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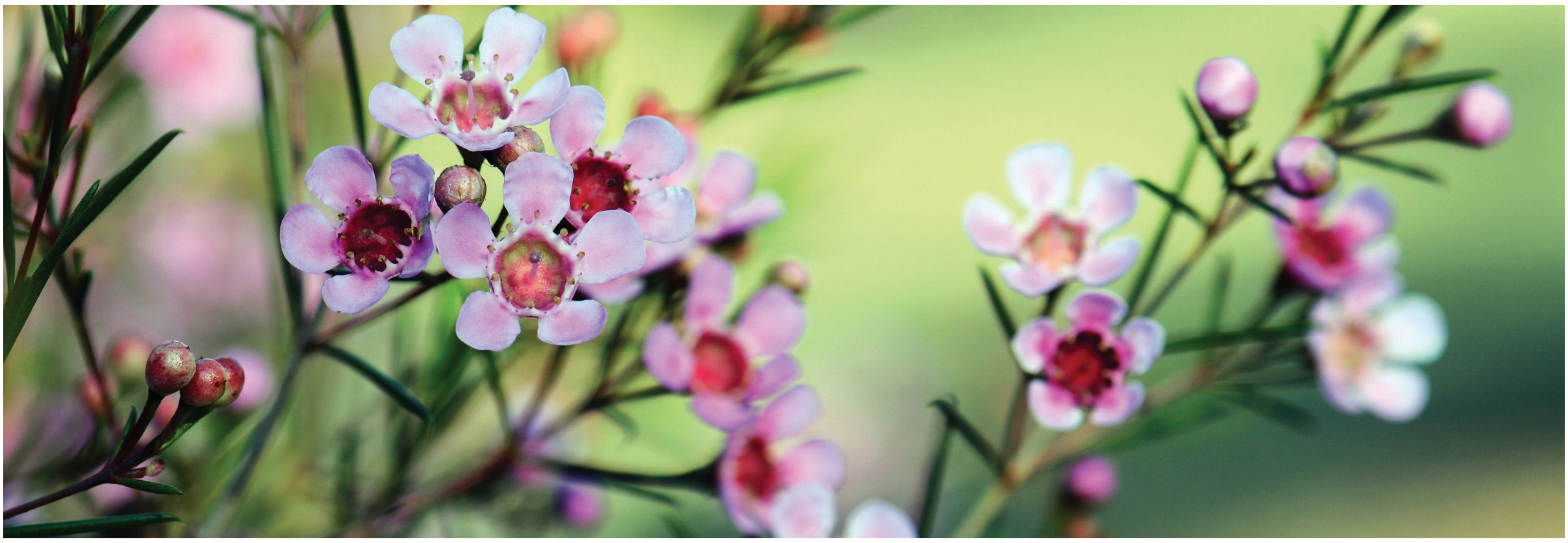

Spring 2020

It's September and spring is finally here. This is always a wonderful time to get out in the garden or in nature, on foot or on your bike, even if travel restrictions mean we need to stay closer to home this year.

The recent company reporting season for the year or half-year to June 30 provided an insight into the financial impact of COVID-19 – on the economy and for investors. Analysis by CommSec showed only 75% of ASX 200 companies reported a net profit in the year to June 30. Full-year earnings were down 38% on aggregate, while dividends were down 36%. In an extremely difficult trading environment, 53% of companies either cut or didn't pay a dividend, a move that will affect investors who depend on dividend income from shares.

There were bright spots though. Gold companies profited from rising gold prices, up almost 30% this year due to gold's status as a 'safe-haven' investment. Iron ore miners benefitted from a lift in demand from China and rising iron ore prices, up 46% this year. While homewares and electronics retailers and those with a strong online presence enjoyed increased demand from Australians staying close to home. Retail trade rose 12.2% in the year to July, the strongest annual growth in 19 years. Consumer confidence is also improving, with the weekly ANZ/Roy Morgan consumer confidence rating up 42% since its March lows to 92.7 points in the last week of August. The Australian dollar is fetching around US73.5c, up almost 5% this year.

Challenges remain, however. Unemployment rose to 7.5% in July, the highest level in 22 years. Business investment fell 11.5% in the year to July and residential building activity fell 12.1% in the year to June – the biggest fall in 19 years. The Reserve Bank forecasts the economy will contract 6% this year before rebounding 5% in 2021.

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Inflation, deflation – what's in a name?

When the inflation rate fell into negative territory in the June quarter, it was so unusual it begged the question of what this means for the economy. Are we facing deflation or even stagflation and what is the difference?

In the June quarter the annual inflation rate fell to minus 0.3 per cent, only the third time in 72 years of record keeping that the rate has been in the negative.[i]

Much of the fall was attributed to free childcare (part of the special COVID-19 measures) and low petroleum prices during the quarter. The general view is that the September quarter will return to positive territory when childcare fees resume.

So what is inflation and why does it matter?

What is inflation?

In Australia, the main measure of inflation is the consumer price index (CPI). This measures the rate of change in the average price of a basket of selected goods and services over time.

While the index can move up and down, a negative inflation rate – no, that's not an oxymoron – is referred to as deflation.

Generally, the Reserve Bank of Australia (RBA) aims to keep the inflation rate between 2 and 3 per cent. But in the current environment, the RBA is now expecting the CPI to remain below 2 per cent until at least December 2022.[ii]

A falling consumer price index – particularly one that is in negative territory – sounds like it should be a good thing as it will give you greater purchasing power with the lower prices. After all, who doesn't like a bargain? But in reality, it can play havoc with retail businesses who are faced with lower profits but not necessarily lower costs. This can put a squeeze on their business, which can often lead to retrenchments and a spike in unemployment.

The other two occasions when Australia experienced deflation were in 1962 and in 1997-98.

The 1962 negative rate was after then Prime Minister Menzies implemented two credit squeezes to end the inflation caused by the Korean War Boom. The 1997 episode was in the wake of the Asian Financial crisis.

A slowing economy

Clearly, we are living in extraordinary times with COVID-19 and until the pandemic is more under control we can expect further slowing in the economy.

But at least this curtailment of economic activity is not coinciding with higher prices for goods. If that were the case, the country would be faced with stagflation which poses a far greater squeeze on households than deflation. Stagflation is a situation with rising inflation (prices) and slowing economic growth, often accompanied with high unemployment.

Of course, if your job is not in jeopardy, you will benefit from cheaper goods. But if lower prices become the norm, people may hold off major purchases on the expectation that they can buy even more cheaply in the future. This is not good news as consumer spending makes up 60 per cent of total economic activity, so a contraction in spending generally results in a contraction in the economy.

However, if your employment is insecure and the overall unemployment rate rises, this will depress household spending. It will also have an impact on the property market.

Unemployment takes its toll

According to the latest figures, more than one million Australians are currently unemployed and many more could face uncertainty going forward.[iii] Whether you rent or are buying your property, finding the funds can present problems.

In some areas, as demand dried up in the June quarter, rents dropped by as much as 25 per cent. This may be good for renters, but it is not for those with investment property as part of their retirement strategy. If rents fall – or indeed if your property is vacant for some time – it may jeopardise retirement income.

Property prices are also under attack with distressed sales coming to the fore as the unemployment rate grows. When property values fall, mortgages become more expensive in real terms as your equity may be reduced – and in some cases you could find yourself with negative equity in your property.

Hopefully, the measures introduced in Australia to counter COVID-19 will prove successful and the economy will begin to recover.

If you would like to discuss your overall investment strategy in light of these challenging times, then please call.

i https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/6401.0Media+Release1June+2020#:~:text=am%20(Canberra%20time)-,CPI%20fell%201.9%20per%20cent%20in%20the%20June%202020%20quarter,Bureau%20of%20Statistics%20(ABS).

ii https://www.rba.gov.au/media-releases/2020/mr-20-18.html

iii https://www.abs.gov.au/ausstats/abs@.nsf/mf/6202.0

Getting retirement plans back on track

After a year when even the best laid plans have been put on hold due to COVID-19, people who were planning to retire soon may be having second thoughts. You may be concerned about a drop in your super balance, insecure work, or an uncertain investment outlook.

Whatever your circumstances, a financial tune-up may be required to get your retirement plans back on track. You may even find you're in better financial shape than you feared, but you won't know until you do your sums.

The best place to start is to think about your future income needs.

What will retirement cost?

Your retirement spending will depend on your lifestyle, if you are married or single, whether you own your home and where you want to live.

Maybe you want to holiday overseas every year while you are still physically active or buy a van and tour Australia. Do you want to eat out regularly, play golf, and lead an active social life; or are you a homebody who enjoys gardening, craftwork or pottering in the shed?

Also think about the cost of creature comforts, such as the ability to upgrade cars, computers and mobiles, buy nice clothes, enjoy good wine and pay for private health insurance.

It's often suggested you will need around 70 per cent of your pre-retirement income to continue living in the manner to which you have become accustomed. That's because it's generally cheaper to live in retirement, with little or no tax to pay and (hopefully) no mortgage or rent.

Draw up a budget

To get you started, the ASFA Retirement Standard may be helpful. It provides sample budgets for different households and living standards.

ASFA suggests singles aged 65 would need around $44,183 a year to live comfortably, while couples would need around $62,435.[i] Of course, comfort is different for everyone so you may wish to aim higher.

To put these figures in perspective, the full Age Pension is currently around $24,550 a year for singles and $37,013 for couples.[ii] As you can see, this doesn't stretch to ASFA's modest budget, let alone a comfortable lifestyle, especially for retirees who are paying rent or still paying off a mortgage.

Then there is the 'known unknown' of how long you will live. Today's 65-year-olds can expect to live to an average age of around 85 years for men and 87 for women. The challenge is to ensure your money lasts the distance.

Can I afford to retire?

Once you have a rough idea what your ideal retirement will cost, you can work out if you have enough super and other savings to fund it.

Using the ASFA benchmark for a comfortable lifestyle, say you hope to retire at age 65 on annual income of $62,000 a year until age 85. Couples would need a lump sum of $640,000 and singles would need $545,000. This assumes you earn 6 per cent a year on your investments, draw down all your capital and receive a part Age Pension.

Add up your savings and investments inside and outside super. Subtract your debts, including outstanding loans and credit card bills, to arrive at your current net savings. Then work out how much you are likely to have by the time you hope to retire if you continue your current savings strategy.

There are many online calculators to help you estimate your retirement balance, such as the MoneySmart super calculator.

Closing the gap

If there's a gap between your retirement dream and your financial reality, you still have choices.

If you have the means, you could make additional super contributions up to your concessional cap of $25,000 a year. You may also be able to make after-tax contributions of up to $100,000 a year or, subject to eligibility, $300,000 in any three-year period.

You might also consider delaying retirement which has the double advantage of allowing you to accumulate more savings and reduce the number of years you need to draw on them.

These are challenging times to be embarking on your retirement journey, but a little planning now could put you back in the driver's seat.

Get in touch if you would like to discuss your retirement strategy.

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

ii https://www.servicesaustralia.gov.au/individuals/services/centrelink/age-pension/how-much-you-can-get

We all have bad habits, and they can be many and varied. They can be as big as poor time management which can impact your productivity, or as small as nail biting which drives your loved ones crazy! You might self-sabotage, such as tucking into that tub of ice-cream even if you've vowed to eat better or checking your phone during face-to-face conversations which can cause hurt feelings.

It's of course unrealistic to be perfect, but you can part company with the habits which are not having a positive impact on your life.

How habits are formed

It's estimated that 40% of our activities are performed daily in the same situations.[i] It can be hard to trace back how habits (good and bad) were formed but they served a purpose at some stage in our lives. Perhaps you took up smoking to fit in or deal with stress, or learned to self-soothe with sugary treats.

A bad habit for one person isn't necessarily a bad habit for someone else. Having a glass or two during wine o'clock might be problematic for someone, but a welcome treat for another.

Why habits are hard to break

Habits become deeply wired over time and often reward us in some way thanks to our brain chemistry. However we don't have to remain at the mercy of them.

As the common failure of our New Year's resolutions show, it's hard to break habits and/or form new ones. Fortunately there has been significant research into how habits are formed, which can help when it comes to breaking our less desired habits.

Leveraging the habit loop

All habits can be broken down into three main components; first comes the cue or trigger which could be in your internal or external environment; then the action (good or bad); and lastly the reward, where your brain receives the positive feedback for your action.[ii]

Appreciating how habits are formed and maintained will enable you to consciously adjust your behaviour, intercepting the habit loop and making your desired behaviours finally stick.

Firstly, create an environment that reminds and encourages you to take action. This could be having your clothes set out for your early morning workout, or scheduling time and moving to a separate space to allow for deep thinking work.

Next identify your current external and your internal cues that trigger your behaviour and set up a process for more productive response, removing any barriers to your success. Are you prone to the 3pm afternoon slump? Take a walk or have some healthy snacks at hand to save you from that sugary snack.

Creating a positive feedback loop for success

Ever wondered why your most addictive habits are often the easiest to adopt and the hardest to kick? These habits, while they may not have a positive impact on your health and wellbeing, have inbuilt reward systems which release a cocktail of positive chemicals in your brain including dopamine, encouraging you to continue your new found habit.

While not all habits have a natural inbuilt reward system, you can create a positive feedback loop to stimulate your brain and embed a new habit, particularly when you are just getting started. For example, studies have shown that a small amount of dark chocolate after a workout can stimulate the same chemicals that will eventually be released by the workout itself.[iii] Creating an immediate reward to spur you on.

...and pace yourself

It takes time to break habits and form new ones – on average, over two months.[iv] Be patient with yourself and realistic with what you can achieve. If you do fall back into your old ways, don't be too hard on yourself, most people fail multiple times before they make it work. Treat yourself with compassion and persevere. It will be worth the effort to dump those habits that just aren't working for you anymore.

i https://www.sciencedaily.com/releases/2014/08/140808111931.htm

ii https://www.forbes.com/sites/quora/2018/02/13/the-science-behind-adopting-new-habits-and-making-them-stick/#671e27a143c7

iii https://www.sciencedaily.com/releases/2016/09/160913101129.htm

iv https://onlinelibrary.wiley.com/doi/abs/10.1002/ejsp.674