QUARTERLY INSIGHT

InterPrac Financial Planning Newsletter Edition 3 2021

Spring update

It is September again which means warmer weather, the spring racing carnival and crowning of the AFL and NRL champions for 2021. For many of us, though, it's hard to get too excited as we navigate long, difficult lockdowns and can't go to support our teams or get dressed up for a fun day at the races.

Despite all the negativity around us, we should try to remain hopeful and optimistic, focusing instead on all the positives in life. Focus on where you want to go and what you want to do, not where you are.

In this newsletter we are looking at insurance cover through your superfund, the tax benefits of shares including franking credits and the lessons that we have learned from investing during the pandemic. We have also looked at Bitcoin and other cryptocurrencies, how it all started, how it works and all the pitfalls and scams surrounding the currencies.

The author Neil Gaiman said, "if you're making mistakes, it means you're out there doing something". (Although we would add that it's best to avoid making the same mistakes over and over!)

Enjoy the read and as always, if you have any questions or need additional information, contact us. We are here to help.

Remember to check in with your friends regularly to ask them if they are OK. Be kind to each other and stay safe!

Investing lessons from the pandemic

When the coronavirus pandemic hit financial markets in March 2020, almost 40 per cent was wiped off the value of shares in less than a month.[i] Understandably, many investors hit the panic button and switched to cash or withdrew savings from superannuation.

With the benefit of hindsight, some people may be regretting acting in haste. Although for others, accessing their super under the early release due to COVID measures was a difficult but necessary decision at the time.

As it happened, shares rebounded faster than anyone dared predict. Australian shares rose 28 per cent in the year to June 2021 while global shares rose 37 per cent. Balanced growth super funds returned 18 per cent for the year, their best performance in 24 years.[ii]

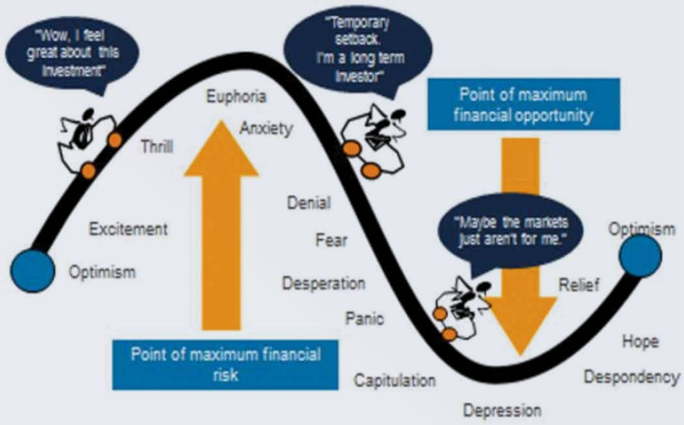
While every financial crisis is different, some investment rules are timeless. So, what are the lessons of the last 18 months?

Lesson #1 Ignore the noise

When markets suffer a major fall as they did last year, the sound can be deafening. From headlines screaming bloodbath, to friends comparing the fall in their super account balance and their dashed retirement hopes.

Yet as we have seen, markets and market sentiment can swing quickly. That's because on any given day markets don't just reflect economic fundamentals but the collective mood swings of all the buyers and sellers. In the long run though, the underlying value of investments generally outweighs short-term price fluctuations.

One of the key lessons of the past 18 months is that ignoring the noisy doomsayers and focussing on long-term investing is better for your wealth.



Lesson #2 Stay diversified

Another lesson is the importance of diversification. By spreading your money across and within asset classes you can minimise the risk of one bad investment or short-term fall in one asset class wiping out your savings.

Diversification also helps smooth out your returns in the long run. For example, in the year to June 2020, Australian shares and listed property fell sharply, but positive returns from bonds and cash acted as a buffer reducing the overall loss of balanced growth super funds to 0.5%.

The following 12 months to June 2021 shares and property bounced back strongly, taking returns of balanced growth super funds to 18 per cent. But investors who switched to cash at the depths of the market despair in March last year would have gone backwards after fees and tax.

More importantly, over the past 10 years balanced growth funds have returned 8.6 per cent per year on average after tax and investment fees. High growth funds returned 10.3 per cent per year and the most conservative funds returned 5.5 per cent per year.[ii]

The mix of investments you choose will depend on your age and tolerance for risk. The younger you are, the more you can afford to have in more aggressive assets that carry a higher level of risk, such as shares and property to grow your wealth over the long term. But even retirees can benefit from having some of their savings in growth assets to help replenish their nest egg even as they withdraw income.

Lesson #3 Stay the course

The Holy Grail of investing is to buy at the bottom of the market and sell when it peaks. If only it were that easy. Even the most experienced fund managers acknowledge that investors with a balanced portfolio should expect a negative return one year in every five or so.

Unfortunately, we can only ever be sure when a market has peaked or troughed after the event, by which time it's usually too late. By switching out of shares and into cash after the market crashed in March last year, investors would have turned short-term paper losses into a real loss with the potential to put a big dent in their long-term savings.

Even if you had seen the writing on the wall in February 2020 and switched to cash, it's unlikely you would have switched back into shares in time to catch the full benefit of the upswing that followed.

Timing the market on the way in and the way out is extremely difficult, if not impossible.

Looking ahead

Every new generation of investors has a pivotal experience where lessons are learned. For older investors, it may have been the crash of '87, the tech wreck of the early 2000s or the global financial crisis. For younger investors and many older ones too, the coronavirus pandemic will be a defining moment in their investing journey.

Now that shares and residential property prices have rebounded strongly, investors face new challenges. That is, how to make the most of the prevailing market conditions while ignoring the FOMO (fear of missing out) crowd.

By choosing an asset allocation that aligns with your age and risk tolerance then staying the course, you can sail through the market highs and lows with your sights firmly set on your investment horizon. Of course, that doesn't mean you shouldn't make adjustments or take advantage of opportunities along the way.

We're here to guide you through the highs and lows of investing, so give us a call if you would like to discuss your investment strategy.

i https://www.forbes.com/sites/lizfrazierpeck/2021/02/11/the-coronavirus-crash-of-2020-and-the-investing-lesson-it-taught-us/?sh=241a03a46cfc

ii https://www.chantwest.com.au/resources/super-funds-post-a-stunning-gain

Don't take super cover for granted

Buying insurance through super has many advantages, but you need to make sure you are getting the right cover for your individual needs. In some cases, you may be paying for nothing.

Most super funds offer life and total and permanent disability (TPD) insurance to fund members and, in some cases, income protection cover.

But since the introduction of the *Protecting your Super* reforms in 2019, this cover is no longer automatic.

If you have less than $6000 in your account or it has been inactive, then the insurance component will have been cancelled unless you advised the fund otherwise. An account may be deemed inactive if, for example, it has not received a contribution for more than 16 months.

In addition, insurance cover is no longer offered to new fund members aged under 25.[i]

Is it right for you?

If you do have insurance in your super account, then it's a good idea to check the cover is right for you. This is particularly the case now that the stapling measure has been introduced as part of the recent *Your Future, Your Super* legislation.

From November 1, unless you choose a new fund when you change jobs, the first fund you joined will be 'stapled' to you throughout your working life. This is where problems can arise; while the fund stays the same, so will the insurance cover.[iii]

Say you move from a low-risk job where the insurance offered in your super was more than adequate to a high-risk job such as in construction or mining. Would your insurance now cover you if you were no longer able to work? And if it did, would the cover be sufficient? It may well be that your new occupation is not even covered.[iv]

Most TPD policies within super are for "any" occupation rather than "own" occupation. This three-letter definition can make a world of difference. If you still have the capacity to work in some other occupation, then it is likely your insurance will not pay out.[v]

Many benefits

Despite this, there are still many benefits from having insurance cover in your super. Firstly, the premiums are generally lower because the fund buys the insurance cover in bulk. In addition, your premium payments are effectively lower as they come out of your pre-tax rather than your post-tax income.

What's more, you are not having to put your hand in your pocket to pay the premiums as the money automatically comes out of your super. Of course, the flipside is you will have less money working to build your retirement savings.[vi]

So, when it comes to taking out insurance, going through your super has lots of positives.

But the downside is that the default level payout may be lower than you might need. You should check if this is the case and maybe consider making additional premium payments to give yourself and your family more appropriate cover. Be aware though that opting for a higher payout could mean you have to undergo a medical.

Regular checks

Wherever you get insurance cover, it's important to remember that its purpose is generally to cover any outstanding debt and ongoing financial obligations should you pass away or become unable to work.

For this reason, it is important to regularly check your insurance within your super to ensure it is sufficient to maintain your lifestyle.

If it falls short, then you might also consider taking out a policy outside super.

While income protection is sometimes available through your super, it may be necessary to look outside. Such policies pay you a regular income for a specified period if you are unable to work through an illness or injury, and premiums are tax-deductible outside super.[viii]

When you are leading a busy life with lots of claims on your income, insurance may be seen as an unnecessary expense. But when it comes to the crunch, it can play a valuable role in you and your family's life when you need it most.

Please call us to discuss your insurance needs and whether your existing cover, both inside super and outside, is sufficient.

i https://www.ato.gov.au/individuals/Super/In-detail/Growing-your-super/Inactive-low-balance-super-accounts/

ii https://www.ato.gov.au/individuals/Super/In-detail/Growing-your-super/Inactive-low-balance-super-accounts/

iii https://www.ato.gov.au/General/New-legislation/In-detail/Super/Super-Reforms---Your-Future,-Your-Super/

iv https://thenewdaily.com.au/finance/dollars-and-sense/2021/08/02/insurance-life-tpd-superannuation/

v https://moneysmart.gov.au/how-life-insurance-works/total-and-permanent-disability-tpd-insurance#:~:text=Your%20own%20occupation%20%E2%80%94%20you're,working%20in%20before%20your%20disability.&text=Any%20occupation%20%E2%80%94%20you're%20unable,your%20education%2C%20training%20or%20experience.

vi https://moneysmart.gov.au/how-life-insurance-works/insurance-through-super

vii https://thenewdaily.com.au/finance/dollars-and-sense/2021/08/02/insurance-life-tpd-superannuation/

viii https://www.ato.gov.au/individuals/income-and-deductions/deductions-you-can-claim/other-deductions/income-protection-insurance/

Frankly speaking: Tax benefits of shares

Australian shares are popular investments with self-funded retirees and anyone who depends on income from their investments, due in part to the favourable tax treatment of franked dividends.

After falling off in the early days of the COVID pandemic, share prices and dividends bounced back strongly in the year to June 2021.

Investors who depend on income from their shares also have more certainty now that the Labor Party has dropped its opposition to cash refunds of excess franking credits, a policy that attracted fierce resistance from retirees at the last federal election.

The hunt for yield

In a low interest rate environment, dividend yields on Australian shares compare favourably with near-zero interest rates on bank term deposits and historically low yields on government bonds.

Over the past 40 years, the dividend yield on Australian shares has averaged just over four per cent and many stocks pay more, dividend yield is the sum of dividends over the past 12 months divided by the current share price.[i] In fact, dividends account for roughly half the total return from Australian shares over the past 20 years.[ii]

These dividend yields are even more attractive when the tax benefits of franking credits are included, especially for investors in retirement phase.

What are franking credits?

Franking credits represent tax a company has already paid in Australia on any profits it distributes to shareholders by way of dividends. The company tax rate in Australia is currently 30 per cent, or 25 per cent for companies with turnover of less than $50 million.

Shareholders can then use these franking credits, also known as imputation credits, to offset their tax liability on other income, including salary, at the end of the financial year. People who pay no tax, such as investors in retirement phase, can claim a full tax refund from the ATO.

If your marginal tax rate is less than the company tax rate of 30 per cent, you may be eligible to receive a refund of the difference between the franking credit and your tax payable.

This is one reason SMSFs are so attracted to shares in Australian companies that pay fully franked dividends. Super funds pay a top income tax rate of 15% and no tax on the earnings or income of investments supporting a retirement pension.

Am I eligible for a tax refund?

You may be eligible for a refund of excess franking credits if all the following apply:

- You receive franked dividends on or after 1 July 2000 either directly or through a trust or partnership
- Your basic tax liability is less than your franking credits, after taking into account any other tax offsets you are entitled to.
- You meet the ATO's anti-avoidance rules, designed to ensure everyone pays their fair share of tax (see the 45-day rule below).

You will also need to keep dividend statements from companies that paid franked dividends to support your claims.

The 45-day rule

Where tax is concerned, there are always rules and franked dividends are no exception. To guard against tax avoidance, the ATO imposes a holding period rule, popularly known as the 45-day Rule.

To be eligible for franking credits you must:

- Hold your shares for a minimum of 45 days, excluding the days of purchase and sale
- Purchase the shares before the ex-dividend date
- Be holding the shares on the ex-dividend date, although you can sell on this date.

The ex-dividend date is the first day a stock trades without the value of the next dividend payment. You can find the ex-dividend and record dates for a stock on the company's website.

The 45-day Rule doesn't apply if you are an individual taxpayer and the total franking credits being claimed are less than $5,000 for the financial year.

So how does franking work?

Franking credits have different impacts depending on your marginal tax rate and whether your share investments are held inside or outside super.

Say you own shares in a company which pays a fully franked dividend of $700. Your dividend statement says there is a franking credit of $300, which represents tax the company has already paid. This means the dividend before company tax was deducted would have been $1,000 ($700 + $300).

In your annual tax return, you must declare the full $1,000 in your taxable income. The after-tax value of the dividend will then depend on your marginal tax rate.

Let's consider the outcome for four scenarios, (see per table following) depending on whether you own shares in an SMSF in pension phase (no tax) or accumulation phase (15 per cent tax); or outside super in your own name at the personal rate of 32.5 per cent or 45 per cent (excluding the Medicare Levy of two per cent).

If you hold the shares in an SMSF tax-free pension account, you will receive a total dividend payment of $1,000 ($700 dividend plus a full cash refund of the attached franking credits).

If you hold the shares in an SMSF accumulation account (15% tax), you will receive $850 ($700 dividend plus a $150 cash refund of franking credits).

If you hold the shares in your own name there will be some tax to pay on your dividend income, but significantly less than you would otherwise have paid without franking credits.

	SMSF pension	SMSF accumulation	Own name 32.5% tax	Own name 45% tax
Dividends paid	$700	$700	$700	$700
Franking credits	$300	$300	$300	$300
Taxable Income	$1,000	$1,000	$1,000	$1,000
Marginal tax rate	0%	15%	32.5%	45%
Gross tax payable	$0	$150	$325	$450
Tax payable (Refund) after deducting franking credit	($300)	($150)	$25	$150

If you would like to discuss your overall investment strategy, please give us a call.

i https://www.marketindex.com.au/statistics

ii https://www.bt.com.au/personal/smsf/manage-your-smsf/investment-insights/the-search-for-dividend-yield-in-a-low-growth-environment.html

Bitcoin and other Cryptocurrencies

The number of cryptocurrencies available to buy and sell has risen from 66 in 2013 to 1,500 in 2019 and to more than 6,000 today. The ten most important cryptocurrencies other than Bitcoin are Ethereum, Litecoin, Cardano, Polkadot, Bitcoin Cash, Stellar, Chainlink, Binance Coin, Tether, and Monero.

A comprehensive definition of cryptocurrency is virtual or digital money that takes the form of tokens or "coins." While some cryptocurrencies have ventured into the physical world with credit cards or other forms, most remain intangible.

Most Cryptocurrencies are designed to be free from government manipulation and control, although as they have grown more popular, this foundational aspect of the industry has come under fire.

Bitcoin was the world's first decentralised cryptocurrency and is still the most popular, have the most extensive user base and market capitalisation.

Bitcoin

On January 3, 2009, Bitcoin was introduced by an anonymous computer programmer (or group of programmers) under the pseudonym "Satoshi Nakamoto". It is alleged that he owns or holds 1-million-bit coins, but as the identity of the person or persons who created the technology is a mystery, it is yet another unfounded truth of the coin itself.

How does Bitcoin work?

The Bitcoin network is a peer-to-peer electronic payment system that uses a native cryptocurrency called bitcoin to transfer value over the internet or act as a store of value. This storage characteristic has been in comparison to gold and silver.

Bitcoin has a fixed supply of 21 million bitcoin, and the bitcoin in circulation cannot be destroyed.

Holders who store their own bitcoins have complete control over them. Without the holder's cryptographic key or token, these bitcoins hold no value.

Users can lose bitcoin and other cryptocurrency tokens due to theft, computer failure, loss of access keys, and more. Users must ensure that passwords or private keys are not lost, as they are irreplaceable. Once the 21 million coins have been mined, it has been insinuated that the total in circulation may fall as some may be lost in cyberspace forever.

One of the safest ways to hold bitcoin is to use "Cold storage" or offline wallets (Paper, storage devices like USB drives, CDs, or bank vaults). They are not accessible via the internet but not very convenient.

The most convenient is to keep it in a "digital wallet" that is hardware-based, like a computer desktop, or mobile phone. The wallet is only accessible via a set of "private keys" if the owner does not lose the key or having the key stolen. It would be best to keep in mind that a computer device can be hacked and information stolen, or the hard drive can crash, causing a loss of information if not backed up.

Bitcoin mining

Each bitcoin comprises of 100,000,000 Satoshis (the smallest units of bitcoin), making individual bitcoin divisible up to 8 decimal places. Bitcoins are either "mined" by a computer through solving mathematical problems, or algorithms are used to verify transaction blocks to be added to the blockchain.

As bitcoin is intangible, value is transacted directly between the sender and the receiver, and there is no need for banking intermediaries to facilitate the transaction. Transactions are recorded on a Bitcoin "blockchain" ledger through a process called "mining." Miners make the Bitcoin payment network trustworthy and secure by verifying transaction information. Miners are provided with a small number of bitcoins. Currently, miners receive 6.25 bitcoins each time they mine a new block.

Before you dive in, please tread carefully

ASIC has recently issued a warning and urged Australians to avoid investing in crypto asset-related financial products through unlicensed entities, such as options and futures. If you are dealing with a licensed entity, you have investor protections in place.

The sale of binary options to retail clients was recently banned in Australia under an order that will remain in force for 18 months, after which it may be extended or made permanent.

The ACCC has also recently reported that losses to investment scams involving Bitcoin have already reached $25.7 million this year, compared to $17.8 million across 2020, representing a 44 percent increase.

Please ensure you seek financial advice before you look at investing in Cryptocurrency.

Chocolate, yoga and sunshine: body chemistry can bring some light to lockdown

By Susan Rossell

The COVID-19 pandemic is taking its toll on all of us. If you've been feeling anxious, stressed, depressed, confused and unable to concentrate or sleep well, you wouldn't be alone.

As a cognitive neuropsychologist and researcher at Swinburne University of Technology's Centre for Mental Health, I have been researching the impact of the COVID-19 pandemic on our mental health.

But you don't need to be an expert to see that the constant disruptions to our everyday routines are taking their toll on our natural reserves and our bodies – especially our brains.

Long-term stress and anxiety cause our brains to release stress hormones – like adrenaline and cortisol – regularly.

This can increase symptoms such as headaches, confusion, poor concentration and insomnia. Eventually more significant long-term mental health problems can emerge, like depression and post-traumatic stress disorder.

So, let's pause to think about how to reverse the negative effects of pandemic stresses and anxieties. Even if you're in lockdown or things are not back to normal, there are things you can do to produce different brain chemicals to siphon some happiness.

Take it from me – these are the things we should all be focusing on right now.

You might have heard of oxytocin – the love drug. It is produced in the hypothalamus and it helps us in social situations, allowing us to bond with and trust other people. Oxytocin gives us that warm, fuzzy feeling.

Increasing your oxytocin will have a positive impact on your mood and emotions. Some things you can do to boost oxytocin are patting the dog or another pet (the fluffy ones are great for this), playing with children, giving or receiving a hug, telling someone how much you care or going to a yoga class.

Actually, yoga is also great for your endorphins – which are produced in the pituitary gland and help us deal with stress and anxiety. They can block pain signals, so they are our bodies' natural painkillers. In fact, endorphins work similarly to opioids in the body.

Endorphins vary between individuals, but other ways you can increase them include engaging in regular exercise, laughing (whether you turn to your favourite comedy, have a chat with friends or even laugh at nothing – since fake laughing works too), dancing, meditation or tapping into your creative side (perhaps it's time for a lockdown hobby that has you creating art or music?).

Perhaps the most-favoured tip for boosting your endorphins is eating dark chocolate.

Another feel-good chemical is dopamine, which makes it the perfect target for a pick-me-up during a COVID-19 lockdown. Dopamine is an important chemical messenger in the brain that has many functions. It is involved in our motivation, learning and memory – and it helps with pleasure and reward.

There are some important ways we can give it a boost, including celebrate the wins no matter how small (got out of bed today? That's a win!), cooking and eating good food, drinking green tea, getting a good night's sleep and perhaps some more meditation.

Lastly, let's not forget about serotonin. This chemical impacts our whole body and helps stabilise our mood and happiness. Serotonin also plays a role in our sleeping, eating, and digestion.

Our serotonin needs all the help it can get during this continuing COVID-19 pandemic. An important way to boost your serotonin is to eat a healthy diet – that means avoiding junk food and eating tryptophan-rich foods (e.g. salmon or nuts).

You should also aim to spend time in the sunshine, which has the added benefit of increasing the vitamin D many of us may be lacking during winter.

You can also listen to your favourite music (and if dancing is involved to get those endorphins up at the same time, all the better), get a massage and, of course, do more exercise. Walking, running and cycling are good activities to get you outside and moving.

Whatever you choose to do, I hope you siphon a little extra happiness this lockdown weekend.

Professor Susan Rossell is a cognitive neuropsychologist and senior NHMRC Research Fellow at Swinburne University of Technology's Centre for Mental Health.

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Australian Financial Services Licence Number 246638, Level 8, 525 Flinders Street Melbourne VIC 3000