



Making the most of the asset building years

During their 20s and 30s, most people focus on the basics of financial security. It's a time when many individuals commit to a long-term partner, start a family, put a deposit on their first home, start saving for retirement (even if it is via compulsory super contributions), and perhaps start thinking about personal investments.

By the time you reach your mid forties, things have usually changed quite a lot. You've progressed in your career and you'll typically see your salary and net worth steadily rising, along with your living expenses. More importantly, you are just about to enter your peak earning years, the time when your skills, dedication and experience often earn their maximum reward. In terms of building assets, these can be your golden years so it is important you plan to use them effectively.

Sorting out the options

This is a period of many options, and a few risks. Sylvia and Gerry's story raises a host of different possibilities and may help you think about your own journey.

Should you concentrate on paying off your mortgage? Reducing your tax? Building your personal investment portfolio? Making a career change? Investing for a more comfortable retirement? Or a combination of these strategies?

Coming up with the right answers means some serious thought about what your life and investment priorities are, and sitting down to talk with your adviser may help. The answers are different for each of us, and getting them right is the key to maximising the financial possibilities that these peak earning years present.¹

Sylvia and Gerry's story

Sylvia runs her own catering company which she has built from scratch while Gerry, also in his mid forties, is a structural engineer. The older of their two sons will be completing school next year.

Gerry was recently promoted and the boost to his salary package means they expect to have at least \$13,000 to save, invest or spend in the coming year. Gerry intends to continue salary sacrificing to build up his super fund which now stands at \$267,000 while Sylvia has accumulated \$22,000 in her fund. She plans to boost her super when she sells her catering business sometime after she reaches 55, or the boys have left home.

They believe their insurance cover is adequate; however, they ran down their modest cash reserves to support Sylvia's new business and have not got around to building that up again. They want to add at least \$15,000 if they can.

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Making the most of the asset building years continued

At the moment Sylvia and Gerry are happy to continue paying off their variable rate mortgage which is \$280,000 though they are not sure if they should be more aggressive in reducing that.

When Sylvia and Gerry sat down with their financial adviser, they brought along their list of questions on superannuation, savings and investments, though Sylvia was more interested in super while Gerry's focus was on building their investments.

Over several meetings, their adviser presented them with a number of scenarios, Sylvia and Gerry were able to weigh up the difference between paying down their mortgage with their surplus funds over time, and compare that option with salary sacrificing that same money into super. The adviser also indicated to Sylvia and Gerry the possible impact that fluctuating market conditions could have on their super balances.

They also determined the lump sum amount required if Sylvia and Gerry wanted to retire when Gerry reached age 65.

This information was a bit of a wake-up call, and gave some focus to their discussions about their preferred strategy. They decided the way forward was to pay down their mortgage with their surplus funds each year, with the surplus funds contributing to their managed investment portfolio. This allowed them to build their wealth inside and outside of super to bolster their retirement goals.

Putting your plans together

As this story suggests, there are many situations and options that people have in their asset-building years, at whatever stage they occur.

It is an important first step to take stock and develop your own 'shopping list'. It is often best to pause and decide what's really important to you, so you can harness the peak earning years and achieve important

financial goals. Help is at hand from your financial adviser who can also link you up with other professionals if required – but the decisions and the changes start with you.



Gen Ys: getting set for life

Emerging from life as a student presents a world of opportunities for Generation Y (Gen Y) to set up their financial future. And the early evidence is that Gen Ys are learning how to save and spend wisely.

A generation of savers

Though some think that Gen Ys are big spenders on depreciating assets such as holidays, iPads and cars, they are actually strong savers.

A recent survey¹ found 36 per cent of Gen Ys do not own a credit card or a store card, and almost 80 per cent report they are saving some money each month.

Saving, of course, comes down to budgeting: knowing your income and expenses. The first step is to work out your budget to make sure your income exceeds your expenses. The second step is to understand as much as possible about interest rates: how they can work for you, and especially how they can work against you.

Getting ahead, step by step

Building assets is not a single leap but a balancing act. It's about keeping debt under control while saving; and about taking some important steps now, with an eye to the future.

For Gen Ys with credit card debt, a good option is to clear it quickly as the interest rates charged are in the high teens.² This generally makes it a higher priority than Higher Education Loan Program (HELP) debt, which is only indexed at 3% and does not attract an interest penalty.

Online bank accounts are often a good place to start saving, with rates up around the 6 per cent mark.³

And as that money starts to build up you can think about investment options because investing is the key to building assets. The questions always are: what to invest in, and how to get started? Will it be in shares, property or a business?

This makes it essential to discuss your options with an adviser who can help you clarify your preferences and choices. And it is a good time to also discuss what insurance cover you need to protect your income and assets.

Finally, while it may be 30 years plus before you have access to your money,



superannuation is where the future vision kicks in. Have you kept track of all your super? If you've changed jobs, or done casual or part-time work, you may have lost track of some super. It is worthwhile making the effort to look for your lost or unclaimed super, as it could mean more money for you in retirement.

Getting a firm grasp of your financial affairs now can set you up for life.

- 1 REST survey, <http://www.superreview.com.au/news/superannuation/gen-y-must-adopt-long-term-saving-habits-rest>
- 2 <http://www.canstar.com.au/interest-rate-comparison/compare-credit-card-rates.html>
- 3 <http://www.canstar.com.au/interest-rate-comparison/compare-online-savings-account-rates.html>

Insuring the value of unpaid work in the home

The value of unpaid work in the home is often overlooked and can sometimes be forgotten when putting insurances in place to safeguard your family. If you have a partner who works part time or not at all and they are not insured, your family's future may not be as secure as you think.



Even if you or your partner do not earn any income, you both support the family. If a non-working parent dies or is disabled the family may need to increase spending on childcare, cooking, cleaning and other household tasks that were previously done out of love.

The cost of employing people to provide childcare and domestic services can easily add up to around \$600 a week, depending on the age and needs of your children. This needs to be taken into account when you sit down with your partner, and your financial adviser, to work out your family's total insurance needs.

The insurance gap

It is not hard to find a typical Australian family with life insurance needs of between \$750,000 and \$1 million, yet Rice Warner Actuaries¹ estimates that life insurance cover in Australia is 49 per cent less than it should be. Part of the reason for this gap in coverage is the underinsurance of non-working spouses.

Life insurance serves two main purposes; to pay off your debts if you die prematurely, and to leave a lump sum that can be invested to produce income for your dependents so they can continue to enjoy their current standard of living.

In addition to life cover, you also need to think about how your family would cope if you or your partner was seriously ill or injured. Even if you are the sole breadwinner

and think the family could continue to live on your income if your partner was seriously ill or disabled, you need to factor in the extra medical costs not covered by health insurance.

Income protection is recommended if you are in the paid workforce but it won't cover a non-working partner. However, total and permanent disability (TPD) insurance and trauma cover may fill that gap.

TPD policies typically pay a benefit if you are permanently unable to work in your own occupation, or any occupation. But some policies include a homemaker definition, allowing a claim if you are permanently unable to perform your regular domestic duties, leave home unaided, and require ongoing medical care.

Protection against serious illness

Trauma cover may provide an alternative to TPD for non-working spouses and pays a lump sum if you suffer a serious illness such as heart attack, cancer or stroke. Your policy will spell out exactly which diseases and conditions are covered.

Rice Warner estimates the overall insurance needs for young parents aged 35 with two kids on average household earnings are roughly \$750,000 of life insurance cover, \$670,000 TPD cover and \$4,500 a month of income protection.²

As a rule of thumb, Rice Warner estimates the cover for a partner who works part-time

or not at all should be roughly half that of the primary wage-earner, but the exact amount will depend on your income, age, number of children and lifestyle requirements.

Case Study – Joe and Kate

Joe and Kate are in their late 30s with three young children.

Joe is a manager at a large consulting firm and earns \$110,000 per annum, with comprehensive insurance coverage provided by his employer. His wife Kate is currently taking time out from her job as an events manager to look after their three small children.

While undergoing a routine examination, Kate was diagnosed with an aggressive form of ovarian cancer. Even with months of intensive treatment, the prognosis was not good. She fought every step of the way while her family prayed for a recovery. Tragically, she did not win her battle and died within a year.

While the couple understood the importance of insuring Joe as the primary provider, they had not considered insuring Kate's essential role as the homemaker. For Joe's family, the shattering loss of Kate was made much harder by the financial burden of paying someone to maintain the household and provide care for the children.

With a combination of life and critical illness insurances, a family like Kate and Joe's may have received a lump sum that could be invested and used to defray the increased costs over the coming years.

Discussions about illness, disability and death are often familiar territory for financial advisers, so you can have an open discussion about these issues. Your adviser understands your personal circumstances and can help you put a dollar value on your overall insurance needs so your family has every base covered, including home base.

¹ Rice Warner Actuaries "Underinsurance in Australia" Research Report (2011)

² Rice Warner Actuaries, *ibid*.

Investment lessons of a lifetime

Widely regarded as one of the most successful investors in the world, Warren Buffett is as famous for his wit as he is for the investment skills that have put him among the world's most wealthy people. But what can you learn from the insights that have made him so successful?

On investing when the market is falling:

Buffett says, "Most people get interested in stocks when everyone else is. The time to get interested is when no one else is. You can't buy what is popular and do well."¹ One of his most famous quotes of all: "Be fearful when others are greedy, and be greedy when others are fearful."²

On value investing:

"It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price" or, more succinctly, "Price is what you pay. Value is what you get."³

"Be fearful when others are greedy, and be greedy when others are fearful."

Buffett's advice is to invest in the future of the business: "If a business does well, the stock eventually follows." He studies annual reports in detail, but warns that "Managers and investors alike must understand that

accounting numbers are the beginning, not the end, of business valuation"⁴ and, with typical Buffett cynicism: "I try to buy stock in businesses that are so wonderful that an idiot can run them. Because sooner or later, one will."⁵

"The investor of today does not profit from yesterday's growth."

On timing the market:

Buffett is a long-term investor. As he says of shares, "Our favourite holding period is forever."⁶ He freely admits that he has "... no idea of market timing. It's easier to tell what will happen than when it will happen,"⁷ and adds that "The fact that people will be full of greed, fear or folly is predictable. (But) the sequence is not predictable."⁸ He also agrees it is deceptive to judge future performance by events of the past, pointing out that "The investor of today does not profit from yesterday's growth."

These are not just pithy quotations.

Buffett has revisited and expanded these themes many times. He attributes his wealth to sticking with the investment basics – value investing in the shares of quality companies while making a long-term commitment, and staying with the market through good and bad times rather than trying to pick the market's rising periods.

When it is boiled down, Buffett's most valuable secret is no secret at all. Sticking with it is the secret.

- 1 <http://warrenbuffettnews.com/top-20-quotes-from-warren-buffett/>
- 2 <http://www.theinvestorsjournal.com/be-greedy-when-others-are-fearful>
- 3 <http://www.stockwatch.com.au/articles/fundamental-analysis/warren-buffett.aspx>
- 4 The Essays of Warren Buffett : *Lessons for Corporate America* (2001), p. 183
- 5 <http://www.marketfolly.com/2009/09/top-25-warren-buffett-quotes.html#ixzz1p4BDcmKt>
- 6 <http://stockmarketinvesting.com.au/Buying-for-Dividends.html>
- 7 *ibid*
- 8 <http://www.marketfolly.com/2009/09/top-25-warren-buffett-quotes.html#ixzz1p4BDcmKt>

News bites

Health insurance rebate changes as of July 2012

As of 1 July 2012, eligibility for the private health insurance rebate will be income tested.

The changes will proportionally lower the private health insurance rebate for those in higher income tiers as well as increasing the Medicare levy surcharge for individuals on higher incomes who do not have a complying private health insurance policy.

In the 2012/13 financial year, single people earning more than \$130,000 per annum and families earning more than \$260,000 will lose the private health insurance rebate entirely. Individuals earning \$84,000 or less, and families earning \$168,000 or less will not be affected by the changes. However the Medicare levy surcharge will increase in 0.25 per cent increments to a maximum of 1.5 per cent depending on an individual or family's income for those without complying health insurance.

Higher income earners will be directly impacted by these changes and may consider pre-paying their private health insurance premiums in the current financial year to ensure they will receive the 30 per cent rebate.

Life expectancy increases for Australians

Over the past decade Australia has seen significant increases in life expectancy. Males are expected to live an extra three years on average, as estimated by the Australian Bureau of Statistics. These increases have been partly due to lower infant mortality, fewer young people dying in motor vehicle accidents, and fewer older men dying from heart disease.

In Victoria, a baby boy born today can expect to live up to 80, up from 77 just a decade ago and a baby girl can expect to live up to 84.3 up from 82.3. Other reasons for increasing life expectancy have been attributed to improving social conditions and advances in medical technology such as mass immunisation and antibiotics.

Demographer Peter McDonald of the Australian National University, attributes the closing of the gap to healthier lifestyles, less smoking, less drinking and far fewer motor vehicle accidents. But increased life expectancy and population growth has considerable implications for government spending on health, age related pensions and aged care, and the workforce's ability to maintain current levels of economic growth.

The number of years spent in the workforce as well years out of the workforce, means planning your future is even more critical to ensure that you have enough support in retirement.

The rise of Australia's wellbeing

A World Bank Report recently estimated Australia's wealth at \$16.3 trillion, of which \$12.1 billion is intangible or human capital.

Intangible wealth measures the immaterial, the unseen and the not easily quantified (for example, levels of confidence, honesty or integrity). Ultimately to increase our wealth we must become more aware of ourselves, our society and our surroundings.

The World Bank economists quantify intangible wealth by the value of education, social institutions, the nation's stock of physical, natural and human capital, along with changes in health, income equality and job satisfaction.

The report found that Australia's wellbeing had increased faster than gross domestic product thanks to the boom in commodity export prices and the development in the combined knowledge of our people.

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