INFORMED INVESTOR

January 2022

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WALKER WAYLAND (NSW) FINANCIAL SERVICES

FURTHER INFORMATION

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WELCOME

KEEPING YOU INFORMED

Welcome to the latest edition of our quarterly newsletter 'Informed Investor.'

In this issue we explore:

1. How to beat Inflation before it beats you
2. Investing in investment bonds
3. Market volatility during COVID-19
4. What alternative assets bring to your super investment mix

As always, if you have any questions about the information contained in these articles or how certain aspects may apply to your personal situation please feel welcome to contact us.

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FINANCIAL PLANNING

HOW TO BEAT INFLATION BEFORE IT BEATS YOU

Investors with long memories – or a good education – will recall the bad old days when inflation was the economic bogeyman.

It broke Germany's Weimar Republic in the 1930s and nearly cratered America's economy in the 1970s.

Fortunately, inflation has been a non-issue in Western economies for decades. But is that about to change? In the first quarter of FY2021, Australian inflation ran at a comfortable 1.1%. By the second quarter it had leaped to 3.8%.

Perpetual's recent Quarterly Update summed up the problem: "With very easy monetary policy likely to continue for the next couple of years, and government spending at record-breaking levels, there remains the risk that inflation could become out-of-control. Historically, high levels of inflation have been very difficult to contain once in place."

INFLATION HURTS RETIREES

Inflation is bad news for retirees. "A continual rise in the price of goods and services can really affect someone who's retired or approaching retirement", says Malissa Tobias, a Perpetual Private adviser in Melbourne. "Inflation eats your purchasing power - you get fewer goods and services for the same amount of money."

If you're still working, your salary can rise to keep pace with inflation. Retirees - especially those with money in low-rate assets like term deposits or cash - suffer because their spending power is cut and the real (after-inflation) value of their capital is falling.

ANTI-INFLATION STRATEGIES FOR RETIREES AND NEAR-RETIREES

Manage your retirement

By managing the timing and shape of your retirement you can offset some of the inflation threat.

If you work a little longer (either full or part-time) you can earn an income that might go up with inflation.

Those extra earning years also give you more time and money to build up the largest possible nest egg to generate your retirement income.

Finally, but just as importantly, retiring later delays the day you start drawing on your capital.

Invest in inflation-beating assets

Investing in higher-returning assets - like shares or property - can deliver the same benefits as earning work-income because their value can rise in line with, or above, the rate of inflation. However, the inevitable complication is that higher returning assets are usually higher risk assets.

Plan your spending

Knowing how much money you're going to need in retirement is a crucial part of retirement planning.

Draw on capital

The recent Retirement Income Review suggested many retirees die with their capital intact. But that's not the case for everyone. In a world where the threat of inflation is rising, some retirees will need to dip into their capital to fund the retirement lifestyle they want. The key is to do that prudently.

Source: Perpetual

INVESTING IN INVESTMENT BONDS

Investment bonds can be used to build wealth without increasing an investor's personal tax liability.

Investment bonds are long-term investments that may offer tax efficiency to investors on a high marginal tax rate and those investing for children or grandchildren.

Unlike traditional investment products, such as managed funds, bonds are a 'tax paid' investment. This means that tax on investment earnings is paid at the applicable company rate of 30 per cent by the bond issuer – not by you, the investor.

Investors receive 'tax paid' returns provided they meet certain conditions – most notably that the investment is held for at least ten years and contributions do not exceed the 125% rule.

125% rule

Bonds have a valuable taxation status; as long as any additional investments you make do not exceed 125 per cent of the investments made in the previous year, then the taxation status will not be jeopardised. This is called the 125% rule.

By using the 125% rule, a bond investment becomes even more tax effective because it gives you the opportunity to make additional investments (or contributions to a savings plan) each year. The level of additional contributions you can make continues to increase until the end of the tenth anniversary, after which all withdrawals from the bond are tax-free.

Investment bond		Managed fund	
Investment earnings	$10,000	Investment earnings	$10,000
Tax paid by bond manager	$3,000	Tax paid by fund manager	$0
Net return (at maturity)	$7,000	Assessable income	$10,000
Assessable income	$0	Tax paid by investor	$4,500
After tax return	$7,000	After tax return	$5,500

For example, if you invest $10,000 in year one, then, using the 125% rule, $12,500 (125%* 10,000) may be invested in year 2, and so on.

A tax-effective alternative

The table above shows the tax benefits of an investment bond.

What investment choices are available?

While different investment bonds have different investment menus, generally they include a wide range of diversified funds, multi-manager funds, Australian share funds, international shares, fixed income and capital guaranteed investments.

Who should consider an investment bond?

Investment bonds may be suitable for:

- investors with a long-term investment horizon (at least 10 years).
- investors who have contributed as much concessional contributions to super as possible.
- parents or grandparents who wish to invest on behalf of the next generation.
- investors who do not require access to their funds, as investment bonds re-invest distributions.

Source: IOOF

MARKET VOLATILITY DURING COVID-19

Market volatility refers to extreme price movements over a given period.

These movements may occur in a particular area, such as real estate or shares, and may be upward or downward.

Ever since COVID-19 started spreading across the world in late 2019, affecting every aspect of our lives, the term 'market volatility' has been hitting headlines.

But, what does market volatility mean? And what might it mean for your finances?

Market volatility can feel like a one-off crisis. However, it's important to remember that volatility is in the very nature of markets. Fluctuations are bound to occur and, sometimes, they're rather extreme.

For instance, in February and March 2020, markets dropped 37%, but fast-forward to the June quarter, and they picked up 16%. That's quite a wild swing. Anyone who panicked and withdrew from the market at the end of March would have missed out on the subsequent gains.

In the scheme of things, three months isn't long at all. In the 141 years since the ASX was established, there have been 28 negative years, and the rest have been positive. In other words, each year, the average investor has a 1 in 5 chance of a setback, but a 1 in 4 chance of making gains.

Further, in the 20 years leading up to 2018, the ten best days in the market were responsible for 50% of returns.

During downturns, it's easy to be swayed by the news. Headlines often focus on the negatives. When the COVID-19 pandemic began, the emotional impact of worrying financial news was intensified by the fact that the virus itself was new and unknown.

Plus, so many people were unable to go to their workplaces, or catch up with friends and relatives.

If you were reading the headlines and not speaking to anyone about them, you may have been susceptible to making big financial decisions based on your emotional reactions.

That's why it's important to speak to your financial adviser, who will remind you of your long term plan—and that a downturn is just a short term blip, when you think of the next 20 years.

Source: TAL

WHAT ALTERNATIVE ASSETS BRING TO YOUR SUPER INVESTMENT MIX

Alternative investments are typically found outside the traditional asset classes.

Most of us have heard of the main asset classes: shares, property, fixed interest and cash, but alternative assets are less well known.

However, these types of assets can provide further diversification and enhanced returns for your super.

Alternative investments are those found outside the traditional asset classes. Typical ones include real estate, private equity, venture capital, infrastructure, renewable energy, hedge funds, commodities, and private debt.

Generally, these are assets that aren't correlated to the performance of the sharemarket, that is they can often perform when sharemarket returns are down or flat.

The net result is that alternative investments add an extra layer of diversification - you're not 'putting all of your eggs in one basket' and seeing all asset class suffer at the same time.

LOW RETURNS PIQUE INTEREST IN ALTERNATIVES

In the current low interest rate environment, which tends to mean lower returns for cash and bonds, alternative investments can help members grow their super to retire comfortably.

Alternative investments differ to publicly available funds as they're part of the private investment market and aren't easily accessible for individual investors. They typically include:

Infrastructure

Infrastructure assets are known for providing long-term, stable and predictable cash flows. Opportunities can be found within energy production and transmission but are also emerging in newer sectors such as agriculture infrastructure and renewable energy, particularly wind-powered energy and a selection of solar-power opportunities.

Private equity

The private equity sector invests in companies that are not publicly traded. The advantage is that by investing at the start of a company's lifecycle, it's possible to generate strong risk-adjusted returns and benefit from high earnings growth when compared to listed markets.

Real estate

Real estate has a low correlation to shares but is often considered to be a good hedge against inflation. The asset class has evolved over time to include publicly listed and real estate investment trusts (REITs) that include data centres, childcare and storage facilities, as well as commercial real estate debt, which provides loans to commercial borrowers who need funding for real estate purposes.

Performance can lift when using alternative assets because alternatives are generally less impacted by daily market movements in the way that other assets are.

Shares and bonds can be quickly affected by changing market, social and economic events, such as the COVID-19 pandemic for example. Therefore, the overall volatility, or the 'roller-coaster ride' of increasing and decreasing valuations, should reduce when funds include a proportion of alternative assets in the mix.

NOT ALL ALTERNATIVES ARE EQUAL

Of course, alternative assets need to be carefully researched and reviewed in order to find the most appropriate options for each particular fund.

They need to be carefully weighed up against other asset classes and sectors to ensure the most appropriate levels of risk and reward that will support investors to achieve a comfortable retirement.

Source: IOOF