stonehouse

Newsletter

Autumn 2022

Women of Stonehouse CBD

As the Morrison Government clears the decks ahead of a May election, Australians will be weighing up the impact on their household budgets.

The war in Ukraine added a major new source of uncertainty to the local and global economic outlook in March. Economic sanctions against Russia have cut its oil exports, sending crude oil prices surging 6% over the month to more than US$111 a barrel. This puts further pressure on inflation, already on the rise as global economies recover from the pandemic. In the US, inflation is at a 40-year high of 7.9% with the US Federal Reserve lifted official interest rates in March for the first time since 2018.

In Australia, the lead-up to the Federal Budget added to the uncertainty. The Reserve Bank is taking a "patient" approach on interest rates for now, but with inflation at 3.5% and tipped to go higher it is expected to begin lifting rates later this year. Australia's economy grew by 3.4% in the December quarter, the strongest gain since 1976 as the nation emerged from lockdowns. Unemployment fell from 4.2% to 4.0% in February, but rising prices are putting pressure on household budgets. Petrol prices hit a high of $2.12 a litre in March, costing the average motorist an extra $66.20 to fill their tank since the start of the year. Consumer confidence is at an 18-month low, with the Westpac-Melbourne Institute index down 4.2% in March to 96.6 points. And a 20.6% lift in home prices in the year to February has pushed the average mortgage on established homes to a record $635,000.

In uncertain times, particularly when markets are volatile it's natural to feel uneasy but the Stonehouse team are here to guide you, so please don't hesitate to get in touch.

Congratulations to Michael Chiel and Savannah who recently got married.

Steven Putt
Senior Financial Adviser, Stonehouse

The Unconventional Guide to Borrowing to Invest

Borrowing to invest has been a popular strategy for Australians for many years. For most people it is quite simply a part of financial reality. Hands up if you could buy a house with money from your own pocket?

Borrowing can work, as it increases the amount you have available to invest and naturally amplifies potential gains as there is a more money invested on which to earn returns. Of course, it can also magnify any losses. If you're using borrowed funds and the investment makes a loss, you are still responsible for the interest on the loan as well as the principal of the loan itself.

One of the most popular concepts is negative gearing. This comes about when earnings from an investment do not cover the costs associated with that investment. This has been popular as these outflows can potentially be claimed as tax deductions in the right circumstances. However, with interest rates currently low, negatively geared investments have been hard to find. Does this mean borrowing to invest is dead? Not necessarily.

While the potential for tax benefits from negative gearing has appealed to many, the key driver of borrowing to invest has always been an increase in potential return from having more money to invest. If Investment A was going to double in value over time, surely the more you could buy, the better the result.

That basic concept doesn't change, but in the current low interest rate environment, it may be worthwhile considering the best way to structure debt. Property investment has always been popular and is often the first thing people think of when borrowing to invest. Borrowing for shares and managed funds is also popular. Assuming you have equity in a home, this can be used to borrow to invest, but if you don't, or you don't want to use your house as security, there are alternatives.

Recently we had a client who had an investment portfolio that was made up of personal equity and borrowings. The loan repayments were principal and interest, and as a result this created further 'equity' in the portfolio by reducing the loan. Equity (investment balance – loan balance) was created then, even if the portfolio didn't grow (which, over the last 18 months it had). These clients were young, with a good income and a long-term investment view, and they were comfortable with the idea of borrowing to invest having seen it work firsthand. They also had more cash flow available because of pay rises at work. Given all this, they wanted to look at increasing their portfolio and wanted advice on how best to do this.

Amongst other things, and ensuring a strict approach to risk management, we looked at switching from the "principal and interest" model of their loan repayments to an interest only approach, and increasing the amount borrowed allowing more to be invested. Paying interest only allowed us to increase the size of the loan substantially, without increasing the monthly repayments. The increased loan then is put to work bulking up the investments, along with the funds they had available to add on a regular basis. This restructure then allowed them to increase the amount invested, without increasing their outgoings, all while not needing any income from the investment to assist with funding the costs. This allowed them to reinvest the income back into the investments, further adding to the potential long-term benefits. Like all investments, there is no guarantee that this will grow in the short term, but as a long-term strategy, having more money to invest now would appear more likely to grow to a greater amount. The new strategy has the loan remaining constant and not being reduced, but given the clients age, we have plenty of time to consider the repayment of the loan when the time is right.

There are many ways to consider borrowing to invest into property, shares, funds or even via your super. Debt recycling strategies can help you reduce mortgage debt, while increasing your assets in the right circumstances. The landscape has changed with lower rates, and therefore a more 'unconventional' non tax driven view needs to be considered. Now may still be a time to consider your options on using debt to grow your wealth.

It is important to note that borrowing to invest is not appropriate for everyone and there are many influencing factors such as age, income, investment timeframe, goals, risk profile and a risk management plan should be in place too. Your adviser can assist to discuss these details and any strategy which could be appropriate for you.

The Road Ahead for Shares

Jeremy Chiel
Director,
Stonehouse

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 is now expected to start raising rates this year.[iii]

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.[iv]

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.

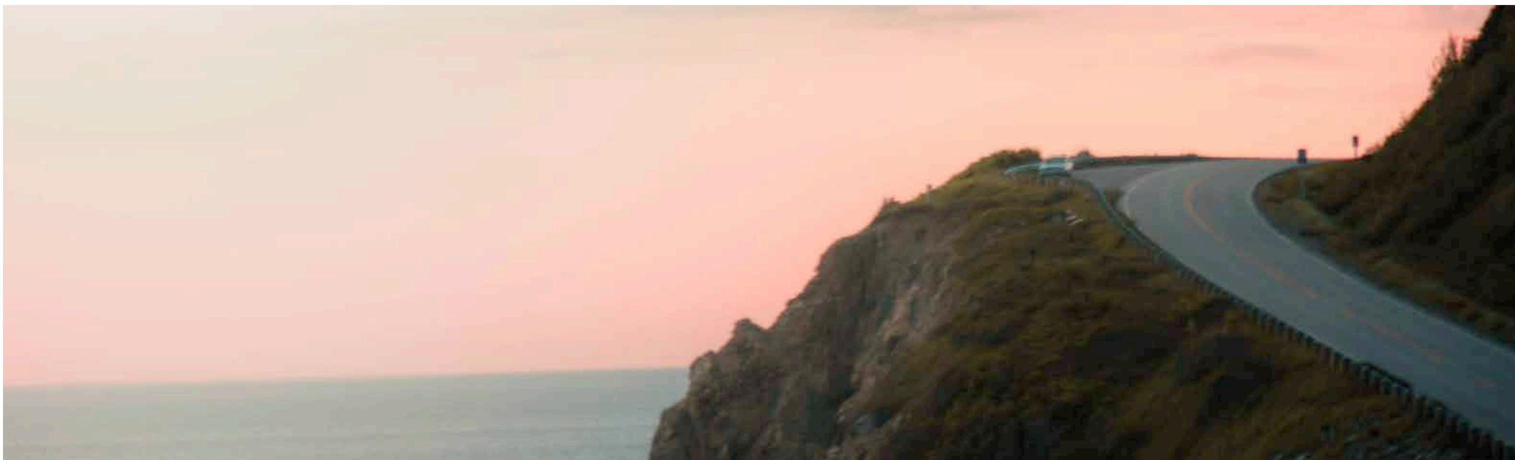
If you would like to discuss your overall investment strategy don't hesitate to get in touch.

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://www.finder.com.au/rba-survey-4-apr

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



Minimum Pension Drawdown Rates Extended

Ben Hancock
Director,
Stonehouse

The Federal Government initially reduced the minimum drawdown rates in March 2020 in response to COVID-19's impact on investment markets for the 2019/2020 and 2020/2021 financial years. Subsequently, these reduced drawdown rates were extended again in May 2021 for the 2021/2022 financial year, and we can now happily report that they have been extended to include 2022/2023.

Reduced minimum rates provide the option to manage your income payments with greater flexibility, helping to ensure that surplus income is not obliged to be drawn from pension assets and thereby remain within the tax-sheltered environment that is an Account Based (or Allocated) Pension.

How it works

It enables retirees to preserve their capital without the need to sell assets at depressed prices during times of market weakness. The Federal Government first introduced such a change in 2008 with the onset of the Global Financial Crisis (GFC) and these reduced minimums remained in place until the end of the 2012/2013 financial year.

An Account Based or Allocated Pension is funded from superannuation assets once you retire or satisfy a condition of release up to the 'transfer balance cap' of $1.7 million.

Once this retirement income stream has commenced, minimum annual payments are calculated on your account balance on 1 July each year and multiplied by a percentage factor that increases as you get older.

The minimum amounts you must withdraw each financial year under the temporary arrangements are set out in the table below, alongside the standard drawdown rates.

Minimum pension payment rates

Age of recipient	Temporary drawdown rates (2019-20 to 2022-23)	Normal drawdown rates (2013-14 to 2018-19)
Under 65	2%	4%
65 – 74	2.5%	5%
75 – 79	3%	6%
80 – 84	3.5%	7%
85 – 89	4.5%	9%
90 – 94	5.5%	11%
95+	7%	14%

Source: SIS Act

Why are the rates set?

The purpose of setting minimum annual payments is to satisfy the sole purpose test. This means that superannuation, and the generous tax concessions it receives, is designed to provide retirement income rather than be a tax-effective way to transfer wealth to the next generation.

There are no maximum annual drawdowns unless it is a Transition to Retirement (TTR) Pension that is not in the retirement phase, in which case, the maximum amount is 10% of your pension account balance.

The government's continued temporary halving of minimum pension drawdown rates will give retirees with Account Based Pensions more flexibility in the management of their pension assets while investment markets remain volatile.

We would recommend that current pension recipients contact their financial adviser if they are not currently utilising the reduced minimum levels and may wish to do so.

5 MINUTES WITH... Ekatarina

As our corporate receptionist and a client service officer, Ekatarina is usually the first point of contact for clients of Stonehouse. A friendly and accommodating team member with keen attention to detail, her warm, generous nature shines and ensures the first contact point with Stonehouse is both welcoming and professional.

Ekatarina previously worked at another boutique financial planning practice for 2 years. Based on the Sunshine Coast, this practice specialised in Self Managed Super Funds and direct equity. Highly organised and methodical, Ekatarina is conscientious and thorough in providing exceptional service to our clients and advisers.

Ekatarina has completed her Bachelor of Psychology specialising in Clinical Psychotherapy at the University of Warsaw and is continuing her studies through a Masters of Psychology at the University of Queensland. During her studies in Warsaw, Ekatarina worked as an English language teacher with students ranging from kindergarteners to adults. Ekatarina has also worked in client service and childcare. With a flair for languages, Ekatarina is fluent in Serbian and speaks conversational Norwegian, Polish and Mandarin Chinese.

Outside the office, Ekatarina's interests include playing tennis, baking and also values spending time with family and friends. With domestic travel opening up again, she was happy to be able to visit her family in Melbourne last weekend after many months apart.