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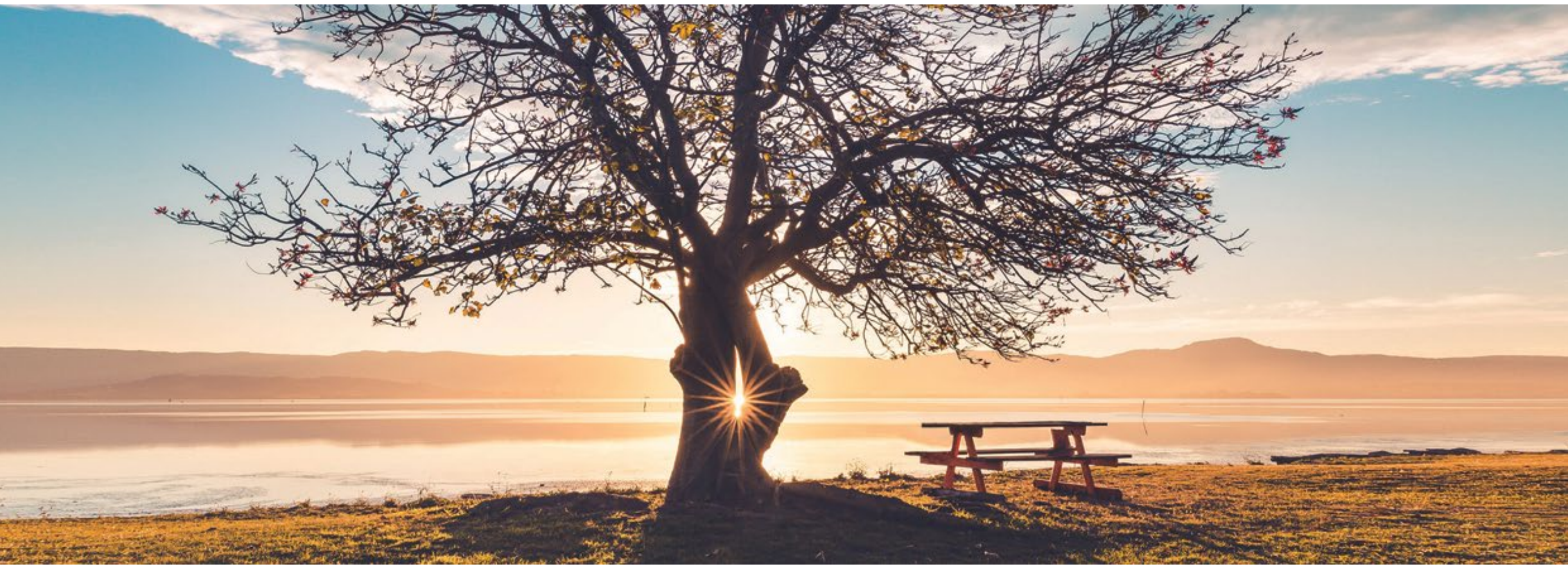

SEAFG Insights - June 2022

June has arrived and so has winter, as the financial year draws to a close. Now that the federal election is out of the way, it's time to focus on planning for the future with more certainty.

Cost of living pressures, inflation and interest rates were major concerns in the lead-up to the May federal election. The Reserve Bank of Australia (RBA) lifted the cash rate for the first time in over 11 years from 0.1% to 0.35%, as inflation hit 5.1%. This followed the US Federal Reserve's decision to lift rates by 50 basis points to 0.75-1.00%, the biggest rate hike in 22 years as inflation hit 8.5%. Global pressures are largely to blame, from war in Ukraine and rising oil prices to supply chain disruptions and food shortages. The price of Brent Crude surged a further 27% in May.

As a result, the RBA has cut its growth forecast for the year to June from 5% to 3.5% and raised its inflation forecast from 3.25% to 4.5%. On the ground, the economic news is mixed. New business investment fell 0.3% in the March quarter but still rose 4.5% on the year. The NAB business confidence index fell from +16.3 point to +9.9 points in April, still above its long-term average. Adding to inflationary pressures, labour and materials shortages and bad weather saw building costs rise 2.8% in the March quarter, while retail trade rose further in April to be up 9.6% over the year.

On the positive side, unemployment fell further from 4% to 3.9% in April, the lowest rate since 1974, while annual wages growth rose slightly in the March quarter from 2.3% to 2.4%, still well below inflation.

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A super end to the *financial year*

As the end of the financial year approaches, now is a good time to check your super and see what you could do to boost your retirement nest egg. What's more, you could potentially reduce your tax bill at the same time.

There are a handful of positive changes to super due to start next financial year, but for most people, these will not impact what you do before June 30 this year.

Changes ahead

Among the changes from 1 July, the superannuation guarantee (SG) will rise from the current 10 per cent to 10.5 per cent.

Another upcoming change is the abolition of the work test for retirees aged 67 to 74 who wish to make non-concessional (after tax) contributions into their super. This will allow eligible older Australians to top up their super even if they are fully retired. Currently you must satisfy the work test or work test exemption. This means working at least 40 hours during a consecutive 30-day period in the year in which the contribution is made.

But remember you still need to comply with the work test for contributions you make this financial year.

Also on the plus side, is the expansion of the downsizer contribution scheme. From 1 July the age to qualify for the scheme will be lowered from 65 to 60, although other details of the scheme will be unchanged. If you sell your home that you have owned for at least 10 years to downsize, you may be eligible to make a one-off contribution of up to $300,000 to your super (up to $600,000 for couples). This is in addition to the usual contribution caps.

Key strategies

While all these changes are positive and something to look forward to, there are still plenty of opportunities to boost your retirement savings before June 30.

For those who have surplus cash languishing in a bank account or who may have come into a windfall, consider taking full advantage of your super contribution caps.

The annual concessional (tax deductible) cap is currently $27,500. This includes your employer's SG contributions, any salary sacrifice contributions you have made during the year and personal contributions for which you plan to claim a tax deduction.

Claiming a tax deduction is generally most effective if your marginal tax rate is greater than the 15 per cent tax rate that applies to super contributions. It is also handy if you have made a capital gain on the sale of an investment asset outside super as the tax deduction can offset any capital gains liability.

Even if you have reached your annual concessional contributions limit, you may be able to carry forward any unused cap amounts from previous years if your super balance is less than $500,000.

Once you have used up your concessional contributions cap, you can still make after-tax non-concessional contributions. The annual limit for these contributions is $110,000 but you can potentially contribute up to $330,000 using the bring-forward rule. The rules can be complex, especially if you already have a relatively high super balance, so it's best to seek advice.

Government and spouse contributions

Lower income earners also have incentives to put more into super. The government's co-contribution scheme is aimed at low to middle income earners who earn at least 10 per cent of their income from employment or business.

If your income is less than $41,112 a year, the government will contribute 50c for every after-tax dollar you squirrel away in super up to a maximum co-contribution of $500. Where else can you get a 50 per cent immediate return on an investment? If you earn between $41,112 and $56,112 you can still benefit but the co-contribution is progressively reduced.

There are also incentives for couples where one is on a much lower income to even the super playing field. If you earn significantly more than your partner, ask us about splitting some of your previous super contributions with them.

Also, if your spouse (or de facto partner) earns less than $37,000 a year, you may be eligible to contribute up to $3000 to their super and claim an 18 per cent tax offset worth up to $540. If they earn between $37,000 and $40,000 you may still benefit but the tax offset is progressively reduced.

As it can take your super fund a few days to process your contributions, don't wait until the very last minute. If you would like to discuss your super options, call now.

Source: ATO

HOW TO MANAGE RISING INTEREST RATES

Rising interest rates are almost always portrayed as bad news, by the media and by politicians of all persuasions. But a rise in rates cuts both ways.

Higher interest rates are a worry for people with home loans and borrowers generally. But they are good news for older Australians who depend on income from bank deposits and young people trying to save for a deposit on their first home.

Rising interest rates are also a sign of a growing economy, which creates jobs and provides the income people need to pay the mortgage and other bills. By lifting interest rates, the Reserve Bank hopes to keep a lid on inflation and rising prices. Yes, it's complicated.

How high will rates go?

In early May, the Reserve Bank lifted the official cash rate from its historic low of 0.1 per cent to a still low 0.35 per cent. The reason the cash rate is watched so closely is that it flows through to mortgages and other lending rates in the economy.

To tackle the rising cost of living, the Reserve Bank expects to lift the cash rate further, to around 2.5 per cent.[i] Inflation is currently running at 5.1 per cent, which means annual wages growth of 2.4 per cent is not keeping pace with rising prices.[ii]

So what does this mean for household budgets?

Mortgage rates on the rise

The people most affected by rising rates are likely those who recently bought their first home. In a double whammy, after several years of booming house prices the size of the average mortgage has also increased.

According to CoreLogic, even though price growth is slowing, the median home value rose 16.7 per cent nationally in the year to April to $748,635. Prices are higher in Sydney, Canberra and Melbourne.

CoreLogic estimates a 1 per cent rise would add $486 a month to repayments on the median new home loan in Sydney, and an additional $1,006 a month for a 2 per cent rise.

The big four banks have already passed on the Reserve Bank's 0.25 per cent increase in the cash rate in full to their standard variable mortgage rates which range from 4.6 to 4.8 per cent. The lowest standard variable rates from smaller lenders are below 2 per cent.

Still, it's believed most homeowners should be able to absorb a 2 per cent rise in their repayments.[iii]

The financial regulator, APRA now insists all lenders apply three percentage points on top of their headline borrowing rate, as a stress test on the amount you can borrow (up from 2.5 per cent prior to October 2021).[iv]

Rate rise action plan

Whatever your circumstances, the shift from a low interest rate, low inflation economic environment to rising rates and inflation is a signal that it's time to revisit some of your financial assumptions.

The first thing you need to do is update your budget to factor in higher loan repayments and the rising cost of essential items such as food, fuel, power, childcare, health and insurances. You could then look for easy cuts from your non-essential spending on things like regular takeaways, eating out and streaming services.

If you have a home loan, then potentially the biggest saving involves absolutely no sacrifice to your lifestyle. Simply pick up the phone and ask your lender to give you a better deal. Banks all offer lower rates to new customers than they do to existing customers, but you can often negotiate a lower rate simply by asking.

If your bank won't budge, then consider switching lenders. Just the mention of switching can often land you a better rate with your existing lender.

The challenge for savers

Older Australians and young savers face a tougher task. Bank savings rates are generally non-negotiable, but it does pay to shop around.

By mid-May only three of the big four banks had increased rates for savings accounts. Several lenders also announced increased rates for term deposits of up to 0.6 per cent.[v]

High interest rates traditionally put a dampener on returns from shares and property, so commentators are warning investors to prepare for lower returns from these investments and superannuation.

That makes it more important than ever to ensure you are getting the best return on your savings and not paying more than necessary on your loans. If you would like to discuss a budgeting and savings plan, give us a call.

i https://www.rba.gov.au/speeches/2022/sp-gov-2022-05-03-q-and-a-transcript.html

ii https://www.abs.gov.au/

iii https://www.canstar.com.au/home-loans/banks-respond-cash-rate-increase/

iv https://www.apra.gov.au/news-and-publications/apra-increases-banks%E2%80%99-loan-serviceability-expectations-to-counter-rising

v https://www.ratecity.com.au/term-deposits/news/banks-increased-term-deposit-interest-rates

THE ROAD AHEAD FOR SHARES

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 has recently raised the official cash rate after 11 ½ years of no increases.

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.[iii]

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