wealthadviser

Financial education for all Australians

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# How long will my money last?

by **JACK STANDING**

In more circumstances than not, financial stress centres around the million-dollar question of "will I be ok"? This, of course, can manifest itself in a number of forms that can include, but are not limited to:

- Am I able to retire now?
- When will I be able to stop work?
- Am I able to help my kids buy their first home?
- Can I go on overseas holidays each year?

Now, this list is by no means exhaustive and you could certainly reframe these in a thousand different ways. From my experience, the majority of people hurtling at light speed towards, or already in, retirement, are worried about whether or not they have enough money saved up to be financially secure to control the next stage of their life.

First and foremost, without financial security, decisions are made by others. Your lifestyle in retirement may be decided by the age pension. Your ability to assist others could be a direct concession on your own quality of life.

In order to reduce (or remove) the stress surrounding these decisions we need to be able to answer two questions:

1. do I have enough money to retire?
2. how long will my money last?

The first of those questions is more of a here and now answer. You either do, or you don't. The second of which is where most of the stress stems from - the ineffable mystery of if and when my money will run out.

## Understanding the Maths

While it is impossible to answer this question with precise accuracy, we can

BEFORE YOU GET STARTED

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remove a large part of the uncertainty which in turn will remove a large part of the stress. Firstly, we need to know a few things:

- How much money do we have?
- How much do we want to spend each year in retirement?
- What is our annualised rate of return expectation? please note - this is not a guarantee
- What do we assume inflation will be? I assume a long-term average of 3%

| Year 1 Consumption Rate* | Life of Capital (years) |
|---|---|
| 7% | 15 |
| 6% | 18 |
| 5% | 23 |
| 4% | ∞ |

*return assumed to be 7% pa year on year

In an ideal world, we do not have to make concessions on lifestyle and for this explanation I will assume in the table below that the amount spent each year is calculated as a percentage of starting capital but stay fixed each year in real dollar terms.

Importantly, in the real world, markets are volatile and average returns do not exist. With the impact of returns sequence, it is likely that money will run out quicker.

## Why is it important to know how long my money will last?

Peace of mind.

If you know that you can turn up each year, knowing you can freely spend your desired amount each year, what is there to worry about?

## What are my options if I don't like where I am headed?

We all have a number of "levers" to pull to change our outcomes. Depending on who you are, each lever could have more or less leverage. The primary ones are:

1. Work longer
2. Downsize
3. Downgrade retirement quality (i.e. spend less each year)
4. Take more risk in the lead up to retirement - this could be fraught with danger

## Does it really matter if my money is not going to last more than 20 years?

Yes.

The biggest issue facing Australians (from a financial perspective) and financial planners today is the sheer length of lives we are likely to live. It will not be uncommon for Australians aged 60+ today (women in particular) to live until they are 90+. For many of these people that is as long, or longer, than the time they spent in the workforce. A scary thought.

The only options after your money runs out is to rely on the age pension or family.

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## How can I improve my outcomes?

One of the main differences between financially successful people and the rest is that they have personal goals that are important enough to strive for. If there is a price to be paid, they will pay it in order to reach their objective. At the same time, just wanting something badly enough will not make it happen. You also need a plan that will help you reach those goals.

Work with your adviser to define and rank your personal goals and develop a plan that will enable you to achieve them.

# What companies will survive? The four key strengths to assess

*Republished from Sharecafe.com.au*

by **STEPHEN ARNOLD**

The COVID-19 pandemic has thrown the world into turmoil with many countries shutting their borders, businesses shutting their doors, and countless employees being stood down. The flow-on effect on global economies has been swifter and much more synchronised than the GFC. How long this crisis will last is anyone's guess.

Given the high uncertainty of time to recovery and the nature of that recovery, many people would be looking at their portfolio and questioning their positions. While panic can set in and sell bias can increase, it is important to review your holdings and assess each one for its ability to weather the storm and come out in a better position. At Aoris Investment Management, we are looking for four key strengths in businesses to assess their ability to endure through the worst of the crisis and come out on the other side, not just having survived but having emerged competitively stronger, ready to grow and take share from their poorly managed peers. Below, we present the lens through which we have evaluated our holdings, together with an example Aoris portfolio company: Nike.

## Earnings strength

Avoid companies that are likely to see earnings fall into negative territory for several quarters, as well as those where the end markets may take several years to recover to prior levels. This risk can be managed by avoiding cyclical businesses whose earnings volatility is amplified during downturns (such as banks) and also avoiding businesses that lack breadth (i.e., are concentrated in a narrow set of end markets and geographies) and a short operating history, all of which heighten earnings risk.

Nike is a leader in the global athletic footwear and apparel industry and has maintained this strong leadership over many decades. As the #1 player with strong brand and loyal customers, Nike has delivered consistent earnings per share (EPS) growth at the rate of 8.3% p.a. over the last five years and 11.3% p.a. over the last 10 years. Nike also showed low levels of cyclicality during the 2009 GFC, where it continued to stay profitable, growing EPS by +2 to 3% in years 2009 and 2010, when most company earnings declined.

## Capital strength

Avoid owning companies with excessive levels of debt, as they can run the risk of being unable to meet interest payments when they fall due and/or are unable to refinance loans when they mature. Earnings risk thus com-

Avoid companies that are **likely to see earnings fall into negative territory** for several quarters, as well as **those where the end markets may take several years to recover to prior levels**.

pounds the risk of debt. If debt is not properly managed, it can even throw good businesses into peril. A good rule of thumb is to avoid companies with >2.0-2.5x net debt-to-EBITDA ratio.

In the case of Nike, it has zero net debt. This places it in a very strong financial position to weather any storm, and still have the ability to invest in people, products and marketing. These are the key competitive advantages of Nike's business.

## Management strength

Seek companies with stable, long-tenured management teams, as they would have experienced previous downturns and are therefore likely to respond most effectively to the current crisis. Be wary of companies that have experienced unusually high turnover in the upper ranks over the last year.

Going back to our example, Nike recently appointed a new CEO, John Donahoe, who has served on Nike's Board of Directors since 2014. He is only the fourth CEO in Nike's history, and two former CEOs still hold positions on the Board. This stability and experience of management gives us confidence that Nike will be able to navigate this period of uncertainty. A good example of this management aptitude is they have been active in applying their learnings from the early COVID-19 experience in China to their worldwide operations, in order to limit adverse impacts to the business as much as possible.

## Competitive strength

Avoid companies where small but meaningful parts of their business (say, 15-30%) is competitively weak. This could be a large geography, product line or division that is just not as good but often gets skipped over due to the strength of the core business. During times of stress, these weaker parts could produce further underperformance and become a drag on the core business, as well as an untimely

distraction on management time and effort. Instead, look for businesses that are the strongest in their market with no material areas of weakness, therefore with a strong case for emerging from the crisis with an enhanced competitive position.

Nike's competitive strength - It is predominantly a single brand that is strong everywhere around the world in every geography it operates in. It has a dominant 50% market share in the global footwear market, which translates to 60% of global footwear profits, well ahead of its nearest competitor Adidas, with around 30% share of both sales and profits. And competitors like Puma, Under Armour and Asics have so far only been able to play on the fringes compared to Nike's centre stage. In these current testing times, Nike's digital capabilities have kept up strongly with the resurgence in online demand. Nike apps are keeping customers engaged (as they remain indoors) by connecting them with master trainers to work out and stay motivated. We believe this reinforcement of the Nike brand and increased customer engagement will see the business emerge in a better position than peers and continue to strengthen its leadership. This was witnessed after the 2009 GFC, when Nike grew faster than the market and took share from smaller players.

The world economy is dealing with heightened levels of uncertainty, within which businesses are facing unprecedented times. Through this turbulence, we see the strength and safety of holding competitively solid businesses backed by strong capital structure and experienced management teams, as this will define their ability to bounce back capably once economic activity resumes.

# Bank Support

COVID-19 SERIES:
by **STAFF WRITERS**

We have seen massive financial support come from the RBA as well as the Australian government highlighting their commitment to support Australians in what may well be a time of need.

Outlined below is a summary of government support, bank support as well as some important contact details for the various lending institutions that may be of interest to you if you are experiencing financial hardship that may impact your existing loans. This is all a major part of what some of you may have heard called, the "Team Australia" effort.

## Reserve Bank of Australia – Supporting the flow and reducing the cost of credit

The RBA announced a term funding facility for the banking system. Banks will have access to at least $90 billion in funding at a fixed interest rate of 0.25 per cent. This will reinforce the benefits of a low cash rate by reducing funding costs for banks, which in turn will help reduce interest rates for borrowers. To encourage lending to businesses, the facility offers additional low-cost funding to banks if they expand their business lending, with particular incentives applying to new loans to SMEs.

In addition, the RBA announced a further easing in monetary policy by reducing the cash rate to 0.25 per cent. It is also extending and complementing the interest rate cut by taking active steps to target a 0.25 per cent yield on 3-year Australian Government Securities.

## Bank measures

The government has also established the Coronavirus SME Guarantee Scheme which is designed to give SMEs access to working capital to help them get through the impact of COVID-19. Under the scheme the government will guarantee 50% of new loans issued by eligible lenders to SMEs. This will provide an increase in the willingness of lenders to provide credit to SMEs and can support up to $40Bn worth of lending.

This new scheme is on top of the $15Bn investment in wholesale funding markets used by small ADI and non-ADI lenders.

In this time most major banks are offering loan repayment holidays for eligible customers.

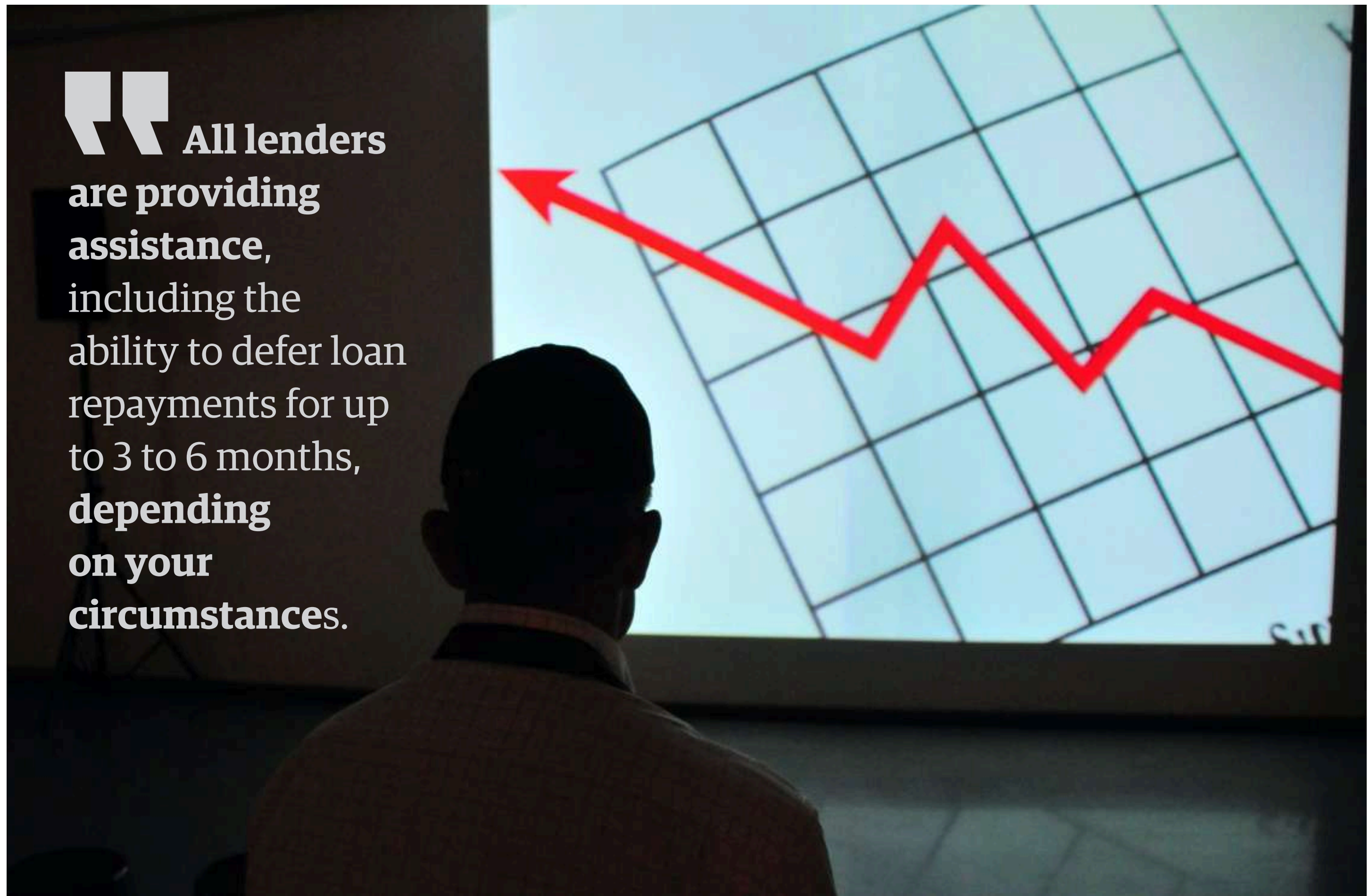
## The key support being provided to businesses by the big four commercial banks are:

1. Six-month deferral of loan repayments for small businesses - defined as having <$3m worth of business debt
2. Implementation of a fast track approval process so small businesses suffering cash flow pressures receive support ASAP
3. Reduction in most small business loan interest rates of 100 to 200 basis points

## Financial hardship assistance from your lender:

All lenders are providing assistance, including the ability to defer loan repayments for up to 3 to 6 months, depending on your circumstances.

While normally this may appear on your credit record, it is likely that any "Covid 19" related credit entry will in future be ignored by any lender because it is such an economy wide event.




In fact, we have already had word from a number of lenders and credit reporting agencies that being proactive with your lender about financial hardship won't negatively affect your credit rating.

It is better to act early and preserve your cashflow if you have been affected.

**Below are the home loan financial hardship contact lines and links to their relevant websites for a range of lenders.**

Please note that the wait times are long on the phone so lodging a request via the website if possible is often recommended as the preferred method.

- ANZ 1800 252 845 or this link
- AMP 13 30 30 or this link
- CBA 13 30 95 or this link
- NAB 1800 701 599 or this link
- Westpac 1800 067 497 or this link
- St George 1300 303 110 or this link
- HSBC 1300 308 008 or this link
- Bankwest 1300 787 144 or this link
- AMP 13 30 30 or this link
- Suncorp 1800 225 223 or this link
- ING 1300 349 166 or this link
- Macquarie 1300 363 330 or this link
- CUA 133 282 or this link
- ME Bank 13 15 63 or this link
- Heritage Bank 13 14 22
- Liberty Financial 13 11 33 or this link
- Smartline Select 1300 543 558 or this link

**Below are the asset (car & equipment etc.) finance and personal loan financial hardship contact lines and links to their relevant websites for a range of lenders also.**

- ANZ 13 23 73
- Macquarie 1300 368 908 or this link
- Westpac 1800 067 497 (press option 2) or 1300 650 110
- Metro Finance 1300 362 627
- Capital Finance 1800 642 626 or businessassistCFAL@westpac.com.au
- BOQ 1800 079 866 or this link
- Pepper Asset Finance 1800 356 383 or assist@pepper.com.au or this link
- Now Finance 1300 275 669
- Liberty Financial 13 11 33 or help@liberty.com.au
- WISR Personal Loans 1300 992 007
- Firstmac 13 12 20 or customercare@firstmac.com.au
- RACV 13 72 28

For those of you with variable rate mortgages (non SMSF) that would like to investigate refinance opportunities to reduce overall interest expense, or a potential move to interest only to assist with cash flow, please contact our office.

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# Top 11 Family Trust Mistakes NOT to Make

**WEALTH ADVISER SERIES:**
Part 1 of 3

## Introduction

A 'discretionary trust' (more commonly known as a 'family trust') can be a very useful and powerful tool in the pursuit of long-term wealth generation and maintenance. The purpose of this guide is to briefly explain what family trusts are and then to focus on some of the, potentially very costly mistakes that are sometimes made in this area. This could help you to make the decision on whether a family trust would be the right option in your particular circumstances. Hopefully the information presented here will also be valuable in terms of helping you to steer clear of some of the pitfalls associated with family trusts.

Trusts can be a fairly complex area and it is highly recommended that you get the best possible expert help before fully committing yourself. The need for financial advice does not cease once the trust is up and running. You will at all times have to ensure that your trust remains compliant in the areas of governance, taxation and income distribution. Getting knowledgeable and competent advisors on board should, therefore, not simply be seen as a 'nice to have' but as a vital part of successfully using a family trust to build and safeguard wealth.

## Family Trust: The Basics

Under Australian law a family trust refers to a discretionary trust that was created to hold the assets belonging to a family or to conduct a family business. Such trusts are commonly set up in order to protect assets or to distribute investment income.

**Family trusts generally have the following characteristics:**

- Established by a family member in order to benefit the 'family group'
- Can be the subject of a family trust election (see below) which provides it with certain tax advantages, provided that the trust passes the family control test and makes distributions of trust income only to beneficiaries of the trust who are within the 'family group'
- Can assist in protecting the family group's assets from the liabilities of one or more of the family members (for instance, in the event of a family member's bankruptcy or insolvency)
- Provides a mechanism to pass family assets to future generations
- Can provide a means of accessing favourable taxation treatment by ensuring all family members use their "tax-free thresholds"

**The following elements have to be put in place in order to set up a family trust:**

- A trust deed: The trust deed is used to clearly set out the terms and conditions under which the trust is established and maintained. A trust is formally established when the trust settlor (see below) and the trustee(s) signs a trust deed and an initial amount is given by the settlor to get the trust up-and-running.
- A settlor: The function of the settlor is to assist in getting the trust of the ground by 'giving' an initial asset (technically known as 'settling an asset on the trust'). This is often

simply a token amount, although more substantial assets may also be transferred at this stage. After the settlor executes the trust deed in this way he or she will generally have no further involvement with the trust. This role is sometimes fulfilled by a lawyer, accountant or financial advisor but a family member or friend could also be asked to act as settlor.

- The trustee(s): The ultimate responsibility for managing the trust and its assets rests with the trustee(s). In the case of typical family trusts this role is often fulfilled by 'mum and dad' (or by a company of which they are shareholders and directors) with the children and other dependents listed as beneficiaries.
- 'Family Trust Election': This refers to the choice made by a trustee to nominate a particular individual (known as the 'test individual') around whom a family group is formed. This is a fairly complicated area and getting competent advice is strongly advised. Once a FTE has been made significant restriction as to who can be beneficiaries of the trust come into play. In general, the 'family group' could include the following people for taxation purposes:
    - The test individual and his or her spouse
    - Any child, nephew or niece of the test individual or their spouse, and any lineal descendent of these individuals
    - The spouse of anyone mentioned above

The list above should make it clear that great care will have to be exercised in nominating the test individual as a wrong choice could lead to someone being 'left out of the circle'. This could have pretty dire consequences. According to ATO: *"A consequence of making a family trust election is that any distributions (broadly defined) outside the family group of the family trust by the trust will be taxed at the top marginal rate applying to individuals plus the Medicare levy."*

One of the most appealing aspects of a family trust is that the trustee(s) can distribute income earned by the trust in any way they see fit as long as distributions are made to those who qualify as beneficiaries. They can, for example, vary proportions over subsequent years in line with the needs of the recipients.

A trust is not required to pay income tax on income that is distributed to beneficiaries (undistributed income will, however, be taxed). This means that the trustees are free to distribute income to as many beneficiaries as possible and in ways that will help them to take the best possible advantage of tax-free thresholds. Once beneficiaries receive a benefit from a trust this must be included in their income declarations.

It should be remembered that distributions received from a trust are not a special form of income, but instead forms part of a beneficiary's assessable income. If the beneficiary receives income from other sources in addition to distributions from the trust, all of the income will be taxed together.

Undistributed income left in the trust is taxed at the top marginal tax rate giving a strong incentive to family trusts to fully distribute the trust's income before the end of each financial year.

The trustee should also take care in relation to which beneficiaries are chosen to receive distributions, as penalty tax rates can apply to distributions made to minors.

With the preliminary discussions out of the way it is now time to turn to some of the serious mistakes that people often make when they place their assets in family trusts. The hope is, once again, that the listing of these mistakes well help you to avoid them (and beyond that to determine whether a trust is the best option in your current circumstances).

## Mistake #1 – Forgetting that trusts have 'Expiry Dates'

If you are aiming for long-term intergenerational wealth creation and maintenance, you will need to think long and hard before committing your assets to a family trust. This is because legislation does not allow for trusts to be set up to exist indefinitely. All states and territories have 'Rules against Perpetuity' governing trusts and these are strictly enforced. This means that you generally shouldn't

expect any trust that you set up to last beyond its 80th year.

When the anti-perpetuity rules kick in trustees will be forced to transfer assets out of the trust. This will trigger a Capital Gains Tax event. You may not see this as much of a problem since you will not be around to witness this happening, but your children and grandchildren could be hit with a very large and unexpected tax bill! If, therefore, you are taking a very long view as far as your wealth building strategy is concerned you should probably also be looking at some other options besides the setting up of a trust.

## Mistake #2 – Placing too much emphasis on asset protection

It is very common for people who begin to 'get ahead' financially to start looking around for ways in which they can protect their wealth and assets. While this is a completely understandable sentiment it is important to understand that an overly cautious approach can sometimes come with a heavy price tag attached in the sense that the price you pay for protection may be more significant than the perceived benefit you are gaining.

It is, of course, true that there is a possibility that some catastrophe could threaten your asset base and that a trust will offer some protection. You need to consider, however, what the probability is of this occurring and whether a trust is necessarily the best way to protect yourself.

In general, the kind of liability that could threaten your financial position would most likely arise from your professional activities or from an event for which you are held responsible (e.g. your dog seriously injures someone). Of course, there is no guarantee that such an event will or will not happen and we have to make a call on the probability of such things happening. Something that we are generally not very adept at doing. We need to acknowledge, however, that for most people who are not in high-risk occupations the probabilities of a first-order catastrophe hurting them financially is probably moderate to low.

Even if catastrophe occurs some protective systems will in most cases have to fail spectacularly for a liability to land on your doorstep:

- If you are in a high-risk occupation, your Professional Indemnity insurance needs to fail
- If it is an adverse event (e.g. the dog incident mentioned above) your Liability Policy needs to fail.

Even if one of the 'fails' mentioned above does occur and you are landed with the liability there may still be some options (e.g. a negotiated settlement) that could allow you to avoid bankruptcy as the worst possible outcome.

It should be clear, in light of the above, that embarking on complicated structural adjustments (which may include making use of trusts) in order to defend yourself against low probability events may not be the best use of your resources and assets. So if asset protection is the only reason why you are considering a trust you may want to get a bit more professional advice before fully committing yourself.

## Mistake #3 – Forgetting about 'Personal Services Income' (PSI)

Income placed under the control of a family trust will potentially fall into one of two categories namely investment income or work-related income. Under current tax law work related income will normally be judged to be Personal Services Income which means that it will be subject to anti-tax avoidance measures. Tax will be payable on that income as if you were an employee. This means that you will not be able to channel work income to someone else as a means of reducing your tax liability.

One of the basic steps to find out whether your income will be classed as Personal Services Income is to head to the following webpage hosted by ATO: https://www.ato.gov.au/Business/Personal-services-income/ It is also strongly recommended that you consult an accountant on this issue before spending money and effort to set up the trust.