FM FINANCIAL

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Accumulating Wealth

Accumulating wealth is a key part of a financial plan to allow you to achieve your goals throughout your life. Please enjoy the articles below and call your Adviser if you would like to discuss further.

Interest rates have been front and centre for the past month, at home and away. The US Federal Reserve kept rates on hold but left the door open for a long-anticipated rate rise in December. The market read this as a vote of confidence in the US economy and global shares rallied. Elsewhere, the pressure on rates is down. The European Central Bank signalled its willingness to ramp up its quantitative easing program and possibly deploy a negative interest rate policy by the end of the year. Meanwhile, the People's Bank of China cut rates for the sixth time since last November.

In Australia, the big four banks raised variable mortgage rates by an average of 17.5 basis points in response to higher capital costs, taking some of the heat out of the housing market. This, and a lower-than-expected inflation reading for the September quarter, has led to speculation that the Reserve Bank could cut rates by the end of the year to boost economic activity. Speculation about an imminent rate cut sent the Australian dollar back below US71c.

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SHARES DOWN *BUT* NOT OUT

Most investors are familiar with Warren Buffett's advice to be fearful when others are greedy and greedy when others are fearful. But when share prices fall around the globe as they have in recent weeks, it's difficult to keep your wits about you when everyone else is at their wit's end.

At a time when it's difficult to forecast what will happen to share prices from one week to the next, what is certain is that investors who focus on value rather than price will be the first to find disgarded gems among the debris.

Before jumping in though, it's important to understand the reasons behind the latest market volatility.

What just happened?

The trigger for the sell-off was the Chinese market's 8.5 per cent fall on Monday August 24. Shares on global markets quickly followed suit. By mid-week, the local market was 16 per cent below its April high.

Although there have been worse corrections since 2008, it was the sight of so many global markets toppling in unison that had many investors rattled.

Chinese slowdown

After climbing 150 per cent in the year to June 12, it was clear to many observers that Chinese shares were due for a reality check. The Shanghai market has fallen about 38 per cent from its June peak, but it's still about 35 per cent higher than a year ago.

The issue that pricked the Chinese share bubble was concern about a worse than feared economic slowdown as the nation transitions from an investment boom to a consumer-driven economy. The International Monetary Fund forecasts growth of 6.8 per cent in 2015, a cracking pace compared with other leading economies, but well down from 7.4 per cent last year.[i]

Global concerns

Events in China may have triggered the recent volatility, but global investors have been worried on a number of fronts all year. Falling oil and commodity prices, the Greek debt crisis and uncertainty about when the US Federal Reserve will start lifting interest rates have made investors cautious.

Sharemarkets hate uncertainty and are likely to over-react to news, good and bad, until the outlook is clearer.

A correction, not a crash

The general consensus among economists and commentators is that local shares are experiencing a correction, not a crash. Our sharemarket is not over-valued and the outlook for the local economy is still fundamentally sound.

According to CommSec, the US and European markets were 18-20 per cent over-priced before the latest sell-off, the Shanghai market was 46 per cent over-valued while Australian shares were just 10 per cent above their long-term average price-to-earnings ratio of 15, where they sit now.

In other words, local shares are not cheap but not expensive either. And some stocks that have been heavily sold may already be in value territory, provided their earnings are underpinned by solid economic fundamentals.

Australia's economy is growing slowly but steadily. The Reserve Bank of Australia forecasts growth will rise from 2 per cent to 2.5-3.5 per cent by the end of 2016. Consumers are spending and property prices are rising. Even falling commodity prices are not all bad; they keep inflation low and they are driving the fall in the Aussie dollar which helps our export and tourism sectors.

Back to basics

When share prices are fluctuating wildly, it's worth remembering that when you invest in shares you are investing in companies not abstract prices. As the annual profit reporting season draws to a close, there were few nasty surprises. Despite the challenging conditions, companies lifted dividends by about 8 per cent on average.

Australian shares offer substantial rewards for investors in quality companies who stay the course.

If you would like to discuss any of the issues raised in this article in the context of your financial situation, don't hesitate to give us a call.

i China's transition to slower but better growth, IMF, 14 August 2015, http://www.imf.org/external/pubs/ft/survey/so/2015/CAR081415B.htm

Property NOT always as safe as houses

Australians' long-lasting love affair with property is a major factor in our increased wealth but there are growing concerns that heavy dependence on a single investment strategy may not be healthy.

Like every asset class, property moves in cycles and the cracks could be starting to appear in a market that has made Australians the richest people in the world.

According to the latest global wealth report from investment bank Credit Suisse, Australians topped the rich list in 2014.[i] But it also revealed that 60 per cent of our wealth was tied up in property. That's not a problem when property values are soaring, but what happens if and when the music stops?

A 'REAL' ASSET

As well as the obsession to own our own home Australians are drawn to real estate as an investment, attracted by the tangible nature of bricks and mortar, the potential for income and some handy tax benefits. There is something about being to drive past your investment that makes it feel like a safe place to park your money.

In recent years the investment choice has been vindicated. Combined capital city home values rose for nearly two and a half years to November 2014, increasing by an impressive 20 per cent, with Sydney and Melbourne the outstanding drivers.[ii]

With domestic and global interest rates at record lows the search for yield has been widespread. Local and international investors have flocked to buy Australian property which is viewed as less volatile than shares and higher growth than cash and bonds.

While the official cash rate stayed at 2.5 per cent for 2014, capital city rental returns for houses were 4 per cent and 4.5 per cent for units.[iii]

MIND THE CYCLE

But property hasn't always been the best place to be. Prior to the latest growth phase property values across the country fell for 18 months.[iv] The outlook is for property price growth to slow once again, albeit off a strong base.[v]

For investors who have only residential property in their portfolio, warning signals about future house prices and rental returns are a timely reminder of the importance of diversification.

Long term data shows that in any given year one asset class may do better than others, but rarely does one asset class take out top honours for more than a year or two running. Only by diversifying your investments across and within asset classes can you be confident of capturing the best returns on offer year in and year out and avoid being wiped out by a single bad investment.

A major downside of real property is that a large portion of your capital is tied up in a single asset that can be difficult to sell in a downturn. What's more, you can't just sell the bathroom to free up cash when you need it. If it is rented there will be tenants to find and repairs and maintenance to keep up-to-date.

UN-REAL PROPERTY

Real property isn't the only option for property lovers. Listed Real Estate Investment Trusts (REITs), which can be bought and sold on the Australian Securities Exchange (ASX), offer a more flexible alternative as well as diversification.

Unlisted managed funds may be another option.

In both cases professionals invest in property across different sectors of the market including residential, retail, industrial and commercial as well as different domestic and international locations. If a downturn is occurring in one sector in one part of the world there is a chance that somewhere else is performing well.

Property investment should always be considered within the broader context of your wealth creation plan.

If you would like to discuss your property investment options as part of a diversified portfolio give us a call.

i http://www.smh.com.au/business/the-economy/property-makes-australians-the-world8217s-richest-says-credit-suisse-20141014-1163ip.html

ii http://www.corelogic.com.au/resources/pdf/reports/qtrly-economic-property-review--nov2014.pdf

iii http://www.corelogic.com.au/resources/pdf/reports/qtrly-economic-property-review--nov2014.pdf p. 8

iv http://www.corelogic.com.au/resources/pdf/reports/qtrly-economic-property-review--nov2014.pdf p. 3

v http://www.corelogic.com.au/resources/pdf/reports/qtrly-economic-property-review--nov2014.pdf p. 27 http://www.corelogic.com.au/media-release/home-value-growth-rate-continues-to-moderate

FUTURE PROOF *your* FAMILY

Life has a habit of throwing us curve balls. Every day in Australia 18 families lose a working parent and a chunk of their future income. That's a strong argument for protecting your loved ones with adequate life insurance.

And it's not just the main breadwinner's life that needs insuring. If a homemaker dies, it is estimated that the family income will drop by half. Even if the homemaker is not working, the spouse will have to fund extra childcare and or/housekeeping help or perhaps work fewer hours, all of which would squeeze the household budget.

How much cover?

The simplest way to work out how much cover you need is to subtract your current financial resources from your future expenses. And when you do so, remember that your debts don't die with you.

It's not just your mortgage you need to take into account but also your credit card and any personal loans as well as your day-to-day living expenses. Actuaries Rice Warner believe you need 15 years' income to be fully covered.[i]

Yet Rice Warner found that the median level of life insurance cover across the working age population only accounts for 64 per cent of basic life insurance needs and only 42 per cent of the amount needed to fully maintain the standard of living of remaining family members.[i]

Insurance within super

For most working Australians, a basic level of life insurance is available automatically through your super account. This can be useful if cash flow is an issue, as the money will come out of your superannuation contributions or balance.

However, life insurance within super is often not enough to meet your needs. The industry average for benefits payable from super is about $70,000, nowhere near the amount needed to provide ongoing support and security for your family.[ii] And if a payout is made to a non-financial dependent, they will pay capital gains tax on amounts over $50,000.

The solution could be to top up your cover in a retail product outside super. The major difference between the two products is the underwriting process.

When you apply for a retail policy your risk is assessed via underwriting. By comparison, most policies within super are not underwritten and cover is automatically granted without any individual risk assessment.

While at first glance automatic acceptance may seem attractive, it does make sense to have an underwritten policy where the insurer assesses your risk through a medical examination or questionnaire as the cover will be tailored to your individual needs. Interestingly, industry statistics show that 93 per cent of people who go through the underwriting process will be accepted at standard premium rates.[iii]

The younger, the better

If you think you are too young to worry about life insurance, think again. The younger you are, the cheaper it will be. That's because you will be deemed low risk and once the policy is in place the insurer can't cancel it.

Next, you need to decide on stepped or level premiums. While stepped premiums start off cheaper, over time level premiums are more cost effective. If you are young and expect to hold the policy for a long time, level premiums are worth considering.

It is estimated that a 35-year-old non-smoking male seeking $500,000 cover will pay $30 a month in premiums while a female with the same profile would pay only $25 a month.[iii]

It's always wise to know exactly what your policy includes. Some policies will pay out before death if you are diagnosed with a terminal illness. Others may cover suicide although they generally have a 13-month exclusion from the date the cover starts.[iv]

Making sure you have the right cover for your needs is vital. If you would like to discuss your options please contact us.

i http://ricewarner.com/newsroom/2013/december/02

ii https://www.amp.com.au/wps/portal/au

iii http://www.lifewise.org.au/insurance-101/how-does-life-insurance-work

iv http://www.lifeinsurancefinder.com.au/post/insurance-types/life-cover-death-benefit/suicide-is-it-covered-by-life-insurance/