futuro FINANCIAL SERVICES

infocus

WINTER 2019

iPlan Financial Services
Confidence | Control | Choice | Opportunity

IPLAN FINANCIAL SERVICES AUST. PTY LTD
Authorised Representative and Credit Representative
ABN 58 928 175 252

ADDRESS:
Ground Floor
139 Coronation Drive
MILTON QLD 4064

EMAIL:
enquiries@iplan.net.au

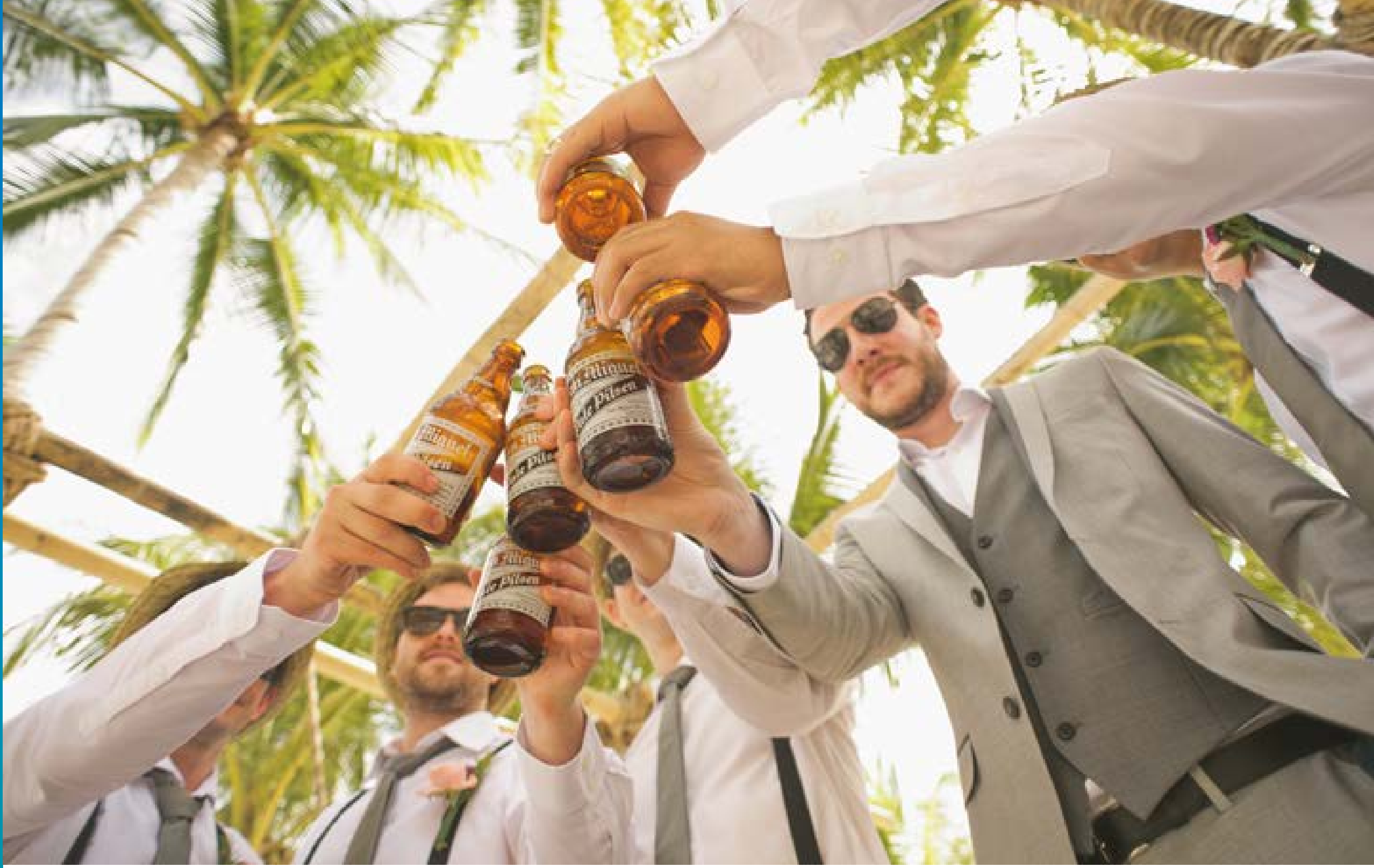
PHONE:
(07) 3062 7444

FACSIMILE:
(07) 3144 5670

www.iplan.net.au

Wealth accumulation and the FIRE movement

No one person has the same financial situation, goals and objectives. Given this, we all walk our own individual path towards achieving financial independence (and, ultimately retirement).



Wealth accumulation and the FIRE movement CONTINUED

In saying that, we often tend to share a similar idea around what an appropriate (and realistic) retirement age looks like. Namely, late 50's or early to mid-60's.

This shared idea can be influenced by the relationship that exists between:

- the natural ageing process and its impact on our physical and/or mental capacity to do work
- the path of the financial lifecycle regarding our wealth accumulation and cashflow generation
- the rules governing access to super savings (one of the main sources of income in retirement)

With the above in mind, we discuss the somewhat controversial FIRE movement.

The FIRE movement

The FIRE movement is a social lifestyle movement that is often publicised as working to achieve financial independence and early retirement. Hence the FIRE (Financial Independence, Retire Early) acronym.

In addition, those considered to be FIRE subscribers are depicted as engaging in radical saving measures during the early part of their career, with the aim of achieving FIRE in their 30's or 40's.

The radical saving measures are saving ≥40% of their after-tax income and investing it in growth-orientated assets. And, the achievement of FIRE* is accumulating a net wealth of 25 times their annual expenses, then commencing a drawdown of 4% per annum.

Given the above description, there have been (and continue to be) criticisms of the FIRE movement.

One criticism is the savings rate, when considering low to middle-income earners and those living in an expensive area. Namely, they may not be able to save and invest ≥40% of their after-tax income.

Another criticism is the net wealth target and 4% drawdown, when considering the retirement timeframe and the risks in retirement (investment, inflation, sequencing, expenditure, legislative, and longevity risk).

Interestingly, a recent study^ aims to clarify some of the commonly held beliefs regarding the motivation of FIRE subscribers, as well as their timeline and pathway to achieving FIRE. Please see below for the results.

*A state in which an individual or household has sufficient wealth to live on without having to depend on employment income.

Wealth accumulation and the FIRE movement CONTINUED

Motivation of FIRE subscribers

The financial independence (FI) component, and the financial security/peace of mind that comes with obtaining it, is the main driver for FIRE subscribers, rather than the retire early (RE) component.

However, when considering the retire early (RE) component, this is more centred around living life on their own terms (having the means/freedom to achieve work-life balance), rather than leaving the workforce.

Timeline to achieving FIRE

The majority of FIRE subscribers would rather retire at a normal time and live more comfortably. This is referred to as 'Fat FIRE', and is characterised as living with a comfortable budget pre and post-retirement.

However, there is a minority that would rather retire early and live a leaner low-cost lifestyle. This is referred to as 'Lean FIRE', and is characterised as living with a modest budget pre and post-retirement.

With the above in mind, here is a breakdown of the FIRE timeline:

- the average age that they begin their journey towards FIRE is 37
- the average age that they achieve the financial independence (FI) component# is 57
- the average age that they decide to follow through with the retire early (RE) component is 62

Pathway to achieving FIRE

The pathway to achieving FIRE primarily involves exercising financial discipline with regards to financial decisions; however, lifestyle/career decisions also play a supportive part.

The financial decisions consist of creating a budget (and tracking spending), paying off their mortgage (and avoiding high-interest debt), investing in growth-orientated assets (and maxing out retirement savings).

Whilst the lifestyle/career decisions consist of downsizing their lifestyle (living within/below their means), and in some cases relocating to a cheaper area and pursuing a secondary income (or higher income career).

In addition to the above, on the pathway to achieving FIRE, the majority of FIRE subscribers:

- Spend money on things that matter, and prioritise saving and investing. This is approached from either a frugalist (saving money) or a minimalist (purposeful/mindful consumption) mindset.
- Acknowledge the benefits of making sacrifices in the short-term (instant vs delayed gratification); however, they do have limits, such as an unwillingness to live like they are broke.
- Reduce spending, as opposed to increase employment income, to maximise their savings rate; however, they save what they can, which isn't necessarily ≥40% of their after-tax income.
- Understand investment risk (risk vs return, time horizons, etc.), and chose to invest in growth-orientated assets (shares and property) for long-term capital growth (and income) purposes.
- Take the time to invest in themselves, by improving upon their financial literacy in areas, such as cashflow and debt management, taxation, investments, and retirement savings.

Moving forward

Whether you agree with the FIRE movement or not, it does raise some interesting food for thought.

Financial independence

The shift from financial dependence to independence (phase 1 and 2), with regard to wealth accumulation and cashflow generation, is a part of your natural progression along the path of the financial lifecycle.

However, as stated above, no one person has the same financial situation, goals and objectives, which means we all walk our own individual path towards achieving financial independence (and retirement).

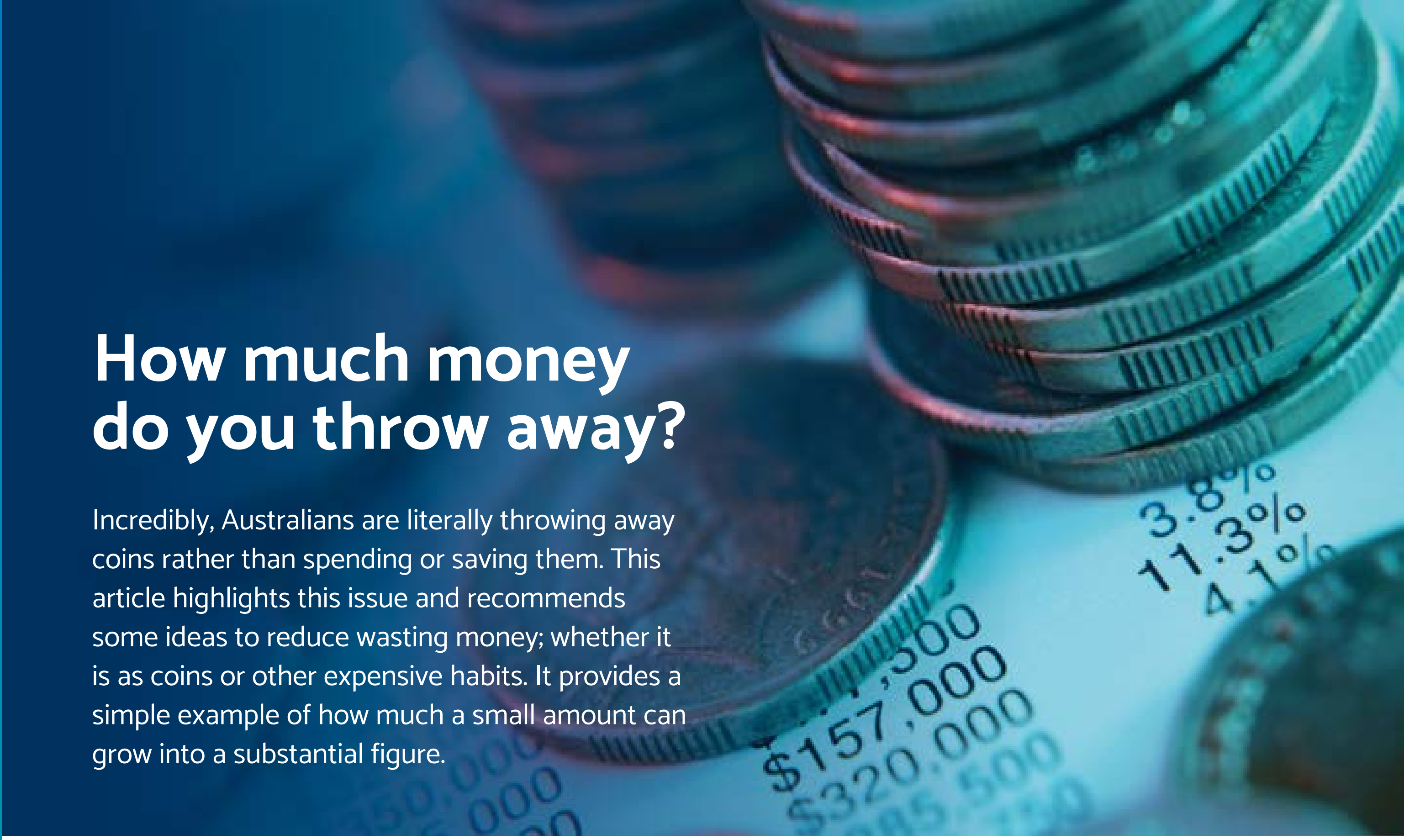
Furthermore, achieving financial independence doesn't necessarily have to mean the end of the line in terms of your employment – it does mean financial security/peace of mind to live life on your own terms.

Saving and spending

In terms of savings rate, yes there can be limitations, such as low income, high expenses, low income + high expenses, or personal choice. Regardless of the situation though, remember that seldom is this permanent.

Also, after reviewing your spending, often adjustments can be made to realise surplus income. Even small sacrifices can make a difference in the long-run when directed towards debt repayment and saving/investing.

#For most FIRE subscribers, financial independence sits between $500,000 and $2m in net wealth. However, for some, this can be ≥$5m (those in the top end of 'Fat FIRE') or <$500,000 (those in the bottom end of 'Lean FIRE').



How much money do you throw away?

Incredibly, Australians are literally throwing away coins rather than spending or saving them. This article highlights this issue and recommends some ideas to reduce wasting money; whether it is as coins or other expensive habits. It provides a simple example of how much a small amount can grow into a substantial figure.

How much money do you throw away?

While the move is on to become a cashless society, notes and coins are likely to be with us for some time yet. 'Touch and go' payments may be increasing, but for many small purchases most of us still rely on good old cash. And because it's easier to hand over a note for each purchase than to scramble in our pockets or purses for the correct change, by the end of the week we often end up with a hefty pile of low value coins. These coins are such a pain that, according to one survey, 93% of respondents admitted to throwing away five cent pieces, with 29% even ditching ten cent pieces.

Okay, so tossing away a dollar's worth of small change each week won't put much of a dent in your future wealth, but at least consider dropping those coins into a donation box. Combined with thousands of other donations your spare change can make a real difference to the people that charities look after.

There are, however, other areas where we effectively throw away money, and in amounts that can truly add up:

- Food: on average Australians throw away around one third of the food we buy.
- Gas and electricity: when was the last time you shopped around for the best deal on your gas and power bills? You could save hundreds of dollars a year.
- Gift cards: often end up at the back of a drawer until they expire, or you may only spend part of the total value.
- Impulse buying: how much do you spend on clothing you don't wear and stuff you don't use?
- Lunches: even if you skip the smashed avo, a takeaway lunch costs much more than one you make yourself.

In most of these cases the solutions are pretty obvious.

- Only buy the food you will use. A few loose carrots and apples might be a better buy than the kilo bags that start to rot in the crisper. If you regularly have a surplus of some foods find recipes that use them. Soups and casseroles are a great way to use up all sorts of ingredients.
- Compare what other gas and electricity retailers are offering.
- Have a good look at your credit card statement. Were all your purchases necessary?
- Place your gift cards in front of your credit cards to remind you to use them instead.
- Make your own lunch. Many people can easily save $10 or $15 dollars per day with very little effort. Once any impulse buying habits are under control, this could be the supercharger of your savings.

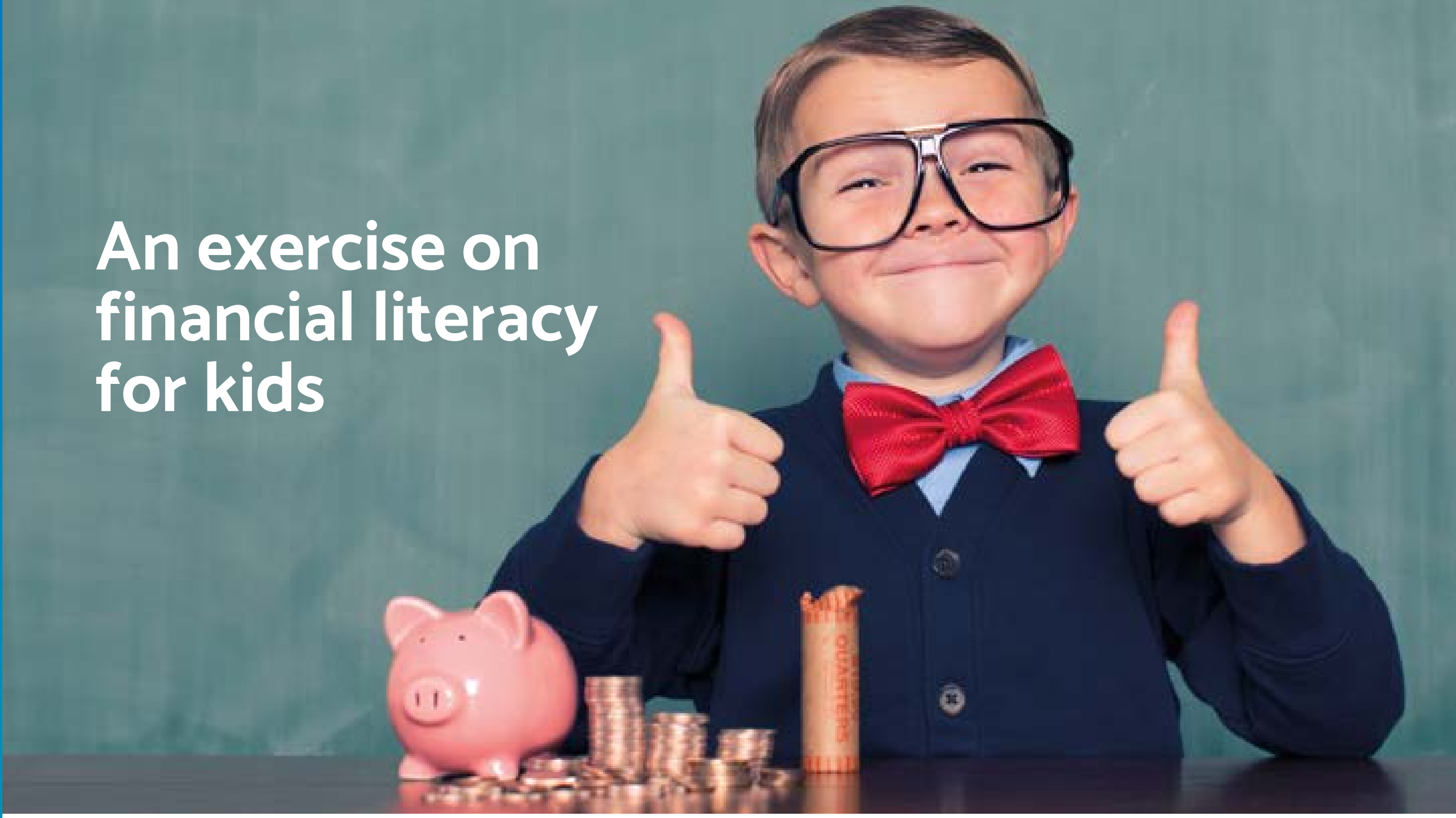
Will implementing these changes make a real difference? Let's see.

Imagine that you adopt some of these suggestions and as a result save an average of $60 per week. Stashed away in a savings account earning an interest rate of 2% per annum for 20 years, those modest weekly savings will grow to over $76,700. Contributed to an investment that provides an average return of 7% pa and you could be looking at having around $136,000 in 20 years' time.

Does that give you a better idea of how much money you could really be throwing away?

What to do with your newfound savings capacity will depend on your goals and situation. Your financial adviser will be able to help you make the most of the money you don't throw away.

An exercise on financial literacy for kids



Financial literacy is an important life skill. It can aid an individual in making sound financial decisions (i.e. via healthy financial attitudes and behaviours) and achieving financial wellbeing (i.e. via positive economic outcomes).

There are differences in the financial literacy scores of the examined age groups. In particular, those aged 15-24 recorded the lowest financial literacy score across the board, and in all assessed areas (i.e. numeracy, inflation, diversification, and risk vs return) bar one (i.e. money illusion).

Importantly, if not appropriately addressed, this can have ramifications for an individual now and into the future – in terms of how they decide to approach earning, spending, saving, investing and giving away money.

An exercise on financial literacy for kids

Admittedly, financial literacy, like any life skill, takes time and effort to master. However, a strong foundation from which to build upon, a willingness to learn and a supportive environment can help.

Financial literacy needs to be nurtured from a young age through the teaching of personal finance concepts and the instilling of healthy financial attitudes and behaviours.

Below we have provided you with a simple exercise (broken down into nine steps) that you may find helpful to get the ball rolling with your children. Importantly, you may need to tailor this to suit your own personal circumstances.

1. Explain the concept of money (showing them cash notes, coins and debit/credit cards in the process). This will teach your children that money provides a common base to value and exchange goods and services and it can also be used as a store of value (to save and use for later).

2. Establish a daily/weekly age-appropriate chore routine that is linked to pocket money (a mixture of low-value cash notes and coins). This will teach your children about the source and destination of cashflow (the way money moves), with emphasis on the fact that 'money doesn't grow on trees'; rather it needs to be earnt.

3. Explain the difference between needs and wants, and ask them to write a list of things they need and want. This will teach your children that there is a difference between needs/necessities and wants/luxuries, whilst also helping them to identify their own (and subsequently better inform their upcoming purchasing decisions).

4. Take them shopping and ask them to write down the cost of the things they need and want (preferably from at least two different retailers). This will teach your children several things:
   - Reinforce that money provides a common base to value and exchange goods and services.
   - The importance of comparing the price of things between different retailers.

An exercise on financial literacy for kids CONTINUED

5 After their first pocket money is received, provide them with three piggy banks/jars, labelled 'Needs', 'Wants', and 'Savings', and ask them to deposit the following percentage amounts into each, 50%, 30%, and 20% respectively. This will teach your children the importance of budgeting and managing their money in a responsible and disciplined way.

6 Ask them to decide the needs and wants from their list that they would like, and can afford, to purchase now. Importantly, don't allow them to bolster their purchasing power with the 'Savings' piggy bank/jar just yet. This will teach your children about money limits and prioritising their purchases – namely, they can't have everything now, a certain level of compromise has to occur.

7 Take them shopping and assist them with purchasing the above things that they have decided upon with their pocket money. This will teach your children about being aware of money leaving their possession. A cash-based payment is tangible – the cash notes and coins that they hold in their hand has value attached to it. This awareness is often lost when using 'tap and pay'.

8 Ask them to donate a small portion from their 'Wants' piggy bank/jar to a charity of their choosing. This will teach your children about taking the time to reflect on not only their life, but also the lives of those less fortunate. In a nutshell, being thankful for what they have and helping those in need where they can – even a small gesture can make a big difference in someone's life.

9 Ask them to review their list of remaining needs and wants, and help them to work out how long it will take them to save for these things given their incoming cashflow and 50/30/20 budgeting split. Importantly, you can now take into account the 'Savings' piggy bank/jar, but a portion should remain at all times. This will teach your children about the benefits of goal setting (and savings plans) and delayed gratification, as well as keeping an emergency buffer at hand.

Please note

Depending on the age of your children, you may also want to introduce them to other concepts, such as the following:

- The impact of inflation and wage growth on purchasing power over time.
- Online and digital purchases and the fact that these still involve the use of real money.
- Savings and everyday accounts, as well as debit and credit cards (or borrowing from you).

Moving forward

Your beliefs on money, which can influence your financial attitudes and behaviours, are often shaped by your experiences, education and relationships (and your interpretation of these things). Importantly, the same also applies to your children.

With this in mind, whilst we have provided you with an exercise to get the ball rolling with your children in terms of their financial literacy, it's important to be mindful of something. Children also learn a lot by watching how you approach your own earning, spending, saving, investing and giving away of money. As such, there needs to be consistency with regards to the messages that your children are receiving.