Connect
Your quarterly newsletter Issue 5

Consultum
Financial Advisers

Turning your savings into an investment

Mastering the discipline of regular saving can be tough, but once you have come to grips with this habit, how can you make the most of what you've got?

Many people who manage to save regularly simply stash their money into a savings account, and while saving via your bank account may give you a return of a few percent per annum, you may be missing out on an opportunity to make your savings work harder for you. Depending on your goals, investment time frames and the point you are at on your investment journey, you may be able to take advantage of a strategy which utilises your savings as investment capital towards a margin loan.

> 'Margin lending can create a great opportunity to increase your investment purchasing power and growth.'

Borrowing to invest

Borrowing money to invest is called margin lending which is a popular wealth creation strategy. A margin loan is a loan taken out to invest in a range of assets such as managed funds or shares. Investing a combination of savings and borrowed funds means that your initial investment is greater than if you had invested your savings alone, which increases potential returns.

How does margin lending work?

A margin loan is a line of credit that is used to borrow money for investment purposes. Margin lending allows you to buy a significant share or managed fund portfolio with as little as a 20 per cent deposit. This approach is also known as 'gearing'.

What are the key benefits?

Many investors would like to increase their exposure to the share market, but lack the funds to do so. For such investors, margin lending can create a great opportunity to increase your investment purchasing power and potential investment growth or income.

Another benefit of taking out a margin loan is that your debt is considered 'deductible'. This provides a variety of potential benefits, such as:

- when it is tax-return time you can claim your interest payments against your assessable income and if you earn less on the share investments than the interest payments you can claim the interest against other assessable income;
- you can prepay the interest up to 13 months ahead, prior to June 30, which helps your cash-flow planning and also allows you to claim the deduction a full year in advance; and
- you can defer any capital gains tax liability until the shares are sold.

Your financial planner will be able to highlight how these benefits may apply to your situation.

What are the risks?

Like all other investment strategies, there are some risks associated with a margin lending strategy.

Specifically, while borrowing to invest can accelerate your investment returns, it also increases your exposure to investments which have the potential to decrease in value. If the value of the investment portfolio drops too close to the value of the loan, the lender may make a 'margin call'. This means you may have to:

- pay off some of the loan sooner than anticipated;
- buy more shares to increase the value of your portfolio; or
- sell some of the existing portfolio to raise money to lower the loan amount.

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In this issue

- Turning your savings into an investment
- What it means to be a 'Multitasker
- Economic update
- Transition to retirement

Financial planning and you ... What it means to be a 'Multitasker'

Multitasker:
Major focus on debt management

In this issue of *Connect,* we examine the concept of life-stage financial planning as it applies to someone who is starting to experience a level of complexity within their financial journey.

The last issue of *Connect* covered the introductory elements of 'life-stage financial planning', examining the needs and opportunities available to someone who is 'Mastering the Basics'.

However, life doesn't stand still for anyone, and just as we are coming to grips with basic saving and budgeting, managing our credit cards and our general financial responsibilities, life will undoubtedly throw us a few curve-balls.

Without warning, many of us soon find ourselves facing new challenges, such as a first mortgage, the arrival of children or other dependants, a change in career and ever-increasing household expenses. With all these additional items clamouring for our attention, you can understand why Consultum has labelled this stage as the 'Multitasker'.

Let's examine some of the financial strategies that a typical 'Multitasker' would face.

Dealing with debt

Many everyday lifestyle items cause us to incur some form of debt. Purchasing property, upgrading cars or simply shopping online using a credit card are all actions that will contribute to our debt levels. And while 'good' debt does exist (i.e. debt that you can claim as a tax deduction) most of this lifestyle debt is 'bad', non-deductible debt.

The mortgage on your residential home is often your largest, non-deductible debt. However there are various options available to help you pay it off faster, such as opening a mortgage offset account or increasing your payment frequency. Similarly, personal loans could be consolidated, and credit cards could be rolled-over into a lower interest card, as long as you close the account on the original card to prevent overspending. When changing debt providers, always be aware of exit or establishment fees or other hidden charges that could set you back even further.

While basic actions such as these can help you get on top of your loans, speaking to a financial planner is still a key step in determining the most appropriate strategies to manage your non-deductible debts.

Even if you are thinking about incurring 'good' debt for the purpose of investment, a professional financial planner will be able to help you. They will carefully consider the structure of the loan, whether it is secured or unsecured, your capacity to handle additional debt, and will determine whether you are entitled to receive any tax deductions. For more information about 'good' debt, refer to the Margin Lending article on page 1.

Protecting your most valuable asset

In this life-stage, you will generally have dependants, loans and other financial obligations which are all reliant on your ability to produce an income. So why wouldn't you protect this valuable asset?

Forming part of your overall financial plan, wealth protection is an insurance strategy which enables you to cover living expenses and other substantial costs, in the unforeseen event of illness or death. It aims to protect your income, investments and lifestyle, and provide peace of mind for you and your family.

➜ Turning your savings into an investment (continued)

Who does margin lending suit?

Margin lending suits investors who:

- are looking for medium to long-term investment opportunities;
- have a relatively high, secure disposable income;
- are willing to bear greater investment risk for the chance of greater return;
- have adequate cash reserves or other security to meet potential margin calls;
- have some understanding of the stock market and its operations; and
- understand that gearing can multiply losses as well as gains.

Seek professional advice

Margin lending is a complex strategy, requiring careful consideration about your attitude to risk, your capacity to bear additional debt and your lifestyle and financial goals. As a margin lender is not allowed to provide tax management or investment advice, consulting a professional financial adviser is most often the best way to determine whether margin lending is the most effective wealth creation strategy for your personal situation. A financial adviser can also help you to understand the tax implications as well as the legal and financial ramifications of the arrangement, to ensure that the strategy and product are right for you.

If you'd like more information about turning your savings into an investment, contact your Consultum financial adviser today.

There are a variety of insurance options, ranging from life insurance, to income protection, trauma insurance and total and permanent disability cover.

Most superannuation (super) funds offer personal insurance cover. While insurance through your super fund is often an easy and cost effective method of arranging insurance cover, it is essential to determine whether or not the minimum level of cover provided by your fund will be adequate given your personal situation.

Your financial adviser can help you determine what level of insurance you may need, the most appropriate definitions and the most cost effective way to insure your income.

Think super

While the average 'Multitasker' may be a few decades away from retirement, engaging in some simple strategies can make all the difference to your superannuation and retirement lifestyle. For example, you could implement a salary sacrifice arrangement with your employer, where your gross salary is reduced by a certain amount, in exchange for increased super contributions. This strategy effectively reduces your taxable income, and boosts your super balance for the years to come.

Don't go it alone

When you're a 'Multitasker', you've got enough on your plate without worrying about your ongoing financial strategy. By engaging a financial planner, you are enlisting the support of a professional, who can help to shoulder the responsibility of your financial affairs. An ongoing relationship and regular reviews with your adviser will also help to ensure that any strategy you undertake is appropriate for your ever-changing needs.

What comes next?

If you are currently facing the challenges of:

- managing your costs of living;
- stabilising your career path or business;
- changes to your family structure; or
- extended financial support of dependants,

then you may be at the financial life-stage of 'Balancing out'... more details to come in Issue 6 of *Connect*.

Balancing out:

Major focus on wealth accumulation

Economic update

By Frank Uhlenbruch, Investment Strategist, Perennial Investment Partners Ltd.

Yet another shock to deal with

After the Russian Debt Crisis in 1998, the Tech Wreck of 2000, September 11 2001, the Iraq War, the global deflation scare and Enron, investors are entitled to wonder if things will ever settle down. Having enjoyed a brief period of stability, investors now have to think through the implications of the sub-prime crisis in the US.

At this stage, the problem is one for the financial sector. As the US Federal Reserve pointed out in early September, the sub-prime problem will only warrant monetary policy action when there are indications that financial sector problems are hurting the real economy.

In the meantime, there are a range of measures the Federal Reserve and other central banks can take to help provide liquidity, particularly to the commercial paper market, without necessarily resorting to cutting overnight interest rates.

In early September the Reserve Bank of Australia (RBA) announced one such measure, with the widening of the range of acceptable securities under repurchase agreements. This technical reform will help provide liquidity to the Australian money market.

However while such initiatives may prove to be sufficient in Europe and Australia, where central banks had been contemplating tightening before the crisis, they may not prove enough in the US, where economic growth is now being forecast below long run trend rates. This gives the Federal Reserve room to ease monetary conditions over the latter part of the year.

Should the Federal Reserve ease monetary conditions, US growth prospects will be bolstered, particularly in 2008. Along with strong global growth elsewhere, the world economy should be able to absorb this shock and continue to grow at least at long run rates. This should provide a helpful backdrop for growth investments, such as global and domestic shares.

So while the impact of the crisis may be short lived on the real economy, it will leave a mark on the financial sector in the form of increased risk spreads, which were previously at very low levels following a period of abnormally low interest rates.

Transition to retirement

The nature of retirement is changing and so are the rules. If you want to reduce your working hours or pay less tax without sacrificing your income, 'transition to retirement' could be the answer.

Longer life expectancies mean many Australians are spending more time in retirement than ever before[1] – increasing the burden on our social security system and the importance of accumulating superannuation (super).

As a consequence, the Government is encouraging us to remain in the workforce beyond the traditional retirement age. A recent incentive is the option to access your super before you fully retire, through a transition to retirement pension.

You can access a transition to retirement pension of between 4-10 per cent of your account balance if you've reached preservation age (currently 55) and you are still working.

A better lifestyle on the same income

Transition to retirement provisions allow you to supplement your income by drawing a regular pension payment from your super fund. There are two principal ways you can benefit:

- convert to part-time work without decreasing your income, and spend more time doing the things you want to do; or
- continue to work full-time but reduce your tax by taking a pension and salary sacrificing more of your income into super (or your spouse's super).

Should you continue working past 65, you also benefit from ongoing employer contributions to super which ultimately increases the value of your retirement nest egg.

Tax treatment

Once you have reached age 60, your pension payments, including lump sums, will generally be tax-free.

Your financial adviser can help you to structure your pensions to legally minimise your tax obligations.

How does the Transition to Retirement strategy work in practice?

Case study

Ted, who is 57, has a salary of $80,000 per annum (plus 9% superannuation). He wishes to continue to receive his current net income but maximise the effectiveness of his super. He currently has $400,000 in super and decides to commence a transition to retirement pension of $30,000 p.a.

	Without strategy*	With strategy*
Gross salary	$80,000	$42,000
9% super contributions	$7,200	$7,200
Salary sacrifice into super	–	$38,000
Super pension drawn	–	$30,000
Tax paid plus Medicare Levy (less offsets)	$20,300	$12,280
Net cash	$59,700	$59,720
Superannuation asset*	$430,962	$435,207
Increase in super due to strategy	–	$4,245

*Earnings are 6% p.a in a superannuation account (net 15% tax) and 6.5% a pension account (nil tax). Salary sacrifice and 9% superannuation contributions are taxed at 15% in super. Earnings and super contributions are credited monthly.

As the table illustrates, Ted has not changed his cash income at all, but has saved over $4,000 in tax each year which stays in his superannuation account. If he retires after turning age 60, all benefits including the tax saving are tax free.

Note about salary sacrificing: Although salary sacrificing into superannuation is a great strategy for increasing your retirement savings, not all employers offer this feature to their employees. Also under these arrangements your 'salary' decreases and this could have a flow on effect to other employment benefits you receive – e.g. compulsory super contributions may be determined using actual (reduced) salary and can also take into account salary sacrifice contributions.

Seek professional advice

Transition to retirement provisions can mean reducing your working commitments and pressures without necessarily reducing your standard of living. There are, however, various levels of complexity and the strategy is not suited to all investors.

Only a financial adviser can help you determine the best approach for you. Ensure your retirement planning is on track by seeking professional advice.

[1] http://www.aihw.gov.au/mortality/data/life_expectancy.cfm

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