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Lack of Interest

1st August, 2019

Just because you don't take an interest in politics doesn't mean politics won't take an interest in you.
Pericles

Let us not bankrupt our todays by paying interest on the regrets of yesterday and by borrowing in advance the troubles of tomorrow.
Ralph W Stockman

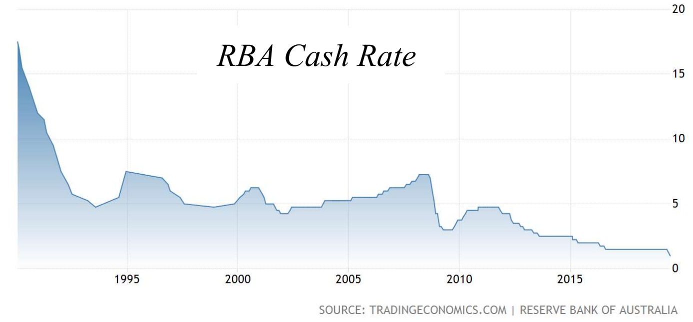
I can't take his money, I can't print my own money, I have to work for money, why don't I just lay down and die?
Homer Simpson

Honey, where did our income go?

The official cash rate (OCR) is the term used in Australia for the bank rate and is the rate of interest which the standardised central bank charges on overnight loans to commercial banks. This allows the Reserve Bank of Australia (RBA) to adjust the interest rates that apply in Australia.

As you all know, the RBA has cut interest rates twice in the last couple of months from 1.5% to 1%. Half a percent doesn't sound like much but that's a 33% drop in interest paid, or to many people, income received if they are invested at the cash rate.

We can invest at a higher cash rate than the OCR on behalf of our clients, however, it is important to understand that these too have fallen, from approximately 2.75% to 2.10%, still a 24% drop. This may worsen with the current market consensus suggesting the OCR is heading towards 0.5% by mid next year. This implies an investor rate in the region of 1.75% or lower.



Disappearing Income!

Bizarrely this is not unusual. We, in Australia, are actually late to the party, the rest of West have been here for almost 10 years, in Japan it's been 30 years! They get no interest on savings in Europe, Japan or North America.

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At least US bonds are 'up' to about 2.3% off their own lows of about 1.3%. Makes the party feel more like a wake…..the death of income.

What compounds this situation is the near certainty of 'lower for longer'. In our personal experience, yours and mine, we are used to seeing interest rates fluctuate through the business cycle. Global central bank money printing and market management has seen this historical cycle become broken. Furthermore, there is so much consumer and corporate debt any, even relatively minor, hikes in rates are going to cause real economic problems. Rates will therefore stay lower for longer which is not great news if you are a retiree, or about to retire.

The response from individuals, and quite a high percentage of professional investors, is to march up the risk curve. This means taking on more risk in an attempt to retain historical income levels. This can come at a cost if investors are not prudent in their decisions and, more importantly, aware of the risks they are taking on. What makes matters worse is the risks they are taking on are not always that obvious! Australian bank hybrids are classic sleeping giant for potential future losses. This is why we don't own any!

Australian shares pay circa 5% dividends, even 'low income' international equities pay around 2-3%. This is more than residential property in most cases.

The big difference of course is cash and term deposits won't fall in value, at least not more than inflation, whilst equities have the potential to fall 40-50%. Residential property needs constant supplies of new investment to cover costs and replace capital items like carpets, curtains, paint, kitchens and bathrooms.

It is important to remember that equities, which we favour throughout the cycle, can "offer" losses to the tune of 35% to a balanced portfolio. Running up the risk curve can be catastrophic if you get caught unprepared, or not cognisant of the risk you are taking on when you go searching for income.

Right now, you are probably thinking "What are we to do?" Well you're not Robinson Crusoe there. I personally have discussed this with seasoned market professionals with 30-40 years' experience. They are almost all unanimous in regarding the current investment climate the most difficult period to invest money in their entire careers.

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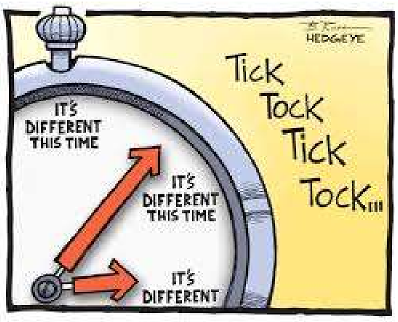
What this same group of seasoned professionals all agree on however is 4 widely regarded investment principles for the current investment climate:

1. Maintain investment discipline
2. Remain highly diversified
3. Resist temptation and be very careful following the herd
4. Be patient

There is absolutely nothing new in any of these guidelines as they have been around for a long time, but they are not as easy to follow as you might think.



As I have said on a few occasions in the past any thinking along the lines of "this time is different" is the four of the most dangerous words in investment. We are in unusual times, especially with interest rates and some equity valuations, but similar episodes have occurred historically.

Where to next?

Whilst challenging, the current circumstances are not impossible to navigate. You need to be intelligent, cautious…… and bold and be prepared to be flexible whilst maintaining the principles of 4 key investment guidelines listed above.

Here at Lifestyle Wealth Partners, we have used a mix of assets with different characteristics, including private equity, unlisted property and further diversification into some loan securities. These have all performed very well in difficult environments. Of course, they are not the answer for all investment capital, NOTHING ever is.

To ensure the advice we recommend to you is current, relevant and based on sound principles, we regularly meet with our investment managers to gain their knowledge and insights.

Our current portfolios are positioned to leverage income and returns to the investor whilst being mindful of the risks we take. We will be here for you in the good times and bad, and are ready to remain a strong stance, no matter what punches are thrown at us.

Our main goal for our investors is to maintain a portfolio that continues to support their lifestyle and that of their family whatever the future holds. In the end, life is about enjoyment and being with those we love. We are confident our current positioning gives you the greatest chance of success, allowing you to enjoy a stress-free lifestyle.

If you would like to discuss this paper or any other matter, please do not hesitate to contact us at support@lifestylewealth.com.au or (02) 9984 7774.

Kind Regards

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