Reach out if you
need some advice
on what to do.

So how low can interest rates go?

It wasn't that long ago when a mortgage interest rate of 4% was considered very good, and a term deposit rate of 1.75% was thought of as pretty ordinary.

Fast forward to September 2020, and a fixed rate in the low 2%'s is on the cards, and a term deposit rate of 0.75% is considered fortunate.

A hot topic any time, and especially so now.

Reach out if you need some advice on what to do.

Brett

Brett & the team

How did interest rates get so low?

HOW DID INTEREST RATES GET SO LOW?

We are operating in a world where interest rates are now very low both overseas and here in Australia. Key drivers include:

- The state of the economy – rates get cut during a recession or economic downturn to encourage borrowing.
- Very low rates of growth – the RBA has been cutting rates since 2019 to encourage borrowing by reducing its cost and in doing so grow business investment and consumer spending across the economy.
- High debt levels – economic growth has been supported by taking on large amounts of debt. Central banks cannot raise rates excessively without sparking a financial crisis from borrowers defaulting. Given this backdrop, deflation is a larger risk. Deflation refers to a situation where the prices of goods and services are falling over time. This means the amount of goods and services your dollar can buy will increase over time. As a result, consumers tend to consume less today and lock in weaker demand for the economy. It also punishes borrowers who benefit from inflation over time especially if their debts are fixed rate in nature. If your mortgage has a fixed rate and there is inflation, typically your wage rises to offset the costs of inflation. The cost of that mortgage for the period it is fixed, will fall each year as your wage increases even if the increase is just related to inflation.

HOW DO YOU SHELTER YOUR ASSETS IN THE CURRENT CLIMATE?

In a world where deflation is a greater risk, there are assets that have, historically, done well in this kind of scenario. The major one is government bonds. It is important to note as well that the return on any investment you hold will, hopefully, keep up with the many rises in your standard of living costs. For bonds, the total return for a bond will be its yield minus inflation or deflation over the period it is held. If we assume a bond yield of 2% and inflation/deflation of 2%, the return would be:

Bond yield	2%
- deflation	- (-2%)
= TOTAL RETURN	**4%**
Bond yield	2%
- inflation	- (2%)
= TOTAL RETURN	**0%**

While in an inflationary period the purchasing power of your bond is static, during deflation it actually adds further value. This illustration highlights how useful bonds can be in a deflationary setting compared to other alternatives.

WHAT RISKS LIE IN THE FUTURE AND USING GOLD AS A DIVERSIFIER

Unlike the global financial crisis, the coronavirus pandemic has been marked by the sheer scale of government spending taking us to the equivalent of World War II deficits in a matter of months. This raises the prospect of an economic recovery and inflation sooner than we might have expected if the stimulus spending had been of a similar scale to past downturns. In addition, there are several geopolitical risks lurking on the horizon such as poor US-China relations that could threaten rising inflation.

Gold is a potential solution to these risks because it:

- Acts as a safe haven in times of crisis, often rallying when geopolitical tensions rise.
- Act as an inflation hedge. Gold has a limited supply and has historically held its value particularly in periods where ordinary currencies are eroded by inflation.
- Act as a diversifier. Gold has performed well in moving differently to either share or bond prices while also appreciating over time. This has helped reduce overall portfolio risk.

Gold is not without its risks, however, it is a volatile asset class and the value of gold can fluctuate substantially. In addition, it has historically gone through long periods of losing value before beginning to recover. In US dollar terms for instance, gold peaked at US$631 in February 1980. It then proceeded to fall 58% over the next 21 years, hitting a low of US$264 in April 2001. It did not fully recover to its 1980 peak until September 2006. That is a period of over 25 years until it broke even. For context, shares have not seen a similar "walking in the desert" moment. Since January 1958, the longest it has ever taken for the Australian share market to regain its value on a price basis has been approximately 12 years (from October 2007 to July 2019). If you reinvested dividends received it was even less (approximately seven years). This gives you a sense of how much pain there has been in holding gold for prolonged periods. Hence it needs to be combined with other assets in a diversified portfolio.

HOW IS GOLD BEST USED AS AN INVESTMENT?

While gold has value as a diversifier it can test your convictions with long periods of underperformance as a "buy and hold" investment. This is why our preference is to limit the exposure to gold and combine it with other asset classes. As well as considering risks such as deflation and inflation when constructing your overall asset allocation to make your investments as robust as possible to different kinds of risks and maximise the chances of you reaching your investment goals over time.

Speak to your financial adviser to find out more about your investment options.

Make technology work for you

Are you a new technology pioneer, or a proud 'technophobe'? Wherever you sit on the digital spectrum, the transformative power of technology is undeniable. What's important is how you harness it. From energy to communications and beyond, there are a myriad of ways that technology can help you simplify your life, save money and lessen your impact on the environment. If you are thinking about investing in household technology to help you if you've started working from home for the first time - doing your research can help you both spend and save safely and wisely.

POWERED BY SOLAR

With rising power costs and no clear resolution from energy policy-makers in sight, installing a solar and battery storage system is an attractive idea for many households. From a purely financial perspective, a solar and storage system will set you back thousands of dollars so before making a decision it's a good idea to see if the investment will pay itself back over time. According to Solar Choice research, payback times from state to state can vary because of factors such as available sunshine hours, cost of the system, cost of grid electricity, any feed-in tariffs and the amount of power the household consumes.[1]

SOLAR AND BATTERY PAYBACK PERIOD FOR EACH CAPITAL CITY

City	Average payback period (years)
Perth	7.3
Brisbane	8.2
Adelaide	8.4
Sydney	9
Melbourne	9.6
Hobart	11.4
Canberra	12.7

While the future is looking bright for solar, it's still a good idea to do the maths before making any decisions.

GET (HOUSE) SMART

The 'Internet of Things', that is, the connectivity of everyday objects to the internet, is becoming increasingly ubiquitous. Smart homes started out with connected lighting and air conditioning and expanded to include a number of home appliances such as fridges, audio devices and home security. According to analysis by McKinsey & Company, such devices now number 29 million in the US alone[2], and the market for these smart home options continues to expand - a space to watch.

1 'Banking on Solar and batteries', Choice, 16 June 2017.

2 'There's no place like (a connected) home', McKinsey & Company.