PT

WEALTH SOLUTIONS

INVESTMENT ESSENTIALS

Get a reliable snapshot on what it takes to invest and what steps you need to follow to make it work for you.

- **5 key principles of investing**
- **Questions to ask yourself before you start investing**
- **Setting your investment goals**
- **What sort of investor are you?**
- **Diversify or invest in one place?**
- **Reduce your risk using dollar cost averaging**
- **Should you borrow to invest?**
- **Your next steps**

5 KEY PRINCIPLES OF INVESTING

Before you start investing, it pays to learn the basic principles. The more you know, the better off you'll be in the long run.

There are five key principles to think about when investing, which can help reduce your risk and build your wealth. You should also remember that your investment strategy depends on your attitude to risk, your financial situation and life goals.

So what are the five key investment principles?

1. Start early, invest regularly and reinvest distributions
2. Set your investment goals and pay yourself first
3. Diversification- Not putting all your eggs in one basket
4. It's time in the market not market timing
5. Invest for the long term - the trade off between risk and return

1. Start early, invest regularly and reinvest distributions

The earlier you start investing, the more opportunity your investment has to grow through compounding - which means you generate earnings on earlier earnings.

Investing the same amount at consistent intervals, known as dollar cost averaging, can help take the stress out of investing as you to don't have to worry about trying to time the market. If the market happens to be falling on the day that you buy, you get more units for your money on that day. It is the opposite when the market is rising. This tends to "average" the cost of your investment and can help "smooth out" market fluctuations.

A key benefit of dollar cost averaging is that you don't risk getting in at the wrong time with a large purchase or waiting too long and missing a rebound.

Let's see how this works in practice:

Jane puts away $100 a month, every month from the day she turns 20 to the day until the day she turns 30, making no withdrawals. By the time she reaches 60, her investment will be worth $962,952. For simplicity's sake, we'll assume that both Jane and Belinda earn 6% each year on their investments.

Belinda puts away $100 every month, but she doesn't start until she's 30. Instead of investing for 10 years, Belinda invests until she's 50 (twice as long as Jane). By the time she reaches 60, her investment is worth $837,960. So despite the fact that's she's put away twice as much, her investment is worth slightly less.

Why? Compound interest has given Jane a massive head start. By age 60, Jane's investment has been compounding for 40 years, while Belinda's has only been compounding for 30 years. As you can see, that extra 10 years makes a huge difference.

- What can we do to get us where we want to be financially?
- We can put away more each month.
- We can save for longer.
- We can reinvest our earnings
- We can try to make our money work harder for us.

2. Set your investment goals

To invest successfully, you need to establish investment goals. Having a clear understanding of your goals will help you select the most appropriate investments to achieve them.

To help you assess your current financial situation, and therefore how much you can afford to invest, you should prepare a current budget. This will help you determine how much you can afford to invest.

Once you have decided on the right type of investment for you, a tried and tested way to stick to your regular investment plan and achieve your goals sooner is to have this investment amount automatically deducted from your pay.

A financial planner can help you through the process of preparing a financial plan, including goals, budget, risk profile and timeframe, as well as recommending a range of investment strategies tailored to your situation.

3. Diversification

Diversification can be one of the keys to successful investing. Do you want to have all of your eggs in one basket, or do you want a few baskets?

Simply put, diversification is about lowering the level of risk across your investment portfolio by spreading your investment across a number of assets and/or markets. Diversification generally reduces the impact of any single investment or asset type negatively affecting the value of your overall portfolio. In a way, it has a smoothing effect - you won't get the huge gains, but nor should you experience the big losses.

4. Timing the market versus time in the market

'Timing the market' is where you try to buy when the market is low and sell when it is high. However, anticipating the top and bottom of the market can be extremely difficult. In practice, many who try to time the market end up worse off.

'Time in the market' refers to the length of time your investment stays in the market. History shows that while assets like shares may experience periods of negative return over the short term, over the longer term returns tend to be higher than less risky investments such as cash. Adopting a longer-term investment strategy helps keep you focused on your financial goals.

5. Invest for the long term - the trade off between risk and return

All investments involve some degree of risk. The potential for higher returns generally means an increased chance of negative returns.

Regardless of the type of investment option you choose, it may not perform according to your expectations. You need to strike a comfortable balance between the level of risk you are prepared to accept and your desired level of return. As a general rule, the longer the timeframe you can invest for, the more risk you can afford to take.

QUESTIONS TO ASK YOURSELF BEFORE YOU START INVESTING

Once you understand the basic principles of investing, it's time to answer some questions.

Simply by thinking about these questions, you're on your way to developing your own investing strategy.

1. What are your investment goals? This is what you intend to do with the money you earn from your investment, including the timeframe in which you want to achieve it. You may have a number of goals with different timeframes.

2. What sort of investor are you? This refers to your approach to investing e.g. conservative, aggressive or somewhere in between. It is made up of a combination of your approach towards risk and your time horizon.

3. How do you want to manage your investments? This is one of the first decisions you need to make. Do you want to invest the money yourself or do you want an investment manager or broker to manage it for you?

4. Do you want to invest outside or within superannuation? This is another important investment decision. Generally the investment options available to you are similar regardless of whether you invest within or outside of superannuation. The main difference comes down to tax implications and accessibility of the money you invest.

5. Do you want to diversify your investment? That is, do you want to invest in a number and variety of asset classes and markets or do you want to mainly invest in one asset class and market?

6. What investment options will suit me? Not all investment options are suitable to everyone. You need to match your investment option to the sort of investor you are.

SETTING YOUR INVESTMENT GOALS

To invest successfully, you need to establish investment goals. Having a clear understanding of your goals will help you select the most appropriate investments to achieve them.

To help you assess your current financial situation, and therefore how much you can afford to invest, you should prepare a budget. This will help you to determine how much you can afford to invest.

Why should I invest?

There are a number of goals you may want to achieve from investing, but they're likely to fall into one or both of the following.

1. Capital growth: building and protecting your money

Planning your investments may help your capital to grow at a real rate (after fees, tax and inflation) so that you'll be able to buy more in the future than you could if you spent your money today.

2. Income generation: paying an income

You may want to reach a stage in your life when you can choose to live off your capital. Typically, this is when you retire and you want your capital to support your lifestyle.

Short vs. long-term goals

You may have a mixture of short, medium and long-term goals. As investments vary in risk and return, you need to understand your goals and match your investments to these goals.

For instance:

- In the **short-term** you may be saving for a car or to take an overseas trip, so you need an investment where your money is accessible and the return is reasonably certain. The best type of investments to suit these goals could be banking products, with no risk of losing any of your money over a short period (even though the return may be minimal).

- At the other end of the spectrum, a medium to **longer-term** goal may be saving for your children's education or a deposit for a house. Here, you should consider products that provide you with more growth over the longer term. Growth assets are more likely to help you achieve this goal.

WHAT SORT OF INVESTOR ARE YOU?

Before you invest, you need to understand your time horizon and how you feel about risk.

In a nutshell:

You're a **conservative investor** if you don't like taking risks and are happy to invest your money for 3+ years whilst it grows steadily.

You're an **aggressive investor** if you don't mind taking risks and you are happy to invest your money for 7+ years with a tolerance for higher volatility.

You're an aggressive investor if you have a tolerance for higher volatility and you are happy to invest your money for 7+ years, with a view to higher returns.

Most investors are somewhere between these two. Before you categorise yourself, answer the following questions.

What is my time horizon?

Ask yourself, 'How long do I intend to invest my money before I need to access it?'

This is essentially your time horizon, and it is a key factor when making your investment decisions. Investment markets move up and down over time, and the value of your investment will move with them. The short term volatility experienced by growth assets such as shares may be less of a concern where you are an investor wanting long term growth. Alternatively, if you want to access your money in the short term, you may prefer a greater weighting in defensive assets that offer less long term growth opportunity but greater short term stability.

What is my attitude towards risk?

Risk is associated with the up and down movement (volatility) of the market and the potential for negative returns. It's very important to understand how you feel about risk.

If you don't like taking risks and are happy to invest your money for 3+ years whilst it grows steadily, then you are more likely to be a **conservative investor**.

If you don't mind taking risks and you are happy to invest your money for 7+ years with a view of higher returns, then you are more likely to be an **aggressive investor**.

You can also ask yourself, 'Am I comfortable with receiving low or negative returns in the short-term in order to obtain higher returns in the long-term?' Could you still sleep at night if this happened and would you stick to your long term strategy?

Or, would you be more comfortable receiving moderate but consistent returns? This is commonly referred to as the trade off between risk and return.

Are your goals and investor profile compatible?

For instance, you may have a short term goal to double your money so you can pay for a holiday, but you have identified that you are a conservative investor. To double your money in a short period will require an investment with high returns, which generally involves high risk. This means your goal is not compatible with your conservative investor profile and you may then wish to look for alternate ways to fund your holiday.

DIVERSIFY OR INVEST IN ONE PLAVE?

You can choose to invest in mainly one asset sector. By not putting all your eggs in one basket through 'diversification' is a recognised technique that can reduce the risks of investing.

Investing in one place (single sector)

Single sector generally allows you to invest in one asset class only, for example property. Depending on your fund manager, you may also be able to spread your investment within that asset class, for example investing in listed property and direct property.

Not putting all your eggs in one basket.

Diversification is one of the golden rules of investing and involves spreading your investment over a number of different assets and/or markets.

The value of different assets and markets can rise and fall at different times. By diversifying you may be able to reduce the likelihood of any single investment or asset reducing the value of your overall portfolio.

What can you diversify?

You can choose to diversify your investment choices (e.g. asset classes), your investment managers (e.g. who looks after your investments) and what markets you have exposure to (e.g. Australia, US and Asia).

Asset classes

The main types of assets are listed below. They are generally classified as either defensive assets or growth assets:

Defensive assets - generally have lower returns over the longer term but are lower risk in the short term.

Growth assets - generally have the potential for higher returns over the long term but a higher risk in the short term.

Type of asset	Classification
Shares: Australian and international	Growth
Property: Direct and Listed	Growth
Fixed interest: Australian and international	Defensive
Cash	Defensive

Before you diversify across asset classes, you need to understand what sort of investor you are and what sort of assets do you wish to invest in (i.e. growth assets, defensive assets or mixture of both).

Fund managers

Always consider the fund manager's investment style, or their approach to investing. Four of the most common styles are:

Indexed - the manager aims to match the performance of a specific index (numerical measure of the price movement in the market).

Value - the manager often buys shares in companies who are out of favour and whose price does not reflect the current value of that company.

Growth - the manager buys shares in companies whose potential for growth in sales and earnings is higher than average.

Quantitative - the manager buys shares that are relatively inexpensive. If the shares appear expensive, they are sold.

Markets

As well as investing in different assets, you can also achieve diversification by investing in different markets, such as Australian and International shares, property, bonds and cash.

REDUCE YOUR RISK USING DOLLAR COST AVERAGING

Now that you know the essentials of investing, it's time to look at some advanced investment strategies. These strategies - when used the right way - can really give your investments a boost.

What is dollar cost averaging?

Put simply, dollar cost averaging is where you continue to buy something, whether the market value of that 'something' is at its highest or lowest cost. You don't wait for the 'right time'. The idea is that as you continue to invest regularly over time, this will tend to 'average' the cost of your investment.

For Example:

Alex would like to start investing in a managed fund.

Let's assume Alex invests $1,000 into an Australian equities managed fund where the prices have been fluctuating. If she invests $1,000 immediately, she will purchase units at $8 per unit. This will provide her with 125 units. However if she invests $200 a year over 5 years in a fluctuating market she will receive 141.51 units (at an average price of $7.07 per unit) over the period.

So you can see by regular investing during the market fluctuations not only has she bought more units, the average cost of her units have dropped from $8.00 to $7.06.

Period	**Investment ($)**	**Unit Price ($)**	**Units**
1	200	8	25.00
2	200	6	33.33
3	200	5	40.00
4	200	8	25.00
5	200	11	18.18
<<b>Total	**1,000**	**7.07 (Average $)**	**141.51**

Note: This does not take into account any distributions paid during this period. This is a general illustration of possible strategies. You should seek advice from a professional financial planner on your own personal circumstances before making any investment decision.

SHOULD YOU BORROW TO INVEST?

Borrowing to invest (also called gearing),may help accelerate your wealth creation. Gearing can allow you to access investments now that you wouldn't otherwise have the money to access. It can also give you the potential to spread money across different investment types, which can help to counter risk. With a larger investment you have the potential to magnify your returns, but gearing can also magnify your losses.

Because what you earn from your investments is assessable income, you may be able to claim interest on your investment loans as a tax deduction.

If you have built some equity in your home or investment portfolio, you may decide to borrow against this equity.

You can consider borrowing against this equity to start or increase an existing investment with the objective of achieving increased returns on your investment. Others take out a special investment loan - often called margin lending . While this type of gearing can result in increased returns in a rising market, it may also lead to a greater loss in a falling market. You need to strike a comfortable balance between the level of risk you are prepared to accept and your desired level of return.

You might borrow to access a lump sum to invest. Alternatively, you could borrow a lump sum as well as regular amounts to add to your investment - known as instalment gearing. Since the interest costs associated with borrowings for investment purposes are usually tax deductible, gearing can be a tax-effective strategy.

In the case of margin loans, lenders allow a maximum gearing level known as the debt to assets ratio (or loan value ratio - LVR). If markets fall and the value of your investment drops, a margin lender may make a 'margin call', requiring you to put up more money at short notice. You might have to offer more security or even sell some of your investment holding at the current prices as a result to bring your gearing back down to the appropriate level.

YOUR NEXT STEPS

Building and maintaining wealth is an ongoing journey. Stay proactive and keep looking for ways to make the most of what you have.

You can get information about financial planning from the Australian Securities and Investment Commission at www.fido.asic.gov.au, or phone 1300 300 630, or the Association of Financial Advisers at www.afa.asn.au, or phone 1800 656 009 or by contact our office on 9891 1544.

In planning your way to wealth you should take a holistic approach, looking at your debts and assets, present and future needs, and considering tax implications and how decisions could impact on entitlement to government benefits.

If you would like further information on these wealth building strategy, please contact **Tony Rimac from PT Wealth Solutions on 9891 1544 or tony@ptws.com.au** who can assist by providing you with the correct tax and investment advice.
