Insights and Investment Solutions

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Welcome

In this edition of Insights and Investment Solutions magazine, read the latest on local and international markets in our market update.

We take a look at investing and how your biggest problem may be your own mindset.

Finally, we share insights on whether it's worth salary sacrificing your super.

Until next time – happy reading.

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Market update

During August ongoing trade tensions again unnerved investors, with tariffs imposed on Chinese goods by the US triggering a spike in volatility across global markets. New leaders emerged in July with former IMF head and French finance minister, Christine Lagarde, chosen as the next president of the ECB, while Boris Johnson took office as the new UK Prime Minister.

Equity markets rallied in the first few months of the quarter, however plunged following Trumps August announcement that the US would impose 10% tariffs on $300Bn worth of imported Chinese goods. China retaliated by allowing the yuan to break the significant level of 7 Yuan to USD, causing Trump to accuse the government of currency manipulation, further amplifying tensions. The MSCI World ex Australia Index finished the month of August up only 0.27%.

China's trade surplus with the US grew to US$31.05 billion in August, surpassing a previous record set in June. China's annual export growth however declined slightly to 9.8%, yet only slightly beneath trends. Tensions between China and the US intensified in the latter half of August, with China announcing increases of 5-10% in tariffs on US$75Bn of US imports.

Domestically, the Reserve Bank's first rate cut in three years in June indicated signalling of an easing cycle due to a weak economic outlook and rising unemployment, with economic consensus forecasting 3 further rate cuts over 2019 to a low of 75 basis points by year end. June quarter GDP figures signified a deceleration of the economy, driven by a decline in consumer sentiment and diminishing house prices over the period.

The Federal Reserve also lowered US interest rates in August, bringing the target range down 25 basis points to 2 to 2.25%. Chairman Powell was quick to remind the markets that the move was a form of insurance against downside risks, as opposed to the start of a quantitative easing programme.

In July, the European Union leaders chose Former French finance minister and IMF head, Christine Lagarde, as the next president to lead the ECB. This coincides with the bank sending signals to the market suggesting a stimulus package is to come.

In the UK, Boris Johnson emerged victorious in securing office in July as the new Prime Minister of the country, raising the likelihood of a hard Brexit on October 31. The Bank of England's (BoE) Financial Stability Report affirmed the UK banks' strength and resilience to face a disorderly no-deal Brexit and global economic weakening.

Political risk became the focal point of European markets in late August as Italy's Prime Minister Conte resigned, ending the League/5-star coalition. If a new coalition is not formed, a flash election may be called or President Mattarella may have to engage a caretaker technocrat government to enable the submission of Italy's budget proposal to the EU in latter half of 2019.

Information current as at 30 August 2019.

Sorry, but your biggest investing problem may be you?

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The human brain is an incredibly powerful processing unit.

Every day we make numerous judgements and decisions – hundreds if not thousands if you conclude everything we do is an individual 'decision'. As the human brain has evolved, in part due to the increasing complexity of our environment, it's developed little short-cuts, or 'heuristics'. These mental pathways circumvent multi-stage decisions and allow us to make judgements quickly and efficiently. While heuristics are helpful and allow us to function without stopping to think about our next action, they can – and do – lead to cognitive biases. There are actually over 100 of these recognised habits[1], and their mix and dominance varies from person to person.

Unfortunately, these biases sometimes trip us up leading to bad judgements and poor decisions. Consequences of sub-par decisions or erroneous conclusions are most often inconsequential but unfortunately – and consequentially - such biases exist in the full spectrum of our decision-making, including those in the realm of safety – and investing.

"The investor's chief problem – even his worst enemy – is likely to be himself" Benjamin Graham

A vital ingredient to successful investing over the longer term is *knowing yourself* – and specifically knowing the mental traps you may fall into when making investment decisions. So to better help know yourself, here are a few of the more typical behavioural biases of investment decision-makers.

[1] https://en.wikipedia.org/wiki/List_of_cognitive_biases

Anchoring bias

Anchoring bias is the tendency to rely on, or anchor to, a particular piece of information, or event. There are a few common anchors for investors. Many people base their investment decisions on the current price of an asset relative to its history. Where a price is now relative to where it has been in the past is not a reliable indicator of the future direction of the price, or whether the asset might be cheap or expensive.

Another Anchor is the purchase price of an asset. While a gain or loss represents the difference between the current price and the purchase price, is this actually helpful when deciding to buy, hold or sell?

An event Anchor, with a good example being the Global Financial Crisis. Many investors, scarred by their loss of capital through the GFC, now anchor to the event (and the associated financial loss or psychological pain) when making investment decisions.

An asset should be assessed based on its *intrinsic value* and investors should attempt to determine an asset's current and potential future worth in isolation from other values (or events). Disconnecting from Anchoring bias can be difficult, but a good starting point is to consider what you anchor to and when you do it.

Herd mentality

There's something innately safe about being in a herd. We humans are hard-wired to herd. So it's not surprising that this is common in investment circles where investors place a big emphasis on what groups are doing.

There's all sorts of emotions at play with this bias. There's an element of FOMO (fear of missing out) when there's a bull-rush to a type of investment (think tech stocks in 1999); there's the psychological pain of going against the crowd; and then there's the fear of humiliation or embarrassment (aside from the financial consideration) of just being proven wrong.

Recognising the lure of running with the pack requires an ability to think independently. Be self-aware about the social and emotional pull of the herd. If this is confusing or overwhelming, then consider using a professional investment manager to dislocate you from this pull.

Confirmation bias

Confirmation bias is the tendency of people to pay close attention to information that confirms their belief, and ignore information that contradicts it. This can be lead to overconfidence and the risk of being blindsided.

Our natural tendency is often to listen to people who agree with us. It feels good to hear our opinions reflected back to us. Many people choose their news sources based on a confirmation bias. Do your news sources reflect your views and opinions? There's nothing particularly wrong with this per se, but such bias can be disastrous for investors, as it can validate and reinforce a view which may be flawed. Instead, we should be looking for *disconfirming* information to test against an initial view. A discipline of stress-testing and deconstructing ideas runs consistent in many of the world's most successful investors. To overcome this bias start looking for information that might disprove your ideas, rather than confirm what you want to do.

Overconfidence bias

People tend to overestimate their skills, abilities, and predictions for success. This bias is prolific in behavioural finance. Careful risk management is critical to successful investing and overconfidence tends to make us less cautious in our investment decisions. Many of these mistakes stem from an illusion of knowledge and/or an illusion of control.

Anecdotally, a significant number of SMSF-holders suffer from overconfidence bias. Asset allocation data collated by the ATO suggests the average SMSF is highly concentrated in domestic assets (particularly shares and cash), poorly diversified and consequently exposed to various material risks.

Overconfident investors often put down their wins to talent and losses to plain bad luck. Guarding against overconfidence involves acute self-awareness and the ability to isolate the role of skill versus timing, or luck.

Loss aversion

Loss aversion is a tendency to dislike losing money a lot more than enjoying making money. This kind of bias is commonplace with stock traders, but definitely also applies to longer term investors. The GFC is a period in many investors' lives which created an enduring fear of substantial loss. Scarred by losses from such periods, investors can be at risk of creating portfolios too conservatively invested with a primary goal of fortifying against loss, rather than looking at their time horizon and structuring a portfolio to suit.

Conversely, there is a new cohort of younger investors whose entire investing experience has been after the GFC, creating hubris around investing skill (see overconfidence) and a portfolio structure which may take on too much risk on the belief that markets will rise in perpetuity.

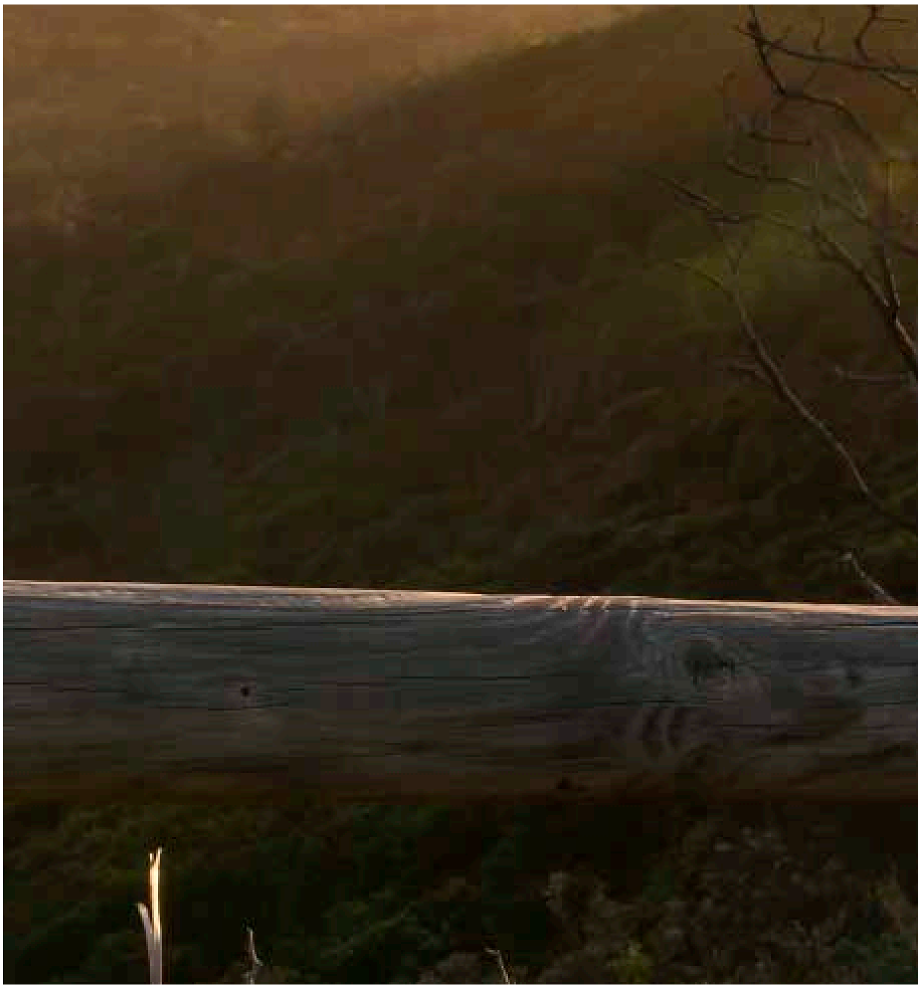
Investors need to remember that to generate a certain level of returns they need to take a certain level of risk, and periods of negative returns are to be expected when taking on risk. The idea is to not take excessive risks in seeking to achieve a return goal.

What are your biases?

What, of the list above might you be most prone to? Can you ascribe one or more biases to an investment mistake? Perhaps write down the three that you think you are most susceptible to. (Remember that there are many more.)

Common to a lot of these biases is the ability to think independently. And if you can't do this, or don't have the time and energy, then consider employing a professional investment manager to do it for you. The best money managers are acutely aware of their biases and actively guard against them by slowing down and testing decision drivers before transacting.

From an evolutionary perspective, mental short-cuts are great but successful investing relies on the application of sound judgment and control over emotions and natural tendencies. Being aware of these academically-proven behavioural biases and how they influence your investment decision-making processes can help with realising long term financial goals.



Is it worth salary sacrificing your super?

Are you worried about retirement? If you're like many people, the thought of having to survive solely on your savings in retirement, might not sit too well.

But the good news is, it's never too late to start growing your retirement income no matter what your situation.

Salary sacrificing into super is effectively a long-term wealth strategy that may help to grow your retirement savings over time.

We take a look at how it works, the benefits and some things to consider.

What is salary sacrificing into super?

Salary sacrificing into super is really about sacrificing some of your income now, to save for your retirement.

This means you're not just relying on your employer's regular super contribution of 9.5 percent to save for your future.

How does salary sacrificing into super work?

It can involve setting up an arrangement between you and your employer whereby you agree to contribute an additional amount into your super from your pre-tax income.

As you'll essentially be taking home less money, you may want to consider calculating how much of your income you can afford to give up. There are a number of calculators available that may help you with this.

So, what are the benefits of salary sacrifice into super?

Salary sacrificing into super offers a number of benefits. These include:

- The amount you salary sacrifice into super is generally taxed at 15 per cent, which for most people will be less than the tax you may pay on that income[1] personally if it was paid to you as salary. This also means you will reduce your taxable income as you'll essentially be taking home less money.
- What you earn off your investments inside super is taxed at 15 percent, which may be less than the tax you may pay on your investment earnings outside super.[2]
- You have additional money being saved towards your retirement, with these regular savings happening automatically for you.

Compounding returns

There is also the added power of compounding returns. As you start adding more money to your super account, you may earn returns on that extra amount over time. So, it's that little bit of returns you earn in the early stages that can make a difference in the end.

What are the restrictions with salary sacrificing into super?

There are a couple of important things to keep in mind if you're thinking about salary sacrificing into super.

The tax benefit is only available if you contribute no more than $25,000 per year[3] from your pre-tax income. This includes the regular super guarantee contributions made by your employer.

It's also important to remember that the extra money you contribute into super is generally not accessible until you retire.

1 ASIC Moneysmart: https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/super-contributions/salary-sacrifice-super

2 ASIC Moneysmart https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/tax-and-super

3 Australian Taxation Office: https://www.ato.gov.au/Rates/Key-superannuation-rates-and-thresholds/?anchor=Concessionalcontributionscap#Concessionalcontributionscap

Superannuation is a means of saving for retirement, which is, in part, compulsory. The government has placed restrictions on when you can access your investment held in superannuation. The Government has set caps on the amount of money that you can add to superannuation each year on both a concessional and non-concessional tax basis. There will be tax consequences if you breach these caps. For more detail, speak with a financial adviser or visit the ATO website.

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