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Economic outlook

Quarterly economic review – 31 March 2021

The global economy

The COVID-19 pandemic remains a major feature on the global stage. Continental Europe has struggled against the more infectious UK strain. Its vaccination rollout has been plagued by logistical challenges and concerns over the AstraZeneca vaccine's ties to a rare blood clot disorder. These concerns did not slow the vaccine rollout in the US and UK which appear to be nearer the end of the pandemic's damaging human and economic impact. Despite the ongoing threat of the pandemic, global economic recovery has continued with current lockdowns having a less severe impact overall.

In the US, a new $US1.9 trillion stimulus program was passed by the Biden administration. This includes payments for households such as a boost to unemployment benefits and $350 billion to support state and local governments. These efforts have prompted some fears over rising inflation as a result of excessive spending. To-date, those fears have not yet materialised. We will however see inflation rise as a normal part of economic recovery as people and businesses grow their confidence in the economy, they can start demanding higher wages and higher prices from customers.

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Australia

The general state of the Australian economy continues to improve from the damage of the 2020 lockdowns. The unemployment rate continued to fall, down to 5.8% in February and pleasingly we saw the participation rate recover back to pre-pandemic levels. Consumer confidence remains strong, supporting the idea that consumer spending can help drive the economy in the near term as people gain confidence to spend some of their excess savings with household savings hitting record levels in June last year.

Small COVID-19 outbreaks, such as in Brisbane, remained a feature that prompted short and sharp lockdowns but without escalating further. The vaccine rollout has become challenging due to a mix of overseas supply problems and issues with distribution and planning. Concerns over the AstraZeneca vaccine saw it effectively pulled as an option for Australians who are under 50. This is disappointing news but will not likely derail the economic recovery. It does however leave us vulnerable to further COVID-19 outbreaks particularly without the safety net of government stimulus programs such as the JobKeeper wage subsidy. It also delays efforts to reopen international borders with the tourism and education sectors, which are reliant on overseas travellers and students, remaining under pressure in the near-term.

Fixed income and currencies

Global central banks such as the US Federal Reserve maintained a commitment to keeping interest rates low for the next few years. The Reserve Bank of Australia restated its view that it will take until 2024 before the economy is sufficiently strong enough to increase interest rates from their record low level of 0.1%.

The prospect of stronger economic growth meant there was a reduced need to 'hide' in bonds. This saw investors exit safer investments such as government bonds in favour of riskier assets such as shares and high yield bonds. These moves by investors saw Australian bonds return their worst quarter since June 1994 with a loss of 3.2%. International bonds fell 2.5% over the same period.

It was a more uneven story for the Australian Dollar. The improvement in UK and US prospects following successful COVID-19 vaccinations saw our currency fall versus the US Dollar and the British Pound. Conversely, our better handling of the pandemic amid a surge in cases in both Europe and Japan continued to support our dollar against their currencies.

Shares

The Australian market continues to rise from its March 2020 lows, finishing the March quarter up 4.3%. It was another three months marked by optimism over global economic recovery which benefitted companies profiting from a re-opened economy such as tourism operator Flight Centre (up more than 13%). Australia's management of the pandemic supported overall economic health and also reduced financial stress for individuals. This means a failure to repay loans is less likely. This also supported the outlook for bank profits, and dividends, and helped the banking sector start the year strongly.

Global share markets also performed strongly with the successful vaccine rollout in the US being a key driver. Declining COVID-19 cases and fatalities spurred a surge of optimism for US shares especially with companies more sensitive to economic growth that tend to outperform the market.

Source: IOOF

Nurturing your nest egg

The current rate of compulsory Superannuation Guarantee (SG) is due to increase to 10% in July 2021. It has been frozen at 9.5% since July 2014 and there have been many arguments for and against increasing SG contributions from the current rate of 9.5% to 12%.

The SG rate is set to reach 12% by July 2025 through yearly increases of 0.5%. The government is still debating this increase with a decision to be made closer to mid-year.

If we take a moment to look at the statistics, the median super account balance for males of retirement age (between 55-64) was $183,000, whereas females of the same age had much less at $118,600. The averages were $332,700 and $245,100 respectively. These figures fall well short of the $545,000 needed for a comfortable retirement according to the ASFA Retirement Standard for a single person*.

Clearly, an increase to compulsory super will help Australians add to their retirement nest egg, which should lead to a more comfortable retirement. A small increase may not sound like much, but over time it could have a large impact on your retirement savings and in turn the quality of your retirement.

You may have heard Australia's retirement income system referred to as a 'three-pillar system'. In retirement, your income may come from a single pillar or a combination of these pillars. The three pillars are:

1. **The Age Pension** – this aims to ensure that a basic standard of living is met in retirement, it also protects individuals who outlive their retirement savings.
2. **SG** – these are your compulsory retirement savings which are accumulated inside a concessionally-taxed super environment. These savings aim to help achieve a standard of retirement above that which could be achieved with the Age Pension alone.
3. **Voluntary savings** – these are your savings both inside and outside of super. This pillar aims to give individuals a standard of living above what could be achieved with SG alone. There are some incentives to make voluntary savings attractive, including:

- entering into a salary sacrifice arrangement with your employer (where you choose to have some of your before-tax income paid into your super). Salary sacrificed contributions are not subject to pay as you go (PAYG) tax^;
- personal tax deductible contributions made to your super from your after tax income~;
- a maximum tax rate of 15% on investment income; and
- discounted capital gains for assets held longer than 12 months (tax reduced to 10%).

While some retirees will rely substantially on the Age Pension, others will have looked to have substantially boosted their superannuation balances by making additional contributions throughout their working years.

A proactive approach towards your retirement planning is vital if you want a comfortable retirement lifestyle and it's never too early to take stock of your super.

Here are some tips to get you started:

- Make sure that your SG contributions are being paid to your chosen super fund. You can check this with your super provider, either online or call them. Your employer should be paying your SG contributions quarterly at a minimum, but many employers will pay your contributions monthly.
- Understand the fees you are paying. You can check your fees on the last statement you received from your super fund. High fees can significantly reduce investment returns over the long term, leaving you to work longer or contribute more to your super. Fees are complex, but that's because there are so many components, all of which you should understand.
- Review your investment options and make sure that they are right for you.
- Find any lost or unclaimed super, you can do this easily by logging into your MyGov account.
- If you have multiple super accounts, consider consolidating. It's an easy way to save fees and potentially increase returns. Remember to take into account any insurance which may be linked to your accounts and consider obtaining financial advice.

Source: Allan Gray

* ASFA Superannuation Statistics December 2020, see statistics here and here.

^ Salary sacrifice contributions are subject to 15% tax in your chosen super fund. Salary sacrifice contributions count towards your concessional contributions cap and include the regular super guarantee contributions (9.5% of your salary) made by your employer, you should consider this and whether you will exceed your cap before making a contribution.

~ Personal tax deductible contributions to super count towards your concessional contributions cap and include the regular super guarantee contributions (9.5% of your salary) made by your employer, you should consider this and whether you will exceed your cap before making a contribution.

How to help your parents and still save for retirement

The financial impact of COVID may have cut into your parents' retirement savings, or perhaps they just simply didn't save enough to last the distance.

Whatever the reason, if you've now found yourself with parents you need to help, you may be wondering how this will affect your own retirement plans.

So, here's a few things you can do to help both you and your parents improve your chances of retiring comfortably.

Analyse your parents' assets and savings

It can be tough to start a conversation about money with your parents, but it's one of the most important conversations you can have to understand their retirement savings.

Having access to their financial information will give you a better understanding about their situation. More importantly, you'll know if you're going to be required to help them financially.

Ideally you want a clear picture about their current assets, savings and debt status plus an understanding of their income and expenses. There are budget planners and phone apps you can use to help get control and visibility around spending habits. You may also want to use a retirement calculator to give an idea of how long their money could last.

If you find they don't have enough income to support their retirement, there may be things they can implement to change it. This could include cutting down expenses, moving to a more affordable home or renegotiating their debt. It's very important to make sure they are maximising any social security entitlements they may have too.

Review their health insurance

Healthcare costs are becoming increasingly onerous so it may be advisable to review your parents' health insurance. It's important they have enough cover for medical expenses, long-term care and other retirement costs.

Seek professional help

Enlisting the help of an expert, such as a financial adviser, may alleviate some of your pressure.

Better yet, financial advisers can assist in developing appropriate strategies to ensure you're meeting your own retirement goals as well as your parents. They can also investigate what tax concessions, or other government benefits, your parents may be entitled to.

Perhaps most importantly, a financial adviser can help you take a holistic view. They can look at your parents' situation and your own and work out strategies that optimise both outcomes over the long-term.

For example, you may need to reduce your current spending to help your parents retire more comfortably. That's a short-term cost to you – but if it means your parents can keep important assets like the family home, you may benefit from that in the long-term. A financial planner –trained, impartial and able to see the big picture - can be a big help.

Set clear boundaries

It's an admirable thing to help your parents but be clear about what that help consists of – for example it's one thing to help out with their bills occasionally, but it's another to have your name placed on loan documents!

If that isn't the type of help you had in mind, it's important to communicate that - and stick to it.

Invest in your own retirement

There are retirement calculators you can use to see if you'll have enough saved to maintain the standard of living you'd like in retirement.

If you find you need to make financial adjustments to increase your retirement savings, one option could be to contribute more to your super on a regular basis using your before-tax or after-tax income. There are tax benefits that come with this too.

For example, if you contribute some of your after-tax income or savings into super, you may be eligible to claim a tax deduction. This means you'll reduce your taxable income for the financial year and potentially pay less tax, while adding to your super balance. It's a win-win.

These types of contributions are capped at $25,000 per financial year however. If you choose to contribute over this amount, you may be required to pay more tax.

Bottom line: We all want to help our parents if they're struggling financially, but it's important to think of your own situation too. And don't forget, money isn't everything—one of the best things you can do for your parents is to spend quality time with them while you've got it!

Source: MLC

Retirees' fears and expectations

For many, the word 'retirement' is associated with the idea of extended holidays to far-flung locations or spending quality time with grandchildren. However, there are a range of financial, emotional and psychological fears that are often linked to retirement – and for good reason.

Australians spend most of their working lives saving so that when the time comes to retire, they can lead a comfortable life. However, many are uncertain about what to expect. There are also the emotional and psychological impacts of transitioning to retirement to be considered.

Research from CoreData found that around 50 per cent of Australians retire early due to unexpected circumstances and within timeframes they did not choose. This can result in retirees feeling out of control and impacted not only financially, but emotionally as well.

Retirement planning is not a 'one size fits all' approach. But no matter what an individual's needs are, solid financial planning allows for a smoother transition and helps alleviate uncertainty.

Common fears and expectations associated with retirement

Despite healthy superannuation balances, CoreData's research shows that close to two-thirds of pre-retirees are worried about being able to fund their retirement, with only a small percentage feeling very optimistic that they will have adequate financial resources to do everything they want in retirement.

In fact, more than half of those with retirement balances of between $750,000-$1 million say they worry about funding their retirement. These concerns only recede once an individual has accumulated more than $1 million in savings.

Encouragingly though, 43.9 per cent of pre-retirees expect to live a reasonable retirement life, understanding that not all of their desires will be fulfilled. Only four in 10 retirees say that their actual retirement lifestyle is aligned with what they expected, and three in 10 say their retirement lifestyle exceeds their expectations.

Successful retirement factors

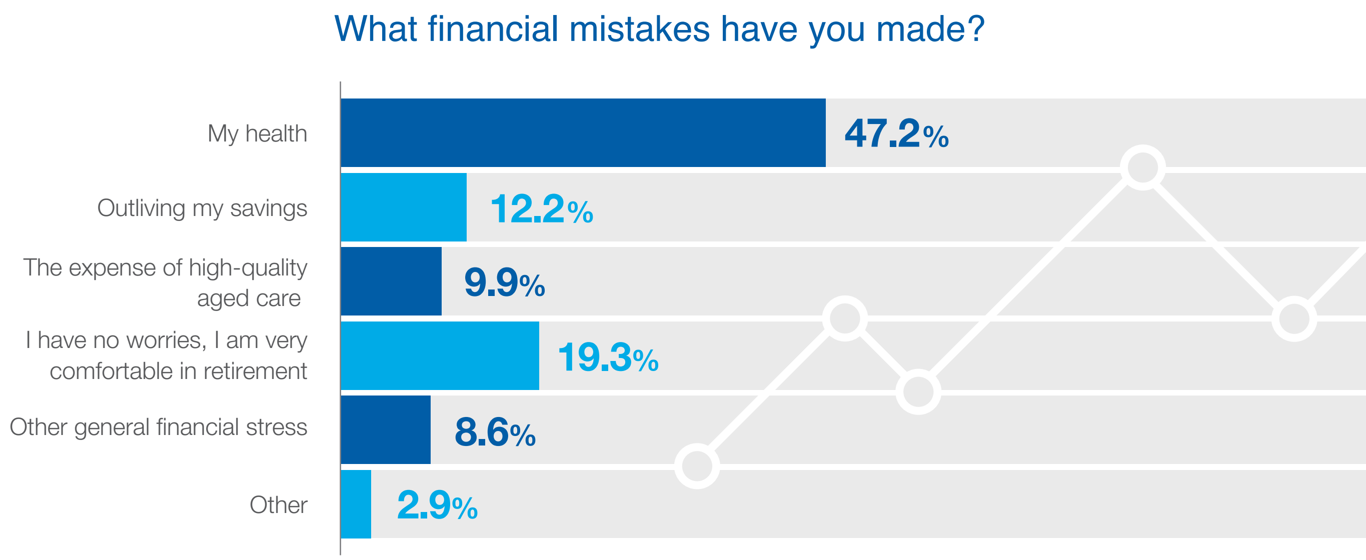
A successful retirement involves more than just money. Other important factors in a successful retirement include, mental and physical health, having realistic expectations and owning a home.

Retirement satisfaction occurs when a retirement lifestyle matches the retiree's expectations. Not every retiree has expectations of a luxurious retirement lifestyle, but all of them expect basic needs to be addressed.

While pre-retirees are concerned about whether they will be able to fund their retirement, once a person is retired, the concern turns to whether they will run out of savings later in life.

Around one in eight say their greatest worry is they will outlive their savings, and close to 10 per cent are worried about affording the costs of high-quality aged care facilities. While the welfare system allows for a basic level of income, budgeting for discretionary expenditure can cause stress.

There are two core factors that determine the amount of savings a retiree needs - life expectancy and projected expenses. Individuals need to consider these, along with other factors including marital status, health and home ownership, when determining how much saving a retiree needs in order to enjoy their desired lifestyle.



Source: Latrobe Financial

Staying healthy

28 per cent of Australians retire early (and unexpectedly) due to health-related issues. Almost half of all retirees consider their health as their greatest worry in retirement.

Research from the Australian Centre for Financial Studies found those who retire early due to health issues are likely to have lower incomes and lower superannuation balances. By default, they are also most likely to incur additional health-related expenses in retirement.

Owning a home

Unsurprisingly, owning a mortgage-free home provides a greater sense of security and retirement satisfaction. Research from the Australian Housing and Urban Research Institute found older people with secure long-term accommodation tend to have better physical and mental health too.

Home ownership is also intrinsically linked to retirement readiness and satisfaction. Those who own more than one property with no mortgage typically experience retirement success. Single property owners also enjoy a high level of retirement satisfaction. In contrast, individuals who own no property score the lowest.

Retirement is one of the single largest changes in an individual's life and it comes with a host of financial, emotional and psychological fears. A sound financial plan can help manage associated fears and expectations and most importantly, ensure the transition into retirement is as seamless as possible.

Source: Fidelity Australia

Fixed income:
Top 10 things you should know

Fact No.1

Fixed income – also known as bonds and credit – is a commonly used type of debt investment. It is a type of 'asset class', meaning a category of asset into which an investor can invest.

Fact No.2

Bonds are issued by governments or corporate entities seeking to raise funds. The issuer (also known as the borrower) sells a bond to an investor (also known as the lender) and the issuer promises to pay the principal back at the bond's maturity date and to make regular fixed interest payments (called coupons), typically twice a year until (and including on) the final maturity date.

Fact No.3

Types of bonds include:

Government bond: issued directly by a government such as the Australian Commonwealth Government and guaranteed by the issuing government.

Corporate bond: issued by large public companies to fund business growth or significant projects, or corporate actions (like a takeover). Corporate bonds do not carry a government guarantee, so they are generally riskier than Government bonds as there is increased credit risk (the risk the issuer will default on payment of coupons and principal). Due to this risk corporate bonds usually pay higher coupons than government bonds.

SSA (Semi-government, Supranationals and Agencies) bonds: issued by entities such as State governments (for example, NSW issues debt through the state government guaranteed entity the NSW Treasury Corporation), semi- Government organisations (entities owned by a government with either an explicit or implicit government guarantee), and Supranationals (entities that are sponsored or supported financially by a group of two or more national governments, for example the World Bank and European Development Bank).

Hybrid: an investment which exhibits characteristics of both fixed income securities and equities. For example, convertible bonds start as bonds but can be converted into equity at a future date. These types of securities typically carry more risk than corporate bonds as they rank lower in the capital structure than corporate bonds. If the issuer defaults on repaying the loan, investors in hybrids will only receive their money back after other security holders – higher up the chain – have received their money.

Fact No.4

Some common terms relating to fixed income include:

- **Coupon:** the annualised interest rate that is paid (typically semi-annually) on the face value, expressed as a percentage.
- **Credit rating:** given to bonds and other debt investments by ratings agencies such as Standard & Poor's or Moody's on the basis of their risk. The scale ranges from AAA (the highest) through to C or D, depending on the agency. The top 4 ratings are considered safe, or 'investment grade', while lower ratings (BBB for Standard & Poor's and Baa3 for Moody's) are known as 'high yield' or 'sub-investment grade'. In general governments have higher credit ratings than companies, reflecting that government debt is typically less risky (which causes it to typically deliver lower rates).
- **Duration:** a risk metric that describes how sensitive a bond is to a change in market yields. For example, a bond with a duration of 6 years will increase in value by 6% for every 1% fall in the market yield. Conversely the value will fall by 6% for a 1% rise in market yields. Maturity and duration are linked, with longer maturity bonds having higher duration and therefore being more sensitive to changes in market yields.
- **Face value:** the amount received at maturity.
- **Maturity:** the pre-set date at which the face value and final coupon is paid.
- **Yield:** the annualised return of the bond at its current price.
- **Yield to maturity:** the total return expected from a bond if the bond is held until its maturity date, and all payments are made as planned and reinvested at the same rate.

Fact No.5

Many investors use fixed income (particularly government issued bonds) as a 'defensive' investment because it can help preserve capital, usually experiences less return volatility than shares and can pay a steady income stream through its regular coupon payments. It is viewed as lower risk than other asset classes such as equities and listed property.

Fact No.6

Bonds can offer diversification benefits because they often perform well when shares perform poorly, which means that bond investments help to lower total risk within a diversified portfolio.

Fact No.7

The total return on bonds comprises income from coupon payments plus any growth or loss from price fluctuations. The price or value of a bond, with fixed coupon payments, increases as the yield-to-maturity declines and vice versa.

Fact No.8

The Australian bond market (government and corporate issues) is worth $958 billion[1] in Australian dollars, while globally the bond market is worth $167 trillion Australian dollars[2].

Fact No.9

You can access bonds directly or through a managed fund. The benefit of a managed fund is that it can hold hundreds, sometimes thousands, of securities which allows it to achieve significantly higher diversification than most individual investors. This means that if there is a default on one security, the impact on the investor is lessened given the high number of other securities held in the portfolio.

Fact No.10

A Fixed Income Fund provides a cost-effective way of accessing a highly diversified portfolio of bonds, which can include a mix of Australian or international government and corporate bonds, or a combination of both.

Source: Schroders

[1] Source: Australian Securities Exchange (ASX) Bond Monthly Update – December 2020.

[2] Source: International Capital Market Association (ICMA) Bond Market Size as at August 2020. Note the figure quoted by this organisation is in US Dollars and has been converted to Australian dollars using the exchange rate of 1 AUD = 0.7645 USD sourced from the Reserve Bank of Australia as at 29/1/21.

Did you know...

The Australian Government has never defaulted on the interest payments on the bonds that it has issued or on the repayment of the principal amount invested in them.

But the Argentinian Government has defaulted nine times since independence from Spain in 1816.

Investing with confidence

When it comes to investing for a comfortable retirement, could you be your own worst enemy? Here's how your unconscious fears and biases could impact your financial decision-making – and what you can do to keep them in control.

When you're thinking about the financial risks you may face in retirement, what do you take into account? If you're like most people, you might consider market volatility, inflation and the risk of outliving your savings.

But have you also considered the risks that can arise from your own behavioural biases?

Being aware of unconscious bias

There are several unconscious biases that could impact the financial decisions you make when preparing for retirement. One of the most important is hyper-loss aversion.

Hyper-loss aversion stems from the pain of a financial loss being felt more keenly than the joy that is felt from financial gain. It can result in investors making rash and ill-considered decisions to avoid the pain of losing money – such as consolidating losses by selling shares and moving money into cash.

This type of behaviour is more common during challenging economic periods, like the Global Financial Crisis and COVID-19. In fact, during the first quarter of 2020, investors pulled money from every asset class in their portfolio, except for cash[1].

The irony is that investing solely in cash may in fact cause the scenario feared most by retirees: running out of money during their lifetime. Research has shown that 61% of retirees fear running out of money more than death itself[2].

With cash-only investments failing to keep up with inflation, retirees are forced to draw on and potentially deplete all their retirement income.

So why the fear?

No two retirees are the same, but we all share the common goal of wanting enough money to live comfortably in our golden years. But research shows that around 60% of Australians aged between 50 and 70 are concerned that their savings won't last the distance.[3]

One of the reasons behind this concern is that on average, Australians are living longer than ever before. For example, in 1960 the average life expectancy of a 65-year-old man was 77.5, and for an Australian woman it was 81. Fast forward to now and that life expectancy has increased to 85 for men and almost 88 for women[4]. This means that if you've just turned 65 and are about to retire, you'll need your retirement savings to last at least 20 years – potentially more.

Another concern among retirees is that a share market downturn will impact savings close to or during retirement – when there's less time for investments to recover before they start drawing down on their value.

Because any fall in the returns generated by a market crash increase the amount of capital they may need to eat into, it can reduce the growth potential of the entire portfolio, reducing its ability to last for the long term.

The downside of backing a sure thing

Despite this, many retirees make the move to cash in times of trouble – choosing short-term certainty over long-term gain. When it comes to money, many people would simply rather take the safer, more familiar route. This can lead to missed opportunities for potential financial gain, and ultimately a retirement portfolio that may be exhausted far too early.

What you can do

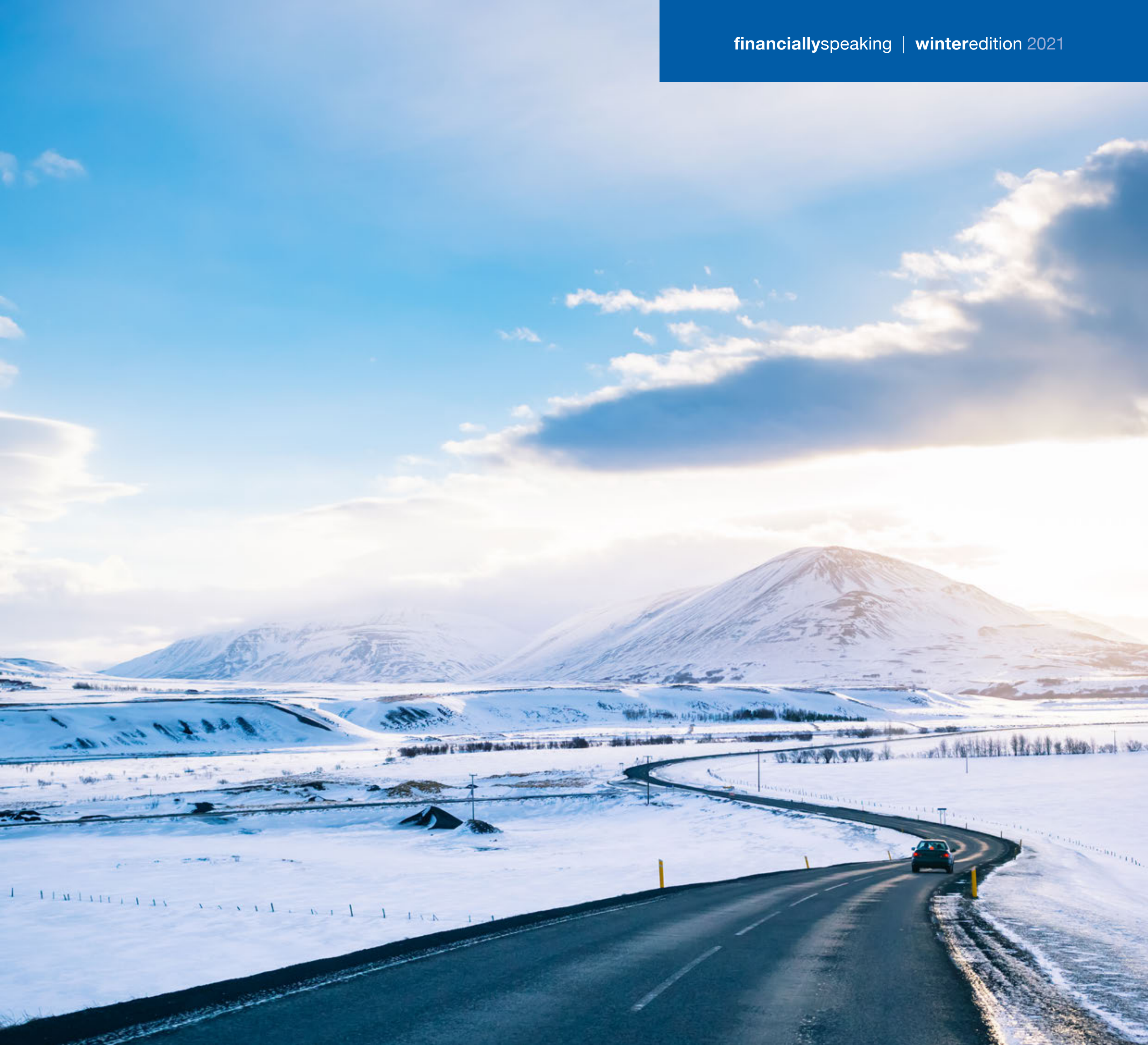
When fears arise, it can be helpful to have an expert by your side. Your financial adviser can provide an objective view of the situation – and help you understand the pros and cons of decisions you make.

Your adviser can also provide you with access to protective strategies and can suggest tools or products that are specifically designed for retirees or near-retirees. This can give you peace of mind about what your future looks like so you can look forward to retirement with confidence.

Source: Allianz

Source: Allianz Retire+

[1] Allianz Retire+, *Investfit projections*, March 2020.
[2] Allianz Life, *Reclaiming The Future Study*, 2010.
[3] National Seniors Australia, *Feeling financially comfortable*, 2019
[4] Australian Institute of Health and Welfare, *Deaths in Australia: Life Expectancy*, 2020.



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