Are you retired and addicted to term deposits?

Do you think term deposits are 'no risk'?

Do you think investing in shares is a casino?

Do you think financial planners can't be trusted?

Then this is something you should read.

CPSA

COMBINED PENSIONERS & SUPERANNUANTS ASSOCIATION

Contents

GFC proves worth of term deposits ...

The Global Financial Crisis which started in October 2007 is considered by many to have been the worst financial crisis since the Great Depression of the 1930s.

The Australian All Ordinaries Index dropped from 6,873 points in October 2007 to 3,090 points in March 2009.

On average, Australian shares lost 55% of their value.

Ten years on, in October 2017, the All Ordinaries was still struggling to get back to its pre-GFC level. The average share price in October 2017 was still 13% lower than ten years before.

Surely, those who were invested in term deposits back in October 2007 came out better in October 2017 than those who were invested in shares?

The table below shows ten years of annual term deposit interest rates from October 2007 to September 2016. In other words, if you had put your money into an annual term deposit in October 2007, just before the Global Financial Crisis and rolled your savings over annually, your average annual interest rate would have been 4.35%.

Not bad, given that this average rate was achieved while the entire world was in extraordinary economic turmoil.

Year	Term Deposit Rate
October 2007	6.10%
October 2008	5.15%
October 2009	5.30%
October 2010	6.00%
October 2011	5.30%
October 2012	4.30%
October 2013	3.40%
October 2014	3.20%
October 2015	2.45%
October 2016	2.35%
10-Year Average	**4.35%**

... or does the GFC prove something else, too?

But now consider this. Say you had put your money in the stock market in October 2017, buying at the highest share prices just before the Global Financial Crisis hit. How would you have fared then?

It all depends on which shares you would have bought. But you are a very careful person, so you would have only chosen stock in Australia's fifty biggest companies listed on the Australian Stock Exchange. Among those stocks you would only have bought so-called defensive stocks among those fifty stocks.

A defensive stock is the stock of a company with stable earnings. Because of the constant demand for their products and services, these stocks are likely to recover when their price drops while paying constant dividends.

Back in October 2017, when share prices peaked and the Global Financial Crisis was about to hit, there were fourteen ultra-defensive stocks in the ASX 50 in the categories of consumer staples, financials (excluding companies dealing in commercial property) and utilities.

All of these fourteen stocks, dropped significantly when the GFC hit. Some have yet to recover completely, while others have recovered and some have more than recovered.

ASX50 Defensive Stocks	Share purchase price just before GFC -October 2007	Lowest share price during GFC	Share price ten years on from start of GFC October 2017
AGL Energy	$14.56	$9.50	$23.00
AMP	$10.72	$3.52	$4.96
ANZ Banking Group	$30.93	$11.83	$29.95
APA Group	$3.79	$2.34	$9.30
ASX	$57.21	$23.15	$52.24
Commonwealth Bank	$60.87	$23.90	$79.84
Coca-Cola Amatil	$10.28	$6.62	$8.22
Insurance Australia Group	$5.15	$2.69	$6.20
Macquarie Bank	$84.97	$14.75	$89.93
National Australia Bank	$42.59	$15.07	$31.50
QBE Insurance	$33.54	$9.23	$10.74
Suncorp	$19.26	$4.17	$13.05
Westpac	$30.13	$14.24	$31.16
Woolworths	$33.01	$20.30	$25.30

Shares v Term Deposits: who wins?

If you compare investing in these defensive ASX50 stocks with investing the same amount in term deposits from the start of the Global Financial Crisis until ten years later, you might get a surprise.

The defensive ASX50 stocks would have made you more money than term deposits during one of the deepest economic crises the world has ever faced.

In fact, only two (AMP and QBE Insurance) out of the fourteen defensive stocks would have lost you money. That loss is more than offset by the gains made by the other twelve stocks.

The value of the initial $1,000 invested in each of the fourteen stocks after ten years added to the dividends paid over ten years equals $22,483. The value of fourteen $1,000 term deposits rolled over for ten years plus interest over ten years equals $20,097.

The average annual return after ten years of investing in these stocks is 6%. The average annual return of keeping your money in term deposits for ten years is 4.35%.

ASX50 Defensive Stocks	Value of initial $1,000 in each stock after ten years	Value of dividends collected over ten years	Value of shares plus dividends collected after ten years
AGL Energy	$1,579.67	$572.12	$2,151.79
AMP	$462.69	$362.41	$825.09
ANZ Banking Group	$968.32	$686.39	$1,654.70
APA Group	$2,453.83	$943.01	$3,396.83
ASX	$913.13	$456.27	$1,369.39
Commonwealth Bank	$1,311.65	$814.85	$2,126.50
Coca-Cola Amatil	$799.61	$630.64	$1,430.25
Insurance Australia Group	$1,203.88	$697.86	$1,901.75
Macquarie Bank	$1,058.37	$384.42	$1,442.79
National Australia Bank	$739.61	$611.13	$1,350.74
QBE Insurance	$320.21	$268.10	$588.31
Suncorp	$677.57	$505.14	$1,182.71
Westpac	$1,034.19	$773.81	$1,808.00
Woolworths	$766.43	$488.34	$1,254.77
	$14,289.16	**$8,194.49**	**$22,483.62**

The lesson to take away: financial planning

The example of the fourteen defensive stocks presented here is just that. An example.

It is not suggested you go out and buy the fourteen stocks used in the example.

It is an example which demonstrates that there are reasonably secure ways of investing your savings apart from term deposits.

That is an important thing to keep in mind at a time when term deposit rates are at all-time record lows.

The second purpose of the example is to demonstrate that choosing what to invest in requires knowledge and analysis.

The fourteen stocks were selected on the basis of (1) company size and (2) defensiveness. These are not the only criteria available. In fact, just using these two criteria is a crude way of picking stocks.

Also, your alternatives to term deposits are not limited to shares. Investment products fall into, or are based on one or more of the following four categories of assets:

- Cash
- Bonds
- Shares
- Derivatives

If you want to safely navigate the investment products markets and don't have the skills of a financial adviser, you are going to need.... a financial adviser.

And that's where the rub is for many people: lack of trust in financial advisers.

Many people have heard about financial fiascos in which financial advisers played a prominent role.

However, there is no doubt that despite its bad name, the financial advice sector has a lot to offer. The bad is outweighed by the good.

Key financial terms

Cash investment products are all bank and building society accounts, including term deposits. They come with a Government guarantee (up to a maximum amount) and are very safe. Because of this low risk, the investment return (interest) is also low.

Bonds are IOUs issued by governments or corporations and are also considered low risk, although there are exceptions. Again, the investment return is low because of this. An important difference between bonds and term deposits is that bonds can be cashed in at any point in time.

Shares are certificates of ownership of a company and can be publicly traded. The investment return on shares comes in two forms, (1) appreciation or depreciation of the share price and (2) a dividend. The risk associated with shares varies.

Derivatives come in many forms, but can best be described as bets on how the price of certain investment products will develop within a certain period. For example, a share trader may buy shares at $2 each. At the same time this trader might acquire an 'option' or right to sell those shares at $2 during a certain period to someone by paying this person 10 cents a share. If the share price goes up by 30 cents within that period, the trader has made a profit of 20 cents per share. If the share price goes down by 30 cents, the trader's loss is only 10 cents.

Managed funds typically invest in shares and use derivatives to reduce their investment risk. However, they can also cash investments and bonds. Anyone can put their money in a managed fund. This entitles participants in a certain number of 'units' in the fund, which can increase or decrease in value.

Listed investment companies are companies whose shares trade on the stock exchange. These companies invest and trade in shares, derivatives, bonds and cash products, much like managed funds. Anyone can buy shares in listed investment companies.

Check out Managed Funds

A mix of managed funds is what financial planners typically advise for their clients.

As the table below shows, over the last five years managed funds have produced better average investment returns than annual term deposits.

But these are average performances. There are managed funds which perform better and ones that perform worse.

This is where you may need the help of a financial adviser.

Because on average managed funds outperformed annual term deposits, consulting a financial planner who advises you on which managed fund to put your savings into will almost certainly mean a better investment return than what an annual term deposit offers.

Performance of Managed Funds and Term Deposits

Average Investment return with fees taken out[1]	Over 1 Year	Over 3 Years	Over 5 Years
Low risk managed funds	5.1%	2.7%	4.7%
Medium risk managed funds	7.7%	4.5%	6.7%
High risk managed funds	9.7%	4.9%	7.7%
Annual Term deposit[2]	2.3%	2.4%	2.8%

[1]https://www.canstar.com.au/compare/managed-funds?profile=Multi-Sector+Moderate&amount=50000 Snapshot taken on 27 February 2018. Managed funds featuring performance fees have been excluded from calculations for technical reasons; it does not mean that these funds under-, or outperform funds that do not charge performance fees. Note that fund fees do not include the fees of a financial planner.

[2]Source: Federal Treasury.

How to find a good Financial Adviser

Many financial planning businesses are part of the operations of one of the big banks (Commonwealth Bank, Westpac, ANZ, National Australia Bank) or AMP.

Many other financial planning businesses are a franchise of a chain which may itself belong to a company that may be controlled by yet another company.

Very few financial planning businesses are stand-alone operations.

The majority of financial planning businesses have a set menu of investment options. Typically they put their clients' money in one or more managed funds from low to medium to high risk, according to clients' risk tolerance.

There are also financial planning businesses which monitor the performance of a wide range of investment products. They don't operate from a set list.

Here's what to watch out for: a financial planner advises you to put your money in, say, a managed fund belonging to the financial planning business the planner works for, or belonging to a company that owns the financial planning business.

This is not illegal, but the financial planner might be advising you that this managed fund is the one for you, because it may be company policy to favour itself or a company it controls or is controlled by. You would want a good explanation as to why this managed fund is recommended. Is it really the best option for you?

But what counts in the end is that you get a better investment than if you put your money in a term deposit.

Questions to ask your Financial Adviser...

The first meeting with a financial adviser is usually free. Here are some questions to ask at that point.

Do you have any direct or indirect links with a company that provides investment products, such as managed funds or other products?

If such a link exists, consider whether there is any point in continuing with the first meeting.

If the adviser or the company they work for receives a payment or benefit (holiday, for example) from a product provider to recommend that provider's product, there is an indirect link between the adviser and the product provider.

Before you go the first meeting, you should also check the financial advice group or company's Financial Services Guide (FSG). It should be published on the adviser's website. Otherwise ask for a copy to be sent to you through the mail. An FSG is not light reading, so clarify anything in it you don't understand at the first meeting.

What are your financial advice qualifications?

Mandatory qualification requirements are becoming more stringent, but it is currently still legal (and will be for some years) to have inadequate qualifications and work as a financial adviser.

These are the qualifications that are desirable: Diploma, Advanced Diploma or Degree in financial advice or planning. Make sure the adviser's qualification is in financial advice/planning. For example, a degree-qualified accountant is not a financial adviser unless they also have a financial advice qualification.

The qualifications of a financial adviser can be checked with the professional organisation they are a member of: the Financial Planning Association (FPA), the Association of Financial Advice (AFA) or the Independent Financial Advisers Association of Australia (IFAAA).

The Australian Securities and Investments Commission (ASIC) maintains a Financial Advisers Register, where you can confirm your Adviser is a registered The Register also details what kinds of financial products the Adviser can recommend.

Do you think that a full Statement of Advice is warranted or will Specific Advice be more appropriate?

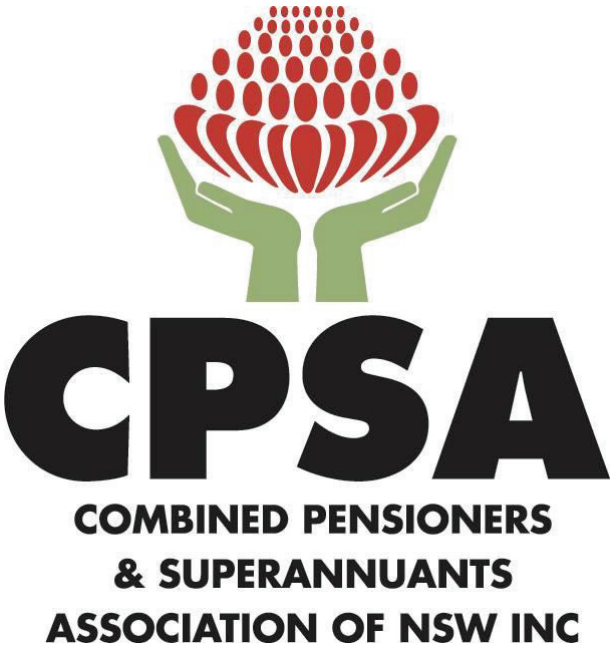
A Statement of Advice, or a full financial plan in everyday language, costs between $2,000 and $4,000. Specific advice is limited to, for example, the best way to invest your savings at a given point in time.

Obviously, paying $2,000 for a full financial plan if you have $50,000 in savings is not a good idea. It may be better for the financial adviser to give you a specific opinion on what you should do with your money.

Can you take me through all the fees and charges that will apply if I go ahead?

These are the fees and charges you can expect:

- Initial advice fee, for your financial plan or one-off specific advice.
- Implementation fee, for putting your savings in investment products as per the initial advice. You are likely to be charged a fee for every investment product you buy. For example, if your adviser puts 70% of your savings in cash-product managed fund and 30% in a managed funds investing in defensive stocks, there will be two fees.
- Ongoing advice fee, for periodically reviewing the performance of your investments. You do not need to agree to receiving ongoing advice and may want decide yourself if and when you want your adviser to carry out a review.
- Service and administration charges. These types of charges are always vague and you should not feel constrained to challenge them.



www.cpsa.org.au

cpsa@cpsa.org.au

1800 451 488

Level 3, 17-21 Macquarie Street,
Parramatta NSW 2150

Funded by the NSW Government