Observer

Bringing you valuable wealth and financial information

Summer 2023-2024

See inside

10 common financial mistakes before retirement

Many of us would like to think that 'older' means 'wiser', but when it comes to money that isn't always the case. The complexity of Australia's superannuation and pension systems doesn't help. The upshot is that there are a number of common mistakes that retiring and retired Australians make.

FUTURO FINANCIAL SERVICES PTY LTD
ABN 30 085 870 015 | AFSL No. 238478
EMAIL: info@futuro.com.au
www.futuro.com.au

INSIGHT INVESTMENT SERVICES PTY LTD
ABN 22 122 230 835 | AFSL No. 309996
EMAIL: info@insightinvestments.com.au
www.insightinvestmentservices.com.au

HEAD OFFICE:
Level 3 240 Queen Street
BRISBANE QLD 4000

PHONE: (07) 3018 0400

WA OFFICE: (08) 9388 9009

What are those mistakes and how might you avoid them?

1. Underestimating how much you need

The Association of Superannuation Funds of Australia's (ASFA) Retirement Standard calculates that a "comfortable" retirement for a couple costs $69,691 per year. For singles the figure is $49,462 per year. To fund these levels of income, the ASFA calculates that a couple will need a nest egg of $690,000, and a single $595,000 at retirement[1]. Less than that and retirees become increasingly reliant on the age pension.

In 2015-2016, the average total superannuation balance for households headed by someone aged 60-64 was around $337,100 – well short of enough to fund a "comfortable" retirement.

2. Retiring too early.

Australians retiring today can expect to live until their mid-80s. For retirees in their mid-50s, that means finding a way to pay for a further 30 years of life.

The obvious solution to retiring too soon is to work longer. This provides a double benefit: it extends the savings period allowing a greater sum to be saved, and delays the point where withdrawals start to eat into accumulated funds.

Many people may also overlook the social benefits of work. They end up bored, and then could face the challenges of trying to re-enter the workforce as an older worker, or taking an extra risk by starting a business.

3. Not topping up super.

Making additional contributions into the tax-favoured superannuation environment can really boost super savings. Strategies involving salary sacrifice, spouse contributions and government co-contributions should all be in play well before retirement. Within the allowable limits of course.

4. Investing too conservatively.

A common view is that retirees should dial back on their investment risk by allocating more of their savings to cash and fixed interest, and less to shares and property. However, even 10 years is a long-term investment horizon, let alone 20 or 30. Cutting too far back on growth assets early in retirement may see savings dwindle too quickly.

5. Withdrawing super as a lump sum.

Superannuation can be withdrawn as a lump sum after retirement, and if you are over 60 it's all tax-free.

But what then? Common choices are to take that big trip or renovate the home. Of course you'll want to celebrate your retirement, but if you're thinking of dipping into your savings in a big way, make sure you understand the potential implications for your future lifestyle.

Another option is to invest outside of super. This may be entirely appropriate. However, don't forget that if you are

[1] As at December

over 60 and your super is in the pension phase, earnings and capital growth will be tax-free. Investing outside of super may see you paying more tax than you need to.

6. Expecting too much age pension.

Just because you've decided to retire doesn't mean the government is ready to give you an age pension. To begin with you need to reach pension age, which is between 65 and 67 depending on your date of birth. If you haven't yet reached your pension age, you'll need to fund your lifestyle until you do.

Then there is an assets test and an income test. Too many assets (not including the family home) or too much income and the amount of pension you can receive will start to fall, eventually to nothing. It's important to remember that these tests apply to the combined assets and income of a couple. If your partner is still working you may receive little or no pension.

7. Forgetting to plan your estate.

If you don't have a current Will, haven't granted someone you trust an enduring power of attorney, or made a binding death benefit nomination for your superannuation, you're likely to leave a big headache for whoever will manage your affairs if you become incapacitated or die. The solution? Talk to a lawyer who specialises in estate planning matters sooner rather than later.

8. Overlooking preservation age and conditions of release.

You can retire any time you like. You may even be able to access some of your super if you have an unrestricted, non-preserved component. Otherwise you need to meet a condition of release. This usually requires reaching preservation age, which is between 55 and 60, again depending on date of birth. If you're under the age of 60 it also means ceasing gainful employment with no intention to being gainfully employed again. Between 60 and 65 it is sufficient just to cease an employment arrangement. All funds can be accessed from age 65, regardless of employment status.

One way to access super after reaching preservation age but without retiring is to start a Transition to Retirement pension. However, this must be paid as an income stream. Lump sum withdrawals are not allowed.

9. Carrying debt into retirement.

It can be hard enough keeping up mortgage, car finance or credit card interest payments even when you're working. It can become a real burden in retirement.

Where possible, do your best to pay down debt. It may help to consolidate debts and pay off one loan at the lowest possible interest rate. Downsizing your home may also allow you to start retirement debt-free.

10. Paying for unnecessary insurance.

Free of debt and without financial dependants, you may not need to maintain the same level of life and disability insurance you once required. Also, premiums can become expensive as you get older. The run up to retirement is an ideal time to review your insurances, a task best done under the guidance of your financial adviser.

Invaluable advice.

While the expectation may be that life should get less complicated as you get older, this short list reveals that's not always the case. Many of these mistakes come with a high price tag but can be avoided by seeking professional advice.

Your financial planner will be able to assess your specific circumstances and help you develop a plan for your retirement. But don't wait until you actually retire. As you can see, it's never too early to start planning.

The impact of Interest Rates on Managing Debt

Credit cards, personal loans, and mortgages. While it can be easy to pick up debt as you go through life, changing interest rates, workplace interruptions and other life changes, can make it much, much harder to repay that debt.

A few simple tips can make the task a lot easier.

Taking Stock of Your Debts

First, know exactly what debts you have. If necessary, write a list of every debt you have, detailing the exact amount outstanding, the rate of interest being charged, including both the interest rate and the dollar amount charged each month and the time required to repay that debt.

If you are unsure of any of these details, contact the debt provider so you can make this list as accurate as possible, listing the debts from the smallest amount to the largest amount you owe.

Unravelling Interest Rates and Charges

Second, understand the exact rate of interest you owe on each debt and how this interest is charged against your account. Typically credit cards will attract the highest rate of interest but will only do so if you don't pay the full amount that is owing each month.

While the annual interest rate charged on a credit card is usually very high, it is typically charged daily, so the actual amount charged can be much higher than you expect it to be. Each credit card will have its own interest rate rules and can have different rates for cash withdrawals compared to normal purchases.

In comparison, the interest rate on your home loan will be much lower and much simpler to work out. While it is charged on the daily balance, it is usually accrued to your loan at a specific day in the month and so it can be easy to reduce you overall interest charges by paying fortnightly for example, rather than monthly.

Be aware of any additional charges relating to any of your debts. These might include late payment fees or other penalties should you miss a payment date and depending on the debt, can be very high.

Penalty fees can be a big issue with buy now, pay later finance. Typically, the charges associated with this debt is carried by the retailer or service provider, but should you miss a payment, you can find yourself paying significant penalties on these loans.

Prioritising Debt Repayment

Third, order your debts, usually from the smallest debt to the largest, and then focus on repaying the smallest debt as quickly as possible. Once this debt is repaid, then you can divert the payments you would normally pay to that debt, to the next smallest debt and repay that debt as quickly as possible.

Typically, the smaller the debt and the faster you repay it, the less interest you will be charged. Some debts have a fixed rate of interest attached to them, so you still pay the same amount of interest no matter how quickly you repay the debt. These debts should be repaid last.

Exploring Debt Consolidation

It is possible to consolidate expensive debt, typically credit cards, into cheaper debts such as your home loan and this can make good sense if you are disciplined and can stop accruing credit card debts you can't repay. Otherwise, this can be an easy way to make your debt burden even worse.

Upholding Timely Debt Payments

Ensure you always make your debt repayments on or before the due date. This is important as it will impact on your credit rating, which the banking system generates for every Australian who borrows money.

If you pay your debts on time, then your credit rating will be high, and you will be able to obtain credit at the cheapest possible rate in the future. If you let you credit rating slide, you will face a higher interest rate and, in some cases, might not be able to borrow at all.

Seeking Advice When Necessary

Your Financial Planner can assist you with budgeting and implementing a plan to reduce and manage your debt, they can also explain tax-effective and non-tax effective debt and how it may affect your personal situation.

Why the share market is not the same as the economy

In recent times, the Australian economy faced potential challenges, including elevated interest rates and inflation levels, which led to concerns about a recession as 2022 commenced. This prompted speculation about the potential impact on the share market, raising the question of whether it might also experience a decline.

However, historical trends offer a different perspective. Throughout various periods, including instances of economic contraction, the Australian share market has demonstrated resilience. Notably, during each of the country's previous nine recessions, the local market managed to trade at higher levels. This underscores the intriguing notion that robust trading on the Australian share market has often coincided with times of economic contraction.

For example, 1983 was the best year ever on the Australian share market, climbing 60 per cent higher, while the economy was stuck hard in the 1981-1983 recession. So, while it is tempting to think poor economic times mean a dismal outlook for the market, there are four key reasons why that is usually not the case.

Throughout various periods, including instances of economic contraction, the Australian share market has demonstrated resilience. Notably, during each of the country's previous nine recessions, the local market managed to trade at higher levels.

Firstly, the market is driven by expectations.

There is an old saying investors buy on the rumour and sell on the facts. Big share market falls occur suddenly, well before the economy officially moves into recession, as investors promptly react to bad news.

Once the economy is in recession, investors look to the future and how companies can take advantage of emerging opportunities in an improving economy. Improvements that can take time to show up in economic data.

Secondly, the share market reflects investor sentiment while consumer concerns and beliefs dominate the economy.

Consumers might cut back on buying clothes or going out in preference to boosting savings when they fear bad times.

In contrast, professional investors are constantly looking for opportunities and, for good or bad, economic downturns, where small businesses go bust and consumer sentiment changes, usually create them.

Thirdly, the share market comprises large successful companies.

In contrast, economic statistics are dominated by what is happening to individuals and small businesses. Two groups that can respond very differently to world events.

For example, the war in Ukraine prompted a rise in energy prices, particularly for oil. Most individuals and small businesses responded by cutting back on their petrol consumption, while large oil companies are cranking up production to take advantage of these higher prices.

Finally, the share market has a much smaller universe than the economy.

The market is made up of large companies entirely focused on getting larger and more profitable and, in doing so, attracting more investors to support their efforts.

The economy is made up of Governments, individuals, and small businesses, all making a wide range of decisions about how they will live and operate in an ever-changing world and are basing those decisions on a raft of factors.

For instance, a coal company may decide to open a new coal mine because it has found significant reserves in a certain location and knows it has the technology and skills to extract that coal and sell it for a profit.

A government might approve the mine because it believes it will boost the local economy through increased employment and activity, increase revenue by taxing the company's profits, and impose royalties on the coal.

Or the government might decide it won't approve the coal mine due to concerns the mine will damage the environment and, in doing so, create a voter backlash.

Individuals wanting jobs at the mine may support it, but others might object to the noise and interruption to their daily routine. Small businesses might welcome the extra activity, but smaller mines might not want the added competition.

So, while the share market and economy are connected, they are influenced by widely different variants that often see them heading in different directions.