# Our latest update

## October 2022

It's October, and in Canberra, Treasurer Jim Chalmers is warming up for his first Budget on October 25 against a background of mounting economic pressures.

In September, persistently high inflation and aggressive rate hikes by the world's central banks put global share and bond markets under pressure. The US Federal Reserve has lifted rates seven times this year, but US inflation remains at 8.3%. There is now growing fear that central banks may push the world into recession. In a surprise twist, the Bank of England (which has also lifted rates seven times this year) was forced to switch back to Quantitative Easing, buying government bonds to support the British pound which crashed to a record low in response to a stimulatory mini-Budget released by the new Conservative Party leadership. This led to a late relief rally on global sharemarkets and a fall in the US dollar and global bond yields. Even so, major global sharemarkets finished the month down 6% or more.

In Australia, the picture is a little brighter. Economic growth was up 3.6% in the year to June. Company profits are also strong, up 28.5% in the year to June, and unemployment remains low, at 3.5% in August. While inflation eased from 7% in July to 6.8% in August, due to falling petrol prices, it is still well above the Reserve Bank's 2-3% target. Aussie consumers continue to spend at record levels, pushing up retail spending by 19.2% in the year to August, and petrol prices are set to increase by at least 22c a litre after the reinstatement of the fuel excise. Both will put upward pressure on inflation and interest rates.

The Aussie dollar fell more than 3c against the surging US dollar in September, to US65c.

### In this issue



## Mortgage vs super

**With interest rates on the rise and investment returns increasingly volatile, Australians with cash to spare may be wondering how to make the most of it. If you have a mortgage, should you make extra repayments or would you be better off in the long run boosting your super?**

The answer is, it depends. Your personal circumstances, interest rates, tax and the investment outlook all need to be taken into consideration.

## What to consider

Some of the things you need to weigh up before committing your hard-earned cash include:

### Your age and years to retirement

The closer you are to retirement and the smaller your mortgage, the more sense it makes to prioritise super. Younger people with a big mortgage, dependent children, and decades until they can access their super have more incentive to pay down housing debt, perhaps building up investments outside super they can access if necessary.

### Your mortgage interest rate

This will depend on whether you have a fixed or variable rate, but both are on the rise. As a guide, the average variable mortgage interest rate is currently around 4.5 per cent so any money directed to your mortgage earns an effective return of 4.5 per cent.[i]

When interest rates were at historic lows, you could earn better returns from super and other investments; but with interest rates rising, the pendulum is swinging back towards repaying the mortgage. The earlier in the term of your loan you make extra repayments, the bigger the savings over the life of the loan. The question then is the amount you can save on your mortgage compared to your potential earnings if you invest in super.

### Super fund returns

In the 10 years to 30 June 2022, super funds returned 8.1 per cent a year on average but fell 3.3 per cent in the final 12 months.[ii] In the short-term, financial markets can be volatile but the longer your investment horizon, the more time there is to ride out market fluctuations. As your money is locked away until you retire, the combination of time, compound interest and concessional tax rates make super an attractive investment for retirement savings.

### Tax

Super is a concessionally taxed retirement savings vehicle, with tax on investment earnings of 15 per cent compared with tax at your marginal rate on investments outside super.

Contributions are taxed at 15 per cent going in, but this is likely to be less than your marginal tax rate if you salary sacrifice into super from your pre-tax income. You may even be able to claim a tax deduction for personal contributions you make up to your annual cap. Once you turn 60 and retire, income from super is generally tax free. By comparison, mortgage interest payments are not tax-deductible.

### Personal sense of security

For many people there is an enormous sense of relief and security that comes with having a home fully paid for and being debt-free heading into retirement. As mortgage interest payments are not tax deductible for the family home (as opposed to investment properties), younger borrowers are often encouraged to pay off their mortgage as quickly as possible. But for those close to retirement, it may make sense to put extra savings into super and use their super to repay any outstanding mortgage debt after they retire.

These days, more people are entering retirement with mortgage debt. So whatever your age, your decision will also depend on the size of your outstanding home loan and your super balance. If your mortgage is a major burden, or you have other outstanding debts, then debt repayment is likely a priority.

## All things considered

As you can see, working out how to get the most out of your savings is rarely simple and the calculations will be different for everyone. The best course of action will ultimately depend on your personal and financial goals.

Buying a home and saving for retirement are both long-term financial commitments that require regular review. If you would like to discuss your overall investment strategy, give us a call.

i https://www.finder.com.au/the-average-home-loan-interest-rate

ii https://www.chantwest.com.au/resources/super-members-spared-the-worst-in-a-rough-year-for-markets

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# Tips to avoid investing badly

**While it's difficult to be the best investor in the world, we can all actively avoid being a 'bad investor' by learning from history and staying the course.**

Extended periods of market volatility regularly spark discussions around great investors and the traits that qualify folks to be included in that category.

This is probably because, like most things in life, no one really questions why things are going right; everyone is after an explanation when things aren't so great.

But rather than focus on what it is to be a great investor or how we could be the next Warren Buffett, perhaps the conversation would be more useful if it was couched in terms of how we could avoid bad investing behaviours that seem to appear when financial markets are turbulent.

Here are a few suggestions from us.

## Don't time the market

It is very common to hear the phrase "time in the market, not timing the market" bandied about but while it sounds logical, Vanguard has done analysis to back up both parts of the phrase to explain why it makes sense, rather than take it at face value.

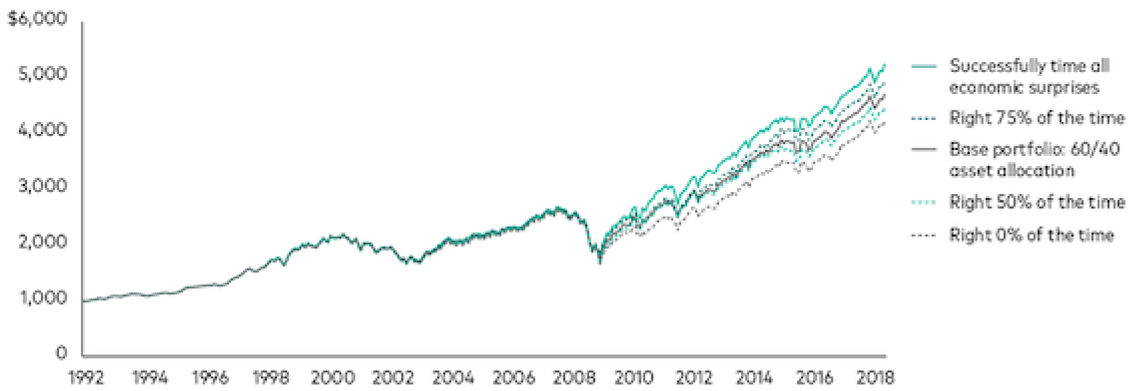
*Timing the market* is hard, and here's why. To successfully time the market means an investor has to get not one but the following *five* factors right, all at the same time:

- Identify a reliable indicator of short-term future market returns.

- Time the exit from an asset class or the market, down to the precise day.
- Time reentry to an asset class or the market, down to the precise day.
- Decide on the size of the allocation and how to fund the trade.
- Execute the trade at a cost (reflecting transaction costs, spreads, and taxes) less than the expected benefit.

To further add to the complexity of the five factors above, getting all five factors right just once is not sufficient to reap the benefits of market timing. An investor would have to do this repeatedly in order to benefit meaningfully from the exercise.

The chart below illustrates this best, showing the return of a $1,000 portfolio in various scenarios, using a traditional balanced portfolio (60% shares, 40% bonds) as the base scenario. It shows that an investor who was right 100% of the time would see a 0.2 percentage point advantage in their annualised returns over 25 years, when compared to a balanced portfolio. Getting things right 75% of the time would see an investor better off than the base scenario at the end of 25 years by $252. And being right half the time meant underperforming the balanced portfolio. Transaction costs were not taken into account in this analysis – meaning the returns would have been even lower had costs been accounted for.




**Source:** Vanguard paper *Here Today, Gone Tomorrow: The Impact of Economic Surprises on Asset Returns,* November 2018. Vanguard calculations using data from the U.S. Bureau of Economic Analysis, the U.S. Bureau of Labor Statistics, Bloomberg, and Refinitiv.

**Notes:** The MSCI USA Index and the Bloomberg U.S. Aggregate Bond Index were used as proxies for U.S. stocks and U.S. bonds. The chart represents the growth of hypothetical portfolios with initial balances of $1,000 as of the start of 1992, growing through August 2018. Significant changes in nonfarm payrolls were used as economic surprises. The hypothetical investors would change the asset allocation to either 80% stocks and 20% bonds in anticipation of a positive economic surprise, or to 40% stocks and 60% bonds in anticipation of a negative surprise.

**Disclaimer**: Note: The example is illustrative only and is based on the factors stated. It should not be taken to contain or provide an estimate of future returns.

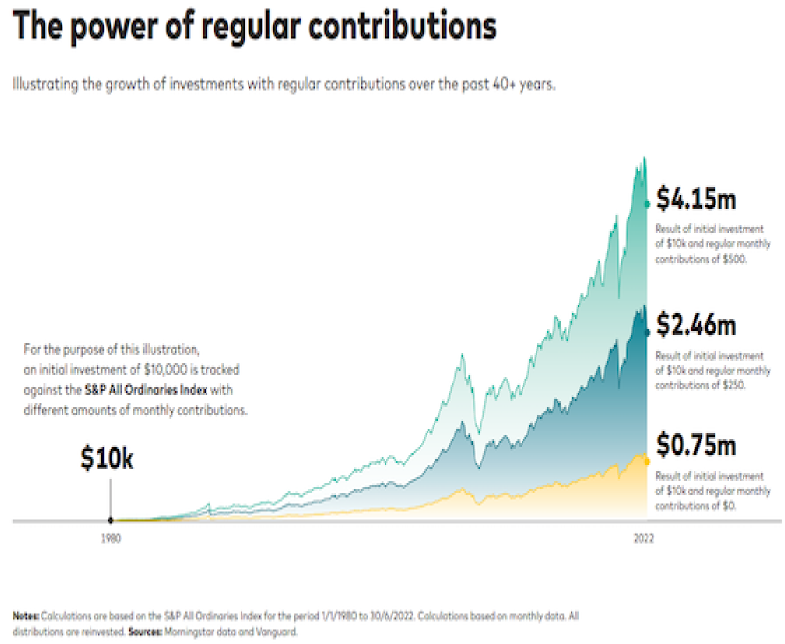
The other conundrum of market timing is not just knowing when to enter the market at the right time, but also exiting at the right time. It can be tempting to stay invested particularly during periods of heightened market volatility and when your portfolio balance fluctuates on a daily basis. But again, Vanguard analysis found that 80% of investors who sold equities and moved to cash during the COVID-19 induced volatility fared worse than those who held their nerve and stayed invested. In moving to cash, those investors inadvertently locked in losses permanently and deprived their portfolios of the opportunity to benefit when markets recovered shortly.

This really brings home the point that not only is precise timing nearly impossible but also that being out of the market at the wrong time costs.

## Spend time in the market and contribute regularly

*Time in the market* is simply putting the theory of compounding into practice. While past performance is no guarantee of future performance, the latest **Vanguard Index Chart** shows that $10,000 invested in US Shares back in 1992, and left untouched over 30 years would grow to $182,376 while the same $10,000 invested in Australian Shares would result in $131,413 over the same period.

More importantly, the chart below shows that adding monthly contributions of $250 or $500 over that same 30-year period would result in a portfolio balance of almost $3 million or almost $5 million respectively.




## Buying high and staying invested

Understandably, the thought of investing during a period of market volatility and potentially losing money can keep any logical person from entering the market. But Vanguard took a look at the worst possible scenarios in the last 50 years to see what happened if an investor invested at the worst possible time – at the peak of a market right before a dip. The table below lists the three worst bear markets in the last five decades and shows how far the market dipped before it started recovering, and the time it took to recover[1].

| Year | Drawdown | Recovery Time (years) | 10Y return from peak | 20Y return from peak |
|---|---|---|---|---|
| 1970 | -61.9% | 8.6 | 4.2% | 10.8% |
| 1987 | -41.3% | 4.0 | 6.4% | 10.9% |
| 2007 | -50.9% | 5.9 | 3.0% | 3.9%** |

*Note: 10Y and 20Y returns are annualised total returns.*
*** Noting that this is only 15 years of data, not 20 years.*

Encouragingly, the results show that if an investor continued investing during the 1970 and 1987 bear markets, their portfolios would have returned an average of nearly 11% in annualised returns after 20 years. If an investor had entered the market just before the Global Financial Crisis, they would have experienced almost 4% in returns over the last 15 years, noting that those returns reflect a shorter period of time.

While we can't all be the best investor in the world, we can certainly actively avoid being a 'bad investor' by learning from history and staying the course.

[1]Calculated using data from Australian total return and price indices represented by spliced MSCI Australia (1970-1992)/ASX 300 (1992+). Daily data was used and reflects local currency.

'Bear' periods represent a period where a peak to trough drawdown of 20%+ occurs, from the starting peak to the point of recovery.

Source: [Vanguard]

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# Wills and powers of attorney

A good estate plan will help make sure your wishes are carried out when you die. It can also help if you become unable to make your own decisions.

## Estate plans

An estate plan records what you want done with your assets after your death. It can include documents such as:

- your will
- a testamentary trust (as part of your will)
- superannuation binding nominations

It also covers how you want to be cared for — medically and financially — if you can no longer make your own decisions. This part of your estate plan may be in documents such as:

- any powers of attorney
- a power of guardianship (giving someone the right to choose where you live and to make decisions about your medical care)
- an advance healthcare directive (your needs, values and preferences for your future care)

The documents you choose will depend on your situation and what you're comfortable to trust others with. Get legal advice if you're not sure.

You must be over 18 and mentally competent when you draw up your estate plan.

## Your will

A will is a legal document stating what you want to happen to your assets when you die. It is part (but not all) of your estate plan.

Your will can cover things like:

- how you want your assets shared
- who will look after your children if they're still young
- any trusts you want to set up

- how much money you'd like to give to charities
- plans for your funeral

*Smart Tip: It's important to have an up to date will. If you die without one, the law decides who will get your assets — and this may not be who you wanted.*

## Making your will

You can get your will written by a solicitor (for a fee) or by a Public Trustee. A Public Trustee may not charge if you:

- are a pensioner or aged over 60, or
- nominate them to carry out the instructions in your will (that is, to be your executor)

The rules vary, so visit the Public Trustee office website for your state.

- Australian Capital Territory public trustee and guardian
- New South Wales trustee and guardian
- Northern Territory public trustee
- Queensland public trustee
- South Australia public trustee
- Tasmania public trustee
- Victoria state trustee
- Western Australia public trustee

If you use an online will kit, get it checked by a solicitor or Public Trustee. They can make sure it's been done properly. If your will isn't done properly, it will be invalid.

Make sure you put your will in a safe place and tell someone close to you where it is.

## Updating your will

It’s important to update your will as your situation changes — for example, if you:

- get married
- divorce or separate
- have children or grandchildren
- have a significant financial change
- lose your spouse (or someone else who is named in your will) through death

## Super and your will

A binding nomination directs who your super fund trustee gives your super benefit to when you die. If you don't nominate someone, the super fund trustee will decide who your money goes to.

## Family trusts and your will

If you have a family trust, it continues after your death. The trust determines who gets your assets, even if your will says something different.

## Testamentary trusts

A testamentary trust is a trust that is written in your will. It takes effect when you die, and it's administered by a trustee, who you usually name in your will.

The trustee looks after your assets until your beneficiaries can get them. This is set out in your will, and is either when:

- a child reaches a certain age, or
- a beneficiary achieves a specific goal (for example, they get married or earn a particular qualification)

You may want to consider setting up a trust if your beneficiaries:

- are minors (under 18), or
- have diminished mental capacity, or
- may not use their inheritance well

Another reason to consider a trust is to avoid family assets being:

- split as part of a divorce settlement, or
- part of bankruptcy proceedings

## Powers of attorney

A power of attorney is a document where you give someone else the legal right to look after your affairs for you. It's important to nominate someone that is trustworthy, financially responsible, and likely to be around when you need them.

Find more information from each state or territory to appoint a power of attorney.

There are different types of powers of attorney:

### General power of attorney

This allows someone to make financial and legal decisions for you. It's usually for a specified time — for example, if you're overseas and can't manage your affairs at home.

If you become unable to make decisions yourself, a general power of attorney becomes invalid.

### Enduring power of attorney

An enduring power of attorney (or EPA) allows someone to make financial and legal decisions for you. If you become unable to make decisions yourself, an enduring power of attorney will still be valid.

### Medical power of attorney

This allows someone to make medical decisions for you if you ever become unable to do so yourself. It doesn't allow them to make other kinds of decisions.

## Legal and financial housekeeping

It will help your family and your executor if you list all the documents you have and where they're kept.

As well as the documents talked about above, other key documents to keep handy are:

- birth certificate
- marriage certificate

- life insurance
- medical insurance
- Medicare card
- pensioner concession card
- house deeds
- home and contents insurance
- deeds and insurance policies for any other real estate you own
- bank account details
- superannuation papers
- investment documents (securities, share certificates, bonds)
- prepaid funeral plans

Source:
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