



WHY LIFE EXPECTANCY NUMBERS ARE WIDELY MISUNDERSTOOD

BY DAVID ORFORD AND JIM HENNINGTON

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The Encyclopaedia Britannica website explains that life expectancy is “an estimate of the average number of additional years that a person of a given age can expect to live.” The key word here is average, and there are different ways of calculating it.

How is life expectancy calculated?

There are two main calculation methods used: *Period Life Expectancy* and *Cohort Life Expectancy*. While these may sound technical, it’s important for everyone working in financial planning, superannuation, the media, etc, to know the difference.

1. Period life expectancy

Period Life Expectancy is the simpler method, and it’s the one typically quoted in the media and in legislation—however, it is highly misleading. Part of the reason it’s so commonly used is it’s easier to look up, and the life expectancies don’t change until the next Life Tables are produced.

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INSIDE

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BEFORE YOU GET STARTED

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Period Life Expectancy figures are just one part of the latest Australian Life Tables published by the Australian Government Actuary (AGA) every five years. The most recent life tables are based on the three calendar years centred on the 2016 census (the ‘period’).

The AGA looks at the total number of deaths in those three years, by age, as a percentage of the number of people who were alive at each age. This data informs a set of ‘mortality rates’ for the Australian population, which are the basis for life expectancy calculations.

Mortality rates give us the probability that a male or a female of any age passes away in the year before their next birthday. The probability an average 30-year-old passes away within a year is under 0.1%. But for older people, the probabilities increase markedly. The probability an average 90-year-old man dies within a year is around 15%.

By looking at the mortality rate at each and every future age of a person’s life, we’re able to calculate the probability they will survive to each future age. For a 60-year-old, we calculate the probability they will survive to age 61, then to age 62, then to age 63, and so on, all the way up to the end of the Australian Life Tables (age 109). This lets us calculate the average age they’ll live to based on all these probabilities.

Using the latest Australian Life Tables, a 60-year-old male’s Period Life Expectancy is 84.0; for a 60-year-old female, it is 86.9.

It is called their Period Life Expectancy because the mortality rates are based on a specific period, in this case, the calendar years 2015 to 2017.

2. Cohort life expectancy

In reality, because of ongoing medical developments and trends toward healthier lifestyles (e.g., a reduction in smoking), mortality rates have been decreasing steadily over the past decades, particularly since the 1970s. This means that life expectancy calculations based only on mortality rates from a specific period are simply wrong for most practical purposes.

Actuaries don’t ‘expect’ that the number of years a person will live in practice is their Period Life Expectancy. We’ve got to allow for these improvement trends. This is where Cohort Life Expectancy comes in.

Cohort Life Expectancy allows for the fact that mortality rates change during the lifespan of a group of people, or cohort, as they get older. Improvements in medical treatments and healthier lifestyles result in a reduction in their mortality rates from one period to the next.

Each time the Australian Life Tables are updated, the AGA carefully analyses how the mortality rate at each age has been changing by looking at data for up to the last 125 years. More recently, each set of Australian Life Tables comes with accompanying estimates of how mortality rates

may change (improve) in the future. These assumptions are called improvement rate assumptions.

Cohort Life Expectancy calculations use this extra information. It means a significant improvement in accuracy. Instead of looking up mortality rates from, say, 2015, which effectively assumes each person spends their entire life in 2015, we acknowledge that people reach each birthday in a *different* future calendar year when mortality rates will have changed (reduced) relative to when the tables were produced.

Chart 1 shows an example of how mortality rates change. It shows the estimated mortality rate at age 75 years over time. For a 65-year-old in 2024, by the time they reach age 75 (in 2034), the mortality rate for 75-year-old males would be nearly 40% less than when the tables were based 18 years ago.

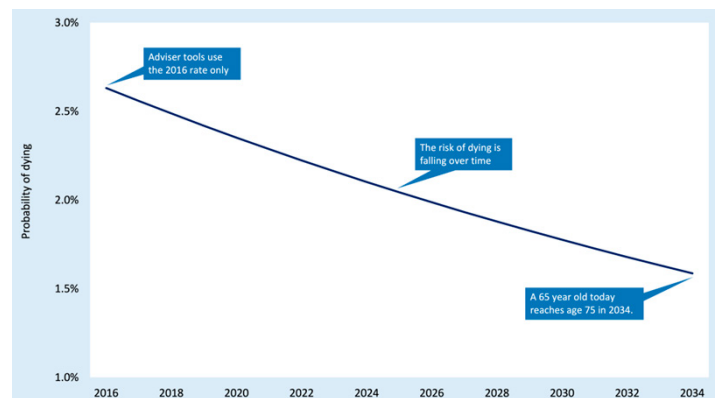


Chart 1: Reducing mortality rate for a 75-year-old male

In Chart 2 below, each column shows the Period Life Expectancy for a 65-year-old male using the mortality rates from historic life tables (noting that today’s 65-year-olds were born in 1959).

The blue bars show strong, steady upward improvement. The red line shows their Cohort Life Expectancies, which are higher because the people’s assumed mortality rates will continue to reduce in the future.

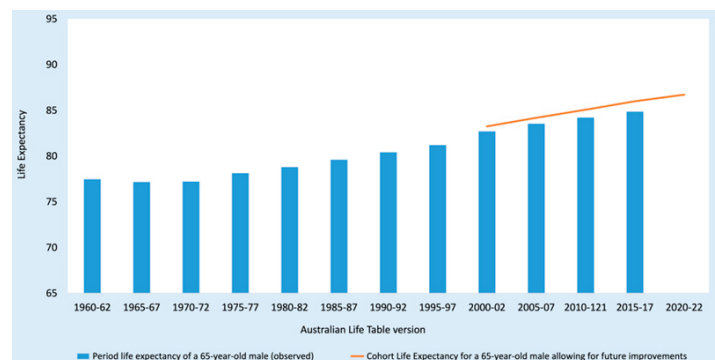


Chart 2: Period and Cohort Life expectancy of a 65-year-old male

Using the latest Australian Life Tables with the 25-year improvement rate assumptions, the Cohort Life Expectancy

of a 60-year-old male is 87.9—about four years more than his Period Life Expectancy. For a 60-year-old female, it's 89.8—about three years more than her Period Life Expectancy.

Estimates are only that, however. Actual rates of improvement can vary from the estimates. Variation can occur if positive future medical advances are different to the estimates or if negative changes occur, such as increases in obesity, drug deaths, pandemics, etc.

At the end of this article, we show that the impact of COVID-19 on population mortality rates was less than many people might expect. The Australian Bureau of Statistics reports that total deaths in 2020 and 2021 were fewer than they anticipated prior to COVID-19, and that this is because public health measures also caused a reduction in deaths from several other causes. Since then, the total number of deaths increased but fell again in 2023. We therefore await the next Australian Life Tables at the end of the year. What is more important for longevity isn't the mortality experience during a few years but over the long term.

Concluding comments or pearls of wisdom

Life expectancy is not a prediction of how long any individual will live—it's just an average for a group or cohort at each age. None of us are average. We are all different, with different lifestyles, different genes, different attitudes to risk, and so on. This means the average is only relevant to a very small percentage of people.

Cohort Life Expectancies are a more realistic representation of the average number of years an individual or a group of people will live. However, as you can see, they are more complex to calculate and not as easy to simply look up in a table—as they depend on the year that you are doing the calculations.

No one should rely on Period Life Expectancy figures in practice, despite being easier to look up. They are only based on mortality rates that applied during a certain historic period. We know there are strong trends for these mortality rates to reduce in future years, resulting in higher life expectancies.

Don't forget: Life expectancy calculations are based on the *range* of lifespans that can transpire for the individuals within a group. They are not a prediction. There is a large standard deviation around average life expectancy figures. For new retirees, the standard deviation is roughly eight years.

For financial planning, it's vital to recognise that some people will have short lifespans, and others will have very long lifespans. What happens to each individual is subject to randomness. A more appropriate rule of thumb might be to focus on the age when *most* people in a group will have passed away.

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Risk of recession is high



KEY POINTS

- The risk of recession is high.
- The falls in shares and commodity prices reflect this.
- Lower growth and recession would mean a high risk of the inflation rate undershooting the RBA's inflation target.
- The RBA should be considering cutting interest rates.
- Share market volatility is bad news but the best approach for most investors is to stick to a long-term strategy.

BY DR SHANE OLIVER

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Introduction

Share markets have seen big falls on the back of rising recession fears. For the last two years there has been constant fears of a recession - or a contraction in economic activity - on the back of central bank rate hikes. With it failing to materialise and inflation falling enabling central banks to pivot to rate cuts many thought it would be avoided, and shares surged to record highs into July. However, recession fears are now back with a vengeance, particularly in the US, so share markets have fallen sharply from their highs - with the key direction setting US share market down 8.5% and global shares off 8.9% and Australian shares having a 5.7% fall from its high last week. What's more, bond yields, commodity prices

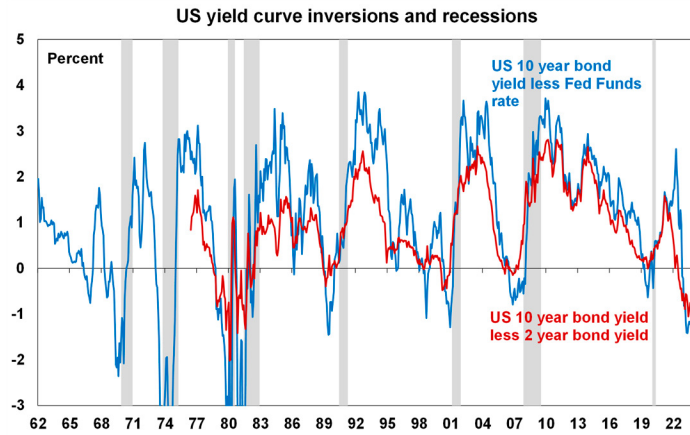
and the \$A are all down consistent with renewed growth concerns. This may have been accentuated by an unwinding of so-called Yen carry trades (where investors borrow cheaply in Yen and invest globally) after the Bank of Japan raised interest rates. Even Bitcoin has had a near 30% fall from its July high indicating again it's become a leveraged version of shares. So why the sudden recession worries? How serious is the risk? Does it mean central banks including the RBA have got it wrong? And what does it mean for investors?

More US recession indicators flashing red

The basic argument for recession over the last two years is that the most rapid monetary tightening in major countries in decades and cost-of-living pressures would depress spending driving a recession. Indeed, the Eurozone, UK and Japan have seen growth stall or arguably have had mild

recessions over the last 18 months and Australia is already in a “per capita recession” (with falling GDP per person) even though GDP has still been rising. But the US economy has been robust, and this has kept the key direction setting US share market strong until recently. However, while the US economy has been stronger than expected, the risk of recession never fully went away, with key indicators highlighting ongoing recession risk. In particular:

- The US yield curve which is a guide to whether monetary policy is tight or loose has been flashing red, with short term interest rates above long-term rates, since 2022. And while this has given false signals it has preceded all US recessions over the last 60 years. It’s still inverted and so its recession signal remains.
- The US leading economic index - which combines things like building permits & confidence - has had a fall consistent with past recessions.



Shading shows recessions defined by the US National Bureau of Economic Research.

Source: Bloomberg, AMP

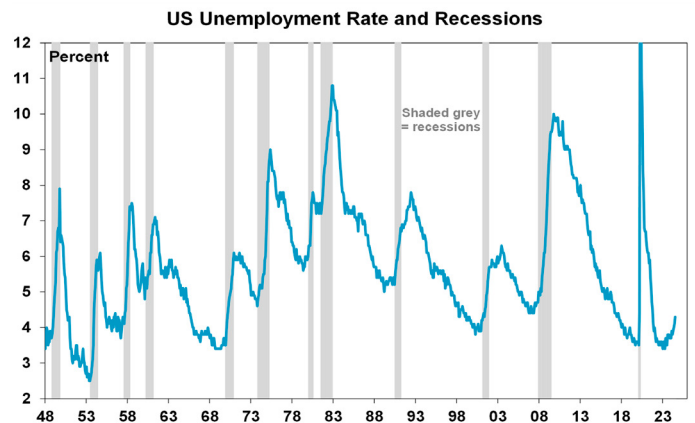
There is nothing new here. And with global growth running around average levels, business conditions indicators remaining solid and US growth still strong many concluded the recession indicators just got it wrong. However, the resilience in economic growth could have just been due to (what Milton Friedman long ago called) the “long and variable lags” with which monetary policy impacts economic activity. And the impact of rate hikes was stretched out this time by the reopening boost from the pandemic, household saving buffers built up in the pandemic and strong labour markets partly reflecting a shortage of workers.

These supports are now fading. Weakening US jobs data suggest that it may indeed have been long lags at work. US job openings and people quitting for new jobs have been falling for some time now. Initially this may have been benign as slowing labour demand just pushed down job openings (and wages growth) but with unemployment remaining low.



Source: Bloomberg, AMP

However, now falling labour demand is showing up in higher unemployment. Historically, small increases in US unemployment tend to be benign but once it goes beyond 0.5 percentage points it tends to keep rising and become associated with a recession as higher unemployment leads to lower spending in the economy. Based on this a US economist named Claudia Sahm observed that whenever the 3-month moving average of the unemployment rate rises by 0.5% above its prior 12 month low a recession has been underway. This has become known as the Sahm Rule and it was triggered by July jobs data in the US on Friday with unemployment spiking to 4.3%, up from a low of 3.4%. It can be seen at work in the next chart. It has a perfect track record, but relationships that work in the past don’t always work in the future and it may have been distorted by a lumpy 420,000 rise in the labour supply in July. That said it’s hard to ignore and suggests along with the still inverted US yield curve and the slump in the US leading indicator that recession risk is now very high in the US. Which is why share markets have plunged and the US money market is now back to allowing nearly 5 rate cuts this year. Recall it was expecting nearly 7 cuts early this year, so it’s almost gone full circle!



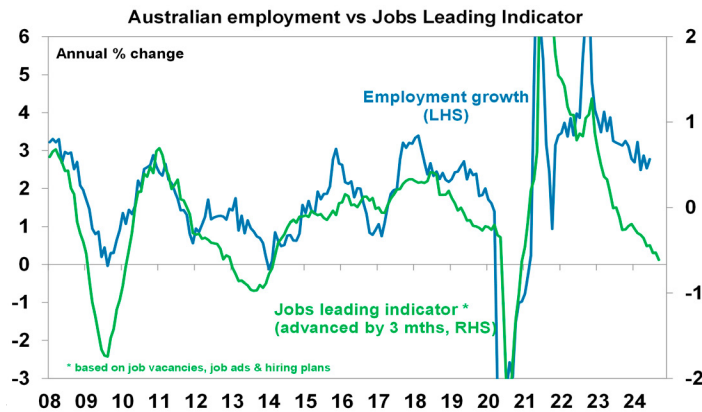
Shading shows recessions as defined by the US NBER.

Source: Bloomberg, AMP

What about Australia?

Leading indicators of Australian economic growth have not been as weak as those in the US. However, there are several reasons for concern that Australia may follow the US. We put the risk of recession here at 50%:

- Interest rates have gone up by more in Australia than in the US as measured by the mortgage rates people actually pay.
- Household debt servicing costs are now at a record share of household income in Australia (which is not the case in the US), and Australia has far more overvalued housing than in the US.
- Australian real household spending has slowed to a crawl.
- The boost to Australian economic growth from record population growth looks set to slow over the year ahead by at least one percentage point. This will more than offset the boost from tax cuts.
- Like in the US job vacancies have been falling here for two years and this will likely soon feed through to a sharp slowdown in jobs growth and rise in unemployment which is already up to 4.1% from 3.5%.
- US recession will drag down global growth which will mean less demand for our exports and indirectly impact via confidence.



Have central banks, including the RBA, got it wrong?

The global monetary policy easing cycle is now underway. However, while lower interest rates are good for shares, this is less so initially in a recession and share markets are signalling increasing concern central banks may have left it too late. Central banks, including the RBA, may not have allowed enough for the “long and variable lags” with which rate hikes impact growth and inflation and so overtightened or left rates too high. This has likely been made worse by the pause in progress getting inflation down over the last six months in the US and then in Australia. Because central banks never know when they have raised rates enough to control inflation they often go too far - resulting in recession. This was the case prior to recessions in Australia in the early 1980s and 1990s.

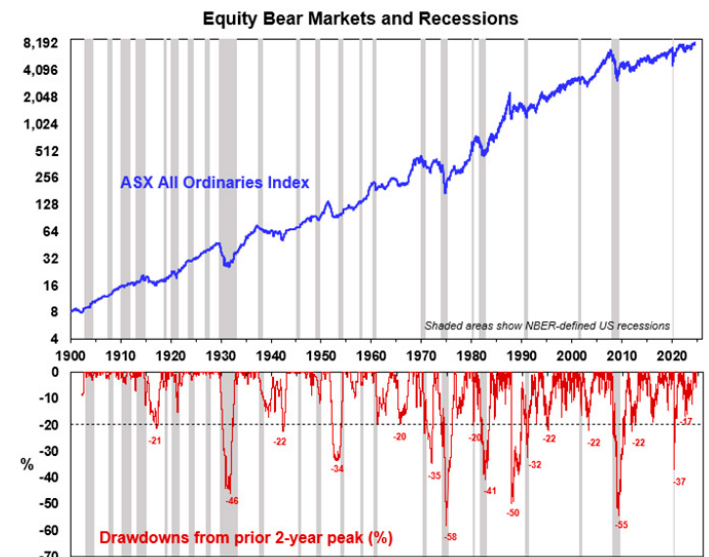
While the RBA still faces inflation that’s too high, given the US experience it should now be giving consideration to a cut in interest rates as it now risks much higher unemployment and inflation falling below target.

What will recession mean for Australians?

A recession normally sees higher unemployment - the early 1980s and 1990s recessions saw a 5 percentage point rise, less job security, lower wages bargaining power, a fall in living standards and low confidence. Recessions eventually also mean lower growth in the cost of living and often lead to lower levels of immigration and less household formation which could take pressure off rents and home prices.

What would be the impact on shares?

Recessions in Australia and the US have tended to be associated with bear markets in shares, ie, 20% or more falls, as they drive a slump in profits. The next chart shows the Australian share market and falls in it against US recessions. Shares are vulnerable now as valuations are stretched, investor sentiment has been high, geopolitical risk is high with the US election and escalating problems in the Middle East and August and September are often rough months. So, it’s likely too early to buy the dip!



Shading shows recessions as defined by the US NBER.

Source: ASX, Bloomberg, AMP

Implications for investors

While times like these can be stressful, for superannuation members and most investors the best approach is to stick to an appropriate long term investment strategy to take advantage of the rising long-term trend in share markets given the difficulty in trying to time short-term swings.

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Why 'timing the market' is a fool's errand

BY ANNABELLE DICKSON

Republished from betashares.com.au

It's an age-old question, is it possible for a person to time the share market? All the data seems to be pointing very firmly to no. It's simply too hard to do.

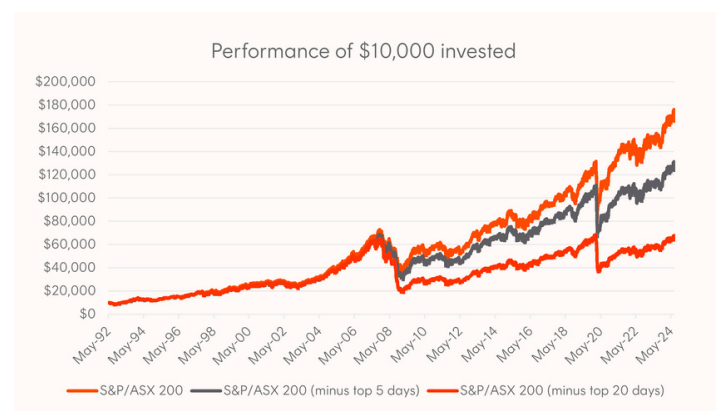
Many investors try to pick the bottom of the share market to take advantage of any following rebound. This approach is referred to as 'market timing' and involves making investment decisions based on short-term market movements.

In contrast, a buy-and-hold approach involves buying shares and holding them over the long-term, irrespective of market movements. An overwhelming body of research finds that this passive buy-and-hold, long-term approach to owning shares produces better long-term results.

We crunched the numbers using the S&P/ASX 200 benchmark index, and our analysis showed just how big a difference it can make when investors miss out on a handful of the biggest rallies.

This might seem like 'cherry-picking', but in reality, if you tried market timing, there's a good chance you'd miss

out on some of the biggest rallies. Humans have a tendency to avoid loss, (called loss-aversion bias) which can cause investors to throw their strategy out the window and sell when markets turn bad. However, this can be precisely the worst time to sell, as the biggest rallies can happen in the middle of major market falls (see table below). And the more of those big rallies that you miss out on, the lower your gains over the long term.



	S&P/ASX 200	S&P/ASX 200 (minus top 5 days)	S&P/ASX 200 (minus top 20 days)
1 Year (%)	12.21%	12.21%	12.21%
3 Years (% p.a.)	5.96%	1.66%	-4.28%
5 Years (% p.a.)	8.51%	5.84%	2.09%
10 Years (% p.a.)	8.79%	7.44%	5.52%
20 Years (% p.a.)	9.31%	8.04%	4.52%
30 Years (% p.a.)	9.80%	8.73%	6.36%

Source: Bloomberg, Betashares. As at 31 July 2024. Past performance is not indicator of future performance. Top five and top 20 days since over the last 30 years have been removed from the respective data sets. None of these days occurred in the past year so one year returns are unaffected.

The 20 biggest 1-day rallies have occurred during or soon after a major crash

ASX			NASDAQ		
Date	1-day rally	Crash	Date	1-day rally	Crash
30/3/2020	7.0%	Covid crash	3/1/2001	18.8%	Dot com bubble
29/10/1997	6.1%	Asian financial crisis	13/10/2008	12.6%	Global financial crisis
17/3/2020	5.8%	Covid crash	5/12/2000	11.7%	Dot com bubble
25/11/2008	5.8%	Global financial crisis	28/10/2008	10.9%	Global financial crisis
13/10/2008	5.6%	Global financial crisis	5/4/2001	10.8%	Dot com bubble
25/3/2020	5.5%	Covid crash	8/5/2002	10.6%	Dot com bubble
3/11/2008	5.1%	Global financial crisis	21/10/1987	10.3%	Black Monday ('87 crash)
25/1/2008	5.0%	Global financial crisis	17/4/2000	10.1%	Dot com bubble
20/8/2007	5.0%	Global financial crisis	30/5/2000	10.1%	Dot com bubble
22/9/2008	4.6%	Global financial crisis	13/3/2020	10.1%	Covid crash
13/3/2020	4.4%	Covid crash	29/10/1987	9.7%	Black Monday ('87 crash)
23/1/2008	4.3%	Global financial crisis	18/4/2001	9.5%	Dot com bubble
6/4/2020	4.3%	Covid crash	22/12/2000	9.5%	Dot com bubble
20/10/2008	4.3%	Global financial crisis	13/10/2000	9.1%	Dot com bubble
28/11/2008	4.3%	Global financial crisis	19/10/2000	8.4%	Dot com bubble
19/9/2008	4.3%	Global financial crisis	25/4/2000	8.0%	Dot com bubble
1/10/2008	4.2%	Global financial crisis	10/4/2001	7.9%	Dot com bubble
24/3/2020	4.2%	Covid crash	30/3/2020	7.8%	Covid crash
8/12/2008	4.1%	Global financial crisis	3/10/2001	7.8%	Dot com bubble/Sept 11 attacks
30/10/2008	4.0%	Global financial crisis	10/11/2022	7.5%	2022 Tech crash

start date 1/6/1992

start date 4/2/1985

Source: Bloomberg, Betashares. As at 31 January 2024. Past performance is not indicator of future performance.

In contrast, by staying invested in the benchmark share market index, you would automatically capture all market movements, which over time may prove to be advantageous.

By way of example, consider a hypothetical investor who sells a \$10,000 investment that provides exposure to a broad share market index during the March 2020 market downturn caused by Covid. From 20 March 2020 to 5 August 2024, the ASX 200 returned 58.8%, which would have resulted in a \$5,880 return on the initial investment of \$10,000. Over the same period, the S&P 500 returned 125.01% and the Nasdaq 100 returned 155.85%, which would have resulted in \$12,501 and \$15,585 in returns respectively. These return figures assume reinvestment of any dividends from the relevant holdings.

The hypothetical investor who sold their investment and stayed out of the market from that point until now would have forgone thousands of dollars in potential gains from the recovery that has followed.

	Total cumulative return (20 March 2020 to 5 August 2024)	Value of \$10,000 initial investment	Potential gains forgone by selling investment at start of period
ASX 200	58.80%	\$15,880.00	\$5,880.00
S&P 500	125.01%	\$22,501.00	\$12,501.00
Nasdaq 100	155.85%	\$25,585.00	\$15,585.00

Source: Bloomberg, 20 March 2020 to 5 August 2024. For illustrative purposes only. You cannot invest directly in an index. Past performance is not an indicator of future performance. Not a recommendation to invest or adopt any investment strategy. These return figures assume reinvestment of any dividends and does not take into account franking credits.

Independent research points to the same result

It is not just our research that is coming to this conclusion. A recent paper from JP Morgan, *Is market timing worth it during periods of intense volatility?* revealed that timing the market is almost impossible to achieve given that good and bad trading days fall so closely together.¹

As at the end of 2021, seven of the best days in the US had occurred within two weeks of their corresponding worst day; but often the gap between the best and worst days was much shorter.

For example, March 12, 2020 was the second-worst day of the year in US share markets, yet that was immediately followed by the second-best day of the year.

JP Morgan's study found that the worst days overwhelmingly occurred before the best days: over the last 20 years, six of the seven best days occurred after the worst day.

The close proximity of the best and worst days makes it virtually impossible to buy shares at the bottom before they climb again as most people are not that quick or lucky.

In other words, it is very unlikely that an investor could be lucky enough to consistently miss the worst days while being invested in the market for the best days.

JP Morgan's final thought is this: "It is important to remind investors that success is achieved through time in the market, not timing the market. And, to quote Dolly Parton, 'If you want the rainbow, you gotta put up with the rain'."

We'd have to agree with that.

The pain of missing out

Separate research from the Schwab Center for Financial Research, *Does Market Timing Work?* found that even badly timed stock market investments were much better than having no share market investments at all.

That's because investors who procrastinate and do nothing are likely to miss out on the stock market's potential growth.

"Procrastination can be worse than bad timing. Long term, it's almost always better to invest in stocks—even at the worst time each year—than not to invest at all," according to their research.

“Given the difficulty of timing the market, the most realistic strategy for the majority of investors would be to invest in stocks immediately.”

If you don't have a large single sum to invest or like the discipline of investing small amounts regularly, then dollar-cost averaging can assist in mitigating market timing risk and can help you gradually accumulate wealth.

Similar to a regular savings plan, dollar cost averaging involves investing the same amount of money at set intervals over a long period - whether market prices are up or down.

The key takeaway

It is almost impossible to time the market consistently whether it is over a short term time frame or over the long term.

Instead, investors should consider having a well-diversified portfolio and holding it over the long-term.

ETFs are well-suited to this investment approach by providing a convenient, cost-effective way to get exposure to all the major asset classes. ETFs track benchmark indices for various markets, including Australian and global equities, fixed income, cash and commodities.

You can use ETFs to build the core of your portfolio - investments that will provide your portfolio with a foundation

for the long term, through the market's up and down cycles. For example, **A200** Australia 200 ETF provides exposure to the largest 200 companies on the ASX at an annual management cost of just 0.04%.

So you can sit back and enjoy your investment growing over time, without trying to time the market.

There are risks associated with an investment in A200, including market risk, security specific risk, industry sector risk and index tracking risk.

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Q&A: Ask a Question

Question 1

I have an SMSF but want to take out personal insurance. Can I do this via my SMSF?

Yes, you can have personal insurance within your Self-Managed Super Fund (SMSF). Your SMSF can hold various types of insurance policies, such as life insurance, total and permanent disability (TPD) insurance, and income protection insurance. These policies must align with the fund's investment strategy and be for the benefit of its members.

Premium payments for these insurance policies can be made from the SMSF's funds, and these payments are generally tax-deductible to the SMSF. It's important that the insurance policies comply with the Superannuation Industry (Supervision) Act 1993 (SIS Act) and other regulations. Proper documentation and adherence to compliance requirements are crucial.

To ensure that the insurance within your SMSF is set up correctly and serves your best interests, seeking advice from your financial planner is recommended. They can help navigate the complexities of regulatory compliance and help you make informed decisions.

Question 2

My friend told me that he pays less tax because he makes additional concessional contributions into his super. How does making a concessional contribution reduce the tax I have to pay?

The tax savings occur because concessional contributions to your superannuation are tax deductible against

your taxable income, albeit you pay a contribution tax of 15% within the fund. Concessional contributions can be made through various methods such as salary sacrifice and deductible personal contributions, you effectively reduce your taxable income. For example, if your annual salary is \$100,000 and you contribute \$10,000 as concessional contributions, your taxable income is reduced to \$90,000. This reduction can lower your overall income tax liability, as you're taxed on the lower amount.

Question 3

Who gets my superannuation once I pass away?

When you pass away, your superannuation fund is distributed based on your nominations and the fund's policies. If you have made a binding death benefit nomination, your super will be paid out to the person or people you've nominated. These nominations can usually be updated, so it's important to review them periodically to ensure they reflect your current wishes.

If you haven't made a binding nomination, the super fund will determine the beneficiaries based on who they consider to be dependents, such as your spouse, children, or anyone financially dependent on you. If no valid nominations are in place and no dependents are identified, the superannuation may be directed to your estate. From there, it will be distributed according to your will or, if you don't have one, under intestacy laws.

It is important that you speak to your financial adviser so that they can guide you in ensuring that your super gets passed on according to your wishes.

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