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Planning Partners

Prosperitas

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Prosperitas: Latin for **prosperity & good fortune**

The Interest in Rates

The prevailing interest rate settings have become the most economically divisive factor in matters of financial planning over the last two years. Newspapers are filled with articles addressing housing affordability, reduced income returns from cash and fixed interest investments, and inflated property and equity markets to name only a few of the concerns of the general public.

These three outcomes afford significant implications to aspiring homeowners, marginally funded retirees and investors but what are the positives of the prevailing interest rate settings and what exactly is the Reserve Bank of Australia endeavouring to achieve?

In theory, reduced interest rates will improve business confidence and will lead to increased corporate spending. This in turn will lead to investment by the corporate sector which will spin money through the community as well as increasing taxation revenue. An element of corporate investment might also relate to increased levels of employment which reduces government support obligations, increases tax revenue and broadly increases community spending. Low interest rates should 'fire' the economy.

Many would argue that over the past few decades Monetary Policy has become a less effective method with which the market could be stimulated or quietened. During the GFC and amid the recovery period, Australia has managed to maintain a higher interest rate setting than most developed economies due to the relative health of the economy and insulation from the extreme effects of global market downturn of 2008/09. This has afforded the Reserve Bank the relative luxury of cutting rates as and when it has been needed but with a further cut on the way, we must now consider what life will be like with a term deposit being issued with a 2% coupon and with no promise of an improved economic environment.

Complicating matters of course is the matter of a Government appearing to be fixated on running the federal budget in a surplus position and facing the prospect of increasing taxes and reduced spending while the revenue from the mining sector has well and truly receded from the boom period of 2005-08. All of these factors have precisely the opposite effect to that being sought by the Reserve Bank.

The US economy is recovering and growing at a rate sufficient for the US Federal Reserve Bank to commence a tightening program. A quick look over our shoulder at historical interest rates provides ample reminder that rates won't remain at this level forever. For those with a mortgage, we would suggest that you repay the debt with renewed vigour; for those inclined to use a credit card, enjoy the reprieve; and for those retired or looking to enter the property market, your patience will be rewarded in time.

Martin R McIntosh
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Fixed interest basics

Fixed interest can provide a buffer against volatile share markets when held in a diversified portfolio.

Fixed interest securities

Fixed interest investments can be issued by the Commonwealth government, state governments, semi-government authorities, banks and other corporations, both locally and overseas, to raise capital for projects.

Fixed interest investments usually have longer investment terms than cash investments. Australian bond maturities range from one to 10 years while US bonds can extend up to 30 years.

Types of fixed interest securities

The main types of fixed interest securities are:

Government bonds - issued directly by a government and are explicitly guaranteed. For instance, in Australia the federal government issues commonwealth securities to help pay for major government projects.

Semi-government bonds - not issued directly by a government but might have a direct or implied guarantee. For instance, state governments and other entities that have a government guarantee (like the World Bank) issue bonds to support their financial needs or to finance public projects.

Corporate bonds - issued by large public companies to fund expansion and other major projects. Corporate bonds differ in two important ways to government bonds - yield and credit quality. Generally, corporate bonds are thought to have a higher level of risk than government or semi-government bonds, so they typically offer higher interest rates.

Risk/return characteristics

Fixed interest is a low- to medium- risk investment suitable for investors with a timeframe of three years or more.

In addition to providing a regular income stream - an important feature for many investors - fixed interest can provide a stabilising effect during periods of share market volatility.

As their name suggests, fixed interest securities make regular interest payments. Interest rates can be fixed or floating. Fixed rates are set for the life of a security, while floating rates are reset periodically.

Total bond returns can include income from interest payments and growth from price fluctuations if traded on the secondary market. Bond yields are calculated by dividing annual income by market value and are inversely related to bond prices. When bond yields rise, bond prices will fall and vice versa.

Bond yields and prices can fluctuate regularly based on the economic outlook. Bonds can provide capital growth (and loss) when sold prior to the maturity date for a higher (or lower) price.

Credit risk refers to the risk of an issuer defaulting on repayment of capital. Credit ratings provide a good indication of the risk level associated with the issuer. Bond issues are rated by independent rating agencies like Standard & Poor's. The higher the rating the less likelihood of the issuer defaulting on repaying your capital. Usually, the higher the risk, the higher the yield.

Accessing fixed interest markets

You can invest in fixed interest investments directly or through a managed fund. Managed funds provide a way of accessing a diversified portfolio of securities, which can include a mix of Australian or international government and corporate fixed interest investments, or a combination of both.

Source: Vanguard Australia

Ownership of assets and estate planning

There are a variety of ways assets can be owned, including in one's own name, a Family Trust or via superannuation. Each ownership structure has various implications, such as tax on income and capital gains, asset protection and accessibility.

The appropriate ownership structure may require consideration of one or more of the above elements as each element may have a conflicting outcome e.g. a particular ownership may provide estate planning benefits however it may be less appropriate from an accessibility perspective.

For instance, superannuation is designed to encourage individuals to save towards their retirement and (as an ownership structure) enjoys tax concessions others do not. However, as a result of these tax concessions, the amount that can be contributed annually is limited and benefits can generally only be accessed upon retirement after reaching preservation age.

Furthermore, if a member does not nominate a dependant to receive their superannuation benefits, or does not direct their benefits to be distributed via their Will, the trustee of the superannuation fund has full discretion as to whom the benefit will be paid.

Estate planning is an important part of a client's financial plan and the right ownership structure for holding assets requires consideration of a client's needs, goals, personal circumstances as well as the circumstances of their direct and extended family. In addition these considerations can be dynamic and the appropriate ownership structure may need to be amended over time.

Source: *FPA Magazine*, Volume 27 Issue 1, February 2015

Behavioural Finance: Self Delusion

One of the most common cognitive traps investors fall into is called representativeness. It describes our willingness to judge events by how they appear rather than by how likely they are to be. We use stereotypes or unrepresentative information at the expense of more accurate, yet complex, data.

The different way our minds treat information is described by behavioural psychologist Daniel Kahneman in the term "what you see is all there is". In short, we jump to conclusions based on limited data. Much of the time, the coherent story we put together in our heads is close enough to reality. But at other times such shortcuts may lead us astray.

In a famous example of representativeness, behavioural psychologists Daniel Kahneman and Amos Tversky asked students how likely it was for an undergraduate, named Tom W, to be studying one of nine disciplines.

To one group they gave no further details. This group was then required to use accurate information about the popularity of those subjects to provide an answer. Another group was asked to make a judgment based on a description of Tom W as a logical thinker who lacked creativity.

When confronted with this description, Kahneman and Tversky found that people neglected statistical facts in favour of stereotypes and ranked Tom W. as most likely to be an engineer or a computer scientist. This was despite the fact that these subjects had fewer undergraduates than the humanities and social sciences. People were driven by the compelling narrative of the description of Tom rather than the cold logic of numbers.

Neglecting facts is something that can happen with investing. Super-normal profits and high growth rates are defended on the basis of new paradigms. In this way, a collective willingness on the part of investors to succumb to representativeness may explain investment bubbles.

With investing, recent experience of how things appear is often simplistically extrapolated into the future. Analysts, for example, consistently forecast high earnings growth for companies that have just delivered high earnings growth.

In reality, earnings growth is not necessarily persistent; rather, it tends to follow the business cycle. This blind-spot is a form of ignoring statistics; analysts and investors are looking for reasons for earnings to stay high.

This suggests that investors need to be careful when making decisions on how things appear. Rather than jumping to conclusions that appear intuitive, people should consider the appropriate information to ground their judgments. History suggests such caution makes for better long-term decisions.

Sourced from Fidelity Investments

Louay Sleiman

Player profile: Louay Sleiman

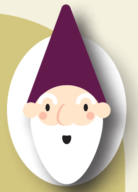
The latest addition to the Planning Partners team is Louay Sleiman. Louay hails from South Morang, in the North of Melbourne but not near Morang, and joined us via Mill Park Secondary, which is not in Mill Park. Confused? We were.

Louay has joined us as a Client Services Officer following stints at the CBA and NAB where he worked in recoveries. In his role at Planning Partners, Louay attends to a myriad of client enquiries and assists our planners with document preparation. Having completed his Bachelor of Business (Financial Planning), Louay is soon to commence his Certified Financial Planner (CFP) studies later this year.

Away from work, Louay is a keen tennis player and enjoys watching The Blacklist, Seinfeld and The Fast & The Furious films, and despite being born a month before Hawthorn's 1991 premiership chose to barrack for Collingwood. Louay also brings a fresh taste in music, with Rhianna, Chris Brown and a raft of bands most of us had never heard of, and is a fan of R & B.

Recently, Louay proposed to Sherine and they are now busy planning a 'destination wedding' in Fiji or Bali. Or perhaps even Morang…?

Garden Clippings



You have used the last of your tomatoes to complete your batch of 'sugo' and the remainder of your summer vegetables are starting to adopt a straggling, struggling look (a la Iggy Pop).

It is time to remove the summer vegies, dig the garden over with a probing hoe, take the opportunity to include fertilizer and then turn your attention to winter vegies.

Your winter vegies may need some encouragement from the soil in the colder months so Chicken manure might provide the lift needed at this time.

The Gnome prefers the following winter vegies (due to his love of soup and roast dinners) in a temperate and cool climate;

Peas, Onions, Carrots, Leek, Broad beans, Beetroot will get the ball rolling in exactly the right direction.

Once the vegie patch is in reasonable repair and set to produce, autumn can also be seen as the perfect time of year to move plants. When it is not too hot and not too cold, evergreens and small shrubs will be moved at this time with greatest success so long as you take care to observe minimum root disturbance. Plenty of organic matter to assist the plant to settle should be afforded to the new plot prior to the move and fingers crossed.

What a great time to be in the garden, when the sun is shining and the evenings are cool. Enjoy!

GG

The Bookworm

We Are All Completely Beside Ourselves – Karen Joy Fowler

Karen Joy Fowler has written a cracking tale about the Cooke family consisting of Mum and Dad, narrator Rosemary and her siblings Lowell and Fern. The story begins in 1970s Indiana, when at the age the age of five Rosemary was sent to her grandparents for a short visit. She did not know why but sensed that she had done wrong; and she expected that her punishment was going to be an indefinite period of time away from her family. But this was not the case; and on her return, it was in fact her sister Fern who has been dispatched – never to be seen again. The reason was never explained to Rosemary.

Soon afterwards, her moody and adolescent brother Lowell leaves during the night without notifying the family, and Rosemary feels responsible again. Lowell then commits a series of crimes in the name of animal rights and becomes wanted by the FBI, causing further tremors to a family already quaking.

The normally talkative Rosemary becomes somewhat reclusive and over time wrestles with a sense of guilt and memories upon which she finds she can no longer rely.

The story then oscillates between the past and present to gradually reveal the complete story of the Cooke family. This style enables the author to explore themes such as animal rights, familial loyalty, parental deception, and guilt.

Though the themes explored by Fowler may sound weighty, The Bookworm found the novel to be quite approachable and one that could equally be enjoyed at the beach or as the monthly book club subject. Shortlisted for the Man Booker Prize in 2014, Fowler has written a superb novel that is humorous in parts and will leave you thinking about the subject matter for some time after completing the book.

★ Page-turner Rating - "Buy and Share"

PROFESSIONAL PRACTICE

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