BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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Money Week

Money Week is an annual event designed to get New Zealanders talking about money, and more specifically to motivate them to have a thorough look at their financial situation. It is an initiative of the Commission for Financial Capability and is supported by various organisations. This year's Money Week was in the first week in September and has raised some interesting points. A Westpac/Stuff survey released to coincide with Money Week shows:

- Approximately 43 percent of respondents have done nothing to prepare for retirement
- Only 15 percent said they were in a financially comfortable position to retire
- More than 80 percent of Kiwis want to own their own home
- Less than one third of those currently renting believe they will reach that goal
- Of those renting, 60 percent had less than $5,000 saved
- Four out of five New Zealanders experienced financial stress in the last year
- 93 percent of respondents want compulsory money management skills taught in schools

Much of what was written in the Money Week articles I read involved planning (or lack of it). Very few people seem to put thought into what sort of retirement they would like. I have written previously of the need to understand the basic principles of the time value of money. Understanding these principles puts investors in a stronger position to plan for their future. You should first give thought to the type of retirement you desire. Do you want to draw down $10,000 per annum over and above Government Super or $50,000 per annum? As soon as you specify a figure you are in a position to work out what is required to achieve it. Understanding basic time value of money calculations will tell you what lump sum is required to achieve your desired level of income. For a refresher on this have another look at the August 2014 newsletter.

One article I read was written by Rob Stock, titled "Don't plan for retirement – plan your 25-year holiday." The theory is that most people plan a holiday meticulously (within a budget) yet fail to give their retirement planning such consideration. I think it's a very good way to get people thinking about how they are going to fund their retirement.

Have You Planned For Your Retirement?

Managing money, like life in general, is all about compromise. In an ideal world we will retire with a debt free home, and would have squirreled enough money away over the years to fund a comfortable retirement. If we're lucky we can invest all of our money in Government bonds and bank deposits so we don't need to take any risk. Even better, we have enough money that we struggle to spend all the interest, our capital then keeps pace with inflation, and we can leave a nest-egg to our children. Is this realistic? Not for the vast majority of people.

The first thing investors should do to determine what sort of compromises need to be made is to try and quantify some of their retirement planning needs. If you can put numbers to some of the following questions you can start putting strategies in place to achieve your goals.

- When do I want to retire?
- What standard of living am I aiming for and what will that cost each year?
- How much income do I need to cover those costs?
- How much capital do I need to generate that level of income?
- How long does my capital need to last?
- Do I want to leave a legacy for my family?

The maths is relatively simple once we start putting numbers to the questions. For example a sum of $500,000 generates $20,000 per annum before tax at a return of 4.00%. Or, if you have determined you need $500,000 as a nest egg in twenty years time, you need to save approximately $16,800 per annum at a compounding return of 4.00% after tax to achieve that goal. The difficulties arise in the more qualitative aspects of financial planning.

- How long will I live?
- What returns will I receive ten years from now?
- Can I depend on Government funded superannuation?
- What level of inflation can I expect?
- Will I have unexpected health costs?

The best you can do when trying to answer these questions is have an educated guess. Most of these things are moving targets and need to be assessed on an ongoing basis, but pinning a number on them initially at least gives you something to work with. The variability in answers to all of these financial planning questions is what makes it an inexact science. At the very least start thinking about what level of income you would like in retirement. Armed with that figure, come and see me and we can look at strategies that might achieve your goal.

So if we have to, where do we begin to compromise? For most of us the problem is that we simply don't have the amount of capital to achieve the dream retirement lifestyle. The areas we can influence include:

- Retirement date – pushing it out allows us more time to build capital, and leaves less time to use it
- Spending – it might not be palatable but we at least have the ability to curb our spending
- Leaving a legacy for the kids – not necessary in my opinion – spend it yourself
- Risk – instead of investing in Government bonds, we have the ability to take on risky investments such as shares and corporate bonds in an attempt to boost returns
- Capital – we have the ability to erode our capital over time
- Income – some take on part-time work to boost their income

All of these strategies involve some sort of compromise that will have an effect on our standard of living. Eroding our capital is possibly the hardest one to come to terms with because it's a double-edged sword. As we eat our capital we reduce our ability to earn, which causes us to have to erode our capital further. Adding to the complexity is the fact we don't know how long we will live. Spending your capital in the belief you will live to eighty-five will look like a poor decision when you are still battling away at one hundred.

Taking on riskier investments is also a compromise. We are giving up the security of a risk-free investment in the hope we can generate a higher income. The problem, of course, is when the risk turns into loss. Retirees don't have the time or the earning capacity to make up for losses in the same way a younger investor with a reliable job has. Share investments require a longer-term view due to their potential for volatility, and this in itself is a compromise. Does an eighty-year old retiree really want to be worried about riding out the peaks and troughs of a volatile sharemarket?

Unless you are one of the lucky few who have the funds to lead the retirement lifestyle you desire without risking your capital, you are going to be faced with some of the compromises mentioned here.

NZX Settlement Rules

Historically when buying shares or bonds on the NZX you have had three working days to settle your account. From March 2016 under new NZX regulations the time-frame will reduce to two working days. Due to the time it takes to deliver mail now it is far more convenient to be able to email contract notes directly to clients. If you are happy to receive contract notes by email and have not done so already please let me know your email address. And on the same note – if you receive this newsletter by post and would be happy to receive it by email please let me know.

Dividend Yields

Last month I lamented the very low returns available in the fixed interest market. Should we be looking to shares to boost our income? Without doubt there are some comparatively good yields available in equities – but are you being fairly compensated for the risk? In the current environment if you can achieve a yield in excess of 10% there must be significant risk involved. You should be very careful looking at dividend yields recorded in the paper. Contact Energy, Infratil and Air New Zealand are examples of companies who have paid special dividends throughout the year. These dividends are unlikely to be paid again next year, yet the yields recorded in the paper take into account everything paid in the previous twelve months. The newspapers claim Contact Energy is now trading on a net dividend yield of 15.38%, after paying a special one-off dividend of 50 cents.

We can achieve gross yields on the electricity generators of between 7% and 11%. The property trusts are returning between 5% and 7%. Retailers including Briscoes, Hallensteins, Kathmandu, Michael Hill, Restaurant Brands and the Warehouse are trading on yields from 5% to 12%.

If you are considering share investments in response to the low interest rates available at the bank please call the office first. It's important you are aware of the risks involved when investing in shares. My concern is that many investors simply look at the return, without weighing up the risk.

Official Cash Rate

As predicted the Reserve Bank again dropped the Official Cash Rate to 2.75% last month. China, emerging economies, the sharp fall in dairy prices, low commodity prices and lower than expected inflation are all reasons why interest rates need to be lower. Expectations are that there will be more cuts to come. Unfortunately for those investors relying on fixed interest for the majority of their income this is not good news. Here is a summary of some of the bank term deposit rates on offer. All have dropped further since last month.

	1 Year	**2 Years**	**3 Years**	**4 Years**	**5 Years**
ANZ	3.65%	3.65%	3.70%	3.75%	3.80%
ASB	3.55%	3.65%	3.70%	3.75%	3.80%
BNZ	3.65%	3.75%	3.80%	3.90%	4.00%
Heartland	3.70%	3.80%	3.85%	3.90%	4.00%
Kiwibank	3.55%	3.60%	3.70%	3.65%	3.60%
Rabobank	3.69%	3.94%	4.09%	4.18%	4.28%
UDC	3.65%	3.60%	3.65%	3.75%	3.85%
Westpac	3.50%	3.60%	3.60%	3.65%	3.70%