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Editorial

The Albanese Government delivered its second Budget on Tuesday, and we'll take a brief look at the key numbers, policies, and economic forecasts, as well as draw some conclusions, including for superannuants and retirees.

Key budget numbers

- This year's Budget is forecast to be in surplus by $9.3 billion, or 0.3% of GDP. That surplus is higher than the December forecast of a $1.1 billion deficit, or 0.0% of GDP, and the original estimate for a deficit of $13.9 billion, equivalent to 0.5% of GDP. It means the Budget will be in surplus for a second year in a row.

- However, future years are expected to slip back into deficit. The Budget estimates a 2024/5 deficit of $28.3 billion (1% of GDP). That's larger than the deficit forecast in December of $18.8 billion. And the $9.5 billion difference entirely comes from new government spending.

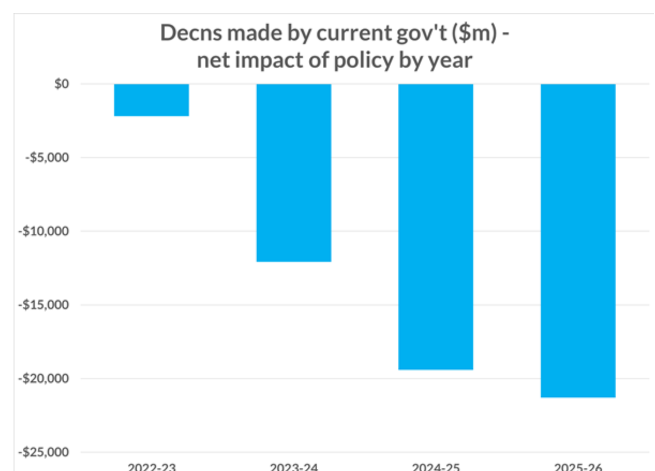
- The budget deficits forecast to 2027/28 range from 0.8% to 1.5% of GDP. It partly comes from an increase in net spending of $24 billion over the next four years. Cumulative deficits of $112 billion are predicted to 2028, and the deficits will run for a decade.

- It will result in spending as a percentage of GDP averaging close to 26% in the long term, compared to 24.8% prior to the pandemic. That's due to the new policy announcements and higher spending from health and aged care, as well as the NDIS.

The "table of truth" - underlying cash budget balance projections

	2023-24	2024-25	2025-26	2026-27	2027-28
May 23-24 Budget,$bn	-13.9	-35.1	-36.6	-28.5	
Dec 2023 MYEFO, $bn	-1.1	-18.8	-35.1	-19.5	-26.5
Parameter chgs, $bn	+10.6	+0.0	+2.6	-4.0	+3.3
New stimulus, $bn	-0.2	-9.5	-10.3	-3.3	-1.2
Projected budget,$bn	**+9.3**	**-28.3**	**-42.8**	**-26.7**	**-24.3**
% GDP	**+0.3**	**-1.0**	**-1.5**	**-0.9**	**-0.8**

Source: Australian Treasury, AMP



Source: Chris Richardson

- Tax cuts will result in a dip in revenue, however the Budget forecasts that revenue will recover, mostly due to bracket creep.

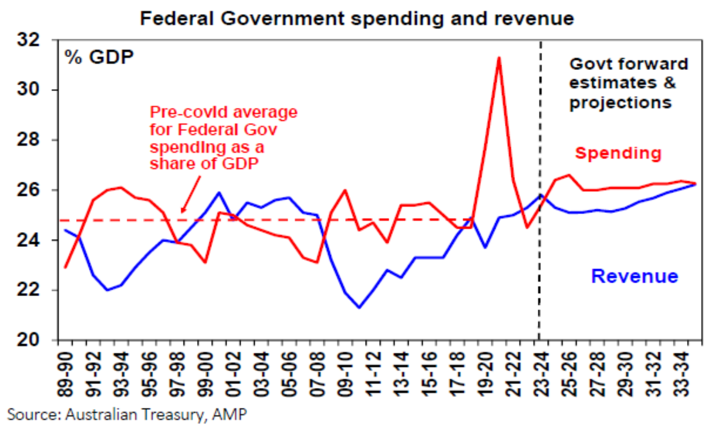
Economic forecasts

- The Government left its forecast for GDP growth unchanged for this financial year, but marginally lowered it for 2025-2026. GDP growth of 1.75% is projected this year, rising to 2% in 2025 and 2.75% in 2026. Interestingly, the bounce in growth is expected to mostly come from a rise in household consumption, which has been tracking poorly in recent months.

- The Government has also lowered its inflation forecasts. It projects 3.5% for this financial year, and 2.75% next year. The upfront energy bill deductions for households and small businesses will reduce headline inflation by 0.5% in 2025. The Budget assumes a slowing in wages growth from 4% in 2023/24 to 3.25% over the next two years.

- The Government increased its forecast for net immigration this financial year to 395,000 from 375,000 in December. It expects international student cutbacks to reduce net immigration to 260,000 next financial year. That will result in population growth falling to 1.4% in 2024/25.

- The Budget maintained most of the Government's commodity price assumptions. An iron price of $60/tonne is predicted from 2026 onwards, compared to the current price above $100/tonne. If iron ore prices continue near current levels, that would be a revenue windfall for future budgets.



Source: Australian Treasury, AMP

Government economic forecasts

	2022/23 (a)	2023/24 (f)	2024/25 (f)	2025/26 (f)
Real GDP	3.10	1.75	2.00	2.25
Household consumption	5.00	0.25	2.00	2.75
Dwelling investment	-3.80	-3.00	0.00	6.50
Business investment	8.30	5.50	1.00	2.00
of which, mining	1.70	4.50	-3.50	2.00
of which, non-mining	10.50	5.50	2.50	2.00
Private demand	4.20	1.00	1.75	3.00
Public demand	2.40	4.50	1.50	1.50
Inventories	-0.10	-0.50	0.25	0.00
GNE	3.50	1.25	1.75	2.50
Exports	6.70	5.00	5.00	2.50
Imports	9.30	2.50	4.00	4.50
Net exports (ppt contrib.)	-0.10	0.75	0.50	-0.25
Nominal GDP	9.90	4.75	2.75	4.00
CPI (%ch yr to June)	6.00	3.50	2.75	2.75
WPI (%ch yr to june)	3.70	4.00	3.25	3.25
GDP deflator	6.50	3.00	0.50	1.75
Participation rate	66.60	66.50	66.50	66.25
Employment (%ch yr to June)	3.50	2.25	0.75	1.25
Unemployment (%, June)	3.60	4.00	4.50	4.50
Terms of trade	-0.50	-3.75	-7.75	-4.00
Current Account (% of GDP)	1.10	1.25	-0.75	-2.00
Net overseas migration ('000s)	528.00	395.00	260.00	255.00

* Annual per cent change unless otherwise specified

Technical assumptions: $ATWI of around 62 and AUD/USD of around 0.65. Oil (Malaysian Tapis) remains around $US94/bbl. Interest rates are informed by the Bloomberg survey of market economists.

Source: CBA, 2024/25 Commonwealth Budget, Macrobond

Major policy announcements

The key spending initiatives were mostly announced prior to the Budget, and include:

'Future Made in Australia'

This is one of the cornerstones of the Budget, with an estimated investment of $22.7 billon over the next decade. The investments will focus on "industries that contribute to net zero transformation where Australia has a competitive advantage, and in areas where Australia has national interest imperatives related to economic security and resilience."

Here's where most of the money will go:

- $7 billion in production tax incentives for the processing and refining of critical minerals.
- $6.7 billion production tax incentive to produce renewable hydrogen.
- $1.7 billion to promote net zero innovation, including for green metals and low-carbon fuels.
- $1.5 billion to strengthen battery and solar panel supply chains.

Cost-of-living relief

Key spending measures include:

- The previously announced personal income tax cuts. The modified stage three tax cuts will come into effect from July 1. The redesigned tax cuts will cost the Budget $106 billion over the next four years. A quick summary:

  - Earn $100k, save $2,179 p.a.
  - Earn $150k, save $3,729 p.a.
  - Earn $200k, save $4,529 p.a.
  - Earn $250k, save $4,529 p.a.
  - Earn $300k, save $4,529 p.a.
  * The figures don't include the Medicare levy and other deductions.

- A 7.8 billion cost-of-living package, including:

  - $3.5 billion in power bill discounts. This will start July 1, run for a year, and equates to $300 off for every household and $325 for small businesses.
  - $1.9 billion for rent assistance. The Government will increase the Commonwealth Rent Assistance by a further 10% after last year's 15% rise. This will increase the maximum rate for a single person living alone from $188.20 per fortnight to close to $200. For a single person in a shared house, it will rise from $125.47 to almost $138 per fortnight.
  - Changing the indexation of student debt from the CPI to the lower of either the Wage Price Index (WPI) or CPI. The Government estimates that this will reduce the outstanding value of student debt by $3.3 billion.

Health

The price of medicines listed on the Pharmaceutical Benefits Scheme (PBS) will be frozen for everyone or at least two years, and longer for older Australians. The maximum price for any PBS-listed drug will be $31.60, and $7.70 for pensioners and concession card holders. The Government estimates the measure will cost $310 million over the next five years.

Aged care

The Government has budgeted a further $500 million this financial year for another 24,100 home care packages.

$610 million will go to the states to help long-stay older residential patients to leave hospital and live back in the community.

Age Pension

Deeming rates for people on government support payments, including the Age Pension, have been frozen at current rates until June next year. The upper deeming rate will stay at 2.25% while the lower deeming rate will remain at 0.25%.

Superannuation

There wasn't a lot in the Budget on super. However, the Government has strengthened the Paid Parental leave (PPL) scheme. Funding includes $1.1 billion over four years to pay super on PPL for births and adoptions on or after 1 July 2025.

Housing

The Government has announced $6.2 billion build more homes. Some of this money will go to the states to unblock bottlenecks preventing houses being built.

$1 billion will go towards crisis accommodation for women and children, and $423 million will go the states to support social housing and homelessness services.

Defence

The Government had previously announced a $330 billion investment in the National Defence Strategy and the Budget allocates an additional $5.7 billion to 2028.

Infrastructure

The Government has committed an additional $2.9 billion over five years to increase its infrastructure investment, with most of the focus on Western Sydney, near the upcoming second airport.

Budget implications

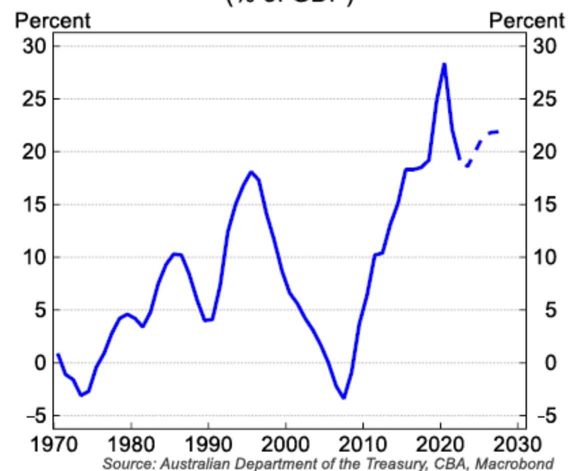
Given that an election is likely not far away, this was a Budget that was always going to be as much about politics as policy. And the majority of economists seems to have given it the thumbs down, echoing the AFR's screaming front-page headline, 'Spending addiction fuels a new decade of deficits'.

They cite the increased spending and 'bigger Government' putting upward pressure on inflation and making it more difficult for the RBA to reduce inflation and interest rates. They also point to structural deficits being a bad thing when the terms of trade are at 100-year highs and unemployment is at 50-year lows. It won't leave much wiggle room when a recession hits.

Also, many economists point to the 'Future Made in Australia' theme being protectionist and a case of the Government cherry-picking ones – things that have been tried in the past and failed.

Finally, they think the housing measures won't be enough to plug the current shortfall in homes – nowhere near it.

Yet, things aren't as gloomy as the economic boffins make out. Australia remains in a sound economic position, and it balance sheet is vastly superior to most of the developed world. Federal Government net debt of 18.6% this year will rise to just under 22% of GDP by June 2028.



That said, the bigger picture is that Australia faces the same problem as much of the West: people are living longer, putting pressure on welfare budgets. The various Intergenerational Reports probably underestimate future longevity given continuing medical advances in the field.

Unfortunately, Governments everywhere, including in Australia, are not living within their means and are funding the welfare through borrowing. And Governments will struggle to keep up with ever-increasing welfare bills. To raise revenue, it's likely that things like super and the Age Pension will continue to be tightening.

James Gruber

In this week's edition...

Graham Hand makes a welcome return to discuss a part of financial markets that's fascinated him over the past six months - and it's probably not what you think. It's residential real estate. The question that hits Graham every day is: where is all the residential money coming from? He looks into rising house prices and how they'll lead to new solutions to enable people to own a home.

When legislation for the proposed new tax on people with more than $3 million in super was first introduced to Parliament, it was referred to a Senate Committee. That Committee reported back last Friday (May 10) with a majority recommendation to pass it unaltered. **Meg Heffron** says it seems that the tax is coming and she outlines how you should prepare for it.

'Putting your affairs in order' is a term that is commonly used when people are approaching the end of their life. It is not as easy as it sounds, though **Noel Whittaker** says it should not be overwhelming, or consume all of your spare time. He suggests the key things that need to be considered.

Shoppers are cutting back spending at supermarkets, gyms, and bakeries to cope with soaring insurance and education costs as household spending continues to slump. **CBA's Stephen Halmarick and Belinda Allen** says renters especially are feeling the pinch.

Another banking reporting season is done, and **Hugh Dive** says the major banks all reported solid results, large share buybacks, and very low bad debts. He looks at the main themes from the results, and the winners and losers.

The most common question that **Ophir's Andrew Mitchell** gets from investors on the outlook for global small caps versus large caps is: “What is the catalyst for smalls caps to start outperforming?” He dives into the potential catalysts as well as why he thinks small caps will hold up better in any future economic downturn.

Last year, AUSIEX did a research report on how by 2028, all Baby Boomers will be eligible for retirement and the Baby Boomer bubble will have all but deflated. In the follow-up report, **Te Okeroa** addresses two key questions: where will the Boomer's money end up, and what are the implications for the wealth management industry?

Lastly, in this week's whitepaper, **TD Epoch** - an affiliate of **GSFM** - delves into November's US election and the potential implications for investors.

Financial pathways to buying a home require planning

Graham Hand

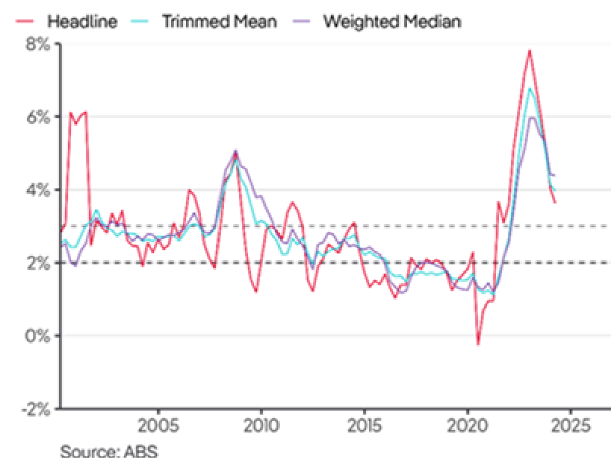
In the six months of my ongoing battle with brain cancer, one part of financial markets has fascinated me whenever I find time to read. It’s probably not what you think. Sure, the Reserve Bank’s ongoing debate about inflation and interest rates has filled economists with anticipation, and global wars have horrified us, making the conflicts almost unwatchable. But one subject that has led the pages of my reading is real estate, especially residential.

The question that hits me every day is: where is all the residential money coming from? Whether it’s $4 million in the inner west, $20 million for a penthouse on the north shore or a $50 million mansion in the east, it’s a continuous surprise to see how much money people have access to.

Real estate is not even my specialty, but the last six months have been both bemusing and fascinating. It’s often difficult to believe that the numbers are true. For example, according to Domain, the average house price in the 2024 March quarter for Sydney is $1.628 million dollars, up from $1.465 million a year ago and up 11.1% in that time. Perth, Adelaide and Brisbane are up even more. Rents have risen almost 8% across Australia, the biggest increases in 15 years. In one year, Sydney’s median house price has risen over $160,000.

It would not have seemed possible a couple of years ago in the face of interest rate increases, of which there were eight in 2022 alone. During COVID, with lending rates falling as low as 2%, a rise of 1% to 2% seemed likely. Homebuyers were doing their numbers as high as 4%, locking in rates for a couple of years where possible. But inflation drove 13 rate increases since April 2022 and have taken cash rates to 4.35%, where rates have stayed since November 2023. Plenty of lenders are now charging 6% or more and cash rates are not forecast to reach below 4% until the end of 2025.

The latest data for 2024 shows the dramatic increase in inflation for the period 2022 and 2023, and the stubborn refusal to fall as much as anticipated this year. Many economists expect only one or two reductions by the end of the year, but some are at zero. The return of inflation to the central bank target range is a long way off.



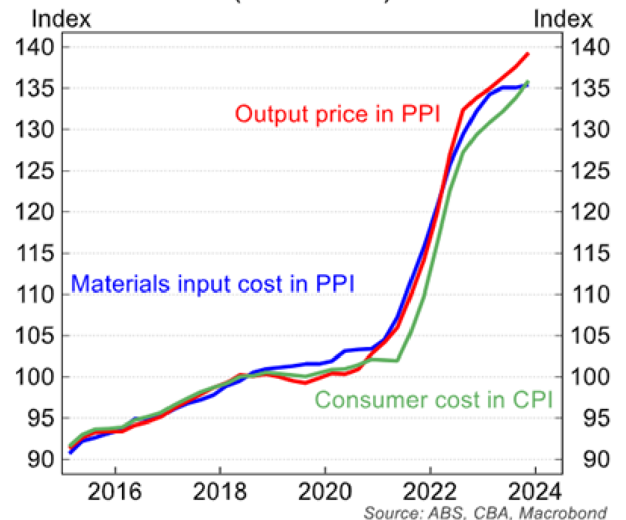
As a sign how much the market has reassessed its interest rate expectations, the ASX 30 day Interbank Cash Rate forecasts little movement by even the middle of 2025, perhaps a full year with no changes. Reserve Bank Governor Michele Bullock expects not to tighten again, but nor does she see easing conditions yet. Let’s hope the new structure of the Reserve Bank board does not push her to act before she needs to.

New building is at decade lows, with many trades attracted to the certainty of long-term government contracts rather than the unpredictability of housing. The Albanese Government's promise of 240,000 dwellings a year looks impossible, even with banks keen to lend. The shortage of materials and inflation on supplies does not help.

Yet there is no shortage of home demand despite supply problems, and home prices, especially for houses, have continued to rise rapidly. This is where new solutions are surfacing.

Borrowers access increasing amounts

First, borrowers are willing to increase their loans with the bank, almost to whatever limit is allowed to secure a home. Whereas 20 or 30 years ago, borrowers relied on accessing three to four times as much of their income, the house price now represents as much as seven to eight times earnings (and it used to be more when rates were lower). Many borrowers will be paying off their principal for decades. The biggest shock for new home buyers has come in construction costs, requiring renegotiation of terms to prevent builders going broke.



There's more to come. Oxford Economics estimates that between 2025 and 2027, median home prices will hit $1.3 million with Sydney at $1.9 million. Home units will exceed $1 million on average. Thousands of people will need to make the 'rent versus buy' trade-off, with a move to new apartments likely given many old houses are in bad condition.

A similar trade-off decision will come from the payoff of student loans, as a debt of $100,000 will go a long way to paying off a home loan. Australia covers three million former students with loans of almost $80 billion. It's a massive burden to carry (and I come from an era of free university education, which was a major bonus).

Major population growth depends on home and infrastructure building (toilets, roads, sewerage, etc). The Housing Industry Association advised recently that the cost of labour, concrete and materials will delay any increase in the amount of high-rise development for at least another year.

So, borrowers will increasingly look beyond their own financial resources, and with rents at new record highs, people will want to buy rather than face the terrible hassles, short leases and scarcity of renting.

Bank of Mum and Dad

Second, the increase in the role of the Bank of Mum and Dad has changed the market. In prior years, as recently as five to 10 years ago, parents might provide some money to help with extra needs, and maybe as much as a deposit. Now, it is not uncommon to hear a group of people bidding to buy a house and each couple has their parents with them with significant support.

It is becoming so common that parents are now more sophisticated in the ways they lend or give money to their children. Increasingly, terms are negotiated to ensure money is retained if a family breaks up. Parents don't want to give their children $250,000 only to see it disappear in a marriage split.

Such documentation may upset one of the children. Terms and conditions are written down with clear definitions of obligations each way. A gift to the son or daughter might be split in the event of a divorce. Except for the wealthiest of families, parents should check their eligibility for pensions and income streams is not affected, and their will should be checked and amended. These agreements often require documentation to cover issues such as capital gains tax, and not simply an assumption that the marriage will last forever.

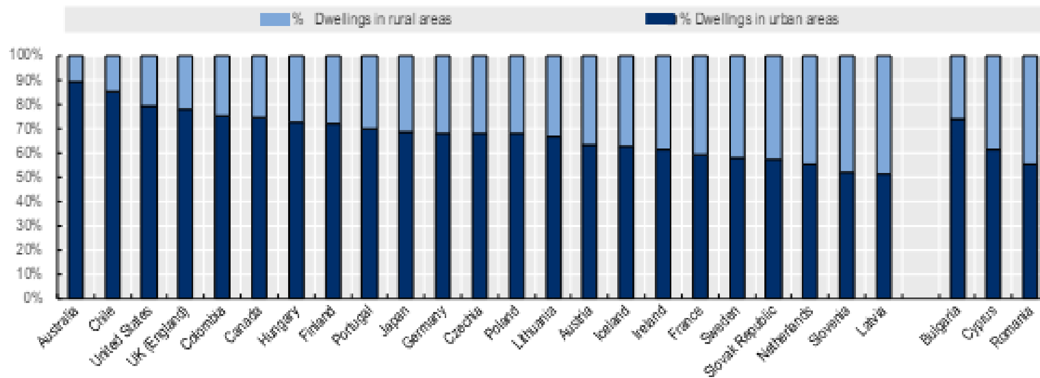
Multigenerational families

Third, it is becoming more common for mutigenerational families to buy and live together. A large house worth say $5 million might not normally be considered by one family. But where they are looking to care for grandparents, cover the long hours that a parent works while also allowing for the needs of the children, homes with three generations living together are becoming more popular.

Of course, they might be living close to family rather than in the same house. Australia is unique with a high proportion of dwellings for people who live in urban areas rather than rural and is at the top of the world at over 90% urban, often due to people wanting to live near or with parents.

Figure HM1.1.3. Dwelling stock in urban and rural areas

Percentage of dwellings located in urban and rural areas, 2021 or latest year available[1,2]



Note: 1. Data are for 2021, except for Colombia (2023), the Netherlands and the United Kingdom (England) (2022), France, Hungary, Iceland, Japan, and Lithuania (2018), Chile, Finland, and Latvia (2017), Ireland (2016), Sweden (2013).
Source: OECD Questionnaire on Affordable and Social Housing (2023, 2021 & 2019).

More people working longer

Fourth is the other side of the generosity of the grandparents. They may delay retirement beyond 60 or 65 by one of them working longer, perhaps while the other looks after the grandchildren. They may now owe more on their house as they borrow for their children, with a third still servicing loans where once they thought it might be time to relax.

Warren Buffett at the age of 93, and before him, Charlie Munger at the age of 99, show that it is possible mixing work and play well into retirement. Many people work beyond 70 (with brain cancer's permission) with a few days mixing it up. It should be part of the funding discussion with a spouse on financial intentions, even if there is 20 years left to live.

Lots of choices

The days are long gone when the only alternative for a couple saving for their first house was to scrimp for 20 years and then live further away than they want to when they buy a home. Many families now accept that if they want their children and perhaps even more importantly, their grandchildren, to have a good life, the older people will need to make a decent contribution. Where once it was common for grandparents to pay for school fees, the same now applies for homes.

It means a lot more planning. Parents may be approached by their children for financial assistance, and a big step is required on legal documentation. Living with multiple generations on one piece of suburban land will come with its challenges but will suit many.

With property increasingly scarce and demand outstripping supply, more people will need to face up to the decisions about living alternatives.

Graham Hand is Editor-At-Large for Firstlinks.

Meg on SMSFs: $3 million super tax is coming whether we're ready or not

Meg Heffron

When legislation for the proposed new tax on people with more than $3 million in super (known as "Division 296 tax") was first introduced to Parliament, it was referred off to a Senate Committee. That Committee reported back last Friday (May 10) with a majority recommendation to pass it unaltered.

The Government made no mention of it in this week's Federal Budget other than to set aside some money to help implement it for members of the Commonwealth defined benefit schemes – perhaps they felt there was nothing more to say.

The Greens are mounting a final effort to get the Government to take *even more* drastic action (their dissenting report from the Senate Committee) but it remains to be seen whether they would risk derailing the measure altogether to secure their extra changes.

To be honest, this all sounds to me like Division 296 tax is coming whether we like it or not.

So, what should those impacted be doing right now?

Don't necessarily withdraw large amounts immediately

First, don't overreact. There will be plenty of people impacted by this change who shouldn't immediately pull large amounts out of super. (And remember, not everyone has that choice anyway. Anyone who's not yet old enough to take money out of super doesn't get a free pass to do so just because of this new tax. The current legislation only allows people to take money out prematurely to actually pay the tax, not to avoid it.)

Here are just some examples of people who should think on it before taking large amounts out now.

One group is members of funds where the assets have already built up very large capital gains. Remember Division 296 tax looks forward – it will tax *future* gains (after 1 July 2025), not capital gains that have built up already. In fact, the only thing that will trigger tax on capital gains built up already is actually selling the asset to transfer the money out of super!

Another is group is members whose funds generate most of their return as income rather than growth. Division 296 tax will certainly mean that income is taxed *more*. But not necessarily as much as if the same amount was invested outside super.

Even those who do decide to move wealth out of super should remember they have some time up their sleeve. If it's legislated as planned, the measure won't start until 1 July 2025. And in fact, someone planning to remove a lot of money from super to take their balance down to less than $3m actually has until 30 June 2026 to do so.

That's because the tax is only paid on a proportion of the member's super fund "earnings" each year (eg during 2025/26 for the first year). The proportion for 2025/26 is nil% for anyone with less than $3 million at 30 June 2026. It doesn't matter how high their earnings were during the year or how much they had in super on 29 June 2026 – if they have less than $3 million in super on 30 June 2026 no Division 296 tax will be paid.

And finally remember that there are ways to manage capital gains tax within a super fund for people who have pension accounts. Sometimes, this will mean it's more attractive to sell assets and withdraw large amounts in *July* rather than the *previous June*. This is all about focusing on a completely different tax – the normal capital gains tax paid by the fund itself when assets are sold to make large pay outs. I explained why in a previous article here.

Re-think long term withdrawal strategies

To date, the objective of many people with large balances and significant taxable income outside super has been to leave as much as possible in their SMSF for as long as possible. The ever-present risk for them has always been dying with a large balance remaining and triggering tax for the next generation (ie death benefits tax). It's why a common decision for the survivor when one member of a couple dies is to move money out of super, particularly if they are already quite elderly.

Division 296 tax just changes the trade-off.

It means many people in this position will find investing inside vs outside super is far closer to being neutral than ever before. In that case, why take the risk with death taxes?

It's likely that the best option for many people will be a progressive wind down of their super balance over $3 million rather than a "big bang" right now. As their SMSF sells assets, they will choose to transfer extra money out and buy anything new outside of super (in their own name, in a trust or some other structure). They'll do that even while both members of a couple are alive and so their family unit is insulated from death benefit taxes (because spouses can inherit each other's super tax free)

Reconsider the right structure for speculative investments

Sadly, Division 296 tax probably means super is no longer the place to hold “blue sky” investments. It has been up until now.

The fact that these investments often produced no income for an extended period didn’t matter because super is by its very nature a long-term thing. Then, if the investment’s success meant a significant capital gain, there were opportunities to minimise the tax impact for those in pension phase. At worst, the tax rate was effectively only 10% in most cases anyway.

And volatility didn’t matter. Again, super is long term, and the actual size of a member’s super balance only became critical for those hovering around important thresholds (such as the ones that impact their ability to make contributions) or starting a pension (where the balance size impacted the amount of pension payments required during the year). That was something people going into these investments were prepared to live with.

But Division 296 tax will change all that. It will mean members might be taxed simply because these investments increase in value. They expose themselves to significant tax bills that they may not have the cash to pay based on movements in an asset that is by definition unpredictable.

I wonder how this will impact access to private equity funding? Or IPOs?

The same applies to assets we might not have thought of as being highly speculative, but which have three important features: they are long term, most of the return comes from capital growth and they can be volatile. This is why so many have focused on farms – it will be far less attractive to hold these in an SMSF than it has been in the past.

A move to defensive assets for SMSFs?

In fact, bringing all these points together, I wonder if we’re likely to see large SMSFs shift to a more defensive position over time.

The members themselves may still have growth assets but they’re more likely to hold these outside their SMSF because of the Division 296 complications with these assets (ie paying tax on the growth as it happens rather than only once the asset is sold). The liquid, income-rich, non-volatile investments will be more attractive for SMSFs. I don’t know what this means for investment markets generally, but this doesn’t feel like a great outcome.

Review legacy pensions urgently

It’s no surprise that many people with large balances have been building up their super over many years. This is also the group most likely to have what are called ‘legacy pensions’ (old style pensions that are much less flexible than modern ones). There are a lot of rules for these pensions that stop their recipients taking money out at will.

Some also come with ‘reserves’. Reserves are a tricky thing – you’ll know if you have them that you’re even more restricted. And Division 296 tax presents even more challenges. If you unwind a legacy pension with reserves in (say) 2025/26 and use that as a trigger to allocate an amount to a member’s super account, the reserves themselves will count as “earnings”. That means they’re potentially subject to Division 296 tax, despite the fact that this isn’t new growth - it’s just an allocation of money that’s already in the SMSF.

Division 296 will definitely present another strong driver to look at legacy pensions now particularly if there are reserves involved.

In fact, the two (legacy pensions and preparing for Division 296) should be considered together. Some people with legacy pensions can find they limit their options if they take large amounts out of super in anticipation of Division 296 tax. That’s because the few chances they do have to wind up their legacy pensions are usually optimised if they have a large amount in super overall. The worst outcome would be to take large amounts out of super and only discover afterwards that doing so limits your choices when it comes to your legacy pension.

It's a shame the Government has taken this particular approach to extracting more tax revenue from wealthier members of the community. I wonder if many would have parted with their hard-earned cash more willingly if they were only paying tax on income their super fund had actually locked in (ie **realised** capital gains). And I wonder if over the long term, the tax take might have been even higher if the Government had chosen a different path.

Meg Heffron is the Managing Director of [Heffron SMSF Solutions](), a sponsor of Firstlinks. This is general information only and it does not constitute any recommendation or advice. It does not consider any personal circumstances and is based on an understanding of relevant rules and legislation at the time of writing.

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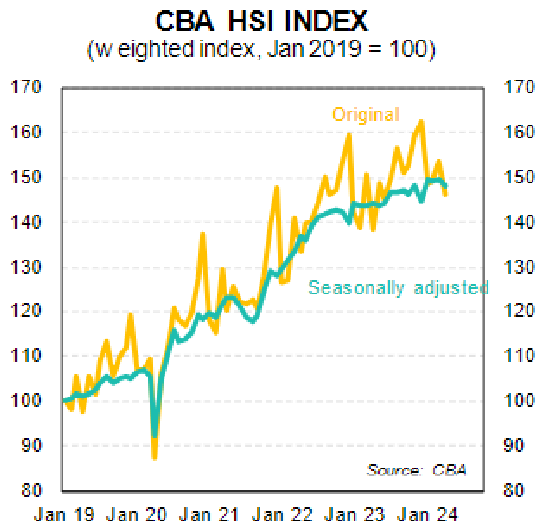
Household spending falls as higher costs bite

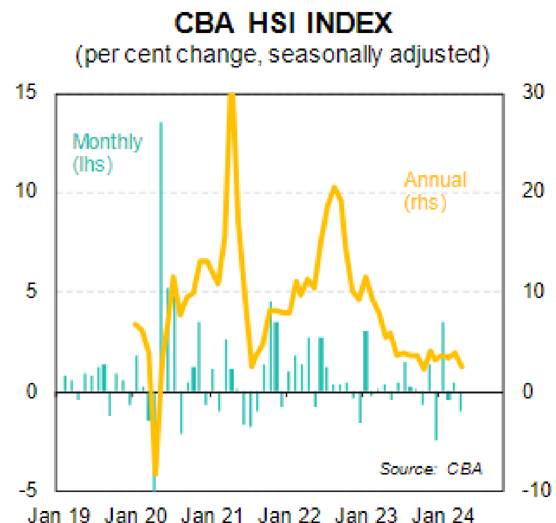
Belinda Allen, Stephen Halmarick

The CommBank Household Spending Insights (HSI) index tracks month-on-month data at a macro level and is based on de-identified payments data from approximately 7 million CBA customers, comprising roughly 30% of all Australian consumer transactions.

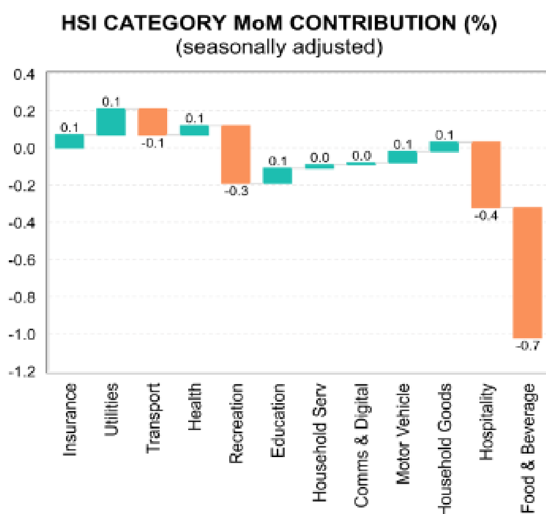
The following is an extract from the [latest HSI report]().

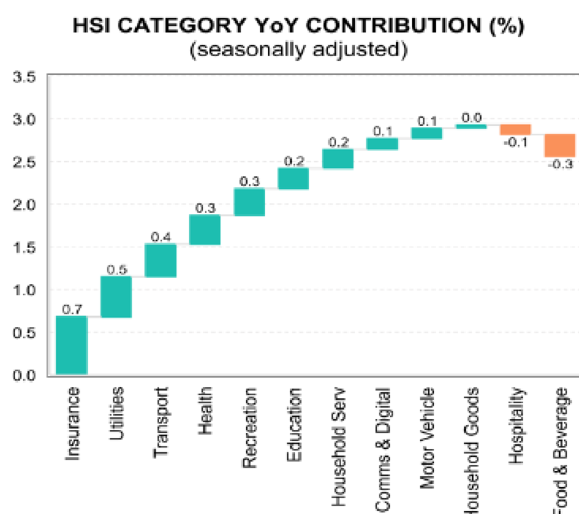
The HSI index for April 2024 declined by a significant 1.0%/mth in seasonally adjusted terms, to 148.1. The fall in April followed a gain of 0.4%/mth in March. At 148.1 the HSI index is down from the January 2024 peak of 149.7, indicating that household spending has weakened over the first four months of 2024.





For April, eight of the 12 HSI categories saw an increase in spending, led higher by spending on Education (3.7%/mth), Utilities (2.5%/mth) and Motor vehicles (1.7%/mth). However, this strength was more than offset by large falls in spending on Food & beverage (-3.8%/mth), Hospitality (-3.3%/mth) and Recreation (-2.6%/mth), as well as lower spending on Transport (-1.7%/mth).





As can be seen from the chart on the left, the fall in Food & beverage spending had by-far the largest impact on the softer reading for April. The fall in Food & beverage spending in April came after a 2.1%/mth rise in March — reflecting the earlier-than-usual time of the Easter holiday in 2024. Similarly, reduced spending on Hospitality in April followed gains in March. In contrast, spending on Recreation has now fallen for three months in a row, after a strong gain in January 2024.

In the year to April 2024 the pace of increase in the HSI index slowed to down from 3.9%/yr in March. The 2.6% annual growth rate is the slowest pace of increase since October 2023. Over the year to April the strongest increase has been spending on Education (10.8%/yr), followed by Insurance (9.6%/yr) and Utilities (9.0%/yr). The weakest spending has been on Food & beverages (-1.4%/yr), Hospitality (-1.0%/yr) and Household goods (+0.3%/yr).

Results by State

SA and Tasmania (both 0.3%/mth) and NSW (0.1%/mth) bucked the national trend and saw an increase in spending in April. All other jurisdictions were lower, led down by NT (-1.7%/mth), Vic (-1.2%/mth), Qld (-0.9%/mth), ACT (-0.7%/mth) and WA (-0.2%/mth). In the year to April, the strongest state for Household spending is now Tasmania (4.0%/yr), followed by SA (3.7%/yr). Softer growth has been seen in Vic and the ACT.

- **WA** declined in April and has now slipped from its previous position as the strongest state. -0.2%/month +3.4%/year
- **SA** saw the equal strongest increase in spending in April and is one of the strongest jurisdictions over the past year. +0.3%/month +3.7%/year
- **NT** was the weakest jurisdiction in April, but is still running above the national average year to April. -1.7%/month +3.3%/year
- **Tas** saw a rise in spending in April and is now the strongest states for spending over the past year. +0.3%/month +4.0%/year
- **Qld** saw a decline in spending in April, with the annual growth rate decelerating. -0.9%/month +3.2%/year
- **NSW** spending edged higher in April, with the pace Of annual growth close to the national average. +0.1%/month +3.1%/year
- **ACT** spending was down in April, with the annual growth rate well below the national rate. -0.7%/month +1.1%/year
- **Vic** saw the second largest decline in spending in April and remains one of the weakest of all the states on an annual basis. -1.2%/month +1.9%/year

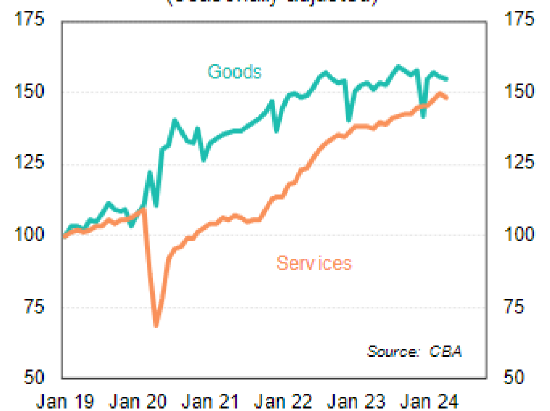
Goods v Services

- Goods spending declined by -0.8%/mth, in seasonally adjusted terms in April — following a -0.8%/mth fall also in March.
- Services spending was down -1.0%/mth in April in seasonally adjusted terms, but this came after a 1.4%/mth gain in March.
- In annual terms, Goods spending is up 2.4%/yr to April, while Services spending is up 7.7%/yr.

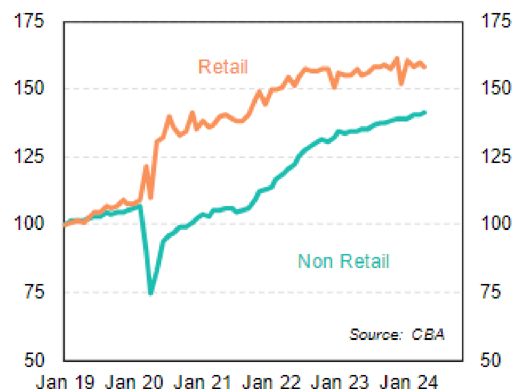
Retail v Non-Retail

- Retail spending fell by -1.1%/mth in April in seasonally adjusted terms, after a 1.0%/mth gain in March.
- Non-retail spending was up 0.4%/mth in April in seasonally adjusted terms, follow a 0.3%/mth gain in March.
- On an annual basis, Retail spending is up just 0.2%/yr in April, but non-retail spending is up a solid 5.3%/yr.

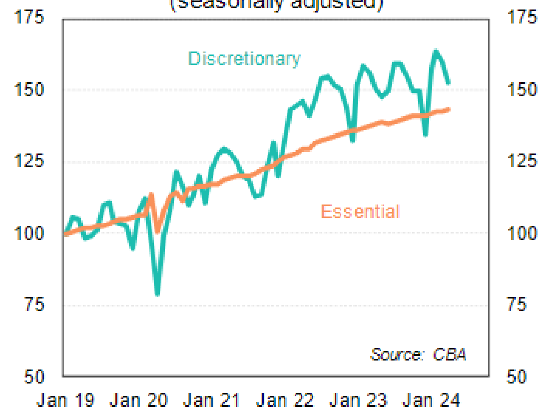
CBA HSI: GOODS VS SERVICES
(seasonally adjusted)



CBA HSI: RETAIL VS NON RETAIL
(seasonally adjusted)



Essential v Discretionary



- Spending on Essential goods & services was up 0.5%/mth in April, after a 0.3%/mth gain in March.
- Spending on Discretionary items fell by a large -4.4%/mth in April, following a decline of -2.2%/mth gain in March.
- On an annual basis, spending on Essentials is up 4.0%/yr to April, while spending on Discretionary is up just 1.8%/yr.

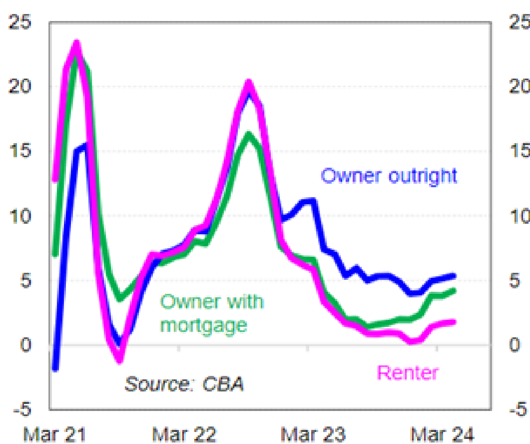
Home ownership insights

From April 2024 we introduce the CommBank HSI by home ownership status. We use a smaller subset of the data to split the HSI into three different home ownership types: Owner with Mortgage, Owner Outright and Renter.

This breakdown emphasises the challenging environment for those who Rent and those who have a Mortgage when compared to those that own their home outright.

Spending by renters have lagged their counterparts since late 2022 with the difference growing over the past year given the large lift in rents.

Mortgage holders are recording a lift in spending in between renters and those that own their home outright (ie without a mortgage).



April 2024	
Home ownership group	Annual % change (original)
Owner with Mortgage	4.5
Owner Outright	6.3
Renter	1.3

Owner with mortgage

- Insurance, utilities and health crowd the top three spots of contribution to spending for those with a mortgage, as it does for the other home ownership types.
- Over the past year those with a mortgage have reduced spending on hospitality, household services and food & beverage goods.

Owner outright

- Homeowners devote a large share of their wallet to insurance, health and utilities and these three categories have contributed the most to spending growth over the past year.
- Household goods and recreation make up the fourth and fifth spot in terms of positive spending contribution, while household services and food & beverage goods detracted from spending growth over the past year.

Renter

- The share of wallet for renters differs, with less spent on insurance, utilities and health. Renters typically devote a larger share of their wallet to hospitality and food & beverage goods.
- Renters have reduced spending on recreation, hospitality, food & beverage goods and household services over the past year.

	Owner with Mortgage			Owner Outright			Renter		
	Category	Contribution	Share of wallet - 2023	Category	Contribution	Share of wallet - 2023	Category	Contribution	Share of wallet - 2023
Highest contribution to annual growth	Insurance	+	9%	Insurance	+	11%	Insurance	+	5%
	Utilities	+	7%	Health	+	6%	Utilities	+	4%
	Health	+	5%	Utilities	+	8%	Health	+	5%
	Household Goods	+	15%	Household Goods	+	15%	Motor Vehicle	+	3%
	Education	+	3%	Recreation	+	14%	Education	+	3%
	Motor Vehicle	+	4%	Motor Vehicle	+	4%	Transport	+	9%
	Communications and Digital	+	6%	Transport	+	7%	Communications and Digital	+	7%
	Transport	+	7%	Communications and Digital	+	5%	Household Goods	+	14%
	Recreation	+	13%	Hospitality	+	7%	Recreation	-	12%
	Hospitality	-	9%	Education	+	2%	Hospitality	-	13%
	Household Services	-	5%	Household Services	-	5%	Food & beverage goods	-	20%
Lowest contribution to annual growth	Food & beverage goods	-	18%	Food & beverage goods	-	18%	Household Services	-	4%

click to enlarge

Stephen Halmarick is Chief Economist - Head of Global Economic & Markets Research, and Belinda Allen is a Senior Economist at Commonwealth Bank of Australia. This article is for informational purposes only and is not to be relied upon for any investment purposes. It has been prepared without taking into account your objectives, financial situation (including your capacity to bear loss), knowledge, experience or needs.

Who gets the gold stars this bank reporting season?

Hugh Dive

The May 2024 bank reporting season was the mildest and most boring in the past decade, with the major banks all reporting solid results, large share buybacks and very low bad debts. The major banks continue to show their resilience in the face of challenges such as the 2018 Royal Commission into Financial Services, Covid-19 lockdowns, system issues in 2021 from expected zero or negative interest rates, and the 'fixed-interest rate cliff' from late 2022 that was forecasted to put the country into a recession as discretionary spending collapsed, defaults spiked, and house prices plummeted.

In this piece, we look at the major themes that have played out over the May 2024 bank reporting season, including Commonwealth Bank's 2024 half-year results from February, and the regional banks, awarding gold stars based on their performance over the last six months.

Reporting season scorecard May 2024

Company	Share Price	Market Cap $B	Cash earnings per share growth (pcp)	Increase in Dividends	Net interest margin	Credit Impairment charge as % of loans	Capital Ratio	Return on Equity	Forward PE Ratio	Forward dividend yield	Grossed Up Yield	2024 total return
Westpac	$26.54	$ 89.5	-14.9%	7.1% ★	1.80%	0.09%	12.5%	11.0%	14.7X	5.3%	7.5%	20.1%
ANZ	$28.13	$ 84.4	-8.0%	2.5%	1.63%	0.01% ★	13.5%	10.7%	12.0X	5.3%	6.6%	12.2%
NAB	$33.80	$ 104.3	-12.3%	0.0%	1.72%	0.10%	12.2%	11.7%	15.6X	4.9%	7.0%	13.2%
Commonwealth (1H24 Results and 3Q24)	$117.85	$ 190.6	-2.0% ★	2.4%	1.99% ★	0.09%	12.3%	13.9% ★	20.4X	3.8%	5.5%	7.7%
Macquarie Half Year	$189.42	$ 71.8	-32.0%	-15.0%	1.89%	0.00% ★	13.6% ★	10.8%	17.9X	3.4%	3.9%	5.8%
BOQ	$5.90	$ 4.1	-33.0%	-15.0%	1.55%	0.04%	10.8%	7.2%	15.1X	5.3%	7.5%	-0.4%
Bendigo Bank	$9.91	$ 5.6	-5.0%	-6.3%	1.83%	0.12%	11.2%	7.8%	13.4X	5.5%	7.9%	5.6%

Source: Company reports, IRESS, Atlas Funds Management

Net interest margins trending down

Net interest margins are always a major topic during any of the banks' reporting season, with most investors going straight to the slide on margin movements in the Investor Discussion Packs. Banks earn a net interest margin [(Interest Received - Interest Paid) divided by Average Invested Assets] by lending out funds at a higher rate than borrowing these funds either from depositors or on the wholesale money markets. Generally,

bank net interest margins have recovered from the lows seen in 2022, as when the prevailing cash rate is 5%, it is much easier for a bank to maintain a profit margin of 2% than when the cash rate is 0.1%.

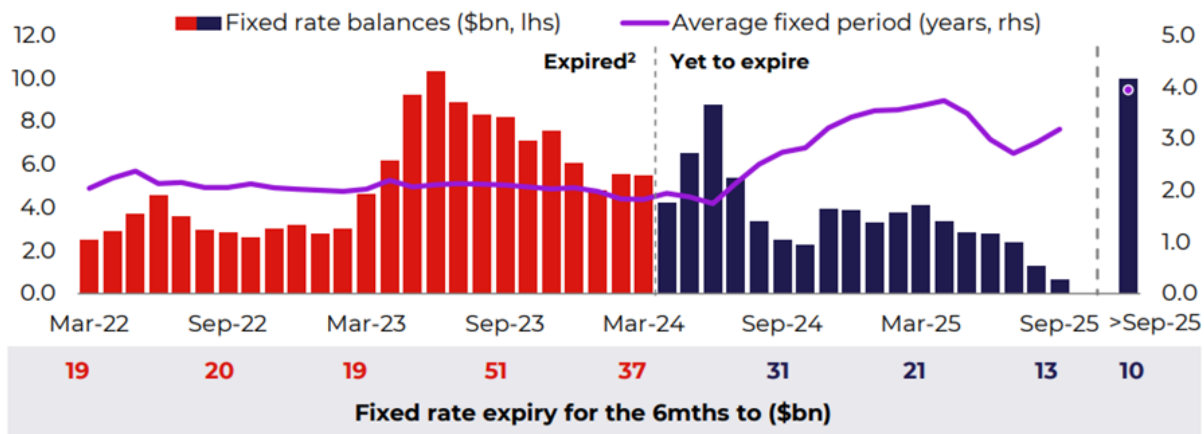
Small changes in the net interest margin significantly impact bank profitability due to the size of a bank's loan book (which ranges from $700 billion to $1.1 trillion) and guide future profitability. Going into this reporting season, many in the market expected a significant fall in the banks' net interest margins due to stronger competition within the mortgage market and increased deposit funding costs. May 2024 saw some downward pressure on interest margins, but less than expected, with management teams reporting a moderation of mortgage competition. Commonwealth Bank again wins the gold star in 2024 with the highest net interest margin.

What fixed interest rate cliff?

During the COVID-19 pandemic, Australian interest rates fell to record lows as the RBA established the Term Funding Facility (TFF) to offer low-cost three-year funding to banks. Between March 2020 and when the TFF closed in June 2021, Australian banks borrowed $188 billion at rates between 0.1% and 0.25%, which was then lent as fixed-rate mortgages in 2020 and 2021 at mortgage rates between 1.75% and 2.25% to around 800,000 borrowers. These low-rate mortgages began expiring in mid-2023, converting to variable loans around 5.5%.

With every cash rate hike, the questions became louder about the negative impact of this fixed rate cliff on retail sales, bank bad debts and house prices, with market experts predicting 2023 and 2024 to be very poor years for the banks and retail sales, as borrowers were unable to afford the higher mortgage payments.

However, in mid-2024, the economy has proven more resilient than expected, and unemployment remains close to all-time lows. Borrowers and the banks have managed this transition to higher rates far better than was expected, building up savings buffers. Indeed, despite increased financial pressures, RBA data shows that less than 1% of home loans are in 90-day arrears, a figure that is lower than before the pandemic - [RBA Financial Stability Review](#).



Source: Westpac

Bad debts remain very low

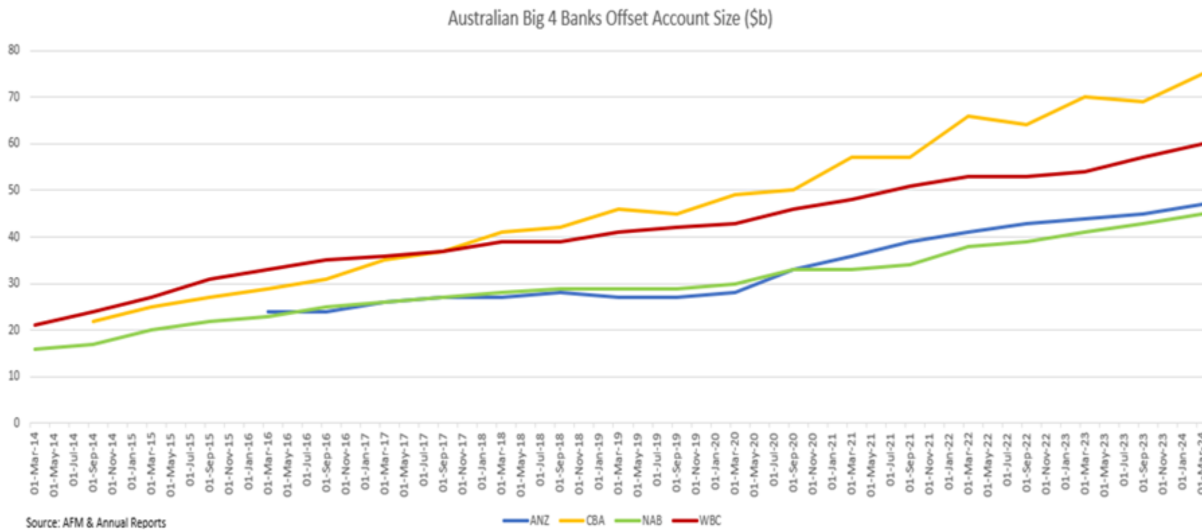
Bad debts have remained low in 2024, with all the banks reporting extremely low loan losses. Macquarie Bank reported the lowest bad debts of 0.00%, with ANZ not far behind with 0.01% loan losses. The level of loan losses is important for investors as high loan losses reduce profits and erodes a bank's capital base. This reporting season has translated low bad debts into increased share buybacks and dividends.

Atlas see that the low level of bad debts is a combination of the bank's managing loan book, stronger than expected economic conditions and more conservative lending than we saw from the banks 2000-07. We believe that the loans to developers, property syndicates and troubled industrial companies that went bad in 2008-2010 now sit with non-bank lenders and private debt funds rather than the big four banks.

Offset accounts benefit everyone

With the narrative of the 'higher rates for longer' slogan slowly becoming the new normal, May 2024 saw a continuation of the trend of rising mortgage offset account balances. This has been a surprise as we would have expected that the fixed rate cliff would have seen offset account balances fall, not rise. Indeed, over the past six months, offset account balances increased by $13 billion to $227 billion.

Rising offset account balances means that banks are forgoing some interest income in exchange for more secure and resilient clients with lower bad debts. We continue to be very surprised by the growth in offset accounts despite rising interest rates, with offset account balances now 59% larger across the Big Four banks than they were pre-pandemic.



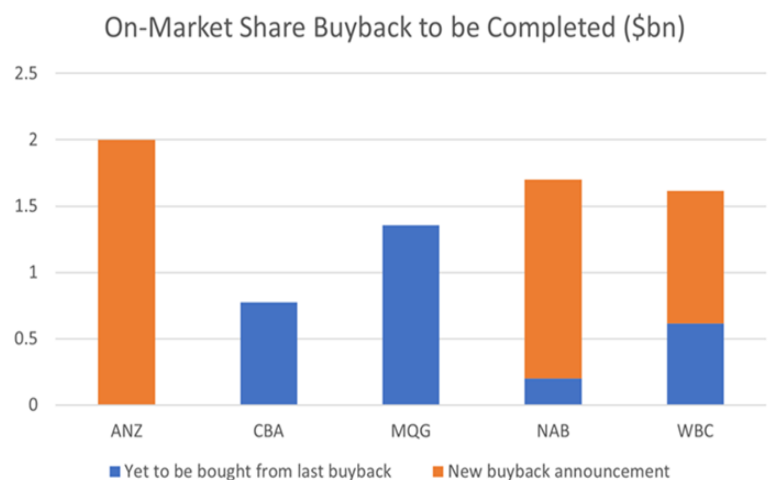
Dividends growing

A feature of the May 2024 banks reporting season was solid dividend growth, with ANZ, CBA, and Westpac increasing their dividends and NAB holding their dividend flat. In the first half of 2024, the big four banks generated $15.6 billion and will return $11 billion to shareholders through dividends or a 71% payout of profits generated throughout the half. Higher dividends reflect the combination of low write-offs from bad debts, minimal new investments (outside ANZ) and high capital levels.

The winner of the star was Westpac, with a dividend increase of 7% or 29% if a special dividend is included. In 2024, all major banks (including Macquarie) will be paying a dividend per share higher than in 2019.

Buybacks support share prices

Capital ratio is the minimum capital requirement that financial institutions in Australia must maintain to weather the potential for loan losses. The bank regulator, the Australian Prudential Regulation Authority (APRA), has mandated that banks hold a minimum of 10.5% of capital against their loans, significantly higher than the 5% requirement pre-GFC. Requiring banks to hold high levels of capital is not done to protect bank investors but rather to avoid the spectre of taxpayers having to bail out banks, as has been done in the USA and UK.



In 2024, the Australian banks are all extremely well capitalised, so much so that ANZ, NAB, and Westpac announced on-market share buyback extensions to return capital to shareholders. During the bank reporting season, NAB announced a $1.5 billion share buyback extension on top of their 200 million remaining from their previous buyback,

Westpac announced a $1 billion extension on top of their $600 million remaining from their previous buyback, ANZ announced a new $2 billion share buyback and Macquarie announcing they still have $1.35 billion to buy back from their $2 billion buyback announced in November. For investors, this not only supports the share price in the coming months but reduces the amount of outstanding shares to divide next year's profits.

In addition to buying back shares to reduce capital, all the big banks, including Macquarie, have neutralised their dividend reinvestment plan (DRP), which allows shareholders to take their dividends in additional shares rather than cash. Neutralising the DRP sees the bank buyback shares on-market equivalent to the new shares issued to shareholders. In May 2024, Atlas estimates that this will see additional net purchases of around $900 million in shares from ANZ, NAB, Westpac and Macquarie.

While buying back shares on the market and then cancelling them is positive for shareholders as it reduces the divisor on future bank profits, bank management teams are awarded bonuses based on their return on equity (ROE). Obviously, buying back shares reduces the equity, thus boosting ROE.

The Vampire Kangaroo – Macquarie

Although Macquarie group profits and dividends were down, their banking and financial services business has been performing well, with their loan book and deposits increasing by 10% to $140 billion and $143 billion, respectively. Macquarie continues to take market share off the big banks but has not given up margins for growth, with Macquarie having the second highest net interest margin of 1.89%, only behind that of CBA with 1.99%. Only three years ago, the sell-side analysts were questioning Macquarie management on why they would want to be involved in this kind of business!

Outside of the bank, it was a more normal year for Macquarie, with the realisation of green energy assets and energy volatility remaining lower than previous years, leading to group profits being -29% lower than last year. But outside of this, Macquarie Capital profits were up 31%, driven primarily by a rotation of capital into their fixed income offering, alongside asset management growing their assets under management to a record high of $938 billion, providing stable base fees over the longer term.

Regional banks

In Australia, the big four banks dominate with a combined market share of 73%, soon to be 75%, once ANZ's acquisition of Suncorp Bank is complete. The closest to breaking into the market is Macquarie, with close to 5% of the market share, followed by the two regional lenders of Bank of Queensland and Bendigo Bank, with a 2% market share each.

As we have seen in the bank matrix at the top, the regional banks did not win a star across any of the segments, with decreased interest income and increases in operating expenses eating away at profit margins. The regional banks continue to see growth hard to come by as they have a higher cost of capital than the major banks. Here, wholesale funders require higher coupons on their bonds to offset their higher risks. Additionally, the regional banks have limited access to the large pools of corporate transaction account balances that have historically paid minimal interest rates. To be competitive against the lending products from the major banks, the regional banks need to accept a lower net interest margin across their loan book, leading to lower returns on equity for investors. Indeed in 2024 the return on equity earned by BoQ and Bendigo Bank of 7% is well below their cost of capital of 10%!

Our take

Overall, we are happy with the financial results from the banks. Our three main overweight positions, ANZ and Westpac, increased their dividends, and Macquarie Bank showed a 49% increase in net profits in the second half, which also guided to increased profits in FY25. All three announced significant on-market share buybacks, which will support share prices.

All banks showed solid net interest margins, low bad debts, and good cost control. Profit growth is likely to be tough to find on the ASX over the next few years, with earnings for resources and consumer discretionary likely to retreat; however, Australia's major banks continue to positively surprise the market with how they have been able to navigate turbulent market conditions. In 2024, the banks will all have cleaner loan books, minimal offshore distractions, and a greater margin of safety than they have had in the past.

Hugh Dive is Chief Investment Officer of [Atlas Funds Management](). This article is for general information only and does not consider the circumstances of any investor.

Small caps v large caps: Don't be penny wise but pound foolish

Andrew Mitchell

Let's examine three key issues:

- What could the catalyst be for a period of sustained small-cap outperformance?
- The worst-case scenario of a U.S. recession. (The good news is that this scenario is largely priced into small caps, which will limit small-cap downside if the U.S. economy turns south.)
- The extreme valuation difference between U.S. small versus large caps and how history is suggesting great relative returns ahead for smaller companies.

When you put all three together, it becomes clear that small-cap stocks are an attractive proposition, which is giving investors a rare window of opportunity to buy into small caps now.

What could be the catalyst for small cap outperformance?

The most common question we get from investors who understand why we are so bullish on the outlook for small caps globally versus large caps is: "What is the catalyst for smalls caps to start outperforming?"

Relative valuations at multi-decade lows for small caps (which we address later) is one big reason to be bullish over the next 5-10 years.

But cheap relative valuation is not a catalyst. The standout and most simple catalyst we believe is simply lower interest rates. And, more specifically, 'soft landing' rate cuts.

December last year was a great case in point. It was the only sustained period of significant market breadth and small-cap outperformance since the beginning of this most recent share market rally in October.

We show this in the chart below which maps the relative performance of U.S. small caps (Russell 2000) to large caps (S&P500).

Chart 1: December 2023 showed market breadth and smalls outperformed on "peak rates/cuts ahead" talk from the Fed

Source: Bloomberg

So, what happened in December?

It was when the U.S. Fed said for the first time this hiking cycle that they are likely done increasing rates, and when they predicted in their 'dot plot' that meaningful rate cuts where likely in 2024. The starters gun for rate hikes that was shot back in late 2021 had seemingly been holstered.

The closer we get to the expectation of soft-landing rate cuts becoming a reality (currently forecast by the market in Q3 or Q4 this year), the closer we may be to small caps having a key catalyst for outperformance.

The natural question then becomes: what if we don't have a soft landing and US recession fears, which have been lingering for the last 12-18 months, finally becomes a reality?

Small caps' already big underperformance suggests limited relative downside in a recession

It's an excellent question because around a recession, small caps typically fall first and further than large caps … but then recover the quickest.

We show this in the gold bars below where, outside of the Eurozone, share markets across all the major regions, including Australia, all highlight biggest peak to trough share market falls in small caps compared to large caps around U.S. recessions.

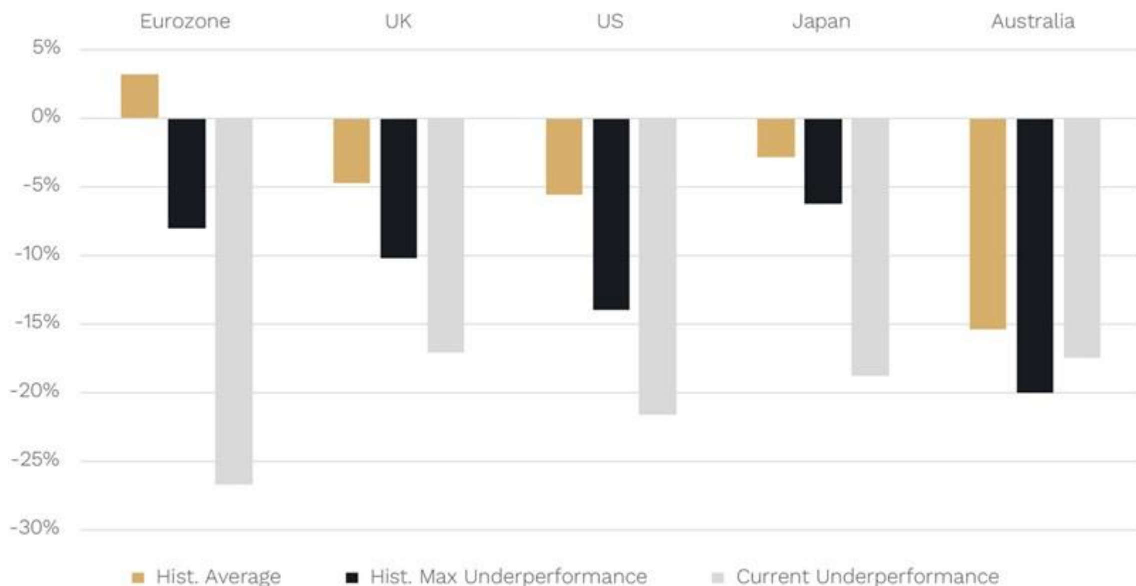
(The reason small caps don't underperform in the Eurozone is largely a data limitation. Small-cap data for the Eurozone is only available for the last three U.S. recessions (2001, 2008 and 2020). And one of those – the 2001 dot com related recession – was unusual, with large caps falling more than smalls due to the nature of the related tech bubble – heavily influencing the Eurozone result.)

In the black bars, what we have also shown is the maximum peak-to-trough underperformance around U.S. recessions across all the regions. This has varied from as low as -6% in Japan, to as high as -20% in Australia – both during the 2020 COVID-induced recession.

What is most striking is that, as the grey bars show, outside of Australia, in every major region small caps have already underperformed more than in any previous recession[1]. (And in the case of Australia the current -17.5% underperformance is just shy of its historical maximum of -20%.)

The key point here is that, if a recession was to occur in the U.S. this cycle, small caps across the world have generally *already* underperformed large caps by more than they have historically in any recession. So, this may limit the size of any underperformance (or they may even outperform!) … should a recession happen.

Chart 2: Smalls already underperforming Large Caps by more than historical maximum around recession (except Aust but its close!)



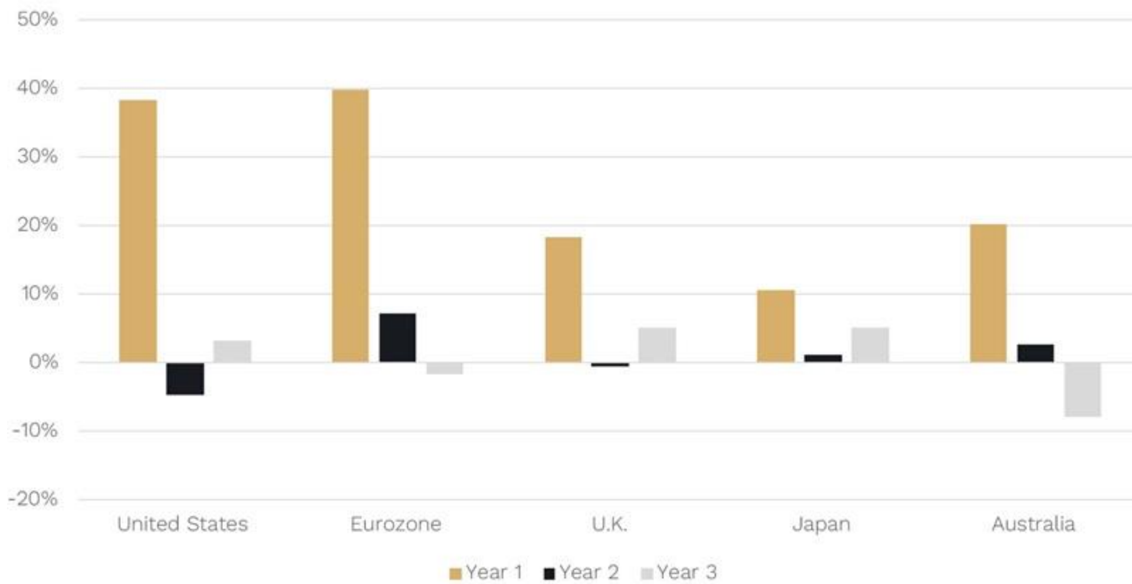
Source: JP Morgan, Bloomberg. Data to 31 March 2024

What typically happens on the other side of a recession in small versus large caps?

Outperformance!

Below we show the historical average outperformance in small versus large caps in the 1 (gold bar), 2 (black bar) and 3 years (grey bar) after the recession-linked low in the major share market regions.

Chart 3: Average Small vs Large Cap outperformance in years since recession linked equity market trough (100% Hit Rate in Year 1)



Source: JP Morgan, Bloomberg

What you can see is that across the board in every major region, including Australia, small caps on average have outperformed large caps in the first year.

Not only that but the hit rate is 100%. That means that, not only is there small-cap outperformance on average, but this outperformance has occurred in the first year on every occasion in every region!

The other point is that all, or at least the vast majority, of that outperformance is delivered in the first year. A more granular analysis shows that much of it occurs in the first 3-6 months. So don't bother trying to time it because it happens so quick you will probably miss it.

The key takeaway is that there is an asymmetry in the payoff of smalls versus large caps globally even if a recession occurs for two reasons:

- The downside versus large caps may be more limited given the already extreme underperformance for small caps, and
- The outperformance on the rebound of small caps has been historically consistent, quite significant (especially compare to the underperformance) and front loaded.

That's why we say, when it comes to small versus large caps globally: don't be penny wise and pound foolish.

That is, if you 'pinch pennies' to avoid the downside (if any given the underperformance already) of small v large caps if a recession occurs, you risk missing the likely big upside (the 'pounds') in outperformance of small caps on the other side of any recession.

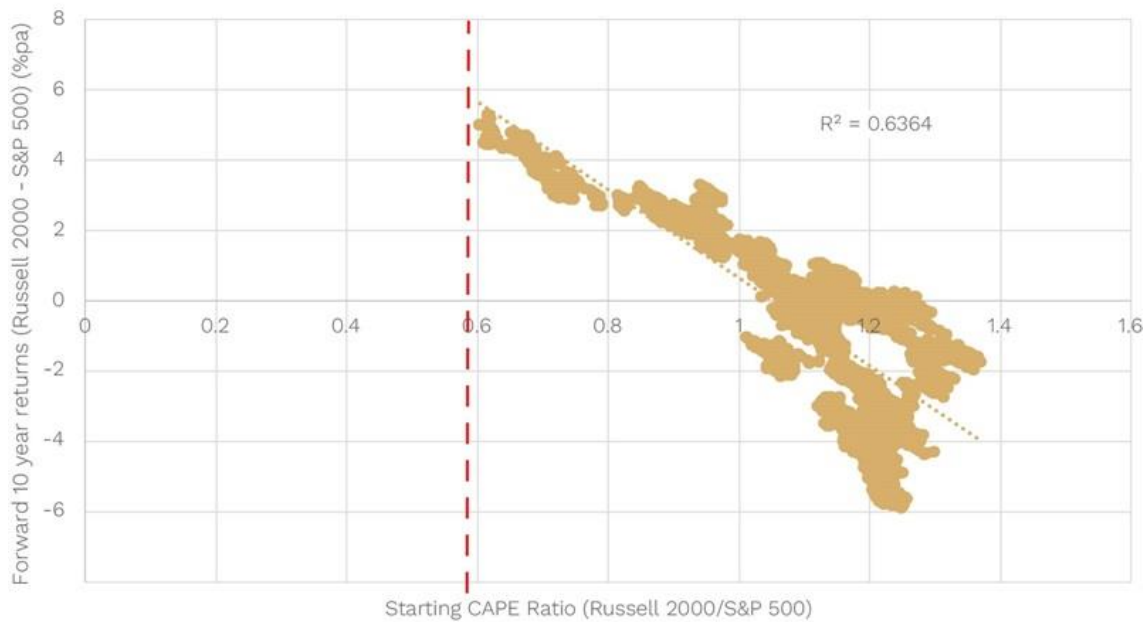
How much better could smalls caps be than large caps in the years ahead?

Over the last few months we have highlighted just how extreme the valuation differences are in small cap land compared to large caps (and also even to mid caps).

While valuations are rubbish at predicting returns over the next week, month or year, at the market level they are generally very good over periods like 5-10 years.

Below we show the differences in relative valuations (using the Cyclically Adjusted Price-Earnings 'CAPE' Ratio) between US small (Russell 2000) and large caps (S&P500) and their subsequent 10-year relative returns.

Chart 4: Russell 2000/S&P500: Valuations and Returns (10 years)



Source: Bloomberg

It is crystal clear that the cheaper U.S. small caps are to large caps (a lower starting relative CAPE ratio), the more small caps tend to outperform large caps over the next 10 years.

The relationship is so good that these starting valuations explain almost 2/3s (64%) of the subsequent return difference.

Today the Russell 2000 CAPE ratio is 19x versus 32x for the S&P500 or a relative valuation of 0.6 (red dotted line). That's about the lowest/cheapest since 2000.

Historically, when U.S. small caps have been this cheap versus large caps, they have gone on to outperform them by around 5% p.a. over the next decade.

This is a big deal.

A 5% return on a $100,000 investment, for example, would give you a $63,000 gain over a decade. But a 10% return would give you a $159,000 gain – more than twice the gain due to the benefits of compounding.

For investors that have never considered allocating to small caps, and who have been riding the recent wave of large-cap outperformance, we hope we have made a compelling case for why we think, like it always does, the cycle will turn and we'll again have the wind at our back as small cap investors.

[1] Using small cap data where available for the last six U.S. recessions back to 1980.

Andrew Mitchell is Director and Senior Portfolio Manager at Ophir Asset Management, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor.

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Estate planning made simple, Part II

Noel Whittaker

This is a second edited extract from Noel's new book, 'Wills, death & taxes made simple'. Last week, we featured an extract on making an effective will. Today looks at a hypothetical example where you have 18 months to live.

For the purposes of this exercise let's assume that you have been told you have a terminal illness and may well die within the next 18 months. These are the things that need to be considered.

Plan for your funeral

Discussing the funeral might be a good starting point. It allows open dialogue between family members and gives you the freedom to think about how you would like your funeral to be.

I recommend the book Never Forgotten by Michelle Lagana. It's only available on Kindle as far as I know, but goes into great depth as to things you might like to think about. It contains a huge amount of information and even includes suggestions for who the pallbearers might be and ideas for preparation of the funeral booklet.

At this stage, think about whether there are any funeral arrangements already in place. These could include a funeral bond or a pre-payment. If they are in place, it is important they be recorded and the documents readily available. The whole family should know of their existence; the last thing they need is to walk out of the service and discover the funeral had already been paid for with a different undertaker.

Share precious personal items

Often people have a range of belongings that really aren't appropriate to mention in the will, but which have considerable sentimental value. These may include photo albums, DVDs, family heirlooms, jewellery, kitchenware such as plates and glasses, or even items like workshop equipment or clothing.

The months before dying could be a time for reminiscing with family and friends, and a great opportunity as you give them some of these items, though remember this may trigger a CGT event, see pages 170—172.

Share important contacts

Most households require a team of people to make it function. These could include your plumber, electrician, gardener, bank staff, solicitor and various healthcare professionals. List the roles and contact details for all these people so things can carry on after your death.

Get your documents in order

It's absolutely vital that the necessary documents are up-to-date and readily available. We discussed this in depth in Chapter 4, and let me remind you about the appendix, Keeping the right records. It includes a link to the *Executors' and attorneys' cheat sheet*, which is available to download, complete, save, share as appropriate, and update at any time.

Is there a will, an enduring power of attorney (EPA) and an advance care directive? Are these documents up-to-date and readily available to the family? True, the EPA ends on your death but if you lose capacity — or just the desire — to deal with practical matters as time passes, the EPA could be essential for a range of financial and medical matters. You can probably figure out where you are likely to need the EPA. If you're not sure, I suggest you take it to at least your bank, accountant, and financial adviser, and have them vet it long before it's needed. I have heard numerous instances of people turning up with an EPA at the last minute, only for the institution to find some reason to reject it, or say they need a week to approve it.

Take a close look at your will. Have there been any major changes to your assets since you made the will? What about the beneficiaries: look for any changes in their situation since the will was executed. These could include having more children, changing tax brackets or ending a long-term relationship. In any such cases, the will should be urgently reviewed in light of their changed circumstances.

Talk to your executor/s

It is your executor/s who will manage your estate after you pass. It would be great if you could meet with them sooner rather than later to discuss your affairs in depth and give them an idea of how you would like things managed after you die. This will not just help them do their job, but also give you some comfort, knowing how your estate will be managed.

Sort out your super

If you have superannuation, you should share the recent statements and explain it all to your family. If your super includes life insurance, that will need to be noted, and your will may need to be amended if a large sum is expected to be paid to the estate. Are trustee nominations to be used? Are any binding death benefit nominations up to date? Are they lapsing or non-lapsing? All of this information is easily obtainable on the superannuation fund website or by calling your superannuation provider.

If you have an SMSF the most recent set of accounts should be available for the family to see, and you should introduce them to the people who administer the fund. This may be the family accountant or a specialist administration firm.

Remember the death tax of 15% plus Medicare levy, which is levied on taxable superannuation payments made to a non-dependant. You may want to withdraw as much of your super as you can before death and place that in your bank account, or, if you have enough liquidity, in a joint account your EPA and executor can access to cover your costs when your bank accounts are frozen.

Clarify the finances

In many couples, one person tends to manage the finances; when they die, problems can arise for the survivor. If you are approaching death, you will need to teach whoever will take over from you how your bank accounts work and give access to all email and contacts so things can be carried on or closed down when you have gone.

This is also a good time to introduce your stockbroker and financial adviser to the people taking over from you, and make sure they are right across your whole portfolio. Time spent discussing your investments, the reasons why they were made, and their potential is time well spent.

Check with your accountant if there are any changes you should make before you pass, such as selling assets with a capital gain to make use of any existing capital losses before they cease to exist on your death.

Delegate digital assets

Ensure that you have put in place the appropriate delegations for your online accounts to enable another person to access your accounts to operate, close, or delete them. Make sure someone is aware of all your online accounts, including social media, email, payment portals, and any other presence you have online. Although these accounts are usually not transferable (as they are not the property of the deceased), many enable the accountholder to appoint another person to deal with the account on their death.

Loyalty programs and points are often not transferable after death (they usually revert back to the provider); however, it is sometimes possible to transfer these points during your lifetime to another family member This could be particularly valuable if you have a credit card linked to an airline frequent flyer program with hundreds of thousands of points. A little forward thinking could provide a family member with enough points for an overseas trip after your death.

If you have cryptocurrency or are trading online, make sure the appropriate delegations or authorities have been put in place to enable these accounts to be closed.

Consider any issues arising from your current situation

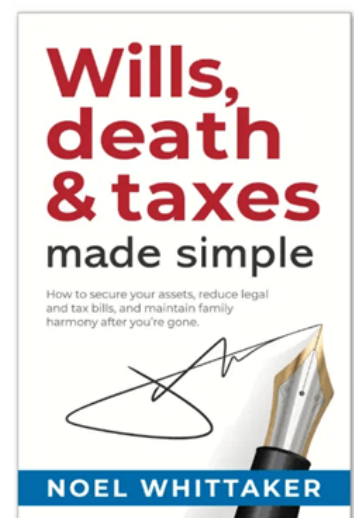
If you are single, who will take care of a much-loved pet?

If you are partnered, does your partner have special needs, and if so, how will they be cared for when you are gone? A common situation with older people is that one person becomes the other's carer, and the situation can get very difficult if it's the carer who dies.

If you have children, will they be able to do the things that normally fall to family? If not, or if you have no children to call on, who will take on responsibilities like going through all your belongings and advising people of your passing?

Do you hold a life interest in a property? If so, what details do you need to give your executor to enable them to hand the property back to the original estate?

Is your current name different from a previous name? If so, what does your executor need to know about your earlier name/s, and what paperwork will they need to demonstrate that they can act for you under that name?



Noel Whittaker is the author of 'Retirement Made Simple' and numerous other books on personal finance. See noelwhittaker.com.au. This is an extract from Noel's book, Wills, death & taxes made simple, and is for general information only.

Where Baby Boomer wealth will end up

Te Okeroa

Within five years, all Baby Boomers will be eligible for retirement and the Boomer 'bubble' will have all but deflated out of the workforce by 2028. This demographic shift will have profound consequences for the financial industry and advisers.

A Productivity Commission paper, released in 2021, estimated that the transfer of inherited assets at about A$120 billion per year, and this figure is expected to grow to almost A$500 billion per year over the next 25 years.

The same research also found that the average age of inheritors is 50 years old, close to the mid-point of the age bracket corresponding with Gen X, which makes them an important part of the answer to the question about who will inherit the bulk of the baby boomer wealth.

Fig 1: Generational Cohorts

	Birth year window		
Cohort	From	To	2023 mid point
Baby Boomers	1946	1964	**68**
Gen X	1965	1980	**51**
Millennials (Gen Y)	1981	1996	**35**
Gen Z	1997	2012	**19**

Likely beneficiaries

Research suggests where money may be directed. *The Future of Legacy Giving: Boomers and Beyond – Australia (November 2023),* found that Baby Boomers and Gen X felt strongly that it was important to help others in need as well as your own family (55% and 61% respectively) and had a higher expectation that their family will need financial support from them (19% and 38% respectively).

Of arguably greater consequence, there also appears to be evidence that females will be the primary beneficiaries of financial flows from the transfer.

The report cites research commissioned by Schroders and McKinsey (UK and US respectively) suggests females will be the primary beneficiaries of the wealth transfer, inheriting 60% to 70% of the wealth transferred, this decade. As women statistically live longer than men on average, it's not inconceivable they will have full control of their family wealth at some point.

All in all, it seems females are set to play a significant role in how the intergenerational wealth transfer will play out and this will likely have a profound impact on the adviser-client relationship and the advice industry overall. Whether the industry has adapted or is ready to is a different question.

Implications for financial advisers

According to *The Value Gap*, a report from Effortless Engagement, over 70% of clients would like their adviser to advise their children, though it may not be a fait accompli that children will use their parents' preferred adviser. Overseas research suggests that many inheritors change their advisers.

Accordingly, working with clients to extend conversations about transfers to beneficiaries and including them in conversations, should be a key priority for the industry.

For advisers, Australian Ethical found in its *2023 Opportunity Next* report, conducted with CoreData, that an overwhelming majority (77%) of advisers who engaged children in wealth transfer conversation, saw an increase in client satisfaction.

Education directly addresses a general need across generations but particularly for younger beneficiaries. Advisers are increasingly leveraging digital channels to help beneficiaries better understand the transfer and investment process and how decisions will impact them.

Advisers can also take advantage of new client portal and reporting technologies to be better informed as to the composition and performance of their portfolios and help strengthen communication and trust between transfer stakeholders.

Technology key

While the intergenerational transfer of wealth presents a substantial opportunity for advisers to engage clients and beneficiaries to establish resilient, long-term revenue streams, success is predicated heavily on their ability to add value as well as serve them profitably.

Naturally, technology is part of the answer. Modern and fully-featured trading platforms provide advisers access to the wide range of markets and asset classes required to build bespoke client portfolios in precise alignment with their objectives and risk profiles.

The net effect and arguably a key role of technology through the wealth transfer is to help address the challenges of communication and trust as root causes of transfer, ensuring there is a common and mutually agreed fact-base for stakeholders in order to deliver transfer plans their best chance of success.

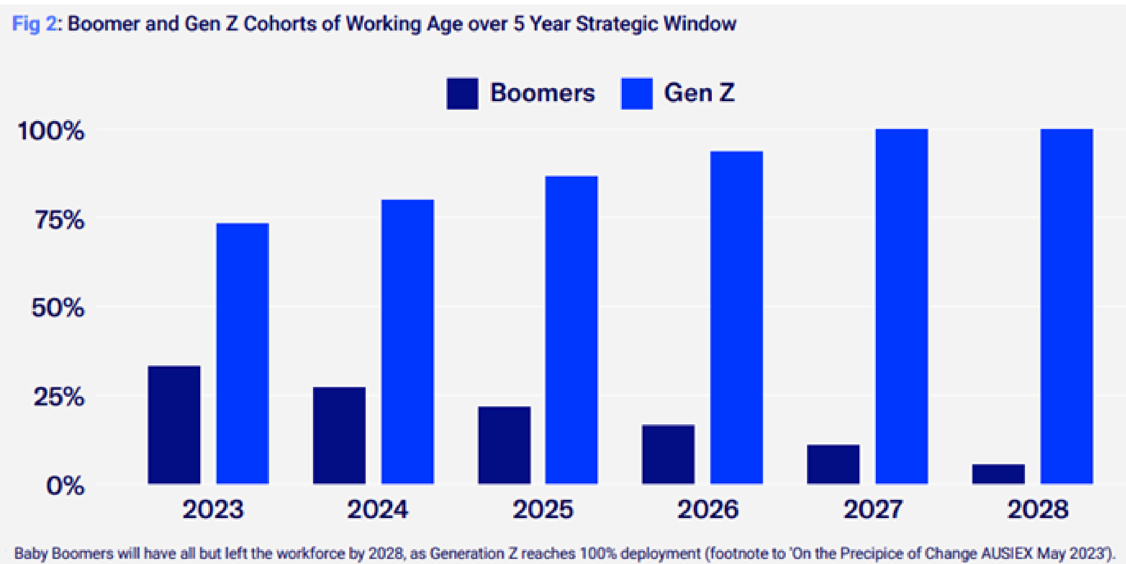
At the same time, technology can help deliver significant operational efficiencies to a practice, allowing them to navigate the challenges and take advantage of the opportunities from the intergenerational wealth transfer.

Adapting to change

Investors and the wealth management industry has always adapted quickly to new technologies to improve products and services.

Our industry has, and will continue to be able to, deal with change. It is just happening faster and with higher impact than many realise.

With the older generations about to leave the system, the younger generations face different challenges than those that came before them, and the transition to innovation in the digital world is continuing apace.



The wealth management industry and equity capital markets are proven at adapting to help the economy find new ways to create capital and increase wealth. It is essential that industry participants become more active in understanding and discussing the changes that are now taking place and engage across the value chain to plan and execute change.

Industry participants need to accelerate their preparations for intergenerational transfer, as the Baby Boomer boom is over.

The full research paper on this topic can be found at: https://www.ausiex.com.au/media/202227/2024-ausiex-intergenerational-wealth-transfer-rgb.pdf.

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