

Newsletter

Winter 2011

Welcome

We extend to you a warm welcome to our Winter newsletter, and to what we feel is a stimulating blend of topics.

Australian property is certainly a topic of constant interest so we start with an analysis of the local property market. Is it a bubble, as some claim, about to burst? Alternatively, is it treading water or deflating gently? We have some insights we hope can enlighten you about what might be happening.

Plus, the combination of baby boomers coming into retirement and the rapid growth of superannuation in Australia has changed the mix of the traditional family nest egg. We look at some strategies that might help you leave a legacy for children and grandchildren.

To round things out, we take a lighter look at the serious topic of financial health. Just one day devoted to a full financial check up might go a long way towards helping you maintain a healthy lifestyle – and bank balance.

Kind Regards,



Scott Farmer

Latest news

As winter looms, it seems little has changed in the last year. If anything the Australian economy looks stronger; our dollar trades consistently above parity with the US greenback, and interest rates remain stable.

At the same time, the share market has moved mostly sideways, with the ASX 200 index at or below levels of 12 months ago. So why is our apparent economic stability not reflected in stronger share prices?

Firstly, the economic impact of the early-year tragedies in Queensland and Japan is emerging. Local growth rates have slowed appreciably while Japan, a major trading partner, experienced its first March trade deficit for 31 years.

Further uncertainty stems from political turmoil in oil-producing countries. The US recovery has slowed under the weight of higher petrol prices, while the European debt crisis remains unresolved.

Though Australia's economy and its prospects remain strong while tied to China's growth, problems remain. The policy responses needed to keep wages and inflation in check while boosting those areas that miss out in our patchwork economy, are not easy to arrive at.

In the face of all this, it is not surprising that saving has priority over spending, and investors remain cautious while company profits and housing prices remain under pressure.

Economic fundamentals are strong, but for the moment investor caution is stronger.

Bubble, Bust or Non-issue?

Australian house prices are falling. While that is clear, opinion is divided about the long-term outlook. Are we watching a housing bubble about to burst or a pause before returning to business as usual? Or is it something in the middle, a so-called soft landing?

Legendary US investor, Jeremy Grantham, received widespread coverage in the local media for his view that Australian residential property is a bubble waiting to pop. He points out that Australian house prices doubled in 8 years and quadrupled in 21 years due to a prolonged economic boom, a lengthy period of low interest rates, record levels of migration, government first home owner grants, and low levels of new housing construction.

Grantham argues that the true test of a bubble is whether a new generation of young buyers can afford a first home in a capital city at normal mortgage rates and home deposit conditions.

Affordable housing

The question of affordability was also highlighted by the latest annual Demographia International Housing Affordability Survey which looked at seven countries including the US, UK, Canada and China, and rated Australia as the least affordable country for home buyers. Sydney was second only to Hong Kong as the least affordable city.

Demographia considers housing markets are affordable when the average home costs three times the average gross household income or less.

Not surprisingly, the US has some of the most affordable housing. The collapse of the American housing market was a trigger for the Global Financial Crisis and the sector is still struggling. Average house prices in the US are now 33 per cent below their peak in July 2006 and there are still thousands of foreclosed houses hitting the market.

Using the latest available figures, Sydney homes are valued at more than 10 times average incomes. The median house price in Sydney was \$500,000 at the end of March while the average taxable income is about \$48,000. The median home price across all capital cities was \$455,000 and is lower still in regional markets. Even allowing for this, and the fact that many homes are bought by couples with two incomes, the great Australian dream chews up a large chunk of the average household's take-home pay.

Robust economy

While international comparisons are interesting, they mask important differences.

While housing stress is on the increase in Australia, it remains at a low level. Westpac, which has the biggest share of housing loans,

stated that just 0.59 per cent of its outstanding home loans were in arrears by 90 days or more.

Australia is also in a strong economic position. The resources sector continues to boost our national coffers, incomes are growing at 6 per cent a year, and unemployment, at just 4.9 per cent, stands out among developed economies as a sign of strength.

Signs of a soft landing

There is some evidence that an Australian property bubble, if it is indeed that, may be deflating gently. If that is the case then it reduces the chance of a property bust further down the track.

According to the RP Data-Rismark home value index, Australia's capital city home prices were flat in the year to March, down just 0.6 per cent in seasonally-adjusted terms. Sydney was the best-performing market, up 2.1 per cent, while Brisbane and Perth were the worst, down 6.8 and 6.4 per cent respectively.

The slowdown gathered pace in the March quarter when capital city property values fell 2.1 per cent. Outside the capital cities house prices fell 1.8 per cent during the quarter.

This is bad news for some homeowners, especially those who entered the market with the help of government grants and little deposit to act as a buffer against falling prices.

But falling property prices are good news for prospective home buyers and investors, especially now that interest rates appear to be close to the top of the cycle, because it means that value should return to the market.



SKI-ing *through retirement?*



Are you leaving a legacy for the next generation?

About a million Baby Boomers will retire by 2020, the first generation of Australians to do so with significant personal superannuation. Their parents tended to live frugally into old age on a combination of savings and pensions, and generally owned only one sizable asset, the family home. But while their parents often managed to leave that home to their descendants, today's self-funded retirees may find it difficult to leave much behind at all unless they take time to plan an inter-generational wealth strategy.

Baby Boomer retirement – the paradox

They've had a dream run for most of their lives. Ready employment, no HECS debt from university studies, property values increasing exponentially, and until the GFC, their compulsory super nest eggs were growing too. With all of these benefits, according to some critics, the Boomers became a self-indulgent generation of conspicuous consumers.

At the same time, overall life expectancy has increased, and the costs of living and of aged care have soared, meaning more retirement dollars are needed for a longer period.

This combination of factors has led to speculation that the next Boomer

trend could be SKI-ing or Spending the Kids' Inheritance, leaving little behind for future generations. In fact, a recent study indicates that some Boomer retirees may have to SKI to survive if their superannuation savings prove to be inadequate.

Investing for retirement

How much you need for retirement is a complex question, dependent on income requirements, future lump sum needs, and individual risk profiles. The basic position is that retirees need either adequate superannuation at retirement, or access to capital from other areas — from the sale of the family home or business, or even an inheritance.

Whatever your situation, there are some important steps you can take to build an effective strategy to leave something to the next generation.

Value in the family home

Many home owners believe that it is an advantage to pay off the mortgage before retirement, allowing them to live rent-free when they stop working. However, this may not be the best solution if you wish to leave a legacy for children or grandchildren.

It's all a matter of tax effectiveness. If you are in the top tax bracket, every dollar you take from your income to pay off your mortgage is taxed at 46.5 per cent, leaving you 53.5 cents in the dollar to clear your mortgage or invest. By contrast, superannuation contributions paid from pre-tax dollars via salary sacrifice are taxed at 15 per cent, leaving you with 85 cents in each dollar to invest. If you

are mid 40s or above, it may be appropriate to salary sacrifice into super up to your concessional cap rather than maximising your mortgage payments. Once you are retired and over 60 you can use your tax free super to pay off the mortgage, taking into account that this will reduce the amount of capital you have available to fund your ongoing income needs. There are a number of important considerations and you should always seek professional financial advice to confirm the preferred course for you.

Investing in retirement

Once you have retired it is important to remember that it is not all about income, interest, dividends and yield. You must also focus on investment growth and avoid the so-called "yield trap", the danger of chasing higher yields that may not have solid foundations and will end up weakening your capital base. In simple terms, to keep your retirement funds in good condition you need to balance the need for short-term income against building and maintaining the base for your future income.

Building your strategy

Whatever solution suits your circumstances, to build a legacy you need an effective inter-generational investment strategy which should be regularly reviewed and rebalanced.

If you wish to discuss a more effective pre- or post- retirement investment strategy and more tax-effective estate planning to benefit your family, please contact us and we would be happy to help you assess the options.

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Take a day:

IT CAN PAY

Ever thought about taking a break from your routine, a “Financial Health Day” to spend some time tightening up your personal finances? It might not be the most exciting day you will ever spend — unless the thought of saving a significant amount of money excites you.

It should be a weekday so you have scope to call banks, credit card issuers, health insurers, and other financial services providers who are easier to contact during office hours. And you will also need all your tools — financial records, current tax return, mortgage, credit card and bank statements — close at hand. Internet access is also important as there are many things you can do online.

Hitting the target

So, what are your objectives? Well, there are two sides to this coin. The first objective is to put more \$\$ in your pocket by saving a little more of and spending a little less of your income, without making your life a penny-pinching misery in the process. The second is to discover some cheaper ways, if they exist, to pay for some of life's essentials.

Start at the beginning by reviewing your monthly budget — or constructing one, if necessary — so you can pinpoint the big expenses before trying to pare them back. Take your power bills, for example. Some power companies will not only reward

you with a discount for combining your gas and electricity, they will also allow you to pay them with a pre-set monthly direct debit, avoiding the shock of that big quarterly hit and smoothing your cash flow.

Monthly payments or saving targets can be an excellent budgeting tactic. In fact, you can even create your own monthly debit system for major expenses such as school fees, annual holidays and Christmas by estimating the cost and transferring monthly instalments to a separate savings account. Your bank can probably make the transfers for you automatically.

If you can manage it painlessly by cutting one or two unnecessary expenses, one good outcome of a budget review would be to save an extra 1 per cent of your salary — just \$1 out of every \$100 you earn — for a major objective like an overseas trip, new carpets or as a reserve fund. The best budgets can be wrecked by unexpected emergencies, whether it is a burst water heater or an unexpected mortgage rise.

Smart moves

Once you have your budget review completed and have set up new direct debits and/or opened one or two new dedicated savings accounts, you should still have a few hours of your Financial Health Day left to look for some significant savings on financial services.

Credit cards are a black hole in many budgets. Could you save by switching to a cheaper card? Are you paying off your card within the interest-free period? What about rewards programs — if you are paying for them, are you using them? Some supermarket reward programs now offer a “double reward” so it may pay to investigate your options. You can compare cards online at several sites such as www.creditcards.com. And if you do decide to change card companies, you might find one that will give you an interest rate holiday for the first 3–6 months as a reward for switching.

Your private health insurance plan is also worth reviewing because your family circumstances might have changed since you took out the plan, or the market may have newer, more flexible options. A Choice Magazine report on 40 private health funds may be a good starting point if you are looking for better value, since they reported cost differences of up to \$800 a year or more. (See www.choice.com.au or www.privatehealth.gov.au)

Planning ahead

And finally, if you haven't had an annual financial check-up, make time before the end of the day to contact us and arrange a review of your insurance, superannuation and investments, to ensure your financial planning strategy is still on track.

All done? Congratulations on a good day's work!

General Advice Warning: This advice may not be suitable to you because it contains general advice that has not been tailored to your personal circumstances. Please seek personal financial advice prior to acting on this information.

Investment Performance: Past performance is not a reliable guide to future returns as future returns may differ from and be more or less volatile than past returns.

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