GUARDIAN INVESTMENTS

June 2023 Newsletter

Consumer inflation slowed to a 13 month low in May of 5.6% (annualised), leading many commentators to express hope that further interest rate rises may be kept in check. In pausing their rise cycle for June and July, the Reserve Bank referenced the moderating inflation outlook. To be clear though, it is widely believed that while we are near the top of the interest rate rise cycle, inflation, even at its current moderated level is still too high. House prices, rental costs, building prices and food inflation have remained stubbornly high, while wage rises are now coming through and energy price increases are yet to come. Our fear is that a higher than acceptable level of inflation will become entrenched and require rates to stay high (higher than at present) for a long period of time.

Adding fuel to our concern is the massive government spending at State and Federal level on 'construction projects' amongst other initiatives. On construction projects alone, currently the total committed is about $360billion of extra spending over 4 years – all borrowed money. Governments have their foot on the accelerator while the Reserve Bank has its foot on the brake. It is extraordinary stuff. Persistent inflation will make us all poorer.

With unemployment remaining resilient at 3.6% and retail sales rising in May, it is increasingly probable that the RBA will have to tip the economy into a recession to tame inflation, such is it's stubbornness. Keeping in mind that investment markets tend to look forward, the local share market appears to be pricing in this possibility. Looking to the medium term, inflation will pass and markets will resume their upward trajectory.

Returns for the full Financial Year (12 months) are:
All Ordinaries: 7401, up 654 points or +9.69%;
Listed Property Accumulation Index 57662, up 4321 or 8.1%;
90 Day Bank Bills 4.35%, up 2.54%;
AUD vs U.S. Dollar 66.65c, down 2.49 cents or down 3.60%;
UK FTSE 100, 7531 points, up 361 points or 5.03%;
Dow Jones Industrial Avg, 34407 points, up 3632 points or 11.81%

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How do interest rates affect your investments?

Interest rates are an important financial lever for world economies. They affect the cost of borrowing and the return on savings, and it makes them an integral part of the return on many investments. It can also affect the value of the currency, which has a further trickle-down effect on other investments.

So, when rates are low they can influence more business investment because it is cheaper to borrow. When rates are high or rising, economic activity slows. As a result, interest rate movements are also a useful tool to control inflation.

Rising steadily

For the past few years, interest rates have been close to zero or even in negative territory in some countries, but that all started to change in the last year or so.

Australia lagged other world economies when it came to increasing rates but since the rises began here last year, the Reserve Bank of Australia (RBA) has introduced hikes on a fairly regular basis. Indeed, the base rate has risen 3.5 per cent since June last year.

The key reason for the rises is the need to dampen inflation. The RBA has long aimed to keep inflation between the 2 and 3 per cent mark. Clearly, that benchmark has been sharply breached and now the consumer price index is well over 7 per cent a year.

Winners and losers

There are two sides to rising interest rates. It hurts if you are a borrower, and it is generally welcomed if you are a saver.

But not all consequences of an interest rate rise are equal for investors and sometimes the extent of its impact may be more of a reflection of your approach to investment risk. If you are a conservative investor with cash making up a significant proportion of your portfolio, then rate rises may be welcome. On the other hand, if your portfolio is focussed on growth with most investments in say, shares and property, higher rates may start to erode the total value of your holdings.

Clearly this underlines the argument for diversity across your investments and an understanding of your goals in the short, medium, and long-term.

Shares take a hit

Higher interest rates tend to have a negative impact on sharemarkets. While it may take time for the effect of higher rates to filter through to the economy, the sharemarket often reacts instantly as investors downgrade their outlook for future company growth.

In addition, shares are viewed as a higher risk investment than more conservative fixed interest options. So, if low risk fixed interest investments are delivering better returns, investors may switch to bonds.

But that does not mean stock prices fall across the board. Traditionally, value stocks such as banks, insurance companies and resources have performed better than growth stocks in this environment.[i] Also investors prefer stocks earning money today rather than those with a promise of future earnings.

But there are a lot of jitters in the sharemarket particularly in the wake of the failure of a number of mid-tier US banks. As a result, the traditional better performers are also struggling.

Fixed interest options

Fixed interest investments include government and semi-government bonds and corporate bonds. If you are invested in long-term bonds, then the outlook is not so rosy because the recent interest rates increases mean your current investments have lost value.

At the moment, fixed interest is experiencing an inverted yield curve, which means long term rates are lower than short term. Such a situation reflects investor uncertainty about potential economic growth and can be a key predictor of recession and deflation. Of course, this is not the only measure to determine the possibility of a recession and many commentators in Australia believe we may avoid this scenario.[ii]

What about housing?

House prices have fallen from their peak in 2022, which is not surprising given the slackening demand as a result of higher mortgage rates.

Australian Bureau of Statistics data showed an annual 35 per cent drop in new investment loans earlier this year.[iii]

The changing times in Australia's economic fortunes can lead to concern about whether you have the right investment mix. If you are unsure about your portfolio, then give us a call to discuss.

i https://www.ig.com/au/trading-strategies/what-are-the-effects-of-interest-rates-on-the-stock-market-220705

ii https://www.macrobusiness.com.au/2023/02/inverted-yield-curve-predicts-australian-recession/#:~:text=Since%20the%20great%20bond%20yield,the%20shape%20of%20the%20curve.

iii https://www.abs.gov.au/statistics/economy/finance/lending-indicators/latest-release

Who needs a testamentary trust?

The rising cost of living is grabbing all the attention right now as people struggle to pay the increasing prices. But in the meantime, our collective wealth has been growing steadily and is being transferred to the next generation at increasing rates.

In fact, the value of inheritances as well as gifts to family and friends has doubled over the past two decades.[i]

A 2021 Productivity Commission report found that $120 billion was passed on in 2018 and that amount is expected to grow fourfold between now and 2050. In 2018, the value of the average inheritance was $125,000 while gifts averaged $8000 each.

So, there is a lot at stake and it means that estate planning – a strategy for dealing with your assets after you die – is vital to help fulfil your wishes and protect the interests of the people you care about.

One powerful tool in planning your estate is a testamentary trust, which only comes into effect after your death. It operates in a similar way to a discretionary family trust and your Will acts as the trust deed, providing instructions for the trust.

It allows you to control the distribution of your assets and provides a way of managing any tax implications for your beneficiaries. Testamentary trusts are often used to protect assets from unforeseen circumstances such as lawsuits, creditors and divorces and they can help to preserve a family's wealth.

A testamentary trust can be useful for those with blended family relationships and children with complex needs. For example, a child with a disability who is unable to manage their own investments can be supported by the use of a trust. Testamentary trusts may also help to provide some certainty for parents that their young children will be provided for. They are also often used by philanthropists as a way of providing a legacy for a cause they support.

Choosing a trustee

If you are setting up a testamentary trust, you will need to appoint one or more trustees who will manage administration and distributions.

The trustee could be a family member (who may also be a beneficiary) or the role could be handed to an independent person or organisation.

Trustees should understand the tax situation of each of the beneficiaries to ensure that the timing and amount of distributions don't inadvertently cause difficulties for them. Trustees must also lodge a tax return every year and maintain trust accounts and records.

As the ATO points out, for the trust to operate effectively, a high level of co-operation between family members may be important so that tax, financial and other information is shared.

The pros and cons

Whether or not you should set up a testamentary trust in your will depends on your own circumstances.

The positives include:

- The ability to control the distribution of income
- The possibility of some tax advantages for your beneficiaries
- A level of protection for your assets from lawsuits, family breakdowns and business difficulties
- A way of keep a family's wealth intact into the future
- Support for vulnerable beneficiaries such as those with special needs or lacking financial experience and minors
- Can be used by anyone with assets to distribute, whatever the size of their estate

On the other hand, there are a number of considerations to be aware of such as:

- The complex paperwork and reporting required
- The cost to establish the trust and keep it running
- The possibility of disputes among beneficiaries or with the trustee over the future of the trust, distributions, and its administration

Testamentary trusts are a valuable strategy to help ensure your wishes are followed. They can shape your legacy, provide fairly for your loved ones and protect assets.

Call us if you would like to know more about establishing a testamentary trust and to see whether it is suitable for you.

i https://apo.org.au/node/315436

Think you'll never fall for a scam?

Think again!

It's no secret that scammers are getting more sophisticated. As this is an ever-evolving space, scammers are constantly developing new ways to part you with your hard-earned cash - and they cast their net wide.

While it's easy to think "it will never happen to me", people who never expected to be victims of scams are actually among the most vulnerable to being taken advantage of. While the stereotype is that older people are the most likely to be scammed, Gen Xers, Millennials, and Gen Zs are actually more likely than seniors to report losing money to fraud.[i]

The reality is scammers don't discriminate and people of any age or demographic who believe they are too smart to be tricked may be less careful and more likely to suffer a loss.[ii] And the losses are considerable. Australians were expected to lose around $4 billion to scams in 2022.[iii]

Here are some scams to be aware of that are doing the rounds:

Texts or calls from a trusted brand

One of the most common scams at the moment is where a criminal pretends to be a trusted brand or government agency getting in touch to collect personal information or demand a payment. You may be contacted by email, social media, phone call, or text message and they will often direct you to an official looking website.

It's easy to be taken in via text message as it can appear to be from a legitimate sender as the scammer uses 'alpha tag' technology to register a mobile number with a word or acronym – the ATO (Australian Tax Office) for example.

Beware of clicking on links and if you get a text message or call that doesn't seem right, you can find the official contact details on the company's website and call them to verify the scam.

Buying and selling

Scammers prey on consumers and businesses that are buying or selling products and services.

As a buyer you may pay the money and never receive the goods you have paid for. To protect yourself be on the alert for scams - if the advertised price looks too good to be true, it probably is. For rental properties or holiday accommodation, only use reputable online booking agents.

As a seller, you may be tricked into believing the buyer has paid in full or even paid over your advertised amount, including sending falsified payment receipts to support their claim. The buyer may then request a refund for overpayment. To protect yourself, don't accept a mobile payment from someone you don't know and never accept or refund a deposit for more than the selling price.

False billing scams request you or your business to pay invoices for services or supplies you did not order so always double check and query demands for payment if in doubt.

Tugging on the heart strings

Dating and romance scammers often make their approaches on social media or dating sites and will go to great lengths to gain trust. Protect yourself by never giving money or goods of value to someone you have never met in real life.

Scammers also appeal to our emotions by impersonating genuine charities to ask for donations after natural disasters or major events. To avoid being scammed approach charity organisations directly and check an organisation's credentials on the Australian Charities and Not-for-Profits Commission (ACNC) website to see if they are a genuine charity.[iv]

Attempts to gain personal information

These include when a scammer gains access to your personal information by using technology.

Consider using multifactor authentication, a security measure that requires one or more proofs of identity to grant you access to any applications you use regularly and change passwords regularly, making sure to choose secure passwords.

Taking a little extra care to be aware and alert to the possibility of being scammed could save you a lot of heartache. Of course, we are here to help if you think something may be a little suspect.

i https://consumer.ftc.gov/consumer-alerts/2022/11/fraud-reports-and-losses-not-just-grandparents-story

ii https://www.finrafoundation.org/sites/finrafoundation/files/exposed-to-scams-what-separates-victims-from-non-victims_0_0.pdf

iii https://www.news.com.au/finance/money/costs/australia-to-cop-4-billion-scam-loss-in-2022-according-to-scamwatch/news-story/890e469b4b05a6c950e3cb6b4f83f56c

iv https://www.acnc.gov.au/charity/charities