springedition 2014

financiallyspeaking

Brought to you by your Financial Planner, North West Financial Services (QLD) Pty Ltd

Women and money – getting into good financial habits

Women generally face more financial hurdles in their retirement than men for a number of reasons. Broken work patterns to raise children, lower average earnings, and a longer life expectancy are the main causes. Therefore, women need to take action when they are young so that they are not significantly disadvantaged later on.

There is a significant financial gap that can open up over a lifetime due to many women spending less time in the paid workforce than men. Over the next 40 years, for example, a 25-year-old male is expected to earn (on average) $2.5 million. In the same period, females are expected to earn just $1.5 million.

With the compulsory employer super system entirely based on earnings, it's not hard to see how the gaps identified above directly impact the amount of super women accumulate during their working lives.

Inside this edition

North West Financial Services (QLD) Pty Ltd
ABN: 96 102 314 045, AFSL: 302318
985 Waterworks Road,
The Gap QLD 4061
Ph: 07 3300 1771
Email: info@nwfs.com.au

Getting into good financial habits

The following ten good financial habits can help you make the most of your wealth accumulation strategy.

1. Start with the basics

The foundations to achieving your financial goals start with getting organised. This means you need to start with the basics – complete a budget and understand your expenditures. This will also allow you to manage your cash-flow to meet your ongoing expenses.

2. Improve your financial literacy

Financial literacy is the ability to make informed judgements and effective decisions about the use and management of money. It is an essential skill for functioning in modern society and is becoming increasingly important in achieving your financial goals.

3. Take control and build your super

Statistics show that women in Australia earn less than men on average, lower earnings means lower superannuation balances[1]. Therefore, it is important to improve your knowledge and take control of your super. Start by tracking down any lost super and providing your tax file number to avoid paying up to 47 per cent tax on your employer contributions. Consolidating your super into one account is also important.

There are a number of ways to build your super and even small contributions can make a big difference over time:

- Salary sacrifice.
- Government super co-contribution: the Federal Government may match your personal after-tax contribution to super if you meet the eligibility criteria.
- Partner or spouse contributions: if you have a low income, or are not working, your partner or spouse may be able to contribute to your super.

4. Understand investment risk

An integral part of your wealth accumulation strategy will be investing into assets such as fixed interest, property and Australian or international shares. It is essential to understand potential investment risks and be comfortable with the impact of decisions you make (such as how much risk you're taking on).

5. Understand your investment options

As a consumer, you probably wouldn't purchase a product you didn't know anything about – you would complete some research to get a greater understanding. The same principal applies to investments. You need to understand what you are investing in, what investment options exist and if these options are suitable for you.

6. Harness the power of regular investing

Making your money work harder for you is good practice. The easiest way to do this is to harness the power of regular investing. Investing regularly over a long period of time allows you to take advantage of compounding investment returns.

7. Protect your most valuable asset

Your ability to earn an income is your most valuable asset. All of your future plans depend on it. If you're unable to work due to illness or injury, you lose this valuable asset – unless you have the right insurance arrangements in place. You should seriously consider taking out appropriate insurance cover, such as income protection and total & permanent disablement cover to ensure your financial stability is protected.

8. Make the right estate plans

It is estimated that nearly half of all Australians die without a Will. Creating one is a vital aspect of your estate planning which should also include enduring power of attorney, medical power of attorney, guardianship of your children and a binding death benefit nomination within your super account.

9. Appreciate that life changes

Particularly for women, circumstances will change throughout your life, therefore, your goals will too. So that you can continue to make the most of what you have, your financial plan should reflect changes. For example, you may get married or you may have children. You may receive inheritance or a redundancy and need some advice about the most tax-effective way to use it.

It's your life; make the most of every opportunity.

10. Develop a strategy

Clear direction to help achieve your goals can be formulated in a strategy within a financial plan. Your financial plan can be likened to a road map which will move with you over time as your circumstances change.

Source: IOOF, August 2014

Speak to your financial planner to ensure you work towards achieving your financial and lifestyle goals.

1 ABS, Category 6302.0, Average Weekly Earnings - Trend, February 2011 (released 19.05.11)

Why does cash matter?

The humble wallet is the latest item under threat by disruptive technology as smart phones and electronic and online payment systems are making banknotes and coins redundant.

American economist Milan Zeleny coined the phrase ‘disruptive technology’ to describe how any given technology evolves in a life cycle to be replaced by a new core technology. A classic example was Henry Ford’s 1908 launch of the first mass-produced car, the Model T.

The Model T spelt the end of the horse drawn carriage. In Australia, coach operator Cobb & Co played an important part in the development of the nation from 1850 until the turn of the 20th century. It went into receivership in 1911 due to the proliferation of rail networks and automobiles.

While it’s an interesting note in history, it raises a larger issue. When we finish our education and embark on a career we hopefully have a reasonable idea about our future occupation.

What we are unlikely to think about is how technology or other events may one day interrupt our employment and ability to earn. It’s likely many of us are not planning our wealth strategy in full recognition of the dynamic and changing environment in which we live.

From the demise of traditional media, to the irrelevance of CDs and paper books, and even the rise of online dating services to replace the pub or club as a social meeting place, we see change everywhere.

Rapid change means you don’t know what the future holds for your career. So it has never been more important to take control of your money, and start making it work for you, to achieve and protect your goals and aspirations.

It all starts with cash flow. For most of us, when we think about how to become financially independent we draw a line from savings to an investment property or shares. But some simple planning cannot only make the whole process smoother but also more effective – and in the long term that can make a huge difference to your wealth.

The first step is getting organised. A cash hub should be high on the list of preparations. Typically, a cash hub accrues interest on a daily basis and acts as a central point from which to pay all your bills through BPAY®, direct credit and direct debt, while also managing your deposits and how your cash is dispersed.

Your financial planner is another vital component in your long term financial security.

Studies show, using a financial planner will yield results. A report by international research group Morningstar[2] in late 2012 put the value a financial planner adds to your financial planning at 1.82 per cent a year. To put that in context, if you put $30,000 into a cash account that earned 6 per cent a year compound interest for 10 years, then the cash balance would grow to $53,725.43. If a financial planner added 1.82 per cent to that annual return it would grow by an additional 18.5 per cent to $63,696.35.

Having a relationship with your financial planner means you never have to face decisions alone.

Source: BT, August 2014

Think of your financial planner as a life coach. Unlike most of us they have been trained to manage cash and to grow investments over the long term.

® Registered to BPAY Pty Ltd.

ABN 69 079 137 518 Information in this article has been provided by third parties has not been independently verified and BT Financial Group is not in any way responsible for such information. While the information contained in this document has been prepared with all reasonable care, BT Financial Group accepts no responsibility or liability for accuracy of information from third parties is accepted.

2. Morningstar report – http://corporate.morningstar.com/ib/documents/PublishedResearch/AlphaBetaandNowGamma.pdf

Health insurance – To cover or not to cover?

Private health insurance – it can be a minefield to navigate and a big decision for many people. Hospital, extras or both? Which fund? What do all the rebates, thresholds and surcharges mean? Here we look at what the future holds for the industry, recent legislative changes and how you can make the most of this important investment into health and wellbeing.

A question of money?

Jean is 56, single and has limited private health cover. She has always enjoyed good health, pays special attention to her fitness and prides herself on rarely needing to see a doctor. However, in the past year, Jean's teeth have been causing her problems and one of her knees needs to be replaced following years of running, limiting her active lifestyle.

Cost does tend to be the biggest factor for most people considering taking out private health insurance and, according to the National Health Survey, 58 per cent of Australians who don't have cover say it's because they can't afford it[3]. However, more than 57 per cent of the population aged 18 or over have chosen to take out private health insurance of some kind[4]. More than 51 per cent of those people cited 'security, protection and peace of mind' as their primary reason for having private health insurance, followed by 'allows treatment as private patient in hospital' (28.5 per cent)[4].

Unfortunately, Jean suddenly discovered all of those reasons applied to her situation. She has received quotes for major dental work that run into thousands of dollars, much of which her health insurance won't cover. Her limited health cover also means she faces a long wait before she is able to have the knee surgery.

An unsustainable model

Driven by an ageing population and increasingly expensive healthcare products and services, in less than four decades a projected 46 per cent of all Australian Government spending will be on health and ageing[5], meaning health inflation is rising consistently faster than the rest of the economy. And annual private health insurance premium increases, which are controlled by the Australian Government, have failed to keep pace with health inflation over the past seven years.

The recent National Commission of Audit acknowledged this problem, saying, 'Health care spending represents the Commonwealth's single largest fiscal challenge over the long-run, with expenditure on all major health programs expected to grow strongly to 2023/24 and beyond. At a practical level, increased health spending reduces resources for other key areas[6].

The Commission also concluded that significant opportunities exist to improve the operation of Australia's private health insurance system, which could help rein in health spending.

Understanding recent changes

One thing that does help with the rising cost of health insurance is the Australian Government rebate on private health insurance, although that assistance has been whittled away in recent years. On 1 July 2012 this rebate became income tested, meaning it was affected by a variety of factors – including your age, income and the number of children covered under the policy.

Since then, the rebate increased by the same proportion as the price of the cover. However, on 1 April 2014, new calculations were introduced and the rebate is now linked to the rate of inflation and the industry average price increase, rather than being a fixed percentage. This change applies to all Australian health funds and means the value of the rebate will actually decrease over time. Your rebate entitlement will continue to be based on your age and income.

The Government's updated private health insurance rebate and Medicare levy surcharge thresholds took effect on 1 July 2014. However, as part of this year's Federal Budget, the Government proposed that the rebate and thresholds be frozen for three years from 1 July 2015. This would likely see the thresholds adjusted on 1 July 2015 and then fixed for three years and the rebate adjusted on 1 April 2015[7] and then fixed for the following three years. But stay tuned… as with many Federal Budget measures, these changes are yet to receive support from the Senate.

Knowledge is power

Private health insurance can get complicated but here are some tips to help you get the most out of health insurance:

- Review your policy. If you've had the same policy for many years, chances are you're paying for things you don't need. You might find you're still covered for pregnancy when your kids have all moved out of home! There are also some legacy health covers still in the market that may mean older people in particular can be paying more than they need to – for example, they may be charged a daily levy for each night spent in hospital on top of their excess.
- Make sure you've registered the correct income threshold. To receive the maximum government rebate on private health insurance, you need to nominate an income threshold, or tier, based on the amount you earn. Avoid a nasty surprise at tax time by ensuring your selected tier reflects your current income.
- Check your ambulance cover. Many people fall into the trap of believing private health insurance covers all ambulance travel but, in fact, it will often only apply to an emergency ambulance – and that depends on how the state ambulance service categorises your medical condition. Cover also varies from state to state, including where the accident or emergency occurs as well as where you are insured.
- Consider your excess. If you're looking to save money, there are options to pay a higher excess to reduce your premium. Just remember, you'll need to be prepared to pay the excess if you do go to hospital.
- The longer you wait, the more you'll pay. The Government's Lifetime Health Cover is a two percent loading on private health insurance premiums for every year that a person over the age of 30 is without private hospital cover (up to a maximum of 70 percent). If you are a high income earner, you'll also pay the Medicare levy surcharge for every day you don't have private health insurance.

The hope, of course, is that people live a long and healthy life and won't need the protection that private health insurance provides. But the reality is that almost everyone will benefit from health cover – be it sooner or later.

Source: Australian Unity, August 2014

To find out more about health insurance, speak to your financial planner.

3. Australian Health Survey: Health Service Usage and Health Related Actions, Australian Bureau of Statistics, 2011-12
4. ibid
5. Long term funding of health and ageing: The rising pressures on commonwealth and state budgets, commissioned by the Business Council of Australia, prepared by Deloitte Access Economics, 2013
6. Towards Responsible Government, The Report of the National Commission of Audit Phase One, Commonwealth of Australia, February 2014
7. Pausing indexation of some Medicare Benefits Schedule fees and the Medicare Levy Surcharge and Private Health Insurance Rebate thresholds, Budget Paper No. 2: Budget Measures, Part 2: Expense Measures, Australian Government, 2014/2015

Bonds pay the bills, shares fund the retirement experience

Patience and education are key to building a strong investment portfolio for retirement. In this article we explore the options for building a portfolio which grows with you and adapts as your goals change.

The importance of education

Education is key to building a sound investment strategy. The more time spent on educating and building your knowledge, the greater the likelihood of aligned goals and outcomes.

Prior to investing, you should clearly understand any asset class you are considering. Try this simple test: can you explain the asset class and reasons for investing to your young child and elderly grandmother? If not, take the time to reflect on whether it's the best investment choice.

The next step is to decide what role that asset will play in your portfolio. Portfolio construction is the reverse of opportunity cost investing.

Portfolio construction and the challenge of balance

A well-constructed portfolio will meet investment goals, volatility expectations and longevity outcomes. The share market had traditionally inherited the role of growth engine for portfolios. However, more recently, there has been a greater move by investors towards consistent dividend-paying companies – that is, "bond-like" shares.

This demand from investors for dividend shares has resulted in a change in behaviour by corporate Australia, which ultimately has the potential to destabilise the goals of portfolio construction. If corporate Australia constantly pays out profits, where will the asset growth necessary for a well-constructed portfolio come from?

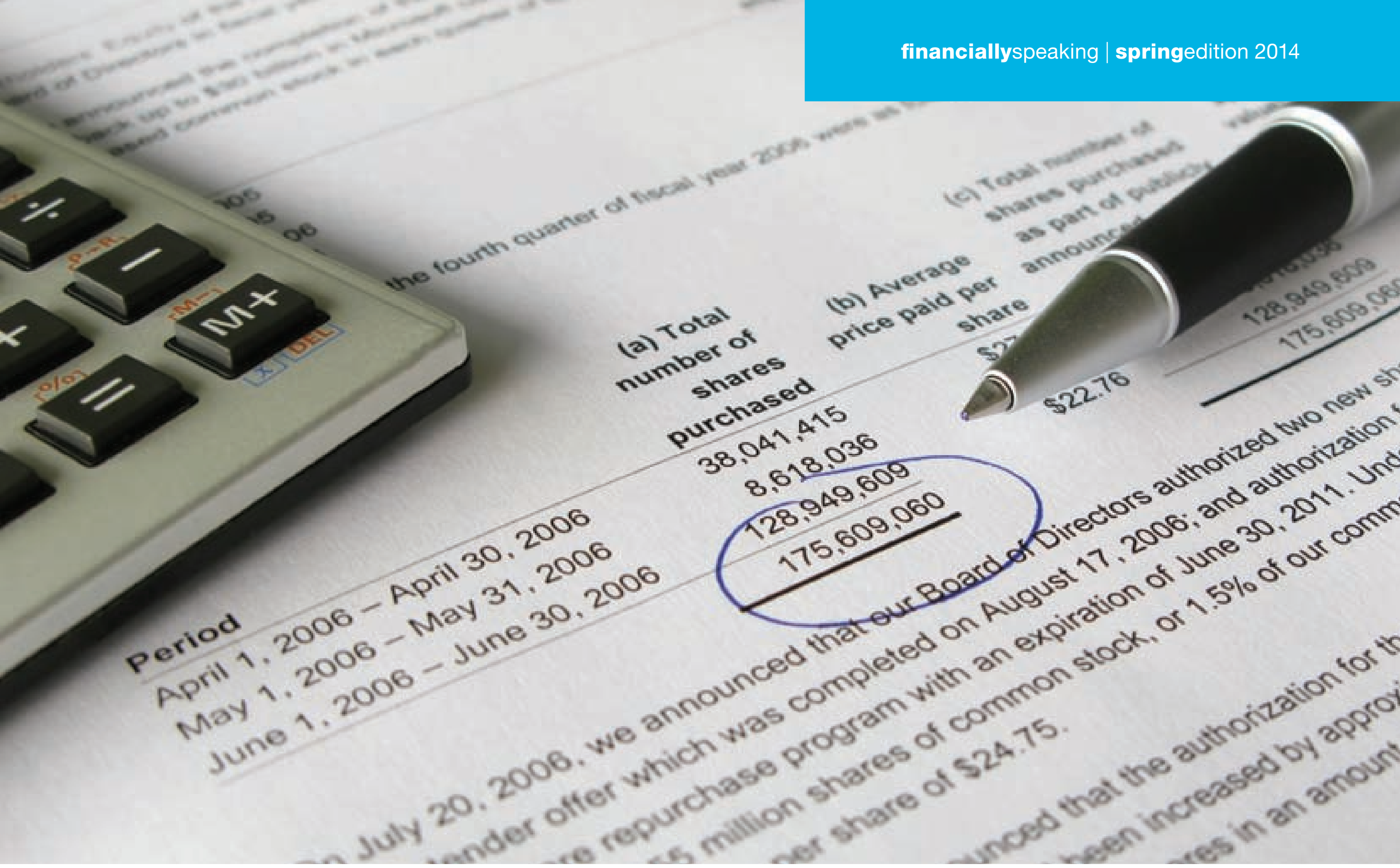
For a comfortable retirement, you need a portfolio that grows with you and adapts as your goals change. This means you need a balanced portfolio that provides income as well as assets that grow at inflation-plus levels.

Investment goals and the benefits of fixed income

While the primary role of fixed income is to provide income, the beauty of the fixed income component of a portfolio is the potential for straightforward investment. Your financial planner can opt for fund manager engagement or embrace the direct investment route, so the questions to ask are, "Will I get my money back?" and, "What is the risk return I am deriving from this asset?"

The benefit of fixed income is the consistent revenue outcomes based on a predetermined series of cash flows. Interest rate volatility is managed by balancing the fund between fixed and floating bonds. In the current investment climate, a portfolio combining inflation, fixed and floating rate bonds should target a return of six per cent. However, in the chase for yield, this is becoming increasingly challenged by crowding out from investors searching for low-volatility assets performing on a relative value-basis comparison.

By supporting investors' liabilities with consistent income results, the risk of the portfolio is naturally reduced. This is not to assume that the portfolio won't be without risk, but the goals of the portfolio have altered – moving from a trading basis to a balance sheet basis. When the objective of the investor is to manage cash flows, monies arriving from fixed income are set aside to cover pending costs.



A winning strategy

Generating income isn't the only purpose of the bond component of a portfolio. Inflation-linked bonds can help mitigate the onerous impact of inflation. It's important for investors to appreciate that inflation has different impacts within different demographics – older investors don't buy as many appliances like flat-screen TVs, for example, but they do buy energy, healthcare and retirement options. As such, although inflation may average 2.5 per cent, the true cost to some segments is significantly higher and needs to be managed. One way to manage the cost of inflation is to buy investment-grade inflation bonds. The goal should be to buy inflation protection at a real rate of anything above three per cent. (The real rate is the interest rate before inflation that has been added to the total return.)

A combination of fixed rate, floating rate and inflation-linked bonds can be constructed to mitigate the high costs of retirement. To enhance the performance of the portfolio, investors need to manage the portfolio from both a credit and duration perspective. Credit spreads are the implied cost of funding– recent bank hybrids have been issued at the bank bill swap rate of +3.20 per cent so the credit spread is then 3.20 per cent. If investors invest at elevated credit spreads they can carry the higher returns, but if credits rally, they should look to bank profits and reinvest at higher spreads. Duration also works in favour of the investor – when yield curves are normal, the longer you invest, the higher the return. Investors then rotate the investment as it moves down the yield curve and reinvest for longer, picking up the improved return. This strategy works best in a rallying or static market. If investors are concerned that rates are going up, they should weight their investments towards floating rate notes.

Embracing the right kind of change

Since portfolio construction is constantly evolving, the challenge is to be consistent. By chasing the latest investment advice, investors run the risk of exchanging alpha for performance. And by chasing trades, they are overrun by the 'what if' rear-view world of investment management. This challenge should be met with a combination of patience and education.

Source: NAB, August 2014

To find out more about building a strong investment portfolio, speak to your financial planner.

Global investment outlook

In general, share markets have been strong over the past 12 months. This is reflected in the performance of the MSCI World Net Total Return Index in Australian dollars, which has risen by 20.3 per cent. The current investment environment is extraordinary. Many world share indices ended June at or near all-time record highs.

We continue to see capital flows that are distorting markets and causing asset prices and currencies to diverge from underlying economic trends. The enormous US$600 billion per annum quantitative easing (QE) being undertaken by the Bank of Japan, as part of Prime Minister Abe's economic plan, is encouraging Japanese banks, insurers and pension funds to sell Japanese government bonds and invest in other assets, including foreign sovereign bonds. This may, in part, explain the rally in US and European government bonds over the past six months (as well as the strong Australian dollar), when economic data would have suggested that the opposite might have been expected.

It is a little surreal that share market volatility and other risk measures appear benign as we edge closer to a cycle of increasing long-term interest rates, with the US Federal Reserve and the Bank of England ending their QE programmes and China appearing to be entering a period of lower growth. While we are not predicting a major downturn in share markets (in the absence of a major global event), they have become more challenging and value has become harder to find as share prices have continued to rise. While nothing is certain in investing, we predict that the next three years will be challenging for shares as they battle the headwind of rising long-term interest rates.

We feel that people cannot retire on "relative investment returns"; only by generating investment returns that exceed the rate of inflation (ideally by a satisfactory margin) will investors increase their wealth over time.

To help achieve this, we continue to be exposed to the following major investment tailwinds:

- The continued rise in emerging market consumption growth: via investments in multi-national consumer franchises.
- US interest rates 'normalising' over the next two years as the US economy recovers.
- A move to a cashless society as there continues to be a strong secular shift from spending via cash and cheque to cashless forms of payments such as credit cards, debit cards, electronic funds transfer and mobile payments.
- US housing recovery in new housing construction, together with investment in existing housing stock, should drive a strong cyclical recovery in companies exposed to the US housing market, while providing a boost to the overall economy.
- Technology/software: we believe that entrenched global software companies boast enormous competitive advantages and exhibit attractive investment characteristics.
- Internet/e-commerce via a number of internet-enabled businesses that are experiencing increasing competitive advantages and showing very attractive investment characteristics.

Source: Magellan, August 2014

To find out more about investing in the share market, speak to your financial planner.

NORTH WEST FINANCIAL SERVICES (QLD) PTY LTD

North West Financial Services (QLD) Pty Ltd
ABN: 96 102 314 045, AFSL: 302318
985 Waterworks Road,
The Gap QLD 4061
Ph: 07 3300 1771
Email: info@nwfs.com.au