THE IRISH 30

Financial Wellbeing Part 3
Investments and Risk

Monday 12th April at 7pm

Important Information

The information contained in this presentation are general statements and should be relied upon as a guide only, as your individual circumstances can be quite different. This presentation has been prepared without taking into account your objectives, financial situation or needs and because of this you should consider the appropriateness of any statements made, to your situation , before taking any action.

You should seek advice about how the relevant laws impact on your particular circumstances before making a decision based on this material.

If any financial product has been mentioned, you should obtain and read a copy of the relevant Product Disclosure Statement and consider the information contained within that statement in regards to your personal circumstances, before making any decision about whether to acquire the product.

Investing

Why Invest?
It's a way to make your money **work harder** for you over a period of time to help with your goals eg; Buying a home, children's education, securing your future, being financially independent.

Returns from cash are at an all time low so more & more people are investing their money to try and get a better return and build wealth.

There are many ways to invest and thousands of books and courses available to help make sense of it all. This presentation is a drop in the ocean and will not answer all the questions but hopefully help you get a better understanding of some of the key words and strategies commonly used in Australia.

Before You Start – Some Basic Tips for Consideration

- **Understand your finances-** Cashflow, budgeting, debt levels, emergency funds
- **Pay yourself first-** know your numbers & understand how much you can invest each week/fortnight/month/year
- It is possible to invest **a lump sum and/or a regular amount**
- **Get your debts and expenses under control** – review your home loan rates; pay down high rates of personal credit cards/ loans first before you start. Little point in getting a 7% return and paying 20% on a credit card balance
- Ensure you have a decent **emergency fund** on hand, 3 – 6 months expenses. Consider an Offset account or redraw facility if you have a home loan.

- **Start as soon as you can**

Einstein said compounding interest was the 8th wonder of the world. **"He who understands it, earns it, he who doesn't pays it".**

Example (excl. tax and fees)
$500 pm over 10 years at 5% = **$75,467**
$250 pm over 20 yrs at 5% pa = **$99,197**

If a lump sum of $10,000 was added at the beginning then the difference is
$10,000 +$500 per month over 10 years at 5% interest = **$91,756.30**
$10,000 +$250 per month over 20 years at 5% interest =**$125,730.84**

- **Inflation is your biggest & most silent enemy – investing is one of the best ways to protect against inflation**

Inflation has been falling over the last 20 years but there are signs that it is coming back at a shop near you!
Inflation is the rise in the price of goods and services over time.

Eg 1980 mars bars cost approx. 15p, now €1.10 and it has got smaller 🙁

Fond memory – Guinness student promotion in Carlow as a student where they were handing out scratch cards with the price of the pint in the old days – got a load of pints for a 1p from around 1920!!

If inflation is running at 2% pa over 10 years then the value of $100 has to increase to $121.90 to retain its purchasing power
At 3% = $134.39

Imagine 20% pa or more in places likes Venezuela & Argentina

Key Terms

Asset

An asset is an item that we can own in full or part where the value can increase or decrease over time.
Common assets to invest in - **Growth v Defensive**

Growth Assets – objective is to achieve a return including income and capital that outpaces inflation over the medium to long term.

Shares/Equities
Full or part ownership in a business, generally bought and sold in the stock market. Capital values can increase/decrease by the second if listed and can pay a dividend to the shareholders. Very liquid asset that can offer significant growth potential over the long term but can have significant market falls over short to medium term; eg Tech Wreck, GFC & Covid 2020.

Dividends
For Australian companies, dividends can be franked, which means that you receive a tax credit for the tax already paid by the company so that you are not taxed twice (once at the company tax rate and again at your marginal tax rate). If your tax rate is less than the company tax rate (currently 30%) you will receive a refund for the extra tax paid by the company. If your tax rate is higher you may need to pay some extra tax.

Shares/Equities

It is possible to invest in most countries in the world eg US, UK, Ireland and with large or small companies.

It is important to invest outside of Australia, which will be the 12th largest economy in the world in 2021 up 2 places since 2019. Australia makes up only 1.6% of the global economy so there are huge advantages to investing internationally. (0.3% of world population)
Source: "Why Australia, Benchmark Report 2021"

- Economic conditions, inflation, interest rates and market views all have a bearing on individual share prices.
- ASX 200 Shares are a highly liquid asset generally which means: the ability to sell the asset quickly and receive cash. Generally very cost effective to buy & sell.
- Common Shares held in Australia – search by Ticker symbol which designates the company: **CBA, BHP, TLS, WBC, WOW**
- Check out their dividend yield i.e. the dividends paid to current price to ascertain if it is higher than a cash return! Eg if annual dividend paid is $1 & share price is $20 then the yield is 5%.
- Shares can be purchased via a Share trading account or through a Managed Fund, Exchange Traded Fund and Super/SMSF
- It is usual to have a portfolio of at least 20 shares to spread investment risk.

Let's take a look at some share profiles from Morningstar.

Property

- Full or part ownership in Residential or Commercial Property. It is a big investment market in Australia and residential property in particular is a favoured asset class.
- Commercial Property is less known however heavily invested by fund managers and Super providers. Includes office blocks, shopping centres and warehouses.
- Same theory as shares in that **capital values can increase/decrease over time**, and income from rent can be received to help with holding costs of the asset. Common to use **negative gearing** in Australia where expenses are higher than income so difference is a tax deduction.
- GFC had a big impact on property values in the US & around the world as their banks were unwilling to lend on some property. Therefore this can be a very illiquid asset as it depends on availability of buyers in the market looking for your property and if finance is required the willingness of the bank to lend on that property.

Rental Yield is used to ascertain if a property is worth investing in: Gross and Net Yields used.
Gross – annual rental income & property value eg $500pw = $26,000 / $500,000 value = 5.2%
Net – includes all expenses so will be lower than Gross = $26,000 rent less $20,000 (expenses) / $500,000 = 1.2%

Most property is purchased using finance so a much bigger commitment than shares. The costs to purchase are also higher, along with maintenance and sales costs.

Examples of Purchase, maintenance & sales costs
Purchase: Stamp Duty – varies by state, however in NSW for an investment property with a price of $700,000 will have an estimated stamp duty cost of $27,500
Purchase: Conveyancing costs – from $800 to $2,500 depending on property & complexity
Maintenance Costs – typically 20% of rental amount but will depend on strata, rates, water, agent fees
Sales Costs: Agent Fees – typically 2% of Sales price plus marketing etc

Property

Investment Property working example with 100% finance & Negative Gearing

Purchase $700,000
Stamp Duty $27,500
<u>**Conveyancing** $2,500</u>
Total $730,000

Require 20% deposit ($700,000 @ 20%) = **$140,000 upfront**

If investor has existing property this sometimes can be funded from property assuming there is sufficient equity. This may even include the stamp duty and upfront costs so $170,000. Dependant on lender and requires advice.

Loan on $560,000 @ 4% = $22,400 interest only
Loan on $170,000 @ 4% = $6,800 interest only
Total $730,000 = $29,200pa

Beware of interest rates rising as a 2% increase in rates will increase the total interest to $43,800 pa

Maintenance Costs
Strata - $800 per quarter = $3,200 pa
Rates - $400 per quarter = $1,600 pa
Water - $250 per quarter = $1,000
Agent – 8% of rent = $2,080
Total costs pa $7,880 + $29,200 pa = $37,080pa
Rent $26,000 so shortfall is $11,080pa

This can be added to tax return as a deduction depending on ownership; individually or jointly.

Things to note

- Remember it is not good practice to buy an investment purely on the potential tax saving
- The investment should be able to grow in rent and capital value terms otherwise you will never make your money back from the tax rebate.
- There are various other tax deductions available especially for New Build property such as depreciation.
- Please note these are examples and it is strongly recommended that individuals see a financial planner to ensure their cashflow is able to cope with void periods and rising interest rates!
- This is considered a high risk strategy due to the high gearing nature

Self Managed Super Funds (SMSF)

- Its common to invest in residential property using a SMSF. Can also be used to buy commercial property, useful if you own your own business. Business can move into the property and pay rent into the SMSF.
- Members are also Trustees and are responsible for the running and decisions of the Super fund.
- It can be a costly exercise so generally recommended to have a decent fund size before it is opened. Ideally 500k but depends on the property to be purchased. Advice should be taken if unsure!
- Super – Usually invests in indirect property such as Real Estate Investment Trusts or Managed Property funds. Available via Retail or Industry funds.

Defensive Assets

Objective of achieving stable returns with little to no capital growth. Main advantage is that the original capital is usually protected but not guaranteed.

Fixed Interest

- Basically a form of debt (IOU) where the borrower pays back a regular income (interest payments) for an agreed period of time. Can be bought & sold and have the potential for capital growth and loss with the market value varying as interest rates change. Well known examples are Government & Corporate Bonds incl Junk Bonds.
- Values are not guaranteed and can have a negative return in times where interest rates are rising. However generally considered low to medium risk. Generally provide a higher return than Cash.

Cash

- Cash can earn interest (but not always) which can be variable increasing or decreasing in relation to interest rates. There is no capital growth however is considered the most secure & useful in the short term. Generally does not keep up with inflation over the long term which usually leads to a loss in buying power.

Alternative Assets

- Non traditional investments that do not fit within the above. Includes hard & soft commodities, Gold & Silver and Bitcoin amongst others. Some can be considered both Growth & Defensive depending on their individual qualities.
- Gold, Silver etc can be bought in physical form, coins from the Perth Mint or via Mining Shares or Managed or Exchanged Traded Funds. Can be a very volatile investment where prices can rise & fall quickly.

Risk

Risks Associated with Investing

- Most peoples perspective of risk is unique to them & due to personal experience, education and a variety of other factors. Numerous studies have been conducted on investment risk & most agree, **people suffer a loss twice as much as a gain.**
- In investment terms, risk is often described as the level of unpredictability of returns or the chance that returns will be different (higher or lower) than expected. There are more risks linked with investing than a falling share market.

There are many kinds of risk. Some of these include:

- Capital risk: losing your invested capital
- Market risk: needing to sell an investment at a time when the price is low
- Inflation risk: the investment's rate of return does not keep pace with inflation
- Interest rate risk: Price sensitivity of a security as a result of a change in interest rates
- Liquidity risk: limitations on access to funds for a period of time
- Legislative risk: changes in laws including tax and superannuation which may make investments less attractive
- Default risk: the failure of an institution in which an investment has been made
- Risk can also be described as the chance that you will not achieve the investment returns needed to meet your financial objectives. While some people may be more comfortable with accepting low levels of risk, the potential consequence may be that the returns achieved are insufficient to meet their financial objectives. For example, this may mean that the required level of savings is not available when needed to pay for items, such as retirement or children's education expenses.

Risk

Example 1

Amy has $400,000 to invest.
She plans to use the funds in 10 years' time and needs her investment to grow to at least $800,000.

If Amy decides to invest in defensive (low risk) assets that are expected to return 5% per annum after fees, her portfolio is expected to grow to $651,558. This is not enough to meet her goals.

Alternatively, Amy could invest in higher risk assets that are expected to return 8% per annum after fees. In this scenario, Amy's portfolio is expected to grow to $863,570 and be sufficient to meet her goals.

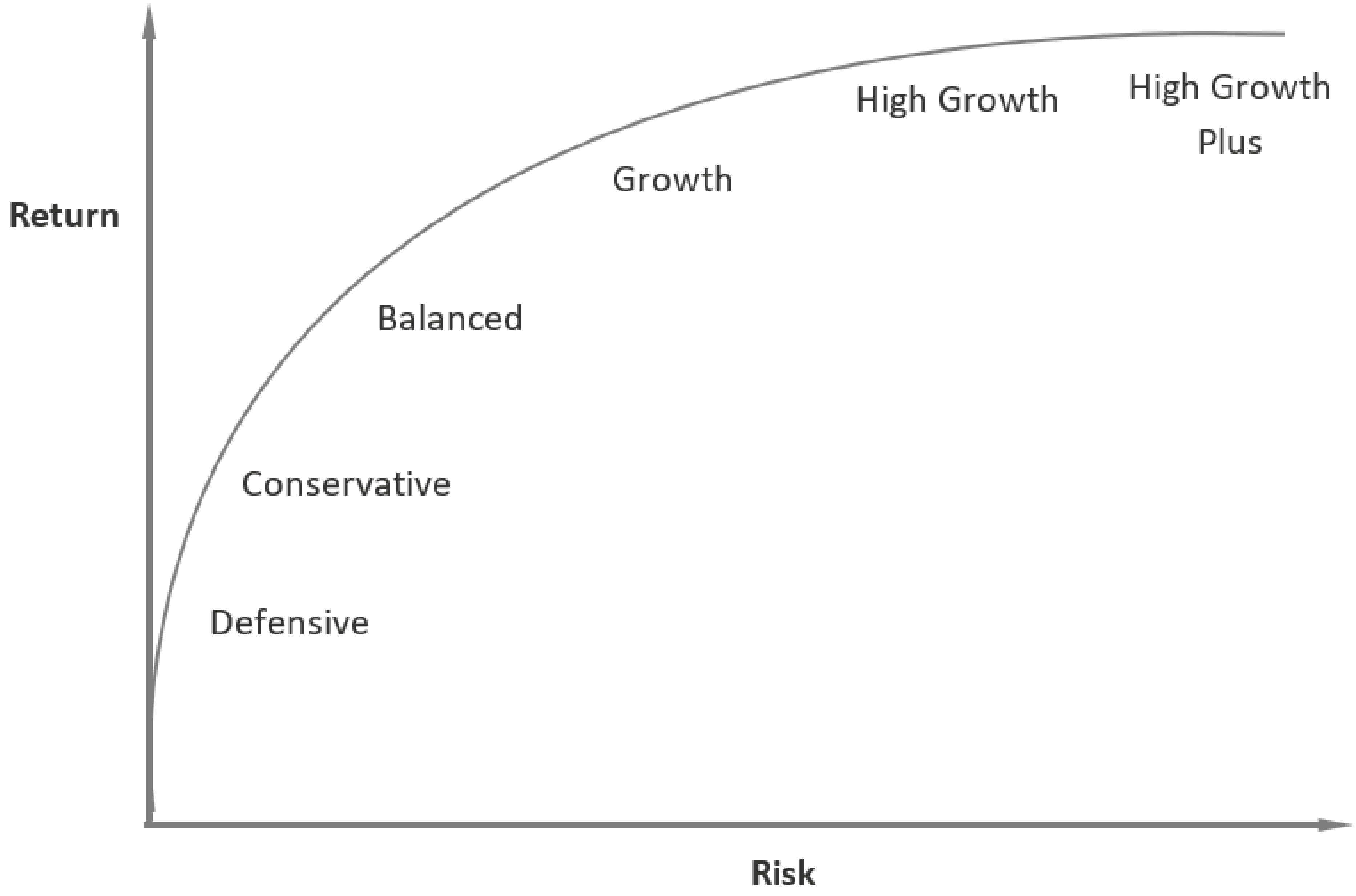
This represents a difference of $212,012 and the potential to meet her goals.

The higher risk investments are more likely to help Amy achieve her financial goals. However, Amy needs to accept the trade-off of greater unpredictability of returns over the 10 year period and the potential for capital losses or poor performance.

As a general rule, the higher the potential return from an investment, the greater is the investment risk and the probability of experiencing capital losses.

Let's look at our Risk Return Trade Off Graph

Risk



The first step in determining whether an investment is appropriate is to understand the relationship between risk and return, and then to determine the level of risk and return that you are comfortable with. This also requires an understanding of the level of risk you may need to accept to generate the likely returns required to meet your financial goals.

Asset Allocation and Diversification

Financial Planners encourage their clients to allocate their investments into the differing assets mentioned and create investment portfolios. These can then be aligned according to a client risk profile using questions designed to help ascertain what the client risk profile is.

Let's look at some risk profiles and strategic asset allocation

Diversification
It is often described by the proverb “Don’t put all your eggs in one basket”.

The goal of diversification is however not to boost performance. It won’t ensure gains or guarantee against losses, but it can help set the appropriate level of risk for an investor’s timeframe, financial goals, and tolerance for portfolio volatility.

To diversify an investment portfolio means to invest in a variety of assets and investments that perform differently to each other over time. You can diversify your portfolio in different ways. Examples of diversification include investing:

- Across a range of asset classes including growth assets like shares and property and defensive assets like fixed interest (bonds) and cash
- Across different countries and regions such as Australian and international assets, Asia and emerging markets
- Across different securities that provide you access to a range of companies and sectors.

The value of diversification
Diversification allows you to participate in the growth and performance of financial markets while reducing risk in your portfolio by moderating the ups and downs in returns over time. This means that you avoid taking big bets in one asset class and/or a few investments that may adversely affect your returns if it that asset class or investment performs badly.
Diversification avoids having your investment fortunes tied to the performance of a small number of securities or assets. It also allows you to have an exposure to a spread of assets and securities and different strategies including both growth and defensive assets.
In essence, diversification provides a greater chance that your portfolio will experience smoother returns over time, by reducing the effects of volatile markets where possible, particularly over shorter periods.

Gearing/Leverage

It is possible to borrow to invest in assets however subject to lender terms & only practicable if rates are competitive.
Margin Lending is a specialised product and advice should be taken to assess appropriateness.
Gearing is only for assertive or higher risk investors with a long term time horizon. Any interest paid is a tax deduction and may help reduce taxes.
Commonly used when purchasing shares and/or property where the bank will lend to a certain percentage of the value.
An asset can be positively or negatively geared in Australia.

Positive geared – expenses are lower than income and therefore surplus income will be added to your personal tax return. This may be taxed depending on overall tax position.

Negatively geared - expenses are higher than income and therefore the deficit is added to the tax return with the potential for a tax rebate when assessed & depending on overall tax position.

Investing when markets fall

Since 1990 there have been significant stock market falls. Some of the best times to invest have been during these falls. They are not for the faint hearted but if you know what you are doing can be a great way to build wealth. A general rule of thumb is to never sell when the market is falling and that it is time in the market rather than timing the market. It is too difficult to guess when to get back in and generally retail investors miss the upswing.

The Vanguard Index is a fantastic visual to look at what has happened over the past 30 years.

In Summary

Summary

- Never too late to start – let the magic of compounding do its work
- Know your numbers
- Research, research, research
- Have a plan & don’t panic when the markets drop
- Diversify & don’t have all your eggs in one basket
- If unsure, ask a professional & get advice

Any Questions??