

SHARES HOW TO WIN IN A VOLATILE MARKET

Money

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If you don't win the lottery or marry money, you need a plan to achieve financial freedom – so here are seven solid, practical investment tips that really work

7 TIPS for investment success

Story Susan Hely

Photography Dominic O'Brien, Pip Blackwood & Tony McDonough

IT'S A KEY AREA IN ORGANISING your life – your finances. It really does need a fair share of your time and organisational skills. Don't put it off. You need to build a financial base so you can be strong against life's uncertainties and have what many people refer to as "enough money".

Enough money means different things to different people, but usually it means you don't have to worry about money. You have more choices in life.

The problem is there are so many pressures on your money: rising interest rates, higher petrol prices, management fees and volatile sharemarkets.

So the challenge is not only to put enough aside, but to navigate these obstacles without losing too much sleep.

"Every Australian needs good yardsticks to be financially secure," explains Robert Lipman, head of Investec Private Advisers.

"If you don't know what you are saving and aiming for, then it's all a mish-mash. You need to know where you are at the moment, your goals and objectives and how you get there."

Lipman says Australians have a distinct lack of awareness of the critical issues, such as how much they need for their retirement and how they get there.

1. GET STARTED NOW

What are you waiting for? If the years are ticking by and you keep putting off seizing control of your finances, look at the reasons why you are delaying.

If you have had some bad money experiences, perhaps left over from childhood, it is time to work through them and move on. Don't hesitate. The sooner you start, the more money you will have.

Take Ashley Ormond's new book, *How to Give Your Kids \$1 Million Each!* It sets out how if you save \$1 a day, starting from the day the child is born, invest it in growth assets that return an average of 12% each year, reinvest all the earnings and never spend them, they can end up with \$1 million.

That's not by 18 but by the time they are 50. If you put in \$2 a day, you could present your child with \$1 million when they are 45 – not an amount to be sneezed at.

THE ROAD TO FINANCIAL SUCCESS

Step 1 Get started now (p 52)

Don't wait a lifetime to decide what to do – get into it now

Step 2 Plan to succeed (p 54)

What is your wishlist? Even if you can't afford it all, write it down

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Even if you don't earn the world you can always put aside something

Step 4 It's time in, not timing the market (p 55)

Think before you buy or sell in the sharemarket

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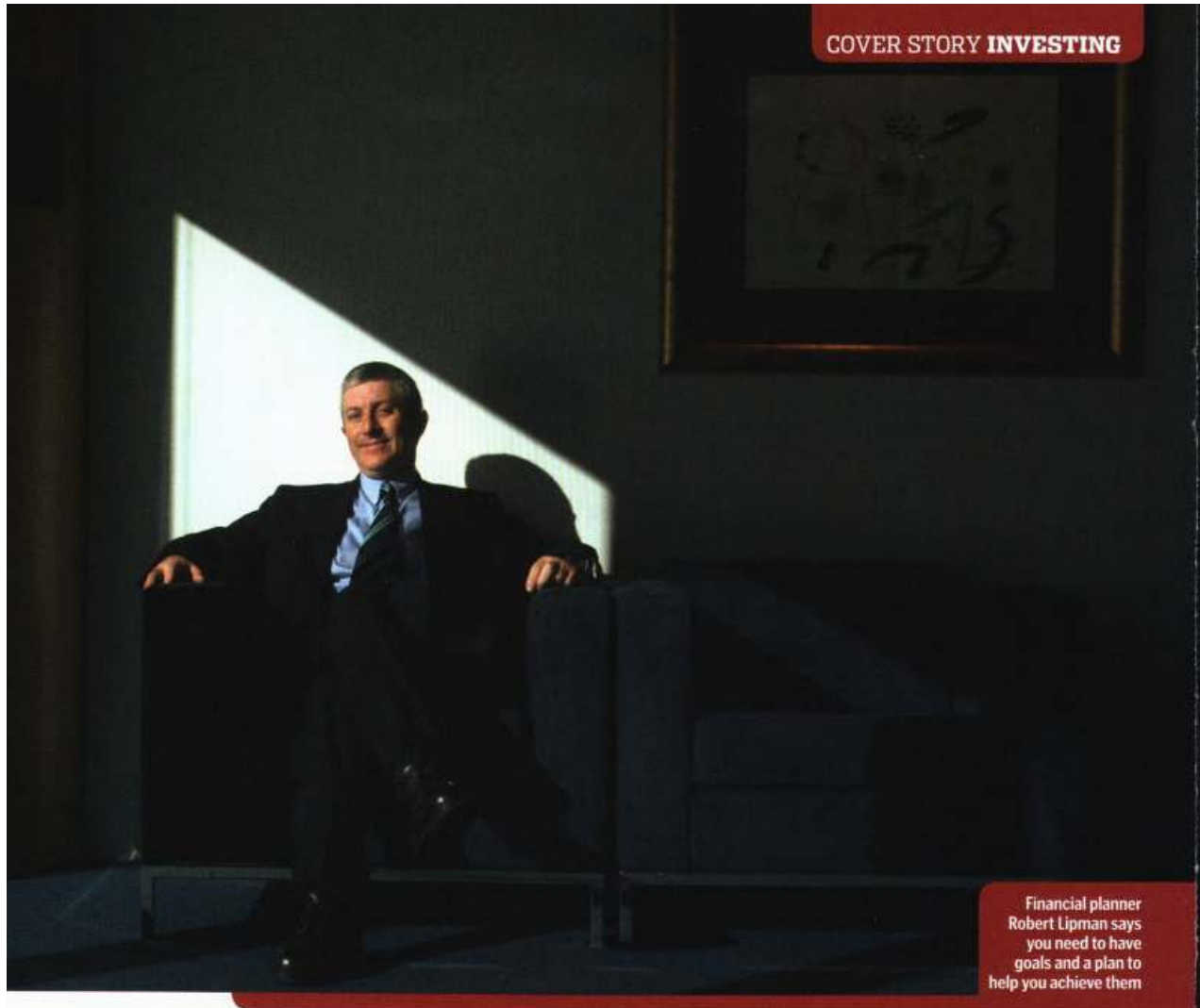
If you own your home you can gear against it at the same rate as your mortgage

Step 6 Borrow to invest (p 58)

Gearing (or borrowing) to invest in shares makes sense when the sharemarket is on the rise

Step 7 Get advice, stay informed (p 58)

Get a good financial planner who can do the monitoring and give advice



The 287-page book, published by John Wiley & Sons, is based on the principle of compounding. While some writers describe compounding as a miracle, Ormond says it's just simple maths.

"There are 365 days in a year, so over 50 years the \$1 per day contributions will add up to \$18,250 or \$365 each year x 50 years. But, because all investment earnings are reinvested in the fund, that \$18,250 turns into \$1 million," writes Ormond.

But there's a problem. By the time a baby reaches 50, \$1 million is not going to be worth the same as it is today.

Ormond estimates that if inflation keeps running at its present rate of 2.5%, \$1 million will lose 70% of its value over 50 years. So it would be like receiving \$300,000 today.

The corrosive effects of inflation on your investment earnings means that you have to hold investments that will give you a return

above inflation, otherwise your savings will be eaten up by inflation and go backwards.

2. PLAN TO SUCCEED

Base your financial plan on a wish list. Write down everything you want. When do you want to retire? Do you want to change careers? Move out of the city? Walk the Inca trail? Take your mother overseas? Spend more time with the family? Send your children to private schools?

Even if you can't afford it all, put it all down. A financial plan focuses the mind on what is most important. You can work out what you can afford and what is out of the question. Private schools may be too expensive and could involve taking on an extra job to afford them. You have to be realistic about your time horizon and how you find the money to fund your plan.

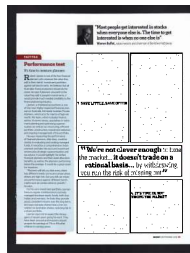
Lipman says one of the best financial aims

is to be financially secure. Threequarters of Australians (74%) say their financial goal is to be able to retire comfortably at an age of their choosing, according to a Newspoll survey for the Investment and Financial Services Association (IFSA).

Lipman tells his clients they need about 20 times their annual living cost at the time of their retirement. For example, if they spend around \$50,000 a year they will need \$1 million. If they spend \$100,000 a year they will need \$2 million of net investment assets.

He bases this on earnings of around 8% each year, then taking away 3% for the rate of inflation, leaving a real return of 5% which will earn around \$100,000 each year for every \$2 million invested.

What Lipman likes about this financial equation is that it provides income while retaining the real value of the capital in perpetuity. The new superannuation rules mean that many



retirees can draw down their superannuation after they are 60 and pay very little tax.

Often your time horizon is the single most important influence on your financial plan. Also your tolerance to risk is important for selecting investments.

Having a financial plan gives you a reference, particularly for uncertain times. You can be safe from knee-jerk reactions during financial turmoil and from being over-exposed in the first place. Selling all your shares during a crash because you have no reference point can be very costly. Hold firm to your financial plan.

3. SAVE LITTLE, SAVE OFTEN

You don't have to be rich to save. Anyone, on any income, can put money aside. Remember, it's the money in the bank rather than the money you spend on your personal effects and other trappings that really matters.

You just have to do it. Small amounts, saved regularly, become large chunks that can pay off debts and grow bigger when invested.

The golden rule of saving is to save first from your salary. Then pay your bills. If you pay your bills first and save what is left over,

\$70,000 had more debt than savings. If you have debt, it is best to get rid of it before you start saving. Credit card interest rates of 16% don't make much sense if you are only getting 6% in your BankWest account. Think of paying off the credit cards as a form of saving.

Lipman likes the logic and discipline of a regular savings plan, particularly if it is a regular debit from your salary or bank account to a managed fund. Even if you have a mortgage, which is non-deductible debt, you can benefit from a regular savings plan. "There is no investment risk with mortgage payments and it is quite a satisfactory rate of return, but on the other hand, investing into a savings plan allows you to generate higher levels of return and may have higher levels of risk."

He suggests a geared equity plan because it can boost your return, particularly if you are young and have a long investment horizon.

For example, if the unit trust returns 10% and you take out 50% gearing, you can generate an effective rate of return of 20%. Regular saving into a managed fund is dollar cost averaging and it can make you more money than periodically investing lump sums. Your regular investment buys more shares when

"We're not clever enough to time the market... it doesn't trade on a rational basis... by withdrawing you run the risk of missing out"

you'll never save anything because there is nothing left.

The best way to save is to have an amount automatically transferred out of your salary to an online, cheque or savings account. It is a painless way to save. What you don't see, you won't miss.

If your salary goes up, resist the temptation to spend the extra. Always resist the temptation to spend more than you earn. Household income makes little difference to saving, according to the Newspoll survey that showed the more you earn, the more you spend.

It found that 47% of people earning more than \$70,000 have more debts than savings while only 34% of those earning less than

prices are low and fewer shares when prices are high. The result is a lower average cost per share. It's a way to limit risk.

4. IT'S TIME IN, NOT TIMING THE MARKET

Over half of all Australians are shareholders either through direct shares or managed funds. On average Australians own shares in six companies and one in four Australians own shares in eight or more companies.

The crucial lesson for investors is that if the sharemarket is volatile, don't try to time it. "The truth is, we're not clever enough to time the market. The market doesn't trade on a rational basis," says Lipman. It is better to



retain some exposure to markets at all times. "Your returns might be down one month, but by withdrawing from the market you run the risk of missing out on the recovery," recommends IFSA.

Market timing is like jumping at shadows; it's impossible to do. If you fear a market downturn, you may be tempted to sell down

IFSA says that if you missed the big days over the past 20 years, you would have a return much more like a defensive investment. "Investors who lose patience and get out of the market run the risk of being absent when significant gains are made," it says.

For example, if you invested \$1000 in Australian shares in December 1983, 22 years

“Investors who lose patience and get out run the risk of being absent when significant gains are made”

temporarily ahead of a bear market, and then buy back in when prices are low. Think again. Seriously.

Studies of the Australian sharemarket over the past 20 years from 1984 to 2005 show that most of the long-term gains on sharemarkets are made or lost in just a few trading days each year.

later it would have grown to \$12,968, making an annualised return of 12.35%, according to IFSA.

But if you invested the same amount over the same period except for the 10 biggest days in the market, it would have grown to \$8240 or an annualised return of 10%, and if you missed the 20 biggest days you have just \$6304 or an

average of 8.7% each year. Also the risk about market timing is that often the good and the bad days are close together.

If you exit the market in volatile times, you can get yourself off on the wrong foot and never recover.

Studies show that eight of the worst 12 days in the last 20 years were within a month of October 20, 1987.

But listen to this. Six of the eight best days in the last 20 years occurred within a month of October 20, 1987. If you had sold out of the market completely and missed those good days, your overall return would have dropped by 2.2% from 13.8% to 11.6%.

"The ability to market time successfully over long periods of time is very difficult," says Lipman.

"Most people get it wrong and the large percentages of investors lose money with market timing."

Instead studies show that investors make money from stock selection rather than market timing. Your strategic long-term asset allocation should be diversified across all the major



asset classes. This limits the overall risk of your investments.

For example your share investments should be spread sensibly between Australia and countries overseas.

By regularly rebalancing your shares back to your long-term benchmark, you are using a rigorous discipline employed by most large professional investment managers, says Lipman.

It builds in objectivity to your decisions about investments, and in heady bull markets you will take profits as the value of your shares increase and you will not be over-exposed when the music stops.

If the market plunges, the same rebalancing discipline will prompt you to buy shares

when they're cheap to maintain your weighting to shares.

5. YOUR HOME AS A SPRINGBOARD

Most Australians want to buy a home that they pay off over their working life, so that when they retire they can live free of accommodation expenses. While rents go on forever, the

mortgage eventually gets paid off.

Increasingly Australians are opting for flexible mortgages that allow them to pay off more of their mortgage and redraw it later, either as a home equity loan or to pay for renovations.

If you own your own home, you can gear against your house at the same rate as your

mortgage. Usually the interest rate for a home equity account is cheaper than a margin loan by about a little less than 1%.

The big plus of a home equity account is that you don't get a margin call. However, a home equity account does not provide regular statements and tax reporting about your shares or managed funds that come through from the margin lenders.

Lipman says that using the home as a wealth creation tool does not suit everyone. It does appeal to people who have paid off their home or those on high tax rates.

Increasingly the family home is being used to build wealth. Some adventurous investors such as Jan Somers, a former high school biology and maths teacher, have bought numerous

residential houses for the long term and utilised the tax advantages of negative gearing.

Jan bought her first house in the outlying Brisbane suburbs with her husband Ian when she married. They set about paying it off quickly. They moved to Sydney for Ian's career in the computer industry.

When they moved back to Brisbane, they bought another house. After another stint in Sydney they bought another house in Brisbane. It was only after accumulating four houses with healthy deposits that she began to explore negative gearing and using the equity in the houses to buy more investment houses.

"Along the way we could enjoy some really significant taxation advantages," says Jan. She worked on a buy and hold philosophy and within five years had accumulated a property portfolio worth millions of dollars.

She has written her investment strategies in a number of books. The latest, *More Wealth from Residential Property*, outlines that investing in residential property can build wealth in 10 to 15 years.

It also explains how to buy a property without a cash deposit; how to estimate the amount you can borrow; why property is better than traditional superannuation; the tax benefits that property investment offers; the relationship between capital growth and rental yield, plus why most financial advisers don't recommend property.

The Somers also sell software to analyse property. through www.somersoft.com.au.

6. BORROW TO INVEST

A rising sharemarket has lured investors back to margin lending as a tool to rev up their wealth accumulation. Over the last three years margin lending assets have doubled to reach nearly \$20 billion at the end of December 2005, according to the Reserve Bank. The number of margin loan accounts has jumped from 105,000 to 152,000 over the three years. Most margin lenders offer a smorgasbord of margin

"It's difficult for most investors to make investment decisions without the help of professional services"



lending products to suit all sorts of investors with wealth accumulation goals and risk tolerance levels. For investors with a medium level of risk tolerance rather than a high risk tolerance, they can gear at a low level, even as low as 10%. Gearing or borrowing to invest in

shares or managed funds makes good sense when you believe the sharemarket is on the up and up. The problem with a margin loan for tumbling shares or managed funds is that gearing magnifies your losses.

For example, if you combine \$20,000 of your own capital with \$30,000 in borrowings to fund a \$50,000 share portfolio and the port-

folio declines by \$5000 or 10%, you still owe the \$30,000 of borrowed money and the loss comes off your capital. Because the investment is geared, this 10% overall loss translates to a 25% loss on your own capital of \$20,000. Gains are similarly magnified.

If you have a margin loan, make sure you do the following:

- Choose your risk strategy to fit your level of comfort
- Diversify your investments
- Set your level of gearing according to your risk level
- Don't let your interest build up or capitalise. Pay it off ever month.

7. GET ADVICE, STAY INFORMED

It is difficult for most investors to make investment decisions without the help of some professional services. The cost of getting the right research about shares and managed funds can be very expensive. It is also tedious, time consuming and difficult to do properly.

"People should seek out a good financial planner who can do the monitoring and give advice about superannuation and taxes," says Investec's Lipman.

According to the Newspoll survey for

IFSA, the factor that makes the biggest difference in whether or not people have more savings than debt is whether they have a financial adviser.

Around 67% of Australians believe that a qualified financial planner is the best person to help them with their finances, while 13% would look to a family member, 11% a bank, 2% friends and only 1% of people would look to an employer.

However, conflicts of interest are widespread among financial planners. A high percentage of planners are recommending that people switch out of low-fee superannuation funds into high-fee funds that pay the planner a commission.

These are the findings of a survey carried out by the government regulator, the Australian Securities and Investments Commission, by research group Roy Morgan. For this reason, investors should seek out planners that charge a fee for service. (Take a look at the story on page 70 for more on this topic). ☺



"Most people get interested in stocks when everyone else is. The time to get interested is when no one else is"

Warren Buffet, value investor and chairman of Berkshire Hathaway



FACT FILE

Performance test

It's time to measure planners

Robert Lipman is one of the few financial planners who measure the value they add to their clients' investment portfolios against set benchmarks. He believes that all Australian financial planners should do the same. He says if planners can point to the value they add to people's investments, it would provide much needed credibility to the financial planning industry.

Lipman, a chartered accountant, is one of the most highly respected financial planners in Australia. He heads Investec Private Advisers, which acts for clients of high net worth. His team, which includes finance author Vivienne James, specialises in retirement planning and optimising superannuation as well as tax structuring, efficient portfolio construction, investment selection and ongoing management of the portfolio.

He says measuring the performance of financial planners, after fees, could be similar to evaluating and ranking managed funds. It would be a comprehensive measurement and take into account investment returns plus strategic superannuation and tax advice. It would highlight the skilled financial planners and their asset allocation benefits, as well as the planners performing below the average. It would be a great asset for investors.

"Planners will tell you that every client has different needs; some are conservative, others are high-risk. But you still can measure performance against different benchmarks such as conservative or growth," he says.

For his own investment portfolio, Lipman favours regular contributions to actively managed boutique equity funds, both Australian and overseas. He finds they provide good, consistent returns over the long term, and says overseas shares have a low correlation to Australian shares, reducing risk in a share portfolio.

Lipman says not to expect the strong gains of recent years going forward. They have been unusual and investors should prepare for earnings of 7% or 8% after inflation in coming years.

"There is no quick road to riches. And if someone promises you a path to overnight riches, cover your ears and close your wallet"

Burton Malkiel, author of "A Random Walk down Wall Street"



CASE STUDY

Claire Harris: A saving & property strategy

Riding the WA building wave

Saving regularly has always been a part of life for 28-year-old Claire Harris. She hasn't had a family to fall back on and so had to put herself through university and establish her own financial base. Growing up she had a paper round, worked on a supermarket checkout and even paid for her own braces.

She boarded with a family when she was at university while working 15-20 hours a week. She recalls always saving for a rainy day. "I didn't have anyone to fall back on, so the idea of having a good amount of money in the bank gave me the security I needed to live my life," she says.

Claire bought her first home when she was 22 and her second at 24. "I wasn't afraid to take a chance on the property market," she says. "I've always thought that I couldn't rely on anyone else but me and if things went pear-shaped I could always sell - so I never felt trapped by being locked into property."

Then she married - she wasn't alone anymore and they bought a third house when she was 26.

Her property purchases have been clever - the Perth property market has boomed on the back of the surge in mining in Western Australia. The median house price in Perth has doubled from \$146,800 in December 2000 to \$325,000 in December 2005. "I have no regrets about buying property," says Claire.

Claire sold two of their houses this year when the market was very strong, realised some gains and bought a block of land with a plan to build a house in the next 18 months. "Property has been kind to us and we've definitely been riding the WA property wave," she says.

She saves through BankWest's TeleNet Saver, a high-interest savings account that pays a 6.6% interest rate for the first 12 months. It has no fees and she can access her account at any time, moving money to other accounts.

"When you build a house you need to be able to access funds all the time," she says.

The couple save Claire's salary and live on what her husband earns. "We have a plan not to touch the extra money and keep it for the house," she says.

While many of their friends have travelled overseas, they have missed out as their property purchases have chewed up all their finances.

Claire has her eye on travel in the next few years, but knows there will be plenty of bills for tiles, curtains and pavers at the same time.

Forever a saver, Claire contributes the 9% superannuation guarantee contribution to her public sector superannuation fund. She plans to bolster her superannuation savings further down the track.





“Success is a lousy teacher. It seduces smart people into thinking they can’t lose”

Bill Gates, chairman Microsoft

CASE STUDY

Colin Garrigan: Shares are the go

He likes the flexibility

When Colin Garrigan moved to Sydney 10 years ago he found his nest egg of \$25,000 didn't buy him a house where he wanted to live. Instead he bought eight blue chip shares through a full-service stockbroker. As his investment confidence grew, he moved to do-it-yourself internet share trading. Using his existing shares as security he borrowed 60% of the value of the shares, taking out a margin loan of around \$20,000.

Colin, a chartered accountant, understands the risks of gearing into shares as well as the tax benefits. His investment philosophy is to buy and hold the shares for at least four to five years.

“I take a keen interest in the market but don't have time to watch each stock in my portfolio daily” he says. “I might go for six months without looking at it.

“I know the stockmarket by its very nature is subject to volatility, and watching daily movements is not my way of keeping check of my

investments. I believe that holding quality blue chip shares for the medium to longer term is the best strategy for me.”

Long-term shareholding is a family tradition for 38-year-old Colin whose grandfather, a Queensland pastoralist, was one of the original shareholders in BHP. His BHP shares were hand-

ed down to Colin's father, then to Colin and his brother. Over the last 10 years Colin has added another 15 blue chip companies and increased his borrowings to around \$150,000 with a Bank of Queensland margin loan. His portfolio is about 35% in resource companies and 65% in industrials.

New shareholdings such as Origin Energy, Rinker, OneSteel and BlueScope Steel were spin-offs from owning Boral, CSR and BHP Billiton. Borrowing to invest has certainly boosted the value of Colin's investments faster because the Australian sharemarket has been so strong, rising an average of 24% a year for the past three years. His loan to value

ratio (LVR) is down from the original 60% to a much lower level these days.

“As the value of the portfolio has grown, it has outgrown the borrowings,” he says. He could borrow more because his LVR is low, but he started his own business in the past 12 months and wants to keep his assets relatively liquid.

Dividends comfortably pay for the margin loan. “I don't touch the dividends,” he says. “The shares effectively pay for the margin loan, but in the early stages of the loan they didn't pay for the margin loan.”

Colin still hasn't bought a home and he knows that all financial planners advise investors to own their own

home. An investment property close to the city would cost \$500,000-plus, and if he bought one and rented it out he would be lucky to realise a net return of 3.5%.

“There's also the pain in the arse factor with tenants, plus the cost of repairs and using an agent,” he says.

He has a good life-style without loading up

too much debt, though a depressed Sydney property market does throw up some buying opportunities. “Property doesn't have that flexibility that you could terminate it quickly if required,” he says.

There are good tax benefits from owning shares; he can claim a tax deduction for the interest he is paying on the margin loan. Also the dividend income from most quality Australian shares has franking credits that can offset income tax.

Colin always prepays the interest on his margin loan before the end of the financial year, which brings forward the next 12 months of interest payments as a tax deduction in the current tax year.

With the benefit of hindsight, Colin wishes he had continually invested in the sharemarket every year, rather than trying to pick the market. Instead he has added to his portfolio every two to three years or so by selecting value blue chip shares. He does regret not buying a bit more regularly.