YOUR PERSONAL WEALTH

AUTUMN 2022

WELCOME TO THE AUTUMN EDITION

The good news is the Omicron wave looks to have peaked in Australia and the negative impacts were less than predicted.

Lockdowns have resulted in a change in consumer behaviour with a shift to buying goods rather than services. This along with supply chain disruptions has been a major contributor to inflation. Hopefully, as lockdowns end the shift back to services will help reduce inflationary pressures.

We also take a look at the differences between a financial planner and a money coach, and how each can assist you to achieve a positive financial future.

Economic forecast

The Reserve Bank (RBA) has just raised its economic forecasts, projecting unemployment to drop from 4.2% to 3.75% this year, a level last seen 50 years ago. Annual core inflation rose to 2.6% in December, years ahead of the RBA's previous forecasts. Underlying inflation is projected to rise to around 3.25% by June this year. Most importantly, wage growth is expected to reach 3% in 2023. This is the level considered necessary by the RBA to lift inflation to its 2% to 3% target range, and to keep it there sustainably. All of this prompted Dr. Lowe (RBA Governor), to say that it was a "plausible scenario" that the Australian cash rate could rise in 2022, or it could occur next year or later. This is a long way from previous statements from the RBA that the next rate hike was unlikely to happen until 2024.

Inflationary pressures

The biggest change in market expectations has been the realisation that inflation in most countries will be both higher and much less transitory than previously thought. The US for example, has speeded up its taper (the unwinding of bond buying of $120bn a month), and we now expect that this quantitative easing will be ended in March this year.

We are now entering a US Federal Reserve (Fed) tightening cycle. Markets are now factoring a rise of 0.5% in March and possibly 6 rises in 2022. The Fed is now obviously behind the curve with annual CPI inflation of 7.5% and wholesale inflation of around 10%. Inflation has broadened out to affect "stickier" areas such as wages and shelter costs.

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The the danger is that inflation will become entrenched, and the Fed will need to become much more aggressive to tame it. Given the massive levels of debt, the Fed will want to be somewhat cautious in hiking rates, but circumstances may force its hand. We should also point out that the neutral cash rate in the US is around 2.5%, with rates now at zero. Similarly in Australia, the neutral cash rate is around 2%. The wild card is the Fed's $US8.8 trillion balance sheet. Fed chair Powell when asked about plans to shrink the Fed's $US8.8 trillion balance sheet, said at some point this year he and his colleagues will allow the balance sheet to run off by selling the bonds that it holds back to the market.

Market volatility

The volatility we experienced in January was partly due to rising bond yields and the expectation of more and faster rate hikes than had been previously factored in. The other feature of equity markets has been a rotation away from high PE (price-to-earnings) growth stocks to cheaper, more value style stocks. The Fed's current priority is to try to get inflation under control, which makes coming to the rescue of the stock market by loosening monetary policy and/or reinstating QE very unlikely, as this would exacerbate the issue of rising inflation.

Furthermore, real interest rates (after inflation) are negative with the US 10-year government bond yield at around 2.0% while estimated 5-year and 10-year inflation is 2.81% and 2.45% respectively (inflation break-evens). The markets are thus hostage to the inflation data, and we would expect quite a bit more volatility in 2022. We would expect equity PE multiples to contract from current levels as interest rates rise. The S&P 500 forward PE was 21.2 times at the end of 2021 (down from a recent high of 23x). The 25-year average S&P 500 forward PE is 16.8 times (JP Morgan, 31 Dec 2021) reflecting higher interest rates. The Australian PE (ASX 200) was 18.1x at 31 December 2021, versus a long term average of 14.7x (JP Morgan, 31 Dec 2021).

Looking ahead

We also expect higher PE stocks, particularly those with no earnings, to underperform in the period ahead. Certainly, the tech-heavy Nasdaq has struggled relative to the broader indices lately. This is also an environment where more cyclical, value style stocks should do well, provided economic growth is maintained at a reasonable level and we do not have an economic downturn as a result of multiple rate hikes. We do expect growth to slow as rates move higher and yield curves flatten.

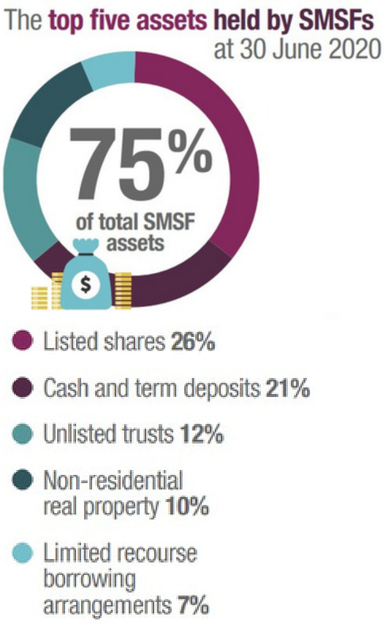
We think this is going to be a much tougher year than last year for equities and likely the second ordinary year in a row for bonds.

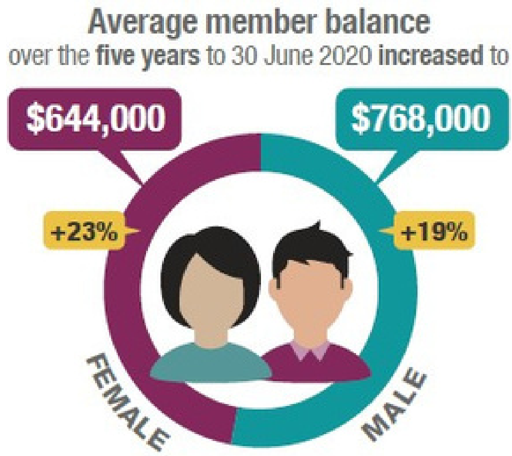
With returns likely to be much lower in 2022 compared to 2021, we expect dividends to increase in importance and to be a larger proportion of total returns.

Our strategy for new money would be one of patience, we would wait for pullbacks in markets or for individual opportunities to arise. The upside is that we think you will get more volatility (or opportunity) this year than we got in 2021. This is a juggling act since we expect inflation to be above central bank targets for the next year or two, and hence expect negative real returns for holding cash.

There are also several geopolitical risks apparent at present. The recent Russian invasion of Ukraine has led to restrictions on a Russian gas pipeline that will keep energy (oil and gas) prices high and add to inflation. The other two potential flashpoints are China invading Taiwan and an Iranian nuclear breakout, likely to lead to other middle eastern states also going nuclear. We are not predictingboth of these, but obviously any more of these outcomes will add to the disruption of equity markets.

SELF MANAGED SUPER FUNDS





What's the story behind the numbers? Talk to us about whether an SMSF is right for you.

Source: ato.com.au

INFLATION HITS HIP POCKETS

In the last quarter of the 2021 calendar year, automotive fuel costs rose 6.6%, vehicles rose 1.9%, and general food costs increased by 1% too, while dairy products increased by 1.7%. The cumulative impact of these inflationary price hikes means that Australian retirees' budgets are under threat by the rise of everyday living expenses.

The Association of Superannuation Funds of Australia (ASFA) Retirement Standard for the December 2021 quarter indicates that couples aged around 65 living a comfortable retirement needs to spend $64,771 per year and singles $45,962, up by 1.5% and 1.6% respectively on the previous quarter. Over the year, prices were up by around 3.5% for the comfortable couple budget and by 3.9% for the comfortable single budget. The annual percentage increases in the comfortable budgets are the largest seen since 2010.

"Australian retirees are now facing significant pressure on their budgets from non-discretionary inflation," said ASFA deputy chief executive Glen McCrea. "This means unavoidable price increases on goods and services such as food, petrol and health costs. It's critical that future retirees are able to build sufficient retirement savings to ensure they can have dignity, health, vitality, and connection in retirement."

The research also found that price increases for retirees are outstripping those for employees. Retirees haven't been able to simply switch what they buy to save. While health costs are largely subsidised, out-of-pocket expenses remain substantial for items such as dental treatment and, particularly in recent months, the cost of COVID-19 rapid antigen tests.

"It's so important that future retirees are able to build sufficient savings over their working lives to ensure they can face retirement with financial confidence," McCrea said. "Over the last couple of years, the balances of women and low-income earners have been impacted by the acceleration of price increases, COVID-19 and policies such as the early release of super".

The government must address the repair of people's retirement budgets, as we emerge from the COVID-19 crisis. However, you can talk to us today about the steps you can take to improve your financial position.

DO I NEED A FINANCIAL PLANNER, MONEY COACH, OR BOTH?

Financial planners and money coaches are both able to help improve your finances, but their approaches are quite different. A financial planner usually focuses on the external or physical factors of your finances, while a money coach starts working with you on the internal or psychological factors.

A **financial planner** focuses on your investments, debts, income, and expenses, and provides strategic, investment, and insurance product advice in these areas. You can outsource the management, advice, and control of your assets, and they can manage the money you have available for wealth creation.

A **money coach** does not manage your investments, nor can they give you specific investment advice. Instead, they focus on transforming your relationship with money including your mindset, behaviours, unconscious patterns, actions, and outcomes. They do this by examining your ‘financial story’ and attitudes toward money, so you can better understand your why and make more conscious money choices.

Together, a money coach and financial planner can help you as their skills can complement each other.

If you’re looking at engaging both a financial planner and a money coach, you should consider seeing a coach first. They can help you understand and improve your relationship with money, so you are better engaged to work with a financial planner. Many financial planners also offer money coaching services. Keep in mind, money coaching isn’t regulated in Australia like financial planning is, so it’s critical you do your research when selecting a money coach to ensure they have specific training, education, and experience to assist you.

ENHANCING SUPERANNUATION OUTCOMES

On 10 February 2022, the Treasury Law Amendment (Enhancing Superannuation Outcomes for Australians and Helping Australian Businesses invest) Bill 2021 passed and has since been given royal assent, and passed into law.

The Bill gives effect to the following superannuation changes effective 1 July 2022:

- Removing the work test requirement for certain personal contributions for people aged between 67 and 75*. These contributions include non-concessional contributions, spouse contributions, contributions made under small business CGT provision, transfers from foreign super funds, salary sacrifice contributions.
- It is important to note that people aged between 67 and 75 still need to meet the work test requirement to be able to make personal deductible contributions.
- Extending eligibility to make non-concessional contributions under the bring forward provision to people aged between 67 and less than 75 at the start of the financial year.
- Reducing eligibility age for downsizer contributions from age 65 to age 60 at the time of making the contribution.
- Increasing the maximum release amount from $30,00 to $50,000 under the First Home Super Saver Scheme.
- Removing the $450 per month income threshold for superannuation guarantee contributions.
- Providing choice to SMSF Trustee on their preferred method of calculating exempt current pension income where members have both accumulation and pension benefits for part, but not all, of the year's income.

NOT included in this Bill

The Federal Budget proposal to relax residency requirements for SMSF members and an amnesty for legacy pension products were not included in this Bill and are yet to be legislated.

Opportunities

This change may open opportunities for older Australians including:

- Cash-out recontribution strategies.
- Ability to make non-concessional contributions post-age 67 without having to meet the work test.
- Making downsizer contributions from age 60.
- Releasing up to $50,000 of previously made personal contributions from super to buy a first home.

Call us to find out more about how you could potentially benefit from these changes, or what actions may need to be assessed prior to 1 July 2022.

* The contribution must be received no later than within 28 days after the month in which the person turns 75.

Nigel Johnston and Johnston Financial Pty Ltd are Authorised Representatives of Lifespan Financial Planning Pty Ltd AFSL 229892

48 Fitzroy Street, Tamworth NSW 2340
P: 02 6766 8211
E: nigel@johnstonfinancial.com.au
W: www.johnstonfinancial.com.au

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superannuation
investment
insurance
advice