Investment Concepts

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Compound interest

Compound interest is your money working for you. You earn interest on the money you deposit, and in time you earn money on this interest. When you are earning interest on your interest – that's compound interest, and it's one of the most important principles of investing and a great reason to start investing as early as possible.

Compounding interest can have a big impact on your final portfolio value. Here's an example of how it works. You invest an initial sum of $50,000 at eight per cent interest and have the choice to have this interest paid out to you – or you can re-invest it.

	INTEREST PAID		INTEREST PAID	
END OF YEAR	INVESTMENT	INTEREST	INVESTMENT	INTEREST
1	$50,000	$4,000	$50,000	$4,000
2	$50,000	$4,000	$54,000	$4,320
3	$50,000	$4,000	$58,320	$4,666
4	$50,000	$4,000	$62,986	$5,039
5	$50,000	$4,000	$68,024	$5,442
6	$50,000	$4,000	$73,466	$5,877
7	$50,000	$4,000	$79,344	$6,347
8	$50,000	$4,000	$85,691	$6,855
9	$50,000	$4,000	$92,547	$7,404
10	$50,000	$4,000	$99,950	$7,996
TOTAL		$40,000		$57,946

After 10 years, with interest paid out, you would have received $40,000 in total interest payments. Meanwhile if you chose to re-invest the interest instead, you would have $57,946 in interest - that's nearly $18,000 or 45 per cent more at the end of 10 years!

And just as with most investments, time invested makes all the difference. Starting early can leave you with a larger balance at retirement than investing more money later in life.

Dollar Cost Averaging

Dollar cost averaging (DCA) is the strategy of investing regular, incremental amounts into your portfolio – such as setting up automatic deposits from your regular pay. As the same amount of money buys you more of something when the price is low, regular deposits over time (for investments such as shares which rise and fall in value over time) could lower the average cost of your investment. This method of investing also lessens the down-side risk of investing a large lump sum right before a market fall.

DCA is most effective in falling markets, however predicting when a market will rise or fall is never simple. This strategy lets you take the emotion out of investing and frees you up from watching the market every day.

Case Study - Matt & Kate

Matt & Kate after considering the Cashflow Management & Wealth Protection modules know they can afford to save $282.69 per week, but after proceeding with the recommended insurance cover at a cost of $17.87 per week, have a remaining surpluss of $264.81 per week to invest.

RSM Financial ask Kate & Matt to continue their agreement to save $220.00 per week or $953 per month of there surplus cashflow. Matt and Kate have chosen to invest into the Active Growth portfolio RSM Financial have created. RSM Financial ask Matt and Kate to invest every month and explain the benefit of contributing thoughout a cycle, better know as dollar cost averaging.

	AMOUNT INVESTED	UNIT PRICE	NUMBER OF UNITS
JANUARY	$953	$22	43.31
FEBRUARY	$953	$24	39.70
MARCH	$953	$27	35.29
APRIL	$953	$25	38.12
MAY	$953	$23	41.43
JUNE	$953	$21	45.38
JULY	$953	$20	47.65
AUGUST	$953	$18	52.94
SEPTEMBER	$953	$16	59.56
OCTOBER	$953	$18	52.94
NOVEMBER	$953	$21	45.38
DECEMBER	$953	$22	43.31
	$11,436	AVERAGE $21.41	TOTAL UNITS 545.01

Matt & Kate, having invested $11,436 over the course of 12 month market cycle, which resulted in possitive and negative returns and accumulating 545.01 units. If Matt and Kate had invested $5,718 in June and July they would have only been able to buy 440.49 units.

The start and the end purchase price are the same, which normally would have resulted in a 0.00% performance over the 12 months, if $11,436 was invested at the start. However, Matt and Kate invested in both the highs and lows which allowed them to accumulate 545.01 units at an average price of $21.41, which results in a net investment of $11,990.22 or a 4.84% return.

Optimise your investment Strategy

Most people are aware of the benefits of investing and most in some form invest when they have surplus funds to do so, this isn’t rocket science.

What most fail to understand and implement is a simple strategy when they invest which has great benefits, but is sadly misunderstood and considered extremely risky. This strategy is:

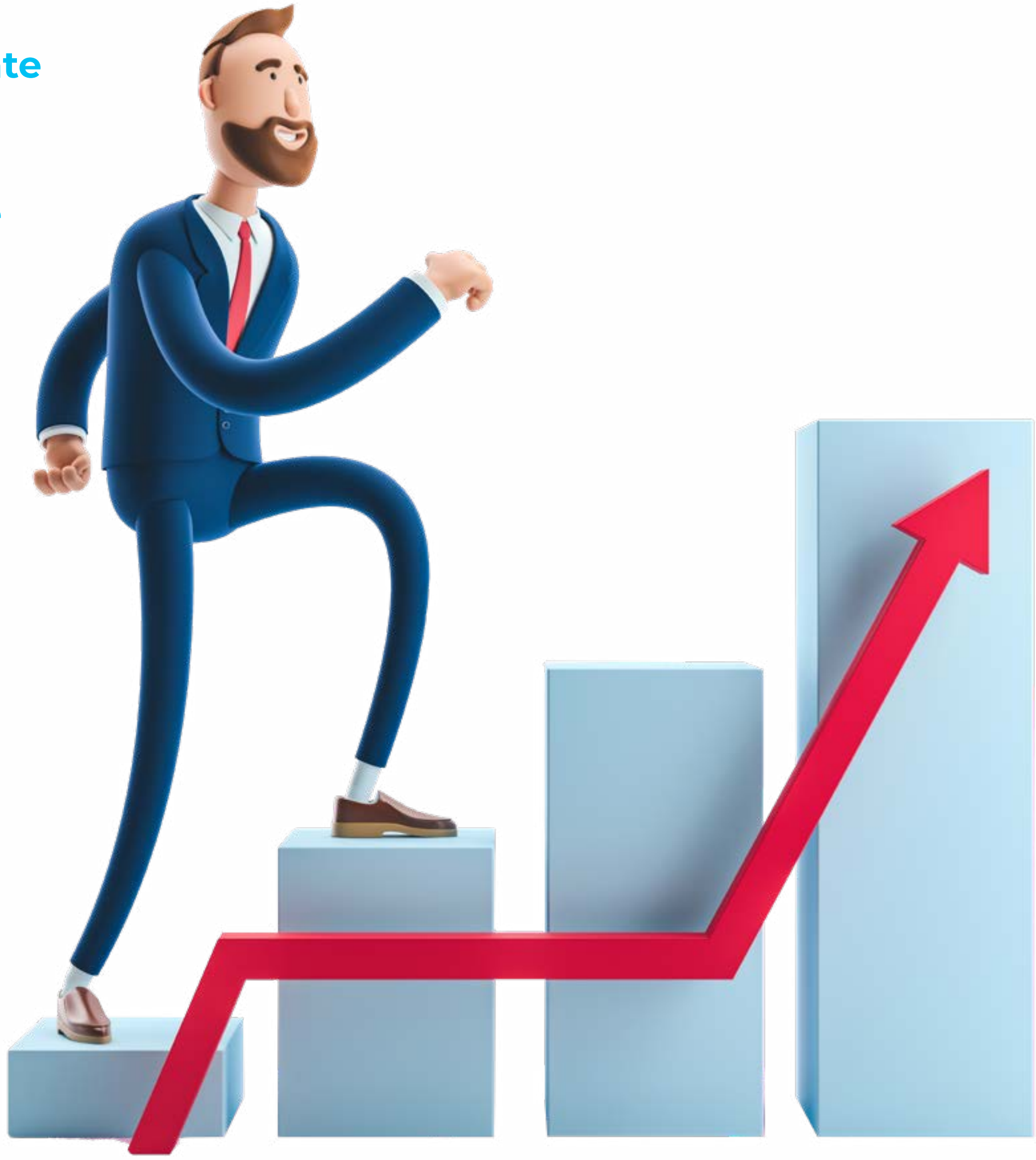
Gearing

Gearing is commonly known as borrowing to invest, it is an investment strategy usually considered by more experienced investors and those with a higher risk appetite. This is because, while gearing can increase the value of your portfolio faster than otherwise possible, it will also magnify your losses in a market downturn.

The principle behind a successful gearing strategy is that the value of your investments will increase faster than the after-tax cost of servicing the debt. However in volatile markets a loss on the investment may mean you are unable to service the debt and can be forced to sell the investment at a loss.

RSM Financials job as your advice team is to help educate an improve your understanding of investment concepts and to optimise the investment strategy you wish to undertake.

An easy way to create additional benefits to your investment strategy is to help you understand the concept of Gearing the RSM Financial way!



Case Study - Matt & Kate

Matt and Kate are wanting to invest $220.00 per week or $953.00 per month as previously agreed. Based on the above dollar cost averaging table and the exact market cycle, RSM Financial provide information to Matt and Kate that considers the concept of Gearing.

RSM Financial suggest Gearing to Kate and Matt on the basis that they don't borrow any more money than what they previously would have invested. The suggestion is made that Matt and Kate consider one small adjustment to their plan for investing the $220.00 per week or $953.00 per month.

The Simple Adjustment

Before investing, RSM Financial ask Kate and Matt to consider utilising the $220.00 p/w to pay off their home loan. Once the home loan is repaid, RSM Financial suggest they consider redrawing the exact same $220.00 to invest in the recommended investment portfolio. The risk of investing is identical to the exact situation where $220.00 p/w or $953.00 p/m is invested without gearing. The benefit Matt and Kate have potentially created is that $953.00 of their home loan per month is now considered Gearing debt, which is tax deductable!

The Cashflow Management module identified that their home loan charges an interest rate of 3.35% and made recommendations to setup their banking structure to make this strategy viable. The potential benefit of adjusting their investment strategy to incorporate Gearing is:

	AMOUNT INVESTED	UNIT PRICE	NUMBER OF UNITS	TAX INTEREST SAVING
JANUARY	$953	$22	43.31	$10.37
FEBRUARY	$953	$24	39.70	$10.37
MARCH	$953	$27	35.29	$10.37
APRIL	$953	$25	38.12	$10.37
MAY	$953	$23	41.43	$10.37
JUNE	$953	$21	45.38	$10.37
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NOVEMBER	$953	$21	45.38	$10.37
DECEMBER	$953	$22	43.31	$10.37
	$11,436	AVERAGE $21.41	TOTAL UNITS 545.01	TOTAL SAVING $124.50

The adjustment to the investment strategy enables access up to $124.50 in tax savings over the course of 12 months. Whilst this saving is minimal, the potential benefit of making this consideration is that up to $124.50 is saved. In other words, it is potentially $124.50 of reduced risk!

Matt and Kate have decided to continue the investment strategy long term (10 years). Over the course of 10 years the couple would have invested $114,360.00. Considering the Gearing adjustment, there would be potentially tax deductable debt of $114,360.00. Based on the current interest rate of 3.35% and $114,360 of borrowings, TAX savings of $1,245.09 per year or 1.3 months of additional savings could result from this strategy. This assumes the same marginal tax rate is applied throughout the period of investment.

RSM FINANCIAL

GET IN TOUCH!

RSM FINANCIAL
Address, 380-382 CANTERBURY RD, SURREY HILLS VIC 3127

Phone 03 9276 0908
Email financialservices@rsmgroup.com.au
Web www.rsmfinancial.com.au

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