SHERLOCK WEALTH

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Prepare for Life

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THE FINANCIAL REWARDS OF *optimism*

If it wasn't already clear, the past 12 months certainly cemented the fact that life has a habit of throwing us the occasional curveball. The reality is we all face challenges, however approaching life with a positive mindset can help us deal with any issues we may face and improve our lives in many ways.

Having a positive outlook not only improves our health and wellbeing, it can also have a meaningful and very positive impact on our finances.

How optimism can improve our finances

If you have a cautious or anxious approach to your finances, such as worrying you'll never have enough money or being wary of spending, it will likely come as a surprise to hear that being optimistic can improve your financial situation.

A recent study connected the link between financial well-being and an optimistic mindset, finding that people who classify themselves as optimists enjoy 62 per cent fewer days of financial stress per year compared to pessimists.

Superior financial well-being

When you are positive in your outlook, you are also much more likely to follow better financial habits in managing your money. Optimists tend to save for major purchases, with around 90 percent of optimists having saved for a significant purchase, be it a car, a house or an overseas holiday, compared to pessimists at just 70 per cent.[i]

However, optimism does not equal naivety and optimists still tend to have contingency plans in place for unforeseen events that may detrimentally impact their bottom line. Some 66 per cent of optimists had an emergency fund, compared to under 50 percent of the pessimists.[i]

This goes to show that maintaining an optimistic approach to your finances does still involve planning for the future. By being prepared, you'll reduce the stress that comes from feeling the rug could be pulled from beneath you without a safety net.

Your career and earning capacity

An optimistic approach to life and your career leads to achieving greater career success and the financial rewards that come with being successful in your job.

Optimists are 40 percent more likely than pessimists to receive a promotion within a space of twelve months and up to six times more predisposed to being highly engaged in their chosen career.[i]

Changing your attitude

Knowing that optimism is great for your wallet and your health is one thing, but how do you shift your outlook? If you're prone to worry, focussing on pessimistic outcomes or a bit of a sceptic, looking on the bright side of life can seem easier said than done.

It is possible to nurture optimism, and you get this opportunity every day. Cultivating optimism can be as simple as adopting optimistic behaviours.

So, what are the financial behaviours of optimists that we can emulate?

Optimists tend to be more comfortable talking about and learning about money and are more likely to follow expert financial advice than their more pessimistic peers.

Positive people display a correspondingly positive approach to their finances. They tend to put plans in place and have the courage to dream big. You don't have to be too ambitious in how you carry out those plans, every small step you take will help you to get where you want to be.

Everyone experiences setbacks at various times, however optimists rise to these challenges, learning from their past mistakes and persisting in their endeavours. Don't be too hard on yourself if you are experiencing difficulties. We all face challenges and during these times, focus on solutions rather than just the problems, be conscious of your "internal talk" and don't be afraid to seek out support. It's important to focus on what you can do differently going forward, this could be as simple as working towards a "rainy day" fund.

It's never too late to change your outlook. By embracing optimism, you can reap the rewards that a more positive outlook provides.

i https://www.optforoptimism.com/optimism/optimismresearch.pdf/

BOOST your super, and get a tax break at the same time?

Back in July 2018, a unique opportunity was introduced that enabled many Australians to receive a much higher tax deduction for their personal contributions to super than was previously available. This opportunity took some years to get traction however it is now appearing to have come of age.

> **If you are one of those people looking for opportunities to maximise your super, and claim a tax deduction along the way, this strategy may appeal to you.**
>
> **However, like most things relating to superannuation, there are some conditions attached.**
>
> **This article focusses on the opportunity for many people to exceed their basic annual concessional contribution cap without incurring adverse tax consequences.**

What is a concessional contribution?

Concessional contributions are those contributions made to a superannuation fund by a person's employer. Employer contributions include the compulsory 10% "superannuation guarantee" contributions, contributions made under a salary sacrifice arrangement, and other discretionary contributions an employer may make.

In addition to employer contributions, contributions we also make in our personal capacity and intend to claim as a tax deduction are also concessional contributions.

Concessional contributions are treated as taxable income of the superannuation fund they are made to, meaning they are taxed within the super fund at a rate of 15%. This is often referred to as "contributions tax".

Contribution cap

The current annual limit, or cap, on concessional contributions is $27,500. This increased on 1 July 2021 from the previous cap of $25,000 per annum, which had been in place since 1 July 2017.

When contributions exceed the concessional contribution cap, additional tax is generally payable.

But wait!

Before 1 July 2018, if a person didn't fully use their concessional contribution cap in a particular financial year, as was common for most people, the unused portion of their cap was lost.

From July 2018 this changed.

Subject to meeting certain conditions, a person may now carry forward the unused portion of their concessional contribution cap that has accrued since 1 July 2018, for up to five years.

However, there is a primary condition that needs to be satisfied.

To be able to carry forward the unused portion of the concessional contribution cap, a person must have a total superannuation balance of less than $500,000.

Total superannuation balance

The total superannuation balance is the value of all superannuation a person holds, including pension accounts, calculated at the previous 30 June.

Let's consider a simple example

On 30 June 2021, Bertina, aged 65 and retired, had a superannuation account with a balance of $58,000. She also had an account-based pension with a balance of $420,000. Therefore, her total superannuation balance (on 30 June 2021) was $478,000.

As a result, she has met the first condition enabling her to carry forward the unused portion of her concessional contribution cap that has accrued since 1 July 2018, to the 2021-22 financial year.

Taking advantage of the carry-forward opportunity

For the sake of this example let's assume in August 2021 Bertina sold an investment property that resulted in a capital gain of $100,000 to be added to her 2022 assessable income.

Bertina's concessional contribution cap for 2021-22 is $27,500.

In the circumstances, Bertina could make a personal contribution to superannuation and claim a tax deduction of $27,500 to help offset the tax payable on her income, including her capital gain.

However, if she has any unused concessional contribution cap that had accrued since 1 July 2018, she is able to carry the unused balance forward to 2021-22.

If Bertina's unused cap from 1 July 2018 through to 30 June 2021 totalled (say) $50,000, she can make a personal tax-deductible contribution to superannuation of up to $77,500 in 2021-22 (that is, $27,500, plus her unused carried forward cap of $50,000).

This will go a long way towards reducing the tax she might otherwise be paying on her capital gain.

Speaking of tax

When it comes to making superannuation contributions, tax is just one consideration.

As mentioned earlier, tax deductible superannuation contributions, such as the one Bertina intends to make, are treated as taxable income of the superannuation fund. In this example, the contributions tax that will be deducted by Bertina's superannuation fund from her contribution of $77,500, will be $11,625.

Provided this is less that the tax Bertina will have paid if the full capital gain was taxed at her marginal tax rate, by making a personal tax-deductible contribution to super, Bertina is ahead.

Is there anything else to consider?

People are generally able to make concessional contributions to super if they are under 67 years of age.

From 67 through until turning 75, they will need to have met a work test, or be eligible for the work test exemption[ii], to make personal contributions to super.

For those who are employed, carrying forward the unused concessional contribution cap can be useful when looking to make contributions under a salary sacrifice arrangement, or when topping up concessional contributions by making personal tax-deductible contributions.

Like most things involving superannuation, there are a lot of moving parts – multiple issues to be considered.

When looking to maximise contributions to superannuation we highly recommend you consult with a qualified financial adviser to ensure the strategy is appropriate for you.

i Special rules apply for members of defined benefit superannuation funds, and for pensions other than account-based pensions

ii Special conditions apply to access the work test exemption

Keeping calm during market volatility

It's been a rocky start to the year on world markets but that doesn't mean you should hit the panic button. Staying the course is generally the best course, but that's not easy when the market's falling.

The key reasons for recent volatility are fear of inflation, rising interest rates and pressure on corporate profits. Add to that concern about COVID-19 and the outbreak of war in Ukraine, and it is hardly surprising markets are jittery.

But fear and the inevitable corrections in share prices that come with it are all a normal part of market action.

Downward pressures

Rising interest rates and inflation traditionally lead to downward pressure on shares as the improved returns from fixed interest investments make them look more attractive. However, inflation in Australia is nowhere near US levels where inflation is at a 40-year high of 7.5 per cent. In fact, the Reserve Bank forecasts underlying inflation to grow to just 3.25 per cent in 2022.[i]

Reserve Bank Governor Philip Lowe concedes interest rates may start to rise this year. Even so, he doesn't believe rates will climb higher than 1.5 to 2 per cent. After all, with the size of mortgages growing in line with rising property prices and high household debt to income levels, rates would not have to rise much to have an impact on household finances and spending.[ii]

Even with rate hikes on the cards, yields on deposits are likely to remain under 1 per cent for the foreseeable future compared with a grossed-up return (after including franking credits) from share dividends of about 5 per cent.[iii]

> *The old adage goes that it's "time in" the market that counts, not "timing" the market.*

So if you rush to sell because you fear stocks may fall further, you risk turning a paper loss into a real one, as well as missing the rebound.

Over time, short-term losses tend to iron out, with higher returns in the long run but higher risk of volatility along the way. The important thing is to have a strategy that allows you to sleep at night and stay the course.

Chance to review

A downturn in the market can present an opportunity to review your portfolio and make sure it reflects your risk profile. Years of bullish performances may have encouraged some to take more risks than their profile would normally dictate.

You may also want to ensure you are sufficiently diversified across the asset classes to put yourself in the best position for current and future market conditions.

Think long term

Over the long term, shares tend to outperform all other asset classes. And even when share prices fall, you are still earning dividends from those shares. And with Australia's dividend imputation system, there are also tax advantages with share investments.

For long-term investors, rather than sell in a kneejerk reaction, it might be worthwhile considering buying stocks at lower prices. This allows you to take advantage of dollar cost averaging, by lowering the average price you pay for a particular company's shares.

Investments are generally for the long term and chopping and changing investments in response to short-term market movements is unlikely to deliver the results you planned.

If recent turbulence has unsettled you, call us to discuss your investment strategy and whether it still reflects your risk profile and long-term objectives.

i https://www.abc.net.au/news/2022-02-02/rba-governor-philip-lowe-press-club-address/100798394

ii https://www.ampcapital.com/au/en/insights-hub/articles/2022/february/the-rba-ends-bond-buying-but-remains-patient-on-rates-we-expect-the-first-rate-hike-in-august?csid=1135474712While

iii https://www.ampcapital.com/au/en/insights-hub/articles/2022/february/the-rba-ends-bond-buying-but-remains-patient-on-rates-we-expect-the-first-rate-hike-in-august?csid=1135474712While

We hope you enjoyed our latest edition of Prepare for Life.

Please contact our office if you would like to discuss anything in this edition.

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