

## Planning for Wealth Accumulation

For many people, securing a financial future is a major concern. Knowing how to build and manage wealth requires consideration of many complex areas and effective planning for their management.

Wealth accumulation requires:

- Setting realistic financial and lifestyle goals,
- Reducing unnecessary costs,
- Finding the money to invest, and
- Identifying appropriate tax effective investments.

This report highlights some key issues to be considered when planning for wealth accumulation.

### Where to begin?

Establishing financial and lifestyle goals that are realistic in the context of your income and living needs should be the first step. This will help you prioritise goals, as not all may be achievable.

### Saving strategies

A person's investment towards their wealth accumulation goals will be determined primarily by their "cash flow"- the difference between income and spending. Spending can be controlled by:

#### a) Eliminating unnecessary living expenses

This can be done by writing a list of every dollar spent per week, fortnight and month and eliminating everything that can be forgone. The difference between the necessary costs remaining and take-home pay is your saving potential. Ensure to include a cash buffer for emergencies.

#### b) Invest savings on a regular basis

Investing on a structured regular basis into a managed fund is known as "dollar cost averaging". The amount invested might buy fewer units of investment during high investment markets, but will buy more during times when investment markets are lower. This means there is no need to try and to pick the "best" time to invest.

#### c) Reducing non-tax-deductible debts quickly

Since most debts charge interest on the balance outstanding on a daily basis, the more that is paid now, the less interest paid later. If it is not affordable to increase the repayment amount, then consider increasing the frequency of payments. Non-tax-deductible debt means the interest is paid from your after-tax income and includes credit card debt and personal loans for items such as holidays and cars. A home mortgage is also non-deductible but at least that debt is funding an asset that will hopefully appreciate in value over time.

#### **d) Reinvesting the return on the investment so that it earns returns on returns**

This is known as compounding returns. Imagine if \$2,000 pa was invested in a managed fund where it earned an average of 7% pa after investment charges and tax (4% growth and 3% income). At the end of 10 years, it would be worth \$29,567, in 15 years it would be worth \$53,776, after 30 years it would be worth \$202,146 and, if a person started investing at 21 and retired at 65, it would be worth \$571,500!

If the \$2,000 pa was invested and income returns were not re-invested, the amount at age 65 would only be worth \$242,000.

#### **e) Examining whether it is worth waiting and making a larger investment later**

If someone started investing ten years later, for example at 30 years of age, and doubled their investment to \$4,000 for the next 10 years, their investment would still be \$356,000 less at age 65. This demonstrates both the value of compounding returns and the cost of waiting to start investing.

### **Investment concepts**

A person's investment choices will depend on their financial and lifestyle goals, investment time frame, their attitude towards risks and estate planning issues. The following should be considered:

#### **a) The trade-offs between managed funds and direct investments**

Managed funds offer many benefits. Investing in managed funds does not require a lot of capital, as the investment is pooled with that of other investors. These pooled funds allow fund managers to spread their investments over many asset classes providing diversification that might not be achievable when investing alone.

#### **b) Gearing**

This is, borrowing money to accumulate wealth. Where the asset purchased provides taxable income, the interest on the amount borrowed is tax deductible.

“Positive gearing” is when the annual income from the investment covers the interest payable and “Negative gearing” is when the interest and expenses are greater than the income.

The advantage of negative gearing is that the shortfall in cash flow can be used to reduce other taxable income.

#### **c) Superannuation**

Although the rules frequently change, superannuation is still one of the most tax effective, long-term investment strategies available. Earnings on superannuation funds are taxed at a maximum rate of 15%.

Contributing to superannuation has proved very attractive both to self-employed people and to employees. Generally, employees cannot get a tax deduction for their contributions, but their employer can - up to certain indexed limits according to the age of the employee.

Many employees agree to reduce their salary to top up the statutory contribution required from their employer- known as “salary sacrifice” – provided the employer agrees to invest the amount of the reduction for the employee's benefit.

## The importance of financial advice

If you are serious about accumulating wealth and achieving financial security, then you should consider professional financial planning advice. Your financial circumstances are unique and our office can demonstrate how the strategies outlined in this report may benefit you.

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