

# Starting out

Even with the best intentions and a good income, building wealth can be a slow process – especially if you want to enjoy a little bit of life at the same time. But with some savings, a budget and the right financial advice, you can create an investment portfolio and reach your goals sooner.

## Introducing Emma

Emma is a 25-year-old graphic designer working for a prominent advertising agency. By choosing to live at home since leaving university she has saved about \$150 a week over the last three years, while still managing to enjoy a few overseas holidays and a new car.

Having saved \$25,000 in a high interest savings account and confident that she can increase her monthly savings after a recent promotion, she now wants to take the next step and start investing. Emma has considered buying an investment property, but with plans to travel and work overseas in two years she doesn't like the idea of leaving behind a large mortgage and having to deal with a property manager or tenant.

Is there another solution which can offer her the opportunity to invest and make the most of her savings?



## The challenge

Her goals	
Short term (1-3 years)	<ul style="list-style-type: none"> <li>&gt; Invest savings and part of monthly income</li> <li>&gt; Work overseas</li> </ul>
Medium term (3-7 years)	<ul style="list-style-type: none"> <li>&gt; Continue building investment portfolio</li> <li>&gt; Save surplus income towards a deposit</li> <li>&gt; Return from overseas</li> </ul>
Long term (7 years+)	<ul style="list-style-type: none"> <li>&gt; Continue building investment portfolio</li> <li>&gt; Purchase a property</li> </ul>

Her financial position	
Income	<ul style="list-style-type: none"> <li>&gt; Gross income of \$60,000 a year</li> <li>&gt; Interest on savings of \$2,100 a year</li> </ul>
Assets	<ul style="list-style-type: none"> <li>&gt; High interest savings account \$25,000</li> <li>&gt; Car \$18,000</li> </ul>
Liabilities	Nil

## The strategy

Emma decides to see a financial adviser to discuss her options. Her adviser, after carefully considering her financial position and goals, recommends she initially invest her \$25,000 of savings plus a regular amount of \$500 each month in a managed fund that will provide her with exposure to growth assets such as shares and property.

In addition, Emma's adviser recommends she use a margin loan to double the size of both her initial and ongoing monthly contributions.

By increasing her initial investment to \$50,000 and ongoing monthly investment to \$1,000, Emma will increase her investment exposure and potential for greater capital gains and income.

Emma plans to use her surplus income to cover the interest costs of her margin loan and will be able to claim this amount as a tax deduction.



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# The result



**Assumptions:** The graph compares the potential return on Emma’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 31.5% including Medicare levy of 1.5%, an average annual margin loan interest rate of 9.50%, an initial margin loan gearing level of 50%, 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 Emma had chosen to just invest \$25,000 of her savings and \$500 a month, her portfolio would have grown in value to \$172,370 after 10 years. After deducting her contributions (initial and ongoing) and allowing for tax on her investment income, the profit on her portfolio would have been \$84,098 before capital gains tax.

But having followed her financial adviser’s recommended strategy of borrowing to invest to increase her exposure to growth assets, Emma’s portfolio grew to \$344,740 after 10 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 \$132,568 before capital gains tax.

The difference in the profit outcomes of both strategies was more than \$48,470 or 58% over the 10 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 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 a margin loan can help you build a larger investment portfolio.

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