

# According to us

## newsletter

Summer 2012/13



## Same old, same old...

by Geoff Greetham, Executive Director

At this time of the year, it is not uncommon to hear market experts outline (before they embark on their summer holidays) their predictions for the next 12 months. Interestingly, we tend not to check their track records however are more than prepared to give some weight to these forecasts.

The view though at the end of 2012, peaking into 2013, does not seem too dissimilar to that at the end of 2011. The same themes dominate i.e. Europe's management of and solutions to its sovereign debt crisis, the success or otherwise of the US' efforts to reflate its economy as well as address its debt position and China's ability to sustain its high growth rate in turn dragging along Australia in its wake. A large part of the current problems also seem to stem from a policy paralysis globally.

The major difference heading into 2013 though, is the fact that investors are becoming more resigned to lacklustre returns until the outlook becomes clearer. And this is despite political developments in the US and China in November, which one would have hoped may have provided much needed clarity. Alas, not. Paul Kasian will discuss the most immediate issue exercising professional investors' minds – the US fiscal cliff and the potential ramifications for share markets – as well as our portfolio positioning against such a backdrop.

It has now become obvious to all, in such a difficult investment environment, that creating wealth has become much harder. Protecting it from being eaten away by inflation and tax, very difficult. And ensuring that you have enough to last for your lifetime, concerning. To address this latter issue (what the industry terms, longevity risk), I explore approaches to gauge where you stand, fortified with the hope, courtesy of our superannuation system, that it is never too late to start. Having a clear goal, we believe, is the only way to measure where you are at. We certainly welcome discussing this with you.

Finally, we wish you well in this busy festive season and holiday period, trusting it provides a welcome opportunity for you to recharge the batteries for the year ahead.

We look forward to seeing you in the New Year and continue to welcome any feedback on our newsletter and any topics you may wish to be addressed.



## The Fiscal Cliff

By Paul Kasian, Chief Investment Officer

There has been a lot of discussion (more so overseas than in Australia) about what will happen in the United States as we approach what the Federal Reserve chairman Ben Bernanke has termed "the fiscal cliff". This issue developed as while both the US Congress (controlled by the Republicans) and the President agreed that reducing the rate of growth of US government debt was important, they couldn't agree on a program on how to achieve this. As an incentive to force all sides to eventually come up with an agreement, the US Congress passed the US Budget Control of 2011. The terms of this act are scheduled to come into effect at midnight on 31 December 2012. This will include the end of temporary payroll tax cuts and other tax breaks for business, the end of the Bush tax cuts and the beginning of taxes related to President Obama's healthcare program. This will be accompanied by significant spending cuts to the US defence budget as well cuts to other federal agencies and cabinet departments.



"Henry is holding his breath until Washington regains its sanity."

If a deal is not reached then it is expected that a fiscal contraction (reduced government spending) between \$500 and \$600 billion will occur in 2013. This is expected to reduce GDP growth in the economy by 3% and push the US into recession. According to Alan Blinder, a former vice chairman of the Federal Reserve, "millions of jobs will be destroyed, incomes and wealth will fall, and businesses will fail in droves - all because a bunch of politicians couldn't agree." Of course the damage will not be limited to the US economy. As Christine Lagarde,

head of the International Monetary Fund, said recently "The US is about 20% of the global economy. If the US suffers as a result of the fiscal cliff, a complete wiping out of its growth, it is going to have repercussions around the world." For example, "if the US economy has 2% less growth there will be 1% less growth in Mexico and China".

Given the pressure on Congress, and the feeling amongst commentators that politicians tend to put self interest ahead of ideology, there is a strong belief that a deal will be done. As a result equity markets have been steadily rising since the middle of November. However, if such a deal fails to materialise soon then investors could start to become very nervous and all markets (including shares, commodities and fixed income) will become very volatile. For this reason we will continue to maintain an overweight cash position in client equity portfolios. However the risk with this position is that the market will continue to look through the "fiscal cliff" and focus on the positives such as the recovery that appears to be underway in the Chinese economy.

# A place to start planning

By Geoff Greetham, Executive Director

"How much money do I need to retire?" is a question often asked and one which has a multitude of answers. Just like most things in life, any answer is often prefaced with the words, "depends on".

Such a question is also taking on increasing relevance as:

- more and more people come to the realisation that the aged pension provided by the government will not only become harder to access but also insufficient to meet even meagre needs;
- health and aged care costs keep increasing at rates greater than inflation or by what is regarded as "excess health price inflation", a term used by the Australian Institute of Health and Welfare, the national statistics and information agency; and
- the fact that we are living longer lives, courtesy of healthier lifestyles, modern medicine and improved living standards, with life expectancy for Australian women now 84, while for Australian men it has now reached 80. In fact, the chance of reaching, say 95, is estimated to be one in nine for a male, one in five for female and one in three for either one of a couple.



The best place to start is by re-phrasing this question to "How much income will I require when I retire?"

From here, we can then explore certain methodologies used in calculating that income requirement in turn providing a basis for estimating that "lump sum" of savings required.

The two most common methods of calculation used are:

## 1. A percentage of current after tax income

Figures of 60-70% are often quoted being at levels seen as sufficient to maintain one's lifestyle after retirement on the presumption that all debts have been cleared.

As an example, based on a median household income for people aged 55-64 of \$108,090 p.a. (source: CPA Australia, Household savings and retirement: Where has all my super gone?, October 2012), this equates to some \$75,000 p.a.

## 2. A percentage of current pre-retirement expenses

Again figures ranging from 60-80% are often used. Differences arise with mortgage expenses. They are either included in pre-retirement expenses to provide a suitable buffer in retirement or excluded in order to match more precisely current spending with retirement spending. The latter assumes that one's lifestyle will remain unchanged.

Whilst the first is easier to calculate as people generally know their income and will have tax returns etc. to support, the second method requires a more forensic analysis of spending patterns but is arguably a better base from which to work.

Neither methodology though allows for increased costs that may be associated with ageing, other than allowing for CPI increases by working in today's dollars. That said, the former method i.e. percentage of current after tax income relies somewhat on the premise that maintaining a certain income level will allow for a comfortable lifestyle, perhaps providing some leeway to that based on current expenditure.

A study published middle of this year by Dimensional Fund Advisors, a US based international investment manager/consultant proved instructive, and although based on US experience, its findings are also relevant in Australia as follows:

- the assumed range of pre-retirement income to maintain the same standard of living can be quite varied, dependent upon individual circumstances, with a range of less than 60% to more than 80% cited in certain circumstances though largely supporting the 60-80% range;
- higher income earners reduced spending in retirement more so than lower income earners, with this translating to being households with annual income of \$50,000 or greater reducing spending by about 10% in retirement whereas those below \$50,000 tended to hold spending constant. It was observed though that discretionary spending eg. entertainment actually rose for both groups as they aged; and
- most households, based on simulation results using actual investment returns and income changes, needed to save 10-15% of income through their working years to have a high probability of maintaining a significant proportion of their pre retirement income.

The last point stresses, in the Australian context, the importance of our superannuation system and the need for a disciplined approach to maximising contribution caps where possible.

Also, to put the above in perspective, an Australian Treasury Study (released in 2011) on the adequacy of Australian retirement incomes estimated the average "spending replacement" rate (ie. ratio of potential private spending after retirement to that during working life) at just over 60%, rising to 80% in around 20 years time, largely in line with these findings.

As part of our service offering, using some of the guidelines defined (and tested) herein as a basis, Accordius is able to model a range of retirement accumulation scenarios for you showing the impact of various contribution scenarios on your ultimate wealth and maintainable income level.

If you would like to us to conduct such an analysis for you, please contact our office and we would be more than to undertake this on your behalf. The results could be enlightening.

## Striking A-c-cord

### Did you know....

In July of this year (and it has not improved that much since), the 10 year US Treasury Note – an important global benchmark – hit its all-time low (1.39%), with data going back as far as 1790. And the UK base rate, set by the Bank of England, remains stuck at 0.50%, its lowest level since the Bank of England's inception in 1694.



Please note that the information in this publication is for general use only. We would be pleased to talk with you in regard to your particular circumstances should you wish to explore any particular aspect further. Any tax planning matters should be discussed with your accountant before proceeding.

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