Part 5 – Remembering the lessons

In the wake of the GFC people felt their ability to assess the state of the share market had weakened. This is also not surprising as in recent years most asset classes have experienced considerable volatility.

In fact almost all assets from housing to infrastructure, art works to deep ocean drill rigs were affected by the GFC. So it is normal, and welcome behaviour for people to respond to that turmoil by taking a closer interest in how their money is working for them and what can be done to make it work harder.

If we look for a silver lining from the GFC it is that Australians have received a shock and are again looking at their aspirations and how they will be met. And they are also putting away more of their income as a buffer to any future shocks and have embraced fixed income products as the basis of a secure investment portfolio.

These products include term deposits and cash management accounts. Australians and Australian businesses have $2.26 trillion deposited in authorised deposit-taking institutions, according to APRA's latest data release in May this year. It is an enormous sum but only $600 million is invested in higher interest paying term deposits.

A cash hub can make tracking and investing your cash in term deposits, super, managed funds and other assets like shares easy, and it can provide your financial planner with a streamlined process to manage all your portfolio, SMSF and tax considerations.

But despite the healthy state of deposits with financial institutions our personal savings are still relatively small compared to our spending.

According to ASIC in 2012 the average household spent $69,166 on general household living costs. While savings have been increasing since mid-2011 it was still only just over $15,000 for the average Australian in early 2013. It's a reasonable buffer but still suggests in a matter of months most households would be financial trouble if a sudden calamity like job loss or injury impacted a household.

> "Knowing where your money is and what it is earning is a vital part of the knowledge base we need to build to make our cash work harder. "

If we review the Household Saving Ratio graph below, we can see that as the GFC commenced in late 2007 and as it progressed over the next couple of years people began to increase their level of savings until it was back at levels not seen since the 1980s.

While savings peaked at above 10 per cent of annual income the levels of savings has already shown a decline as the initial shock from the disruption of the GFC wears off and people begin to feel more secure about the strength of the Australian economy and the ability of the world to work out its problems. That is potentially a dangerous expectation.

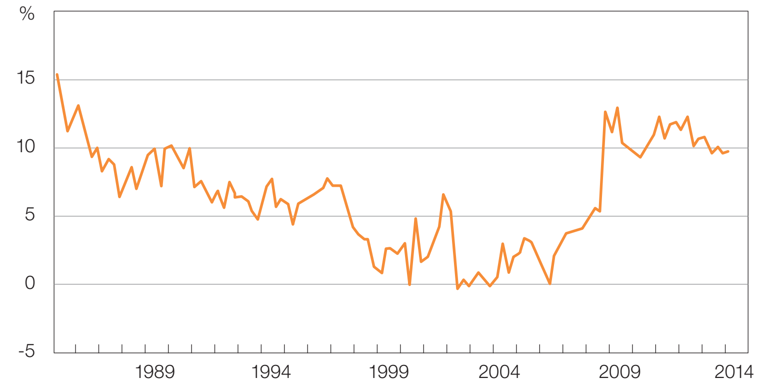
Particularly if we look further at how well Australians are placed to weather any further crisis.

According to leading business information gatherer Dun & Bradstreet six in 10 Australians were concerned about their financial position because of a lack of savings in the final quarter of 2012. D&B's Consumer Credit Expectations Survey found despite household savings being at a 20 year high one-third of low income earners and a quarter of older Australians would only be able to survive for up to one month without a steady income.

It also found a quarter of low income households and one-in-five older Australians admitted to having no savings, despite economic conditions refocusing their attention towards saving.

Household Saving Ratio*

Per cent of household disposable income



* Net of depreciation
Source: ABS

Shock therapy can reboot thinking

While we can acknowledge the GFC awakened many people to the safety of their financial position the question remains as to whether enough people have responded to those concerns.

One of world's most acknowledged investors, Jeremy Grantham, was asked in an interview in October 2008 what we had learnt from the GFC. He replied: "In the short term a lot, in the medium term a little, in the long term, nothing at all."

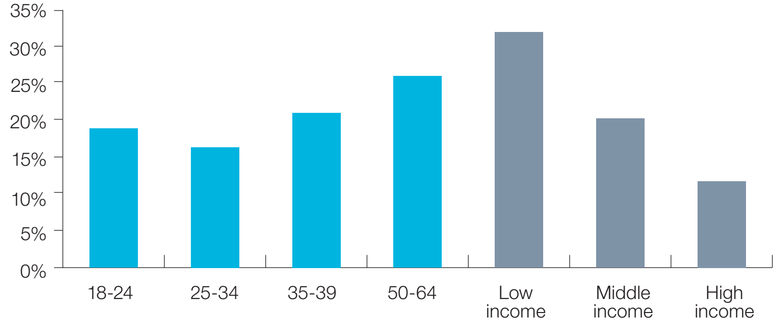
Grantham summed up the greatest problem with wealth creation – people have a propensity to forget the lessons of the past and be swayed by the herd mentality that drives not just share markets but communities, government policy and our perceptions on a day-to-day basis.

And so we need to become a person that has learnt from the past. We need to remember that there are investment cycles and that the performance of assets varies over the investment cycle.

We need to remember that we live in a dynamic global environment and that there is volatility present which at some point will likely affect one or more of our asset types. But we also need to remember we are focused on the long term goal of financial independence and that in the long term those volatile periods even out. If we make smart decisions our wealth profile will be a single line constantly moving upwards over a period of decades.

And we should always remember when making wealth creation decisions the words 'Don't Panic'. Panic can be a wealth destabiliser causing us to take short term actions that have a long term impact, such as selling share portfolios at the bottom of a market. Consider your adviser your counsellor. In times of panic it pays to take a deep breath and get some advice before taking action.

Those who are very concerned about their financial situation – age/income



Source: Dun & Bradstreet

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