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QUARTERLY INSIGHT

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What type of retirement are you preparing for?

Overview

The traditional approach to retirement has been relatively straightforward - to save and invest as much as you can, for as long as you can, starting as early as you can, to accumulate enough retirement savings that you no longer need to work, and instead can enjoy a life of leisure. For those who struggle to save, Social Security provides some retirement safety net, and for everyone else, the more and faster you save, the earlier you can retire and the more leisure time there may be.

However, the problem is that a growing base of retirement research finds that fewer and fewer people actually want a retirement of all leisure and no work. Retirement is actually boring for many! Barely half of today's retirees state that they never intend to work again, and barely 1/3 of pre-retirees have an intention to make retirement a period of not working indefinitely. Instead, whether it's part-time work, entrepreneurialism, an encore career, or some other path, retirement is less and less about not working at all, and more and more about finding a different kind of engagement, which may still generate income.

The significance of these changes is that if an intense period of work followed by an extended period of leisure turns out not to be the ideal approach retirement, instead, better alternatives might be an extended period of 'semi-retirement', including part-time work, or a series of 'temporary retirements', interspersed with breaks and new careers. With these alternative 'retirements', the traditional retirement savings approach might not make sense either.

The reality is that if retirement is really more about doing different and perhaps more fulfilling work, still earning some income, then it really might not take nearly as much to 'retire' as commonly assumed. And 'retirement' portfolios themselves might look very different if their primary purpose is to be a buffer for retirement transition and scaled back work, rather than earning nothing at all. Some actually necessitate more savings, but have a smaller average balance, as savings are built up and spent, while other types of retirement would actually allow for less ongoing savings and smaller retirement account balances, supplemented by work in 'semi-retirement' that could last for years, or decades.

In turn, a future with different types of retirement could also increase demand for income insurance, as a greater reliance on the ability to work and earn income puts us at even greater risk if that goes away, and increase the need for emergency savings, for more extended mid-career transitions.

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Source Michael Kitces and InterPrac FP

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What type of retirement are you preparing for?

The Evolution of Retirement

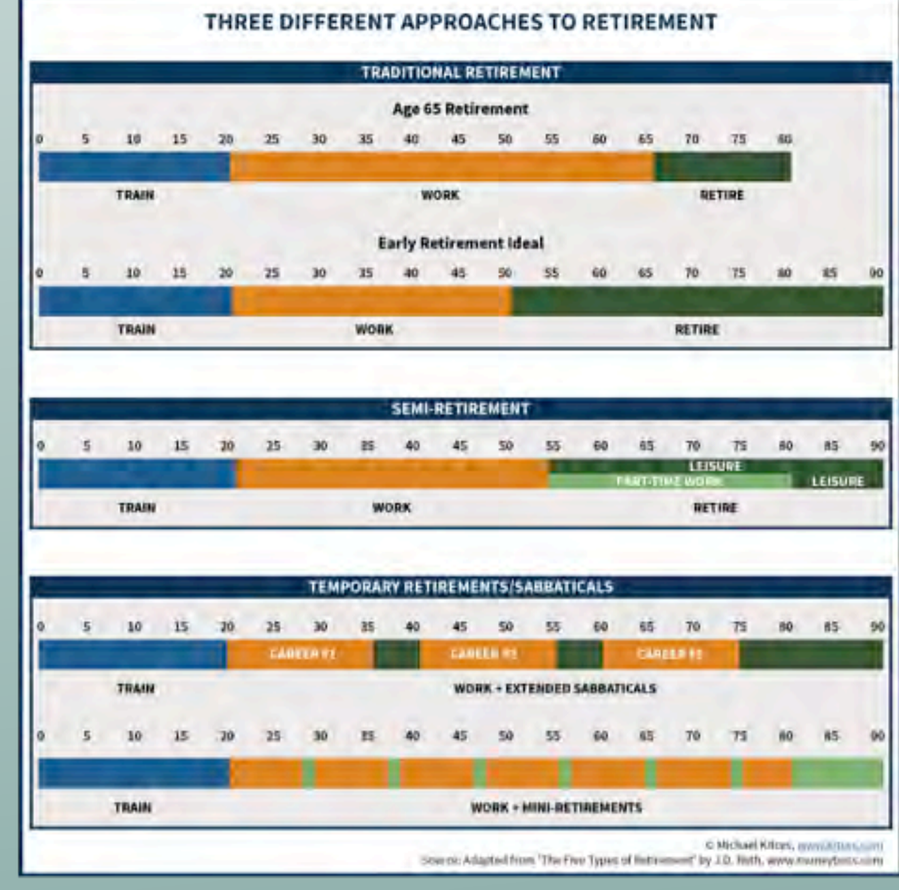
For most of human history, work was something we did for survival, as long as we were physically capable. Of course, the caveat is that the longer we live, the more likely it is we'll reach a phase in our lives where we physically or mentally can't work anymore. Yet continued medical advances over the past century have fundamentally shifted retirement, from a period of worker obsolescence, into a world where retirement itself lasts so long that it's actually a 'phase of life'.

As retirement shifted from a period of obsolescence to one of leisure, it is not surprising that many wanted to maximize the leisure time, with the caveat that retiring earlier means it's necessary to save more in order to retire.

For those who are working – particularly in a job they don't enjoy – the idea of an extended retirement of leisure sounds like a highly appealing goal to reach. However, the problem is that not everyone seems to enjoy it once they arrive.

A growing number of retirees are seeking ways to stay active even after retirement. In other words, retirement doesn't necessarily mean retiring from work altogether. This is important, from the perspective of the focus on saving for retirement.

The traditional type of retirement is the one that we're all most familiar with - save early and often, invest prudently for growth, and retire as soon as you're financially able. If you can grow your retirement portfolio fast enough, you can retire early. The time in retirement is filled with leisure or perhaps engagement through volunteer work, without any financial remuneration.



One alternative is a form of semi-retirement, where work is scaled back, but not eliminated. This might entail starting a business, pursuing a new career, or engaging in consulting or part-time work in a prior career. In essence, semi-retirement in this context means retirement from the current full-time work, but not necessarily from all work.

The third type of retirement is engaging in a series of temporary retirement/s, in essence, planned sabbaticals, after which the individual returns to the working world, perhaps in a new job or career track. In this approach, retirement is not something that comes at the end but instead is dispersed more regularly throughout the individual's productive years, perhaps as transitions between extended careers. The phase of retirement at the end would be shortened, as those initial retirement years are intentionally redistributed in earlier phases of life.

The reason why these different types of retirement are so important is that the 'standard' saving for retirement approach is really only effective for traditional retirement. This is because in other forms of retirement as there is not such an extended period without work income, it's simply not as necessary to generate a huge pile of retirement dollars in the first place!

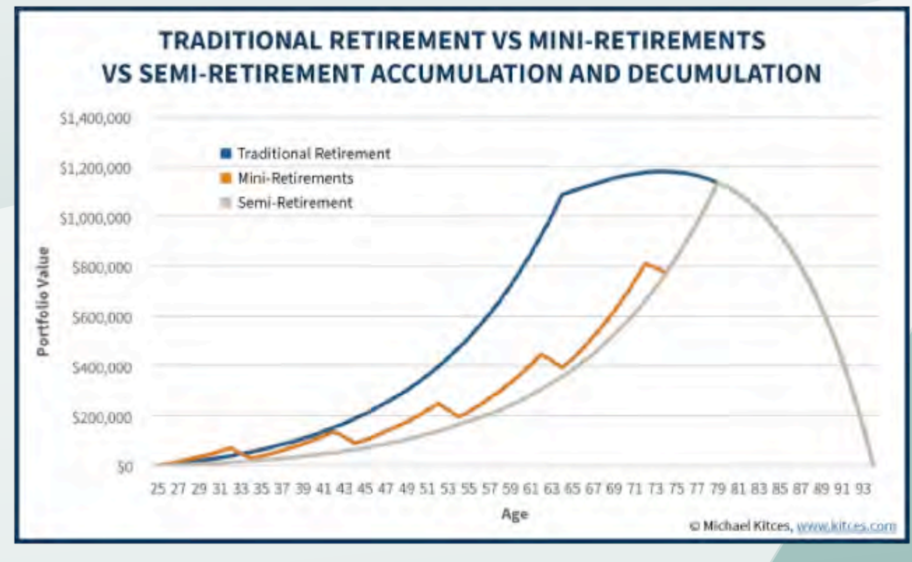
For instance, if leisure periods are going to be shorter and temporary, followed by returning to work, then the reality is that you never need as much of a lump sum in retirement savings, as it only peaks at the very end, to cover the last decade or so when some sort of work is no longer feasible.

With a series of ongoing temporary retirements (or sabbaticals), the retirement savings account never quite

accumulates as high, and doesn't need to be accumulated nearly as rapidly, because the retirement phases just aren't that long. On the other hand, it's notable that with shorter ramp-ups and faster spend-downs, the portfolio never has as much time to grow and compound, nor will it be invested as aggressively given the shorter time horizons, which means the retiree will need to spend less and save more to make the balance work and maintain the same standard of living. Yet ultimately, that's simply a trade-off decision to consider when choosing your ideal type of retirement.

Similarly, someone who chooses to engage in semi-retirement and continues to partially work while being financially independent, also drastically reduces the required upfront savings for retirement.

Notably, in the semi-retirement scenario above, where it is assumed that the retiree works part-time to cover household expenses from age 55 to 80, there may still ultimately be a final period without any work at all, but again, it tends to be much shorter in duration and occurs later. In this context, retirement savings is less about a period of 'leisure' and more about ensuring expenses are covered. The fact that the portfolio itself has longer to grow also drastically reduces the required retirement savings.



Considerations

The key point is not merely that these alternative paths to retirement may entail different retirement savings strategies, but specifically that alternative forms of retirement may require far more in ongoing monthly retirement savings or far less, depending on the type of retirement. Either way, most will have a much smaller retirement account balance for most of their lifetime. In the context of today's prospective retirees in particular, for those able to engage in 'semi-retirement' and still partially work, you may be unnecessarily stressing about your ability to save for a 'retirement' that won't actually necessitate nearly as much in retirement savings.

One of the key risks to consider in these alternative types of retirement is that as retirement savings do not generally accumulate as high, or at least, not until much later, and are more reliant on earned income and 'human capital', you don't have as much of a buffer against truly unexpected retirement, due to disability for example. Social Security provides at least some safety net, but may be far below the standard of living you are accustomed to.

Arguably, this makes income and disability insurance even more important in the future of retirement. An important consideration, given that in practice today, these insurances often go until age 65 and provide a bridge to relying on Social Security in 'traditional' retirement. At a minimum, having an even larger emergency savings to help navigate the transitions becomes more important.

Conclusion

Alternative types of retirement will by necessity require alternative considerations regarding appropriate retirement savings advice for you. This highlights the importance of engaging in an open, honest discussion about how you see your retirement goals. Are you seeking a traditional type of retirement, do you plan to take 'mini-career breaks' and perhaps use this time to go exploring whilst you are able, or do you plan to keep engaged in some form of paid work whilst enjoying your 'retirement'.

With planned semi-retirement or sequential temporary retirements, retirement savings will not be invested nearly as long, which demands a different portfolio composition, and will be unlikely to accumulate as high, since there is not as long a non-work period. In turn, emergency savings and disability insurance become even more important, as do other key human-capital-related elements of financial advice, from guidance on career advice and job retraining to help navigate each 're-entry' after a transition phase, or to find an appropriate semi-retirement role.

However you see your 'retirement' future, we are able to assist to construct a suitable financial plan to help you meet your retirement goals.

SMSFs: Avoid small mistakes

Based on article and presentation by Keat Chew, Head of Technical Services, Netwealth

Taking control of investment decisions through a self-managed super fund (SMSF) is empowering, but also requires a great degree of personal responsibility from each trustee.

You need to have a detailed knowledge of the many facets of SMSFs, as what seems like a minor mistake, could result in very costly consequences. Trustees need to understand, amongst other things, the sole purpose test and how it applies to the fund; recognise the importance of ongoing accounting and the associated reporting responsibilities; be aware of lending rules; and realise that often the costs of trustees getting professional help and advice is generally much cheaper than the penalties incurred should things go awry.

There have been many cases where financially savvy members and trustees have been caught out for not being compliant with the ATO regulations. This was highlighted in a recent case where a former bank chief executive and multi-national corporate chairman was charged by the ATO for not paying enough to meet the minimum pension standards. Because the minimum payments weren't made, income from the fund became taxable, and the SMSF was hit with a much steeper tax bill than he anticipated. Ultimately, the case was settled out of court, but who wants to go through this trauma and expense for such a simple error?

As this case shows, relatively simple mistakes can be very costly and it is therefore imperative that before setting up an SMSF, you are confident that you are able to, or have the resources to, comply with all legal and tax obligations.

Some of the key issues that can often cause SMSF trustees problems are highlighted here.

Estate Planning

Estate planning is one of the most complicated aspects of managing a SMSF. A poorly-made estate plan can invalidate a lifetime of wealth-building and create a legal nightmare for trustees and their families. It is imperative that your SMSF is properly integrated with your Will and estate plans to potentially save a lot of money and avoid unnecessary stress for all involved in the long run.

Considering the amount of time and effort spent building wealth throughout the lifetime of an SMSF, the worst thing that could occur following the passing of a member is for their life savings to be distributed against their wishes. This can occur when an SMSF is set up without a clear understanding of the terms and definitions used within the relevant bodies of law and regulations, for example, not understanding the key differences between the trustee's duties and discretion, and the interaction between the member's Will and the relevant superannuation, taxation and estate law when setting up an SMSF. Past cases have demonstrated that following the death of a member, what happens with their SMSF death benefit, as permitted by law and under the deed and the trustee discretionary powers, can be vastly different to what the deceased member would have expected and planned for.

Moving overseas

If an SMSF member intends to move overseas, great caution should be taken with the on-going management of the SMSF. This is because any super fund must be an Australian super fund to be eligible for very attractive super tax concessions and benefits.

SMSFs and member data is carefully scrutinised by the Australian Taxation Office (ATO) and members considering moving overseas, and therefore trustees of such SMSFs, need to be aware of the three tests the ATO will apply to determine whether it is an Australian super fund. Briefly, they are as follows:

1. The fund must be established in Australia, or one of its assets is in Australia.
2. The central management and control test demands high level strategic, trustee rather than administrative and accounting, decisions for the fund are be made in Australia. There is a provision for members to make decisions if temporarily overseas for up to two years. However, even with this, extreme care is needed to ensure that the absence, even if under two years, is still temporary. The ATO has issued very strict guidelines on what is 'temporarily' overseas so it is usually imperative that members and trustees seek professional legal assistance to ensure that this test is not breached.
3. The fund must have either no active members (members making

with major consequences

contributions) or the active members in the fund who hold at least 50% of the fund's total market value, or sum payable to members if they left the fund, must be Australian residents.

These tests must be met at all times throughout the year. The penalties for failing any one of these tests are high. You could lose up to half of the fund's assets and the assessable income will be taxed at the highest marginal tax rate.

There are ways to avoid this outcome if you do move overseas. Trustees can set up an enduring power of attorney (EPOA) based in Australia. This means the trustees moving overseas should resign and the SMSF EPOA will take over total control of the fund. However, the original trustees will lose their direct control over their SMSF, so they will need confidence in whomever is appointed as EPOA. Active members with over 50% of the fund can also cease contributions, although this can be complicated by an overseas employer making contributions, causing the test to fail.

One simple and safe solution is to wind up the SMSF and rollover to a retail super fund. By their very nature, a retail fund should always meet the three tests. In turn, this means that the member who has moved overseas can continue to make the investment decisions, make contribution and effectively control their own super outcomes. However, youwill need to be aware of taxation implications of any rollovers.

Borrowing

Limited recourse borrowing arrangements (LRBAs), which allow super fund trustees to borrow to purchase an asset in the fund, present numerous opportunities for SMSF members. They allow the purchase of high value assets such as real property.

LBRAs, however, can introduce several complex issues. For example, establishing the holding trust correctly; understanding that the contract and documentation varies from state to state; stamp duty issues; cash flow requirements to fund the debt; and legislative guidelines and reporting, to name a few.

Some trustees also don't recognise that LRBAs must be maintained for only a single asset. For example, undertaking a strata title and subdividing a block of land would breach the LRBA guidelines possibly triggering unexpected stamp duty, tax consequences and costs.

Understanding the many nuances of an SMSF

SMSFs are extremely complex in nature and if they are not carefully planned from the outset, some decisions have the potential to invalidate a lifetime of wealth-building and create a legal nightmare for trustees, members and their families. Getting professional specialist advice is the best way to help ensure an SMSF is fully compliant and will help avoid any unwanted scrutiny, unplanned tax obligations and potential fines.

Call our office today if you have any questions regarding SMSFs.

Six Important Money Steps to Take in Your Twenties

Based on article by Miriam Caldwell

When you are in your twenties, you are building a solid foundation for your financial future. The choices that you make now will affect you as you move into your thirties and beyond. You can take the steps now to build a solid future for yourself and your family, should you decide to have one. These steps will help to establish habits that will help you successfully manage your finances over the coming years. Following these steps makes it possible for you to enjoy your twenties while still planning for your future.

1. Create a Solid Financial Plan

You would never go on a trip without a solid destination in mind. It is important to have a solid financial plan, so identify where you want to end up financially and what steps you need to take to get there. Your financial plan should include everything from buying a home to retirement. If you get married and have children, you will need to adjust the plan. Do not put off creating a financial plan just because you are single. You should always have specific savings and retirement goals that you are working toward.

2. Take Control of Your Credit Card Usage

One of the biggest things you can do is to take control of your credit card usage. It is too easy to get into credit card debt, and to find in a few years that you have managed to run up large amounts of debt. Take the time now to minimise or stop using your credit cards, even for emergencies. This will prevent you from having to dig out from under large amounts of debt when you get older. Establishing a budget, and an emergency fund will help you to accomplish this goal.

3. Budget Every Month

The simple key to growing your wealth is to spend less than you earn!

The most important step you can take in your twenties is to begin budgeting. You will need to budget for every month for the rest of your life. The sooner you start budgeting the better off you will be financially. Your budget gives you the ability to decide how you want to spend your money. It helps you to track your spending and can prevent you from overspending. It takes time and work, but if you are budgeting you can be confident that you are handling your finances responsibly. Every dollar should be assigned a category before the month begins, and when you run out of money in that category, you will need to stop spending. If you can master this step, you can win financially.

4. Establish an Emergency Fund

Your emergency fund will give you peace of mind. It can help you deal with the unexpected things that life throws at you from your car breaking down to home repairs to losing a job. The larger your emergency fund, the safer you can feel. While you are still getting out of debt, you can put aside at least $1,000 as an emergency fund, but you may want to make that one month's worth of income. After you are out of debt, try to put aside a year's worth of expenses. You can put your emergency fund in a savings account that offers slightly higher interest rates.

5. Save for a Deposit

As soon as you have paid off your credit card debt, you can start putting money aside to use as a down payment on a home. It does not need to be very much money while you are paying off your student loans, but after you do, you can aim to save enough to buy your first home in your late twenties or early thirties. A down payment makes it easier to qualify for a good interest rate on your mortgage. Saving now will help you be ready when it does come time to buy.

6. Save for Retirement

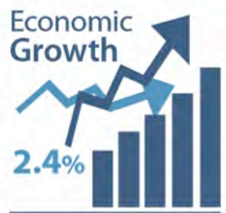
If you are aiming for a traditional type of retirement, you need to start saving now. The sooner you start, the sooner you will be able to retire. Your money will have longer to compound and grow, which means you will not need to contribute a larger percentage as you get older and you are trying to catch up with your retirement savings.

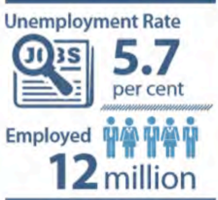
If you have friends or family in their twenties, please let us know. We would love the opportunity to help them build a solid foundation for their financial future.

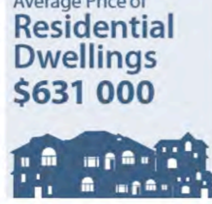
The Philosophical Failings of Forecasting

Source Barry Ritholtz and InterPrac FP

Australian Economy
SNAPSHOT 8 March 2017







Let's take a look at the underlying cognitive and philosophical failings that are associated with the forecasting industry. This context should provide a framework for understanding the problems and investing risks of forecasting.

In William Sherden's 1998 book, "The Fortune Sellers; The Big Business of Buying and Selling Predictions", the point is made that even 5,000 years ago, "forecasting was widely practiced in the ancient world in the form of divination, the art of telling the future by seeing patterns and clues in everything from animal entrails to celestial patterns." Sherden explains how a wide range of prognosticators - consultants, economists, investment advisers and others - have turned the dark arts of foretelling the future into a lucrative profession. They have successfully developed the tools to separate those who badly want to know the unknowable from their money. Given how frequently this involves finance-related professions such as stock analysis, banking, investing, trading and economics, our interest in the topic should be quite understandable.

As with so many issues that involve money, cognitive problems arise.

People conceive of their own sense of self by making a number of reasonable albeit incorrect assumptions about the world. They often begin by pretending they know what is going on around them. People dislike uncertainty -- it forces them to acknowledge how little they actually understand about the complications of the world they live in. Recognising these limitations is an unpleasant concession to many.

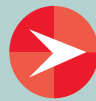
Philosophically, most people don't like to admit the inherently random nature of life. This manifests itself in a variety of ways, but most typically it involves taking credit for successes but placing blame elsewhere for failures. Success, even though the credit for it should be attributed to coincidence or mere luck, is inevitably followed by overconfidence. Too often, what comes next are self-inflicted errors.

Believing in predictions allows people to overlook their own ignorance, discount the role of randomness and generally overestimate their own skills. If you think you can divine the future, you create the illusion of control and stability, where often there is none. Order is created out of chaos; it is a comforting illusion.

For investors, one of the biggest risks of forecasting is the unfortunate tendency to stay wedded to predictions. Consider as an example the person who makes a bearish or bullish forecast. The market then goes against them. Rather than admit the error, they double down on the claim. The fear isn't only that of being wrong, but looking even more foolish as they capitulate just as the unexpected move comes to an end. This fear has caused legions of investors to miss big gains or to sell during the lows after a crash.

You can avoid that sort of behaviour, by building in rules that reduce these sorts of errors. Refusal to admit error is an obvious ego-driven foible, but I keep coming back to the bigger issue of pretending we can accurately discern the future. We can acknowledge our inability to foresee what will happen. We can also undertake specific steps to try to have a better process for thinking about what we do and don't know about the future in order to make better decisions.

The sooner we understand what is and isn't knowable, the better off we – and our portfolios – will be.



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