rise financial

Take Control - With Your Independent Financial Adviser

With tax cuts and stimulus payments on the way, Treasurer Josh Frydenberg is urging us to open our wallets and spend to kick start the national economy. But if your personal balance sheet could do with a kick along, then saving and investing what you can, also makes sense.

One positive from this COVID-19 induced recession, is that it has made many of us more aware of the importance of building a financial buffer to tide us over in lean times. Even people with secure employment have caught the savings bug.

According to the latest ME Bank Household Finance Confidence Report, 57 per cent of households are spending less than they earn. This is the highest percentage in almost a decade.[i]

More troubling however, was the finding that one in five households has less than $1,000 in savings, and only one third of households could maintain their lifestyle for three months if they lost their income.

Whatever your financial position, if saving is a priority the next step is deciding where to put your cash.

Banking on low interest

Everyone needs cash in the bank for living expenses and a rainy day. If you've been caught short this year, then building a cash buffer may be a priority.

If you have a short-term savings goal such as buying a car or your first home within the next year or so, then the bank may also be the best place for your savings. Your capital is guaranteed by the Government so there's no risk of investment losses.

But with interest rates close to zero, the bank is probably not the best place for long-term savings. So once your need for readily accessible cash is covered, there are more attractive places to build long-term wealth.

Pay down your mortgage

If you have a mortgage, then making extra repayments can reduce the total amount of interest you pay and cut years off the life of your loan. This strategy has the most impact for younger people in the early years of a 25 to 30-year loan.

If your mortgage has a redraw or offset facility, you can still access your savings if you need cash for an emergency or home renovations down the track. This may be a deciding factor if retirement is a long way off.

Boost your super

Making extra super contributions is arguably the most tax-effective investment, especially for higher income earners.

Even so, super is likely to be more attractive as you get closer to retirement, the kids have left home, and your home is close to being paid off. (see Mortgage or super on the next page).

You can make personal, tax-deductible contributions up to the annual cap of $25,000. Be aware though that this cap includes super guarantee (SG) payments made by your employer and salary sacrifice amounts.

You can also make after-tax contributions of up to $100,000 a year up to age 75, subject to a work test after age 67.

Invest outside super

If you would like to invest in shares or property but don't want to lock your money away in super until you retire, then you could invest outside super.

If you are new to investing, you could wait until you have saved $5,000 or so in the bank and then buy a parcel of shares or an exchange-traded fund (ETF). ETFs give you access to a diversified portfolio of investments in a particular market, market sector or asset class.

First home buyers might consider the federal government's expanded First Home Loan Deposit Scheme with as little as 5 per cent deposit. There are limited packages available and price caps on the home value, depending on where you live.

With tax cuts set to flow and a new appreciation of the importance of financial security, now is the perfect time to start a savings plan.

Contact our office if you would like to discuss your savings and investment strategy.

Mortgage or super?

A question often asked is whether it's better to put savings into super or your mortgage. Well, it depends on factors including your age, personal circumstances and preferences, interest rates and tax bracket.

Mitch is 35 with 25-year, $500,000 mortgage and monthly repayments of $2,300. If he increases his repayment by $400 a month, he could cut five years off the term of his loan and save almost $40,000 in interest.[ii]

But what if Mitch were to salary sacrifice that extra $400 a month into his super? He currently earns $85,000 a year which puts him in the 34.5 per cent tax bracket, including the Medicare Levy. By age 60, his super balance would be around $138,000 higher than if he relied on his employer's SG contributions alone.

Mathematically, Mitch would be better off putting extra savings into super than his mortgage. But he and his partner Grace are planning to marry and start a family, so getting on top of the mortgage and having access to his savings to upgrade their home and fund their kids' education is a bigger priority than retirement right now.

It's different for Gail, who at age 55 has $200,000 and 10 years left on her mortgage and just $100,000 in super. If she puts an extra $400 a month into her mortgage, she will save around $5,800. But if she salary sacrifices $400 a month into super until age 65, she will boost her balance by around $48,000 and still manage to pay her home off by the same time.[iii]

i https://www.mebank.com.au/getmedia/c27b0a0d-cc4e-470e-8a37-722d6f00af98/Household_Financial_Comfort_Report_July_2020_FINAL.pdf

ii Calculations using the MoneySmart mortgage calculator, 14 October 2020, using default assumptions. https://moneysmart.gov.au/home-loans/mortgage-calculator

iii Calculations using the MoneySmart super calculator, 14 October 2020, using default assumptions. https://moneysmart.gov.au/how-super-works/superannuation-calculator

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