Prepare for Life

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PAYING IT FORWARD

By Peter Kelly, Retirement Strategies and Solutions

Do you ever get to the stage when you think you have just got on top of your finances and then a big bill arrives?

You know what it is like... one of those bills that come in on a quarterly, half-yearly or annual basis. It may be house insurance, council rates, body corporate fees, electricity, gas or private health insurance.

While insurance companies and similar providers may offer a facility to pay premiums on a regular basis, even as frequently as weekly or fortnightly, some service providers don't.

So how do you manage those big bills and avoid the shock of receiving one large bill of $1,000 or more?

One thing you can consider is to work out roughly how much you will pay for that service over the course of the next year. When I do this exercise, I add a bit, generally around 10%, to the estimated annual amount to allow for increases in the cost of the service.

Then divide the annual amount by the number of paydays in the year. This might be 52, 26, 12, or at irregular intervals for self-employed and casual workers.

Each pay you then put the nominated amount aside so that when the bills come in, the money is there to pay it. Alternatively, a separate bank account can be set up for these regular amounts to be deposited to.

But, being human, idle money sitting aside for a special purpose may be raided for other uses. You know how it is:

'I will just borrow $500 from my 'bills account' for a weekend away. It's OK, I have plenty of time until the bill comes in and I will save a bit extra to make sure it is covered'.

The reality is, unless we are very disciplined, we never make up the amount borrowed and then when the bill finally arrives, desperation sets it – or we just pay the bill using a credit card – which is not a desirable outcome on so many fronts.

So, is there an alternative?

Many service providers allow bills to be paid using BPAY. Provided your 'customer number' remains the same from bill to bill, you can set up a regular payment to your service provider using BPAY. However frequently you are paid regular instalments can be paid to your service provider.

These then accrue as a credit to your account so that when the bill finally arrives, the outstanding amount due is either very small or zero. In some situations, particularly when bills may fluctuate seasonally, such as with electricity and gas, you may even find your account carries a credit balance which can carry over to the next bill.

Before a 'pay forward' system like this, check with your service provider to ensure that pre-paid amounts will be credited to your account and not lost in the 'ether'.

I have been using this practice of 'paying forward' for a couple of years now. I use it for my electricity, body corporate fee, council rates and health insurance. Receiving bills in the mail (or by email) is no longer met with a sense of dread and loathing.

> "But, being human, idle money sitting aside for a special purpose may be raided for other uses."

GOAL-BASED RISK

By Ryan Murphy and Steve Wendel, Morningstar Research Paper

It is common in the finance industry to use people's subjective feelings about risk as part of the process to develop a particular investment strategy. Risk tolerance questionnaires are used to quantify these vague feelings and map people to a range of conservative, moderate, or aggressive portfolios. Goals-Based Risk addresses the shortcomings of this approach and instead focuses on investment goals as the lodestar in the financial planning process, while still being mindful of the strong emotional reactions people have to risk and volatility.

Taking a New Perspective on Investor Risks

Investors face risks from a variety of sources. Risk is often equated to variance in returns, referred to as Market Risk (or unsystemic risk). This risk can be mitigated by portfolio diversification and well-known optimisation methods. Goals-Based Risk highlights another equally important source of risk that comes from people making unwise choices, termed Behavioural Risk. This risk results from people acting as their own worst enemy and making poor investment decisions that can potentially reduce their long-term earnings. Examples of self- defeating behaviour include people trying to time markets, chasing returns, and panic selling. Behavioural risk emerges when people deviate from principled investment strategies and make impulsive choices. This resulting "Behavioural Gap" can cost investors about 1.0-2.5% per year. Simply put, investors meddling with their portfolios typically make their performance worse, and as such, investors can be a menace to themselves when they make emotional decisions.

Behavioural risk should not be ignored, and it cannot be solved with the well-known approaches that are used to diminish market risk—behavioural risk requires different kinds of solutions.

Advisers as Behavioural Coaches

The Goals-Based Risk framework posits that a major value of financial advisers is not just in the portfolio construction process, but in the financial planning process, and furthermore in their bolstering investor's risk resilience. Effective advisers act as behavioural coaches—think of this as a kind of therapist that is paid proportionally to their assets under management. As behavioural coaches, advisers can cultivate calm, thoughtful, and goal-directed behaviour that prevents their clients from acting as their own worst enemy while investing. This framing helps align the incentives of investors and advisers, and further highlights the value of good financial advice in helping clients both make effective plans and exercise the discipline to execute their plans diligently over the long haul.

An Integrated Investment Planning Approach

Goals-Based Risk provides a framework where the objective characteristics of an investor determine what makes for a good financial plan and investment strategy, and the subjective characteristics highlight the framing, interventions, and nudges that are useful to help investors stay the course. The objective characteristics correspond generally to an investor's risk capacity, while the subjective characteristics capture the core investor psychology that drives behavioural risk. Successful investing demands dealing with both effectively. Goals-Based Risk does so and provides a detailed investor profile, including insights about a person's risk preferences and their risk reactivity (i.e., how market volatility affects their risk preferences over time). This expanded profile supports tools that give advisers timely information about what interventions are most effective and when they should be implemented to help investors stay on track.

> “Behavioural risk should not be ignored and it cannot be solved with the well-known approaches that are used to diminish market risk”

Putting Risk Preferences in Their Proper Place

An investor’s financial goals—not emotionally driven risk preferences—should determine what investments they have. For investors, whose risk preferences are stable and broadly consistent with their goals and an efficient portfolio that serves those goals, there is little conflict and their experience should be smooth. For investors, whose preferences are unstable and/or inconsistent with a strategy required to reach their goals, there is a special need for a financial adviser to act as a behavioural coach. These “conflicted” investors may need more feedback and guidance, which provides an opportunity for advisers to be particularly effective. These investors, with proper behavioural coaching, can constructively adjust and bring their investment strategy in-line with their feeling-based risk preferences. For example, investors can increase their savings rate, give themselves more time before making withdrawals, curtail their goals, and/or find ways to understand and deal with the ups-and-downs that will inevitably occur.

Risk preferences still play a role in all of this, but not by directing a person’s investment choices. Instead, risk preferences highlight decision frames and interventions that help a person stay committed to investment strategies that serve their long-term financial goals.

CLAIMING AN AGE PENSION

By Mark Teale - Retirement Strategies and Solutions Specialist, Centrepoint Alliance

The process of claiming an Age Pension can be complicated and daunting.

There is a very lengthy claim form, asking a series of questions which needs to be completed and then depending on your circumstances, you may need to complete even more documents.

You can choose to lodge your claim on line via your myGov account and if you have a Customer Reference Number (CRN), you can then link your account to Centrelink and set up an online account. If you do not have a CRN you will need to visit your local Centrelink office with your identification to get a CRN.

Although this will take time, the good news is that you don't have to wait until you turn the appropriate qualifying age to lodge your claim, you can start the process 13 weeks prior to this date.

The Age Pension you receive will be based on the information that you do provide in relation to your assets and income. So, it is extremely important that you provide the correct information.

Do not be tempted to not fully disclose all the necessary information, it is important to remember the claim form is a legal document with your signature attesting to the accuracy of the answers you have provided to the question.

On the Income and Assets form, which you will also need to complete with your Age Pension application, you will be asked to provide details of the balances of your bank accounts and the monies you have invested in superannuation and other investments.

The form will also ask you to value your household contents and personal effects. This question often causes a little consternation as people are not or were not aware that the value of their household contents could influence the amount of pension that they are paid.

It is for this reason that when completing this question, the valuation that you provide is a fire sale value. In other words, what you would get if you were to sell your furniture and contents in a garage sale. It is not the value that you may have your contents insured for, which for some people could be as high as $60,000

A reasonable value which is more than acceptable for the average 3-bedroom home is $10,000. The difference between a value of $60,000 and $10,000 for a couple assessed under the assets test is a reduction in their pension of $150 per fortnight. So, it is important from a financial aspect that you do not overvalue your contents and personal items.

The same analogy applies to the valuation you are asked to provide for your motor vehicles, it is the value you would receive if you were to sell your car, not necessarily the insured value.

These are just a couple of points and as I mentioned at the beginning of the article, applying for the age pension is not easy. Take some time before you reach Age Pension age and view the Centrelink site to understand the process. If after doing so you are still confused or have question, talk to your adviser - they will be able to ensure you complete the process correctly.

ABOUT US

Things I would have done differently.

When I ask people what they would have done differently if they had their time again, many say they should've taken more risk.

It's natural to have an aversion towards risk because of our need for certainty. It's a survival mechanism to feel in control and to know what's coming next, so we can feel secure about our future. It's the need for basic comfort to avoid pain and stress.

How we deal with achieving certainty affects how much risk we're willing to take in life; our jobs, investments and in our relationships. The higher the need for certainty, the less risk you'll be willing to take or emotionally bear.

As emotions drive decisions, people often become irrational in times of chaos habitually leading them to exchange a hopeful dream for an abrupt reality.

The tragedy about failure is that it is historically all but irrelevant to a lifetime of possible outcomes. It's important we don't get blighted by irrational reasons that cause fear and prevent us from achieving our future dreams.

History shows that optimism is the only realism. It's in every aspect of our lives, from technological advances to living longer, it squares every fact with a historical record.

How much risk we're willing to take is a general predictor of success, however, equally important is having a disciplined strategy.

We are here to help you.

Michael Kakaras

Contact us for further information

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