GUARDIAN INVESTMENTS

June 2022

June was a big month in an eventful year for the local and global economy, with inflation and interest rates continuing to dominate. The US Federal Reserve lifted official rates by 0.75% to a target range of 1.50-1.75% to combat surging inflation of 8.6% in the year to May, stoking fears of a US recession. Australia faces similar but less acute challenges. With inflation sitting at 5.1%, the Reserve Bank lifted the cash rate by 0.5% to 0.85% in June and Governor Philip Lowe hinted at several rises for the remainder of 2022. COVID-based economic stimulus has effectively brought forward demand from future years into 2020 and 2021. In 2022, governments are faced with the consequences of over-stimulating their economies, forcing them to apply rate rises and other measures to curb price/cost growth.

The Australian economy is still growing relatively strongly at an annual rate of 3.3%. Retail trade rose 10.4% in the year to May on the back of low unemployment and high household savings. Household wealth rose to a record high of $574,807 in the year to March, but since then there has been a global sell-off in shares, a slowdown in the Australian housing market and cost of living pressures (exacerbated by supply-side shortfalls) are very evident. It is no surprise that consumer sentiment is turning decidedly negative as housholds work through higher costs and what is likely the peak of house prices for some years. Consumers can absorb some higher costs and some erosion of their feeling of wealth but there is a limit.

The unemployment rate is a key indicator of how we will navigate a potentially rocky year ahead - unemployment is the primary driver of house prices, consumer sentiment and spending. Current indications for the next 12 months are for employment to remain robust. Given 'full employment' is a core part of the Reserve Bank function, we expect the RBA will cautiously use rate rises so as not to cause unemployment to become an issue.

Returns for the full Financial Year (12 months) are: All Ordinaries: 6747, down 838 points or -11.05%; Listed Property Accumulation Index 53341, down 7450 or 12.25%; 90 Day Bank Bills 1.81%, up 1.78%; AUD vs U.S. Dollar 69.14c, down 5.56 cents or down 7.44%; UK FTSE 100, 7170 points, up 160 points or 2.28%; Dow Jones Industrial Avg, 30775 points, down 3470 points or 10.13%

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THE ROAD AHEAD FOR SHARES

Trying to time investment markets is difficult if not impossible at the best of times, let alone now. The war in Ukraine, rising inflation and interest rates and an upcoming federal election have all added to market uncertainty and volatility.

At times like these investors may be tempted to retreat to the "safety" of cash, but that can be costly. Not only is it difficult to time your exit, but you are also likely to miss out on any upswing that follows a dip.

Take Australian shares. Despite COVID and the recent wall of worries on global markets, Aussie shares soared 64 per cent in the two years from the pandemic low in March 2020 to the end of March 2022.[i] Who would have thought?

So what lies ahead for shares? The recent Federal Budget contained some clues.

The economic outlook

The Budget doesn't only outline the government's spending priorities, it provides a snapshot of where Treasury thinks the Australian economy is headed. While forecasts can be wide of the mark, they do influence market behaviour.

Australia's economic growth is expected to peak at 4.25 per cent this financial year, underpinned by strong company profits, employment growth and surging commodity prices. Our economy is growing at a faster rate than the global average of 3.75 per cent, and ahead of the US and Europe, which helps explain why Australian shares have performed so strongly.[ii]

However, growth is expected to taper off to 2.5 per cent by 2023-24, as key commodity prices fall from their current giddy heights by the end of September this year.

Commodity prices have jumped on the back of supply chain disruptions during the pandemic and the war in Ukraine. While much depends on the situation in Ukraine, Treasury estimates that prices for iron ore, oil and coal will all drop sharply later this year.

Share market winners and losers

Rising commodity prices have been a boon for Australia's resources sector and demand should continue while interest rates remain low and global economies recover from their pandemic lows.

Government spending commitments in the recent Budget will also put extra cash in the pockets of households and the market sectors that depend on them. This is good news for companies in the retail sector, from supermarkets to specialty stores selling discretionary items.

Elsewhere, building supplies, construction and property development companies should benefit from the pipeline of big infrastructure projects combined with support for first home buyers and a strong property market.

Increased Budget spending on defence, and a major investment to improve regional telecommunications, should also flow through to listed companies that supply those sectors as well as the big telcos and internet providers.

But there are other influences on the horizon for investors to be aware of.

Rising inflation and interest rates

With inflation on the rise in Australia and the rest of the world, central banks are beginning to lift interest rates from their historic lows. Australia's Reserve Bank has recently raised the official cash rate after 11 ½ years of no increases.

Global bond markets are already anticipating higher rates, with yields on Australian and US 10-year government bonds jumping to 2.98 per cent and 2.67 per cent respectively.[iii]

Rising inflation and interest rates can slow economic growth and put a dampener on shares. At the same time, higher interest rates are a cause for celebration for retirees and anyone who depends on income from fixed interest securities and bank deposits. But it's not that black and white.

While rising interest rates and volatile markets generally constrain returns from shares, some sectors still tend to outperform the market. This includes the banks, because they can charge borrowers more, suppliers and retailers of staples such as food and drink, and healthcare among others.

Putting it all together

In uncertain times when markets are volatile, it's natural for investors to be a little nervous. But history shows there are investment winners and losers at every point in the economic cycle. At times like these, the best strategy is to have a well-diversified portfolio with a focus on quality.

For share investors, this means quality businesses with stable demand for their goods or services and those able to pass on increased costs to customers.

If you would like to discuss your overall investment strategy don't hesitate to get in touch.

i https://www.commsec.com.au/market-news/the-markets/2022/mar-22-budget-sharemarket-winners-and-losers.html

ii https://budget.gov.au/2022-23/content/bp1/download/bp1_bs-2.pdf

iii https://tradingeconomics.com/united-states/government-bond-yield

A SUPER WINDOW OF OPPORTUNITY

New rules coming into force on July 1 will create opportunities for older Australians to boost their retirement savings and younger Australians to build a home deposit, all within the tax-efficient superannuation system.

Using the existing First Home Super Saver Scheme, people can now release up to $50,000 from their super account for a first home deposit, up from $30,000 previously.

Another change that will help low-income earners and people who work in the gig economy is the scrapping of the Super Guarantee (SG) threshold. Previously, employees only began receiving compulsory SG payments from their employer once they earned $450 a month.

But the biggest potential benefits from the recent changes will flow to Australians aged 55 and older. Here's a rundown of the key changes and potential strategies.

Work test changes

From July 1, anyone under the age of 75 can make and receive personal or salary sacrifice super contributions without having to satisfy a work test. Annual contribution limits still apply and personal contributions for which you claim a tax deduction are still not allowed.

Previously, people aged 67 to 74 were required to work for at least 40 hours in a consecutive 30-day period in a financial year or be eligible for the work test exemption.

This means you can potentially top up your super account until you turn 75 (or no later than 28 days after the end of the month you turn 75). It also opens up potential new strategies for making a big last-minute contribution, using the bring-forward rule.

Extension of the bring-forward rule

The bring-forward rule allows eligible people to ''bring forward" up to two years' worth of non-concessional (after tax) super contributions. The current annual non-concessional contributions cap is $110,000, which means you can potentially contribute up to $330,000.

When combined with the removal of the work test for people aged 67-75, this opens a 10-year window of opportunity for older Australians to boost their super even as they draw down retirement income.

Some potential strategies you might consider are:

- Transferring wealth you hold outside super – such as shares, investment property or an inheritance – into super to take advantage of the tax-free environment of super in retirement phase
- Withdrawing a lump sum from your super and recontributing it to your spouse's super, to make the most of your combined super under the existing limits
- Using the bring-forward rule in conjunction with downsizer contributions when you sell your family home.

Downsizer contributions age lowered to 60

From July 1, you can make a downsizer contribution into super from age 60, down from 65 previously. (In the May 2022 election campaign, the previous Morrison government proposed lowering the eligibility age further to 55, a promise matched by Labor. This is yet to be legislated.)

The downsizer rules allow eligible individuals to contribute up to $300,000 from the sale of their home into super. Couples can contribute up to this amount each, up to a combined $600,000. You must have owned the home for at least 10 years.

Downsizer contributions don't count towards your concessional or non-concessional caps. And as there is no work test or age limit, downsizer contributions provide a lot of flexibility for older Australians to manage their financial resources in retirement.

For instance, you could sell your home and make a downsizer contribution of up to $300,000 combined with bringing forward non-concessional contributions of up to $330,000. This would allow an individual to potentially boost their super by up to $630,000, while couples could contribute up to a combined $1,260,000.

Rules relaxed, not removed

The latest rule changes will make it easier for many Australians to build and manage their retirement savings within the concessional tax environment of super. But those generous tax concessions still have their limits.

Currently, there's a $1.7 million limit on the amount you can transfer into the pension phase of super, called your transfer balance cap. Just to confuse matters, there's also a cap on the total amount you can have in super (your total super balance) to be eligible for a range of non-concessional contributions.

As you can see, it's complicated. So if you would like to discuss how the new super rules might benefit you, please get in touch.

Source: ATO

A WILL TO *give*

As baby boomers shift into retirement, Australia is on the brink of the nation's biggest ever intergenerational wealth transfer. Yet estate or inheritance planning is rarely discussed by families.

Talking openly about how you want your assets to be passed on can help avoid family disputes that take a toll both financially and emotionally. It provides a certain peace of mind for you – that your intentions will be met – and for your family and friends.

Certainly the stakes have never been higher, with growing house prices and healthy superannuation balances contributing to a considerable increase in the wealth of many older Australians in the past two decades.

Around $1.5 trillion was transferred in gifts or inheritances between 2002 and 2018. In 2018 alone, some $107 billion dollars was inherited while $14 billion was handed out in gifts.[i]

The importance of planning

With so much at stake, having an estate plan in place helps to protect the interests of those you care about and to fulfil your wishes. It takes careful thought and professional advice, but that is no excuse for putting the task aside for later. If something happens to you in the meantime, your assets may not be distributed as you would like and there could be tax implications for your beneficiaries.

An estate plan includes a Will and, in some cases, funeral arrangements and instructions for the care of children and animals. Without a Will, your assets will be distributed according to state inheritance laws which may not be what you intended.

A plan may also include instructions for a testamentary trust to hold assets that are then distributed in a tax-effective way to your beneficiaries. And don't forget your 'digital will', a list of any online accounts and passwords that may be important.

Meanwhile, to protect your interests in case you are incapacitated in some way, an enduring power of attorney and a medical power of attorney nominate the people you would like to handle your affairs until you are better.

Complex families

Estate planning is even more important in the case of blended families or for those with complex family relationships, especially where the emotional issue of the family home is concerned.

Disputes often centre around who gets the house when there are children from a previous marriage, but your new spouse is living in the family home. You could allocate other assets to the children and leave the home to your spouse or require that the house be sold and the proceeds distributed to all. Alternatively, your Will could grant lifetime tenure in the home for your spouse with it passing to your children after your spouse dies. Having conversations early about your intentions, can help alleviate possible conflict.

If you are concerned about protecting the interests of a family member with mental health or addiction issues, a testamentary trust can help to look after your assets and distribute funds in a controlled way. A testamentary trust is also often used to provide for young children, holding the assets until they reach adulthood.

Dividing it up

When it comes to deciding how best to allocate assets among children, some prefer to hand out equal shares no matter their individual financial circumstances, while others prefer to give extra to one who may be struggling. Given that Wills are frequently challenged by family members or others who believe they are owed a share or an even bigger share, it's wise to make your intentions clear in your Will including reasons and documentation.

While people who receive inheritances are usually well into middle age – on average 50-years-old[ii] – and perhaps comfortably well-off, you could choose to bypass the next generation. Instead, you might consider leaving your estate to grandchildren, to help set them up with a deposit for a home or covering school fees.

Another option is to begin distributing your estate while you are alive and can share the enjoyment of the benefits the extra financial help might bring.

What's not covered?

It is important to note that some assets are not covered by your Will. These include assets jointly held with someone else (such as a bank account or a house), super benefits and life insurance.

In the case of jointly held assets, ownership generally passes to the surviving partner and life insurance is paid to the beneficiary named in the policy. For super, it's vital to complete a binding death benefit nomination to ensure the funds are paid to the person you choose.

With so much to consider, expert advice is critical when preparing an estate plan, so call us to begin the discussion.

i https://www.pc.gov.au/research/completed/wealth-transfers

ii Wealth Transfers and their Economic Effects - Commission Research Paper - Productivity Commission (pc.gov.au)