

Starting out

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 create an investment portfolio and reach your goals sooner.

Introducing John

John is a 27-year-old accountant working for a mid-size suburban firm. By choosing to live at home since leaving University he has saved about \$150 a week over the last four years, while still managing to enjoy a few overseas holidays and a new car.

Having saved \$35,000 in a high interest savings account and confident that he can increase his monthly savings after a recent promotion, he now wants to take the next step and start investing. John has considered buying an investment property, but with plans to work overseas in two years doesn't like the idea of leaving behind a large mortgage and having to deal with a property manager or tenant.

Is there another solution which can offer him the opportunity to invest and make the most of his savings?

The challenge

His goals	
Short term (1-3 years)	<ul style="list-style-type: none"> > Invest savings and part of monthly income > Work overseas
Medium term (3-7 years)	<ul style="list-style-type: none"> > Continue building investment portfolio > Save surplus income towards a deposit > Return from overseas
Long term (7 years+)	<ul style="list-style-type: none"> > Continue building investment portfolio > Purchase home

His financial position	
Income	<ul style="list-style-type: none"> > Gross income of \$60,000 a year > Interest on savings of \$2,100 a year
Assets	<ul style="list-style-type: none"> > High interest savings account \$35,000 > Car \$18,000
Liabilities	Nil

The strategy

John decides to see a financial adviser to discuss his options. His adviser, after carefully considering his financial position and goals, recommends he initially invest his \$35,000 of savings plus a regular amount of \$500 each month in a managed fund that will provide him with exposure to growth assets such as shares and property.

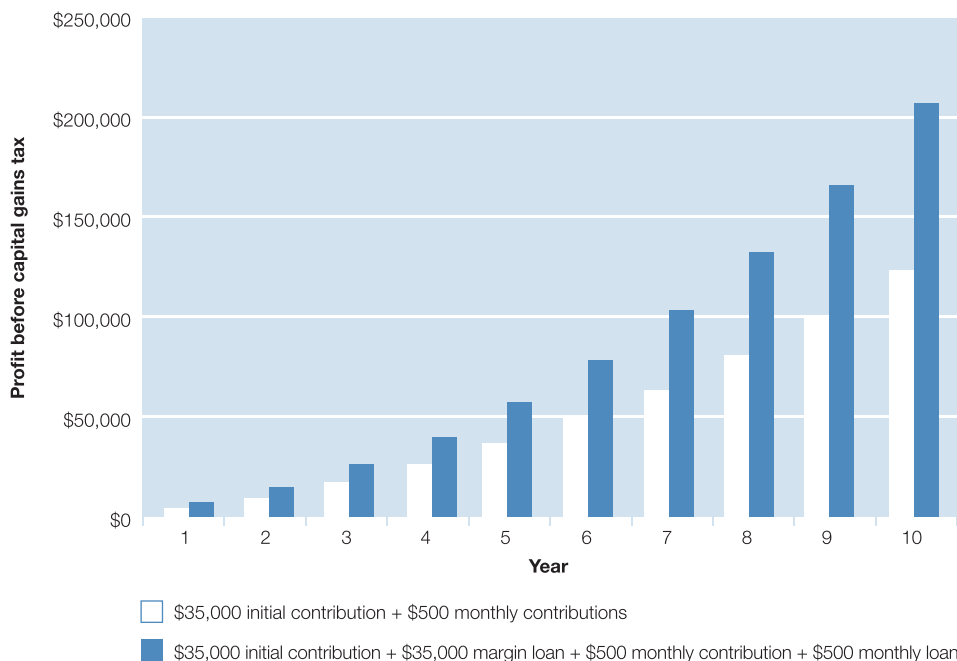
In addition, John's adviser recommends he use a margin loan to double the size of both his initial and ongoing monthly contributions.

By increasing his initial investment to \$70,000 and ongoing monthly investment to \$1,000, John will increase his investment exposure and potential for greater capital gains and income.

John plans to use his surplus income to cover the interest costs of his margin loan and will be able to claim this amount as a tax deduction.



The result



- Assumptions:** The graph compares the potential return on John's investment portfolio with and without a margin loan.
- > The calculations show the profit before capital gains tax of each strategy after loan and interest costs have been paid.
 - > It assumes an average annual capital growth rate of 8.50%, an income yield of 3.50% with all income reinvested, distributions are 80% franked, a company tax rate of 30%, a marginal tax rate of 31.5% including Medicare levy of 1.5%, an average annual margin loan interest rate of 9.15%, an initial margin 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.

If John had chosen to just invest \$35,000 of his savings and \$500 a month, his portfolio would have grown in value to \$221,784 after 10 years. After deducting his contributions (initial and ongoing) and allowing for tax on his investment income, the profit on his portfolio would have been \$123,756 before capital gains tax.

But having followed his financial adviser's recommended strategy of borrowing to invest to increase his exposure to growth assets, John's portfolio grew to \$443,569 after 10 years. After allowing for his contributions (initial and ongoing), the margin loan, investment income, interest paid and income tax, the profit on his portfolio was \$206,929 before capital gains tax.

The difference in the profit outcomes of both strategies was more than \$83,100 or 67% over the 10 year period.

Getting the right advice

As with any financial strategy, using a margin loan to borrow and invest is not without its risks. One of the key risks of using a margin loan is that just as it can multiply your gains when you invest successfully, it can also multiply your losses if your investments fall in value. That's why it's important to get the right advice to ensure a margin loan is appropriate for your particular situation. Your adviser can help you construct a personalised investment strategy that takes advantage of the benefits while minimising the risks.

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

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