Walden Financial Planning

Insights and Investment Solutions magazine

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Welcome

In this edition of Insights and Investment Solutions magazine, we look at what's happening in local and international markets, delve into the detail on accessing your super when you're planning to retire and we share some tips on reviewing your self-managed super fund investment strategy.

Until next time – happy reading.

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Market update

Fears are growing that COVID-19 will become a pandemic and will be the trigger for the world to fall into recession. The Australian dollar hit an 11-year low over February while the US S&P 500 fell at a pace not seen since the GFC, losing 11.5%. Global bond yields also hit new lows by month-end.

The coronavirus (COVID-19) outbreak has sent shockwaves across financial markets worldwide with increasing levels of uncertainty and misinformation evident across multiple regions. Outbreaks in Iran, Italy and South Korea have raised concerns of the spread increasing outside of China definitely growing. Chinese authorities reacted by enforcing quarantine conditions across many provinces, including tourism and travel restrictions.

Prime Minister Scott Morrison declared COVID-19 will become a global pandemic, and has further extended its travel ban on Chinese visitors. Morrison announced a health emergency response plan and opens the door to economic stimulus for the education and tourism sectors.

Domestically, the RBA kept the cash rate at a record low of 0.75% at its February meeting, the first of 2020. A clear theme amongst the minutes of the RBA's meeting was the uncertain times facing RBA policymakers and acknowledged COVID-19 was still evolving.

Australian construction activity was weaker than expected in Q4 with construction falling 3%. CoreLogic data showed dwelling prices recorded strong gain across in February. Sydney and Melbourne prices rose 1.7% and 1.2% respectively. Continued strong population growth and ultra-low interest rates are underpinning the demand for housing with expectation of higher dwelling prices over the year.

US ISM manufacturing index dipped 50.1 in February. Businesses slowed to a crawl as supply bottlenecks tied to COVID-19 impaired their ability to get parts. US GDP remained unrevised at an annualised rate of 2.1%. Underlying demand was slower than expected.

The UK Prime Minister, Boris Johnson told the EU he'll walk away from talks in June if it's not clear he's going to get a Canada-style free trade agreement for the UK. Johnson has rejected European demands to submit to independent oversight of Britain's laws. British chancellor, Sajid Javid, resigned weeks before the scheduled annual budget statement.

The Australian economy is beginning to feel the impact owing to its close trading partnerships with China on the back of fears COVID-19 may not be able to be contained. The AUD fell to its lowest levels since the GFC, hitting US65.44c before bouncing at a close of US65.56c at month close. Commodity prices trended lower with risk aversion increasing, amid COVID-19 and resultant global growth slowdown risks.

The Australian share market saw a 10% fall over the final week of February. No sector was spared as investors took profits from the previous period of strong market returns, which was also met with panic selling, causing low buying support for 'fair value stocks'. Blue chip stocks were hit hardest, with technology and energy sectors following suit. The bond markets continued to reflect pessimism with yields on the 10-year Treasury bond fell 1.08%. The drop, driven by rising bond prices is an indication that investors are looking for a safe haven for their savings.

Information current as at 29 February 2020.

Accessing super when you retire - accumulation to pension phase

If there comes a time when you decide to move your super account from the accumulation to pension phase, it is important to know some key facts before accessing your super.

Do I have to fill out any forms? Do I have to notify my super fund?

Once you stop working, your main (possibly only) source of income also ceases. Your superannuation benefits which have been accumulating during your working life, via contributions made by your employer (and possibly additional contributions made by you, your spouse or the government), are now potentially accessible to you, subject to meeting certain conditions[1]. Your super fund will need to be notified, and they will have a range of forms that can facilitate the next steps.

You may want to consider seeking advice from a qualified professional when thinking about accessing super, as they will be able to assess your personal situation and provide appropriate financial advice to you.

Do I have to transfer my super to a pension account?

When a person retires after reaching their preservation age[2], they can request their superannuation monies to be moved to an account-based pension structure. In other words, they can request their superannuation to be moved from accumulation phase, to drawdown (or pension) phase.

Transferring superannuation from accumulation phase to pension phase is not compulsory. However, there may be some tax advantages to transferring your super from an accumulation account to an account-based pension.

Does the tax rate on my super change?

Investment earnings on your super in accumulation phase is generally 15%. If and when your super monies are converted to an account-based pension account or a transition to retirement pension account in the retirement phase, the tax rate on investment earnings reduces to zero. Note that depending on your age when you are drawing down a pension, you may still incur tax on the actual pension payments (if under age 60). Once you turn 60, all drawdowns are tax free in your hands.

How do I take out money? Can I take as much as I want out as often as I like? Are there rules and restrictions in accessing super?

Once you have reached your preservation age and have ceased all paid employment, there are no restrictions on the maximum amount that can be withdrawn from a super or pension account.

The rules do however specify:

– a maximum amount that can be transferred to a pension account, currently set at a maximum of $1.6 million across all pension accounts you may have (anything above this can either be withdrawn from the super system or remain in an accumulation phase account and be subject to the concessional 15% tax rate on earnings), and

– a minimum drawdown requirement for monies held within a pension account, which starts at 4% of your account balance at commencement and each 1 July thereafter, if aged under 65.

As you get older, the minimum percentage increases gradually. A pension is a zero tax structure but you are required to withdraw a proportion of your accumulated savings, to be able to continue to enjoy the concessional tax treatment it receives.

If you draw down an amount above and beyond your personal requirements, you are likely to accumulate monies in your own name, for which you will be personally liable to pay tax on any earnings that are derived. As a result, it might make sense to only drawdown what you require (or are obliged to draw down).

Is it a good time to change my investment strategy?

This should be part of the broader discussion with your advice professional, but generally speaking, when people move from 'accumulating' capital for their retirement to 'drawing' on their capital, this usually coincides with a "re-setting" of a person's asset allocation, as part of their overall investment strategy.

Typically, moving to 'retirement' sees a reduction in the proportion of growth assets such as shares and property within a person's super portfolio, and an increase in defensive assets such as cash and fixed interest.

The reason is because you are now selling assets to fund pension drawdowns and as a result, the investment timeframe for a portion of these accumulated monies is in the short to medium term, and as a consequence, the importance of allocating them into suitable assets.

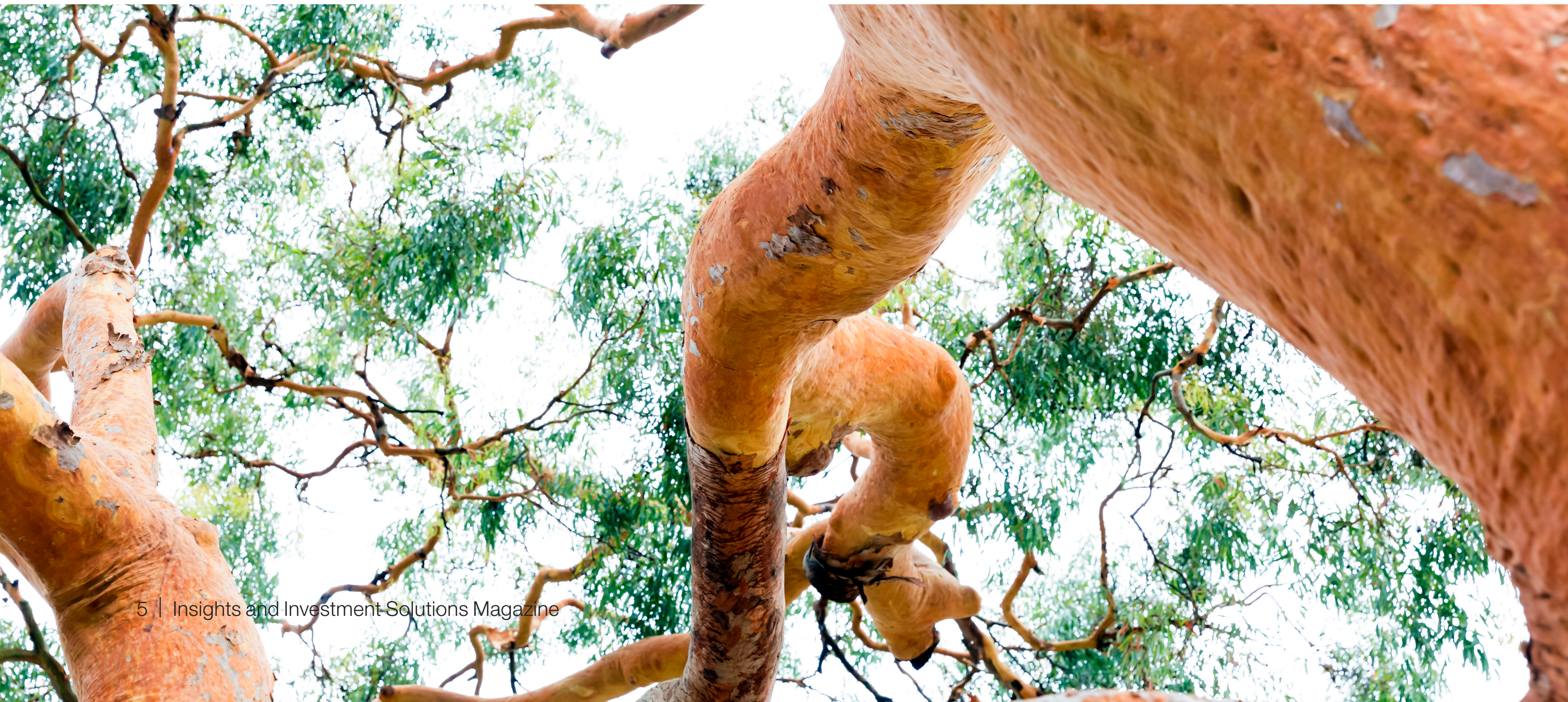
What happens if I retire and start accessing super and then change my mind and go back to work?

Whilst a declaration of genuine intent to cease all gainful employment after reaching your preservation age will potentially make accumulated super monies available, this does not mean you are ever prevented from returning to work. Changing one's mind (for whatever reason) and returning to work will not reverse the above process, although it does potentially mean that new contributions to super are preserved until you satisfy (or re-satisfy) a new 'condition of release'.

In summary, it is recommended that professional advice is sought from a suitably qualified adviser, as this will mean your superannuation savings are within the appropriate structure and have the right investment mix to help you through your retirement years.

1 The ATO has a useful summary on the circumstances in which you can access your super.

2 Your preservation age is based on your date of birth. Your preservation age can be found here: https://www.ato.gov.au/Individuals/Super/In-detail/Withdrawing-and-using-your-super/Withdrawing-your-super-and-paying-tax/?anchor=Whenyoucanaccessyoursuper



How to review your SMSF investment strategy

It's a good idea for SMSF trustees to revisit finances with an eye to reviewing their SMSF investment strategy from time to time.

The question is: what is a good investment strategy? Unfortunately, there is no simple answer.

Super law does set out some requirements that trustees of regulated super funds need to consider when formulating an investment strategy, including (but not limited to) the composition of investments, risk and return, liquidity, insurance and the ability to pay liabilities (including member benefits) as they become due.

Looking first at the composition of investments, there isn't a requirement that SMSF investments must be diversified, and there are some SMSFs that have large investments in a single asset or asset class. Most commonly this occurs where the SMSF has a direct property investment, with a comparatively smaller investment in cash in order to make relevant payments as necessary.

Whether or not this approach is right is a question for the trustees of each SMSF to determine for themselves, but the old saying of "not putting all your eggs in one basket" is worth considering. Using this example, what would happen if the property market was to fall? Do you have enough time to ride out fluctuations and get your money back? This points to the next consideration of risk versus return.

With any investment decision, a consideration of the risk involved in a particular investment balanced against the potential returns or reward should probably be undertaken. Of course, these are both forward looking. History may tell us a little about the risks and returns for particular investments over a period of time, but there are no guarantees about what will happen in the future. This is why it's usually important for SMSF trustees to spend some time making an assessment of these important characteristics.

However, it is unlikely that a consideration of risk and return is just limited to the actual investments themselves. Often the best starting place is what the SMSF trustee's risk and return parameters are. If the market was to fall by 10 per cent, how long would they be willing to stay invested in the same asset to recover the capital? This can help determine how much risk the SMSF trustee is willing to take on. And this consideration may not be about a particular investment, but rather the composition of all the assets in the SMSF. How much to allocate to growth assets (which usually have higher risk) compared to how much to invest in more stable investments (which are generally subject to less volatility).

Risk may only be one side of the equation – return may be equally as important to consider. In fact, given one of the key objectives of super is to grow wealth towards retirement, generating an appropriate level of return is important, and invariably involves taking on some element of risk.

Another requirement may be liquidity and the ability to pay liabilities as and when they fall due. There is no doubt that you need to be able to pay for the ongoing running costs of your SMSF, but consideration of liquidity takes on heightened importance as members approach retirement. With super used to fund members' retirement lifestyles, the need to ensure there is sufficient liquidity is arguably more important, and will involve a consideration of how much should be held in cash (or other liquid investments) and how much should stay invested in less liquid investments to provide for future potential growth in the SMSF.

SMSF trustees are also required to consider the insurance needs of members in formulating the investment strategy. Given that quite often the trustees of an SMSF are also the members of the SMSF, this is about considering whether you have sufficient insurance of your own, and if not, whether you should acquire more cover through your super.

Depending on the type of investments in your SMSF, you should also consider if you need the fund to take out other types of insurance. This could be an important consideration if you hold property.

So what makes a good SMSF investment strategy? It's likely one that aligns to the future goals of the members (the trust deed should cover this) and what they are trying to achieve, and ensures this is done with appropriate consideration of the risks in achieving these goals. It should also comply with super legislation and the sole purpose test.

Finally, while the start of a new year is an opportune time to review the investment strategy for your SMSF, don't forget that it's a requirement for trustees to do so on a regular basis.

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