Investment Planning Guide

Achieve the financial freedom and lifestyle you want

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Financial Planning

The What, Why, When and Where of Investment Planning?

This guide provides the what, when, where, why and how of investing. Investing has risks and benefits. What is appropriate for you is unique and it is important when investing to seek advice from a financial adviser who can consider your individual circumstances.

What is Investing?

Investing is the act of committing money or capital to an endeavour with the expectation of obtaining additional income or profit. Investing is how you make your money grow or appreciate for long term financial goals. It is different from saving, which is a plan to set aside a certain amount of earned income over a short period of time to achieve a short-term goal.

Why Invest?

Chances are you want to pay today's bills and have resources to enjoy life with family and friends, build assets for the future, as well as save for your children's needs. Investing can help deliver against these goals and more, depending on what you are setting out to achieve. Taking some of your hard-earned income and investing for your future needs is a way to make the most of what you earn.

When Should I Start?

Having a plan and starting early is crucial in achieving your goals. Think of your investment plan as a map to get you to your financial goal. It will help you set your destination and the route you will need to take. The earlier you start the better chance you have of getting to your destination.

Where Do I Start?

Before embarking on the investment journey, it is important to work out your needs and objectives. You need to consider if you have your debts under control, cash on hand for emergencies and adequate insurance protection. Once you have ascertained that you are ready to invest, then it is time to set your goals.

How to Invest

Once you have decided now is the time to invest, there are several steps you need to take to help make your decision.

1. Goal Setting

Think about what your goals are. They may be to save for your wedding, save for your children's university fees or for your retirement. Each of these goals has a different timeframe. You may have two years to save for your wedding, but if you are saving for your retirement you may have 30 plus years.

Defining a timeframe for each investment goal can help you determine how much investment risk you can afford to take. If you are investing over a short period of time you should avoid volatile investments, but if you are saving for a longer-term goal then you have time to "ride out" the ups and downs of the market.

For more information check out our [Guide to Insurance Planning].

2. Assess Your Investment Options Before You Invest

Once you have set your goals you then need to decide where to invest your money. Before you invest it is important to carefully assess each investment and its suitability for your needs. There are many different asset classes in which you can invest. Understanding what to expect from each asset class can help you make the investment decisions for your situation and timeframe.

Asset Classes - Asset classes are the building blocks of any investment. An asset class is a category of investments which have similar characteristics in the market. Investments within a similar asset class have similar risks and returns, are subject to the same laws and regulations and perform similarly in different market movements.

Defensive Assets – Focus On Generating Income.

Cash – Safest, most readily available asset class with a very high degree of capital security (i.e. term deposits).

Fixed Income – A debt security issued by a bank, corporation or government which pays the investor an ongoing coupon or interest at a set rate and returns the principal amount at maturity (i.e. Government bonds).

Growth Assets – Focus on capital growth and income

Property – Listed investments in companies and listed property trusts which buy, sell, manage, and/or develop a range of properties across different property sectors and locations around the world (i.e. Listed Property Trusts or Real Estate Investment Trusts (REITs)).

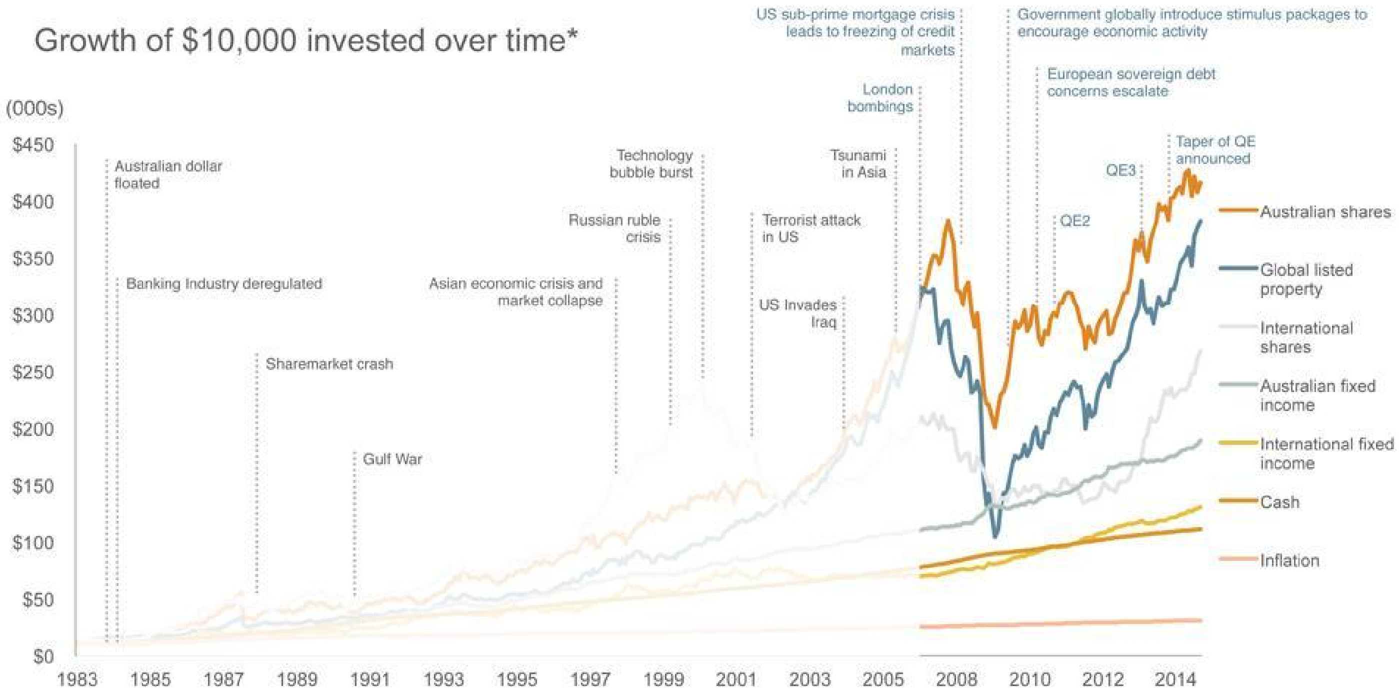
For more information check out [Property Investment Guide].

Australian Shares – Investing in Australian shares represents part ownership of a company. Shares are generally bought and sold on the stock exchange.

International Shares – International shares generally work the same as Australian shares. The additional benefit is the increased opportunity to invest in a broader range of regions, sectors, and companies (shares lists on global stock exchanges).

Alternative Assets – Alternative assets behave differently to traditional asset classes such as shares, listed property and fixed income. Alternative assets Include hedge funds, structured credit, unlisted property, unlisted infrastructure, private equity, and commodities.

The below graph shows the performance of several asset classes over the past 25 years.



The behaviour of the major asset classes during, and in the years since the Global Financial Crisis, show the risk/return characteristics of the different asset classes. We can see, for example, that cash provided stable returns, but the returns were below that of other asset classes. Shares characteristically showed they can be volatile in the very short term, but that time can generally make up any losses incurred over shorter time periods.

3. Balance Risk and Return

There are two golden rules when it comes to investing which will help you balance your risk and return:

1. **Diversification** – Diversification is the biggest risk management tool. Fundamentally it means not putting all your eggs in one basket. It is a technique whereby you mix a wide variety of investments within your portfolio. Instead of only investing in property, you diversify and invest in property, shares, and term deposits. It also means that if you buy shares, you don't buy all your shares in one sector such as banking, you would spread your share portfolio across multiple sectors such as banking, natural resources, and retail.

2. **Time in the Market** – This is time in the market, not "timing" the market. It is your investment horizon set by your goals. Risk tolerance is your ability to cope with dips in the value of your investments and is affected by variables such as your age, your ability to recover from capital losses and your health. Your risk tolerance is a trade-off between the risk you are comfortable with and the timeframe of your investment. Generally, the longer the timeframe the more risk that can be tolerated.

Risks of Investing

Nothing is without risk. When you invest you are exposed to different types of risk. It is important to know the risks, so you make an informed decision when investing your money.

- **Market Risk –** the risk of investments declining in value due to economic developments or other events that affect the entire market. The main types of market risk are equity risk, interest rate risk and currency risk.
- **Concentration Risk –** this is the opposite of diversification. This is the risk of loss because all your money is amassed in one investment type.
- **Credit Risk –** applies to debt investments such as bonds. It is the risk that the entity or company that issued the bond will be unable to pay the interest or repay the principal at maturity. This risk can be minimised by looking for entities with a AAA credit rating.
- **Inflation Risk –** the risk of a loss in your purchasing power because the value of your investments has not kept up with inflation.
- **Liquidity Risk –** this is the risk of being unable to sell your investment when you want to for a fair price. It may see you compelled to accept a lower price or you're simply not able to sell the asset.
- **Reinvestment Risk –** the risk of loss from reinvesting principal or income at a lower interest rate.
- **Longevity Risk –** the risk of outliving your savings. This risk is mostly relevant for people who are retired or are approaching retirement.
- **Horizon Risk –** the risk that your investment timeline may be shortened due to an unforeseen event, for example, divorce. This may force you to sell investments in the short term that you were expecting to retain for the long term.
- **Foreign Investment Risk –** the risk of investing in foreign countries which may tackle different issues to that of your own country, particularly in emerging markets.

4. Balance Risk and Return

With the golden rules always in mind, you then select how and where you invest. There are several different types of investment strategies, asset allocation determines these. What is appropriate for you depends on your personal risk tolerance, investment horizon and goals. The two main investment strategies are:

High Growth – A portfolio allocation focused on maximising earnings. This type of strategy has a long investment horizon, typically 10 plus years. It is particularly relevant for younger people trying to accumulate retirement balances where long-run returns compensate for the risks of short-term losses. In a high growth strategy, people are happy to sacrifice short-term returns to access assets whose return potential is superior over the course of a full market cycle.

Conservative – An investment strategy that aims to grow capital over the long term. Generally suited for those who are sensitive to downside risks, i.e. those approaching or in retirement, or those who already have accumulated a large retirement balance but wish to preserve capital whilst still generating return above the inflation rate. These people are happy to sacrifice long run returns to protect against downside risks and for possible more stable returns year to year.

Managed Fund vs Directly Investing

You can also choose to invest in a managed fund or directly invest. Managed funds are a pool of money which allow people with similar investment strategies to individually invest into a chosen fund. These funds can match your investment strategy and are generally classed by the investment strategies mentioned above.

The benefits of a managed fund are:

- Access to skilled and knowledgeable experts
- Access to ‘hard to get’ asset classes such as infrastructure
- Pooled investment power when combined with other investors
- Diversification across asset classes and countries

There are many different types of managed funds you can select from; single-manager, multi-manager, single sector, and multi-sector. What is appropriate for you is a solution that meets your investment horizon and risk tolerance.

Get Expert Advice

For tailored investment advice contact the award-winning team at
Elliot Watson Financial Planning on 02 4038 1623 for an initial consultation.

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