Gift for Life

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We first published this article nearly 10 years ago and got very little feedback. How times have changed.

In the last 12 months a number of our clients are asking us the following questions.

- **How do we help our children buy their first home/get into the housing market?**
- **How much do we need to put aside to help fund our children's/grandchildren's private school fees?**

Here's an interesting thought. Suppose you and your partner have just had a baby, or perhaps your children are still young and financially dependant on you? **What will it take to ensure financial security for them in retirement? And is this really your problem?**

A good starting point is ensuring they get a good education. If all goes well, they will learn that by essentially providing for other people's needs, one is financially rewarded in the form of a salary, or entrepreneurial success. This will ensure sufficient cash flow to meet their short, medium and long term needs, including setting aside surplus funds for retirement. Maybe not…..

The pace of change in almost all aspects of life has accelerated markedly since the GFC.
One of the more concerning aspects relates to the ability of our children to sustain the competitive edge necessary to ensure continuous employment / entrepreneurial success. The impact of globalisation and robotics on full-time employment is already evident in the rise of the 'gig' economy. And this is before the imminent impact of Artificial Intelligence on work itself.

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It may be that providing for retirement may be considerably more difficult for our children's generation. They may have an enhanced need to try to create wealth and attain 'financial fitness' whilst working – in order to be in a position to successfully negotiate the inevitable transitions in their careers or businesses. Current earnings will be used to build financial buffers to navigate low income periods whilst they re-train or fund new business ventures.

With the remarkable change in demographics, and the increasing dependence of large numbers of retirees on relatively fewer workers' over time, the ability of the Treasury to sustain the current age pension and other welfare benefits will be severely stretched. **And then there's that high probability that they will live into their 100's.**

One way of ensuring your children's retirement, whilst assisting them to preserve income for transition periods, would be to leverage the most powerful force in the universe – **the power of compounding.**

Using the example of our newborn above, one can consider setting some cash aside when your child (or grandchild) is born.

The question is: How much would you need to invest today so that when ones offspring finally retires, he or she is totally financially independent up to age 100?

Taking a look at history – a fully invested portfolio ie 100% Equities going back 26 years has delivered a 8.7% annualised return net of all fees.

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As this annualised return is unlikely to re-occur in the future we have forecast at 7.03% pa (net of all fees) with inflation at 2.5% (thus a real return of 4.53% pa).Thus a small amount of capital today can become a much larger amount of capital in real terms in the future.

Let's assume that your child will still retire at 65 and that the monthly income requirement in today's terms is $12,500. In addition, in retirement the capital providing the income delivers a real return of 4.53%. What pops out of this calculation is a figure of $140,000 which needs to be invested at birth to ensure that one's baby can retire comfortably.

Thus with an initial investment of $140,000, it is possible to secure your child's retirement needs upfront. Alternatively, a monthly savings plan of $1,000 per month until your child is 21 years old (total cash flow of $252,000 over 21 years) would also suffice or perhaps more realistically $500 per month initially, and escalating at 10% pa until age 18 (total cash flow of $273,595) would do the trick.

Would it not have been great to have been set up for life with a certain retirement?

These 3 scenarios assume:

- That a market return is achieved after costs (not impossible if you choose a good manager and your financial advisor is charging a reasonable fee) – we have assumed total fees including fund manager fees at 1.5%;
- The individual starts on a 47% marginal tax rate (including medicare) and that CGT applies at the rate of 23.5% (50% discount applies).
- The individual utilises the superannuation environment and maximises non concessional contributions under current legislation over time.

See the graph below for the capital profile over the duration of your child's life.

Give it a thought!

$140,000 per child for young parents with a newborn and all that comes with this life stage – may be a tall order so the $500 per month escalating at 10% may be a more realistic option.

Perhaps it's time to put the idea to the grandparents!

The same logic can be applied to funding your child's (grandchild's) private school education or their first home.