Personal Financial Planning for 2023

30 November 2022

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Agenda

1. Market Outlook for 2023

- Interest Rates & Inflation
- Equity Market Update
- Headwinds & Tailwinds

2. Financial Protection

- Protecting your Assets
- Protecting your Cashflow
- Succession Planning

3. Portfolio Management

- Asset Allocation Strategies
- Diversification
- Navigating the current Market Environment

4. Cashflow Planning

- Income and Outgoings
- Essential v Discretionary spending
- Surplus Capital options

8 Pillars of Holistic Wealth Management

Retirement Planning

Asset Allocation

Tax & Cost Efficiency

Succession Planning

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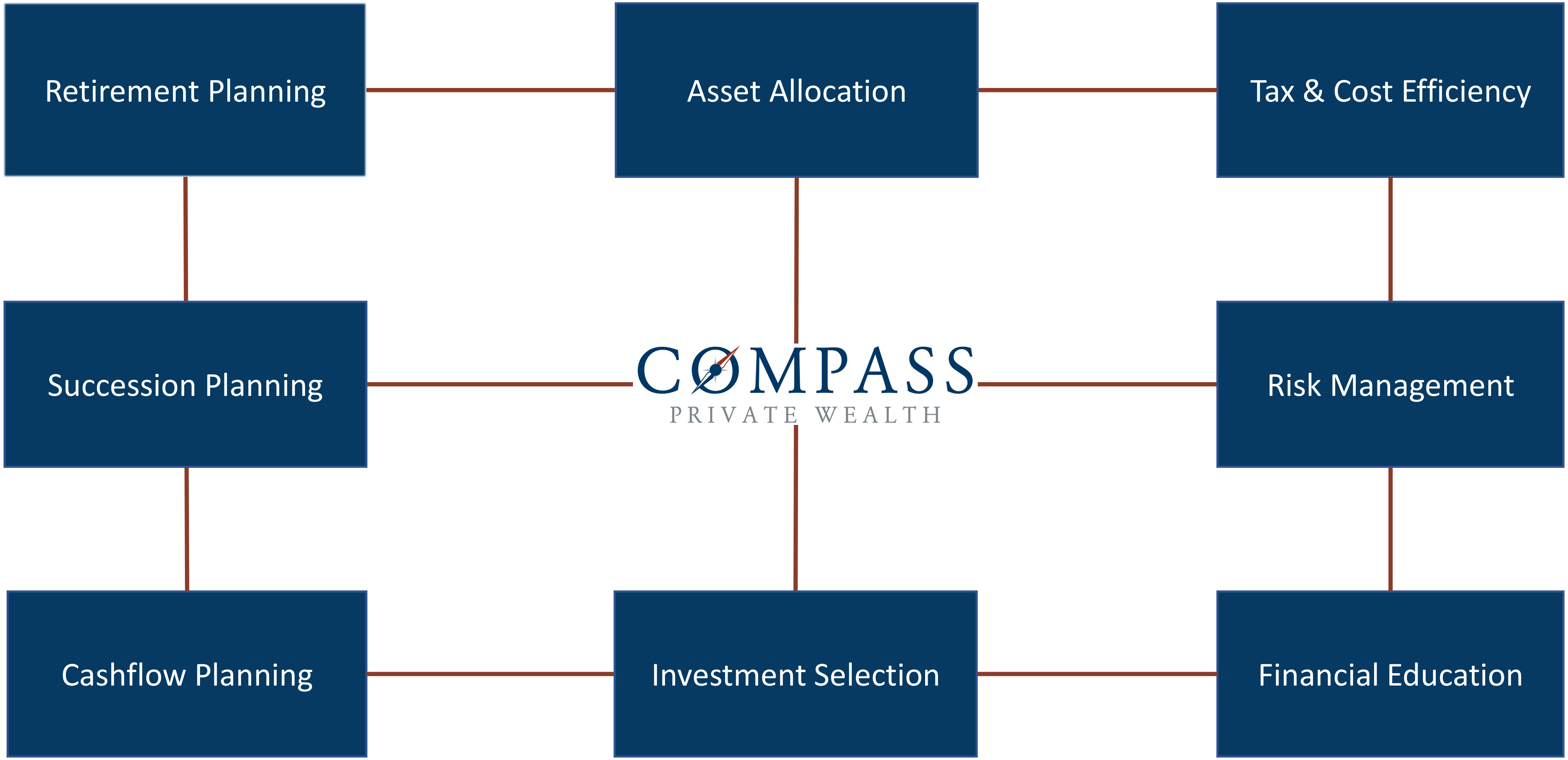
Risk Management

Cashflow Planning

Investment Selection

Financial Education

8 Pillars of Holistic Wealth Management



Investment Market Outlook for 2023.

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Summary Highlights: 2022

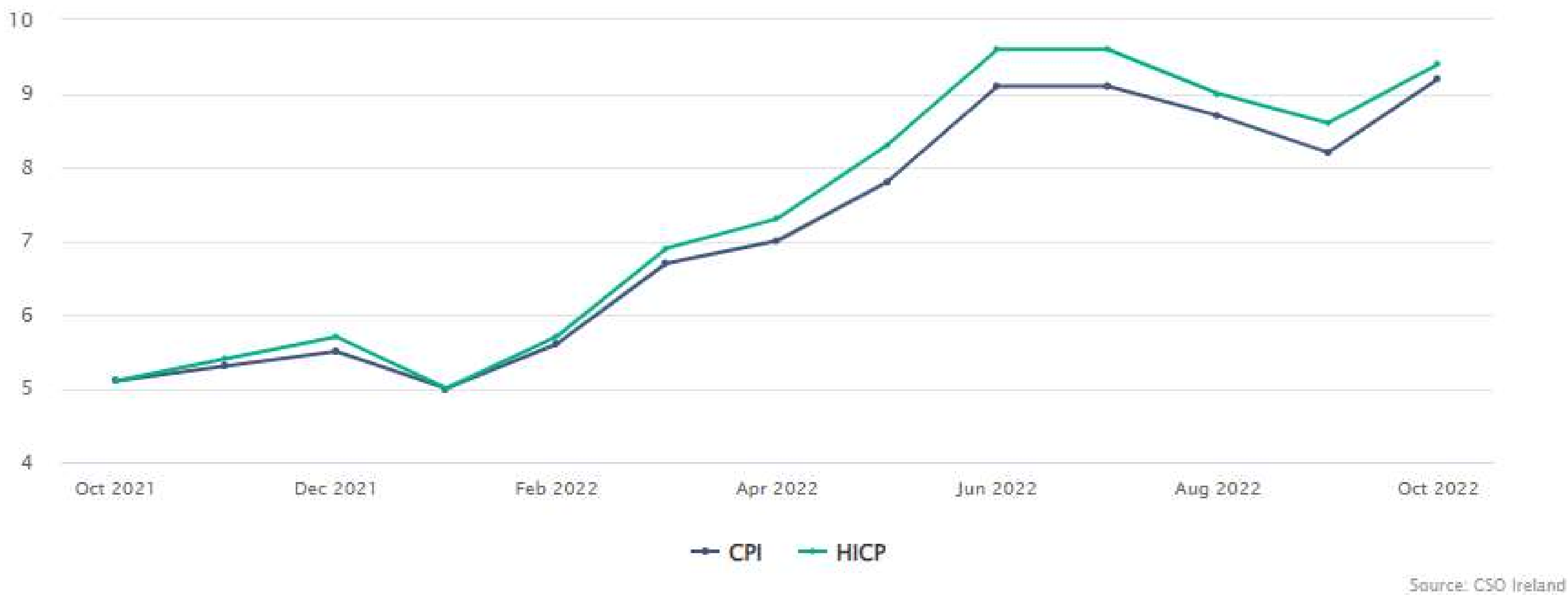
- The **Russia – Ukraine** conflict dominated year to date and has brought about huge uncertainty for the global economy and by extension, Investment Markets
- **Both Bonds & Equities** have both sold off significantly over the same period
- **Inflation** is running extremely hot globally. In recent months there have been some potential indications of a cooling off in inflation expectations
- **Central Banks** globally have started to **increase interest rates** dramatically
- **Stagflation** has now become a key risk over the **medium term**, whereby the growth in economies would be lower than inflation

Market Update: Asset Classes

Interest Rates	*Increasing Fast.* **Central Banks** globally are **increasing rates** to fight **inflationary** pressures.
Bonds	*Rising (or Risen?) Yields:* **Bond yields** had been at historically depressed levels, but **have increased**, impacting on the Price of Bonds.
Equity Markets	*Unprecedented Volatility:* Official **‘Bear Market**’ of **20% fall** from peak in most markets this year.
Deposit Rates	*Negligible:* ECB **Interest Rate increases** have not been passed on to **Irish depositors.**

Focus on Inflation (Ireland)

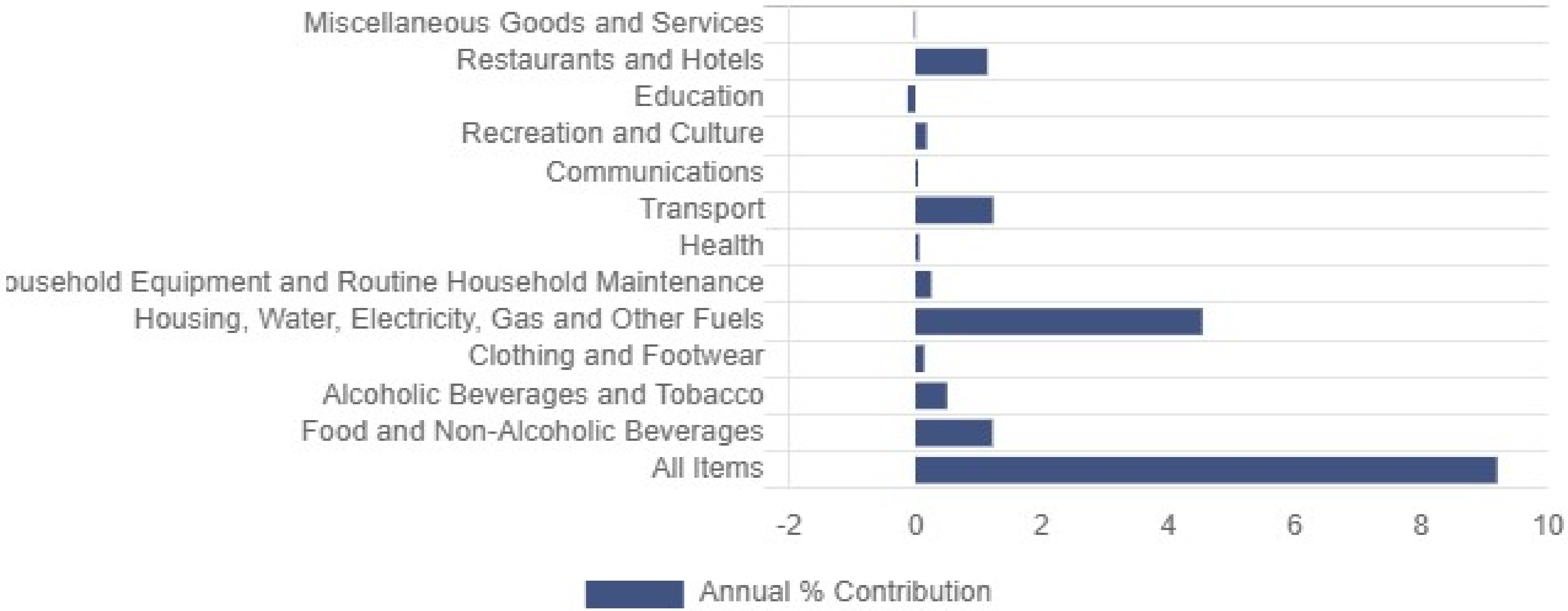
The Annual rate of **inflation** dropped to **8.2%** in September (the lowest rate since May) but jumped back up in October to **9.2%**



Overall, there has however been a general cooling in prices globally in recent weeks & months.

Focus on Inflation (Ireland)

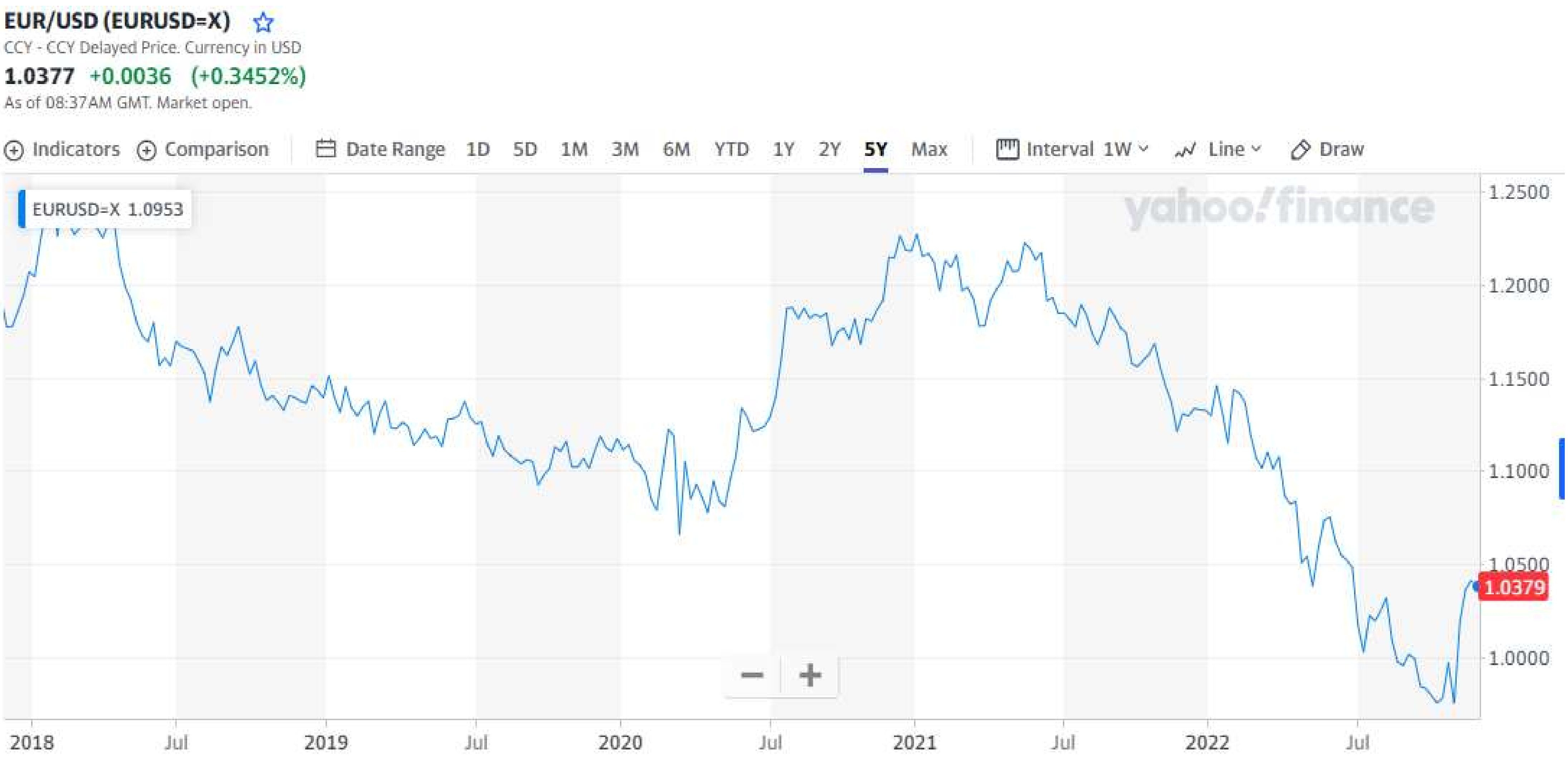
Contribution to **Inflation** in October: **Energy** has been the main culprit.



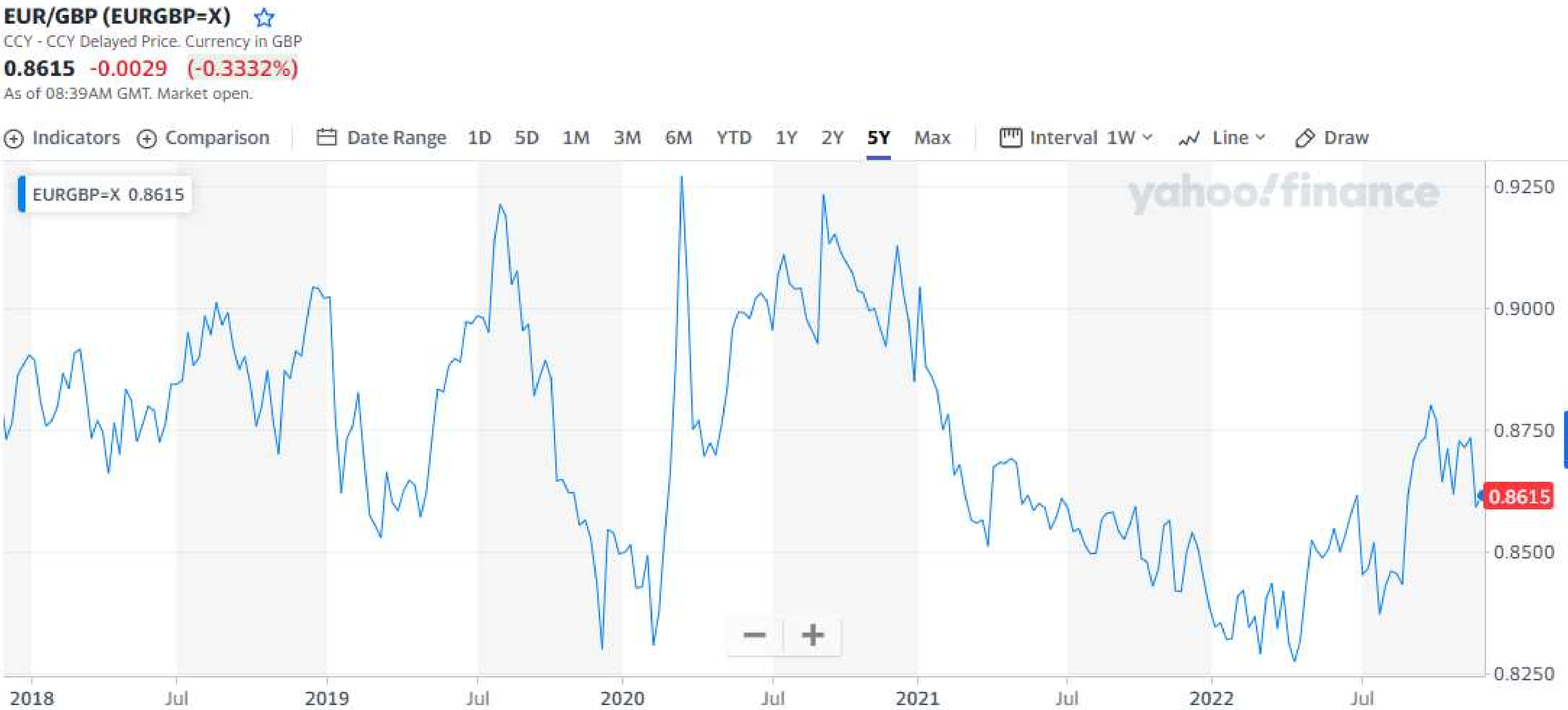
In **October** alone, ‘Housing, Water, Electricity, Gas & Other Fuels’ jumped by **8.7%**

Source: CSO Ireland

Currencies: Euro Dollar over 5 Years

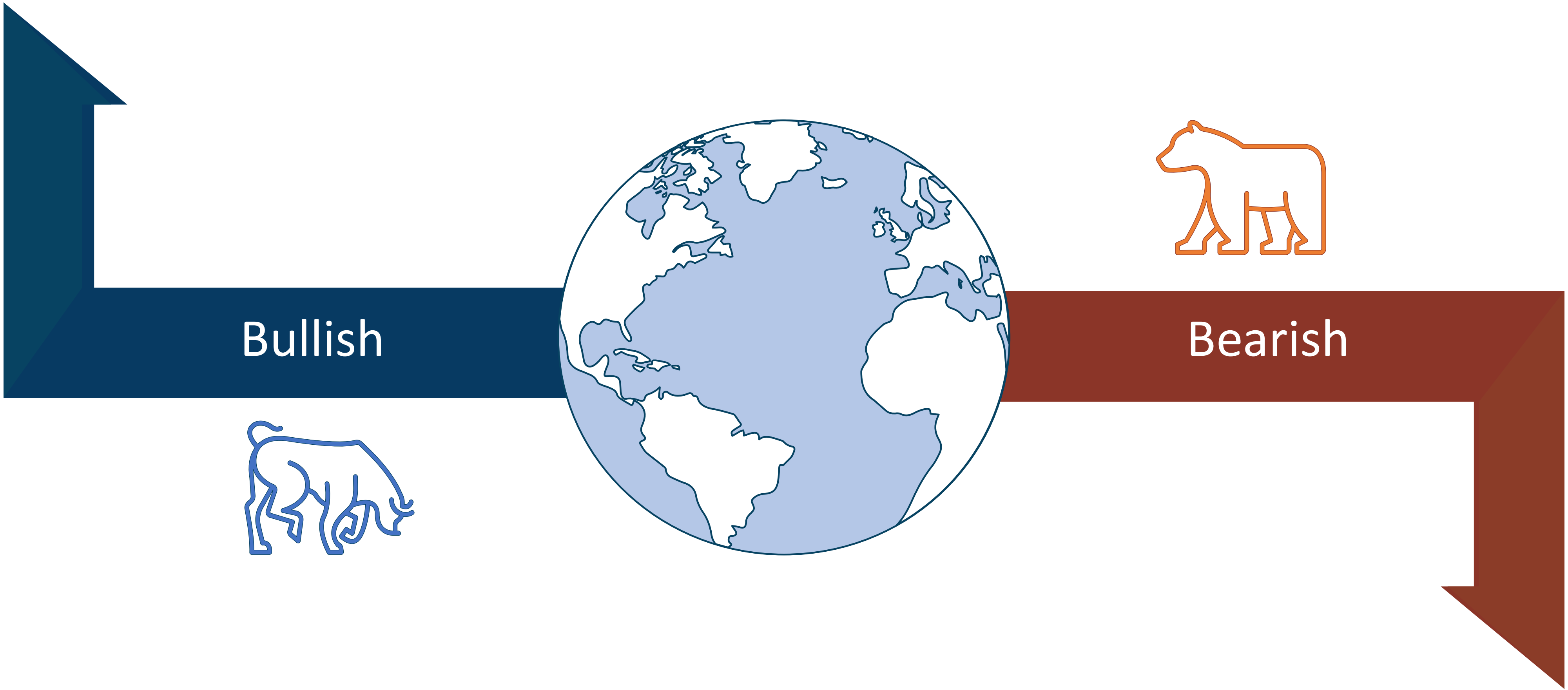


Currencies: Euro Sterling over 5 Years



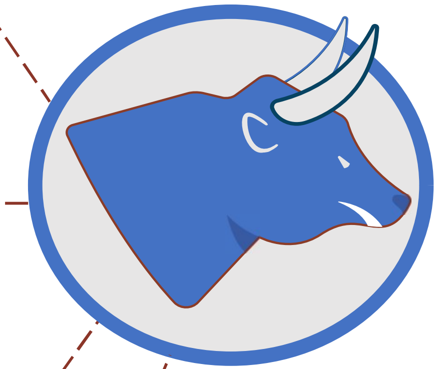
The Currency volatility spiked to **0.9780** on **10th October 2022** due to the UK Mini-Budget

Market Sentiment: Looking Forward?



Is 2023 looking more positive?

The Yes's



Government **Bonds** are better value

Employment data is strong

Property yields remain strong

Inflation is potentially cooling

The No's

Equities remain uncertain

Property: Rental Caps

Deposit Interest: Still negligible

Geopolitical risks globally

Financial Protection.

Financial Risks that Require Protection

Asset Allocation / Capital Risks:

1. Too **much** invested generally
2. Too **exposed** into one Asset Class / Sector / Company
3. Too **little** invested: **Inflation** Risk

Cashflow Risk:

4. Your '**Earned Income**' ceases due to illness
5. Your **Outgoings** exceed your **Net Income** i.e. you spend too **much**
6. **Liquidity Risk**: Too **much** capital locked up in **illiquid asset**(s)
7. **Longevity Risk**: Your retire too early

Financial Risks that Require Protection

Legacy Risk

8. Financial **Dependents** aren't sufficiently financially catered for in the case of early death.
9. A mess of an **Estate** is left behind for children

Other Risks….

10. Own bias Risk

11. External Risks: Economics, Market & Political

12. Risk of *having **no fun*** & not enjoying your accumulated assets & income

Mitigating Asset Allocation Risk (1-3)

- **Diversification**
- **Holistic** View
- **Discipline**: Never be tempted by glossy product brochures
- Invest in **liquid & regulated** Investments
- Why have **concentrated** stock positions unless it's your own business
- **Phase** into the market
- **Compartmentalise capital** for the long-term, enabling you to take risk with that element of your capital

Mitigating Cashflow Risk (4-6)

- Have **Income Protection** in place for **Earned** (Employment) **Income**
- **Regular Budgeting** (see **Cashflow** section)
- Be mindful of **unnecessary debt**
- **Live within** your means & cut your cloth to measure
- When considering **helping Children** financially, ensure you have **sufficient capital** for yourself in retirement
- **Build** your own **Private Pension** to fund retirement

Mitigating Legacy Risk (7 & 8)

- Have **Life Insurance** in place: The amount of cover depends on your financial circumstances
- Have a **Will** in place
- Consider an **Enduring Power of Attorney** when > 70
- **Discuss Assets** with children / beneficiaries
- Have **Executors** decided upon and discuss with them
- **Carry out** as much **planning** as possible

Mitigating Other Risks (10,11&12)

There as just as many people under-spending as there are over-spending

- Own Risk Bias: Never put your head in the sand; **take expert advice**, think long-term & make financial decisions with your head
- Understand what you **can or can't control** in the external economic / market & political environment
- **Enjoy** your Life and <u>your</u> savings. Don't hold back if you have the financial means

Do I need Financial Protection Policies?

- Firstly, **check what cover you already have**. A lot of people don't factor in Death-In-Service cover they may have (through work) & Mortgage Protection (against their Mortgage)

- Secondly - consider **how much (additional) cover you need to protect your downside?**

The more Financial Dependents you have, the more Cover is needed

The higher your future earning potential, the more cover is needed

The Older you are, generally the need for Protection cover reduces

Investing / Portfolio Management.

Asset Classes: Least Worst Option?

There are **6** main **Asset Classes** where Capital can be 'parked' or allocated:

1. **Cash / An Post:** Preservation of (Nominal) Capital
2. **Bonds:** Government or Corporate; Direct or Collective
3. **Equities / Shares**
4. **Property**: Residential or Commercial; Active or Passive
5. **Private Equity**: May only be suitable for certain types of investors
6. **Alternatives:** All assets outside of the above

Important Points:

- Currently, **none** of the **6 asset classes** jump out as being a '**no-brainer**' and this is the difficulty with the current investment environment.
- Unique to the **current** environment is that **all** have been **underperforming** consistently at the same time.

Investment Strategy: Key Principles for 2023

Diversification

Spread your Risk
Minimise your downside

Transparency

Understand your Investments

Holistic View

Consider **all of your assets**, regardless of the structure

Inertia

Do not fall into the **inertia trap**. Make **changes** where necessary

Clear Mandate

Ensure that you and any Advisors **are clear** as to your **Risk & Objectives**

Conflicts of Interest

Trust your advisor that they have your best interests at heart

Investment Strategy: Why Invest

Why Invest your Capital?

- To generate **growth** in Capital (or Income) **in excess of** the Risk-Free rate of return.
- To **avoid** the **real value** of your money being **eroded** due to **Inflation**
- To **fund** your **Retirement** Years
- As a **Succession Plan** for the **next generation**

When should you not Invest?

- If your **financial** circumstances or **personal** preferences mean that you have a low:
  - **Tolerance** for Risk
  - **Appetite** to Risk
  - **Capacity** for Risk
- If you do not have a **medium to long term** investment **time horizon**

Inflation in 2023

The most negatively impacted...:

- Those **over-allocated to Cash** in a high-inflation, low-deposit rate environment over the long-term
- Where **Outgoings are increasing** at a rate at or higher than inflation
- Owners of **residential property with 2% rent caps** (in rent pressure zones)
- Those who put **too much capital at risk** to ‘catch’ inflation, and are disproportionally negatively impacted in bear markets
- Those on **fixed incomes** (e.g. DB Pensions) that are not linked to Inflation

Not as bad for....

- **Nominal Debt** gets ‘eroded away’ in inflationary times
- Borrowers on **longer-term fixed rates** that are locked in at lower rates, in a rising inflationary environment
- **Employment Income** that goes up **in line with inflation** Income
- **Passive Income** that **keeps up with inflation**
- Those who can easily **cut back on outgoings**

Investment Strategy: Diversification

Investment Strategies can be split (diversified) in terms of:

- Asset Class
- Geography
- Investment Type
- Custodian / Provider
- Sector
- Liquid v Illiquid
- Growth v Income focused

Why Diversify your exposure?

Risk Reduction	More Smoothed out returns

Navigating the Current Market Environment

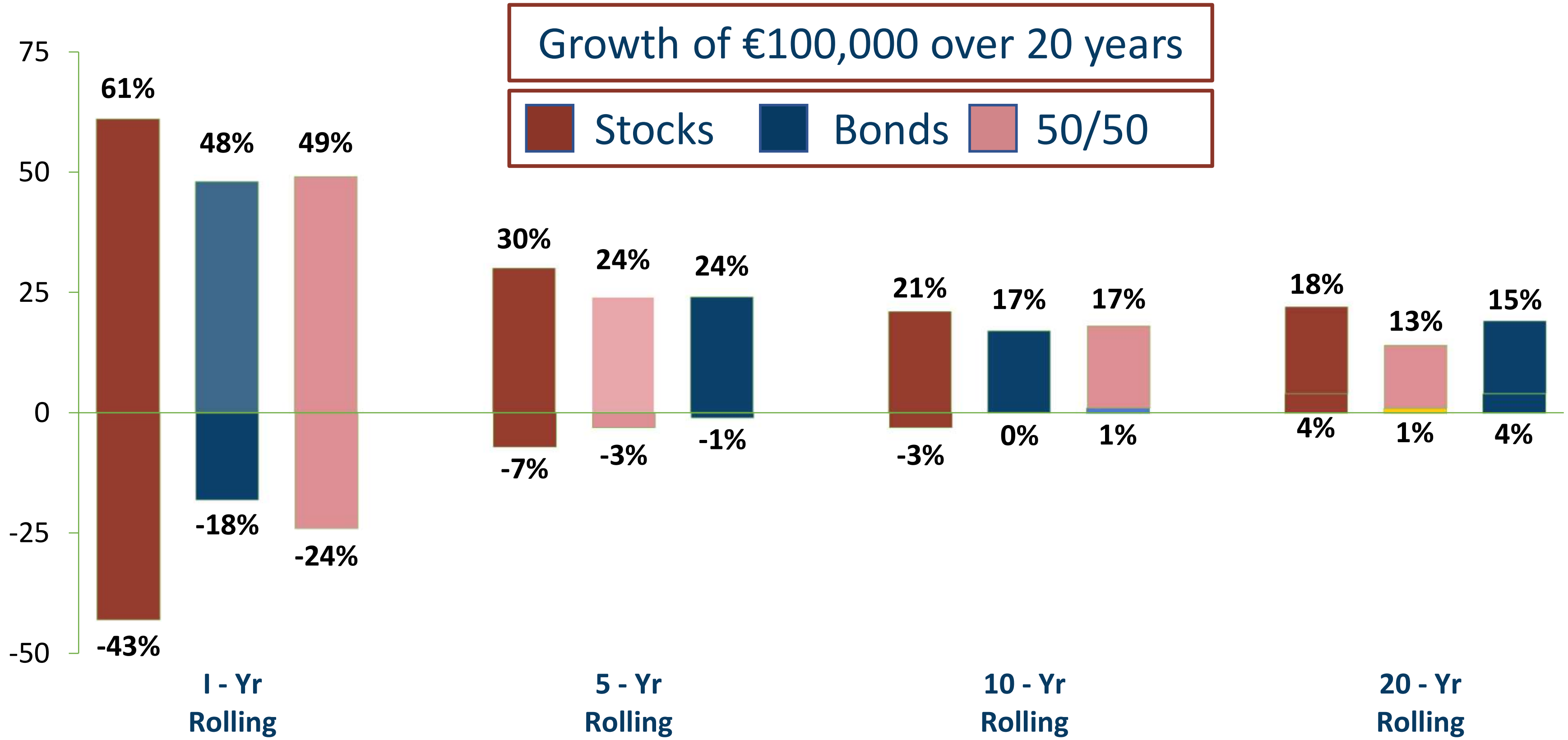
Headwinds to navigate through in 2023

- Interest Rates
- Equity Market Volatility
- Domestic Political Situation
- Russia – Ukraine
- Global Recession
- The next big (unforeseeable) global risk

Time, Diversification and the Volatility of Returns

Long term investors get rewarded

And diversification helps to reduce the risk



The longer we invest, the ranges get narrower and move upwards.

Equities display the most volatility, but the better returns.

Source: JP Morgan

Risk Management

Level of Risk depends on....

Age Profile

Younger Pension-owner = Further from Retirement **= More Capacity for Risk**

Personal Risk Profile

Personal Preferences : **Appetite to Risk** varies from person to person.

Non Pension Assets

The risk profile of the Pension-owners' other assets need to be considered i.e. **holistic view**

View on Markets/ Assets

Some people view certain asset classes are riskier or safer than others.

Think in terms of **Baskets**.

What does more Risk mean?

- **More** exposure to '**Risk Assets**' such as Equities, Property etc.
- **Less** exposure to '**Low Risk**' Assets e.g. Cash

Cashflow Planning.

Household Cashflow Planning

Knowing your current **Household Cashflow** Position (what comes in vs what goes out) is extremely **important** as we face into **2023**

Regardless of your **Financial Position**, you (& your Partner / Family) need to sit down to:

- **Calculate ALL** Current Income & Outgoings
- **Predict** your Cashflow position over the next 1 Year & 5 Years
- **Consider** any one-off changes to your Cashflow situation

Calculating Income & Outgoings

- Totting up your **Gross Income** is easy… Everyone knows (roughly) what they currently earn in terms of **Earned** (Employment) or **Passive Income**

- Calculating **Outgoings** is a lot more difficult

✓ IF Gross Income > [Tax + All Outgoings] **THEN** you have an annual **CASHFLOW SURPLUS**

✗ IF Gross Income < All Outgoings **THEN** you have an annual **CASHFLOW DEFICIT**

50 / 20 / 30 Budgeting

The **50/20/30 Rule*** says that you should spend….

- The first **50%** of your Income on **ESSENTIALS**
- The next **20%** of your Income on **Savings & Investing** (Pensions)
- The last **30%** on **Discretionary** Spending

*The **Key Point** is:*

*If you can **increase** your **Income** at a **higher rate** than your **Essential Outgoings**, you'll have **more Cash** to fund long-term **Savings** & have **fun** on **Discretionary Spending***

* According to Harvard Bankruptcy Expert (and recent Democratic Nominee for US President) Elizabeth Warren

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Categorise your Outgoings

You Need to look at **ALL** of your Expenses and categorise them as:

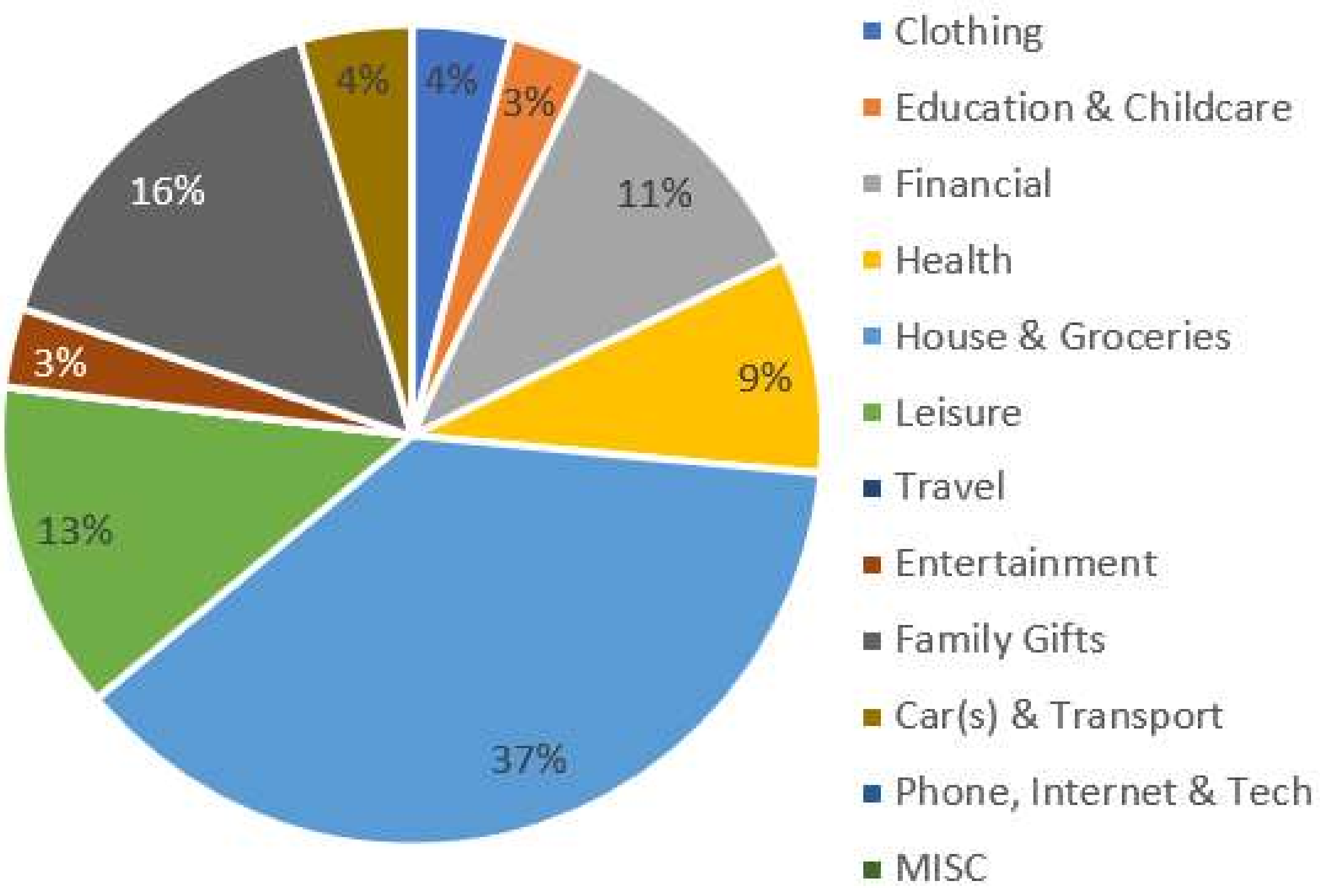
- **Essentials** e.g. Mortgage, Utility Bills, Transport to work etc.
- **Discretionary** e.g. Foreign Holidays, having that extra Car, Gym membership that's not being used
- **Non-Essential Discretionary** i.e. anything between Essential & Outgoings

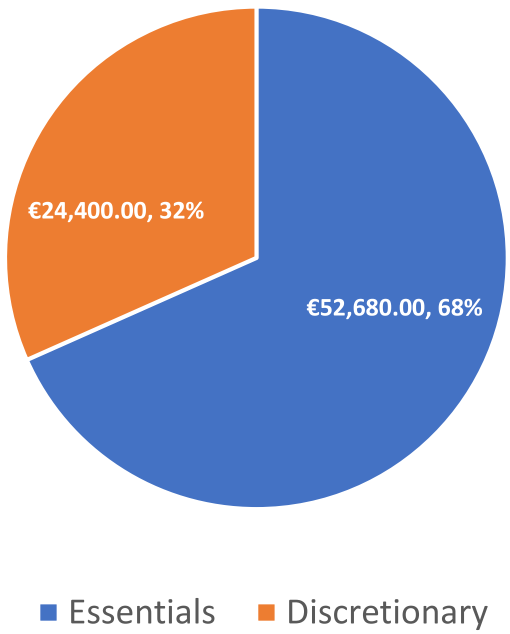
Note: What is Essential for one person, may not be Essential for another. Equally, what is Discretionary for some is Essential for others. ***So you need to understand what is Essential & Discretionary for YOU and YOUR FAMILY***

Outgoing Analysis in Retirement: SAMPLE

Outgoing	*Amount*	*Frequency p.a.*	*Total Annual*	**Category**	**Essentials v Discretionary**
Gas & Electricity	€200.00	12	€2,400.00	House & Groceries	Essentials
Bins / Refuse Collection	€40.00	12	€480.00	House & Groceries	Essentials
Clothes & Foorwear	€250.00	12	€3,000.00	Clothing	Essentials
Meals Out	€200.00	12	€2,400.00	Entertainment	Discretionary
Educational Fees	€400.00	6	€2,400.00	Education & Childcare	Essentials
Food / Groceries	€1,500.00	12	€18,000.00	House & Groceries	Essentials
Garden Maintenance	€100.00	2	€200.00	House & Groceries	Essentials
Hair & Beauty	€200.00	6	€1,200.00	Health	Essentials
Holidays	€10,000.00	1	€10,000.00	Leisure	Discretionary
Housekeeping	€150.00	52	€7,800.00	House & Groceries	Essentials
Health Insurance	€150.00	12	€1,800.00	Health	Essentials
Loan Repayments	€500.00	12	€6,000.00	Financial	Essentials
Gifts to kids	€6,000.00	2	€12,000.00	Family Gifts	Discretionary
Insurance	€200.00	12	€2,400.00	Financial	Essentials
Cars: Tax	€500.00	1	€500.00	Car(s) & Transport	Essentials
Cars: Wear & Tear	€200.00	12	€2,400.00	Car(s) & Transport	Essentials
Car Insurance	€500.00	1	€500.00	Car(s) & Transport	Essentials
Medical Bills	€300.00	12	€3,600.00	Health	Essentials
		Total	**€77,080.00**		

Outgoing Analysis: SAMPLE





Household Cashflow Planning

Sometimes in **Cashflow Planning**, certain expenses are categorised as Cashflow **Outgoings** but in fact they are adding to your Capital **Position**. The best **3 examples** of this are:

Paying down the **Principle** element of your mortgage (**Debt reduction** improves your Capital position)	**Personal Pension** Contributions and Additional Voluntary Contributions (**AVCs**)	**Monthly Savings** to a Cash or Investment account

There's nothing wrong with being '**Cashflow Neutral**' or even in **a Deficit if** your Capital position is **improving**

Cashflow Planning for Retirement

Factors that determine your future Retirement Fund value

Current € Value of All Assets	Your **Starting Point** to get to your Target Retirement Capital Value at **Retirement Age**
Years to Retirement	**Target** Retirement Age - Current Age = Years to Retirement
Cashflow Surplus	Net Income **versus** All Outgoings in your **Working** Years: **Prioritise** Pension Contributions
Assumed Annual Return on All Assets	Annual Average **Performance** on Invested Assets **Remember:** Cash currently at zero (or negative)

Income v Outgoings: Considerations

Understand the **time period** of Incomes & Outgoings:

Most incomes & outgoings will **only last** for a **finite** period

- '**Earned Income**' will **cease** on retirement
- **Pension Income** will **commence** on pension drawdown / a certain age
- **Mortgage repayments** will usually **end** in your 60s
- **Childcare costs** & 2^{nd} / 3^{rd} level education costs will **cease** at a certain period
- **Lots** more examples

Income v Outgoings: Considerations

Strip out capital investments & **debt** reduction from cashflow surplus / deficit calculation

Example:

- A **couple** with a high combined gross income every year struggle to maintain a cashflow **surplus**
- On **examination**, they are **each** maximising pension contributions (total c. €50k p.a.) and the **majority** of their mortgage repayments are **reducing down** the outstanding principle (€50k p.a.)
- **So,** while they may be **cashflow neutral**, their capital position is **improving** by €100k p.a., all else being equal

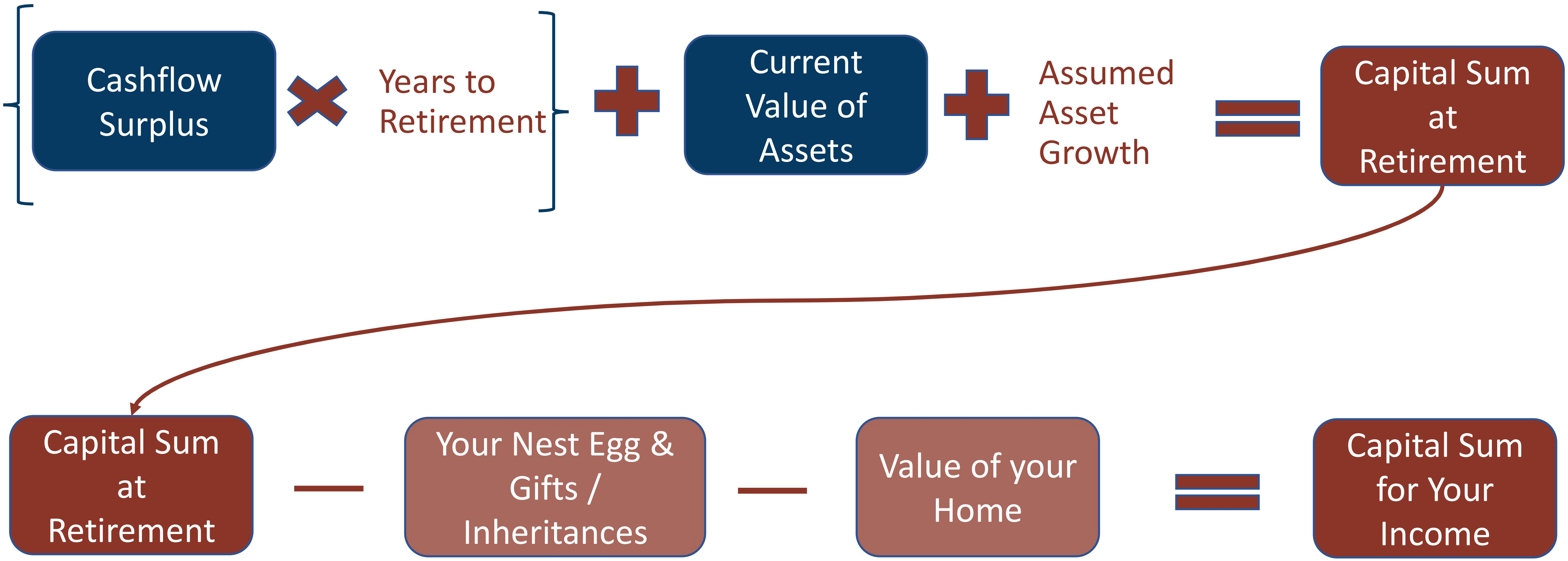
Income v Outgoings: Considerations

- "**Don't** sweat the small stuff"
- **Minimise** taxes / **Optimise** tax efficiencies e.g. Pension Contributions
- **Be aware** that most **living costs** are '**fixed**' in nature. So a **20%** net increase in Income could have a **50%** increase in **Net** Cashflow
- **Factor** in **Inflation** to your **future** Cashflows
- An Individual / Family may need to:
  - **Pull in** the reins on spending & live within their budget **OR**
  - May actually have sufficient capital / income to spend more!

Retirement Planning.

Building a Capital Sum (for Income)

Building a **Retirement Pot** before Retiring…



Financial Planning in Retirement…

Financing Retirement…

Regular after-tax Income — Regular Outgoings — One Off Costs = Cashflow Deficit

Regular after-tax Income

- State Pension
- ARF Income
- Investment Income

Regular Outgoings

- House, Car(s), Health
- Leisure & Holidays

One Off Costs

- **One off** Capital Costs
- **Gifts** to children / grandchildren
- **New** Car / House extension

HOWEVER, a **robust** plan must have

Capital Sum for Your Income Greater than [Cashflow Deficit × Years in Retirement] ✓

Financial Planning for Retirement

Q: **How much** of a *Capital Sum for* ***Income*** do a couple need to build up?

- This depends **firstly** on your **forecasted** Number of Years In Retirement i.e. the **younger** you retire, the **bigger** the Capital Pot you need
- **Rule of Thumb**: **Calculate** your **Gross** Annual Income Need & Multiply by 20x to '**Capitalise**' this in terms of the Capital Need.
- **So** if a **couple** in their **mid 60s** want to have €100k **Gross Income** in retirement, they **need** a €2m Capital Pot built up

How to **a) Avoid** running out of money in Retirement & **b) Enjoy** Retirement?

- **Maximise** Pension contributions while working
- Consider **delaying** Retirement
- **Ensure** your **spending** in Retirement is appropriate
- **Ensure** your Pensions & Investments are **risk-appropriate**

Financial Planning in Retirement…

We are now **living a lot longer** than **previous** generations, but our **target** retirement age may be the same as our Grandparents….!

Previously

WORKING								RETIRED		
25	30	35	40	45	50	55	60	65	70	75

Currently

WORKING								RETIRED					
25	30	35	40	45	50	55	60	65	70	75	80	85	90

We may have 20 – 25 years of **extra spending** in retirement & **no 'Earned Income'**

Costs of living can **increase** in retirement, mainly due to:

- Inflation & added Healthcare needs & having more time
- Helping out children financially

Lack of **State** Support:

- Full State Pension of c. €13,000 p.a. is far from sufficient
- Changing Demographics i.e. more 'retirees' in future years

Earned Income to Passive Income

*The **key** to **successful retirement** planning is **replacing** Earned Income with Passive Income*

When you retire from employment, your **Earned Income will reduce dramatically**

→

Passive Income must replace Earned Income to enjoy your Retirement

→

Building a **Capital Sum (Pensions & Other)** to create a Passive Income stream is key

The **Irish Government** incentivises workers to fund their **own** Private Pension by:

- €2m Standard Fund Threshold
- Tax Relief on Contributions
- Tax Free Growth
- Tax Efficient Drawdown

Financial Planning in Retirement…

3 PHASES of Retirement

1	2	3
Planning for (future) Retirement	**Transitioning** to Retirement	**Being** in your Retirement Years
*Between **1 & 10** Years pre-Retiring*	***12 months** before & after Retirement*	*Getting **used to** Retirement*

Key Principles

- Maximise Pension Contributions
- Be Flexible on Retirement Age
- Have a Cashflow v Capital Plan

Refer a Friend....?

A reminder to our loyal Client and Professional Advisor Base...

Compass Private Wealth are ***Open For business*** & are recruiting new clients between now & year end.

Virtual Coffee:

If you feel that any of your contacts would benefit from a conversation with Compass Private Wealth in relation to their Financial Planning affairs, then please do reach out and make the introduction.....

Q&A.

Markets: Questions

Why is there **so much** inflation ?

- Historically low interest rates since 2008 / 2009 after Global Financial Crisis
- Covid-19: Increased Money Supply to stimulate economies & subsequent hike in demand post lock-downs
- Russia – Ukraine Conflict

Are we heading for a **Recession** ?

- Very possible / probably: A Recession is 2 consecutive quarters of negative GDP which would seem likely in most economicies
- Growth of economies lagging inflation is technically ‘Stagflation’, but essentially this is the same effect of a Recession

Markets: Questions

How have Central Banks **reacted** to Inflation ?

- Central Banks have to 'cool' inflation by increasing interest rates
- Increased interest rates rewards savers and penalises borrowers.
- Central Banks want economies to run in a goldilocks scenario i.e. not too hot, not too cold

Is the stockmarket **directly correlated** with current news flow ?

- Yes and No
- Markets generally look 9 months in advance
- Sometimes 'good' economic news is bad for markets, and 'bad' economic news is good for markets

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