

Financially speaking

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Macro Perspectives: Recession, inflation and duration consideration



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From a macroeconomic perspective, 2022 centered around the actions of reserve banks around the world. While the fight against inflation continues into 2023, the discussions are more focused on recession and potential weakness in the US Dollar. I recently gathered with some of our economists across the firm to discuss these topics – here are some of my key takeaways:

- **US inflation is trending lower, but the fight isn't over yet.** This contrasts with Europe, where inflation remains higher and has not peaked. Asia has generally seen milder inflation. Japan, for the first time in over 20 years, is experiencing inflation and positive real interest rates. Our economists disagree on how quickly and how far inflation will fall. The market consensus suggests US inflation will run at roughly 3% for the full year. Internally, we have a healthy debate on how quickly inflation will fall and whether it will get to the US Federal Reserve's (Fed's) 2% target.

- **Interest rates are near peaking.** In the United States, we expect the Fed's policy rate to rise to at least consensus expectations of around 5%, with the possibility of reaching 5.25%. Our economists disagree on how long the Fed will hold rates at the higher level. The implications for fixed income and equity investors are that the Fed is unlikely to provide a "Fed put" if the market has a correction.
- **How deep might a US recession be?** One could describe 2023's economic outlook as "the most-anticipated recession ever," with surveys of economic forecasters and market behaviour in 2022 providing the evidence. Everyone seems to "know" the United States is going to have a recession, and everyone seems to "know" it will be mild. Whenever "everybody" thinks something, that type of herd mentality makes me nervous because often the herd is misguided. I gain some comfort from internal discussion and healthy debate among our economists, whose views on recession vary from the possibility of no recession at all, to a "normal" recession, which typically lasts about 10 months.



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- **Time to consider increasing fixed income allocation.** Fixed income is now providing income again. Rates are near a peak, and 2023 may be a year of positive returns for fixed income. We see a general shift toward larger fixed income allocations no matter how one is currently positioned.
- **There's a quality bias when leaning into fixed income.** We believe investment grade and sovereigns are particularly attractive in this environment, with continued economic uncertainty perhaps providing opportunities on a selective basis in areas like high yield.
- **Opportunity outside of the United States.** This year, analysts expect US growth to come in below that of Japan – which has not happened for over two decades – while emerging and developed Asia overall will likely see higher growth than the United States. Meanwhile, Europe's economy is doing better than many forecasts expected, due largely because of a mild winter.
- **Expect volatility.** While our economists agree that taking a long-term strategic view suggests taking on a bit more duration, there may be tactical opportunities within the fixed income markets.
- **Emerging markets may have tailwinds.** Both debt and equity markets in emerging markets are seeing favourable conditions. Relatively stronger growth rates combined with tempered inflation – and the potential US Dollar may have peaked – provides opportunities, particularly in Asia.
- **Asia generally, and specifically Japan and China, may provide new opportunities for active investors.** With a whiff of inflation in Japan, it is now facing different dynamics than during previous decades of deflation. Meanwhile, China is finally coming out of COVID-19 lockdown, which should help spur renewed consumption and improve global growth prospects.

These are my main observations as we lean into 2023. The table below explores some of these issues more deeply from the lens of the economists across Franklin Templeton.



Wild cards: Worries and optimism

Here are some key themes our economists are watching closely.

US debt ceiling/budget deficits

Government deficits around the world have grown since pre-COVID. We are mindful of economic and market risk if the United States does not resolve its debt-ceiling limit. This could cause severe market volatility, and in the worst case, could lead to a ratings downgrade.

“Sticky” inflation

If the global economy is stronger than expected, and inflation proves more long-lasting, this could cause a very different monetary policy approach (tighter for longer) than the market is currently pricing in.

Growth in Asia and China's reopening

With China beginning to reopen, growth dynamics could have some moderate inflationary impacts.

The recognition that Asia's growth rate is likely to outperform that of the United States' is not without country-specific risks, but also creates opportunities for investors in non-dollar assets.

Europe, energy and war

Amid a milder-than expected winter, Europe seems unlikely to face the type of severe downturn feared just a few months ago. The outlook can be considered fairly encouraging, but still represents geopolitical uncertainty, especially as the Russia-Ukraine war continues.

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A Will isn't always the only way

You would have heard the saying: "where there's a will, there's a way". This statement is usually used to encourage people who are losing enthusiasm for a task or goal.

But it also reflects the way many people feel about estate planning. They think that so long as you have a Will, you have a way to ensure your wealth is passed correctly to your loved ones. But this is not necessarily the case.



The truth about Wills

A Will can help ensure the assets that form part of your estate are distributed according to your wishes.

But did you know that a Will typically only applies to personally held assets and therefore may not deal with a significant portion of your wealth?

For example, the proceeds from your superannuation funds and life insurance policies don't necessarily form part of your Estate. They can pass directly to certain beneficiaries, who may have been nominated by you, or go to your Estate where they'll be dealt with by your Will.

Also, some assets never form part of an estate, like jointly owned assets or assets held in a discretionary family trust.

To cover all bases, thorough estate planning (or personal succession planning as it's also known) involves putting in place strategies that address all your assets, not just those covered by your Will.



Do I need a personal succession plan?

Just about every asset you own and every investment you make has estate planning implications. As a result, personal succession planning is something everyone needs to consider, regardless of age or stage in life.

At a minimum, every individual should have:

- a current Will to distribute estate assets
- an Enduring Power of Attorney to cover situations where they're unable to make financial decisions themselves
- appropriate superannuation and insurance beneficiary nominations, and
- appropriate arrangements in place to distribute or pass control of any assets that are not covered by the Will.



What are the benefits of personal succession planning?

Personal succession planning can:

- provide certainty by getting the right assets in the hands of the right people, at the right time
- enable you to provide for and protect your loved ones while reducing tax payable by your beneficiaries, and
- provide certainty that your children are taken care of.



What are the consequences of NOT having a personal succession plan?

Personal succession is something you should address now. Don't wait until it's too late. If you die without a valid Will, intestacy legislation will determine how your estate assets are distributed among your surviving family members.

If you die without a valid superannuation or life insurance death benefit nomination, the proceeds may not be distributed according to your wishes.

And, if you're badly injured in an accident or lose mental capacity, who will manage your affairs while you're still alive but unable to make your own decisions?

How we can help

With assistance from legal and tax professionals where appropriate, we can:

- Ensure you're making the right ownership decisions when acquiring new assets or re-structuring your existing assets. For example, we can help you determine whether it's best to invest in your name, your partner's name, or jointly with your partner. We may also identify whether further tax and legal advice is required to consider another ownership arrangement, such as a trust, is appropriate.
- Determine if you have sufficient means to achieve your estate planning objectives. Additional life insurance inside or outside of superannuation may be necessary to provide your family with a lump sum payment or an income stream to repay debts, meet their ongoing living expenses and cover your children's future education costs upon your death.

- Develop a range of strategies to provide certainty, tax efficiency and/or asset protection. For example, we can explain superannuation death benefit and life insurance beneficiary nomination options. By making appropriate nominations now, your beneficiaries will be able to effectively and efficiently receive the death benefit when you're no longer around.

We can help you address these and other estate planning issues as part of your broader financial planning.



The many benefits of a sporting life

Taking part in regular sports or physical activity has incredible health and wellbeing benefits – and it can even extend your life for seven years or more¹.

Playing sports is something that is generally linked to children and younger adults – with participation waning the older we get.

Taking part in sport and physical activity, however, has many benefits – so if you've been thinking about reigniting a sporting passion, or simply getting your body moving again, here are the positives that lie ahead.

The physical and mental benefits of playing sport

1. Improvement to cardiovascular health. Research has shown that exercise prevents both the onset and development of cardiovascular disease² – helping strengthen the heart³ and lungs⁴. Regular physical activity can also help lower blood pressure⁵ and reduce the risk of heart disease,⁶ too, by helping keep your weight under control, lowering cholesterol, blood sugar and blood pressure.

2. Muscles get stronger and more flexible, helping us to avoid injuries and keeping our joints moving freely as we get older.⁷ Exercise can also improve balance and coordination which can reduce the risk of falls and injuries in older adults.⁸

3. Can help to reduce the risk of chronic diseases such as obesity, type 2 diabetes, and certain types of cancer.⁹

4. It can help you get a better night's sleep which is vitally important from a health and wellbeing perspective.¹⁰

5. It could help you live longer, taking part in 150 minutes of physical activity a week can give you an extra seven years of life, while higher activity levels can increase your lifespan even more – regardless of your weight, age or gender.¹¹

6. Stress and anxiety decrease. A number of studies have proven the link between playing sport and a reduction in stress, anxiety and depression.¹² When we're physically active endorphins are released creating a feeling of wellbeing. Sport also provides an outlet for pent-up energy and emotions, and that break from the everyday is hugely valuable.

7. Mood and self-esteem increases¹³ through achieving goals, building confidence and positive feedback.

8. You'll meet new people, building those social connections can be incredibly valuable – it can create new friendships and reduce social isolation, which of course can positively impact physical and mental health, too!



The most popular physical activities for adults in Australia¹⁴

46.5% Recreational walking	5.7% Football/soccer
37.5% Fitness/gym	5.7% Golf
20.7% Athletics/running	4.7% Basketball
17.5% Swimming	4.3% Pilates
15% Cycling	3.2% Surfing
9.8% Bush walking	2.9% Australian Rules football
6.9% Yoga	2.8% Netball
5.8% Tennis	

Sources: ¹<https://asf.org.au/the-benefits-of-sport> ²www.ncbi.nlm.nih.gov/pmc/articles/PMC6557987/ ³www.heartfoundation.org.au/heart-health-education/benefits-of-physical-activity ⁴<https://lungfoundation.com.au/patients-carers/support-services/lung-disease-and-exercise/lungs-in-action/> ⁵<https://www.mayoclinic.org/diseases-conditions/high-blood-pressure/in-depth/high-blood-pressure/art-20046974> ⁶www.hopkinsmedicine.org/health/wellness-and-prevention/3-kinds-of-exercise-that-boost-heart-health#:~:text=Being%20physically%20active%20is%20a,to%20heart%20attack%20or%20stroke ⁷www.healthline.com/health/benefits-of-flexibility#benefits ⁸https://libres.uncg.edu/ir/uncg/i/J_Etnier_Physical_2010.pdf ⁹www.aihw.gov.au/reports/burden-of-disease/impact-of-physical-inactivity-chronic-conditions ¹⁰www.healthline.com/nutrition/10-reasons-why-good-sleep-is-important#4.-May-strengthen-your-heart ¹¹<https://asf.org.au/the-benefits-of-sport> ¹²www.ncbi.nlm.nih.gov/pmc/articles/PMC1470658/ ¹³www.ncbi.nlm.nih.gov/pmc/articles/PMC6572041/ ¹⁴AusPlay survey, 2020-21

Thinking ahead? Let's talk about strategies for creating a positive financial future.

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