Financial Momentum

Autumn 2016

After a sizzling end to summer we can now look forward to some cooler weather. Autumn is a perfect time of year to get back into the garden or to simply make the most of the great outdoors before winter arrives.

On the economic front, the outlook for Australia is still a case of two steps forwards, one step back. The latest profit reporting season was a case in point. Qantas posted a record half year profit of $921 million before tax in the six months to December, making 2015 the national carrier's best year in its 95-year history. While cheap oil put the wind under Qantas' wings, it helped drag BHP Billiton to a US$7billion operating loss in the December half. This prompted a cut in interim dividend from US62c to US16c a share.

There were also mixed signals from the broader economy in February. Consumer sentiment bounced back with a 4.2 per cent rise according to the Westpac/Melbourne Institute Consumer Confidence survey, despite sluggish wage growth. Annual wage growth fell 2.3 per cent to an 18-year low in 2015. New business spending on buildings and equipment also fell last year, by 16.4 per cent. Even more troubling was an 18 per cent drop in business expectations of future investment. This is despite historically low interest rates and the lower Australian dollar which is hovering around US72c.

On the upside, with official interest rates at 2 per cent the Reserve Bank still has some firepower left if it chooses to cut rates further this year to help stimulate the economy.

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Profiting from cheap oil

Low oil prices have weighed heavily on global markets in 2016, with investors and pundits alike unsettled by the speed and size of the fall. But where there are losers there are also winners, depending on whether you are a producer or a consumer of what was once hailed as black gold.

From a high of US$145 a barrel in 2008, the price of West Texas Intermediate, America's benchmark oil price, has dipped below US$30, its lowest level in 13 years. Crude oil prices have fallen by over 70 per cent since mid-2014.

To understand why this is happening, you need to start with global supply and demand.

Supply and demand

The collapse in oil prices is due mostly, but not exclusively, to oversupply. When oil was fetching more than US$80 a barrel there was a great incentive for the United States to boost production of shale oil, gas and coal to reduce its energy dependence on OPEC.

By 2015, US daily oil production overtook that of Saudi Arabia, putting downward pressure on prices. But rather than turning off the taps to prop up prices, as you might normally expect, OPEC responded by abandoning output quotas to protect market share and drive higher-cost producers out of business.

Then just as it seemed prices couldn't go any lower, the US lifted trade sanctions against Iran, a major oil producer. Uncertainty about how much oil Iran will export is helping to keep prices low.

In February, Saudi Arabia and Russia moved to freeze output at current levels. Iran supported the move, but only after it increases output to levels achieved before the imposition of trade sanctions in 2012.

Another factor weighing on the oil market is weakening demand due to the sluggish global economy. All of which adds up to oil prices staying lower for longer.

Relief at the pump

Some of the biggest winners from lower oil prices are motorists. In Australia, the wholesale price of unleaded fuel has fallen to around 96c a litre, its lowest level in seven years. While petrol retailers can be tardy in passing on lower prices, the national average price of unleaded fuel has been as low as $1 a litre in some capital cities this year.

According to CommSec, the average household is saving around $56 a month on filling up the car with petrol compared with June last year. That's equivalent to half a percent rate cut on a $180,000 mortgage.[i]

Any savings on petrol leaves more in the wallet for other spending. It also helps keep a lid on inflation and provides a boost to consumer confidence, which is good for business and good for the economy.

Market volatility

On the downside, the rapid fall in oil prices has contributed to sharemarket volatility.

With little sign of a rise in oil prices in the near future, global investors are becoming increasingly nervous about the potential for some of the more marginal energy producers to default on their loans. This would put pressure on banks, one of the reasons bank stocks have been heavy sold in recent months.

On the ASX, the energy sector was down 36 per cent in the year to mid-February, compared with a fall of 13.6 per cent for the broader market. Major oil and gas producers such as BHP Billiton, Woodside Petroleum and Santos have all been hit hard.

Oil price winners

Yet despite all the gloom and doom, there are a number of market sectors and companies that stand to benefit from lower oil prices.

Aviation and transport companies have been major beneficiaries of cheap oil. Qantas and Virgin have both lifted profits while ratings agency S&P recently upgraded Qantas' credit rating. Competitive airfares are also good for tourism-related businesses.

While the oil market is stuck in an arm-wrestle between producers, the outook for oil prices will remain uncertain.

If you would like to discuss the contents of this article in the context of your portfolio, please give us a call.

i 'Petrol at 7-year low', CommSec Economic Insights, Feb 22, 2016, https://www.commsec.com.au/content/dam/EN/ResearchNews/ECO_Insights_150216.pdf

HAVE YOUR KIDS GOT IT COVERED?

Just because your children are adults, with good jobs and maybe even married with children of their own, it doesn't mean they shouldn't be considered in your retirement plans.

Family is a risk that many don't consider when planning for retirement. After all, you probably have little or no debt now the kids are independent and you are retired or close to retirement. Hopefully you feel you have enough money saved to live the retirement lifestyle you looked forward to as you worked to raise your family.

However, unforeseen circumstances and emergencies can impact wealth. What if something were to happen to one of your adult children and they are not sufficiently insured, then who are they going to call? In most cases, it's you. Few parents would turn their backs on their children in a crisis.

Protecting loved ones

Let's say the unexpected were to happen and your son-in-law passed away tragically in his late 30s, leaving behind your daughter and two small children. If he had insufficient life insurance, your daughter could find herself struggling to pay the bills on her own.

Most likely you would step up to the plate to offer financial help, or invite your daughter to move back home with her children. All of a sudden, your travel and retirement plans are on the back burner and your well-earned nest egg may start to erode.

In contrast, if your son-in-law had made sure he had sufficient insurance cover, it would be a different story. Of course, you would still need to deal with the emotional trauma of your daughter becoming a young widow, but at least you would know she had sufficient funds to support her family.

Start a conversation

It makes sense to have a conversation with your children to make sure they are adequately covered. You are not only looking out for them but also ensuring that your life plans stay on track, given that it is a time when it would be difficult for you to recover financially.

Life insurance, total and permanent disability, income protection and trauma cover are all insurances about which your children should consider seeking professional advice. For many, life and TPD insurance can be bought through super although it's important to make sure it provides sufficient cover to meet expenses such as funeral costs, mortgage/ rental payments, education, groceries, and recreation.

If your children are concerned about the cost of premiums, you might consider sharing the cost with them.

Even if your children have not yet started a family – perhaps they are still living at home in their 20s – a similar situation might arise. For instance, if they were to face a serious illness or a permanent injury, who would pay the medical bills? If they can no longer earn, the money has to come from somewhere.

Look after their health

It's not just life insurance you need to consider. Health insurance is also important for your adult children. Many health funds no longer cover children as part of the family premium once they reach a certain age.

Generally speaking, they will be covered up to age 25 while they are a full-time student. If not, their cover may cut out from age 18. Yet if they are injured, private cover may be necessary to get speedy access to treatment and it may be left to you to foot the bill.

If your independent child is under 25 you may be able to pay an additional premium to include them on your family private health insurance. This might be cheaper than them taking out their own private health cover.

Protect your retirement

It's easy to say you don't need life insurance once your debts are under control and to an extent this might be true. But your children may still be at the stage of life when they need full protection.

Make a time to chat to them about what cover they have and whether they think it is enough for their needs. If they are unsure, speak to us as we can assess their requirements and provide them with guidance.

Beat the INFORMATION overload

It's 2016. We're well and truly in the digital era. Statistically speaking[i], you probably not only have a desktop computer, but a laptop and a smart phone too.

You, along with most Aussies, are more connected than ever before. Whether that's a good thing is up for debate. For business, socialising and entertainment, the answer is maybe. Running your business or staying in touch with loved ones on the go has definite measurable benefits for your physical and mental health, as well as your bank balance.

But when it comes to financial information on the internet, the answer is less clear. Some commentators suggest that there is too much data, reporting and opinions online for the average person to process. Over a certain threshold, you simply can't use or act on every piece of information you can access.

This is financial information overload.

Is online information making us financially smarter?

In a word, no.

Behavioural finance (yes, that's a thing) academics have investigated this issue in depth[ii]. Financial information overload leads us to be passive, or to simply make bad decisions. In this instance, 'passive' means taking the default option, such as a default super fund option. And a bad decision can be anything from choosing a product that offers suboptimal returns, to losing a significant amount of money.

There are a few different reasons why this happens. First, there's the sheer quantity of information available. It is literally impossible to read everything that might be applicable to your financial situation. Second, there are often too many options to choose from. There are a myriad of ways to reach your financial goals, and products upon products at your disposal.

Beware of bias in financial 'news'

When you're reading an investment report, business editorial or other content, it's important to remember that the author (or the publication) has a reason for putting that information out there. And they have a reason for the way they present that information – what they choose to include, what they choose to leave out, the style, the tone, and so on.

Media outlets put their own spin on major events for the benefit of their sales and advertising.

The recent stock market turmoil is a good example. After stock market crashes around the world in late January and February, the media was awash with headlines on 'the deadly truth' and 'dire warnings' about the 'bloodbath' to come. It's exactly the kind of emotive language designed to make people reactive, not thoughtful and proactive.

In order to cut through the noise, you need someone whose full-time job is to keep on top of the latest developments and filter out the bias.

That's where we come in.

Let us be your information filter

Our job is to help you work towards your wealth goals and benchmarks. Part of that is helping you deal with financial information overload. Read something that's made you go 'hmmm'? Having a debate with your partner about something you've spotted online? Wondering whether a new product you've seen advertised would fit in with your portfolio? Spend less time poring over reports and releases, and more time enjoying the fruits of your labour. Get in touch to arrange an appointment today.

If you've come across an online article or report that you have questions about, we'd be happy to review and discuss it with you.

i Deloitte Media Consumer Survey 2015

ii For a good overview of financial information overload from this point of view, see JR Agnew and LR Szykman, 'Asset allocation and information overload: The influence of information display, asset choice, and investor experience' The Journal of Behavioral Finance 6.2 (2005): 57-70.