Financial Foundations: A Plan for Life

Ever wondered why the good things in life seem to come easier to some than others? In most instances it's not just luck, it's because they know what they want and have actively worked to make it happen.

*Note: The information contained in this presentation is general in nature and does not constitute financial advice on your personal situation. We recommend talking to your Financial Advisor or Accountant for detailed information relevant to your personal circumstances.

Contents

A typical financial lifecycle

Throughout life, most people go through four distinct phases of money management. We'll take a look at those phases now, giving you a quick understanding of each one.

1. Developing good habits.

During these years income and assets grow together. It's important to start developing good habits at this time, because as life continues, you'll start having long-term money commitments that make wealth fluctuate.

2. Focused savings.

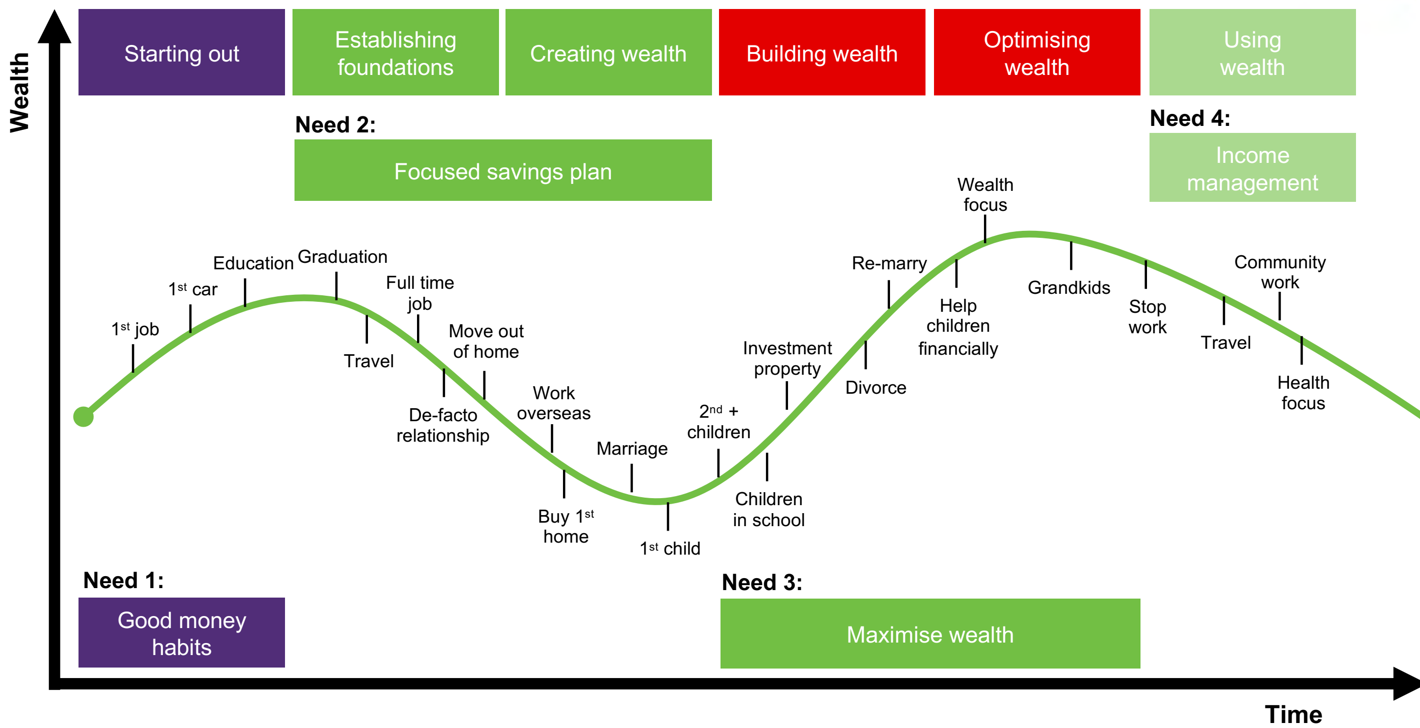
This is the time you spend practising the good habits you've learned in the earlier phase of the lifecycle. It's about putting your budget into action and reaping the rewards.

3. Maximise wealth.

During this stage you'll be building and optimising wealth. This time is about maximising your investments, as they will sustain you during your retirement.

4. Income management.

At this point you spend on all those things that you have built up your wealth for – be it travel, community work or simply spending time with the grandkids. You still need to manage wealth and the income from it to ensure it lasts your lifetime.



Starting out

No matter which life stage you're at, you're going to have some goals. Good spending habits give you the tools to achieve them.

Understanding spending

Start a spending diary.

Write down every single cent you spend for one month. Don't cheat! Because this will give you a very clear picture of where you are spending your money.

Categorise your spending.

Think of a pie chart to represent every dollar you earn. Then, using your spending diary work out how much you spend on each slice.

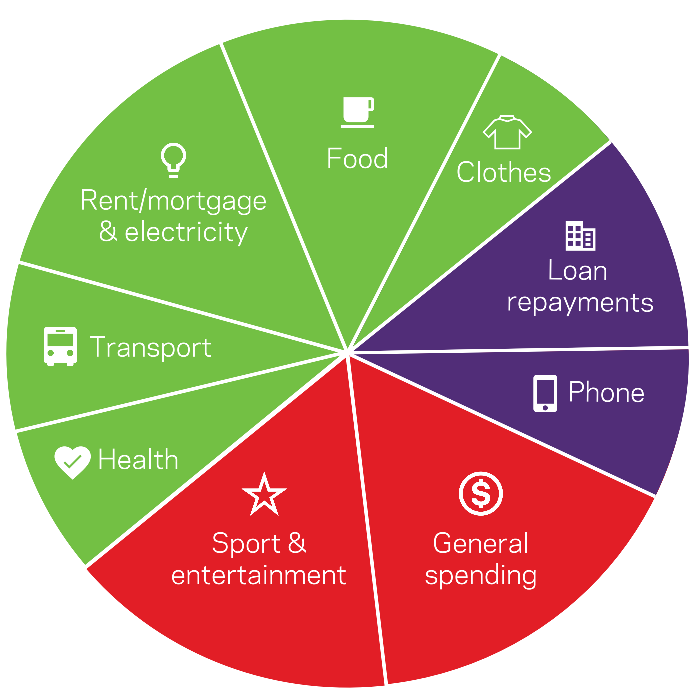
Categorising spending:

First, break it down into three sections:

Commitments
e.g. loan repayments, phone plans or similar

Essentials
e.g. rent and electricity, transport, food, clothing, and health

Lifestyle
e.g. sport and entertainment and general spending



Once you have categorised your spending, you can compare it against your income. You'll then understand how long it will take to achieve your goals (and whether they're achievable). If it's going to take too long to achieve them, you may need to adjust your spending on non-essentials. By prioritising what's most important, you can construct a manageable budget for yourself.

Budgeting

Good budgets start with inflow and outflow.

Inflow:

This is where your cashflow starts. Most of the time it's made up of your salary, but it can also come from other places. Your primary inflow is the main source of your income.

Outflow:

After you've been paid, you then need to allocate your money to things. We call these outflows, and we have broken them down into 4 buckets. They are:

Spend It Now
This covers regular everyday living costs like rent, mortgage, food and transport.

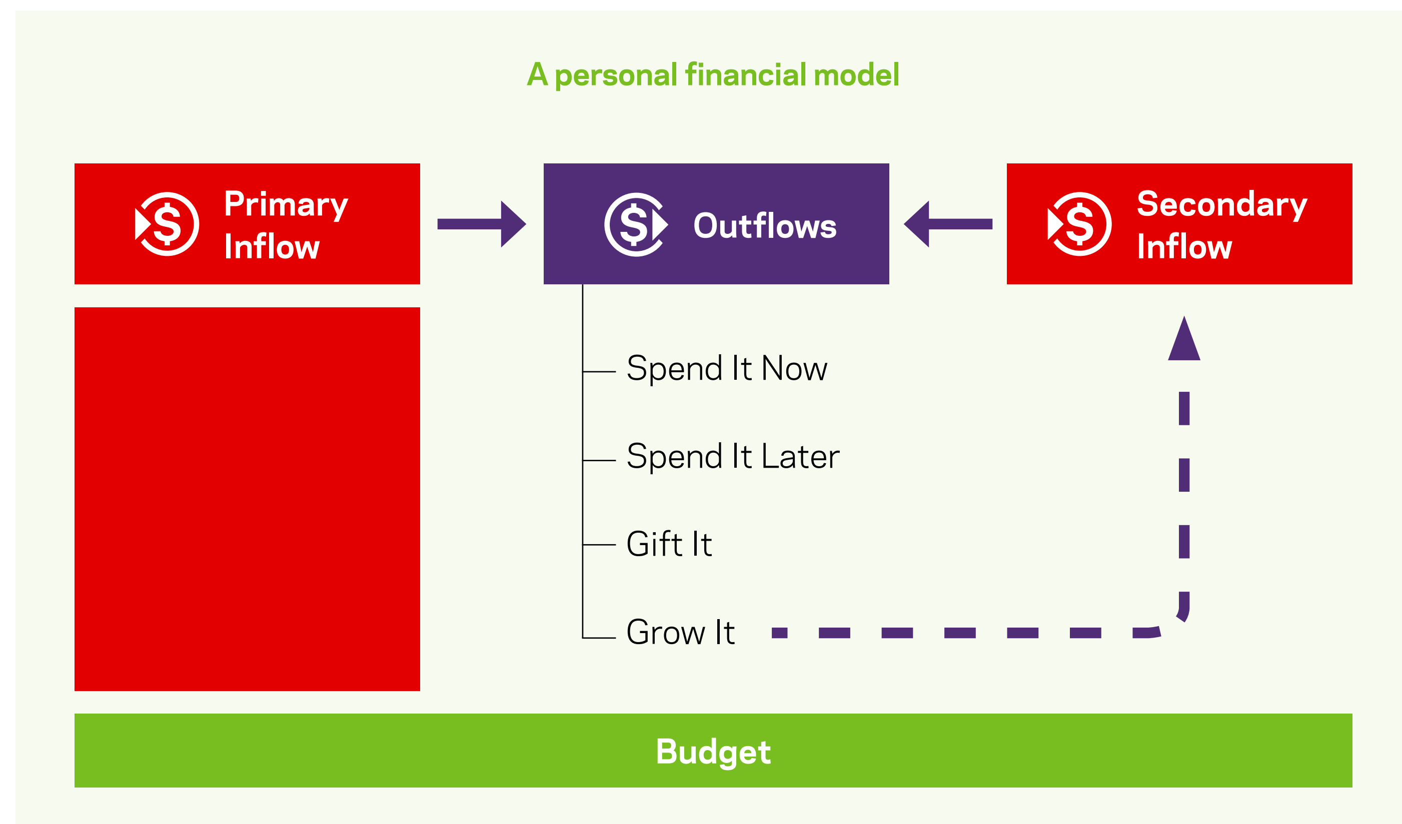
Spend It Later
These are larger expenses. Generally, you put this money in a savings account to earn a little bit of interest. But your ultimate intention is to spend this money on something you need down the track.

Gift It
This not only involves charity but also Christmas, birthday and other gifts.

Grow It
This is where you choose to put aside an amount of your primary income to actively grow it through investing.

The aim of the 'grow it' section of your budget is to create a secondary inflow of income from investments. By using both your primary income and whatever you earn from a secondary income (it could be rent from an investment property), you grow your cashflow and wealth.

This scenario is strongest with a good solid budget as its foundation. Remember, a budget isn't about placing restrictions on you, it's about helping you get what you want out of life.



Establishing foundations

This stage of your financial journey is about consolidating your foundations so that they become assets that provide more wealth.

During this stage some of your goals start to get larger and more expensive so you might also need to borrow.

Saving and borrowing are two different ways of achieving the same thing. The key to deciding whether to use your savings or get a loan lies in understanding the total cost.

Buying a car with savings vs borrowing

Purchasing through savings:

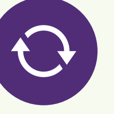
- A car costs $25,000
- You could save $470 per month
- It could take you a little over 4 years to reach your goal and roughly $23,800 of your own money (the other $1,200 comes from the interest your savings accrue)

Purchasing through borrowing:

- You borrow $25,000 to purchase the car on an unsecured loan
- You pay $470 a month
- Add 12.99% p.a. interest and a $250 establishment fee to calculate the total cost. For example, it could take $39,580 of your money and 7 years to pay off.

Save: $470 per month
Takes: 4 years 2 months

St.George Incentive, earning 2.30% p.a. interest (1.50% standard interest + 0.80% bonus interest)



Repay: $470 per month
Takes: 7 years

St.George unsecured personal loan charging 12.99% p.a. interest, plus $250 establishment fee.

For illustrative purposes only. Actual results may vary depending on individual circumstances.

Maximising wealth

Once you've established a strong foundation, you then need to build on that. Throughout this phase of your, life there's only a finite time to prepare yourself for life after work.

In terms of your personal financial lifecycle, this is where you maximise income-earning assets. You could do this through investing.

When investing, time is the most valuable asset. The longer your money is invested, the better chance you have of achieving your goals. This is because time allows you to take advantage of compound interest, adding to your investment, and riding out volatility.

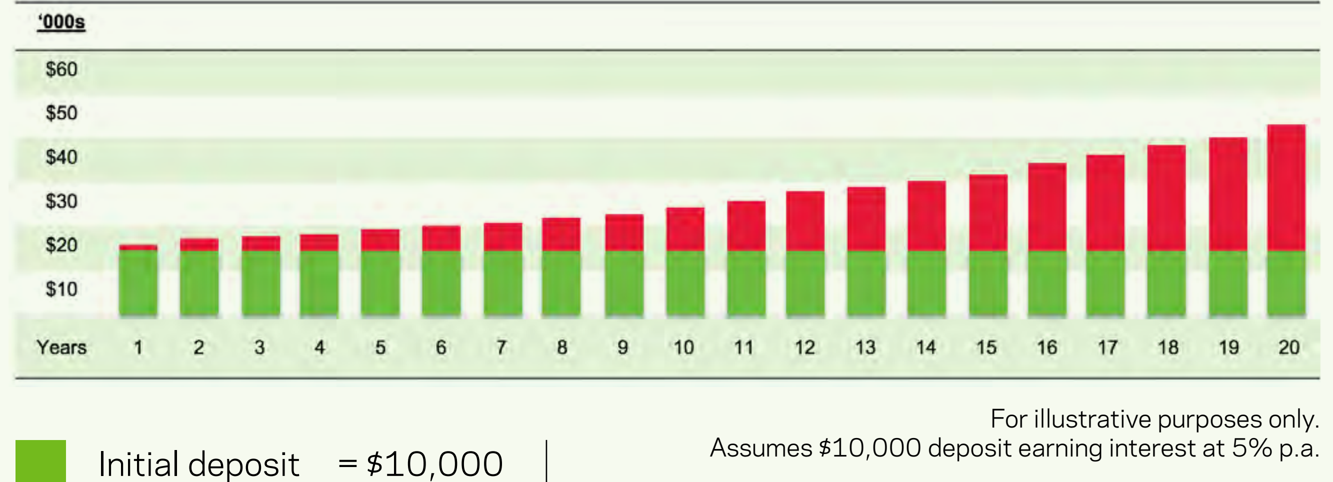
Compound interest

When you invest money, you earn a return. Depending on the investment, this could be called 'interest', 'dividend', 'rent' or even 'yield'. Regardless of what it is called, compounding is simply the process of earning further money on that return.

For example:

- You invest $10,000.
- You put it into an account that pays you 5% per annum for 20 years.
- You also choose not to make any additional deposits.
- At the end of the first year, you have $10,000 (your investment) + $500 (interest).

The next year, you would be earning interest on $10,500, instead of $10,000. The longer you leave your savings untouched, the more it compounds. If you leave this investment untouched for 20 years, you could have earned $16,533 in interest and have $26,533 to put towards your goal.



For illustrative purposes only.
Assumes $10,000 deposit earning interest at 5% p.a.

Initial deposit = $10,000

Extra deposits = $0,000

Interest earned = $16,533

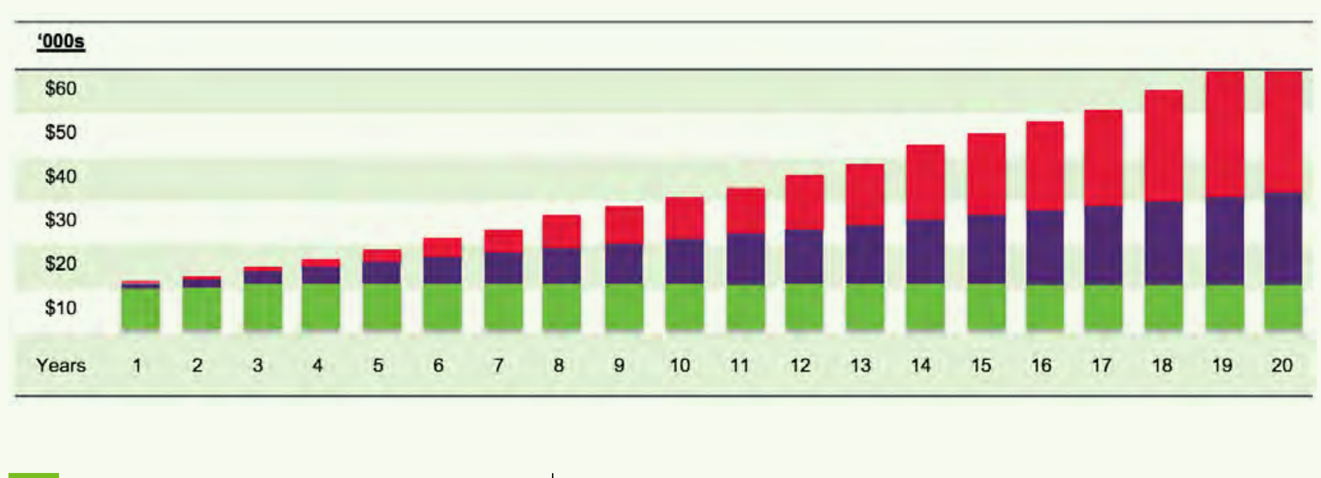
Total = $26,533

Adding to the investment

For example:

- You add $1,000 per year over 20 years to our previous investment.
- At the end you'd have $30,000 and $29,599 in interest.
- A total of $59,599.

Even if you only start with a small amount, small regular additions will add up over time. The longer you continue, the greater the amount you are likely to earn.



Initial deposit = $10,000

Extra deposits = $20,000

Interest earned = $29,599

Total = $59,599

For illustrative purposes only.
Assumes $10,000 deposit earning interest at 5% p.a.

Volatility

In the example we just looked at, we assumed a 5% return every year for 20 years.
In reality investment returns fluctuate, sometimes negatively.
This is called 'Volatility'.

One way to manage volatility is with a diverse portfolio of investments. There are different types of assets you can invest in, each carrying different levels of risk. We can reduce our exposure to any volatility by spreading money around these classes.

The most common asset classes.

Cash

Cash is flexible and enables you to move it to better offers, or use it in an emergency or for something unexpected. It's usually the money you keep in a savings account. Cash is a low-risk investment but generally doesn't provide as high a return as some other investment types.

Fixed Interest

Fixed interest is cash kept in a term deposit or bond. These investments generally pay a higher return than cash. You can get your money back before the term expires. However you may lose some of the interest or even some of the money invested.

Property

Investment properties (not owner-occupied) fall into this class of assets. You might earn capital growth as property value generally goes up over time. You can also get the rental return from the property. Investing in property is long-term and considered medium to high risk. There's also volatility in property prices, and the rental yield is not guaranteed.

Shares

Purchasing shares is essentially investing in a business. If a business is profitable, it will increase the value of the shares over time, and it may pay some of its profits as dividends. Note that not all shares pay dividends. The share market is subject to the most volatility of the investment types. And a portfolio of shares could increase or decrease significantly over a day.

Borrowing to invest

You might choose to borrow to invest. This is commonly referred to as gearing. It includes, but is not limited to, taking out a mortgage on an investment property or borrowing money on a margin loan to purchase shares.

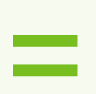
For example:

Using your own money:

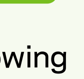
- You invest $10,000 of your own money.
- You get a return of 10% and earn $1,000.

Borrowing:

- You use your $10,000 equity as a 20% deposit and borrow $40,000, investing $50,000.
- You get a return of 10% and earn $5,000.
- You pay interest on $40,000. Let's say the interest rate is 5% and you have to pay $2,000 interest.
- You earn $3,000.



Equity $10,000 | Return 10% | $1,000 Profit



Borrowing $40,000 + Equity $10,000 | Return 10% Less interest 5% | $5,000 $2,000 $3,000 Profit

By borrowing money, you could make a higher return as long as the interest rate is less than the return you make on the investment.

But if the investment value declines or the return does not happen, then you may have to sell other assets (perhaps your home) to pay back the money. It's a good idea to seek financial advice when borrowing to invest.

Superannuation

Superannuation is a long term investment that is taxed differently to other investments. It allows you to salary sacrifice your contributions up to a specific amount. Not only are you reducing your taxable income, but also your concessional contributions are taxed at 15% instead of your marginal tax rate.

You cannot access your super until you retire. If your goal is to have enough money to retire comfortably, then directing your investment money into your superannuation could be worth considering.

Investment Structures

	Individual	Company	Super	Retiree
Income tax	46.5%	30%	**15%**	**0%**
Capital Gains tax	24%	30%	**10%**	**0%**

Superannuation (Super and Retiree columns)

Using wealth

Having developed good money habits, laid sound foundations and built your wealth, the next phase of your life begins.

Retirement is when you start using your accumulated wealth to provide your income. What you can and can't do in retirement will depend heavily on how successful you have been with your plan for life, your health and how long you will live for.

Retirement makes people ask questions like:

- Do I retire outright or, if I am still able to work and enjoy doing so, do I continue or perhaps reduce my hours?
- Do I extract a lump sum from my retirement savings, or draw a regular pension?
- How does the current economic environment impact my savings and how I access them?
- What are the tax implications?

Take the time much earlier in your life to work out your finances for this stage of your life to give you a better chance of having the retirement you want.

Summing up:

- ◯ Look at your goals and what you want to achieve out of life.
- ◯ Start a spending diary to help you build a budget for the things you want.
- ◯ Establish solid foundations by obtaining the assets you need to live, borrowing where necessary and protecting the things that matter most to you.
- ◯ Grow your wealth by investing.
- ◯ Plan how to use the wealth during retirement.

For more information

Things you should know: Credit criteria, terms and conditions, fees and charges apply.

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