SEFTON FINANCIAL
Secure today, protect tomorrow

Newsletter: March 2020

Welcome to the latest edition of our client newsletters.

Our articles cover a range of topics which we hope you will find interesting. We aim to keep you informed of changes as they happen, but we also want to provide ideas to help you live the life you want – now and in the future.

In this edition topics include:

- 3 factors affecting retirement income
- Rebooting for retirement
- Dividends explained.

If you would like to discuss any of the issues raised in this newsletter, please don't hesitate to contact us.

In the meantime we hope you enjoy the read.

All the best

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Dividends explained

If you are a shareholder of a company, you may receive payments known as dividends. These payments represent your share of the company's profits and are your reward for investing.

Dividends may be a great way to boost your income and are often considered tax effective. Find out exactly how they work and how often you'll get paid.

Why and when companies pay dividends

When a publicly listed company makes a profit, its board of directors decides whether to:

- pay out the profit to shareholders in the form of dividends
- retain the profit to invest in the company's growth, or
- a mixture of both.

Australian companies tend to pay out a high proportion of earnings as dividends compared to companies listed in other countries. This currently sits around 65% compared to around 45% for global shares[i], which could make Australian shares popular with income-seeking investors.

Some Australian listed companies choose to pay dividends twice a year, known as the interim and final dividends. However, dividends are not guaranteed, and some companies don't pay any dividends at all. In fact, a company that has previously paid dividends may decide not to, and vice versa. The size of the dividend can also vary, and often depends on how the company has performed.

Dr Shane Oliver – Head of Investment Strategy and Economics and Chief Economist, AMP Capital says companies like to manage dividend expectations smoothly.

"They rarely raise the level of dividends if they think it will be unsustainable. Sure, some companies do cut their dividends at times, but the key is to have a well-diversified portfolio of sustainable and decent dividend paying shares."[i]

Large, well-established companies with stable earnings and certain industries like banks tend to pay dividends consistently.

Other companies, such as those involved in developing new technology or medical research, often choose to reinvest all their earnings for research and development and pay no dividends at all. Investors in these types of companies are typically looking for long-term growth rather than income.

How are dividends paid?

Companies generally pay dividends in cash to the bank account that you nominate or send you a cheque.

In some cases, rather than receive a cash payment, investors may be able to take advantage of a dividend reinvestment plan. This involves the company offering investors the choice to use their dividends to purchase more shares in the company, instead of receiving the cash. Often, the shares are offered at a discount to the current market price.

It's important to consider your particular circumstances and goals before deciding what's right for you. For example, investors who want to increase their income may prefer to receive their dividends as cash payments. However, investors who are more focused on growing their wealth may consider a dividend reinvestment plan to help grow the number of shares they own over time. It's a good idea to seek financial advice to help determine a strategy that suits your needs.

How are dividends taxed?

Dividends are considered income for tax purposes. Just like the income you may earn from other sources, like rent from an investment property or interest from a bank account, dividends will be taxed at your marginal tax rate.

The current income tax rates are published on the Australian Taxation Office website.

It's important to keep records of your dividends so you or your accountant can complete your tax return accurately.

You'll receive a statement when dividends are paid. If you take advantage of a dividend reinvestment plan, you still need to include the dividend income in your tax return, even if you didn't actually receive the cash payment.

Details of a company's dividend are also published both on the company's website as well as the Australian Securities Exchange (ASX) website.

What are franked dividends?

Companies are required to pay tax on their profits, which means the money they distribute via dividends has already been taxed. To avoid double taxation of company earnings, (once in the hands of the company, and then again in the hands of the investor) these dividends come with a franking credit, also sometimes referred to as an imputation credit. The franking credit represents the amount of tax that has already been paid either partially or in full.

Full-franked dividend

30% tax has already been paid by the company before the investor receives the dividend.

Partially-franked dividend

30% tax has already been paid on part of the dividend only. The exact amount will be specified by the company as a percentage.

Unfranked dividend

No tax has been paid.

When you do your taxes for the year, you will receive a credit for any tax the company has already paid. If your top tax rate is less than the company's tax rate of 30%, you'll receive a refund from the Australian Taxation Office (ATO) for the difference. That's why franked dividends are considered tax effective.

We can help you make the most of dividends and create a strategy to help you reach your goals.

i https://www.amp.com.au/personal/hub/grow-my-wealth/why-i-still-love-dividends-and-you-should-love-them-too

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Rebooting for retirement

As retirement comes into view, it's time to imagine a new you for the post-work age.

You remember your first day at school, your first job, your first home. And now your final pay check is in sight. That's quite an achievement.

As with other big life events, retirement triggers choices that shape your future. It's time to take stock and reboot your life. It makes sense to make sure you're ready when the time comes so you can minimise surprises and maximise your new free time.

For instance, if you're downsizing your house or vehicle, you might consider how shedding assets and acquiring new ones affect your tax position before you retire.

Having your finances in order is important, but there's more than money to enjoying the fruits of your new phase of life. Here are five ways you can make sure retirement's a milestone not a millstone.

1. Think mind and body

Without a clear idea of how you'll spend your time, the initial euphoria of the untouched morning alarm can give way to anything from boredom to panic. Most of your 24 hours may be unstructured, so figure out how you'll spend it wisely.

You might try something new. Perhaps now is the time to keep bees, join a choir or learn archery. If you have a partner, remember to involve them in the planning. Even if they don't fancy joining you on a skydive, they may see a chance to learn how to take better action pictures.

Travel is near the top of many wish lists in retirement. If you don't have the funds for a Caribbean cruise, there are a host of cheaper options around Australia and even beyond. And now you'll have more time to spend, without worrying about annual leave quotas, or who'll look after your business while you're away.

2. Have a purpose

A rest is as good as a change. Although it's great to have unstructured time to think and dream, boredom can be a damaging state of mind, particularly if it's prolonged.

If you're already physically active, this can be a great time to extend yourself, embrace something new like yoga, or aqua aerobics. If you're healthy but know you could improve, you might sign up for a sponsored cycle ride or walk to help a cause you care about.

3. Catch up on what you've missed

Many of us put off expanding our passions while we're working because we don't have time.

If you've always wanted to read the classics, now might be your chance to explore the jewels of world literature. Reading is brain expanding and inexpensive. Books older than 70 years from the death of the author are out of copyright and therefore cheap in print or even free on your Kindle.

4. Follow your heart, not the herd

Many people downsize coming up to retirement. A smaller property usually means lower utility bills and maintenance.

But it's not for everyone. If your spare bedroom has the right natural light for your artist's studio or you just love your lemon trees, you might be better off staying where you are and saving yourself the real estate fees and hassles.

You're facing a change in life, but you don't have to change for change's sake. Put yourself and your loved ones first.

5. Listen to the voice of experience

As with so many things in life, you can learn from experts. Talk to people you know who have already retired, and see what worked for them, and what they wish they'd put in place before they took the plunge.

Consider what will make you happy in the years beyond work, so you can live the life you want.

Finally, if you haven't yet given these things serious thought yet, don't panic. You've dealt with other changes in your life, this is just another one.

Think of it as a new adventure. Let's face it, you've earned it.

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3 factors affecting retirement income

High life expectancy and low interest rates may make it harder for some retirees to live long and prosper.

Here we look at three elements from an AMP Capital Investors report[i] that affect a post-work reasonable income – interest rates, inflation, and longevity.

1. Interest rates - high valuations, low returns

Historically low interest rates have driven valuations of defensive assets such as cash and fixed interest to unprecedented highs. Generally, a defensive asset is seen as a lower-risk, lower reward investment.

High valuations mean low yields (or percentage income returns in the form of dividends and interest) for defensive assets.

AMP Capital Investors reports record-low yields across many fixed income assets and some types of property. Term deposit rates are also at fresh lows, following the Reserve Bank of Australia's reduction in interest rates.

Low interest rates affect variables such as inflation and investment returns, which in turn affect how we save for retirement.

2. The inflation perspective

Inflation has a big impact on retirees who are less able to earn and save more after their working lives have finished. Falling returns mean providing for retirement is challenging, but although returns are low now compared to in the past, the impact is eased when you take inflation into account.

Inflation was running at around 15 per cent in the late 70s and 80s, which ate up much of the bond and term deposit returns.

Nevertheless, the combination of low interest rates and low inflation make it hard for retirees to find returns.

There are risks too, should the current global inflation rate of about three per cent shift higher than the defensive asset classes. As these assets are priced for the very low inflation of today, they would face major negative revisions.

3. The longevity conundrum

Australians are also living longer, increasing the risk that a retiree will outlive their savings. Back in 1980, a man starting a pension at age 65 had a life expectancy of 78 – 13 more years. Now, a male starting a pension at 65 has a life expectancy of 86 – an additional 21 years. While this is great news in many ways, financially it means higher income needs and the need to grow the assets over time to make up for rising costs of living.

This is a concern in an environment which sees retirees drawing down on their pool of retirement assets because they can no longer generate sufficient income returns. This means retirement account balances are being depleted relatively quicker than in the past, especially if retirees lack exposure to growth assets to generate some capital growth over their longer lives.

Supporting an ageing population to achieve their retirement goals in a market of lower investment returns is a major challenge. A stable policy framework for superannuation and a long-term approach will be important in giving retirees the best chance of achieving a comfortable retirement.

Planning ahead

When investing with a goal – such as retirement – in mind, it pays to think long term.

Of course we are also here to help you work out what's right for you.

i Retirement today – the challenge of generating retirement returns. AMP Capital Investors, 19 August 2019.

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