MONEYNEWS

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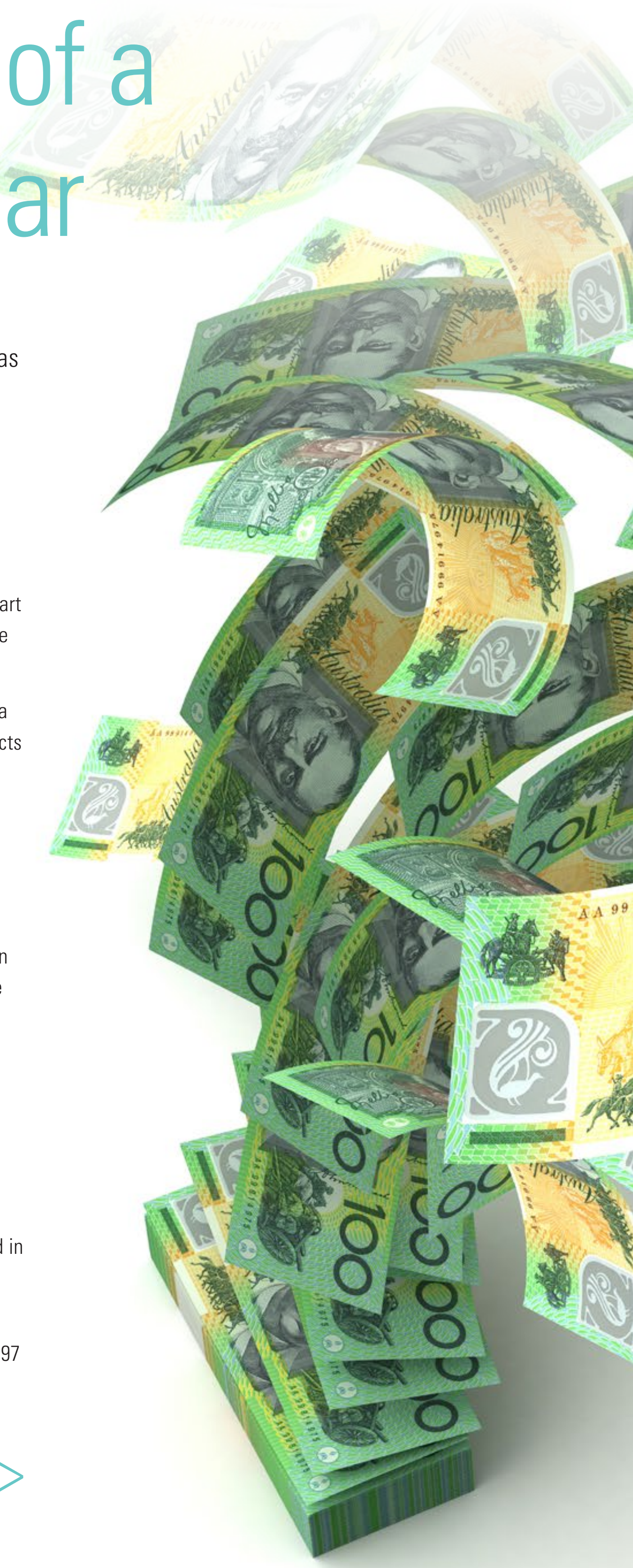
Making the most of a falling aussie dollar



One of the major themes for local investors in 2018 is the fall in the Australian dollar, and it's not just Aussie travellers heading overseas who are affected. Currency movements can have a big impact on your investment returns, but where there's risk there's also opportunity.

The Aussie dollar has dropped from a high of US81c in January to recent levels around US74c, its lowest in 18 months. So, what's behind this decline and will it continue?

The interest rate gap

The US dollar has been rising against most other currencies this year, including ours. Part of the reason for this is the increasing interest rate differential between the US and the rest of the world.

The US Federal Reserve has lifted rates seven times since late 2015 from near zero to a range of 1.75-2.0 per cent. Federal Reserve chairman, Jerome Powell has said he expects to do so twice more this year and three times in 2019 due to solid growth in the US economy.[i]

By comparison, Australia's official cash rate has fallen over the same period and sits at an historic low of 1.5 per cent. Commentators expect the next move will be up, but possibly not until late next year.

Higher US interest rates relative to Australia make the US a more attractive destination for yield-seeking investors. As foreign money flows into the US market, demand for the US dollar increases and its value rises.

Threat of trade war

Also weighing heavily on the Aussie dollar are the threat of an escalating trade war between the US and China and falling commodity prices, notably iron ore.

The tit-for-tat tariffs placed on imports by the world's two biggest economies has the potential to impact the Australian economy more than most. Australia is viewed as a resources-based economy and any rise or fall in commodity prices tends to be reflected in the value of our currency.

When the first salvos in the trade dispute were fired in July, iron ore was trading at around US$63 a tonne down from a high of US$78 earlier this year and a peak of US$197 back in 2008. Australia is the world's biggest exporter of iron ore, most of it headed to China for steel production.

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China's growth eased slightly in the June quarter to 6.7 per cent, the slowest in 21 months. If tariffs put a dent in China's economic growth and demand for iron ore, our dollar could head lower.

While currency movements are just one factor influencing investment returns, it pays to understand the impact of a falling dollar to capitalise on the benefits and reduce currency risk.

Managing currency risk

For local share investors, a drop in the Australian dollar is good for exporters and companies with offshore operations because it improves their competitiveness in overseas markets.

The currency effect can also increase the appeal of global shares. Local investors who own 'unhedged' global shares have already enjoyed the double benefit of rising international share prices and a falling Aussie dollar. Hedged returns perform better when the Aussie dollar is rising or flat while unhedged returns do better when the dollar is falling.

To illustrate the impact of hedging, Vanguard's International Shares Index Fund (hedged) returned 11.46 per cent in the year to June 2018 while the same fund unhedged returned 15.44 per cent.

Avoiding the cash trap

While currency risk can be a challenge for share investors to manage, one of the biggest risks when the Aussie dollar is falling is to leave all your cash in the bank. At a time when historically low interest rates have already reduced the amount you receive from cash investments, your purchasing power is further reduced when you buy overseas goods.

While investment decisions should never be based on currency factors alone, understanding the impact of a falling dollar can help you minimise currency risk and make the most of opportunities.

If you would like to discuss your investment strategy, give us a call.

i 'US Fed raises interest rates, expects 2 more hikes this year', by Akin Oyedele, Business Insider Australia, 14 June 2018, https://www.businessinsider.com.au/federal-reserve-fomc-statement-and-interest-rate-decision-june-2018-2018-6?r=US&IR=T

Super and inheritance:

Making your wishes known

People often think their superannuation will be treated as part of their estate when they die and distributed according to their Will, but that's not the case. Unless you have nominated your beneficiaries, the decision as to who receives your super is in the hands of the trustees of your fund.

When that happens, the trustees normally direct all funds to your dependants – your spouse, your children, financial dependents and people with whom you had an 'interdependency relationship' such as living together.

But wouldn't it be better to nominate exactly who you want to inherit your super death benefits? (Death benefits is the term for all of the money in your super account plus any life insurance.) You can generally nominate beneficiaries with either a binding or a non-binding nomination, although some super funds only provide a member with the ability to make non-binding nominations.

Make your wishes binding

For binding nominations, the trustees have to carry out your wishes, provided you have nominated eligible recipients. If a nomination is non-binding, it tells the trustee how you would like your benefits distributed, but leaves the ultimate discretion with the trustee, taking into consideration your circumstance and relationships at the date of death.

Under super law, death benefits can only be left to a dependent or your personal legal representative (the executor of your Will), in which case it will pass into your estate for distribution according to the terms of your Will.

It's important to note that a binding nomination generally only has a limited life. Every three years you need to advise your super fund in writing of your nominated beneficiaries or it becomes invalid.

If you have not nominated a beneficiary and have not yet organised a Will, then your super will be distributed according to a state-based formula which may not reflect your intentions.

Consider taxation

It's also important to take tax into account when nominating beneficiaries. If your spouse is alive then it is likely your death benefits will go to your partner as a lump sum and/or an income stream referred to as a reversionary pension. There is no tax liability if it's paid as a lump sum unless both you and your spouse are aged under 60 when you die. Also, the maximum your spouse can have in their pension account is $1.6 million. So there are considerations if the death benefit pension causes your spouse to exceed this income.

If your spouse predeceases you then the benefit will be divided between other dependants. Be aware though that there's a difference in the definition of dependants under super and tax law.

Under super law, a child of any age may receive your death benefit, but under tax law if they are aged over 18 and not financially dependent on you, they will be subject to 17 per cent taxation on the taxable component of the sum they receive. For this reason, your adult children may be better off receiving the money through your estate as they will only pay 15 per cent tax, saving the 2 per cent Medicare levy.

Non-dependent adult children cannot receive a reversionary pension; instead they must take a lump sum.

If you are legally divorced, then your ex-spouse is no longer deemed a dependant under super law. However, if you still want to leave your super to your ex-spouse it must go to your estate and be paid from there. Interestingly, your ex-spouse will receive the money tax free.

Self-managed funds

For those with a self-managed super fund, you can use a clause in the fund's trust deed to either nominate a valid dependent who will receive the benefit or else have the money paid to your legal representative who will pay the money into the estate.

Making sure your hard-earned money is distributed according to your wishes is not an onerous task, but it is an important one. Not nominating a beneficiary, or nominating someone who is not eligible to receive your super, can lead to lengthy delays and emotional upset at what is already a difficult time for your family.

Seeking professional and legal advice can help to ensure that your death super benefits are considered as part of your overall estate planning and that your wishes are carried out.

Fired up for financial independence

Millennials are often accused of living for the present and wasting their money on smashed avocado. So it may come as a surprise that younger Australians are at the vanguard of a growing movement committed to the old-fashioned virtues of thrift and saving, but with a modern twist.

Whereas the mantra of the Baby Boomers in the 1960s was ‘turn on, tune in, drop out’, their adult children also want to leave the rat race, but they want to do it with a substantial nest egg to allow them to pursue their dream lifestyle. The new mantra is ‘Financial Independence, Retire Early’, or FIRE for short.

The FIRE Brigade

The fundamentals of the movement come down to three lifestyle changes – living frugally, increasing income and investing the surplus – that they believe will help them achieve FIRE.

The godmother of the FIRE movement is Vicki Robin, the author of Your Money or Your Life. Robin suggested to her readers that they consider the ‘hours of life energy’ a purchase entailed. For example, a person earning $60,000 a year who is contemplating buying a $30,000 car should ask themselves whether owning the vehicle is a reasonable trade-off for six months of their life.

Robin’s book came out during the pre-GFC consumption frenzy and failed to have much impact. However, over the last decade or so, increasing numbers of individuals and couples in their twenties and thirties have embraced its core message about stepping off the consumerist treadmill.

FIRE blogs, websites and books are largely devoted to money-saving tips such as trade your car for a bike, be content with fewer, cheaper items of clothing and forget about eating smashed avocado on toast at cafes. FIRE enthusiasts are also highly motivated to increase their income by working smarter, studying or starting a side business. When it comes to investing surplus income, they are also actively engaged with a preference for income-producing assets such as property and bonds and dividend paying stocks.

Fuelling the FIRE

It’s not clear what has drawn so many Millennials to the idea of achieving financial independence earlier in life than their parents. It’s possible that the GFC had the same kind of impact on them as the Great Depression had on their grandparents. It’s also conceivable Millennials have less interest in flaunting status symbols than preceding generations. Or it could simply be the case that Millennials value freedom and autonomy and want to escape the rat race asap.

Being Millenials, technology is central to spreading the FIRE message. The favoured online hangout of Australian FIRE fans appears to be the Reddit, sub fiaustralia, which has 8,400 subscribers.[i] There are even Australian FIRE celebrities, such as ‘Aussie Firebug’. While remaining anonymous, Firebug has revealed he’s in his mid-twenties and determined to achieve financial independence by no later than his mid-thirties. He defines this as: “Having sufficient personal wealth to live, without having to work actively for basic necessities. For financially independent people, their assets generate income that is greater than their expenses.”[ii]

While its adherents skew towards the young, people of any age can embrace the FIRE philosophy. Many older Australians with modest super balances are doing much the same things as FIRE devotees, albeit out of the fear of having to keep working past retirement age rather than the hope of quitting their job in their thirties.

A timeless approach

Despite its recent arrival, the FIRE philosophy is essentially a modern makeover of some timeless financial wisdom. Work hard, spend less than you earn and invest the surplus in assets that will grow your wealth and produce income when you retire.

It could be argued that 26 years without a recession and access to easy credit has made many Australians too relaxed about living within their means. If that’s the case, the FIRE movement could be the spark we all need.

If you’re interested in building wealth to enjoy a financially independent future, give us a call.

i https://www.reddit.com/r/fiaustralia/

ii http://www.aussiefirebug.com/about/

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