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Spring 2017

Welcome

Spring is finally here and it's not just nature showing signs of growth. The Australian economy is also bearing fruit.

There's little doubt that the next move in interest rates, when it comes, will be up. While no-one's expecting a rate rise any time soon, all borrowers need to be prepared for an eventual return to more normal interest rate settings. In this snapshot, we look at steps you can take now to make the most of low interest rates while they last and minimise the impact of future rate rises.

Our second article looks at insurance inside super. It may be inexpensive, but has it got you covered?

And finally, if you are feeling like many of your relationships are being conducted via text, email and social media, here are some tips to help you to reclaim the lost art of conversation.

As always, if you would like to discuss the contents of this newsletter don't hesitate to call our office.

Kind regards

Neil McLennan - Partner
Carthills Financial Services Pty Ltd

Economic update

Most of the top 200 ASX-listed companies have now announced their results for the 2017 financial year and the overall report card is good. According to CommSec, 90 per cent of companies reporting full-year results turned a profit while 91 per cent paid a dividend. Earnings were up a combined 67 per cent on a year ago, dividends were up 10 per cent and cash levels rose 27 per cent to almost $108 billion. The strongest sectors were mining, which benefited from stronger commodity prices and cost cutting, followed by food companies, REITs and companies dependent on the housing market. Dragging the chain were consumer-focused and media companies.

The healthy company scene was reflected in a fall in unemployment from 5.7 per cent to 5.6 per cent in July, although wage growth is still sluggish – up just 0.5 per cent in the June quarter for an annual rate of 1.9 per cent. The NAB business conditions index rose to a 9-year high of 15 points in July while the business confidence index also firmed 8.4 points to 11.7. Consumers are less positive, with the weekly ANZ/Roy Morgan consumer confidence rating lifting off a 12-month low to finish August at 113.5. The Australian dollar remains a challenge for exporters, firming to end the month close to US80c.

How to be prepared for climbing interest rates

Interest rates have been low for so long it's tempting to think low rates are the new normal. So when the Reserve Bank suggests that a cash rate of 3.5 per cent is the new 'neutral', people take notice. Even the Prime Minister warned Australian householders to prepare for higher interest rates ahead.[i]

The official cash rate has been held at a record low of 1.5 per cent since August 2016, but in recent months the Reserve Bank has begun preparing the ground for higher rates. The Reserve Bank says it now considers the 'neutral' cash rate to be 3.5 per cent. Neutral is central bank-speak for the sweet spot where growth is supported without pushing inflation too high.

Then in a speech on July 26, Reserve Bank Governor Philip Lowe made it clear that rates will only rise once there's a gradual lift in wages growth and inflation.[ii] As things stand, he's in no hurry.

Wages, inflation keep rates low

Annual wages growth is currently running at below 2 per cent, which means many workers are standing still after inflation is taken into account. The annual rate of inflation eased from 2.1 per cent to 1.9 per cent in the June quarter, below the central bank's 2-3 per cent target band.

The central bank is also reluctant to put more pressure on borrowers while household debt grows faster than income. The level of household debt to income has increased from about 148 per cent in 2012 to a record 190 per cent in March 2017. For households with a mortgage, the figure is closer to 300 per cent.

So what can you do to make the most of today's low rates and soften the impact of higher rates in future?

Quit the bad debt habit

Make the most of low interest rates to pay down expensive debt such as credit cards and personal loans. Credit card interest rates begin at around 12 per cent and rise to as much as 20 per cent on popular rewards cards.

One strategy is to consolidate personal debts into your mortgage and save up to 15 per cent in interest. You also need to increase repayments on your mortgage, otherwise you could be paying off your credit cards for 20 years or more.

Lock in fixed rates

If you have a mortgage and an increase in interest rates would blow a hole in your budget, then think about fixing all or part of your loan.

The best fixed rates for two and three-year terms are currently around 4 per cent, not much more than the best variable rates on offer.

Bear in mind that fixed loans are less flexible than variable loans. You can't make extra repayments or redraw funds and there are penalties for exiting a fixed loan early, even if it's to sell your home. One popular solution is to split your loan into fixed and variable amounts for peace of mind with the flexibility to make extra repayments or redraw funds if necessary.

Make extra repayments

If you have a variable rate mortgage, then it's a good strategy to use any extra savings or lump sums to reduce your loan while rates are at historic lows.

You can tip this money into an offset account where it will reduce the interest you pay, but this only works if you're disciplined and avoid the temptation to dip into your offset account for everyday spending. You may be better off making additional ongoing or one-off loan repayments; they will still be available for a rainy day if you choose a loan with a redraw facility.

Catch the rising tide

Higher interest rates are not all bad news. If you're a saver or depend on income from investments, higher rates can't come quick enough.

If you would like to discuss ways to reduce debt or grow your savings and investments, don't hesitate to call.

i 'Prepare for interest rates to climb, Malcolm Turnbull warns', by David Ross, The New Daily 20 July 2017, http://thenewdaily.com.au/money/finance-news/2017/07/20/malcolm-turnbull-warning-interest-rates/

ii "The labour market and monetary policy', speech by RBA Governor Philip Lowe, 26 July 2017, http://www.rba.gov.au/speeches/2017/sp-gov-2017-07-26.html

Life insurance INSIDE OR OUTSIDE super?

If you've got super, chances are you'll have some default insurance included and the option to buy more at an attractive price. It's a cost effective way to get a basic level of cover, but holding insurance inside super does have some downsides.

Forms of super insurance

There are three types of insurance you can hold inside super: life, total and permanent disability (TPD) and income protection insurance. Many super funds automatically insure their members and will provide a (relatively small) payout if, for example, they die or suffer a debilitating accident. But the level of default cover is likely to fall short of your needs.

Canstar found that while young families typically need around $680,000 of life cover, the average default life policy is only $200,000.

Nevertheless, you can pay a little extra to top up your insurance through your super fund if you want more cover. There are three big advantages to doing this:

- These policies are relatively inexpensive because super funds can buy in bulk and pass on the discount they receive to members;
- These policies are easily accessed. You'll typically have your application for insurance approved without having to be examined by a doctor or provide detailed medical information;
- You pay for cover from your pre-tax income because the cost of premiums is taken out of the super contribution your employer deposits in your fund.

What's the catch?

Some life insurance is better than none, but there are downsides of a one-size-fits-all solution.

Super funds get bulk-buying discounts on the basis that they purchase standardised 'off the shelf' policies. Such a policy may or may not be suited to your individual needs.

Automatic default cover also means younger, healthy members are subsidising older and less healthy members. And while paying for insurance out of your super contributions can help your cash flow, it's money that's being diverted from your retirement nest egg.

You also need to keep in mind that insurance taken out through your super isn't portable; if you switch to another super fund that insurance will cease. Payouts can take a while because the insurer pays the super fund, which then pays the claimant.

If you fail to make a binding beneficiary nomination, or your super fund doesn't offer binding nominations, the super trustee will decide who gets your benefits if you die. That beneficiary may be taxed more heavily than would be the case with a retail policy. And finally, the insurance ends when you retire.

Going outside

Getting insurance outside of super can be a little more expensive and time-consuming but it's worth considering for a number of reasons.

- You'll have access to a wider range of policies. That means you can find one that's more tailored to your individual needs.
- You can't get trauma insurance through super, but you can in a retail policy.
- Payouts tend to be faster and you'll have more capacity to ensure a death benefit goes to the beneficiary you want it to.
- If you're in good shape, your premiums will reflect this.
- While you'll be using your after-tax income to pay for it, income-protection insurance is tax deductible.

Another issue with income-protection policies through super is that they are linked to your current income. This may be unusually low when you make a claim due to, for example, having gone part-time to look after children. In contrast, retail income protection policies can offer a guaranteed benefit.

SMSFs and insurance

It's not just big public super funds that can provide insurance cover. If you have your own self-managed super fund (SMSF) you're legally obliged to consider the insurance needs of members when drafting your fund's investment strategy. Life, TPD and income protection insurance can all be purchased through an SMSF but it won't have access to the discounts large funds enjoy. Plus, you generally need to undergo a medical examination before receiving cover, so there are few advantages of holding insurance inside your SMSF.

If you would like to discuss the best insurance solution for your family's needs, please give us a call.

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When was the last time you had a lengthy chat to a friend over the phone or, rarer still, a decent face-to-face catch up? Remember spending time with a loved one making the most of precious hours having saved up every story, anecdote and interesting conversation starter up your sleeve? Nowadays the bulk of our relationships seem to be conducted via text.

It's not just SMS. We now have so many different ways to communicate 24/7, if you also include email, social media and video as well as phone calls. We are adapting the way we communicate to suit these means. Communication now tends to happen in brief, rapid-fire snatches and it can feel like conversation is becoming a lost art.

Is technology really making it easier?

It's certainly not all bad. Much is made of the way that social media makes it easier to connect with friends and family you don't see often. There's a reason that Facebook's tagline is the somewhat emotive: '...helps you connect and share with the people in your life'.

Proponents of digital communications platforms say that accessibility and human-centred design means that social platforms aren't just fads, they're representative of a real change in the way humans communicate. And they point to certain stats, like older Aussies being the fastest growing demographic of social media users, to prove their point.[i]

On the flip side, proud Luddites say that communicating might be easier than ever, but it's a lot less meaningful. Sometimes it seems like they've got a point. There's a big difference between sitting down for a cuppa and a chat with a friend and getting a text that's basically four words, perhaps with a few nonsense vegetable emojis thrown in for good measure.

It's so easy to misconstrue the tone of a text, it can be hard to tell if someone is serious or pulling your leg. Think of how much is conveyed with a smile, a grimace, an eye roll or an arched eyebrow. That's why emojis were invented, to help us to more easily navigate the complexities of not being able to see the expression on someone's face or hear the inflection in their voice.

We are also becoming more glued to our devices to the detriment of real life connections. It's not hard to miss, say, the pair of high schools girls walking side by side texting furiously, the table of friends ignoring their lattes in favour of their screens or the couple checking out their socials instead of each other.

Of course, there are exceptions to every rule in this debate. For every person who feels like they've missed out on connecting face to face, there's a person in dire straits who's been able to reach out to strangers – think things like medical crowdfunding.[ii] And that's without even touching on the millions of conversations that happen every day on dating sites.

Balancing convenience and 'real' conversation

While we are certainly not advocating forgoing the convenience of technology, being able to initiate and maintain a conversation is an important skill. Conversations are good for the soul and the river of words that flows, pauses and goes off on tangents helps you to develop and express your ideas.

If you're interested in reclaiming the lost art of conversation, there are some simple steps you can take to have a more meaningful connection with those you care about.

- Limit your use of technology at the dinner table and be 'present' with your loved ones.
- Conversations are about listening as much as speaking; ask questions and try not to interrupt the speaker.
- Look into the speaker's eyes as you talk and take notice of their body language and facial expressions.

Happy chatting!

i https://www2.deloitte.com/au/en/pages/technology-media-and-telecommunications/articles/media-consumer-survey-2017.html

ii http://www.sbs.com.au/news/article/2015/09/18/why-are-so-many-australians-forced-crowdfund-medical-costs