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Achieving Financial Security

Fifteen Golden Rules to help you achieve financial security

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GENERAL ADVICE WARNING

The information contained in this report is general information only and does not take into account your individual objectives, financial situation or needs. This means that, before acting on any information in this report, you should consider whether it is appropriate for you, having regard to your own objectives, financial situation and needs.

ABOUT THE AUTHOR

Steven Pritchard obtained a Bachelor of Commerce degree from the University of Newcastle in 1986 and qualified as a Certified Practising Accountant in 1988.

He became a director of Rees Pritchard Pty Limited in 1989, and was, at the time, the youngest partner of any firm of Certified Practising Accountants in Newcastle.

He made his first investment in the stock market in 1977 when he was 16 years old, and has been providing investment advice as a representative of a licensed dealer in securities since 1988.

He completed the Graduate Diploma in Applied Finance and Investment, and was admitted as a Fellow of the Financial Services Institute of Australasia in 1993.

In 1996 he was admitted as a member of Stock Exchange of Newcastle Limited ("NSX"). He was instrumental in establishing Pritchard & Partners Pty Limited, which became the first new member firm of NSX in 26 years.

He was a director of NSX from 1996 to 2003, and its chairman from 2000 to 2003. During his time with NSX he was responsible for developing a strategic plan which saw the renaissance of NSX as a capital market for small, medium and regionally based companies.

In 2002 he established of Hamilton Capital Proprietary Limited, which acquired the ASX Participating Organisation Cameron Stockbrokers Limited. He is the current Executive Chairman of the Hamilton Capital Proprietary Limited Group, which includes Hamilton Asset Management Limited.

Hamilton Asset Management Limited is an Australian based funds manager that is developing a unique range of investment products to assist investors in meeting their financial goals.

He is a director of a number of listed and private investment companies, and is also currently a director of each of FijiStock Brokers Limited and South Pacific Stock Exchange Limited.

He is a past Branch Councillor and Chairman of CPA Australia, and received the President's Award in 2000 for outstanding contributions to CPA Australia.

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RULE 1
INVEST IN YOURSELF

Most people will make far more money from their profession, trade or business than from their investments. It is only very rarely that someone makes a large fortune from investments.

The first step to increase your wealth is therefore to enhance your ability to earn.

The more skill and knowledge you have, the greater your ability to earn. A person learns more about their profession, trade or business will be greatly rewarded.

If you are in a profession, you can consult and exchange knowledge with other persons in the same profession so that you become a specialist — in greater demand and commanding higher fees.

If you are in a trade, you can seek to learn the methods of those most skilful in the same trade so that your skills are increased, and you can command more money for your services.

If you are in business, you can learn more about the markets in which you operate — gaining a competitive advantage.

As Benjamin Franklin said "***An investment in knowledge always pays the best interest***."

RULE 2
BUY YOUR OWN HOME

It ought not to be beyond the capacity of any working person to own their own home.

When you own your own home, not only do you have a valuable asset which will give you a great sense of satisfaction and security, but you will also greatly reduce your future cost of living, with your only housing costs being maintenance and rates. This will ensure that more of your earnings are available to assist in building your future wealth.

Additionally, your own home is one of the few assets that are not generally subject to capital gains tax in Australia.

If you need to borrow to buy your own home, you should try to repay your housing loan as quickly as possible.

By making small additional repayments on your loan, you will make a significant difference to the term of the loan and the total amount you ultimately repay.

EXAMPLES

If you bought a house that cost $450,000 and borrowed $360,000 or 80% of its value from a bank, building society or credit union at an interest rate of 7% per annum, and chose to pay the loan off by equal monthly instalments over 25 years, your monthly instalments would be $2,544. The total interest you would have to pay would be $403,323 over 25 years, with total repayments of $763,323.

However, if, all else being equal, you chose to make fortnightly payments of $1,272 instead of monthly payments of $2,544, you would pay the loan off in just 20 years instead of 25 years. The total interest you would have to pay would be $319,354 instead of $403,323, a saving of $83,969.

If you wished to pay your house off over 10 years, your repayments would need to be $4,180 per month. The total interest you would have to pay would be $141,589, and you would make an interest saving of $261,734.

Whatever loan you take out, you should increase your loan repayments every year by at least the amount of the increase in the consumer price index. After all, if you were renting your home, your rent would be going up at a similar rate.

RULE 3
PAY YOURSELF FIRST

Most people pay themselves last. They put aside for their future only what is left after everything else has been paid, which in many cases is nothing.

What most people find is that as their income increases, they spend more, and their wealth does not grow with their additional income.

You should always pay yourself first by putting away at least 10% of your income. After a short period you will find that you manage just as well as you did before, as many expenses can be eliminated or reduced without affecting your lifestyle greatly. You will now have taken your first steps towards creating some wealth for the future.

If you put 10% of your income away every year, after 10 years you will have saved a whole year's income.

The money you put aside can be invested to produce additional wealth, and you can take advantage of Rule 6: The Magic of Compounding Returns.

You should open a separate high interest account at your bank, building society or credit union, and deposit your 10% into it until you have a sufficient sum to invest.

Many managed funds offer regular savings plans, often with minimum monthly contributions starting as low as $100, with the amount you wish to invest being debited to your bank, building society or credit union account. These savings plans can provide you with a simple but effective way to start investing your money regularly.

RULE 4
PREPARE A BUDGET

After you have paid yourself, you should draw up a budget so that you can see and keep track of where your remaining money is being spent.

For many people, the expenses that they regard as necessary grow at a rate equal to or greater than the rate at which their earnings are growing.

Most people have more desires than their earnings can satisfy, and it is for this reason that as their earnings increase, so also do the amounts they use to satisfy their desires.

By drawing up a budget, you can determine what really are necessary expenses, and what are only things that you would like to have.

Once you have drawn up your budget, you should study it carefully and see what expenses can be reduced or eliminated altogether.

Select those items that are necessary and those that are affordable if you limit your spending to nine tenths of your income. Then cross out the rest.

Here is a simple table showing a suggested form for a family budget.

FAMILY BUDGET

INCOME	**Earner 1 ($)**	**Earner 2 ($)**
Gross salary / wages		
Other taxable income (pre-tax)		
Other non-taxable income		
Current Centrelink/DVA benefit		
Total income		
Estimated tax payable		
Estimated income after tax		
Combined after tax income		
Less investments and savings of at least 10%		
Household disposable income		

EXPENDITURE		**Weekly ($)**	**Monthly ($)**	**Annual ($)**
Housing	Rent / mortgage repayments			
	Council rates / water rates			
	Electricity / gas / oil			
	Telephone			
	House and contents insurance			
	Household repairs / maintenance			
	Other			
Transport	Petrol / fuel / services / repairs			
	Registration / licences / insurance			
	Public transport / taxi fares			
	Loan / lease repayments / parking / other			
Health	Health benefits / insurance			
	Chemist / other			
Education	Fees / books			
	Child care / other			
Personal	Food / groceries			
	Clothing / footwear / haircuts			
	Sports / recreation / hobbies / subscriptions			
	Gifts / presents / entertainment			
	Books / magazines / newspapers			
	Life insurance / disability insurance			
	Other			
Total household expenditure				
Annual surplus: Household disposable income less total household expenditure				

RULE 5

DON'T ASSUME YOU CAN REPLACE YOUR WEALTH

The fact that you have been able to earn what you have does not mean that you could earn it again if you lost it.

Markets and opportunities change, technology changes and laws change. Conditions may be different from what they were when you acquired the wealth you have now. And as time passes, changes to regulation and taxation may make it harder to grow your wealth.

So treat what you have as though you could never earn it again. Don't take chances with your wealth on the assumption that you could always get it back.

Don't take risks with complicated schemes in the hope of multiplying your capital quickly. Your investment plan should be aimed, first and foremost, at preserving the capital that you have from investment loss and mismanagement.

As Warren Buffett said "The first rule of investing is don't lose money; the second rule is don't forget Rule No. 1."

RULE 6

USE THE MAGIC OF COMPOUNDING RETURNS TO INCREASE YOUR WEALTH

Each dollar you put aside should be put to work for you in making more dollars. The earnings on those new dollars can also be put to work for you, thus multiplying your wealth. This is the magic of compounding returns.

EXAMPLE 1

If you put aside $100 a month for your new born child in an investment which earns 8% per annum, by the time they reach the age of 21 the capital amount will be $65,035. The total amount invested will have been $25,200, and the total return over this period will have been $39,835.

If your child then decides to leave this money invested until they retire at the age of 55, then (if they don't make any further contributions and it continues to earn 8% per annum) they will then have a nest egg of $978,380. This amount represents your original investment of $25,200, and a total return of $953,180.

This is the magic of your money working for you through compounding your returns.

EXAMPLE 2

You are aged 30 at the time your child is born, and have decided you wish to accumulate enough wealth to retire at 55 and have a comfortable retirement.

With the help of your accountant you work out that if you put aside $1,050 per month for the next 25 years, and your investment returns 8% per annum, you will have accumulated $1,000,000 of total wealth by the time you are 55.

Important: These examples show how compounding returns work, not what returns are likely to be. The rate of return shown may never be achieved, or sustained over the longer term. The dollar amounts make no allowance for inflation which can make a big difference to the value of money over time.

RULE 7
RECOGNISE THE DIFFERENCE BETWEEN INVESTING AND SPECULATING

When you invest, you accept the return the markets are paying investors in general. When you speculate, you attempt to beat that return and to do better than other investors are doing, through astute timing, forecasting or stock selection, and with the implicit belief that you are smarter than most other investors.

There's nothing wrong with speculating, provided you do it with money you can afford to lose. But you shouldn't risk the money that's precious to you by betting that you can outperform other investors.

RULE 8
NO ONE CAN PREDICT THE FUTURE

Events in the investment markets result from the decisions of millions of different people. Financial advisers can no more predict the future actions of human beings than can psychics or fortune-tellers. And so events never unfold exactly as financial advisers think they will.

There have certainly been forecasts that have come true. But the only reason we notice them is because it's so exceptional for even one forecast to come true. We forget about all the failed predictions because they're so commonplace.

No one can reliably tell you what stocks will do next year, what interest rates will be, whether there will be more inflation, or how the economy will perform.

RULE 9

NO ONE CAN GUIDE YOU CONSISTENTLY IN AND OUT OF INVESTMENTS WITH PRECISE AND PROFITABLE TIMING

Rule 9 is really just an extension of Rule 8. You'll hear about many so called financial wizards, but the financial adviser with the perfect record up to now will most likely lose their touch the moment you start acting on their advice.

Investment advisers can be very valuable. A good adviser can help you understand how to do the things you need to do. They can help call your attention to risks you may have overlooked. And they can make you aware of alternative investments and new opportunities.

But no one can guarantee to always put you in the right place at the right time. And even worse, attempts to do so can sometimes be catastrophic for your financial security.

RULE 10

TRADING SYSTEMS NEVER WORK AS WELL IN THE FUTURE AS THEY DID IN THE PAST

You'll come across many trading systems or indicators that seem always to have signalled correctly where your money should have been, but somehow the systems never come through when your money is on the line.

Even if it were possible for some bright person to develop a sound trading system, everyone would soon learn about it and try to turn it to their advantage. This would alter the dynamics of the market and undermine the principles on which the trading system was based. So the system would very quickly cease to be effective.

RULE 11

DIVERSIFY YOUR INVESTMENT PORTFOLIO

Every investment has its time in the sun, and its moment of shame. Precious metals ruled the roost in the 1970s while stocks and bonds were in disgrace. But then gold and silver became the losers of the 1980s and 1990s, while stocks and bonds multiplied their value. No single investment is good for all times.

Even government bonds and bank deposits can lose real value during times of inflation.

We live in an uncertain world, and surprises are the norm. You shouldn't risk the chance that a single surprise will wipe out a large part of your investments.

Diversifying across your investment portfolio with different asset classes can help you to smooth out the returns of the portfolio over time. Whilst this strategy cannot entirely protect you from negative returns, it can reduce the impact of poorly performing asset classes.

Asset classes perform differently at different times of the economic cycle, and the performance of different classes can have negative correlations. Holding a diversified portfolio can help to reduce the volatility of your portfolio returns, with better performing investments helping to offset underperforming ones.

These are really just different ways of saying "don't put all your eggs in one basket".

The table on page 17 shows how different asset classes have performed over the period 1996 to 2011.

RULE 12
DON'T USE DEBT

When someone goes bankrupt, it's almost always because they have borrowed money. In many cases, the person was already quite wealthy, but they wanted to increase their fortune with borrowed money.

Using margin lending accounts or mortgages for general investment purposes puts you at risk of losing more than your original investment. If you handle all your investments on a cash basis, it's almost impossible to lose everything, no matter what might happen in the world, and especially if you follow the other rules in this book.

RULE 13
ONLY INVEST IN THINGS YOU UNDERSTAND

Don't make any investment, or follow an investment program that you don't understand. If you do, you may later discover risks you weren't aware of, and your losses might turn out to be greater than the amount you have invested.

It's better to leave your money in a term deposit than to take chances with investments you don't fully comprehend. It doesn't matter that your doctor, brother-in-law or best friend understands some money-making scheme. It isn't their money at risk. If you don't understand it, don't participate in it.

RULE 14

SPECULATE ONLY WITH THE MONEY YOU CAN AFFORD TO LOSE

If you want to try to beat the market, set up a separate portfolio with which you can speculate to your heart's content. But make sure this portfolio contains no more of your wealth than you can afford to lose.

The investments in this separate portfolio will vary as your outlook for the future changes. It might be all or part in speculative stocks or gold or something else, basically whatever looks good at the time.

You can take chances with this portfolio because you know that, whatever happens, no loss can be devastating. You can only lose money which you have already decided you can afford to lose.

RULE 15

BEWARE OF TAX-AVOIDANCE SCHEMES

A great deal of money has been lost by people who have hoped to beat the taxation system by developing or participating in elaborate tax schemes.

Many of these losses have come from investments that provided special tax advantages but have not necessarily made economic sense. Agricultural managed investment schemes sometimes fall into this category — some have lost many millions of dollars for investors. Some "sure thing" tax schemes have been disallowed by the Australian Taxation Office, with penalties and interest imposed on top of tax liabilities.

There are a number of simple ways to make sure you don't end up paying more than your fair share of taxes. These can include establishing family trusts and companies, contributing to superannuation funds and making salary sacrifices.

These methods can be effective — and they won't come back to haunt you provided you stick to the rules.

FINANCIAL YEAR TOTAL RETURNS (%) FOR THE MAJOR ASSET CLASSES

Year	Cash1	Aust. fixed interest2	Int'l fixed interest3	Aust equities4	Int'l equities5	Listed property trusts6	CPI7
1991	13.5	22.4	15.3	5.9	-2.0	7.7	3.4
1992	9.0	22.0	15.8	13.3	7.1	14.7	1.3
1993	5.9	13.9	14.7	9.9	31.8	17.1	1.9
1994	4.9	-1.1	2.1	18.5	0.0	9.8	1.7
1995	7.1	11.9	13.1	5.7	14.2	7.9	4.5
1996	7.8	9.5	11.2	15.8	6.7	3.6	3.1
1997	6.8	16.8	12.1	26.6	28.6	28.5	0.3
1998	5.1	10.9	11.0	1.6	42.2	10.0	0.7
1999	5.0	3.2	5.5	15.3	8.2	4.3	1.1
2000	5.6	6.2	5.0	13.7	23.8	12.1	3.2
2001	6.1	7.4	9.0	8.8	-6.0	14.1	6.0
2002	4.7	6.2	8.0	-4.5	-23.5	15.5	2.8
2003	5.0	9.8	12.2	-1.1	-18.5	12.1	2.7
2004	5.3	2.3	3.5	22.4	19.4	17.2	2.5
2005	5.6	7.8	12.3	24.7	0.1	18.1	2.5
2006	5.8	3.4	1.2	24.2	19.9	18.0	3.9
2007	6.4	4.0	5.2	30.3	7.8	25.9	2.1
2008	7.4	4.4	8.6	-12.1	-21.3	-36.3	4.5
2009	5.5	10.8	11.5	-22.1	-16.3	-42.3	1.5
2010	3.9	7.9	9.3	13.8	5.2	20.4	3.1
2011	5.0	5.5	5.7	12.2	2.7	5.8	3.6
2012	4.7	12.4	11.9	-7.0	-0.5	11.0	1.2
2013	3.3	2.8	4.4	20.7	33.1	24.2	2.4
2014	2.7	6.1	7.2	17.6	20.4	11.1	3.0
2015	2.6	5.6	6.3	5.7	25.2	20.3	1.5
2016	2.2	7.0	10.8	2.0	0.4	24.6	1.1
2017	1.8	0.2	-1.0	13.1	14.7	-6.3	1.9

= Best **= Worst**

Notes-1. Data Prior to March 1987 supplied by reserve Bank of Australia. From March 1987 the index is the Bloomberg Aus Bond Bank Bill Index. 2. Prior to December 1989 the Index is the Commonwealth Bank all series greater than 10 years bond accumulation Index. From September 1989 the index Is Bloomberg AusBond Composite 0+ Yr index. 3. Index prior to 30 June 2008 is the Citigroup World Government Bond Index AUD hedged, from 30 June 2008 the index is the Barclays Global Treasury Index AUD hedged (previously: Lehman Global Treasury Index AUD hedged). 4. S&P/ASX All Ordinaries Accumulation Index. 5. MSCI World ex-Australian Net Total Return Index. 6. S&P/ASX 200 A-REIT Accumulation Index. 7. ABS Consumer Price Index (to June 2017).