Personal Wealth Adviser

Managing your personal finances

ISSUE 1

HLB MANN JUDD
ADVISORY AND ACCOUNTING

Welcome to our inaugural issue of Personal Wealth Adviser

Our Sydney personal wealth management team now provides you with a simple solution for your personal wealth needs. We have specialists in wealth management, superannuation, self-managed superfunds, estate planning, debt advisory and insurance services.

This regular newsletter will keep you updated with what you need to know and do to look after your personal finances. This issue provides insight into what you should be doing today to help secure the future for you and your family.

We encourage you to share this valuable content with your friends, family and colleagues.

MICHAEL HUTTON
Partner, Personal Wealth Management

TEN FACTORS TO RATE YOUR WEALTH BY

Accumulating wealth is the goal of any good investor, particularly those who want to fund a particular lifestyle in retirement. But is all wealth created equal? And how should people rate the investments that they do have?

Considering both the quantity and quality of wealth is an important first step. An investment portfolio of $1 million may seem impressive but is more impressive if it is invested in a diversified portfolio of quality assets instead of sitting in cash.

In terms of being able to fund a lifestyle and becoming financially independent, a rough rule of thumb is to have an amount that can support withdrawals of 5 per cent a year. For example, those who wish to spend $100,000 a year would need at least $2 million invested.

And don't forget tax. People would need more than $2 million invested to fund $100,000 a year after tax, also assuming their investments are of a quality that can maintain at least 5 per cent earnings.

So that's the quantity side of the equation, let's now look at quality. It's important to weigh up the following 10 factors when considering the quality of a portfolio.

The first is the **goals and objectives**. For those whose goal is to have cash to fund a lifestyle, then the 5 per cent rule of thumb above is the best approach. But if the goal is instead capital accumulation, the types of investments required are different.

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The **structure** for holding investments is important, too. It affects accessibility and also tax. A 65-year-old having all of their investments in superannuation is great for minimising tax and optimising accessibility. But the same can't be said for a 50-year-old who cannot access their superannuation until they retire.

Another quality factor to take into account is **liquidity**. Does the liquidity of the investments suit the investment purpose? If people need to start drawing on their investments to cover living and other expenses, having wealth tied up in illiquid assets such as property is not helpful. Wealth in a managed fund or shares would be much easier to access.

And that leads into **diversity** of investments. How well are investments spread across the broad asset classes of Australian shares, international shares, property/infrastructure, fixed interest and cash? And within each asset class, how well are investments diversified? An Australian equity portfolio containing just the big four banks does not represent diversification. Managed funds can be a useful tool to improve diversification.

Next, is there an appropriate level of **risk** in the portfolio to meet financial goals? A cautious investor may prefer less risky assets, like cash or bonds, but these won't deliver a 5 per cent return in the current environment. Investors may need to recalibrate their comfort with risk to achieve their wealth goals.

Understanding risk is important when it comes to the **quality of investments**. Speculative investments may have a role in a portfolio but only as a very small allocation. Seek out the ratings and reports of researchers to find out the true quality of investments.

And what about the **expected returns** of investments? Different investments have different return profiles over different periods of time. They also have different tax outcomes. Capital growth tends to be more tax effective, for example, than the yield on income-producing investments.

The time frame investors have available and the **duration of their portfolio** is also key. If investing for the long term, even for the next generation, they could potentially be more aggressive in the investment approach than if they were investing to create funds to buy a property in the next five years.

Don't forget **wealth protection** either. The use of superannuation and trusts can be effective in protecting investments from creditors. Insurance products such as income protection can help protect accumulated wealth if you can no longer work.

And finally, is the wealth administered and structured in a manner that will be easy to **bequeath to beneficiaries** upon death? This includes keeping reliable records and making sure beneficiaries know where these records are kept.

If you feel you have considered all of these factors appropriately, rate your wealth a 10/10. Congratulations! If not, use this opportunity to improve your wealth rating in as many areas as possible.

Michael Hutton has a monthly opinion piece in the Australian Financial Review. This article first appeared as part of this series on 17 August 2021.

JONATHAN PHILPOT
Partner, Personal Wealth Management

BALANCED INVESTOR PROFILE UNDERGOES ALLOCATION SHIFT

The long-held 60/40 asset allocation rule is no longer adequate if Australians are to retire comfortably, with an 80/20 ratio of risky vs secure assets far more appropriate in the current market environment.

The traditional balanced investor profile previously meant a fairly equal allocation between more secure fixed interest and cash investments, and riskier Australian, international shares and property investments. However, with the ultra-low interest rate environment set to continue for some time yet, the secure part of the portfolio could only return about two per cent over the next 10 years.

The balanced profile is now reflecting an allocation of about 70 per cent risky investments and 30 per cent secure investments. This is the default super option for many industry and retail superannuation funds; however, some super funds are classifying higher-risk corporate debt and property-type investments as part of their secure or defensive part of the portfolio.

This not only exposes investors to greater risk, but also shows the importance of comparing like-for-like funds on performance tables.

While the US share market in particular has benefitted from the huge tech sector gains of the past ten years – returning an average of 13.68 per cent – the next 10 years will not be able to generate anywhere near that type of return, given the current high valuations.

Excluding the US, global returns over the past decade have been 6.17 per cent, with this projected to be 5-6 per cent in the coming ten years.

Retirees in particular will seek to preserve their capital throughout retirement which requires a 5 per cent plus return from super, indicating they would need to be invested 100 per cent in the share market to achieve this.

However, just say another unexpected global event takes place that upsets the economy and causes share markets to plummet 30%. This is far too great a risk for retirees as they are likely to panic and sell, locking in those losses. All portfolios need some level of protection.

It's therefore critical for these investors to carefully consider their risk vs return profile. Having 20 per cent of a portfolio in secure assets is a four-year bucket of future pension payments at 5 per cent per annum. This should be sufficient to provide liquidity in the event there's a significant pull back in share markets, without needing to sell shares at the worst time.

It's critical for investors to carefully consider their risk vs return profile

BETTY PRESHAW
Director, HLB Debt Advisory

TO FIX OR NOT TO FIX? THAT IS THE QUESTION...

It's a tricky one to answer because, well, the truth is that understanding what makes interest rates move is a bit like trying to read Shakespeare at high school — the words are familiar, they're definitely some kind of English, but you're not *really* sure what they mean.

If we look at the current interest rate environment simplistically, the Cash Rate is at a historical low of 0.10%, in fact we have not seen an increase in the Cash Rate for 11 years. The RBA has recently inferred that the Cash Rate will start to increase at the end of 2022. We can therefore agree with some certainty, that we are at the bottom of the interest rate cycle, and that interest rates will start to increase in the short to medium term.

All of this has manifested in all the lenders increasing their fixed interest rates. In early 2021 for example, if you were after the sharpest rate on the market you needed to fix your home loan. The margin between fixed and variable was at least 0.50%, and a fixed rate with a 1 in front of it was offered by most lenders, with some even offering a 4-year fixed rate of 1.89%. The margin between fixed and variable has now reversed, if you are after a sharper rate today you might be best off sticking with a variable rate.

So, what should you do?

Well, my job is not to tell you *what* to do. But here are some inputs worth considering when pondering the 'fix' question:

- Interest rates are still very low and still the lowest rates we have seen in decades.
- Sometimes it makes sense because of your stage of life to think about fixing your repayments for a certain period of time. For example, you might have kids in childcare and those expenses will reduce when they start school unless, of course, you go 'private' and fees will be ongoing.
- 'Fixing' can be beneficial if you want peace-of-mind around budgeting.
- Extra income you might get from a bonus, for example, cannot be paid on your fixed rate home loan, as you do not get the benefit of an offset account (a feature of many variable rate loans).
- Even if you fix, many lenders will allow you to make extra repayments of up to $10,000 a year.
- You might want to consider splitting your loan to be partially fixed and variable. A feature that all lenders offer.

And if you do choose to fix your home loan, here are a few likely impacts:

- Remember: You are entering a contract and if you break that contract by, for example, exiting midway through the fixed rate period, you may be up for significant 'break' costs. Break costs are economic costs to the lender. If the lender will be relending the money at a lower rate, you will be paying the difference.
- Even though rates are at record lows, they may drop further. Fixing your rate means you won't see any of that upside during the fixed term of your loan.

So where does that leave us?

In Shakespeare's *Antony and Cleopatra*, Antony notes that "Sometimes we see a cloud that's dragonish. Sometimes there's a cloud like a bear or a lion, a castle, a floating rock, a craggy mountain. Or it might look like a blue cliff with trees on it that bow to the ground. These things fool our eyes by seeming solid, when they are actually only air. You've seen these illusions. They're spectacles that appear at sunset."

That sounds like interest rates to me...

ROBERT MONAHAN
Director, Estate Services

WILL MY SUPERANNUATION BE TAXED WHEN I DIE?

Superannuation death benefits payments are potentially taxable depending on who receives it and the components of the super payment. Generally, superannuation has two components, a tax-free component and a taxable component. The components can usually be found on your fund statement. The tax-free component is tax free, regardless of who receives the benefit. However, the taxable component may be taxed as follows:

1. If paid to a 'death benefit dependant' both components are tax free. An eligible death benefit dependant is one of the following:
   a. Spouse, whether married or de facto
   b. A former spouse
   c. A child under 18 years
   d. A child over 18 years, who was actually dependant on the deceased member at the time of death
   e. Any other person who is actually dependant on the deceased member at the time of death
2. If the death benefit is received by someone who is not a 'death benefit dependant', the taxable component is taxed at 15% plus Medicare levy of 2%. If the death benefit is paid to the Legal Personal Representative (Executor) and distributed to a person who is not a 'death benefit dependant' the estate pays a tax of 15% but no medicate levy. If a death benefit includes a life insurance benefit, then the life insurance component can be taxed at 30%.

Consider the following example

Tom (aged 64 years) is a retired widower who has two adult children, Ted and Tess. Ted is married with children, and Tess is single and still lives at home with Tom. Tom has a nomination in place dividing any super death benefit equally between Ted and Tess. Tom's Will leave all assets equally to Ted and Tess. Tom dies leaving a death benefit of $1 million made up as follows:

- $500,000 tax free component
- $500,000 taxable component

As Tess qualifies as a 'death benefit dependant', she receives $500,000 tax free. However, as Ted is not a death benefit dependant, he receives $457,500 after paying tax of $42,500.

Could Tom have taken steps to minimise the tax consequences of his death? Yes, as set out below.

1. As Tom is over 60 years old and retired, he could have withdrawn his super prior to his death, and the withdrawal would be tax free. The super proceeds would then form an asset of his estate and passed tax free to Ted and Tess.
2. Tom should have in place an Enduring Power of Attorney (EPA) appointing Ted and Tess as financial attorneys. If Tom was incapacitated, Ted and Tess could use the EPA to withdraw the funds prior to Tom's death. The funds would be received on behalf of Tom and would be tax free.
3. Assuming that there was no opportunity to withdraw the super before Tom's death, the tax could have been minimised by Tom opting to pay the super death benefit to his Executor, so it passed to Ted and Tess via Tom's estate. That would reduce the tax on the taxable component from 17% to 15%, a saving of $5,000.

ANDREW KENNEDY
Risk Adviser, HLB Insurance Services

START 2022 RIGHT – REVIEW YOUR INSURANCES

Do you treat your insurance as set and forget? With insurance premiums rising each year, you need to ensure you have the best cover for your own needs.

Who should review their insurance/s?

- **Families** - Marriage, purchase of a new home or investment property and birth of a child are all common trigger points for the need for advice and appropriate cover.
- **Executives and Business Owners** - Executives and business owners will often need business equity insurance as well as keyperson cover.

- **Anyone who holds an existing policy** (both inside and outside super) - we will do a like-for-like market comparison to ensure they are not paying too much. (In approx. 90% of cases we can source a better combination of pricing and product.)

HLB Insurance Services is a specialised life insurance advisory firm that provides an additional service offering to clients.

We can help you:

Quantify your risk

- Review your current situation and determine your exposure to financial risk which may result from illness, injury or death for you, your family, and your business.
- Identify other relevant issues so that you can make an informed decision about how you choose to handle financial risk.

Review your portfolio

- Ensure your existing insurance portfolio is relevant to your needs and that it is structured appropriately.
- Obtain higher quality insurance cover whilst saving money through reduced premiums.

Recommend strategies

- Implement strategic risk advice for quality and cost-effective insurance cover. (If your existing insurances are sufficient to your needs and are competitive, we will inform you so. No changes are recommended unless it is to your benefit.)

Ongoing support

- Be confident with continued support and an annual review of your status and insurance cover to ensure our advice remains appropriate for your needs.
- Claims management service
- When disaster strikes and you or your family need to access funds quickly and simply, our claims management service utilises our experience and relationships with insurers to expedite valid claims.

ANDREW YEE
Director, Superannuation

SMSF TRUSTEE DIRECTORS ARE NOW REQUIRED TO HAVE A DIRECTOR IDENTIFICATION NUMBER

The new director identification number (DIN) came into force from 1 November 2021 and all directors, including directors of a self-managed super fund (SMSF) trustee company are required to have a DIN.

The ATO statistics from June 2020 found that about 63% of all SMSFs have a corporate trustee and about 690,000 of existing trustee directors will need to take action.

A DIN is a 15-digit identifier given to a director (or someone who intends to become a director) who has verified their identity. The DIN is a unique and permanent identifier issued by the Australian Business Registry Services (ABRS) to combat and prevent fraud. Eventually every director will have a single ID, regardless of the number of directorships held. Any individual who is a director or acting as an alternate director, must register.

When will you need a DIN?

When a director is required to apply for a director ID will depend on the date that they became a director.

Date you became a director	Date you must apply
On or before 31 October 2021	By 30 November 2022
Between 1 November 2021 and 4 April 2022	Within 28 days of appointment
From 5 April 2022	Before appointment

How to apply for your DIN?

There are three ways to apply for a DIN:

1. Online application via the myGovID app. This is different to myGov and is the quickest way to obtain a DIN.
2. Phone application.
3. Paper application (which is the slowest process).

All methods require proof of identity documents, however certified copies are also required if using the paper application option.

Directors must apply for their director ID personally as they need to verify their identity. No one else can apply on their behalf. This may prove challenging for some directors.

The ATO manages the application process and recommends the online application.

Further details on DIN the application process can be found on the ABRS website:

www.abrs.gov.au/director-identification-number

Where a director refuses, or is unable to comply, it is expected that ASIC would stop their directorship. Where the company is acting as a trustee for an SMSF this may cause a breach of the SMSF director/member rules which would need to be rectified within 6 months. Such rectification may require the member to leave the fund.

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