YOUR PERSONAL WEALTH

SUMMER 22/23

WELCOME TO SUMMER

As we head into our summer break, whilst there has been some good news out of the US with the October CPI coming in slightly lower than expected, the jury is still undecided as to whether we're out of the inflationary woods yet.

With the interest rate hikes combined with cost of living increases, many are feeling the pinch and cutting back on their festive season plans. **With us by your side, you can be more confident about reducing the potential impact of these pressures on achieving your financial goals, and enjoy your well-deserved holiday season!**

How are your holiday plans rating?	2	Are investment bonds worth considering?	3
Achieve success through Atomic Habits	4	Would you like fries with that?	4

MARKETS RALLY ON SOFTER INFLATION

The US October CPI came in at a lower-than-expected annual increase of 7.7% (the expectation was 7.9%), and triggered a big rally in stocks as well as bonds. The S&P 500 rallied well over 10% to be out of bear market territory, however, it is still down around 17% from its high. Meanwhile, the tech-heavy Nasdaq remains in a bear market, with a loss from its peak of around 30%. (Bear market is generally defined as a prolonged market drop of 20% or more from recent highs). The US 10-year Treasury yield is trading around 3.8%, down from its October high of 4.3%.

The US dollar index fell by over 7%, as the Australian dollar has rebounded over 8% from its 2½-year low of US61.69¢. All this is mostly as a result of inflation having likely peaked and markets anticipating that future US Fed rate rises will be smaller than the recent string of 0.75% rises and that the peak in interest rates may be lower than expected. The Australian dollar has also been helped by China's apparent softening of coronavirus restrictions, and a subsequent rise in the price of economically sensitive commodities such as copper. Higher commodity prices and stronger growth almost always benefit the Aussie dollar.

Are we out of the woods?

We would urge caution as the jury is still very much out on whether this is just another bear market rally or if we are in the clear from here.

Firstly, the US Core CPI (which excludes food and energy) remains very elevated at 6.3%. It is only marginally down from the 40-year high in September of 6.6%, and a long way from the 2% target.

Secondly, every time markets have become exuberant, there has been no shortage of Fed officials hosing down expectations. The reason the Fed does not want rapidly rising equity prices is that this represents an easing of financial conditions and this makes it harder to combat inflation.

6.6%
US Core CPI Sept 22

6.3%
US Core CPI Nov 22

2%
US Core CPI Target

CONTINUED ON PAGE 2

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Thirdly, monetary policy operates with variable lags. So, with the Fed having quickly raised rates, much of this has likely not impacted the real economy yet. These lags mean that the chances of tightening too much are very high based on historical outcomes, with the probability of a hard landing far exceeding that of a soft landing for the US economy.

Where to from here?

If the Fed is going to keep rates high for a lengthy period, current estimates for S&P 500 are likely too high if the economy slows. Earnings estimates in the US have actually been falling, it is energy stocks that are masking that trend.

There is a risk interest rates will continue to go higher. Longer term we believe the Aussie should trade in the 70’s rather than the current 63 US cents.

We are still not comfortable enough to add to growth assets as we are expecting a downgrade cycle in stocks as economies slow down, particularly after the strong rally we have had. We believe we are approaching the top of the trading range for stocks and if it were to go much further, valuation becomes an issue in the US (which is over 60% of the global index).

We would continue to be patient in this market and look to take advantage of opportunities that will likely arise in a very volatile market.

HOW ARE YOUR HOLIDAY PLANS RATING?

It might have taken several months but interest rate rises are impacting many Australians' holiday season plans. Many are feeling the pinch of higher repayments, combined with an increasing cost of living. With discretionary spending squeezed, holidays and Christmas gifts are often first to go.

The Reserve Bank of Australia (RBA) started increasing the cash rate in May, as an attempt to slow down rising inflation. This had seen seven consecutive cash rate rises by mid-November, with the cash rate then at 2.85%. According to an October survey by the Lendi Group, more than half (56%) of all mortgage borrowers had not anticipated the cash rate to rise beyond 2.5%.

YouGov research conducted in late October also noted rate rise stress is seeing “half of Aussies change their holiday plans”, with 28% or nearly three in 10 households already admitting they have cancelled their upcoming festivities and holidays. Overall, the data revealed 7 in every 10 households have been forced to reduce spending on holidays and gift buying this season.

Interestingly, Millennials (84%) were most concerned about the impact on their seasonal plans, followed by Gen X (73%) and Baby Boomers (50%).

This comes as data has revealed half a billion in ‘lazy loans’ are left untouched by their owners over the past five years. This accounts for a quarter of the $2 trillion outstanding in the mortgage market across Australia. Around $130 billion worth of fixed-rate loans are due to expire from mid-2023. This will leave many households facing significantly higher repayments as soon as their current fixed rate term ends.

With a financial planner by your side helping you make better short-, medium- and long-term financial decisions, you can be more confident about reducing the potential impact of these fluctuations on achieving your financial goals, and enjoy your holiday season!

ARE INVESTMENT BONDS WORTH CONSIDERING?

Popular in the days before compulsory superannuation, investment bonds fell out of favour as super became the preferred tax-advantaged environment. **Investment bonds can be a cost-effective, tax-effective, and convenient way to pass on your wealth**, and with tighter restrictions on super contributions and increased market uncertainty, bonds might be worth a fresh look.

Investment bonds (also known as insurance bonds) are a combination of an investment portfolio and a life insurance policy. Available from a range of providers, investors can choose from a suite of underlying investments in much the same way as regular managed funds. Investment bonds shouldn't be confused with interest-paying government or corporate bonds. They are a unique type of asset offering a range of advantages.

Tax advantages

The primary attraction of investment bonds is that earnings are taxed in the hands of the issuing company at a rate of 30%. Unlike traditional investments, bonds are a 'tax paid' investment. Provided the bond is held for more than 10 years no further tax is payable when the bond is cashed in.

While 30% is more than the 15% tax rate that applies to superannuation, it is less than the marginal rates of 34.5 to 47% (including Medicare levy) that apply to people with an annual taxable income above $45,000. The higher your marginal tax rate the more attractive investment bonds become.

What's more, investment bonds don't lock up your money for the long term as super does. You can access your money, though you do need to be aware of some rules, particularly if you are looking to access it in less than 10 years.

Bonds can be purchased with a single lump sum or with regular additions. However, to keep the original start date, an annual contribution cannot exceed 125% of the previous year's contribution. If it does, the clock starts again for the 10-year rule. Another option is to simply purchase a new bond.

Additional benefits

Insurance bonds can be useful estate planning tools, or they can help with long-term saving for big-ticket items such as education. Investment bonds let you invest on behalf of a child (or grandchild). As a form of life insurance, if the owner dies the proceeds will be paid directly to nominated beneficiaries. The money doesn't go through the estate and can be paid out quickly. In addition, the proceeds are not taxable in the hands of the beneficiaries, even if the bond is less than 10 years old.

Allowing for relevant tax rates, they may also be a good vehicle for saving for a child's education or another long-term goal.

Timing

Due to their long-term nature, it isn't just your current marginal tax rate that is important; it's what your rate will be in the future. As many retirees pay little or no tax, particular consideration needs to be given to purchasing a bond that will be held until after retirement.

Suitability

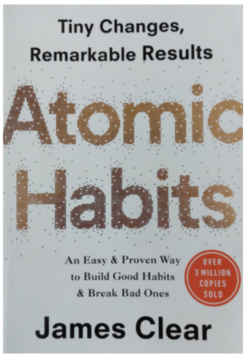
Investment bonds aren't for everyone, but they may suit investors who:

- have reached their concessional cap for super contributions;
- do not wish to lock away their money in super;
- are saving for a long-term goal and have a marginal tax rate above 30%;
- have specific estate planning needs.

There is much more about investment bonds than we can cover here. As with any type of investing, there are risks involved with bonds and these must be considered. Contact us if you would like to learn more.

ACHIEVE SUCCESS THROUGH ATOMIC HABITS

"Successful and unsuccessful people often share the same goals. It's only when you implement a system of continuous small improvements that you can achieve a different outcome".



Habits are like the atoms of our lives, each one a fundamental unit that contributes to your overall improvement. At first, they may seem insignificant, but over time the compound effect gathers pace, and a simple and easy regular practice, routine, or habit becomes the source of incredible power. Quite literally, you become your habits.

It doesn't matter how successful you are right now. What matters is whether your habits are setting you on the path to success. Your current trajectory is more significant than your current results. If you're a millionaire spending more than you earn each month, your trajectory will not end well. Conversely, if you're broke but managing to save a little each month, you're consistently improving your position, even if it's not as quickly as you'd like.

Whilst goals are good for setting a direction, it's the systems you implement that enable you to progress toward that direction. If you want better results, then focus on your systems (or habits). In life, you do not rise to the level of your goals, you fall to the level of your systems.

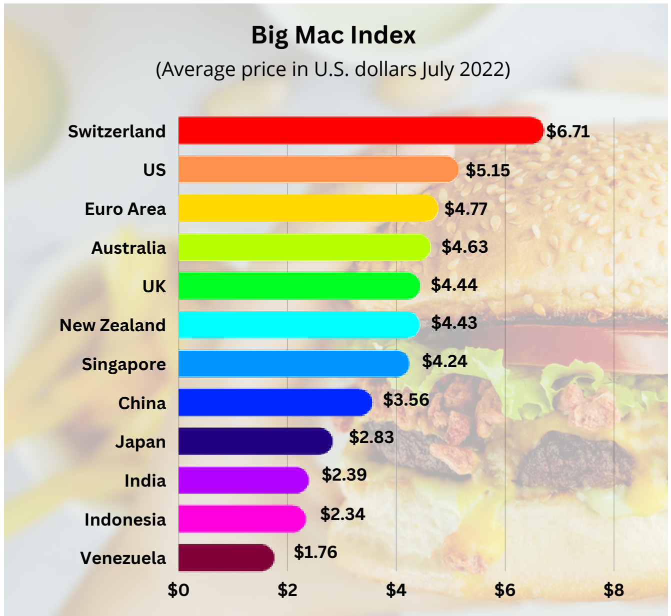
Want to know more? Grab yourself a copy of James Clear's 'Atomic Habits'. With over three million copies sold, James outlines a revolutionary way to get 1% better every day. **These small changes can have a transformative effect on your career, your relationships, and your life.**

WOULD YOU LIKE FRIES WITH THAT?

Invented by The Economist in 1986, the **Big Mac Index** was designed as a light-hearted attempt to make exchange-rate theory easier to digest!

It's based on the theory of purchasing-power parity (PPP), which implies that exchange rates are determined by the relative value of goods that each currency can buy, equalizing the purchasing power. These differences in local prices for the relatively consistent and widely available Big Mac, can suggest what the exchange rate should be. These figures are also adjusted to account for the cheaper labour costs in poorer countries. The idea is that you can estimate how much one currency is under or over-valued relative to another, by comparing the relative price of burgers in two countries, against the actual exchange rate.

Alternatively, it's a fun way to find out how much a burger is likely to cost when you go on your next international holiday!



If you're interested, you can read more here, "Dollar-euro parity may be justified. But the yen looks cheap as chips".

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