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Retirees: February 2016

Retiree News from FM Financial. We hope you enjoy these specifically selected articles and a brief analysis.

Now that February is here, the holidays are over and the nation is getting back to business, investors finally have time to digest January's rollercoaster markets. Shares had their worst start to the year on record, while oil and the Aussie dollar also fell. But the markets are not the same thing as the economy, which is holding up well.

After lifting interest rates in December for the first time in seven years, the US Federal Reserve kept rates on hold in January while repeating its intention to raise rates at a 'gradual' pace. This 'steady as she goes' approach reassured financial markets that the US economic recovery is still intact. It should also support the gradual decline of the Aussie dollar.

After falling 11 per cent last year to US73c the Aussie dollar dipped below US70c last in January before firming slightly to around US71c. The weaker currency has helped cushion our falling terms of trade – or the ratio of imports to exports – which fell by 5.2 per cent in 2015. This was due mostly to falling commodity prices and reduced demand from China. As well as partly offsetting falling commodity prices, longer term the currency effect should also help boost exports. The NAB Business Survey released in January reported positive business conditions in all sectors outside mining and construction. With inflation at an annual rate of 1.7 per cent, the Reserve Bank still has room to cut interest rates to further stimulate growth in non-mining sectors of the economy.

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RENT EXEMPTION for Aged Care Removed

One of the toughest financial and emotional decisions when moving in to residential aged care often involves the sale of the family home. Sometimes turning the home into a rental property is a more appealing option.

Not only does renting the house out delay making a decision to sell or avoid a fire sale, but the income generated can help with the cost of aged care accommodation.

Up until 1 January 2016 there was a potential advantage for people entering aged care to keep the family home and fund all or part of their accommodation costs in the aged care facility through rental income.

The former home remained an exempt asset for pension purposes, and the rent received was also exempt under both the pension income test and the means tested care fees for aged care purposes.

Unfortunately, the rent is no longer exempt and other ways of paying the accommodation cost may have to be considered.

Accommodation costs

All potential aged care residents have the option of paying accommodation costs as a lump sum, known as a Refundable Accommodation Deposit, or periodically as Daily Accommodation Payments. They can also pay a combination of both.

All residents pay a Basic Daily Care Fee and may also be asked to pay a means-tested care fee.

Homes can still be kept and rented out to pay care costs, but from 1 January 2016 there is no longer an exemption for people who pay their care costs periodically through rental income. The Government implemented this with a view to improve the fairness and equity of aged care means testing arrangements for new residents.

Let's look at a hypothetical example. We'll call her Jane. As Jane's story shows, the difference in the means tested care fees for someone looking to rent their house to pay for their care costs may be considerably higher after the change.

Jane's story

Jane is a single, part pensioner who owns her own home which she wants to keep after she moves into an aged care facility.

She has assets to pay $400,000 of the $420,000 Refundable Accommodation Deposit (RAD) without selling her home. She plans to pay the remaining $20,000 in Daily Accommodation Payments (RAD x maximum permissible interest rate/365), financed by renting her home for $860 a week.

As the table below shows, under the new rules Jane's home and rental income will be assessed by Centrelink resulting in a means tested care fee of $20,191 a year. Previously, the home and rent would have been exempt and the means tested care fee would have been just $6,034 a year.

The upshot is that Jane will be worse off by more than $14,000 a year. The calculations are complex and will be different for everyone so it is important to get professional advice.

Because the RAD is not counted as an asset by Centrelink for age pension purposes Jane's age pension is not necessarily impacted.

No impact for existing residents

The new rule doesn't affect anyone who entered care before 1 January 2016, including residents who may have moved in and out of hospital or transferred from one facility to another on either side of that date.

The change also has no impact on the annual fee caps and lifetime fee caps that apply to the means-tested care fees payable when someone is in care.

Renting out the family home may avoid the need to make a decision on whether to sell at all, or sell it quickly, but there are often other issues to consider. These include whether the rent will cover the full cost of aged care and who will take care of the cost of ongoing maintenance and management of the property.

If you would like to discuss your aged care funding options, give us a call.

Annual care costs when the home is rented before and after 1 January 2016

	Cost of care before 1 January	Cost of care after 1 January
Basic daily care fee	$17,469	$17,469
Daily Accommodation Payment (DAP)	$1,228*	$1,244**
Means-tested care fee	$6,034	$20,191
Total aged care fees	**$24,731**	**$38,904**

* The Maximum Permissible Interest Rate (MPIR) 6.14% pa   ** MPIR 6.22% pa

-HOW TO SPOT- *a quality dividend*

With interest rates at record lows, investors have been searching high and low for a decent yield. And they've been finding them, but not where you might expect.

Conventional wisdom says to buy bonds and term deposits for income and shares for growth, but low interest rates have turned that advice on its head. Instead, investors seeking income have been flocking to local shares for their relatively high dividend yields, but are they safe?

The average dividend yield on Australian shares was around 4 per cent in the second quarter and more than 8 per cent for some high-yielding stocks. While yields have fallen in recent years, they are still streets ahead of traditional income-producing investments.

Towards the end of the 2014-15 financial year the yield on Australian government 10-year bonds was around 3 per cent, a paltry reward for locking your savings away for a decade.[i] The best rate available for three-year term deposits was 3.3 per cent while 1-year term deposits were paying 3.1 per cent at best.[ii]

So what's the catch?

While equities can and do provide a valuable source of income, investors who have ventured out of term deposits into shares in pursuit of higher yields need to understand the difference between a sustainable dividend income and a high yield. One will boost wealth while the other may potentially cost you money.

Calculating dividend yields

To work out the dividend yield on a share you divide annual dividend payments by the current share price. For example, National Australia Bank was trading at $39.47 a share after paying annual dividends of $1.98, giving a dividend yield of 5.02 per cent. When you add in franking credits, the after-tax return is around 7 per cent.[iii]

Australia's major banks have a history of strong profit growth and reliable dividend income, making them extremely popular with income investors. But the highest yields in the current market belong to some out-of-favour resource stocks.

Fortescue Metals has a dividend yield of more than 7 per cent before franking credits[iii], thanks to a 65 per cent fall in its share price in the year to April. As the share price falls and dividends remain unchanged, the yield rises.

Fortescue's share price, and its business, have been hit hard by the fall in iron ore prices. If commodity prices recover, the shares may rebound and the dividends may keep flowing. But in the meantime, investors who are tempted to buy Fortescue for its yield alone need to weigh up whether its current dividend policy is sustainable.

This is not a recommendation or otherwise for Fortescue or National Australia Bank, they simply illustrate the importance of understanding how a dividend yield is derived and what it may signify.

Income or growth

When companies earn a profit, directors decide how much of their earnings to pay shareholders in the form of dividends and how much to reinvest in the company to fund growth.

So a high yield might signal that the company has poor future growth prospects. Or a falling share price, or both. But if a company's growth outlook is sound, a high yield may indicate a buying opportunity.

That's what happened following the financial crisis when yields on many quality stocks soared as dividends were maintained in the face of falling share prices. Investors who banked on fundamentally sound companies bouncing back were rewarded with strong capital gains as well as a steady income stream.

Unlike term deposits, the total return from shares comes from a combination of income and growth. While dividends provide a buffer against short term capital losses, both elements need to be taken into account over the long run.

The bottom line is that you won't make money out of bad stocks no matter what the dividend yield. But sustainable dividends that grow over time are a gift that keeps on giving. If you would like to discuss your income needs, give us a call.

i Bloomberg, Australian Government Bonds, viewed 13 April 2015

ii Canstar, www.canstar.com.au, as at 7 April 2015

iii Top Yields 'highest dividend stocks', viewed 13 April 2015, http://www.topyields.nl/Top-dividend-yields-of-ASX50.php

How to reach 100 NOT OUT

Who would have thought doing the Silly Walk created by John Cleese in Monty Python could hold the key to a happy and healthy life in your 90s and beyond?

According to Californian neuroscientist Michael Merzenich, making your body move in a new and complicated way each day will challenge your brain and help grow new synapses and neurons. And that can go a long way towards making you a happy and healthy centenarian.

Reaching 100 is becoming more commonplace around the globe. By 2020 there will be 12,000 Australians who live to a hundred and that figure is expected to blow out to 50,000 by 2050.

But living a long life is only good if it's a healthy life. There's no point your heart still beating if you have long lost both your mental and physical capabilities.

So what are the secrets to being a healthy and happy centenarian?

Mental agility

Aside from the Silly Walk, there are many mental activities that can help keep your brain sharp. Crosswords, sudoku, bridge, learning a language and even studying for a degree are all excellent brain workouts. The sports maxim "use it or lose it" rings true when you are looking at mental agility.

A positive attitude is also an important factor. The more optimistic you are about life, the happier and healthier you will be.

Lack of stress also plays its part so pursuing such activities as yoga can help keep you calm and help you towards a healthy long life.

But it's not just your brain that you want to keep in good shape. You also need to be physically fit.

Physical health

The top tips most often mentioned for a long and healthy life are to avoid smoking, eat a balanced diet, drink in moderation and maintain a healthy weight range.

Keeping up physical activity is also important. Bowls, walking, the gym or swimming, for instance, all help to increase wellbeing.

Of course, the sooner you start these practices the better. It's no good deciding at 80 that you are suddenly going to eat sensibly.

Eating less might also prove significant. In Okinawa in Japan, an island which has the highest percentage of centenarians in the world, the locals claim to stop eating once they feel 80 per cent full.

Eating less means your metabolism has less work to do so this puts less long-term stress on your body.

Genetics also plays a major role. If your parents have lived to a ripe old age then you can probably expect to have a similar experience. And given advances in medicine, education about lifestyle choices, improved sanitation and disease control, it is likely you will live even longer.

A question of balance

One UK newspaper report listed 25 simple ways to extend your life and they were as simple as eating three walnuts a day, drinking tea rather than coffee and even balancing on one leg while getting dressed to strengthen your core.

Regular sex is also meant to help you live longer, according to a Welsh study that found not only will it extend your life but you could look up to seven years younger in the process!

Of course, if you are going to live to 100 it's smart to make sure you have enough money to go the distance. Taking out an annuity (a regular payment until you die) with part of your retirement savings is one option that may provide you with peace of mind.

The Who may well have sung "hope I die before I get old" but if you plan your retirement successfully a long life can be a happy and healthy one.

Improve your odds of hitting 100

+9 YRS	Be happy!
+6 YRS	Cut down on stress
+5 YRS	Eat the recommended serves of fruits and veggies
+4 YRS	Maintain a good sex life
+2-5YRS	Work out at least five days a week