

A helping hand when starting out

For many Australians in their late teens and early twenties the thought of investing rarely comes to mind. Some would like to start investing, however with little to no savings it is often difficult to get started. But with a helping hand, a little income and the right advice, it is possible to start investing and accumulating wealth now.

Introducing Fiona, Jack and Edith

At 20, Fiona is in her second year of a teaching degree at university. Although she receives some financial assistance from her parents, Fiona recently started working part-time at a local café to build up her savings.

With \$4,000 in savings and \$450 left over each month, she would like to start investing but doesn't feel as though she has enough to get started.

Jack and Edith are Fiona's grandparents. After receiving good financial advice over the past two decades, they retired a few years ago and are financially secure. They are encouraged by their eldest grandchild's plan to invest and would like to help, but are unsure how.

The challenge

Goals	
Fiona	<ul style="list-style-type: none"> > Invest \$2,000 of savings and start accumulating wealth > Purchase a property by age 30
Jack & Edith	<ul style="list-style-type: none"> > Assist grandchildren financially > Remain financially secure throughout retirement
Their resources	
Income	<ul style="list-style-type: none"> > Fiona – Gross salary of \$12,500 a year > Jack and Edith – Allocated Pension \$50,000 a year > Jack and Edith – Investment income \$3,850 a year
Assets	<ul style="list-style-type: none"> > Fiona – \$4,000 in savings > Jack and Edith – Family home \$700,000 > Jack and Edith – Superannuation \$830,000 > Jack and Edith – Investment portfolio \$110,000
Liabilities	<ul style="list-style-type: none"> > Fiona – Nil > Jack and Edith – Nil

The strategy

Jack and Edith visit their financial adviser to see what options are available to them. Their financial adviser suggests they offer \$20,000 of their investment portfolio as third party security, allowing Fiona to borrow \$15,000. Together with her initial planned investment of \$2,000 (leaving a \$2,000 cash reserve), Fiona now has \$17,000 available to invest in a managed fund.

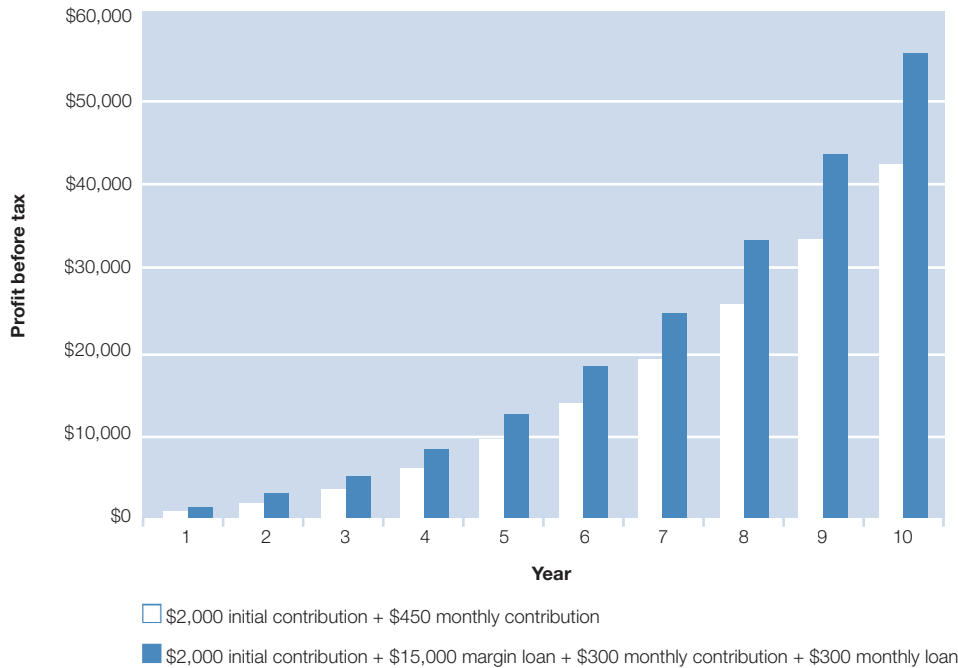
As Fiona expects to have \$450 of surplus income each month, the adviser also recommends she start a regular gearing plan of \$600 per month, by contributing \$300 of her own money and borrowing the remaining \$300. This would leave Fiona with \$150 a month to cover the ongoing interest expense of her margin loan.

Adopting this strategy allows Jack and Edith to help Fiona get started with a larger lump sum. And if her managed fund performs well over time, Fiona could release her grandparent's security and rely solely on her own investments to secure her margin loan.



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The result



Assumptions: The graph compares the potential return on Fiona's investment portfolio with and without a margin loan.

- > The calculations show the profit before capital gains tax of each strategy after loan and interest costs have been paid.
- > It assumes an average annual capital growth rate of 7.00%, an income yield of 3.50% with all income reinvested, distributions are 70% franked, a company tax rate of 30%, a marginal tax rate of 16.5% including Medicare levy of 1.5%, an average annual margin loan interest rate of 9.50%, an initial margin loan gearing level of approximately 40%, brokerage and any other fees are excluded.
- > While capital gains tax implications have been ignored, they should be considered before investing.
- > This example is for illustrative purposes only.

If Fiona had simply invested her \$2,000 and combined it with a \$450 per month regular savings plan, her portfolio would have grown to a value of \$96,409 after ten years. After deducting her contributions (initial and ongoing), and allowing for tax on the investment income, the profit on her portfolio would have been \$41,511 before capital gains tax.

However, Fiona decided to follow the financial adviser's strategy and accept her grandparent's offer which allowed her to invest more initially and each month. By using a margin loan and combining it with a regular gearing plan, Fiona's portfolio grew to \$167,447 after ten years. After allowing for her contributions (initial and ongoing), the margin loan, investment income, interest paid and income tax, the profit on her portfolio was \$54,559 before capital gains tax.

The difference in the profit outcomes of both strategies was \$13,048 or 31% more at the end of the ten year period.

Getting the right advice

As with any financial strategy, using a margin loan to borrow and invest is not without its risks. One of the key risks of using a margin loan is that just as it can multiply your gains when you invest successfully, it can also multiply your losses if your investments fall in value. That's why it's important to get the right advice to ensure a margin loan is appropriate for your particular situation. Your financial adviser can help you construct a personalised investment strategy that takes advantage of the benefits while minimising the risks.

Please speak to your financial adviser for more information about how using third party security can help you build a larger investment portfolio.

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