

THE PSYCHOLOGY OF MONEY by Morgan Housel

BY WEALTH ADVISER

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“The Psychology of Money” by Morgan Housel is a captivating exploration of how our minds shape our financial decisions. This insightful book delves into the complex relationship between human behaviour and money management, offering a fresh perspective on personal finance that goes beyond traditional advice.

Housel presents a series of short stories that illustrate how emotions, personal experiences, and cognitive biases influence our approach to money. From the role of luck in financial success to the power of compounding, the book covers a wide range of topics that are crucial for anyone looking to improve their financial well-being.

What sets this book apart is its focus on the ‘why’ behind our financial choices rather than just the ‘how’. Housel argues that doing well with money has little to do with how smart you are and a lot to do with how you behave. Through engaging anecdotes and clear

BEFORE YOU GET STARTED

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explanations, he offers valuable lessons on developing a healthy mindset towards money, saving, and investing.

Whether you're a seasoned investor or just starting your financial journey, "The Psychology of Money" provides timeless wisdom that can help you make better decisions with your money and ultimately lead a more financially satisfying life.

Question 1: How does personal experience shape one's perspective on money?

Personal experiences significantly influence how individuals view and handle money. People from different generations, backgrounds, and economic circumstances develop unique mental models about how money works based on their lived experiences. These experiences can lead to vastly different beliefs about risk, reward, and financial decision-making, even among equally intelligent people. Understanding this concept helps explain why financial advice that works for one person may not be suitable for another, as each individual's perspective on money is shaped by their unique set of experiences.

Question 2: What role do luck and risk play in financial success?

Luck and risk are fundamental yet often overlooked factors in financial outcomes. While individual effort and decision-making are important, unpredictable events can significantly impact results. Recognising the role of luck helps in understanding that not all financial success is due to skill, and not all failure is due to poor choices. This perspective encourages a more balanced view of both personal achievements and setbacks, as well as those of others, leading to more realistic expectations and greater empathy in financial matters.

Question 3: How can compounding impact long-term wealth building?

Compounding is a powerful force in long-term wealth building, often underestimated due to its counterintuitive nature. Small, consistent investments can grow exponentially over time, potentially leading to significant wealth accumulation. The key to harnessing compounding is time - the longer an investment has to grow, the more dramatic the effects of compounding become. This principle underscores the importance of starting to invest early and maintaining a long-term perspective, even if initial gains seem modest.

Question 4: Why is it important to be reasonable rather than rational with money?

Being reasonable rather than strictly rational with money acknowledges the emotional and psychological aspects of financial decision-making. While traditional economic theory

assumes people make purely logical choices, real-world decisions often involve complex emotions and personal values. A reasonable approach takes into account individual circumstances, risk tolerance, and personal goals, potentially leading to more sustainable and satisfying financial choices. This perspective allows for a more holistic view of money management that aligns with personal well-being rather than just maximising returns.

Question 5: What is the relationship between wealth and happiness?

The relationship between wealth and happiness is complex and often misunderstood. While money can provide security and access to certain comforts, it doesn't guarantee happiness. The text suggests that one of the highest forms of wealth is the ability to control one's time and make choices freely. This type of wealth, which allows for independence and the pursuit of personally meaningful activities, can contribute more to happiness than material possessions or status symbols. Understanding this relationship can help individuals set more fulfilling financial goals beyond mere accumulation of money.

Question 6: How does social comparison affect financial decisions?

Social comparison can significantly influence financial decisions, often leading to suboptimal choices. People tend to measure their financial well-being against their peers, which can result in excessive spending or risk-taking to "keep up with the Joneses." This behaviour can be particularly detrimental when individuals compare themselves to those playing a different financial "game" or with vastly different circumstances. Recognising and mitigating the effects of social comparison can lead to more personalised and sustainable financial strategies.

Question 7: Why is saving money important, even without a specific goal?

Saving money without a specific goal serves as a form of financial insurance against life's inevitable uncertainties. It provides a buffer against unexpected expenses, job loss, or economic downturns. Moreover, having savings offers flexibility and freedom to take advantage of unforeseen opportunities. This approach to saving acknowledges that life is unpredictable and that financial security often comes from being prepared for the unknown, rather than just planning for specific, anticipated events.

Question 8: What is the concept of "enough" in relation to wealth?

The concept of "enough" in wealth is about recognising the point at which additional money no longer significantly

improves one's life quality or happiness. It involves understanding personal financial goals and being content once they are met, rather than endlessly pursuing more wealth. This mindset can prevent the pitfalls of excessive risk-taking or unethical behaviour in the pursuit of unnecessary wealth. Recognising "enough" can lead to greater financial satisfaction and allow individuals to focus on other aspects of life beyond money.

Question 9: How do financial bubbles form and why do they keep happening?

Financial bubbles form when asset prices rise to levels significantly above their fundamental value, often driven by excessive optimism and speculation. They persist because of a combination of factors, including herd mentality, the difficulty in recognising bubbles in real-time, and the tendency for short-term investors to influence market prices. Bubbles continue to occur because human psychology, including greed and the fear of missing out, remains relatively constant over time, even as specific market conditions change.

Question 10: What is the importance of having a long-term perspective in investing?

A long-term perspective in investing is crucial because it allows investors to benefit from compounding returns and ride out short-term market volatility. It helps in avoiding emotional decision-making based on temporary market fluctuations. Long-term investing also aligns with the historical upward trajectory of markets, potentially leading to better overall returns. This approach encourages patience and discipline, key traits for successful investing, and helps investors focus on their ultimate financial goals rather than short-term performance.

Question 11: How does the "man in the car paradox" relate to wealth and status?

The "man in the car paradox" illustrates how people often misinterpret the relationship between material possessions and admiration. When someone sees a person in an expensive car, they typically imagine themselves in that car rather than admiring the actual driver. This paradox highlights that purchasing luxury items for status often fails to achieve the desired effect of gaining respect or admiration from others. Instead, it suggests that traits like kindness and humility are more likely to earn genuine respect and admiration.

Question 12: What is the role of room for error in financial planning?

Room for error in financial planning is crucial for long-term success and peace of mind. It involves building buffers into financial strategies to account for unexpected events

or mistakes. This approach recognises that the future is inherently uncertain and that even the best-laid plans can go awry. By incorporating margins of safety, such as emergency funds or conservative investment allocations, individuals can better weather financial storms and avoid catastrophic losses that could derail their long-term financial goals.

Question 13: Why is it crucial to understand your own time horizon in investing?

Understanding one's own time horizon is essential in investing because it influences risk tolerance, asset allocation, and overall investment strategy. Different time horizons require different approaches - short-term goals may necessitate more conservative investments, while long-term objectives can often withstand higher risk for potentially greater returns. Recognising and staying true to one's time horizon can help avoid making emotional decisions based on short-term market fluctuations, leading to more consistent and potentially successful long-term investing outcomes.

Question 14: How does pessimism affect financial decision-making?

Pessimism can significantly impact financial decision-making, often leading to overly conservative choices or missed opportunities. While a degree of caution is healthy, excessive pessimism can result in paralysis or an inability to take necessary risks for growth. Interestingly, financial pessimism often sounds more intelligent than optimism, which can give it undue influence. Understanding the role of pessimism can help individuals balance their outlook, recognising potential risks while still remaining open to opportunities for financial growth and success.

Question 15: What is the importance of surviving in financial success?

Survival is a crucial yet often overlooked aspect of financial success. The ability to stay in the game, avoiding financial ruin or forced exit from investments, is fundamental to long-term wealth building. This principle emphasises the importance of risk management and avoiding catastrophic losses, even if it means potentially sacrificing some upside. Survival in finance allows for the power of compounding to work over time and provides opportunities to benefit from unexpected positive events, underlining the adage that "you have to be in it to win it."

Question 16: How do stories and narratives impact economic behaviour?

Stories and narratives play a crucial role in shaping economic behaviour by influencing people's expectations, decisions, and actions. They can create shared beliefs about the economy, market trends, or the value of certain assets,

sometimes leading to self-fulfilling prophecies. Narratives can drive economic booms or busts, as seen in speculative bubbles or market panics. Understanding the power of economic narratives helps explain why markets don't always behave rationally and why economic outcomes can be influenced by collective storytelling as much as by fundamental factors.

Question 17: What is the concept of “tails” in investing and why are they important?

In investing, “tails” refer to the extreme ends of a distribution of outcomes - the outlier events that have an outsized impact on overall returns. The concept of tails is important because a small number of exceptional investments often drive the majority of returns in a portfolio. This principle applies not just to individual stocks but to many aspects of investing and business. Recognising the importance of tails encourages investors to be patient with winners, diversify to capture potential outliers, and understand that many investments may underperform while a few dramatically outperform.

Question 18: How has the American consumer’s relationship with money evolved since World War II?

The American consumer’s relationship with money has undergone significant changes since World War II. In the immediate post-war period, there was a shift towards increased consumption, fuelled by economic growth, new consumer credit options, and changing cultural attitudes towards debt. Over time, income inequality grew, leading to stretched finances for many as they attempted to maintain lifestyles in line with perceived societal standards. This

evolution has been marked by periods of economic boom and bust, changing attitudes towards saving and spending, and an increasing complexity in financial products and decisions facing consumers.

Question 19: What is the psychology behind taking on debt to maintain a certain lifestyle?

The psychology behind taking on debt to maintain a certain lifestyle often stems from a combination of social comparison, lifestyle inflation, and the belief that current income or future prospects will improve. People may feel pressure to meet societal expectations or maintain a standard of living they’ve grown accustomed to, even when their income doesn’t support it. This behaviour can be reinforced by easy access to credit and a cultural acceptance of debt. Understanding this psychology helps explain why many individuals take on unsustainable levels of debt despite the long-term financial risks.

Question 20: How can individuals make better financial decisions according to the author?

According to the author, individuals can make better financial decisions by focusing on a few key principles. These include understanding and accepting the role of luck and risk, prioritising long-term thinking and compounding, defining personal financial goals and what “enough” means, maintaining a reasonable rather than strictly rational approach to money, creating room for error in financial plans, and avoiding the pitfalls of social comparison. The author also emphasises the importance of aligning financial decisions with personal values and life goals, rather than pursuing wealth for its own sake or to impress others.





BOOM OR BUST?

Understanding the Forces Shaping Australia's Property Prices

BY WEALTH ADVISER

Introduction

Australia's housing market has long been a subject of national interest and debate. House prices are not only a reflection of economic prosperity but are also central to the wealth of many Australians. Over the past few decades, the property market has seen tremendous growth, turning real estate into one of the most sought-after investments. However, with fluctuating economic conditions, many are left asking: Are we heading for another boom, or is a bust on the horizon?

This article explores the forces shaping property prices in Australia today. We'll break down regional trends, the economic factors that drive price fluctuations, and the ever-present question of whether the market is on the verge of a crash. By the end, you'll have a better understanding of where the market stands and how investors can navigate this uncertain landscape.

Australia's Housing Price League Table

The first step in understanding the market is recognizing regional variations in housing prices. A league table of property prices, like the one highlighted in the Firstlinks article,

serves as a valuable tool for comparing cities and suburbs across Australia.

For example, as of 2024, Sydney maintains its position as the most expensive city, with a median house price of approximately AUD 1.2 million, while Melbourne follows closely at AUD 900,000. Other cities show a more moderate price range, such as Brisbane at AUD 800,000 and Adelaide at AUD 750,000. Meanwhile, Hobart, historically a smaller player in the housing market, has seen significant growth in recent years, with median prices now around AUD 700,000. Conversely, Perth and Darwin, which experienced price surges during the mining boom, have seen stagnation, with median prices around AUD 600,000.

These figures illustrate how certain regions continue to experience price growth, while others have plateaued or even declined, indicating the highly localized nature of the housing market.

Factors Driving Property Price Changes

Understanding why property prices move requires dissecting the various economic and social forces at play. Three core factors significantly influence house prices: interest rates, economic growth, and government policies.



- 1. Interest Rates:** Interest rates are one of the primary drivers of housing affordability. When the Reserve Bank of Australia (RBA) cuts interest rates, borrowing becomes cheaper, leading to an increase in demand for property. Conversely, when rates rise, mortgages become more expensive, cooling the market. In the last few years, the RBA cut interest rates to historic lows, with the cash rate reaching 0.10% in 2020 during the pandemic, fueling a housing boom. However, as inflationary pressures build, the RBA has since raised rates, bringing them to 4.1% as of mid-2024, leading to a slowdown in the housing market.
- 2. Economic Growth and Employment:** A strong economy typically correlates with rising property prices. In 2022, Australia's GDP growth rate was 3.6%, which supported housing demand. However, with global economic uncertainty and rising inflation, growth is projected to slow to 2.2% in 2024, raising concerns about the sustainability of housing price increases. Additionally, unemployment remains relatively low at 3.5%, supporting demand, but any uptick in job losses could have a dampening effect on the housing market.
- 3. Government Policies:** Federal and state governments play an essential role in the housing market through policies like stamp duty exemptions, first-home buyer incentives, and the regulation of negative gearing. The First Home Loan Deposit Scheme, introduced in 2020, allowed buyers to enter the market with as little as a 5% deposit,

contributing to the housing boom. However, debates over the removal of negative gearing tax concessions could shift investor sentiment and affect future price dynamics.

Further, supply constraints significantly impact prices. With Australia's population growth at 1.1% per year, driven primarily by immigration, the demand for housing continues to grow. In cities like Sydney and Melbourne, where new housing supply has not kept pace with demand, prices have risen rapidly. In 2023, housing completions fell short of demand, with only 180,000 new dwellings completed compared to the 240,000 required to meet demand.

Market Speculation: Crash or Continuation?

One of the most discussed topics in the property market is whether Australia is heading towards a housing crash. This speculation isn't new. Since the rapid rise in house prices during the 2000s, various analysts have predicted a downturn. However, the market has consistently defied expectations.

Proponents of a potential crash often cite Australia's high household debt levels. As of 2024, Australia's household debt-to-income ratio stands at 187%, one of the highest in the world. This leaves many homeowners vulnerable to interest rate increases. For instance, a 1% rise in interest rates could increase the average mortgage repayment by over AUD 500 per month, putting significant financial strain on homeowners and potentially leading to forced sales.

However, others argue that while certain regions may see price adjustments, a full-scale crash is unlikely. Australia's population growth and the persistent demand for housing, especially in major cities, continue to underpin the market. In the aftermath of the global financial crisis, Australia's housing market experienced only a modest dip, with prices falling by just 4.5% nationwide, compared to much larger drops in other countries like the United States and the UK.

The reality likely lies somewhere between these two extremes. While high household debt and rising interest rates present risks, Australia's robust population growth and supply constraints mean that a full-blown crash remains unlikely. Instead, we are likely to see regional price adjustments rather than a nationwide collapse.

Investment Strategies in Uncertain Times

For investors, navigating the housing market in times of uncertainty can be challenging. However, there are several strategies that can help mitigate risks and capitalize on potential opportunities.

1. **Diversification:** Instead of focusing solely on one city or type of property, spreading investments across different regions or asset classes (e.g., residential and commercial properties) can help balance risk.
2. **Focus on Fundamentals:** Investors should prioritize areas with strong economic fundamentals, such as low unemployment, population growth, and infrastructure development. In 2024, cities like Brisbane and Adelaide are showing the highest year-on-year growth, with prices increasing by 6% and 5.3% respectively, making them attractive options.
3. **Manage Debt Wisely:** Given the possibility of rising interest rates, investors should avoid over-leveraging their portfolios. For example, homeowners with a AUD 1 million mortgage could see their monthly repayments rise by AUD 1,000 or more with just a 1% rate hike.
4. **Timing the Market:** While predicting the exact timing of a market peak or trough is difficult, paying attention to key indicators like interest rate movements, government policy changes, and economic growth can provide valuable insights for timing property purchases or sales.
5. **Long-term Perspective:** Property investment is often most rewarding over the long term. Investors who focus on buying properties with solid fundamentals and holding them through market fluctuations tend to achieve the best outcomes. Over the past 20 years, Australian property has returned an average annual growth rate of 7%, making it a reliable long-term investment.

Conclusion

The question of whether Australia's housing market is headed for a boom or bust remains open. While there are signs of a cooling market in some regions, others continue to show strong growth, buoyed by population demand and supply constraints. The forces that drive property prices—interest rates, economic growth, and government policies—are complex and often unpredictable.

For investors and homeowners alike, understanding these forces is key to making informed decisions. By focusing on fundamentals, managing risk, and keeping a long-term perspective, individuals can navigate this uncertain landscape with greater confidence.

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BY WEALTH ADVISER

Introduction

Aged care in Australia is undergoing significant transformation. With an aging population, the demand for aged care services has surged, leading to increased complexity in the provision of care and financial advice. Navigating the aged care system, with its intricate financial arrangements and legal obligations, can be overwhelming for consumers. Ensuring consumer protection in this context is critical, as older Australians often face risks of exploitation, misinformation, and inadequate care.

This article explores the major challenges in consumer protection within aged care, focusing on recent developments in government policy, including the 2024-25 Federal Budget and the reforms introduced by the Aged Care Taskforce. By examining these changes and considering the broader financial implications of aged care, we aim to provide practical guidance to aged care clients and their advisers on how to navigate the evolving landscape.

The Consumer Protection Challenge in Aged Care

Aged care consumers are particularly vulnerable due to their age, declining health, and often limited understanding of financial and legal matters. This vulnerability is exacerbated by the complexity of the aged care system, which involves decisions about financial products, residential care contracts, and government benefits. Many older Australians and their families rely heavily on the expertise of financial advisers to navigate these issues. However, this reliance also exposes them to risks, particularly when advisers may lack the requisite knowledge of aged care products or when conflicts of interest arise.

Key consumer protection concerns include:

- **Lack of transparency:** Aged care financial products can be opaque, with fees and conditions that are not easily understood by consumers.
- **Complexity of advice:** Financial advisers must navigate a maze of regulations, products, and government schemes to provide appropriate advice, often without sufficient training.

- **Potential for exploitation:** Vulnerable clients may be at risk of being sold inappropriate financial products or services that serve the adviser's interests rather than the client's.

In addition to these challenges, as highlighted in Firstlinks, one major concern is that the costs of aged care are not only borne by the wealthy. Middle-income Australians are increasingly finding themselves financially stretched due to rising aged care fees and the means-tested nature of government support. This creates further pressure for consumers to seek financial advice, but it also amplifies the risks if the advice is inadequate or self-serving.

The current regulatory framework, governed by the Australian Securities and Investments Commission (ASIC) and other bodies, seeks to address these challenges. However, gaps remain in ensuring that aged care clients receive appropriate and unbiased advice.

Impact of 2024 Federal Budget on Aged Care

The 2024-25 Federal Budget introduced several significant measures aimed at strengthening the aged care system, particularly in the area of consumer protection. One of the key provisions was the increase in funding for aged care services, with a focus on improving transparency and accountability in financial advice.

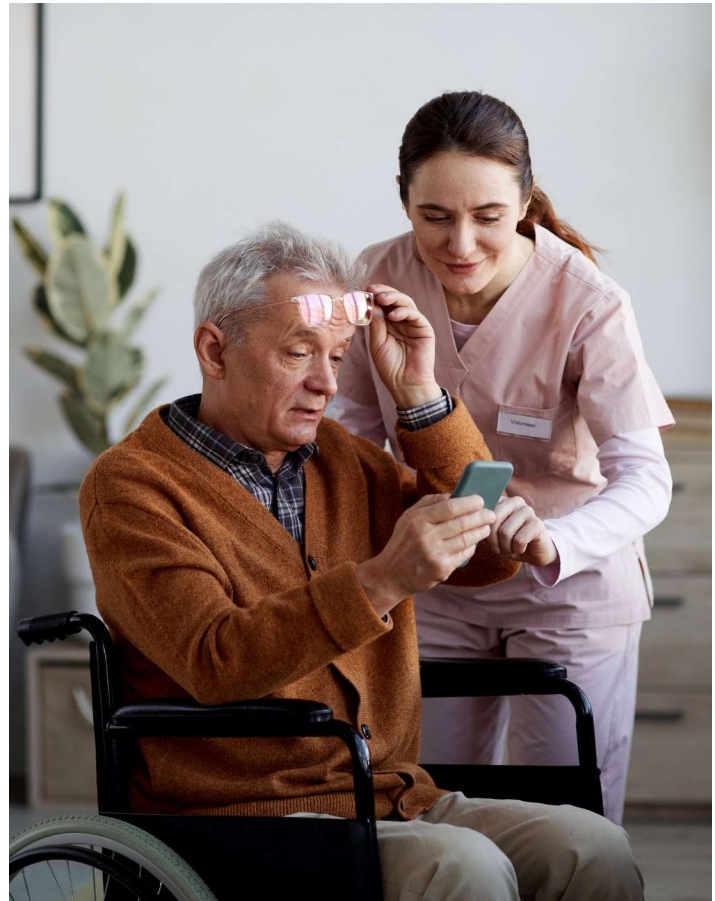
Some of the budgetary measures include:

- **Increased funding for aged care services:** This funding is aimed at enhancing the quality of care provided to older Australians and ensuring that financial advice given to aged care clients is better regulated.
- **New guidelines for financial advisers:** The government introduced guidelines requiring financial advisers to undergo specialized training in aged care financial products. This move aims to reduce the incidence of inappropriate advice and ensure that advisers are fully equipped to support their clients.
- **Stronger penalties for misconduct:** The budget also outlined stronger penalties for advisers who engage in misconduct, particularly where vulnerable clients are exploited.

In addition to these provisions, the Firstlinks article emphasizes that the financial burden of aged care is shifting towards families. The increased means-testing for government support, combined with rising costs, means that more families will need to rely on private savings and home equity to cover aged care expenses. This further complicates the role of financial advisers, who must balance the need to protect clients' assets while ensuring they can afford the care they need.

Looming Changes from the Aged Care Taskforce

The Aged Care Taskforce, established to review and



reform the aged care system, has proposed a series of changes that are likely to have a profound impact on aged care consumers and financial advisers. The Taskforce's work is driven by a recognition that the current system does not adequately protect consumers, particularly in light of increasing demand for services and the complexity of financial advice.

Some of the key reforms proposed by the Taskforce include:

- **Reforming the accreditation process for aged care providers and financial advisers:** The Taskforce has recommended tighter regulations on who can provide financial advice to aged care clients, ensuring that only qualified and trained professionals are allowed to operate in this space.
- **Introducing standardized financial products:** To reduce confusion and protect consumers from exploitative products, the Taskforce is considering introducing standardized financial products for aged care. This would allow consumers to compare products more easily and make informed decisions.
- **Greater oversight of aged care contracts:** The Taskforce has recommended stronger oversight of the contracts that aged care consumers sign with service providers, with an emphasis on ensuring transparency and fairness.

These reforms aim to address the gaps in consumer protection identified in the current system. However, they also present challenges for advisers, who will need to adapt to new regulations and ensure they stay informed about the evolving landscape.

What These Changes Mean for You

For aged care consumers, the changes outlined above bring both challenges and opportunities. On one hand, the reforms are likely to result in better protection and more transparent advice. On the other hand, navigating these changes will require greater awareness and proactivity on the part of consumers.

To ensure you are protected, consider the following steps:

- **Seek qualified financial advice:** Ensure that your financial adviser is accredited and has undergone the necessary training to provide aged care advice.
- **Understand your options:** Familiarize yourself with the standardized products and contracts being introduced by the Taskforce, so you can make informed decisions about your care and finances.
- **Stay informed:** Keep up-to-date with the latest changes in aged care policy, as these will impact the advice you receive and the options available to you.

For financial advisers, the key takeaway is that the landscape is shifting, and staying ahead of these changes is critical. Advisers should seek additional training, familiarize

themselves with new products, and ensure they are compliant with the latest regulations.

Conclusion

The aged care system in Australia is in the midst of significant reform, driven by a need to better protect consumers and improve the quality of financial advice. The 2024-25 Federal Budget and the work of the Aged Care Taskforce are important steps in addressing the challenges faced by aged care clients, but much work remains to be done.

As the aged care sector continues to evolve, consumers and advisers alike must remain vigilant and proactive to ensure that they are adequately protected. By understanding the key changes and taking steps to navigate the new landscape, aged care clients can ensure they receive the best possible advice and support in their later years.

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Q&A: Ask a Question

Question 1

I recently heard about testamentary trusts after my friend completed his estate planning with his. How do they work?

A testamentary trust is a type of trust established through your will and activates upon your death. It allows you to dictate how your assets are managed and distributed to beneficiaries. This type of trust offers several advantages, including potential tax benefits, as income distributed from the trust may be taxed at lower rates than if given directly to beneficiaries. It also provides you with control over the timing and manner of asset distribution, ensuring they align with your wishes.

While a testamentary trust can be a valuable estate planning tool, particularly in complex family situations, it does require careful legal drafting and consideration, often necessitating professional advice to navigate associated costs and administrative details. Ultimately, it helps ensure your assets are managed according to your specific desires after your passing.

Question 2

My friend told me that when I pass away, my super might be taxed before it's distributed to my children. How does this work?

Your superannuation may be taxed before it is distributed to your beneficiaries. How this is taxed is dependent on who your beneficiary is and the taxable components of your super fund. There is a taxable component, typically comprised of employer contributions, voluntary taxable

contributions, and investment earnings of your super. This portion may be subject to tax upon distribution if the beneficiary is not a tax dependent such as an adult child, incurring a tax of 15% plus a 2% Medicare levy. Dependents such as a spouse or children under 18 will receive it tax-free.

Conversely, the tax free component, which consists of after-tax contributions, is tax-free for all beneficiaries regardless. Understanding these distinctions is crucial for effective estate planning, as it allows you to strategise how your superannuation will be allocated to your beneficiaries.

Question 3

I noticed on my super statement that there were different fees listed. What are these fees for, and should I be worried they will affect my balance?

Super funds typically charge a range of fees, including administration fees, investment fees, and sometimes insurance premiums. Administration fees cover the day-to-day costs of managing your account, while investment fees relate to managing the assets in your super. Insurance premiums, if applicable, cover any life, TPD, or income protection insurance you hold within your super. These fees are deducted directly from your super balance.

While some fees are necessary to manage your account and investments, they can reduce your overall returns over time. Even small differences in fees can significantly impact how much your super grows, especially over the long term. You should see a financial adviser who can regularly review your super statement to ensure you're not paying more than you need and that the fees align with the services and performance you're receiving compared to the market.

If you have a question that you would like to see answered in **Wealth Adviser**, please send it through to centraladvice@wtfglimited.com.

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