Newsletter

August 2016

EVEREST PARTNERS
PRIVATE WEALTH MANAGEMENT

Introduction

Welcome to our newsletter for August 2016. This newsletter combines the articles that we have published on our site since we last published a discrete newsletter. We provide the newsletter in this format so that you have a single, portable document that you can read at your leisure.

In this newsletter, we discuss why business owners should not delay starting a separate and unrelated investment strategy. We also look at how interest rates are set, and examine good and bad ways for parents to help adult children enter the property market – something that is close to heart for every parent. Finally, we end with a very useful, time-saving tip for business owners or investors.

Please feel free to share this newsletter with anyone you think would find it helpful. And please also free to get in touch with us if there is anything that you would like to discuss about its contents.

Did You Know… the month of August

August has been a key month in Australian history. Perth was founded in August 1828, with Melbourne following soon after in August 1835. In August 1903, the Australian High Court was founded and in August 1908, the great Don Bradman was born.

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Why Business Owners Should Start Investing Sooner Rather than Later

When you start investing is often more important than how much you start investing with.

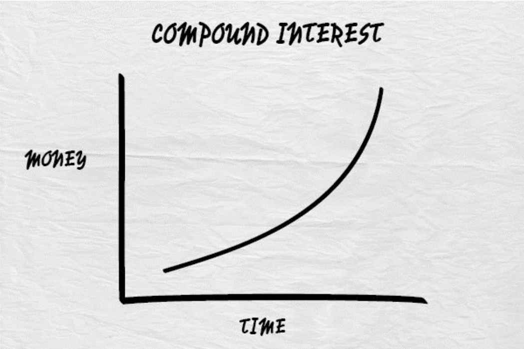
Here is an interesting question: two small business owners have just sold their businesses and want to invest the proceeds. One sold for $1,000,000 and the other sold for $500,000. They both make the same investment and achieve the same return. Which one will retire with more money?

The answer is: you can't tell on these facts. The most important fact is how old each person is. If the investors are the same age, then the one who started with more will finish with more. But if the one with less to invest is *younger*, things get really interesting.

Let's say that the two investors are aged 30 ($500,000) and 50 ($1,000,000). And they both make an investment into an index-based exchange-traded fund. If you do not know what that is, don't worry. For now, just understand that the return on the investment will be the same as the market average. Over the twenty years to the end of 2015, the average return in the share market was about 8.7%. Average inflation was around 3% per year, meaning that the average return after inflation was around 5.5%.

An investment returning around 5.5% will double in value every thirteen years. So, after 13 years, the $500,000 has become $1,000,000 and the $1,000,000 has become $2,000,000. And the investors are now aged 43 and 63. The second one is about to retire – with $2,000,000. But the first investor has another 20 years to go. If his investment continues to grow at 5.5%, then by the time he reaches 63 he will have $2,900,000 available.

The business owner who sold his business for half the price ends up with 45% more to retire with. And these are inflation-adjusted figures, so the difference between the two retirement amounts is not affected by inflation. The owner of the smaller business really does end up with more.



The difference is all about timing. The sooner you start investing, the better. This is such an important point that it is worth restating in a different way: the time you start to invest can be more important than how much you decide to invest – and maybe even what you actually invest in.

This is a really important point for business owners. How many times have you heard a business owner say ‘my business is my superannuation?’ The problem is that these business owners are waiting to sell their business before they start investing for their retirement. They are leaving it too late.

The problem is a real one. The Association of Super Funds of Australia report that almost 30% of self-employed people have no super at all. If these people are thinking about retirement at all, then they are leaving it way too late to start this form of investing. As the example above shows, late starts simply can’t be made up.

Cash flow is usually the main reason that businesses leave super until it’s too late. And we get it. Cash flow can be hard and there are always a hundred demands on what cash you do bring in. But it is still imperative that you try to get even a little bit away into super each year.

Let’s say you pay marginal tax at 30%. If you give up just $70 a week after tax, then you will be able to contribute $100 per week into super. This gets taxed at just 15% – meaning that your foregone $70 has instantly turned into $85. If you then invest that $85 into an investment that gets the market average of 5.5% after inflation, then in ten years’ time you will have just under $57,000. Do it for 20 years and you will have $155,000. Do it for 30 years and you will have more than $320,000.

$10 a day snowballing into $320,000 – in today’s dollars – in 30 years’ time.

You can see why you really need to start investing today, at the very latest. Give us a call and we can show you how to get started with investing.

Interest Rate Announcements.

Ever wondered why interest rates go up and down? Here's the answer.

On the first Tuesday of each month, the nightly news always includes a story about interest rates. More specifically, the story is about what the Reserve Bank of Australia (the RBA) is doing with interest rates. It even happens on Melbourne Cup Day: the race that stops the nation does not stop the RBA – although they do get their meeting out of the way in the morning, well before they jump.

The Board of the RBA meets on the first Tuesday of each month to set its target for interest rates throughout much of the economy. It does this by setting a target rate for one particular interest rate, known as the 'cash rate.' The cash rate is the rate at which banks lend each other money on an overnight basis. By setting a target price for this market, the RBA affects the other major markets in which money is borrowed or lent.

The RBA influences the market for overnight lending by entering it. It borrows or lends money itself, in order to achieve the desired effect on interest rates. It is a lot like buying and selling in any market: if you flood the market with supply (in this case, money to lend), prices fall. If you buy up everything in the market, prices rise. Interest rates are simply the price of borrowed money.

Of course, given that everyone else in the market knows what the target cash rate is, the RBA does not actually have to do too much buying and selling. If everyone knows what the price "should" be, that is the price they trade at.

A targeted reduction in interest rates is known as 'monetary easing.' This has happened regularly over the last few years and happened again last week. Monetary easing theoretically leads to lower interest rates throughout the economy. We say 'theoretically' because the effect on common interest rates such as home loan rates is often less than the reduction in the target rate. That happened last week, too. Malcolm Turnbull was less than impressed.

Monetary easing is generally good news for borrowers. The reason is simple – the interest burden of their loans is reduced. It is not such good news for lenders – which is what you are if you have your money in a cash management account or on term deposit. The amount of interest you receive on your investment is reduced.

That said, monetary easing tends not to have much impact on credit card rates. The market forces at work here are quite removed from the other lending markets.

The RBA reduces interest rates to stimulate the economy. If people borrow and spend more, economic activity gets a boost. So, falling interest rates tend to be a sign that the economy needs a boost – which is not necessarily the good news that people think it is.

Increasing the interest rate is known as 'monetary tightening.' The RBA increases interest rates to discourage borrowers. This slows down the economy: higher interest rates mean less borrowing which in turn means less spending. So, higher interest rates tend to be a sign that the economy is going well.

Helping Adult Kids Buy Homes

Most parents are keen to help their kids buy a home. There are good ways and not so good ways to do so.

Glenn Stevens has just stepped down from his role as the Governor of the Reserve Bank. It has been his job to monitor the economy for the last several years, and then to set interest rates accordingly. He probably knows more than any other Australian about housing affordability and how hard it is for young people to buy homes.

Stevens gave an interview this week. In the interview he agreed that it is almost impossible for a young first home buyer to buy a house in Sydney (where he lives) without parental support. The situation may not be quite as bad in the other capital cities – but it is still very difficult for younger people to buy a first home. Many, if not most, young first home buyers use some form of parental or grandparental support to help with the purchase.

This kind of parental support is really a way of bringing forward the benefits of a young person's inheritance. The Grattan Institute have reported that most people who receive inheritances are aged in their 50s or 60s. This makes sense as it means that the last remaining parent died in his or her eighties or even nineties. As elderly mums and dads live longer, inheritances are passed on later in their children's life.

Living longer makes the elderly wealthier – as long as they own a home. 43% of total private wealth in Australia is locked up in the homes that people are living in. Because older homeowners hold their homes for longer periods, the increase in the value of that home compounds over a longer period.

Put these two things together and you see that people are inheriting more from their parents than they ever have before – but that they are receiving that inheritance in their fifties or even their sixties, well after their own peak cost years have passed.

This all sets the scene for families to look to assist across the generations *before* the older generations pass away – which is what Stevens is observing in the Sydney market where he lives. And this kind of assistance is something that parents are usually keen to provide… if only so that their grandkids live closer than they otherwise would!

There are various ways for older generations to help out younger generations. Some make more sense than others, and so it pays to really do your thinking about how assistance should be given. Straight out gifts are almost always bad news – especially if there is a partner involved.

One very simple way is for mum and/or dad to use their own savings account to offset their children's mortgage. In essence, this becomes an interest-free loan that saves the younger person the amount of interest that they would have paid on their own home loan. For example, mum and dad might have say $40,000 in a savings account. The money is perhaps earmarked for their own retirement holiday or a new car in a few years' time. Allowing this money to offset their adult child's mortgage will save that child around $2,000 a year in interest to the bank. This interest is not tax deductible, meaning that someone paying marginal tax rate of 30% has to earn $2,800 in order to pay it. If the young person keeps up the same level of repayments, then they will find themselves reducing the principal of their loan by $2,000 a year.

The key benefit is that the money in the savings account remains mum and dads. It does not really cost mum and dad anything to use their money like this. If they left it in a savings account in their own name, they would receive no more than $100 or so in interest. Giving up $100 to save your kids $2,000 is a bit of a no-brainer.

This is just one of the many pain-free and low-risk ways that older generations can help younger ones. There are also some very high risk ways that should be avoided (straight out gifts of cash to the adult child are almost always a bad idea). It is important that you do the right thing in the right way.

So, if you would like to help your children to buy their own home, make sure you give us a call so we can discuss the very best way to do so.

A simple way to keep track of small business expenses

Dedicated-use credit cards make for a simple way to keep track of business expenses.

All businesses want to make sure that they claim every possible deduction that they can. But costs must be substantiated to be deducted from your assessable income.

Substantiation requires you to keep records, and to have access to receipts and tax invoices so you can prove your claim for deductions against your assessable income.

It's a hassle to have to record all the little costs you incur on a day-to-day basis as you go about earning your income. Indeed, things can become really silly if the time taken to record small expenses exceeds the tax benefit of doing so. There is an easier way.

One simple solution is to use two credit cards. The first credit card is used strictly for private purposes. Pay-wave lunches and coffees, clothes, groceries and other personal items. There are two associated things to remember:

1. This card is only used for private and domestic costs; and
2. This card is never used for deductible costs.

The second credit card is used strictly for business purposes. Petrol for your car, on-line business payments, business airfares and accommodation, automatic professional subscriptions and so on. Once again, there are two associated things to remember:

1. This card is only used for deductible costs; and
2. This card is never used for private and domestic costs.

If you buy two books at a bookshop, Jamie's latest cook book for your husband and Roth's Top Stocks for your investment portfolio, you would pay for the cook book with your private credit card and you would pay for Top Stocks with your business credit card.

Once a month, once a quarter or once a year you simply download your business credit card statement to get an automatic on-line record of your smaller deductible costs and it's all there ready for the ATO, in the unlikely event of an audit.

You can then set your business bank or overdraft account up so it automatically pays your business credit card off using a direct debit every month. The repayment is recorded as, say, "sundry deductible costs" and is automatically coded in your accounting software.

This has two advantages. First, you will never incur any credit card interest costs. Second, you will not incur any time costs: you will never have to think about it again.

The Legal Stuff

General Advice and Tax Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

We recommend you seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

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