis from Credit Suisse tells us Australian shares have paid investors an average annual return of 6.7% per year since 1900. That makes us the second best performing sharemarket in the world over 120 years.[1]

The compounding effect

One of the reasons sharemarket returns can be so high over the long term is that they generate compounding returns. That's where you earn interest on the interest (or growth on the growth) you've accumulated over time.

Fundamentally, it's like planting a tree. As that tree grows, it gets taller – but it also produces seeds that you plant to grow other trees. Those trees will also grow and produce seeds of their own. With enough time, you could turn one young tree into an entire forest.

Because the benefit of compounding returns are generally most effective over a long timeframe the longer your money has time to grow, the better.

Bottom line: if you can afford to put your money away for a lengthy period, you may maximise your chances of good returns.

2. Spread your investments out

Spreading your investments across many asset classes, countries, industries and even investment managers ensures you're not putting all your eggs in one basket.

The advantage of this diversification is that when one area of your portfolio is falling – another may be rising.

If you have money invested across many areas, changes in their values may balance each other out.

It doesn't mean you can avoid negative returns altogether, but it helps reduce the impact a fall in one asset class has on your total portfolio.

3. Set aside a savings fund for emergencies

A savings fund for emergencies provides a financial safety net to draw on when you really need it. Nobody could predict that a pandemic would shut every pub in Sydney for months. But a prudent bar manager would have had some cash in the bank – just in case something did.

And this doesn't require a lot of cash up front. You can transfer a small amount of your pay into a high interest savings account on a weekly, fortnightly, or monthly basis to build up your rainy-day fund.

Alternatively, you could have the money sitting in a mortgage offset account that provides the ability to draw back on your loan if you get into trouble.

A good rule of thumb is to have three to six months' worth of savings, but this varies depending on your circumstances. Speaking to a financial adviser may help to clarify.

4. Review your insurance policies

Insurance helps to transfer financial risk from you to someone else, especially during unforeseen events such as the loss of income you could suffer if you become critically sick or injured.

It's important to ensure you have enough cover, the right types of cover and that your insurance is up to date – your needs as a single student at 20 are vastly different to your needs at 40 with a mortgage, partner and two kids. Make sure to read the policy fine print too as this covers any exclusions you may not be insured for.

Don't forget, if you're a member of a super fund, you'll likely have insurance through your super. Now may be a good time to decide if this is something you want to hold onto or adjust to suit your needs.

5. Seek professional help

Obtaining independent advice from a financial adviser can help you design a financial plan to achieve your own lifestyle goals – whatever they are.

They can also help you put the lessons of COVID-19 into practice. An often under-rated element of advice is that it helps people do common-sense thing – like investing long-term, staying calm in a crisis, putting away some cash and insuring your income.

[1] Credit Suisse: www.livewiremarkets.com/wires/australian-sharemarket-wins-gold

Shares: why long-term investing works

Some people invest in shares with a short-term view, looking to take advantage of small movements in share prices to pick up quick wins.

While this approach – also known as share-trading – might pay off if you've got the luck, expertise, and time to do it, the risks of short-term investing are high and can often outweigh the rewards.

So, if you're looking to use the sharemarket to grow *your* wealth over time, you've come to the right place.

Key benefits of long-term investing

There are many reasons to believe a long-term approach is effective.

As one of the world's most famous investors Warren Buffett has advocates: "Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years".

Strong performance

One of the main benefits of long-term investing is that it has proven to deliver returns.

According to analysis from Credit Suisse, Australian shares have given their investors an average annual return of 6.7% per year since 1900.[1] That makes us the second best performing sharemarket in the world over 120 years.

Lower fees and costs

Lower transaction costs are a key advantage of long-term investing – and that translates into higher returns.

Transaction costs – the price you pay to invest your money in a company's shares – are often overlooked.

There are transaction fees involved with investing in shares, including brokerage. But these are only triggered when you buy or sell. If you hold shares for years, you're going to incur much lower expenses than a short-term trader.

Another factor to consider is Capital Gains Tax. You pay tax on any returns you make from your original investment, charged at your marginal tax rate (could be up to 47% including Medicare levy). If you hold your shares for at least 12 months however, you may be eligible for tax concessions.

Riding out the rough times

As we've seen recently with the COVID-19 pandemic, it's extremely difficult to predict what's going to happen in the next month or year.

Disruptions to sharemarkets happen all the time, from the 1987 Stock Market Crash, the bursting of the Tech Bubble in 2000, to the Global Financial Crisis in 2007. Each trigger is different and the time it takes to recover varies too.

So, investing in shares with a long-term approach puts time on your side. Generally speaking, shares outperform many other investments over the long-term meaning your chance of a negative return gets lower the longer you invest.

The other advantage of time, is that if an unforeseen event does occur, you're able to hold your investments until markets recover. So, always consider what your objectives are and your investment timeframe.

Emotional side of investing

While it's good to know the facts, it's also important to acknowledge the emotional side of investing too. Sometimes we react irrationally when events cause anxiety. This means we may set out to invest for the long-term, but instead react to short-term market volatility like selling out in a crisis.

That's one good reason to work with a financial adviser. They can help instil some discipline into your long-term investing strategy. And that means the strategy has more chance of delivering the returns you need.

Bottom line: If you can afford to put your money away for a lengthy period, you're more likely to reduce your risk and maximise your chances of returns. Patience pays.

[1] Credit Suisse: www.livewiremarkets.com/wires/australian-sharemarket-wins-gold

If you would like need more information or to review your financial plans, please feel free to contact me.