Investing in
knowledge

I can't change the direction of the wind, but I can adjust my sails to always reach my destination – Jimmy Dean.

Q2/13

Are low interest rates HERE TO STAY?

New Zealanders are currently experiencing historically low interest rates. This is obviously great for those who wish to borrow money as we are seeing interest rates in and around 5.5% with the ability to negotiate these lower with selected banks, plus receive all manner of additional incentives to sign up with a particular bank. However, low interest rates have a downside for savers and investors who may need income from money sitting in term deposits or from bond yields.

One can never determine with any certainty what will happen with interest rates but there are some key drivers to consider.

- This year, the NZ$ has attained historical highs against a number of other key trading currencies. Our interest rates might be low by New Zealand standards but they are still exceptionally high in comparison to countries such as UK, US, Japan and much of Europe where interest rates are close to zero. New Zealand is regarded as an attractive place to invest so more money flows into New Zealand and this pushes up the value of our dollar – which in turn makes imports cheaper but exports more expensive. An artificially inflated NZ$ causes slower economic growth for New Zealand.
- Our Reserve Bank has a real quandary. On one side, it wants to lower interest rates to make it less attractive for overseas investment in our dollar, but a lower interest rate will further stimulate

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Taxing Times

With the passing of another financial year, it is that time when we start to think about sorting out our tax paperwork. At Generation Wealth we offer a tax return completion service to our clients to ensure that these obligations are easily dealt with. If you would like us to complete your income tax return this year, please send us your interest or dividend certificates for investments held outside of the portfolio we manage. Our charges for this service are unchanged from last year. If we haven't completed a return for you before and you would like our assistance, please call us and we'll arrange for you to be linked to our tax agency with the IRD.

Inside

an already overinflated property market – especially in Auckland and Christchurch. In addition, lower interest rates could fuel a return to a debt-laden economy and mindset with households spending way more than they earn.

It is likely (but not guaranteed) that interest rates will remain low in New Zealand for a number of years to come. There may be periodic small increases in the Official Cash Rate (OCR) but unless something dramatic occurs, we are unlikely to see a return to mortgage rates of 7% plus or term deposit rates of 5% plus until there is a normalisation of interest rates elsewhere in the world and the interest in the NZ$ declines.

Potentially sustainable low interest rates are beneficial for equities and commercial property, and could give rise to increased profits and corresponding dividend flows. Investors will need to re-orientate themselves to the 'new norm' of low interest rates. For many, this will require a rethink in how portfolios are constructed plus an acceptance that those who require income from a relatively small investment portfolio to supplement their pension may have to start consuming capital. This in itself is not inherently bad (it is the accepted practice elsewhere in the world) but it will be a significant mindset shift for many New Zealanders who have been brought up on the belief that sufficient high yielding income can be derived from a low risk investment portfolio to provide adequate retirement income.

Talk to us about the range of options available to deal with providing income in retirement.

Life's tips/1

"Someone's sitting in the shade today because someone planted a tree a long time ago."

– Warren Buffett

The retirement funding QUANDARY

ONLY 9 PER CENT OF NEW ZEALANDERS BELIEVE THAT NZ SUPERANNUATION ALONE WILL GIVE THEM AN ADEQUATE INCOME IN RETIREMENT ACCORDING TO HORIZON RESEARCH SURVEY RESULTS RELEASED IN MARCH BY THE FINANCIAL SERVICES COUNCIL. NEW ZEALAND SUPERANNUATION CURRENTLY PROVIDES A MAXIMUM (AFTER TAX) OF $357 PER WEEK FOR AN INDIVIDUAL AND $549 PER WEEK FOR A COUPLE.

"As a nation we are not planning sufficiently for our retirement and we are certainly not feeling optimistic about our ability to survive financially when we retire," said Peter Neilson Chief Executive of the Financial Services Council.

New Zealanders have a well-founded lack of optimism about their financial position at retirement, said Neilson, and even those who believe they are prepared need to look closely at their savings plans.

"Whilst 2 million New Zealanders have enrolled in KiwiSaver most are currently contributing at 2 per cent for the employee and 2 per cent for the employer respectively. (This increased to 3% on 1 April 2013) At these levels, individuals will fall below the savings threshold that will provide them with a comfortable retirement."

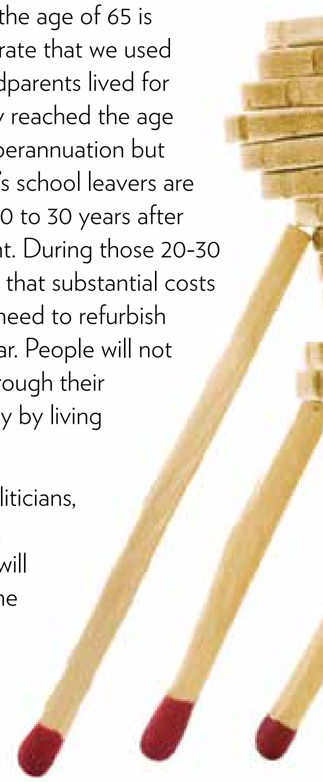
In an earlier Horizon Research survey most New Zealanders defined 'comfortable' as a weekly living amount that is about twice that of the NZ superannuation entitlement, or about $300 more per week for an individual and $500 more per week for a couple.

"Our calculations are that people need to save 10 per cent of their income from the time they start working to achieve a comfortable retirement," said Neilson. "That percentage increases rapidly as people delay starting to save for their retirement."

"We estimate that only about one in every ten KiwiSaver members are currently saving at a rate sufficient to fund a comfortable retirement."

With longevity increasing and average life expectancy improving faster than has been assumed in the Treasury's long-term fiscal projections, the savings gap is likely to have serious consequences for many New Zealanders.

"We now know that the number of years that we will live after the age of 65 is growing at twice the rate that we used to assume. Our grandparents lived for 10-20 years after they reached the age of entitlement for superannuation but the majority of today's school leavers are expected to live for 20 to 30 years after the age of entitlement. During those 20-30 years it is highly likely that substantial costs will arise such as the need to refurbish homes or replace a car. People will not be able to make it through their retirement years solely by living frugally."



"People, including politicians, tend to procrastinate. We all know that we will regret not having done more in terms of our savings when we reach retirement age. But for the next generation this will not just make the difference between comfort and luxury but between poverty and comfort for an extended period in their lives. We can avoid sliding into crisis gradually if we do something about this issue now.

"There is no doubt in my mind that New Zealand superannuation is the best first-tier age pension in the world but it needs to be supplemented with wider participation in KiwiSaver and a gradual lift in contribution rates into KiwiSaver as wages and salaries increase."

Summing up

- Interest rates likely to remain low and generating high yield income harder.
- Most Kiwis consider twice the current weekly pension would be 'comfortable'.

Putting the correct

FINANCIAL FOUNDATIONS IN PLACE

THE LARGEST ASSET FOR MANY PRE-RETIREMENT NEW ZEALANDERS IS THEIR ABILITY TO GENERATE A FUTURE INCOME. THE YOUNGER ONE IS, THE BIGGER THAT ASSET OBVIOUSLY IS.

A recent two-year research project by Massey University and Horizon Research indicates that only 15% of households have income protection insurance compared to 100% ACC coverage that provides the claimant with 80% of their income following an accident. You might be asking "So where is the problem – I have ACC so surely that is enough?"

The problem is this: Serious illness where the person will be off work for six months or more (which is not covered by ACC) is 2.6 times more likely to strike than a serious accident. Each year, 15,000 primary income earners fall seriously ill and are unable to work for six months or more. For a married/partnered person on the M tax rate, the sickness benefit is $343.68 a week (after tax), and this is means tested. If another person from the household is earning income, many families find they are too rich to get a household income tested sickness benefit, but too poor to pay the rent, mortgage or food bills.

The Financial Services Council believes this is creating a huge vulnerability gap and enormous personal and emotional turmoil for 288 New Zealand families every week. The solution – have a chat to us about the statistics associated with being injured vs long term sickness and whether you have the appropriate cover if this happens to you.

Life's tips/2

"Your present circumstances don't determine where you can go; they merely determine where you start."
– Nido Qubein

1 APRIL CHANGES: CHECK YOUR SITUATION?

SEVERAL CHANGES ANNOUNCED IN LAST YEAR'S BUDGET TOOK EFFECT FROM APRIL 1.

These include:

- KiwiSaver: the minimum employee deduction and employer contribution increases from 2% to 3%
- Tax codes: Any employees using the ML and ML SL tax codes need to have their codes changed as these can no longer be used
- Student Loans: The repayment rate for student loan deductions increased from 10 to 12 cents in the dollar.

While checking things out, review your taxable income for the 2012/13 financial year to see if it triggers a change to your PIR (prescribed investor rate). If so, please advise us so we can alter the amount of tax deducted from your investment income.

Give us a call if you have any queries.

Summing up

- Income protection insurance could make a huge difference if you get sick.
- Have you updated yourself with the tax changes yet?

RETIREMENT COSTS

Research last August by the Financial Education & Research Centre at Massey University showed the cost of living a 'no frills' retirement for a couple living in a metro area was about $12,500 per annum and about $12,700 per annum for a couple in a provincial centre. A comfortable or 'choices' retirement cost about $39,600 per annum in a metro centre and around $36,000 per annum in the provinces.

However, these figures didn't include housing costs. If you add in the average housing costs according to Massey University, that pushes the cost of living up to around $27,000 – $33,000 p.a. for a modest retirement, and around $50,000 – $60,000 p.a. for a couple living a 'comfortable' retirement.

The December 2012 annual CPI data shows that insurance costs rose 7%, electricity costs rose 5%; and housing & utility costs were up 3%. Other main contributors to the increase were healthcare costs up 8%, domestic travel & holidays up 6% and fuel costs rose 3%. These are just the things people like to enjoy in retirement i.e. more travel and leisure time; and are more reliant on medical and healthcare.

A key decision people can make right now is to take an active interest in their retirement and KiwiSaver funds. Make sure you are in the right investments to achieve your retirement objectives, as it could make all the difference between a modest or a comfortable retirement in years to come.

NEW BANKING POLICY

WITH THE RESERVE BANK'S NEW OPEN BANK RESOLUTION POLICY NOW IN PLACE, IF THERE WAS A BANKING CRISIS, THE RESERVE BANK COULD EFFECTIVELY FORCE BANK DEPOSITORS TO VISIT THE FISCAL BARBER FOR A SHAVE.

There is now no government deposit guarantee scheme to protect bank depositors – the scheme initiated when the global financial crisis struck in 2008 ended in December 2011. So, bank depositors should know that they are exposed – no bank guarantee scheme and depositors are unsecured creditors. That feeling of exposure will be lessened considerably by the fact that New Zealand has soundly managed and profitable banks which are well regulated.

Nevertheless, many Kiwis who have always valued the security of the bank (perhaps without thinking about it much) might wonder, if their bank deposits are not absolutely safe, what is? The simple answer is nothing: there is no such thing as a perfectly safe investment. All investment means that you give your money to someone else: and as soon as you do that, there is always a chance that you will not get it back again.

Traditionally, bank deposits have been regarded as the safest, most secure store of wealth – the place where the most defensive investors put their money. However, the GFC showed (and Cyprus has underlined) that while relatively safe, they are not absolutely safe: bank depositors sometimes lose money. A few people would say that gold is a good store of wealth – a true investment safe haven. This is plainly untrue: the price of gold is volatile and, over long periods of time hardly keeps up with inflation. What, then, should an investor do? The simple answer: diversify.

Diversification is the best (and safest) store of wealth ever invented. It means spreading your money across two main things. First, diversify across the four main asset classes. This means having some bonds, cash, property and shares. The weighting that you have to each is determined by your investor type and by your investment goals. It would only be very brave investors who had all their wealth in just one asset class, even when that asset class is bank deposits (my high school English teacher always said that there was often little difference between bravery and stupidity). Second, diversify within each asset class. This is to have a good spread of investments in each area to get good exposure to the overall market.

This is not just having a spread of bonds or shares, but can extend to those who have significant bank deposits. Such people may hold their deposits with two or more different banks (say, one of the big Australian banks and another bank with a different style like Rabo or KiwiBank).

You can never be absolutely safe financially – but diversification is the next best thing.

Next step

··· See us about the best investment options for you.

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