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financiallyspeaking

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Economic outlook

Global economy

The landslide UK election win by the Conservative Party, led by Boris Johnson, saw a major risk for investors subside - the risk of a disruptive UK exit from the European Union (EU). The focus is now on his re-negotiated deal with the EU rather than the period of uncertainty experienced in the three years following the Brexit referendum in 2016.

We have also seen progress on US-China trade negotiations. This included President Trump deferring planned tariffs for 15 December 2019 after increasing tariffs on Chinese imports in early September. A ‘phase one’ trade deal was widely anticipated and signed on January 15, 2020.

Leading indicators of economic growth improved during the quarter. For example, The Markit Global Composite Purchasing Managers Index (PMI) reached an eight-month high pointing to stronger growth in the global economy in the short-term.

Weakness in the EU’s services sector prompted a restart of the European Central Bank’s asset purchasing program, also known as ‘quantitative easing’, which aims to increase the money supply and encourage lending and investment.

In this issue

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Economic outlook continued

Australia

In Australia, economic growth in the September 2019 quarter remained weak with annual growth at 1.7%. Public sector spending and net exports contributed 1.1% each to annual growth but, concerningly, a decline in private sector spending, which accounted for 73% of gross domestic product (GDP) in the September quarter, reduced annual growth by -0.5%.

Business activity and confidence was below average as was consumer sentiment. This suggests weaker growth will likely persist in the short-term.

The bushfire disaster is also expected to be a drag on economic growth but the exact extent of the impact is uncertain. These factors are expected to see the Reserve Bank of Australia (RBA) cut interest rates at least once this year.

Shares

During the December quarter the Australian share market rose 0.7%. At a sector level, health care (up 14%) and energy stocks (up 6.3%) were strong and offset weak performance in the financial sector (down 7.8%).

The health care sector's performance was driven by biotechnology company CSL whose share price rose 18% from $233.69 to $275.70 following a positive outlook for the 2020 financial year of 7 to 10% growth in profits. This growth is because of a supply squeeze on one of its core antibody product lines which is expected to push the product line's price higher.

Energy stocks benefited from stronger oil prices following a decision by the Organisation of the Petroleum Exporting Countries (OPEC) to cut back on oil production.

The major disappointment among large companies was Westpac. The company saw its share price fall from $29.64 to $24.23, a decline of 18.3%. This followed a lawsuit by regulator Austrac over breaches of counter-terrorism and anti-money laundering legislation because of inadequate controls over international money transfers.

Fixed income and currencies

Bond prices fell, driving bond yields higher both here and overseas. This occurred despite the RBA cutting interest rates by 0.25% in early October. Normally it is expected that a reduction in interest rates would result in a rise in bond prices however positive global factors, including the Brexit resolution in late December and more concrete progress on US-China trade negotiations, saw bond prices fall.

This also saw investors seeking riskier assets such as shares. These drivers are likely catalysts for a stronger economic environment heading into 2020.

The Australian dollar also benefitted from these drivers even with the RBA rate cut which would normally contribute to the Australian dollar falling.

Source: IOOF

Westpac share price down from $29.64 to $24.23

-18.3%

How to manage anchoring bias

Anchoring is the use of irrelevant information as a reference for evaluating or estimating an unknown value of a good or service. This behavioural bias can cloud our decision-making. In investing, anchoring can negatively impact our decision making in a variety of ways.

Examples of Anchoring in Investing

1. Expecting 'average' to occur regularly: Often times financial advisors show potential investors an "average expected return" for a particular portfolio or risk objective. Unfortunately if the investor is told that the portfolio may average 6% per year, they are now anchored to that 6% number in their mind. The reality is that markets or asset classes rarely perform near their long-term average in shorter time periods, i.e. in a calendar year. Investors may derive unrealistic expectations from the 'average anchor', making it difficult to maintain a level head when investments are volatile.
2. Basing a sell decision on a purchase price: An investor may have bought stock XYZ for $50 per share years ago. A financial advisor then suggests selling the stock today at $45 per share based on new information that has come to light in the past few years but the investor replies 'let's wait until it gets back to $50 per share then we will sell'. The original purchase price of $50 per share has no bearing on the value of the stock today but the investor is anchored to that number.
3. Basing perception of quality on past experiences: When we are accustomed to a particular system or method we tend to benchmark any new experience to what we're used to. You may be advised by a friend of a 'better' route to and from work – but you're not familiar with the bottle-necks on the road or with the train schedule for the line suggested. "I'm better off with what I know" you think to yourself.

Suggestions to help combat anchoring

1. Expecting 'average' to occur regularly: Investors should ask their financial advisor about the potential range of investment outcomes for a given asset allocation, or when investing on your own behalf – do the necessary research on the potential ranges. For example, the yearly returns of the All Ordinaries Accumulation Index (XAOA) had an average return of 13.1% between 1900 and 2018, but it has gained as much as 62.9% in 1975 and lost as much as -40.4% in 2008. In fact, the All Ordinaries Accumulation Index has been within 2% either way of that long-term 13.1% average in a calendar year in only 14 of the last 118 years[1].
2. Basing a sell decision on purchase price: the author has found that financial advisor's clients respond well to the acronym MAIN – monitor, adjust, inform and navigate. These words really resonate with investors. Inform clients that since the original purchase was made you have been monitoring the company and would like to make adjustments to the position as you navigate the current conditions.
3. Basing perception of quality on past experiences: There is no silver bullet to "solving" the mental heuristic of anchoring. Being aware of the biases we have can help us keep an open mind and avoid pitfalls. Things change and evolution of thought is necessary in our daily lives to allow ourselves to take advantage of new and improved processes or opportunities. When we view it simply as "change" or "the unfamiliar" we become frustrated / confused / annoyed. We need to constantly evolve our thinking or opinion.

Anchoring is one of many behavioural heuristics or biases that can inhibit investor returns. Whether you are investing on your own behalf, or consult a financial advisor, we hope the examples and suggestions presented above help in your decision making process.

Source: Invesco

1 https://topforeignstocks.com/2017/06/14/the-historical-average-annual-returns-of-australian-stock-market-since-1900/

Investment strategies for your super

Your super returns may be doing ok, but could they be better?

Being actively involved in how and where your super is invested, could make a real difference to your retirement savings over the long-term.

If you are considering going down this route, there are some factors to think about such as your retirement goals, how long you have until you retire and the amount of risk you're comfortable taking on.

For instance, if you're close to retiring, you may want to avoid putting your super somewhere that's too risky. Riskier investments tend to experience more ups and downs so time may help to ride them out.

This article considers four examples of investment strategies for your super.

The importance of diversification

Before we discuss the various investment strategies, it's important to highlight the significance of diversification. Like any type of investment, spreading your super across different types of investment options, can help to build a strong portfolio and manage risk.

Why?

Because if you were to invest all of your super into one asset class such as property, your investment may suffer a loss if the property market was to fall in value. However, if you spread your money across multiple assets, you may have a different result.

Investment strategy type 1: Growth

If you don't think you'll be accessing your super for at least 10 years or more, a growth strategy may work for you as a longer timeframe may help an investment portfolio withstand volatility while aiming for returns.

A growth strategy that follows a higher risk, higher return approach tends to have a larger focus on assets that are exposed to capital appreciation. That is, investing in assets which are expected to grow at a higher rate than the industry or overall market.

For instance, this may involve an investment of around 70-85 per cent in shares or property with the rest in fixed interest and cash-based investments.

Historically, over any 20-year period, a growth strategy has delivered better returns than more conservative portfolios which would mainly be invested in fixed interest and cash. However, over a short-term period, you may experience significant losses as a result of market volatility.

Another key benefit of a growth strategy is that by making greater returns on your investment, your savings are more likely to keep up with the rising cost of living. This is arguably important because over time inflation may reduce the value of your retirement savings, which could make it difficult to maintain your standard of living when you're retired.

Investment strategy type 2: Balanced

Similar to a growth strategy, if you aren't planning to access your super anytime soon, opting for a balanced investment portfolio may be another option.

This strategy is aimed at balancing risk and return so your portfolio has enough risk to provide reasonable returns, but not enough to cause significant losses.

A balanced strategy typically involves investing around 60-70 per cent in shares or property, with the rest in fixed interest and cash-based investments.

Investment strategy type 3: Conservative

You may be considering how you could protect your capital if you want to access your super within 3-5 years.

A safe or conservative strategy follows a lower risk, lower return approach so it's really about preserving the value of your investment portfolio. While there may be less risk of losing money, a downside could be that your returns may not keep up with inflation.

For example, this could involve investing around 20-30 per cent of your super in shares and property, with the rest in fixed interest and cash-based investments.

Investment strategy type 4: Ethical and sustainable

You may choose not to invest in certain companies based on ethical grounds. For example, taking a stance against investing in firearms. This approach is called ethical or socially responsible investing.

There is also sustainable investing which goes beyond incorporating just ethical and social factors. That is, it approaches investing from an environmental and governance lens too. Some super funds now offer this, so if these factors are important to you, speak to your super fund for more details.

If you're a self managed super fund (SMSF) trustee, there are a range of sustainable managed funds which you can tap into.

Review your investment approach

You may want to review your current investment approach with your super fund or SMSF to consider how it aligns with your goals and risk comfort.

For example, if you are looking to take an active role by directly investing your super in shares, exchange traded funds and managed funds, there are super products and platforms which enable you to do this.

Alternatively, a SMSF is an option that enables you to have more control over how your super is invested with the added bonus of being able to access more investment options such as direct property and commodities. You also have the ability to borrow within your super fund for investment. There are a number of administration requirements however, as well as legislative requirements to adhere to.

You may want to consider speaking to a financial expert when determining which super product may be best for you.

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Superannuation is a means of saving for retirement, which is, in part, compulsory. The government has placed restrictions on when you can access your investment held in superannuation. The Government has set caps on the amount of money that you can add to superannuation each year on both a concessional and non-concessional tax basis. There will be tax consequences if you breach these caps. For more detail, speak with a financial adviser or visit the ATO website.

Source: BT

Self-employed?
Don’t leave your business at risk.

What would you do if you became sick or injured and were unable to keep your business running? It’s not something that is often thought about, but it is important to take a moment to consider it.

Did you know that 1 in 2 Australian men and women will be diagnosed with cancer before the age of 85[1]? And that heart, stroke and blood vessel diseases (cardiovascular) diseases kill 1 Australian every 12 minutes[2]?

These alarming statistics may make you think twice about covering yourself, and your business, for the unexpected.

If you were unable to work for 12 months, would your business survive? A serious illness is debilitating and may require extended leave to recover. Are you aware of the total cost of all your business expenses every month? How would you pay for these expenses if something were to happen to you? It’s something that every business owner should consider.

Many life insurance companies offer business insurance solutions which are designed specifically for the self-employed or business owner. This type of insurance includes business expenses insurance which covers the fixed expenses of a business or practice that still need to be paid, even if the life insured cannot work due to injury or sickness.

Business expenses that you need to consider may include, but are not limited to:

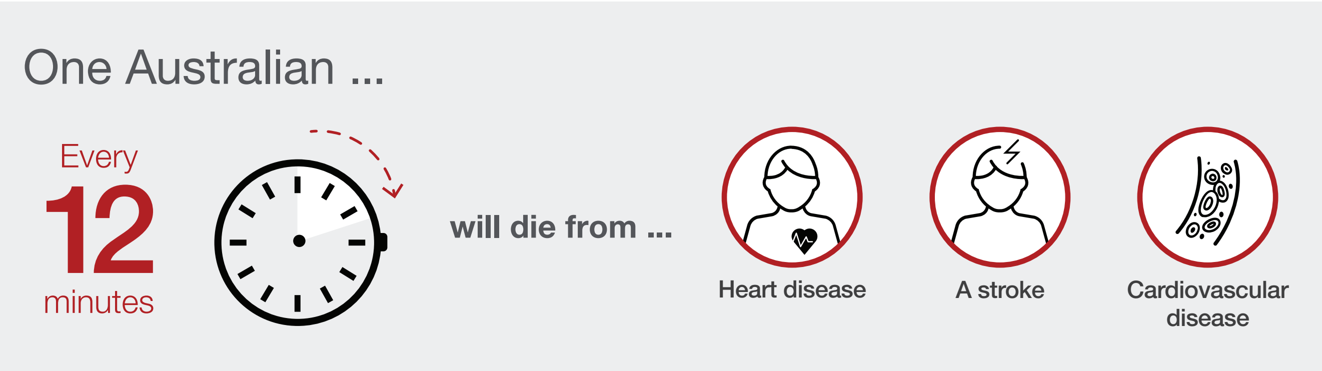
- Accounting and auditing fees
- Regular advertising costs, postage, printing and stationery
- Electricity, heating, gas, water, telephone and cleaning costs
- Security costs
- Net costs of a locum
- Rent, property rates and taxes

If you become disabled, and depending on the type of policy you purchase, the benefit may be paid monthly over a period of 12 months. This period may be able to be extended if at the end of the 12 months the life insured remains totally disabled.

The type of policy you choose and the amount of cover that you need depends on you and your business needs.

Some people think that their income protection insurance is enough to cover themselves and their business. The trouble is, income protection covers around 75% of your earnings derived through your business after expenses, which will help to cover your normal living expenses, but all the bills of the business also keep coming in. Premises and equipment leases, utilities and administration staff must continue to be paid. The advantage of combining a business insurance policy with an income protection policy is that as well as receiving an income stream from your income protection policy, your net business expenses will also be paid. It’s a small price to pay for peace of mind.

Source: AIA Australia



1 Australian Institute of Health and Welfare 2019. Cancer in Australia: In brief 2019. Cancer series no. 122. Cat no. CAN 126. Canberra: AIHW

2 Australian Bureau of Statistics 2018, Causes of Death 2017, ABS cat. no. 3303.0, September

What can retirees do about longevity risk?

A recent National Seniors Australia report highlights that the majority of older Australians worry about outliving their savings. Much of this concern is driven by the fact that most retirees and pre-retirees don't know how long they will live. As a result, they don't know how long they need their savings to last and many under-spend because of this fear of running out. This fear can be alleviated with a good plan for retirement income.

Increasing life expectancy

At face value, a longer life is a good thing. It only becomes a problem when we don't have a proper plan to pay for it. Planning can be a problem because the length of our life is uncertain. We are living longer, but older people don't always know what number to use for planning. Numbers from the Australian Bureau of Statistics (ABS) measure life expectancy from birth. For 2016-18 , the life expectancy of an Australian male is 80.7 years and 84.9 years for a female.

These ABS numbers are low for two reasons. Firstly, they are an estimate from birth, so the average includes people who die young from accidents or illness. Having reached 65, you will live longer than average because you are already a survivor. Secondly, improvements in health mean that younger people will live longer than older people today.

Adding the mortality improvements for someone approaching retirement means the average 65-year-old will live up to seven years longer than an average newborn. Based on the improvements of the past 25 years a 65-year-old today will live, on average, to 88 for males and 90 for females.

Not everyone is average

Remember that these numbers are only averages. In reality, there is a wide distribution of outcomes either side of the average. A plan that only lasts up to the average life expectancy will disappoint one in two retirees.

As most people worry about living longer, they adjust by reducing their spending to ensure that their money lasts. The risk here is that they miss out on enjoying the benefits of spending while they are young enough to enjoy it and endure a lower standard of living than they deserved. This might be good news for the 'kids' inheritance, but spending it on themselves will be better for many retirees.

Building the right plan

It's possible to build a retirement income plan that can provide retirees with some confidence to spend.

Retirees need an understanding of essential spending and what are the 'nice-to-haves' that can be reduced if necessary.

> In simple terms, the essentials for a retiree are things that they would worry about missing out on, such as paying the electricity bill and outings with the grandkids.

Having identified these items, a retiree can check whether they would be able to afford them no matter what happens to their savings. For most older Australians, the Age Pension will provide some help, but for many, especially those with a reasonable level of retirement savings, it won't be enough.

For these people, a guaranteed lifetime income stream, such as a lifetime annuity, can bridge the gap. A lifetime annuity provides a guaranteed monthly income that is regular and dependable. It can help to cover essential expenses and maintain standard of living for as long as one lives, even if their original investment has been fully paid out to them due to living longer than average life expectancy. Typically, this is done with part of the retiree's savings, with the remainder invested to support their desired lifestyle.

The confidence to spend

Understanding essential living expenses and having a plan to cover those expenses provides retirees with the peace of mind to confidently spend their savings on the things they really want to fully enjoy their retirement. They can take the overseas holidays or do more socialising with friends while they are relatively young and can still get the most out of life. When life starts to wind down, these retirees will have cash flows for all the essentials that they need and can take comfort in the knowledge that they were able to enjoy life while they could.

Source: Challenger

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