Autumn Edition 2022

News from the Nest

Welcome to our Autumn Edition of 'News from the Nest'

Lots to share as always in our latest edition. We'll delve into investor decision making during market corrections, and how having an inclusive and collaborative relationship with us as your financial advisers can help you make the right decisions when things are a little uncertain.

We also talk about something that hasn't been talked about for a while – inflation! Is that genie out of the bottle, and if so what could it mean for investors?

Another topic of pertinence to many of our clients is covered in an informative article about the 'R' word – Retirement. It can be a time of reflection and anxiety for some who are approaching this important milestone. We hope to help you to focus on some key elements and a few things you may not have considered when making these big decisions.

Plus some very exciting news in the world of superannuation, and a little about what FinNest Financial has been up to in supporting our local community. Yours truly even dusted off his runners for a good cause!

Thank you for your continued support & best wishes,

Brendan Stone
Director – Financial Advice,
FinNest Financial Pty Ltd.

IMPORTANT SUPER CHANGES

A really big change that will have significant positive impacts for many clients from the 1st July 2022.

Non-concessional and salary sacrifice contributions can be made by anyone up to the 28th day of the month following that in which they turn 75 years of age, without having to meet a work test.

This is an increase from the current eligible age of 67 years of age, so gives many people significantly greater opportunity to increase their superannuation assets to build greater retirement income who are not working and therefore had been unable to bolster their superannuation investments.

Commonly we see people receiving inheritances or selling investment property at this stage of life, amongst other opportunities, and this gives our clients another option within these ages that wasn't previously available.

This also can apply to the 'bring forward rule', meaning some people will be eligible to contribute up to three years' worth of non-concessional limit at once.

These are strategies that are intricate and complex, so seek advice from us before proceeding to ensure you are eligible and take full advantage of the new rules.

HELPING THE MORETON BAY REGIONAL PROSTATE CANCER SUPPORT GROUP

In September last year, the Stone family (myself, Louise and daughter Emma) joined a hardy crew to put some miles in the legs to raise money for the Moreton Bay Regional Prostate Cancer Group by participating in their annual fun run.

This is a group organised by the Urology departments of both the Redcliffe Hospital and the RBWH, and they do a fantastic job in supporting those who are going through the rigors of treatment for this disease. It's also a cause close to our hearts, with both my father and Louise's father both having had Prostate Cancer.

When we came on board to support this cause, the group was struggling with their fundraising efforts, but with great thanks to a number of our valued clients, they not only reached their fundraising target, but with your help we well and truly exceeded it! Thank you so much for your support and for getting behind this worthy cause, we and they greatly appreciate your thoughtfulness and generosity.

LESSON LEARNED: STAYING THE COURSE DURING A MARKET CRASH

Many investors overreacted when the coronavirus pandemic struck and switched their investments to cash. Here's how to avoid falling into the trap.

The coronavirus pandemic changed the way we live forever. Unfortunately, it's also set to change the way many older Australians now live their retirement.

Billions of dollars were switched from balanced funds into cash as the coronavirus pandemic swept the world in March 2020. That decision came with a hefty price as markets quickly rebounded.

It presents another painful lesson for investors – one that has been repeated many times throughout history.

But there are some simple things to keep in mind which can help investors avoid making the same mistake the next time a market downturn occurs.

Switching after a market fall locks in losses

Switching from high-growth investments like shares to low- returning assets like cash seems rational in the moment. But it can cost you dearly.

Investors were ecstatic when the S&P/ASX 200 hit an all-time high in February 2020. A month later, it all came crashing down. From its highest point to its lowest, the S&P/ASX 200 lost more than a third of its value[1].

One large super fund told the economics committee that members shifted almost $3 billion of their retirement savings into cash[2].

Unfortunately, those investors crystalised their losses – one month later, the S&P/ASX 200 recovered 13%. By the end of the year, it was 31% up from its March lows[3].

The moral of the story is don't try to shut the gate when the horse has already bolted.

Rather than locking in losses, the best course of action can often be to do nothing at all and wait for the market to rebound.

Decision-making under pressure is likely to be worse

The old adage goes 'buy low and sell high'. Unfortunately, that advice gets thrown out the window when markets drop. But the reason why isn't wilful ignorance. Rather, it's usually the inability of investors to manage their emotions.

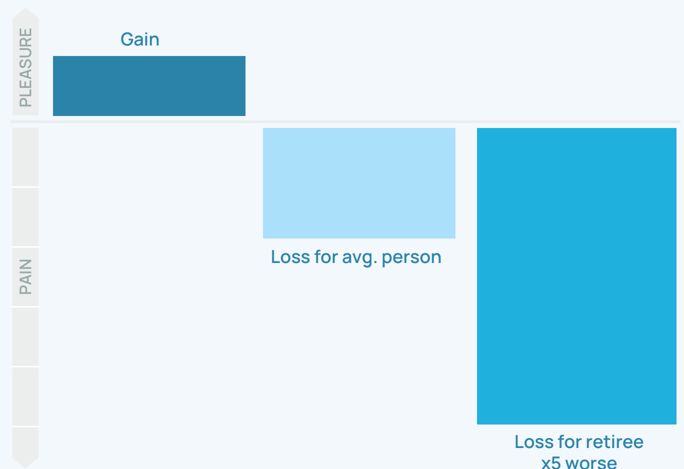
People value losses and gains differently, according to a theory developed by psychologists Amos Tversky and Daniel Kahneman. Typically, the pain from a loss hurts twice as much as the pleasure from a gain, although other studies have suggested retirees feel losses even more acutely.

"Research on loss aversion has become considerably more common in recent years, establishing that loss-averse behaviour is nearly ubiquitous, appearing across different groups of people, types of choices, and even species," according to a study in the journal Current Directions in Psychological Science[4].

This explains the strong emotions investors feel when the market crashes. However, it's important not to react to such emotions. Retaining a rational, structured approach to investing is the best way to achieve your goals.

Loss aversion in action

The average person weights a loss twice as much as a gain, but retirees tend to weight losses five times more.



Focus on the long- term, not short-term market movements

When the market unexpectedly crashes, it's easy to think it will never recover.

But looking back in history shows market downturns are a natural part of the investment cycle.

Whether it's the Tech Wreck (early- 2000s), the Global Financial Crisis (2007- 08), or the current pandemic, each time markets eventually recovered. It takes a concerted effort not to get caught up in the daily news headlines.

Taking a step back and assessing what's happening from a historical perspective is crucial.

A good financial plan should map out your short and long-term goals and manage any short-term market volatility.

Even a retiree can expect to live for at least another two decades, which means the long-term should always be front of mind.

The team at FinNest Financial can help you build a financial plan that successfully navigates through the other side of a market downturn.

1 Historical market statistics. (2021, March 05). Retrieved from https://www2.asx.com.au/about/market-statistics/historical-market-statistics
2 Documents Part Three - Fiducian to Hostplus – Parliament of Australia. (2021, March 05). Retrieved from https://www.aph.gov.au/Parliamentary_Business/ Committees/House/Economics/SuperannuationSector/Documents_Part_Three_-_Fiducian_to_Hostplus#FirstStateSuper
3 20-323MR ASIC report explores how to measure 'value for money' in default insurance in superannuation | ASIC - Australian Securities and Investments Commission. (2021, March 05). Retrieved from https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-323mr-asic-report-explores- how-to-measure-value-for-money-in-default-insurance-in-superannuation
4 Sokol-Hessner, P., & Rutledge, R. B. (2018). The Psychological and Neural Basis of Loss Aversion. Curr. Dir. Psychol. Sci., 28(1), 20–27. doi: 10.1177/0963721418806510

Talk to the experts. If you have any concerns about your investments or market conditions, we can help.

WHAT DOES RISING INFLATION MEAN FOR INVESTORS?

Inflation may be on the way back thanks to massive government stimulus aimed at reviving the economy. Should investors be worried?

"Inflation is as violent as a mugger, as frightening as an armed robber, and as deadly as a hitman," former US president Ronald Reagan said as the US battled soaring inflation in the early 1980s. Since then, governments have largely kept inflation under lock and key. It has gradually been falling for decades, which has driven the value of growth assets such as shares higher.

But as economies re-emerge from the pandemic, inflation is rising again. Inflation in Australia jumped to 3.8% in the second quarter of the year, up from just 1.1% in the **first**[1]. Meanwhile, US inflation rose by 5.4% in June year-on-year, the fastest pace in **30 years**[2].

Should investors be concerned or is the spike just transitory after the pandemic?

"That's the million-dollar question," says ClearView Chief Investment Officer Justin McLaughlin. "The short answer is no one really knows. But I think it's going to be transitionary. If you look at the RBA's forecast, they clearly think there will be a fairly modest increase in inflation at best."

Why has falling inflation been good? Falling inflation usually prompts central banks to cut interest rates, which fires up the economy. It is easier for businesses to borrow money to invest and hire new staff, while consumers with loans such as mortgages pay less interest, leaving them with more money to spend.

The average rolling 12-month return for global equities when inflation was trending down over the last five decades was 10.4%, according to a SSgA report[3]. When inflation was rising, annualised returns fell to just 5.3%. Central banks have taken interest rates to around zero (and in some cases negative) in the years since the global financial crisis in 2008-09, providing a powerful tailwind for equities. However, productivity and wages growth have remained stubbornly low.

The pandemic which struck in early 2020 presented a new challenge. With little monetary policy ammunition left, governments have unleashed record spending programs aimed at pumping up their shutdown economies.

But while inflation has since rebounded strongly, McLaughlin suggests it may largely be because inflation was so low (or even deflationary) during the pandemic lockdown. Supply chain bottlenecks, caused by production companies trying to keep up with newfound consumer demand, may also be driving higher inflation.

"We might continue to have an inflationary spike as things reemerge this year," McLaughlin says.

"But we don't expect inflation to rise again and again, year after year. To get sustained inflation the economy needs wages growth and that's quite a bit of a challenge for Wall Street and, in Australia, George Street."

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Investment opportunities won't be curtailed if inflation rises

McLaughlin says three scenarios could eventuate: inflation could continue to rise, it could go back to recent lows, or reach the RBA's target.

"If we can't get inflation up, we are going to be stuck in this very low, slow growth world, which we've been struggling to get out of for a while. The key is to get inflation and wages growth up," says McLaughlin.

"It'll have investment implications so far as cash rates and bond yields would be very low for a long time. Investors with conservative mixes of investments would be struggling because there wouldn't be much yield out there."

The optimal range for inflation would be 2%-2.5%, which would boost wages and demand without devaluing goods and services through excessive inflation. It would also help people saving and retirees who generate income from cash and bonds.

"A lot of people are very happy to have their wages going up each year. A lot of retirees would probably quite like the increasing returns on their cash investments too."

While rising interest rates would hurt bonds in the short term (capital prices would decline), newly issued bonds would start to generate a higher interest rate. Some bonds are inflation-linked, which offers the best protection against rising inflation.

Professional fund managers also have an array of options to manage through changing market conditions. For example, SSgA research found that some equity investment styles, such as low volatility, quality, momentum and value, outperformed during periods of rising inflation over the last 20 years.

"The point is: don't be scared of inflation," McLaughlin says. "There are winners and losers. In my view, the winner is more likely to be the real economy under the current circumstances as we head towards the target."

If you have any questions or would like to review your investment portfolio, FinNest Financial can help you.

1 Measures of Consumer Price Inflation. (2021, July 28). Retrieved from https://www.rba.gov.au/inflation/measures-cpi.html
2 Individual income tax rates. (2021, July 01). Retrieved from https://www.ato.gov.au/rates/individual-income-tax-rates
3 Inflation – What it Really Means for Equities. State Street Global Advisors.
Retrieved from: https://www.ssga.com/library-content/products/fund-docs/mf/apac/au/monthly%20commentary/ Australian_Equities_Monthly_Commentary.pdf

THREE REASONS TO NOT BE AFRAID OF RETIREMENT

Retirement marks a new beginning but many retirees lack the confidence to enjoy it.

Many older Australians worry they will outlive their retirement nest egg but a recent government report suggests those worries might be misplaced.

The Retirement Income Review (RIR) found most retirees leave the bulk of the wealth they had at retirement as a bequest[1].

"The system is designed on the basis that people should draw down their savings to support them in retirement," the RIR found[2].

Yet they don't. Instead, many live off the returns from their retirement savings rather than draw down the capital.

Super is an important pillar that supports retirees' lifestyles – but it's not the only thing holding it up. A closer look at the facts can give retirees the confidence they need to enjoy retirement.

1. The family home can provide a source of income

The home can be a gold mine if you know where to dig. Older Australians hold a combined half a trillion dollars of value in their homes, according to a 2018 ASIC report. Yet most people leave its value untapped, with many viewing the home as sacrosanct.

The RIR suggested older Australians would enjoy a higher standard of living by tapping into this value. There are new ways to do this that don't involve selling the home.

The government's Pension Loans Scheme (PLS) – its version of a reverse mortgage product – is one option.

The PLS allows retirees to draw down a tax-free fortnightly income stream, with the possibility of lump sums being available from 1 July 2022, from their home equity.

The scheme was made even more attractive in this year's Federal Budget. A 'no negative equity guarantee' eliminates the risk that borrowers may end up repaying more than the market value of their property.

"Using relatively small portions of home equity through the Pension Loans Scheme or similar equity release products can substantially improve retirement incomes for many people," the RIR said.

Another feature of this year's budget is the proposal to extend Downsizer contributions from 1 July 2022, to people aged over 60, down from 65 previously. Up to $300,000 from the sale can be made as a special super contribution.

2. The Age Pension acts as an investment buffer

Millions of Australians receive the government Age Pension, which ensures the retirement system is equitable.

If markets fall and the value of a retirees' investments decline, the Age Pension automatically picks up some of the slack because it is means-tested. Even most relatively wealthy Australians will be eligible for a part Age Pension as they draw down on their super over time.

Actuarial firm Milliman modelled thousands of future scenarios for retired couples, demonstrating that the potential future Age Pension payments they might receive over the next 25 years have a median value of around $180,000[2].

"The government Age Pension can potentially offset a one-third decline in the value of a wealthy retired couple's investment portfolio," according to the Milliman analysis.

This buffer should provide retirees with comfort in the face of uncertainty, such as the COVID-19 pandemic or the Global Financial Crisis, which wiped billions of dollars from super funds.

3. Most adult children can look after themselves

Some may frown on 'spending the kid's inheritance' but they shouldn't – at least when it comes to super. With the average Australian living to about 82 years of age, an inheritance will end up in the hands of children who are likely in their pre-retirement years themselves.

Even the then Treasurer and now Prime Minister, Scott Morrison, in 2015 said retirees shouldn't use their super as a tax-advantaged inheritance vehicle.

"The purpose of providing tax incentives to encourage people to build up their super is so they can draw down on it in their retirement, not maintain it as a capital pool to be passed on as an inheritance," he said[3].

Most adult children are functioning members of society and can support themselves.

The RIR also found this process of fostering intergenerational wealth exacerbates the wealth divide for future Australians.

"Most people die with the majority of wealth they had when they retired. If this does not change, as the superannuation system matures, superannuation balances will be larger when people die, as will inheritances."

1 Retirement Income Review - Final Report | Treasury.gov.au. (2021, May 27). Retrieved from https://treasury.gov.au/publication/p2020-100554

2 Why the Age Pension helps retirees with losses in turbulent times. (2020, April 02). Retrieved from https://au.milliman.com/en/insight/Why-the-Age-Pension- helps-retirees-with-losses-in-turbulent-times

3 Tingle, L (2015). Scott Morrison tells retirees they must spend their superannuation. Australian Financial Review. Retrieved from https://www.afr.com/wealth/ superannuation/scott-morrison-tells-retirees-they-must-spend-their-superannuation-20150524-gh8gz2

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