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QUARTERLY INSIGHT

InterPrac Financial Planning Newsletter Edition 2 2022

Winter update

Winter has arrived with a bang, and we are experiencing extremely cold weather - even in Queensland. Those who enjoy snow sports are no doubt very happy with the level of cover on the ski-fields so early in the season.

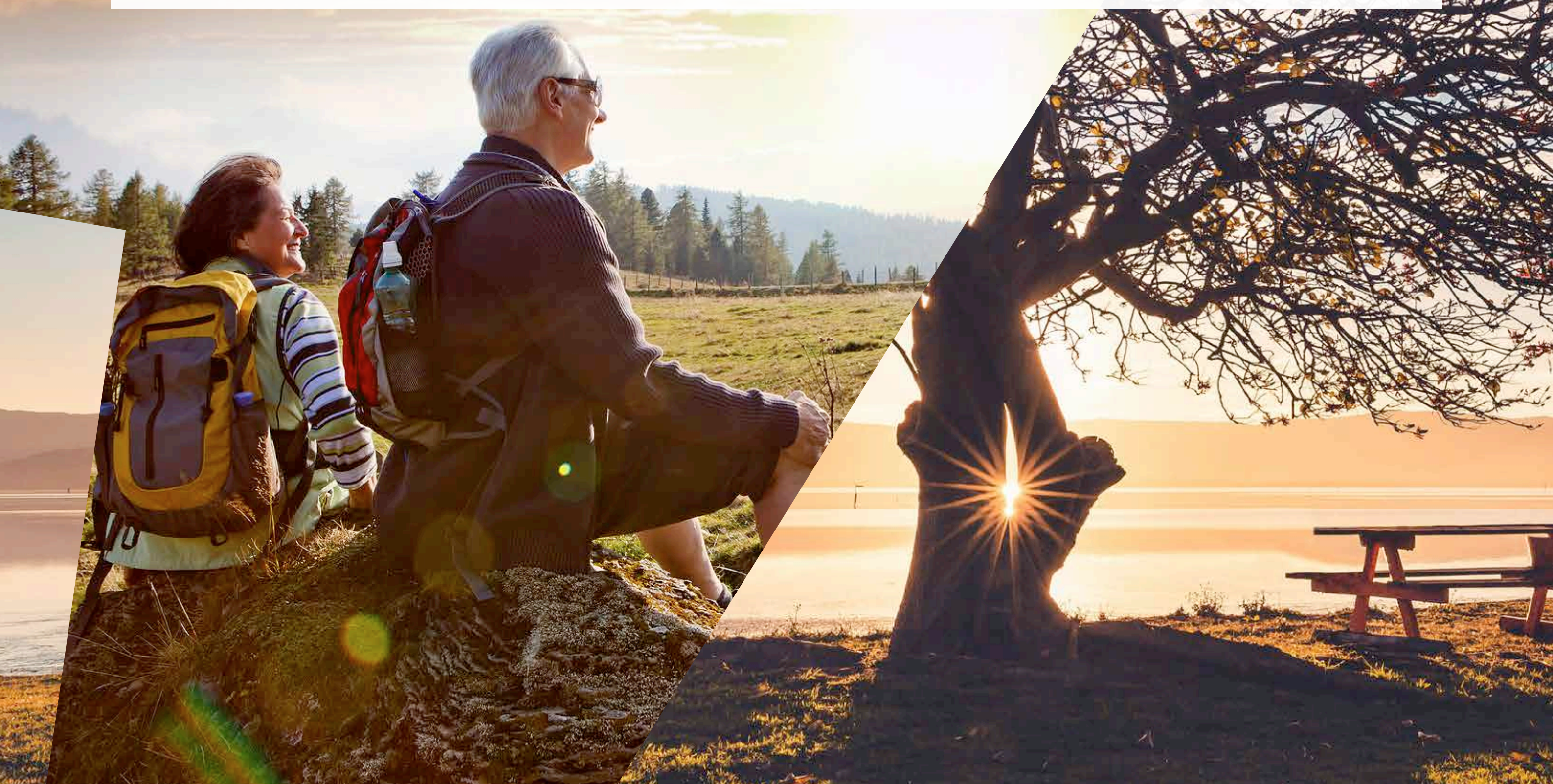
The Federal Election has come and gone, and our new government is settling into their new roles. Australians have had their say and although we may not all be happy with the outcome, it's fair to say there are some major challenges we all face as a nation. Greater unity and working together may be more productive right now in tackling the big issues, instead of the inter-party bickering we often see.

High rates of inflation and the resulting recent increases in interest rates in an attempt to curb this rise will continue to put pressure on many Australian families, especially as more interest rate rises are expected. This is at a time when energy prices are also under huge upward pressure and many people are increasingly concerned about being able to afford food, electricity, and gas.

As we are nearing the financial year end, there are many things to consider and last-minute changes to make to ensure we optimise our tax savings. There are also a few changes income tax wise in the new financial year and we need to be aware of all of these too, ensuring we avoid any pitfalls but also benefiting where possible.

We all need a friend and we have given you a few suggestions on how to find new friends and why we should nurture old friendships.

Lastly, try our French Onion Soup and Cheese Toast Recipe and keep warm!



Markets Outlook

In the last 12 months markets have been quite volatile and for the first time in several years a variety of assets that had previously looked next generational have fallen in value many off the cliff.

The most important thing to keep in mind during an economic slowdown is that it's normal for the any asset market to have negative years—it's part of the business cycle. If you are a long-term investor (meaning a time horizon of 10+ years), one option is to take advantage of dollar-cost averaging (DCA).

This term is most often referred to in respect to shares but, it applies to all assets where each new contribution you make to your investment occurs buy acquiring new units in that asset.

We all wish to buy low and sell high, so in a longer-term accumulation sense when the price of an asset falls it is sage to consider increasing the number of units you acquire when the unit price has fallen.

By purchasing units after price deterioration, you end up buying more units at a low price when the market is down. Over the long run, your cost will "average down," leaving you with a better overall entry price for your shares or units in a fund.

The month of June is a time when many self-employed or employees consider salary sacrificing a lump sum one off contribution in to super to tax plan, with markets down, the dollar cost averaging strategy is timely.

If you are in accumulation and can make a tax effective one-off contribution to your super fund dollar cost averaging is a strategy that cuts down on your investment risk.

The term dollar-cost averaging refers to the practice of investing a consistent dollar amount in the same investment over a period. For instance, you might be interested in buying XYZ stock but don't want to take the risk of putting in your money all at once.

You could instead invest a steady amount, say $300, every month. If the stock trades at $10 one month, you will buy 30 shares. If it later goes up to $12, you will end up with 25 shares that month. And if the price falls to $8 another month, you will accumulate 37 shares.

There are both pros and cons to dollar-cost averaging that can help an investor determine if it is the right investment strategy for them.

Key takeaways

- Dollar-cost averaging refers to the practice of investing a consistent dollar amount in the same investment over a period.
- The method of dollar-cost averaging reduces investment risk but is also less likely to result in outsized returns.
- The pros of dollar-cost averaging include the reduction of the emotional component of investing and avoiding bad timings of purchases.
- The cons of dollar-cost averaging include missing out on higher returns over the long term and not being a solution to all other investing risks.

Pros

Reduces Emotional Component

One advantage to dollar-cost averaging is that by investing mechanically, you will take the emotional component out of your decision-making. You will continue a pre-set course of buying a certain dollar amount of your preferred investment irrespective of how wildly the price swings. This way, you will not bail out of your investment when the price goes down in a wild swing, but rather see it as an opportunity to acquire more shares at a lower cost.

Avoids Bad Timing

If you invest your money all at once in a particular investment, there is the risk that you will invest just before a big market downturn. Imagine you had jumped into an investment just before the market downturn that began in 2007. You would have ended up losing more money than if you had invested only some of your money before the downturn.

It is almost always impossible to determine a market bottom, which is why dollar-cost averaging can help smooth out market timings.

Of course, the other side of this coin is that you might also miss out on investing at just the right time before the market starts trending upward in a bull market.

Cons

Market Rises Over Time

A disadvantage of dollar-cost averaging is that the market tends to go up over time. This means that if you invest a lump sum earlier, it is likely to do better than smaller amounts invested over a period of time. The lump sum will provide a better return over the long run as a result of the market's rising tendency.

Not a Substitute for Identifying Good Investments

Dollar-cost averaging is not a solution for all investment risks, however. You will have to take on the task of identifying good investments and do your research even if you opt for a passive dollar-cost averaging approach. If the investment you identify turns out to be a bad pick, you will only be investing steadily into a losing investment.

Also, by adopting a passive approach, you will not be responding to the changing environment. As the investment environment changes, you might get new information about an investment that might want to make you rethink your approach.

For instance, if you hear that XYZ company is making an acquisition that will add to its earnings, you might want to increase your exposure to the company. However, a dollar-cost averaging approach does not allow for that sort of dynamic portfolio management.

The Bottom Line

If you are a less experienced investor and want to follow a pre-set approach so that you are not exposed to wild market swings, dollar-cost averaging could be a good approach. On the other hand, if you are experienced, you might be able to get better returns by active strategizing rather than going for dollar-cost averaging.

If you would like to discuss making a one-off contribution whilst the market has had its current pull back and wish to do so pre-June 30, please give us a call.

How to manage rising interest rates

Rising interest rates are almost always portrayed as bad news, by the media and by politicians of all persuasions. But a rise in rates cuts both ways.

Higher interest rates are a worry for people with home loans and borrowers generally. But they are good news for older Australians who depend on income from bank deposits and young people trying to save for a deposit on their first home.

Rising interest rates are also a sign of a growing economy, which creates jobs and provides the income people need to pay the mortgage and other bills. By lifting interest rates, the Reserve Bank hopes to keep a lid on inflation and rising prices. Yes, it's complicated.

How high will rates go?

In early May, the Reserve Bank lifted the official cash rate for the first time since November 2010, from its historic low of 0.1 per cent. The reason the cash rate is watched so closely is that it flows through to mortgages and other lending rates in the economy.

To tackle the rising cost of living, the Reserve Bank expects to lift the cash rate further, to around 2.5 per cent.[i] Inflation is currently running at 5.1 per cent and while unemployment is below 4 per cent, annual wages growth of 2.4 per cent is not keeping pace with rising prices.[ii]

So what does this mean for household budgets?

Mortgage rates on the rise

The people most affected by rising rates are likely those who recently bought their first home. In a double whammy, after several years of booming house prices the size of the average mortgage has also increased.

According to CoreLogic, even though price growth is slowing, the median home value rose 16.7 per cent nationally in the year to April to $748,635. Prices are higher in Sydney, Canberra and Melbourne.

The table below shows the impact a rate rise of 1-2 per cent rise would have on monthly mortgage repayments in Australia's capital cities. For example, a 1 per cent rise would add $486 a month to repayments on the median new home loan in Sydney, and an additional $1,006 a month for a 2 per cent rise.

While the big four banks are not obliged to pass on the cash rate changes, in May they passed on the Reserve Bank's 0.25 per cent increase in the cash rate in full to their standard variable mortgage rates which range from 4.6 to 4.8 per cent. The lowest standard variable rates from smaller lenders are below 2 per cent.[iii]

How much could mortgage repayments rise for a new owner occupier?

			Monthly mortgage repayments		
	Median value	Loan amount (80% LVR)	Current*	Increase with 1% rise	Increase with 2% rise
Sydney	$1,127,723	$902,178	$3,560	$486	$1,006
Melbourne	$806,144	$644,915	$2,545	$348	$719
Brisbane	$770,808	$616,646	$2,433	$332	$687
Adelaide	$619,819	$495,855	$1,957	$267	$553
Perth	$552,128	$441,702	$1,743	$238	$492
Hobart	$735,425	$588,340	$2,322	$317	$656
Darwin	$501,182	$400,945	$1,582	$216	$447
Canberra	$947,309	$757,847	$2,990	$408	$845

Source: CoreLogic. *Assumes current average variable rate of 2.49%, monthly P&I repayments over 30 years.

Still, it's believed most homeowners should be able to absorb a 2 per cent rise in their repayments.

The financial regulator, APRA now insists all lenders apply three percentage points on top of their headline borrowing rate, as a stress test on the amount you can borrow (up from 2.5 per cent prior to October 2021).

But with prices increasing for food, fuel, childcare and other basics, budgets are tight, and households may need to cut back non-essential spending or increase their hours of work.

Before you take drastic measures, it's worth looking at some painless ways to improve your household budget.

Rate rise action plan

Whatever your circumstances, the shift from a low interest rate, low inflation economic environment to rising rates and inflation is a signal that it's time to revisit some of your financial assumptions.

The first thing you need to do is update your budget to factor in higher loan repayments and the rising cost of essential items such as food, fuel, power, childcare, health and insurances. You could then look for easy cuts from your non-essential spending on things like regular takeaways, eating out and streaming services.

If you have a home loan, then potentially the biggest saving involves absolutely no sacrifice to your lifestyle. Simply pick up the phone and ask your lender to give you a better deal. Banks all offer lower rates to new customers than they do to existing customers, but you can often negotiate a lower rate simply by asking.

The big four banks' discount rates are more than 2 per cent below their current headline rates, a potential saving of tens of thousands over dollars over the life of your loan. If your bank won't budge, then consider switching lenders. Just the mention of switching can often land you a better rate with your existing lender.

The challenge for savers

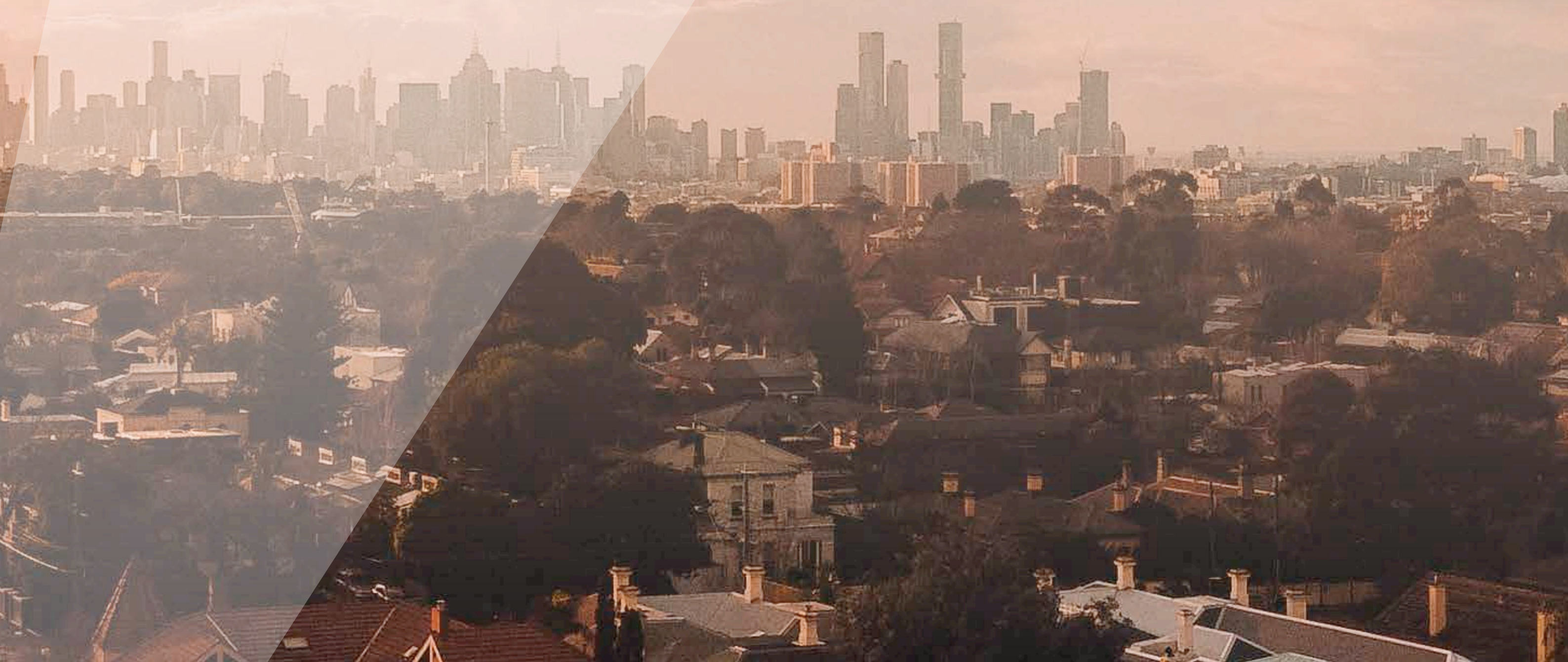
Older Australians and young savers face a tougher task. Bank savings rates are generally non-negotiable, but it does pay to shop around.

The silver lining is that many people will also see increased interest rates on their savings accounts as the cash rate increases. Banks can, however, be slower to pass on the full increase in the cash rate to savings accounts. By mid-May only three of the big four had increased rates for savings accounts. Several lenders also announced increased rates for term deposits of up to 0.6 per cent.[iv]

High interest rates traditionally put a dampener on returns from shares and property, so commentators are warning investors to prepare for lower returns from these investments and superannuation.

That makes it more important than ever to ensure you are getting the best return on your savings and not paying more than necessary on your loans. If you would like to discuss a budgeting and savings plan, give us a call.

i https://www.rba.gov.au/speeches/2022/sp-gov-2022-05-03-q-and-a-transcript.html
ii https://www.abs.gov.au/
iii https://www.canstar.com.au/home-loans/banks-respond-cash-rate-increase/
iv https://www.ratecity.com.au/term-deposits/news/banks-increased-term-deposit-interest-rates



A super end to the financial year

As the end of the financial year approaches, now is a good time to check your super and see what you could do to boost your retirement nest egg. What's more, you could potentially reduce your tax bill at the same time.

There are a handful of positive changes to super due to start next financial year, but for most people, these will not impact what you do before June 30 this year.

Changes ahead

Among the changes from 1 July, the superannuation guarantee (SG) will rise from the current 10 per cent to 10.5 per cent.

Another upcoming change is the abolition of the work test for retirees aged 67 to 74 who wish to make non-concessional (after tax) contributions into their super. This will allow eligible older Australians to top up their super even if they are fully retired. Currently you must satisfy the work test or work test exemption. This means working at least 40 hours during a consecutive 30-day period in the year in which the contribution is made.

But remember you still need to comply with the work test for contributions you make this financial year.

Also on the plus side, is the expansion of the downsizer contribution scheme. From 1 July the age to qualify for the scheme will be lowered from 65 to 60, although other details of the scheme will be unchanged. If you sell your home that you have owned for at least 10 years to downsize, you may be eligible to make a one-off contribution of up to $300,000 to your super (up to $600,000 for couples). This is in addition to the usual contribution caps.

Key strategies

While all these changes are positive and something to look forward to, there are still plenty of opportunities to boost your retirement savings before June 30.

For those who have surplus cash languishing in a bank account or who may have come into a windfall, consider taking full advantage of your super contribution caps.

The annual concessional (tax deductible) cap is currently $27,500. This includes your employer's SG contributions, any salary sacrifice contributions you have made during the year and personal contributions for which you plan to claim a tax deduction.

Claiming a tax deduction is generally most effective if your marginal tax rate is greater than the 15 per cent tax rate that applies to super contributions. It is also handy if you have made a capital gain on the sale of an investment asset outside super as the tax deduction can offset any capital gains liability.

Even if you have reached your annual concessional contributions limit, you may be able to carry forward any unused cap amounts from previous years if your super balance is less than $500,000.

Once you have used up your concessional contributions cap, you can still make after-tax non-concessional contributions. The annual limit for these contributions is $110,000 but you can potentially contribute up to $330,000 using the bring-forward rule. The rules can be complex, especially if you already have a relatively high super balance, so it's best to seek advice.

Government and spouse contributions

Lower income earners also have incentives to put more into super. The government's co-contribution scheme is aimed at low to middle income earners who earn at least 10 per cent of their income from employment or business.

If your income is less than $41,112 a year, the government will contribute 50c for every after-tax dollar you squirrel away in super up to a maximum co-contribution of $500. Where else can you get a 50 per cent immediate return on an investment? If you earn between $41,112 and $56,112 you can still benefit but the co-contribution is progressively reduced.

There are also incentives for couples where one is on a much lower income to even the super playing field. If you earn significantly more than your partner, ask us about splitting some of your previous super contributions with them.

Also, if your spouse (or de facto partner) earns less than $37,000 a year, you may be eligible to contribute up to $3000 to their super and claim an 18 per cent tax offset worth up to $540. If they earn between $37,000 and $40,000 you may still benefit but the tax offset is progressively reduced.

As it can take your super fund a few days to process your contributions, don't wait until the very last minute. If you would like to discuss your super options, call now.

Source: ATO

Thriving on social connection

The phrase 'no man is an island' is from a poem written by John Donne and expresses the idea that humans need to be part of a community to thrive. That's certainly true, by nature we are social creatures and connection is a core human need. So why do some many of us feel alone and what can we do to feel more connected?

The last few years have highlighted the importance of social connection on our mental health and physical well-being, as our movements were restricted to varying degrees. The need to connect socially is as basic as our need for food, water, and shelter, with studies showing that it reduces the incidence of heart disease and stroke.[i]

You're not alone in feeling alone

While we all need social connection, so many of us are feeling that it's lacking in our lives. Feeling isolated is pretty common and happens to us all at one time or another, although loneliness appears to be particularly prevalent at the moment. A 2018 survey revealed that one in four of us are lonely and this increased to around half of us during the pandemic.[ii,iii]

So, what measures can we take to feel more connected?

Think about what you need

Everyone has different social needs. If you're used to spending a lot of time with colleagues, friends and loved ones, you might feel isolated or lonely with just a few interactions per week, while for someone who likes their own company that might be simply fine.

On that note, it's important to be able to enjoy your own company and sometimes periods of being alone can provide inner peace and time for introspection, making those moments of connection all the more precious.

Your social needs also change over time and under different circumstances. A life change like becoming a parent or retiring from the workforce can prompt a shift in your need to connect with others.

Quality can be more important than quantity

It's important to consider the significance of meaningful connections rather than just social interaction, for the sake of it. Often the intimacy of a deep and meaningful discussion with a close mate can be much more enjoyable than a dinner with people you barely know.

Foster good social skills

Social connection is a two-way street so there are things you can do to improve the quality of your social interactions. You can forge deeper connections by talking about things that matter to you and to the other person, developing good listening skills and demonstrating real interest in what they have to say.

Seek out new people and experiences

It can be hard to foster new social connections. One effective way is to join a group to be with people who have similar interests. This growing need has led to apps being built for this purpose, with one of the most popular being *meetup*.[iv] Meetup has groups for everything, whether you are interested in bike riding, cinema, salsa dancing or dining. If you can't find a group that's of interest you can always create your own.

When looking to meet new people, try to open yourself up to try new experiences. Not everything you try your hand at will open doors to friendship, but you can always learn from the experience and hopefully have some fun along the way.

Dust off old friendships

Friendships need nurturing and many of us have been guilty of neglecting old buddies – particularly of late. Have a think about the people in your life and the relationships that may have fallen by the wayside and reach out, even if it's just to grab a coffee.

It can take a little time and effort, but it's always possible to reach out and strengthen existing connections or forge new ones. The benefits of having those social connections in our lives are profound. Keep in mind that you're not the only one out there in search of connection and your efforts are not just helping yourself but also benefitting those you are reaching out to.

i https://www.heartfoundation.org.au/media-releases/Loneliness-link-to-heart-disease-in-older-Australi

ii https://psychweek.org.au/wp/wp-content/uploads/2018/11/Psychology-Week-2018-Australian-Loneliness-Report.pdf

iii https://www.blackdoginstitute.org.au/news/what-is-loneliness-and-how-can-we-overcome-it-during-these-times/

iv https://www.meetup.com/en-AU/

French onion soup

This French onion soup with cheese toast is the answer to your dining dilemmas.

By Ellie and Sam Studd

The magic of cheese-making lies in the process, say Ellie and Sam Studd, who take their time with a luxurious French onion soup complete with cheesy, toasty topping.

Ingredients

40g unsalted butter (we used Le Conquerant), plus extra to spread

4 large onions, halved, thinly sliced

4 eschalots, thinly sliced

2 thyme sprigs

8 cups (2L) beef bone broth (or any good quality beef stock)

2 tbs sherry or ruby port

1/2 garlic clove

4 slices sourdough bread

1 cup Bruny Island C2 or other hard Alpine cheese, grated

Method

1. Melt butter in a large heavy-based saucepan with a lid over medium-low heat. Add onion and eschalot and cook, covered, for 40-50 minutes, stirring frequently, until deep golden and sweet. (You may need to stir more frequently towards the end. Be careful not to burn the onions, as they will become bitter.)

2. Add thyme, stir to combine, then add half the broth and simmer, uncovered, for 15 minutes. Add remaining broth and sherry, and simmer for a further 40 minutes or until the soup is rich and has reduced slightly. Season to taste.

3. Meanwhile, to make the Bruny Island C2 cheese toast, preheat oven to 180°C. Rub garlic over both sides of the sourdough slices and spread with extra butter. Place on an oven tray and bake for 3-4 minutes until lightly toasted.

4. Ladle hot soup into four ovenproof bowls. Top each with a piece of toast, then sprinkle cheese generously and evenly across the top. Switch oven to grill and cook for 2-3 minutes, watching carefully, until cheese is melted, golden and crispy and the soup is bubbling.

Source: delicious

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