MONEY MATTERS.

Advice. Life. Investments. Superannuation and Retirement.

Edition 2, 2021

Are you insuring away your super?

Freeing up home equity through reverse mortgages

As good as gold

Lesson learned: Staying the course during a market crash

Investors buoyed as vaccine points way to post-COVID world

Are you insuring away your super?

Almost 10 million Australians have life insurance attached to their superannuation funds[1]. But for many, the costs far outweigh the benefits.

Default insurance provides millions of Australians with a safety net from death and disability. It keeps costs down and gives cover to people who otherwise may not hold insurance.

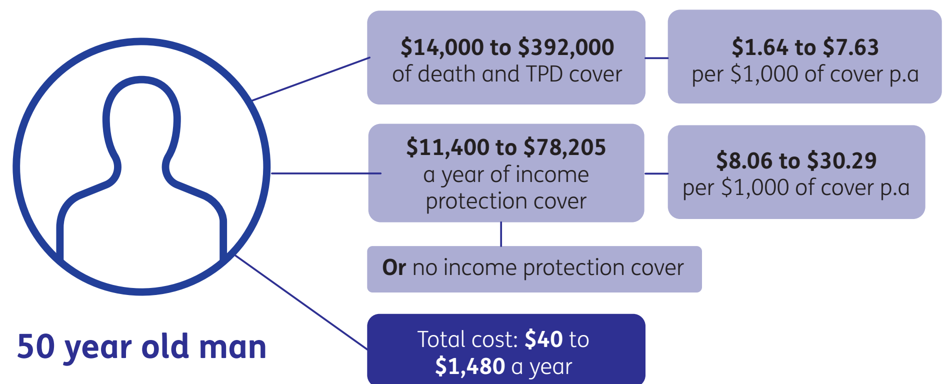
But it has little to do with saving for a comfortable retirement, even if insurance is commonly bundled with super.

"Many superannuation members are not even aware that they have insurance through their superannuation, or that they are paying for it," according to a recent report from the corporate regulator (Australian Securities and Investments Commission (ASIC))[1].

For those that are aware, the confusing labyrinth of design features and terms and conditions makes it difficult to understand.

The ASIC report found wide variations in the design and pricing of default insurance across funds[1]. Some funds even offered more than 20 times as much default death and TPD cover to identical members[1].

The figure below shows that a 50-year-old man could be paying almost five times as much per $1,000 of death and TPD cover in the default product[1].



Why your default super insurance is probably not for you

Super funds decide the type of cover, the level of cover and pricing cross-subsidies across their membership.

The problem arises when radically different groups are lumped together under the same insurance plan. ASIC says young people are often short-changed. People aged under 30 are generally healthy and claim less than those aged over 50, and so are paying more than what they need[1].

"This is an intentional design feature of some group insurance," ASIC said.

"However, it can also be an unintentional result of levels of risk changing over time without premiums being adjusted in response."

Contents

Are you insuring away your super? 2

Freeing up home equity through reverse mortgages 4

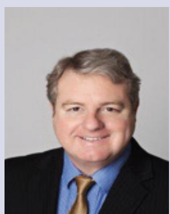
As good as gold 6

Lesson learned: Staying the course during a market crash 7

Investor buoyed as vaccine points way to post-COVID world 8

We hope you enjoy our latest edition of Money Matters.

Please contact our office if you would like to discuss anything in this edition.


Greg Roberts

Damien Roberts

The regulator found some super funds have overhauled their life insurance plans to make them fairer, but others 'did not appear to be fully aware of the imbalances' between different age groups. There is also a risk that a change in existing product design and pricing can mean that currently, older members continue to be supported by the cross subsidies, whilst a younger member of the fund may be removed and as a result, when they get older, they never receive a similar benefit.

Some super funds also don't consider the impact of members' different jobs. Super funds used to concentrate on specific industries and so could better address member needs, however most have now become open to members from any industry and occupation and this increases the difficulty of having cover that caters to most members.

Many default funds that cover members in riskier blue-collar jobs, like construction, charge higher prices. White-collar workers, who usually work in offices, are charged less because they're exposed to fewer life-altering accidents.

While the regulator found that many super funds do confirm their members' employment status, 'most members do not provide such information and are provided cover on the default occupational setting.'[1].

Even worse, not all super funds tailor their insurance based on occupational categories, and those that do use different classifications.

Weighing up the costs and benefits

Thinking about superannuation and life insurance often sends a shiver up one's spine. There is a myriad of conflicting and confusing factors that can determine the right product for you.

From deciding what types of cover is provided, how much you are insured for, to how much you are being charged for life insurance, it can quickly become overwhelming.

Fortunately, financial advisers can weigh up the costs and benefits and provide the right plan for you.

It's crucial to keep in mind that there are price differences that reflect the different risks people face, which are justified.

Older members pay more for insurance than younger ones, while men, who are more prone to death and injury, fork out more than women.

However, having such a fluctuating price range for the same person depending on which product they get lumped into is inherently unfair.

Especially when that person is not aware that these invisible costs may be eating into their retirement income.

If you would like to review your insurance, contact our office to speak with your adviser at any time.

1 20-323MR ASIC report explores how to measure 'value for money' in default insurance in superannuation | ASIC - Australian Securities and Investments Commission. (2021, March 05). Retrieved from https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-323mr-asic-report-explores-how-to-measure-value-for-money-in-default-insurance-in-superannuation

Freeing up home equity through reverse mortgages

Many older Australians are struggling to fund their retirement income while sitting on a gold mine. Could a new government initiative change the situation?

Many Australians are concerned they'll outlive their retirement savings, but few ever consider unlocking the value of their family home.

The reasons are understandable. The home is sacrosanct and, after a lifetime of paying a mortgage, few want to sell their equity back to a bank.

But if properly understood, reverse mortgage products can be a way of securing your financial freedom without having to move out of home.

Consider the risks

Reverse mortgages let homeowners aged over 60 borrow money using the value of their property as security. The cash can be used for anything – to renovate the house or pay for medical expenses – and the amount you can borrow depends on factors such as your age and your home's value.

But, despite the obvious benefits, only 40,000 homeowners had taken out a reverse mortgage by the end of 2014[1]. The reason is mostly because reverse mortgage schemes charge higher interest than traditional mortgages. And as the interest compounds over time, the amount owed to the reverse mortgage provider can dramatically increase. A recent report by the corporate regulator found that many borrowers can be left with substantially less home equity if the interest rate on their loan rises or if property prices stagnate[2].

Reverse mortgages vs Pension Loans Scheme

Reverse mortgage

Offered by banks and mortgage providers

Can pay you either a regular income or a lump sum

As of February 2021, interest rates ranged from 4.9% to 5.8%

You may have to pay a small application fee for the loan

Could impact how much you get from the Age Pension

Pension Loans Scheme

Offered by the government

Only available as regular income payments

April 2021, interest rate was 4.5%

No fee to apply for or begin the loan

Doesn't impact how much you get from the Age Pension

Common to both

You can remain in your home

You can free up money to improve your standard of living or for needs such as aged care

Usually repaid with the sale of your home, but you can pay it off early

The longer the loan remains and the larger it is, the more likely these factors will eat into a retirees' home equity.

An alternative: Pension Loans Scheme (PLS)

The government's PLS is a type of reverse mortgage that partially addresses the problem of variable, high-interest rates.

The loan is secured at a competitive interest rate of 4.5%[3] against insured local residential property that the retiree or their partner own. (Most mortgages that younger Australians rely on to buy a home currently charge rates somewhere between 2-3%).

Under the scheme, a retiree aged over 66 can receive up to 150% of the fortnightly maximum rate of the age pension[4].

There are also safeguards in place to ensure the borrower is not drawing dangerously high levels of equity from the home.

While there are still inherent risks to consider, the government's recent Retirement Income Review found using relatively small portions of home equity through the PLS can substantially improve retirement incomes for many people.

Weighing up the options

Reverse mortgages and the PLS both carry a variety of risks besides compound interest. For example, if you are a sole owner and someone lives with you, that person may not be able to stay in the house when you die. Some reverse mortgage schemes may also affect the rate of the government's Age Pension (although the PLS is exempt).

But retiring without assessing your options can be just as risky. Some 42% of Australians entering retirement are undecided on what they will do with their family home, according to a recent report by RMIT and reverse mortgage provider Heartland Seniors Finance[5].

When properly assessed, these schemes can provide a viable option for older Australians to boost their retirement income and unlock some financial freedom. However, the issue is complex and varies from person to person, which is why seeing a financial adviser is crucial.

1. Retirement Income Review - Final Report | Treasury.gov.au. (2021, February 19). https://treasury.gov.au/publication/p2020-100554ASIC Report 586
2. REP 586 Review of reverse mortgage lending in Australia | ASIC - Australian Securities and Investments Commission. (2021, March 12). https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-586-review-of-reverse-mortgage-lending-in-australia
3. Rate current at April 2021
4. Pension Loans Scheme - Services Australia. (2021, February 19). https://www.servicesaustralia.gov.au/individuals/services/centrelink/pension-loans-scheme
5. RMIT and Heartland Seniors Finance, Reverse mortgages – Financing ageing in place. https://cur.org.au/cms/wp-content/uploads/2020/11/financing-ageing-in-place.pdf

As good as gold

The value of gold skyrocketed as the pandemic struck the world. But now it's falling back down to earth. Is the party over?

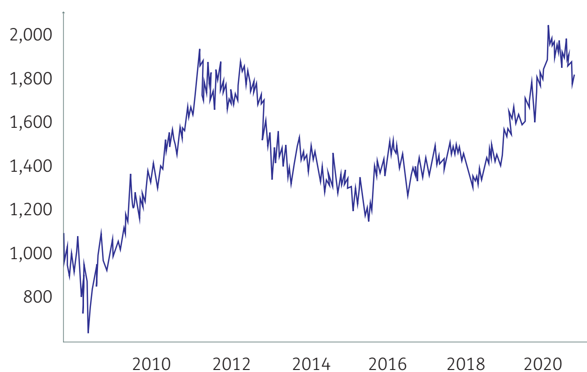
Investors ploughed into gold as the pandemic threatened to derail the global economy. Even legendary investor Warren Buffett bought gold for the first time. But over the next nine months, those gains evaporated.

Yet, the allure of gold remains timeless.

"Gold is your actual real value," says precious metal expert and gold trader Roy Cohen from Sydney's Gold Company Group. "Gold is what used to back currencies. Gold is real money."

The price of gold surged by almost one-third (28%) over the first eight months last year. The price rise was even more spectacular over the preceding two years.

The fluctuating price of gold (USD/Oz)



Macrotrends

The price of gold is driven by multiple complex factors, including inflation, supply, and investor sentiment. The value of the $US currency is also a significant driver.

As the pandemic escalated, governments and central banks printed trillions of dollars of new money to bolster their economies. This can erode the value of currencies – and gold acts as the perfect hedge, according to Cohen.

"It's a good time to protect yourself against the devaluation of currencies, which has been done by every government worldwide," he says. "It's a good time to be your own central bank."

However, the more recent drop in the gold price – which has coincided with stronger investor confidence as the economy recovers – shows just how complex the forces affecting the price of gold can be.

"There will be some sort of percentage of the gold and silver price that's going to be determined by supply and demand, and as people become a little bit more confident, they aren't turning to gold and silver as much."

Cohen says another factor driving gold prices down recently has been rising interest rates on government bonds.

"But the long-term trajectory of the gold and silver price is up. Why? Because the long-term trajectory of the value of currencies is down. It's an inverse relationship."

These are not easy forces to predict – even Warren Buffett's 2020 investment in New York Stock Exchange-listed Barrick Gold didn't pan out quite as he expected. He sold earlier this year.

But while understanding the changing value of the gold price is difficult, in a world of invisible money, there's still something special about holding an ounce of gold.

It stands on top of the podium above other precious metals like silver for several reasons. It is abundant enough to make coins but scarce enough to limit supply. And people still value it today, just as they did hundreds of years ago.

"It is still a good time to buy," says Cohen.

Three tips to sell your gold

Got some old gold jewellery lying around? Cashing it in is a good way to make some quick money. But don't be a swindler's dream. Understanding the criteria for selling gold is essential before you look for a gold buyer.

1. **Know what unit gold is measured in.** Understand how to calculate the carat (weight) of your gold and check the current gold price before you go. There are plenty of tricks of the trade, and you don't want to end up selling your item for less than it's worth.
2. **Read the fine print.** This can be an issue if you're thinking of selling your gold through a mail-in-service. Some places have high shipping fees if the customer backs out of a deal. Even worse, some dealers are unlicensed and may not offer you compensation if they lose your item.
3. **Shop around.** Compare the market and get the best deal. Like any other business in an open market, different gold buyers have different business strategies. Go in for a free evaluation and pick the place you feel most comfortable with.

Your adviser can help ensure your investment portfolio is structured to achieve your personal financial goals. Contact our office to speak with your adviser.

Lesson learned: Staying the course during a market crash

Many investors overreacted when the coronavirus pandemic struck and switched their investments to cash. Here's how to avoid falling into the trap.

The coronavirus pandemic changed the way we live forever. Unfortunately, it's also set to change the way many older Australians now live their retirement.

Billions of dollars were switched from balanced funds into cash as the coronavirus pandemic swept the world in March 2020. That decision came with a hefty price as markets quickly rebounded.

It presents another painful lesson for investors – one that has been repeated many times throughout history.

But there are some simple things to keep in mind which can help investors avoid making the same mistake the next time a market downturn occurs.

1. Switching after a market fall locks in losses

Switching from high-growth investments like shares to low-returning assets like cash seems rational in the moment. But it can cost you dearly.

Investors were ecstatic when the S&P/ASX 200 hit an all-time high in February 2020. A month later, it all came crashing down. From its highest point to its lowest, the S&P/ASX 200 lost more than a third of its value[1].

One large super fund told the economics committee that members shifted almost $3 billion of their retirement savings into cash[2].

Unfortunately, those investors crystalised their losses – one month later, the S&P/ASX 200 recovered 13%. By the end of the year, it was 31% up from its March lows[3].

The moral of the story is don't try to shut the gate when the horse has already bolted.

Rather than locking in losses, the best course of action can often be to do nothing at all and wait for the market to rebound.

2. Decision-making under pressure is likely to be worse

The old adage goes 'buy low and sell high'. Unfortunately, that advice gets thrown out the window when markets drop. But the reason why isn't wilful ignorance. Rather, it's usually the inability of investors to manage their emotions.

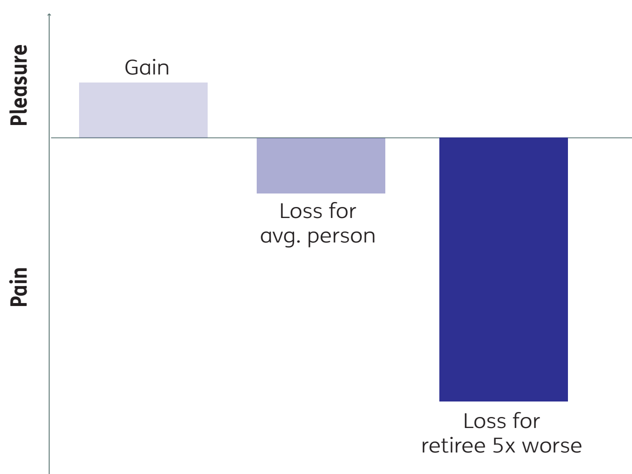
People value losses and gains differently, according to a theory developed by psychologists Amos Tversky and Daniel Kahneman. Typically, the pain from a loss hurts twice as much as the pleasure from a gain, although other studies have suggested retirees feel losses even more acutely.

"Research on loss aversion has become considerably more common in recent years, establishing that loss-averse behaviour is nearly ubiquitous, appearing across different groups of people, types of choices, and even species," according to a study in the journal Current Directions in Psychological Science[4].

This explains the strong emotions investors feel when the market crashes. However, it's important not to react to such emotions. Retaining a rational, structured approach to investing is the best way to achieve your goals.

Loss aversion in action

The average person weights a loss twice as much as a gain, but retirees tend to weight losses five times more.



Source: AARP and the American Council of Life Insurers

3. Focus on the long-term, not short-term market movements

When the market unexpectedly crashes, it's easy to think it will never recover.

But looking back in history shows market downturns are a natural part of the investment cycle.

Whether it's the Tech Wreck (early-2000s), the Global Financial Crisis (2007-08), or the current pandemic, each time markets eventually recovered. It takes a concerted effort not to get caught up in the daily news headlines.

Taking a step back and assessing what's happening from a historical perspective is crucial.

A good financial plan should map out your short and long-term goals and manage any short-term market volatility.

Even a retiree can expect to live for at least another two decades, which means the long-term should always be front of mind.

A good financial adviser can help you build a financial plan that successfully navigates through the other side of a market downturn.

If you have any concerns about your investments or market conditions, your adviser can help. Call our office today.

1 Historical market statistics. (2021, March 05). Retrieved from https://www2.asx.com.au/about/market-statistics/historical-market-statistics

2 Documents Part Three - Fiducian to Hostplus – Parliament of Australia. (2021, March 05). Retrieved from https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/SuperannuationSector/Documents_Part_Three_-_Fiducian_to_Hostplus#FirstStateSuper

3 20-323MR ASIC report explores how to measure 'value for money' in default insurance in superannuation | ASIC - Australian Securities and Investments Commission. (2021, March 05). Retrieved from https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-323mr-asic-report-explores-how-to-measure-value-for-money-in-default-insurance-in-superannuation

4 Sokol-Hessner, P., & Rutledge, R. B. (2018). The Psychological and Neural Basis of Loss Aversion. Curr. Dir. Psychol. Sci., 28(1), 20–27. doi: 10.1177/0963721418806510

Investors buoyed as vaccine points way to post-COVID world

A lift in sentiment about the prospects for a recovering global economy has caused most investment markets to steady. Australian equities opened the year in solid fashion while US equities moved higher, although markets generally remain volatile with some regions still suffering COVID-19 outbreaks.

The Organisation for Economic Co-operation and Development (OECD) now expects the world economy to grow by 5.6% this year – an increase of more than 1% compared to its view just last December, as vaccines are rolled out.

"Global economic prospects have improved markedly in recent months, helped by the gradual deployment of effective vaccines, announcements of additional fiscal support in some countries, and signs that economies are coping better with measures to suppress the virus," the OECD said.

The world is also eagerly awaiting the rollout of US President Biden's $US1.9 trillion COVID relief package, which is expected to prop up the largest economy in the world.

While the low-interest rate environment is expected to persist for several years, 10-year bond yields picked up as the market acknowledged stronger inflation is a long-term possibility, particularly in the US.

The Reserve Bank of Australia said the local economy is recovering better than expected on the back of extensive fiscal and monetary policy support and the general success of health measures implemented across the country. There have also been broad-based increases in commodity prices, including record iron ore exports, which will provide the upcoming Federal budget with a boost.

The JobKeeper subsidy, which reduced many businesses' operating expenses and lifted both earnings and margins, ended in March, prompting concerns that vast numbers of Australians could soon lose their jobs. About 1 million people were covered by the scheme. JobSeeker payments to unemployed recipients were also recently cut after a temporary increase during the height of the pandemic. However, the unemployment rate is currently better than expected, as companies reported strong end of calendar year earnings.

The Government continues to support sectors that continue to struggle, such as travel, with specific subsidies. Australian house prices continued their meteoric rise across the country. REA Insights said the housing boom has been fuelled by heightened demand for property, low volume of available stock for sale, and historic low borrowing costs.

Another factor is Australia's slowing population growth falling to levels not seen in a century.

If you are concerned about current market conditions, please contact our office today to speak with your adviser, who can help at any time.

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