Starting Out:
Case Study

Emma

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 start investing today and reach your financial goals sooner.

Introducing Emma

Emma is 27 years of age and since joining the workforce has saved about $600 a month, while still managing to enjoy a few overseas holidays and a new car.

Emma has saved $25,000 in her bank account and is confident that she can increase her monthly savings after a recent promotion. However, she feels the small amount of interest she earns on her savings may not be best way of growing her wealth. She now wants to take the next step and start investing for her future.

Is there a solution which can make the most of her savings and accelerate her wealth?

The Challenge

Emma is looking for a solution that will allow her to invest $25,000 today and also make an additional investment each month. She is keen to grow her wealth faster without taking on too much risk. She is unsure how or where to invest her money and decides to see a financial planner to discuss her options.

Her Financial Position	
Income	• Gross income of $70,000 a year • Interest on savings of $250 a year
Assets	• Savings account $25,000 • Car $18,000
Liabilities	• Nil

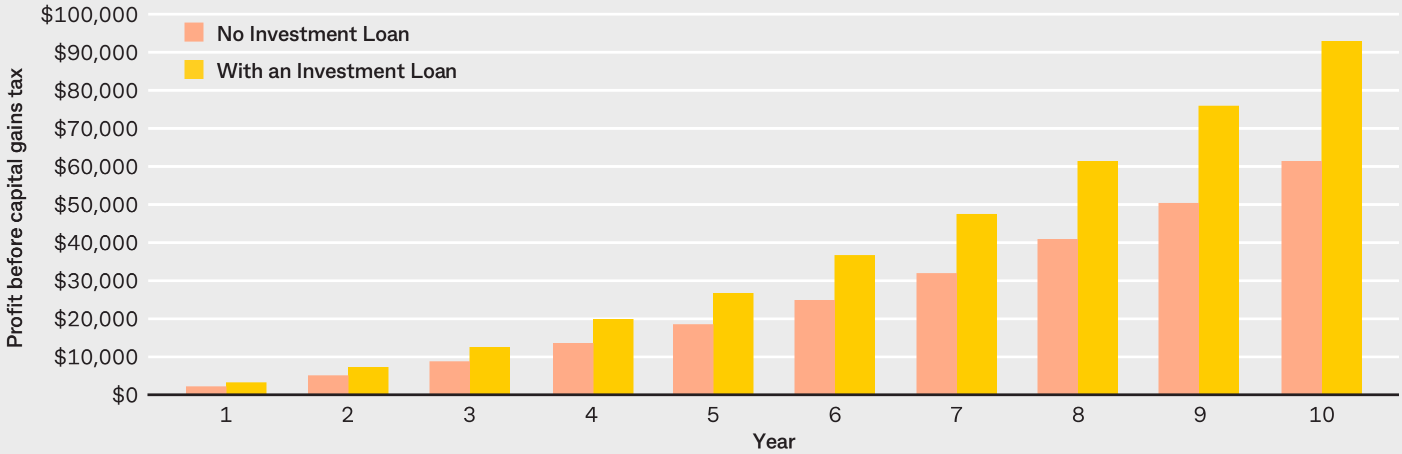
The Strategy

Emma's adviser, after carefully considering her financial position, risk profile and financial goals, recommends she initially invest her $25,000 of savings plus a regular amount of $500 each month in a selection of managed funds. These managed funds will provide her with exposure to growth assets such as shares and property.

In addition, Emma's adviser recommends she also borrows to invest using a Geared Investments Loan to double the size of her initial investment to $50,000 and monthly investment to $1,000.

By doing so Emma will increase her investment exposure and potential for greater capital gains and income. Emma will also use her surplus income to cover the interest costs of her Geared Investments Loan and will be able to claim this amount as a tax deduction.

The Result



Assumptions: The graph compares the potential return on Emma's investment portfolio with and without a Geared Investments Loan.

- The calculations show the profit before capital gains tax of each strategy after interest costs and loan repayment.
- It assumes an average annual capital growth rate of 4.50% p.a., an income yield of 4.00% p.a. with all income reinvested, distributions are 70% franked, a company tax rate of 30%, a marginal tax rate of 34.5% including Medicare levy of 2.0%, an average annual investment loan interest rate of 8.00% p.a., an initial investment 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. It does not reflect any particular person or situation and should not be taken as an accurate forecast of any outcome.

If Emma had chosen to just invest her $25,000 in savings and $500 a month, her portfolio would have grown in value to $150,931 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 $61,222 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 $301,863 after 10 years. After allowing for her contributions (initial and ongoing), her investment loan, investment income, interest paid and income tax, the profit on her portfolio was $93,755 before capital gains tax.

The difference in the profit outcomes of both strategies was more than $32,533 or 53% over the 10 year period.

What are the Risks Involved?

Borrowing to invest can multiply your investment returns in a rising market. However, if your investments perform poorly, it can also multiply your investment losses.
Other risks associated with an investment loan include:

- borrowing limits may be reduced, increasing the potential for a Margin Call.
- the variable interest rate may increase resulting in higher interest costs.
- margin calls may require investments to be sold quickly at unfavourable prices if you are unprepared.
- tax legislation or marginal tax rates may change.

There are a number of things you can do to reduce the risks associated with an investment loan. For example, borrowing less than the maximum allowed reduces the risk of a margin call.

Before you apply for an investment loan, you should speak to your financial adviser who will be able to help you put an appropriate strategy in place. Investors should also obtain professional taxation advice that addresses their individual circumstances before taking out an investment loan.

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

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