MONEYNEWS

The newsletter of Moneywise Personal Financial Management Pty Ltd

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2018 Year in Review

Investors started 2018 full of hope, with the global economy and financial markets in good shape, but by year's end they were uncertain and a little anxious about what lay ahead. Markets responded with last minute falls across all asset classes.

The issues that weighed heavily were the unresolved trade dispute between the US and China, confusion over Brexit, rising US interest rates, falling commodity prices and the US government shutdown. Australians were also distracted by political instability and falling house prices in Sydney and Melbourne.

With so much uncertainty about, it was easy to lose sight of the solid progress we've made.

Positive economic growth

The global economy grew at a steady 3.1 per cent. However, the World Bank estimates global growth will ease slightly to 3 per cent this year and 2.9 per cent in 2020 as central banks remove monetary stimulus in place since the financial crisis.[i]

The US economy continued its strong recovery, expanding by 3 per cent in the year to September.

China's growth slowed to 6.5 per cent, its lowest since 2010, as the trade dispute with the US began to bite.[ii]

Australia enjoyed steady growth of 2.8 per cent in the year to September after 27 years without recession. Corporate profits are at record levels, inflation is a tame 1.9 per cent, unemployment fell to 5.1 per cent.

Consumers remain cautiously upbeat. The Westpac Melbourne Institute rose a percentage point over the year to 104.4 – anything over 100 is regarded as optimistic.[iii]

Focus on interest rates

The Australian dollar fell 10 per cent in 2018 to finish at US70c, due largely to US dollar strength and a widening of the gap between local and US interest rates.

The US Federal Reserve lifted rates four times to 2.5 per cent but indicated there may be only two more hikes in 2019, not three as previously forecast, due to the slowing economy. By contrast, Australia's cash rate finished the year where it started at 1.5 per cent.

At the other end of the yield curve, US 10-year government bond yields were barely changed at 2.7 per cent, reflecting market fears of economic slowdown. Yields on Australian 10-year bonds eased to 2.3 per cent.[iv]

The lower dollar is good news for our exporters and should soften the impact of falling commodity prices, caught in the cross-hairs of trade wars and fears about an economic slowdown.

Iron ore was down 3 per cent while oil, copper, aluminium, zinc and nickel prices dropped between 16 and 19 per cent. The one bright spot for local producers was wheat, up almost 20 per cent.[iv]

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2018 Year in Review

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Shares correction

Global shares retreated as the year came to an end, with the MSCI World Index down 10.4 per cent.[v]

The US market fell 6.5 per cent, its worst performance in a decade. UK shares fell 12 per cent with no Brexit deal in sight while political and economic uncertainty also weighted heavily on share prices across the Eurozone. In Asia, Chinese shares fell 25.5 per cent while the Japanese market fell 12 per cent.[iv]

Australian shares tapped into the global mood, with the ASX 200 down 6.9 per cent, its worst year since 2011. However, the total return from shares was down just 3.5 per cent when dividends are added.[vi]

Property loses steam

The heat came out of Australia's residential property market in 2018, with big falls in Sydney and Melbourne dragging the national market down 4.8 per cent, according to CoreLogic.[vii]

This is the biggest annual fall in a decade and follows tighter lending practices, rising supply, higher mortgage interest rate and falling investor demand.

Looking ahead

The late market reversals of 2018 were driven by gloomy expectations rather than the reality of solid economic gains. Future performance will depend on US interest rates, the resolution of trade tensions and the negotiation of a workable Brexit.

In Australia, uncertainty will persist until the Federal election is out of the way. Then investors can get back to focusing on our solid economic growth, a strong corporate sector, resilient consumers, low interest rates and more affordable housing.

i World Bank, 5 June 2018, http://www.worldbank.org/en/news/press-release/2018/06/05/global-economy-to-expand-by-3-1-percent-in-2018-slower-growth-seen-ahead

ii Trading economics, as at September 2018, https://tradingeconomics.com/china/gdp-growth-annual

iii Westpac Melbourne Institute, 12 December 2018, https://melbourneinstitute.unimelb.edu.au/__data/assets/pdf_file/0009/2943036/PressReleaseCSI20181212.pdf

iv Trading economics.

v Financial Times, 1 January 2019, https://markets.ft.com/data/indices/tearsheet/summary?s=MS-WX:MSI

vi Year in Review 2018, CommSec Economic Insights, 2 January 2019

vii CoreLogic, 2 January 2019, https://www.corelogic.com.au/news/australian-dwelling-values-fell-48-through-2018-marking-weakest-housing-market-conditions-0

Can you afford your dream retirement?

Planning your dream retirement can be an exciting time. The chance to travel overseas or around Australia without having to rush back to work, time to pursue new hobbies, learn a language or spend time with the grandkids. The possibilities are endless, but what will it cost?

Working out how much you will need to live the dream, and what you can afford will come down to a variety of factors. These include whether you own your home, the value of your superannuation and other investments, the return you earn on those investments and your spending patterns. You may also have a younger spouse who will be dependent on income from your investments after you die.

And that's the big unknown, because none of us know how long we will live.

Plan for a long life

Today's 65-year-olds can expect to live to an average age of 84.6 years for men and 87.3 for women, or roughly 20 and 22 years respectively in retirement. That's a long time, and it's only an average. Half will live longer than that, many into their 90s.[i]

The challenge is to ensure your cash lasts the distance, however long that may be. You may retire at age 65 but your money needs to keep working to produce the returns you need to live out your days in the style to which you have become accustomed.

A good way to begin thinking about your retirement needs and working out a budget is to visit the ASFA Retirement Standard, where you will find detailed budgets for different households and living standards.[ii] The budgets are updated quarterly and assume people own their own home.

Adding up the costs

As at June 2018, the ASFA Retirement Standard calculated that singles aged around age 65 would need $27,425 a year to live a modest lifestyle while couples would need $39,442. A comfortable lifestyle would cost $42,953 for singles and $60,604 for couples. The comfortable budget allows for higher spending on things such as health, insurances, home improvements, clothing, eating out, entertainment and travel.

To put this in perspective, the full age pension is currently $23,823.80 a year for singles and $35,916.40 for couples.[iii] As you can see, this does not stretch to ASFA's modest budget, let alone a comfortable lifestyle, especially for pensioners who are paying rent or still paying off a mortgage on top of other expenses.

Of course, everyone's income needs and lifestyle will be different. Some people may need to spend more on their health, while a contented gardener and homebody may need less money than a keen global traveller with a season ticket to opera, theatre or football.

It's also important to recognise that your spending patterns are likely to change in predictable ways over the course of your retirement, determined by your health and mobility.

The three stages of retirement

Most people go through three phases of retirement. The timing of each phase will be different for everyone, but the sequence is the same.

- **The active years.** Most Australians currently retire by age 65, although there is a growing trend to maintain some connection to the workforce on a part-time basis. Either way, in your 60s and 70s you finally have the flexibility to travel, spend time with the grandkids and pursue other interests. Expenditure is likely to be high, especially if overseas travel is high on your bucket list. You may also want to help your adult children buy their first home.
- **Slowing down.** At some point the joints get a little creaky and niggling health problems may emerge. As your mobility and activity decline so does your spending. Travel is closer to home, you may do some voluntary work and begin to live a little more frugally. Spending on health may increase and many will consider downsizing their home.
- **The frail years.** Most of us hope to remain in our own homes, but many will spend our final years in residential aged care. This may be due to increased frailty, a sudden medical event or cognitive decline. Whatever the reason, spending on health and aged care are likely to increase significantly during this phase. While government subsidies may reduce the out-of-pocket costs, having savings will increase your options and access to high quality care in your own home or an aged care facility.

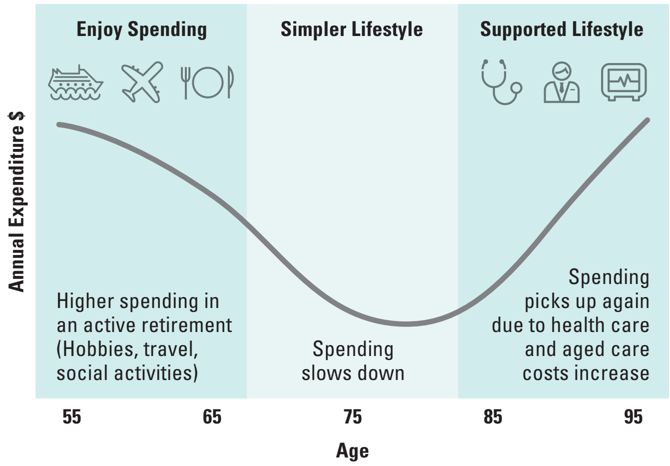

Chart 1: Typical spending during retirement

Seek professional help

Australians are living longer, healthier lives which means many of us can expect to enjoy almost as many years in retirement as we did in the workforce. And that requires careful financial planning.

Before you can set financial targets and investment objectives, you need to work out what your dream retirement might cost.

If you would like help to make your retirement dream a reality, give us a call.

i https://www.aihw.gov.au/getmedia/7b986857-7b41-4aae-b7ff-eab57eb20f13/20457.pdf.aspx?inline=true

ii https://www.superannuation.asn.au/resources/retirement-standard

iii https://www.humanservices.gov.au/individuals/services/centrelink/age-pension/eligibility/payment-rates

Financial Rules to Live By in 2019

Australia has enjoyed almost three decades of economic sunshine. But it's worth remembering that dark clouds can appear without warning over both individuals and economies.

You may have little control over being caught up in a round of redundancies or experiencing the fallout of an international trade war. But you can choose to manage your finances in a way that lets you keep your head above water come what may.

Financial rule #1: Have an emergency fund

A recent NAB/Centre for Social Impact report found one in seven adult Australians had no savings. One in three were just two missed pay cheques away from serious financial stress.[i]

The advantages of a rainy-day fund are both practical and psychological. If you do suffer an unexpected setback, you'll have a financial cushion to fall back on. Plus, knowing you have, say, three months' worth of living expenses set aside will allow you to make unhurried, rational decisions. (There's a growing body of research that shows financial stress causes people to behave in short-sighted ways likely to deepen their financial distress.)

Financial rule #2: Get the right insurance

Many Australians who wouldn't dream of not insuring their home and vehicle are happy to hope for the best when it comes to their income. Surveys suggest only around a third of adult Australians have life insurance, income protection or TPD cover, and many of those are underinsured.[ii]

If you're one of that majority of underinsured Australians you may wish to consider the wisdom of insuring your car (which could be replaced for a few thousand dollars) but not doing anything to ensure you – or your dependents, if you're no longer around – can stay on top of mortgage payments and grocery bills should the income from your job or business disappear.

Financial rule #3: Be smart about debt

While lenders are beginning to tighten their home-lending criteria, there's never been a time when credit has been so readily available. Technological advances mean this access is only going to become more 'frictionless' during 2019.

When it comes to debt, it's important to understand the difference between the good, the bad and the ugly.

Good debt is used to create wealth, for example, borrowing to buy appreciating assets such as a house or investments. Then there's acceptable debt, such as getting a car loan so you have the means to get to work. But credit cards, as well as increasingly popular buy-now-pay-later services such as Afterpay and ZipPay, and the short-term online loans offered typically facilitate bad debt, where high-interest credit is used to fund holidays, restaurant meals, clothes shopping and the like.

It's unrealistic to expect you'll never splurge using other people's money but do try to keep it to a minimum, shop around for the best interest rate and repay what you owe as soon as possible.

Financial rule #4: Forge a positive economic partnership

Money issues can be a major cause of tension in relationships if left unspoken. By opening the lines of communication around money you will not only help build harmony but also make it easier to develop and reach shared goals.

You and your better half are unlikely to be at the same point on the saver-spender spectrum, so some conflict is inevitable. Nonetheless, it's possible to engineer workable compromises around joint finances.

The 'Yours/Mine/Ours' method works well for many. It involves each partner getting a set amount of money to do whatever they wish with, allowing them to enjoy some autonomy. The trade-off is that both agree to direct the rest of their disposable income towards reaching mutually agreed goals. For example, paying off the mortgage within five years, making voluntary contributions to super or building a share portfolio.

When it comes to creating economic security for you and your family, small changes in behaviour can make a big difference. If you'd like some help getting your finances in shape for the new year, please call.

i Financial Resilience in Australia 2016, NAB and Centre for Social Impact, p.9,https://www.nab.com.au/content/dam/nabrwd/documents/reports/financial/financial-resilience-report.pdf

ii Life Insurance – Are you underinsured? Canstar, Oct 2016,https://www.canstar.com.au/life-insurance/life-insurance-are-we-underinsured/; Underinsurance in Australia, Finder, https://www.finder.com.au/underinsurance-in-australia

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