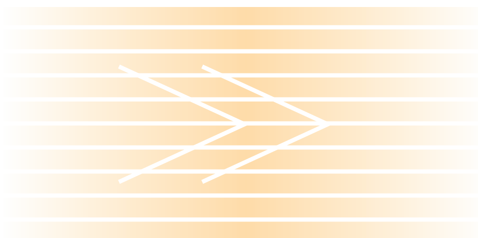


IFSA

Getting the edge with managed funds

Money matters for under 25s

Landing your first ever job can be an awesome experience. Receiving your first ever pay cheque is even better. It's your first step towards financial independence and seeing a healthy bank balance will make you feel like a millionaire (even if it's only temporary).

Now that homework is history, and you'll be earning more money than ever before, it's also a great time to make the most of your new financial status and start building your wealth. Why now? Because you'll probably have fewer financial commitments, like monthly mortgage repayments, and it's one of the few times in life that you can snatch a head start. And it's a simple fact that you don't need mountains of cash to get started on a wealth creation plan. Starting early with smaller amounts is actually more valuable than trying to catch up with larger amounts later in life, as you can see in the case of Joe and Ben.

The cost of leaving it till later

Joe and Ben, best friends from uni, both landed their first job when they were 20. Earning roughly the same salary, they each had very different attitudes towards money and what they did with their monthly pay packets.

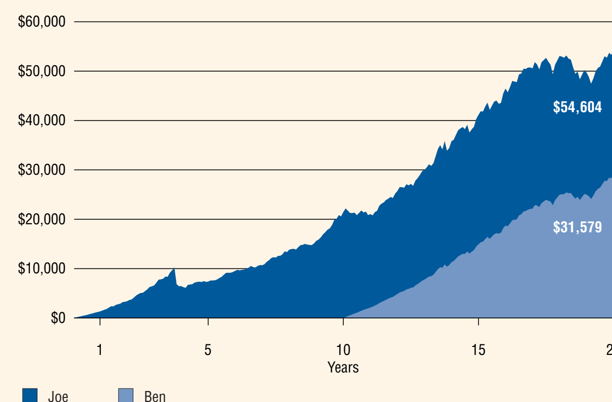
Since the day he received his first pay cheque, Ben was obsessed with buying things. At first it was a new stereo and TV and a new car the following year.

Joe had a different approach. He had watched a lot of his mates get into debt and was keen to steer clear. It was also important to him to start saving right away - he wanted to get a deposit together for a house, so starting with his first pay cheque, Joe decided to invest $100 each month over a 20-year period starting in January 1984. However, Ben didn't start saving until 10 years later, and tried to make up for lost time by investing $200 a month for 10 years.

20 years later

Although both Joe and Ben invest a total of $24,000, their accounts have very different balances after 20 years, as the chart shows. This is because Joe started earlier, and made small regular contributions over time.

Ben loses out



Source: Morningstar. Investment returns based on the Morningstar Multisector Trusts Growth Index, from 31 December 1983 to 31 December 2003.

Pay yourself first

Pay yourself first is a simple but effective strategy that can help you a) get what you want and, b) become a disciplined saver. It's a simple trick that involves setting aside a portion of your pay packet each time you receive it. This amount will ideally be deposited into a savings account, where it will easily accumulate over time.

The idea is simple because you don't give yourself a choice. Think of it as a fixed expense you owe yourself. Since you'll be dealing with money for the rest of your life, think of paying yourself first as a very important principle for managing money. The earlier you develop the habit of saving, the better off you'll be.

The debt trap

Unfortunately, for many Australian teenagers and students, debt is a fact of life. The Office of Fair Trading has reported

Investment and Financial Services Association Ltd ABN 82 080 744 163 IFSA represents the retail and wholesale funds management and life insurance industries. IFSA has over 100 members who are responsible for investing more than $725 billion on behalf of over nine million Australians.

The information contained in this brochure is general information only and does not take into account your individual objectives, financial situation or needs. You should assess whether the information is relevant to you and consider talking to a financial adviser before making an investment decision.

that teenagers have an average debt of $3,000, and for those aged 18-24 the debt level jumps to $6,000 with credit cards, mobile phones, car repayments and fines being the main offenders for getting into the red.[1]

Having one foot in broke-dom this early in life, thanks to a "use now, pay later" attitude means that many will be saddled with debts they'll carry well into adulthood and are destined to always be behind. To make things worse, this can result in a poor credit rating, which means securing a loan or mortgage down the track won't be easy.

Striking the right balance between spending and saving can be tricky. But there are clever ways to make sure you don't go pear-shaped financially. You could "pay yourself first" by putting aside 10% of your earnings before paying other expenses, such as your mobile phone bill and rent, and investing this amount into a managed investment.

What are managed investments?

A managed investment is a great way to build wealth. When you invest in a managed investment, your money is pooled together with a lot of other people's - and invested in a range of asset classes including property, shares, cash and fixed interest or a mixture of all of these.

A snapshot of the different asset classes

Cash

You may choose to put your money into a savings account where you loan your money to a bank and earn interest. Cash is the lowest-risk investment and historically it also has the lowest returns.

Property

There is a range of property investments available: commercial, residential, industrial, and rural.

Property has the potential for high growth over the long term.

Fixed interest

Fixed interest investments are loans made to a company or government. In return for the loan, you receive the promise that the funds will be returned to you with interest. Bonds, bank bills and debentures are examples of fixed interest investments.

Shares

You can also buy shares in a company and become a joint owner of the business. If the company prospers, you share in its profits, in the form of dividends. If the company's value declines, so does the value of your investment. Although shares carry the highest level of risk, history shows that they usually provide the best returns over the long term.

Investing in a managed investment can give you exposure to each or all of these asset classes and they're a low cost way to get the benefits of diversification. Diversification is all about spreading your money over a range of assets, so by having broad exposure you're not as likely to lose out if one area performs poorly. Sadly, few of us have reliable psychic abilities, which means it's near impossible to pick the best performing investment - markets are unpredictable and today's performer could be tomorrow's failure. So if you're a wise investor you won't put all your eggs in one basket.

By pooling your money with other investors, you also gain access to investments that wouldn't normally be affordable or available to a single investor. This might include things like a large hotel, shopping centre or shares in a global blue chip company like Nokia. Investing in a managed investment also means that you can sit back and let the experts work on your behalf. Professional fund managers carry out the research, choose the best assets to buy and decide on the optimum time to sell.

And don't be fooled into thinking that you need loads of cash up front to start investing in a managed investment. Most funds have a minimum investment of $1,000. You can also opt for a regular investment plan - which allows you to invest an amount each month. By doing this, you can smooth out the impact of fluctuations in the market and reduce risk. It's also a great 'set and forget' strategy to build your wealth and pretty soon your balance will surprise you. For more details, check out the fact sheets within IFSA's Education Corner at www.ifsa.com.au.

Single investor versus managed investment

Kate was desperate to invest in shares but she only had $1,000. She was keen to have an Australian share portfolio, but knew she'd need a lot more money.

So what are Kate's options? Realistically, if Kate was an individual investor, she could only afford to invest in one or maybe two Australian companies. If those companies performed poorly, Kate could lose her money.

Alternatively, if Kate invested in a managed investment, depending on what type of fund it was, Kate could potentially invest in up to 50 Australian companies. Kate's money would also be managed by professionals, who have access to a lot more share research than Kate would by herself.

Super - your first investment

Chances are, if you're over eighteen and already working, you could already be investing in managed investments without realising it - through your super fund. You can access exactly the same asset classes; however, super has one distinct advantage - tax benefits. All earnings generated by investments within your super fund are taxed at a maximum of 15%, while earnings generated by investments outside of super are taxed at your marginal tax rate, which

[1] Youth Debt Report: Office of Fair Trading, November 2003.

can be as high as 47%. If you're earning over $450 per month, your employer has to make contributions to your super fund on your behalf. Although you can't access your super savings until you reach a certain age, you can still take an active role in its management - to make sure you have more later on.

When it comes to super it's normal to feel a bit overwhelmed. It's a complicated product but it's worthwhile taking the time to learn a few facts. New laws have been passed which will allow most people to choose the fund that their super will be paid into. The new legislation comes into play on 1 July 2005, so after this date it will be important for people to understand what they want from a super fund. Uncovering this kind of information is pretty easy. You can start by looking at the fund's detailed information booklet or Product Disclosure Statement (PDS), which should include details about the fund's main features.

Don't forget insurance

When you hear the word insurance, you probably tell yourself 'I don't need insurance', but even the most watertight plans are not immune to unforeseen circumstances. That's why you should consider protecting your most valuable resource, your future income. What will you reasonably earn in your working life? What will happen if you are unable to earn that income? Income Protection and Trauma cover are two products you should consider to reduce the impact if you are unable to work fulltime.

Many of us have HECS and credit card debts, and loans that we are paying off, and you'll still be expected to come up with the money for rent and these expenses if you can't go to work. Fortunately, many of these income protection policies are tax deductible.

Death insurance is also relatively inexpensive and although it's not a subject many people want to think about, it should also be on your shopping list for your own piece of mind if you don't want to leave debts behind for loved ones should the worst ever happen.

Getting more information

There are a variety of sources where you can go to get more information about managed investments and investing in general.

1. You could start by looking at the other fact sheets within IFSA's Education Corner - especially *Getting the edge with managed investments*, *Four lessons from the market* and *Take control of your money*. You can also speak to a financial planner who will also act as your guide when you select a managed investment. IFSA's *Six easy steps to choosing a financial planner* can help you find a financial planner with whom you feel comfortable.
2. Check out the variety of fund manager sites - all of which contain copies of their managed investment's Product Disclosure Statements (PDS). A PDS contains all the relevant information about the particular fund, including its asset allocation, size, fund strategy, and applicable fees. To invest in the fund you need to complete an application form - which is usually at the back of the PDS. Fund manager websites will also have downloadable investor magazines, fact sheets and fund profile sheets. The IFSA website includes a list of member companies which links straight through to their websites.
3. The Australian Securities and Investments Commission (ASIC) have a section on their website, www.asic.gov.au called Fido, which has a host of information for consumers and investors.
4. You can also obtain information from trade press magazines and journals, such as *Money*, *Personal Investor*, and *Shares*, all sold at newsagents.
5. The Financial Planning Association (FPA) has launched a financial planning workbook called *Dollarsmart*, which is specifically designed to help teenagers learn about money and managing their finances. You can download a copy of *Dollarsmart* from the FPA's website, www.fpa.asn.au.
6. For further information on life insurance, IFSA has a range of fact sheets on its website to explain life insurance, how it works and the type and range available. Armed with this information, you can then discuss your particular needs with a financial planner or insurance adviser.

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