Freedom Stage 7
Part A

Adrian Pinkewich

Wealth Creation

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ACCOUNTING
Your financial potential. Realised.

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No action should be taken solely on the material contained in this presentation as the information is of a general nature and does not take into account your specific personal needs or circumstances.

You should consider whether what is discussed today is suitable for you and your personal circumstances.

Before you make any decision about whether to acquire a certain financial product, you should obtain and read the relevant product disclosure statement.

In Australia personal financial advice by a licensed financial adviser is ordinarily accompanied by an advice document called a statement of advice. If you have not received a statement of advice it is likely you have not received personal financial advice. Registered financial advisers are listed on a government website, along with the scope of their authorisation.

Introducing

Adrian Pinkewich CA

Chartered Accountant

Registered Tax Agent

Financial Adviser

For more information see www.nowaccounting.com.au or search the financial advisers register. Financial services guides provided at no cost on request.

This course is a designed to help you unlearn the bad financial "advice" that has been marketed to most people by a broken industry and replace it with proven principles that create to financial freedom, wealth and your best life.

Freedom Stages

1. Plan your financial freedom
2. Mini emergency fund
3. Protect your income (with insurance)
4. The debt snowball
5. Emergency fund
6. Healthy housing
7. Wealth Creation
8. Generosity

Wealth Creation

Financial Freedom…Now!

What is financial freedom?

The ability to cover future expenses without needing to work

Wealth Creation

Retirement

Planning for retirement and/or financial freedom/independence:

It is helpful to have a plan for retirement that specifically identifies:

Your target spending (could identify both “minimum & ideal”)

Your buffer for one off expenses (new roof, new hip, epic holiday)

Your expected rate of return from investing and the capital needed to get there

Reality check:

Compare your current spending to the age/disability pension

Compare your current spending and expected rate of return to your current investment assets

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Retirement

Your numbers:

I would like to retire _______________

My lowest retirement income would be ______________

My ideal retirement income would be _______________

My expected rate of return is ______________

To achieve that income I need _____________ invested

I am currently able to invest ____________ per ________

Wealth Creation

Retirement

Warning: Sequencing risk

Example. Flossy expects to retire next week with an ideal retirement income of $150,000. Flossy expects a retirement income return of 10% and has 1.5m invested.

If this return was experienced on average each year – no issue, capital stays the same, this can go on indefinitely.

If the investments halved in value on the day of retirement – huge issue, capital at serious risk of being reduced – potential to wipe out the whole fund in under 10 years.

It can be helpful to identify goals but the real world is complicated. This course will hopefully help you navigate that complexity!

Your income is your greatest wealth creation tool

If you consistently invest your income, you can create significant wealth and financial freedom

Consistency is key!

You can achieve the same results investing:

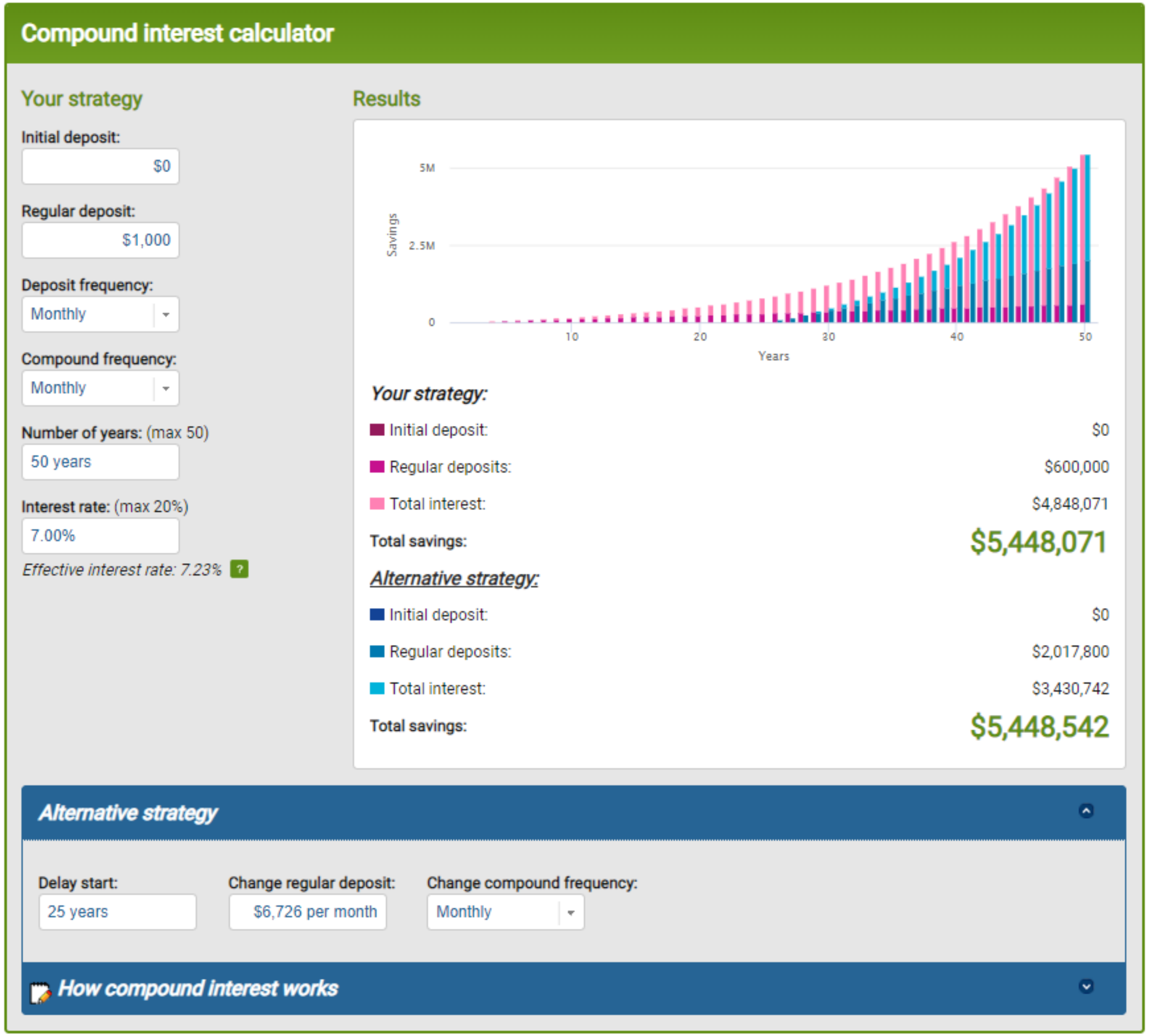
$1,000 per month for 50 years

or

$6,726 per month for 25 years

The 50 year investor puts in $600k.
The 25 year investor puts in $2m+.

The 25 year investor contributes three times as much of their own money.



https://www.moneysmart.gov.au/tools-and-resources/calculators-and-apps/compound-interest-calculator

Wealth Creation:

Consistency

Many people think that in order to use their income to build wealth, they have to borrow a lot of money or take a lot of risk. “This is my one big shot”.

Wealth creation is easier, and safer than you might think.

Here is an example inspired by the thinking within book The Slight Edge (which shows how slight but consistent differences can make a huge difference over time):

Adam and Adrian generate the same income and have everything the same except…:

Adrian keeps borrowing money for cars and pays out $1,000 per month on car loans

Adam drives an older car and invests $1,000 per month into Superannuation

Wealth Creation

Retirement

At 7.2% net return, after 10 years, Adam has $175,003 more than Adrian. After 30 years, its $1,269,225.

Compound interest calculator

Your strategy

Initial deposit: $0

Regular deposit: $1,000

Deposit frequency: Monthly

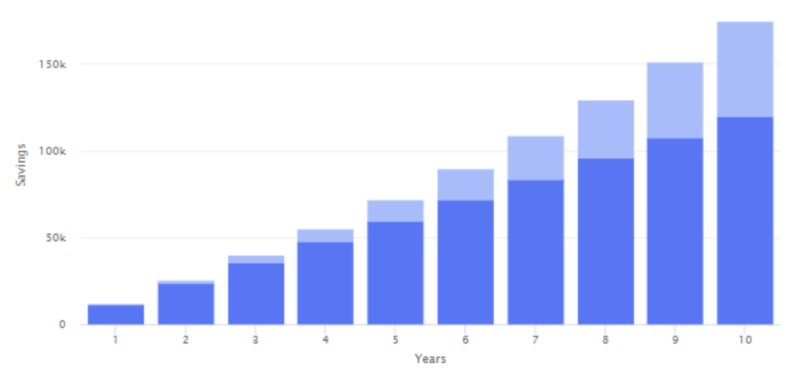
Compound frequency: Monthly

Number of years: (max 50) 10 years

Annual interest rate: (max 20%) 7.20%

Effective interest rate: 7.44%

Results



Your strategy:

Initial deposit:	$0
Regular deposits:	$120,000
Total interest:	$55,003
Total savings:	$175,003

Compound interest calculator

Your strategy

Initial deposit: $0

Regular deposit: $1,000

Deposit frequency: Monthly

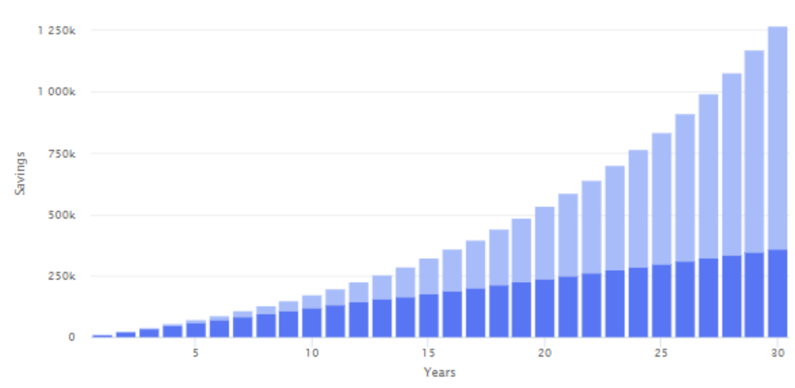
Compound frequency: Monthly

Number of years: (max 50) 30 years

Annual interest rate: (max 20%) 7.20%

Effective interest rate: 7.44%

Results



Your strategy:

Initial deposit:	$0
Regular deposits:	$360,000
Total interest:	$909,225
Total savings:	$1,269,225

Wealth Creation

You can become a millionaire by making a series of smart, $1,000 decisions.

It can be a combination of what you say no to, and what you say yes to.

This $1,000 per month example is powerful because its so accessible in Australia.

You could start investing $1,000 per month either by reducing expenditure, increasing income, or both.

Some people in this room will do $1,000 per week. Imagine how much that will add up to?

Consistency works.

Wealth Creation

How much do I need to be consistent with?

Experts suggest that you save and invest 15% of your income to replace your income in retirement across your whole working life.

Once you get your finances sorted, out of debt, have protected your income, and are ready to build wealth, you need to identify how much of your income you are going to set aside for investing.

A good investment calculator can help you identify how much money you can expect for the future.

A financial planner can help you do detailed analysis and projections for your specific circumstances to recommend the right amount to invest to meet your present and future goals.

Wealth Creation is not as hard as some people think.

You want to consistently direct income to investments that make money over time and watch your wealth grow.

Historical Returns are good!

We need to stay in the market as long term investors, having only invested money in long term investments that is there for the long term.

Investors need to get their head around volatility and focus on the long term.

Markets do fluctuate, but average returns are good.

ASX 300 to June 2019, 10 year return was 9.0%

S&P 500 to June 19, 10 Year return was over 16%

Notes & Disclaimers:
This is research from Vanguard Investments.
https://personal.vanguard.com/us/insights/saving-investing/model-portfolio-allocations

Please do not confuse the returns on bonds with bank interest and term deposits.

Past performance is no guarantee of future performance.

These returns are before inflation, fees and taxes.

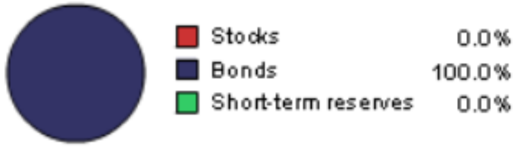
100% stocks

Historical Risk/Return (1926–2017)	
Average annual return	10.3%
Best year (1933)	54.2%
Worst year (1931)	–43.1%
Years with a loss	25 of 92

50% stocks / 50% bonds

Historical Risk/Return (1926–2017)	
Average annual return	8.4%
Best year (1933)	32.3%
Worst year (1931)	–22.5%
Years with a loss	17 of 92

100% bonds



Historical Risk/Return (1926–2017)	
Average annual return	5.4%
Best year (1982)	32.6%
Worst year (1969)	–8.1%
Years with a loss	14 of 92

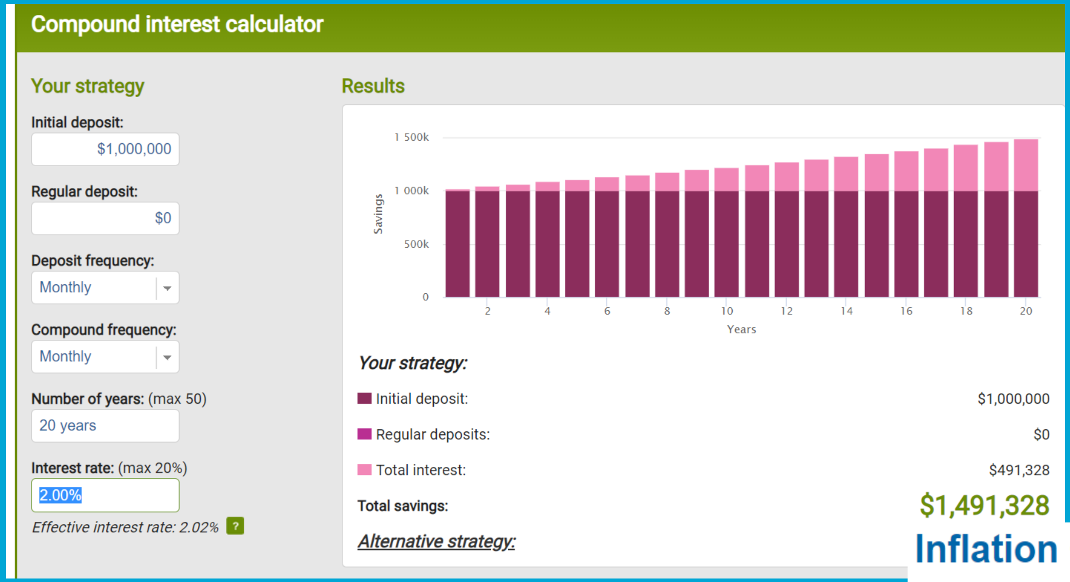
What if I leave my money in the bank and don’t invest?

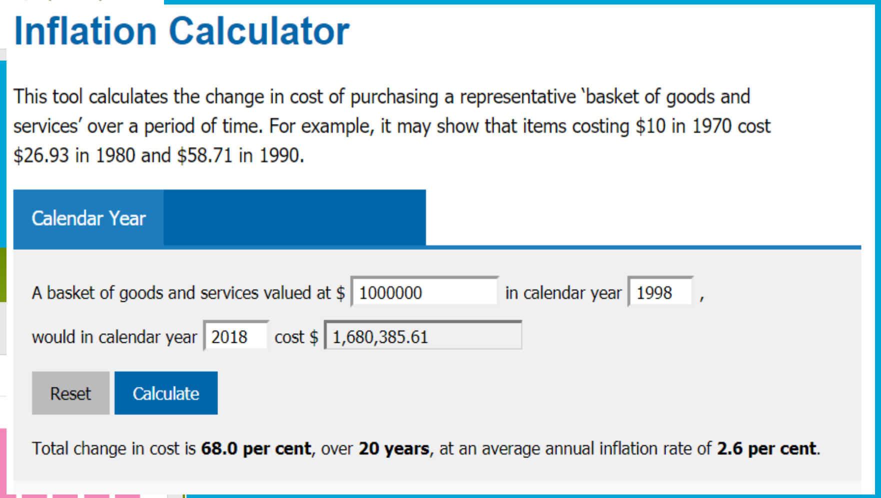
Interest calculator is available at ASIC/Money Smart.

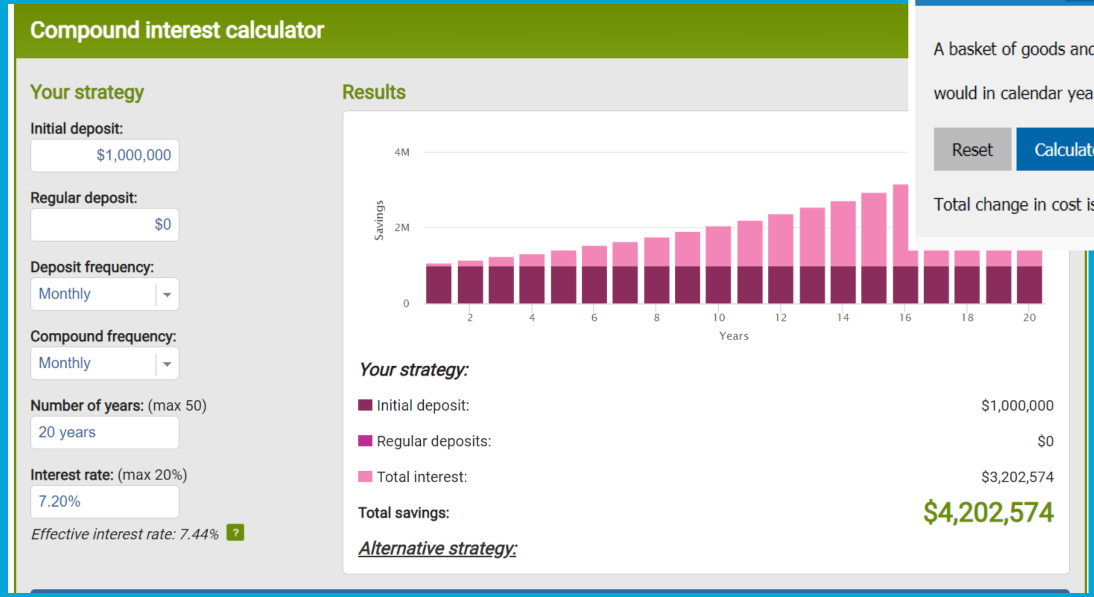
https://www.moneysmart.gov.au/tools-and-resources/calculators-and-apps/compound-interest-calculator

Inflation calculator is available at the RBA.

https://www.rba.gov.au/calculator/annualDecimal.html







Wealth Creation

How does this fit together?

Get clear on goals

Get a budget in place

Protect your income with insurance – this is your primary wealth creation tool!

Get an emergency fund in place

Get rid of debt

Approach housing in a healthy way

Then understand its from this place of financial control and discipline that having a consistent amount to invest will generate wealth.

If you have jumped ahead in the course, its up to you but you won’t be able to get the maximum benefit from the course skipping over those important steps.

Everyday Millionaires – Chris Hogan

Study of over 10,000 Americans who had achieved millionaire status (net assets over $1 million):

- 79% of those participants achieved their millionaire status through the American equivalent of **regular Superannuation contributions and had received no inheritance**.
- The top three occupations for those questioned were **engineer, accountant and teacher**, only 7% had an average household income over $200,000 and only 31% had an average household income over $100,000.
- The average age where this was achieved was 49, and the top two factors attributed to becoming wealthy by these millionaires are **discipline and consistency**. Only 5% became millionaires in 10 years or less.

When surveyed to rank contributing factors that creates millionaires:

Millionaires	Contributing factor
1	Financial Discipline
2	Investment Consistency
3	Values from Upbringing
4	High-paying job
5	Investment Strategy
6	Luck
7	Inheritance
8	Real Estate Investments

General Population	Contributing factor
1	Financial Discipline
2	Inheritance
3	Investment Strategy
4	Luck
5	High-paying job
6	Values from Upbringing
7	Investment Consistency
8	Real Estate Investments

Wealth Creation

What can I invest in?

We are going to look at three key areas.

1) Strategies and investment philosophies

2) Asset classes / categories (with examples)

3) Structures, fees (costs) and tax implications

The examples given are not a recommendation that any particular option is right for you. We believe in and give personal financial advice.
This is general information with a goal of education to assist clients whether or not they engage with us for financial advice.

Working out your game plan for investing

Our Beliefs (investment philosophy)

Tax is an investors biggest expense and should be minimised over the long term with smart strategies. Taxation and investment advice should only be provided by qualified and licensed experts.

Transparency is imperative. Nobody should invest in a financial product that does not provide transparency and awareness of the underlying investment exposure and risks.

Rather than sales it’s **expert advice** that investors need and this pays for itself many times over. Unnecessary investment expenses are to be minimised or eliminated; all investment expenses must justify their contribution to the investors take home returns.

Smart investors do the **worrying up front**: To avoid selling investments at a bad time, it is wise to only place funds in growth investments that can withstand volatility over time.

Diversification helps real humans stick to proven investment strategies. We invest our clients funds across entire markets, specific regions and multiple currencies and favour low cost strategies that help our clients succeed at investing over the long term.

Asset Allocation

There are many different types of investments.

The main categories we use when providing financial advice and comparing investment portfolios are:

Cash

Fixed Interest – Domestic

Fixed Interest – International

Shares – Domestic

Shares – International

Property – Domestic

Property – International

Infrastructure (although this can also be called Property)

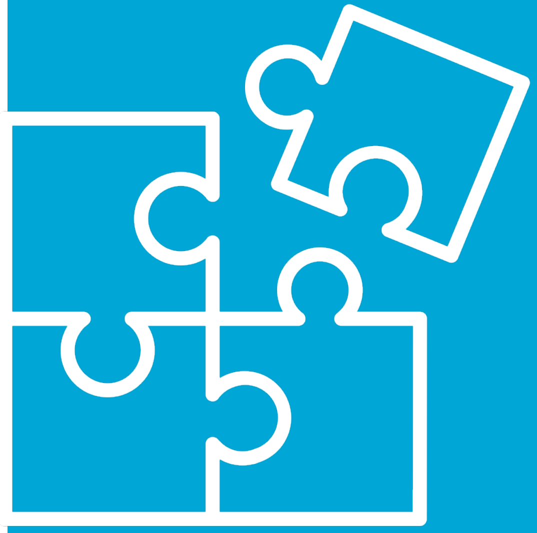
Alternatives

Cash

Cash – money in the bank that is available at call.

Earns interest.

Currently, government guarantee per customer and bank of $250k.



Fixed interest

Fixed Interest

Fixed interest is a category that can refer to:
Term deposits
Bonds
Loans

While its usually categorised as defensive, the risk depends on the specific investment. Many investors who start making loans to people lose their money.

Term deposits – locked in for a period of time in exchange for interest.
Can get the government guarantee ($250k cap)

Bonds – Government Bonds. Loans to companies. Pay interest, and then repay the loan at a future date.

Lots of products and varied credit risk.

Understanding bonds

Example: Exchange Traded Fund investing in bonds (ETF will be explored in detail later). This illustration is not a recommendation. This fund has a lot of government bonds.

Name	Weight (%)
AUSTRALIA GOVERNMENT BOND 3.25% APR-29	8.6
AUSTRALIA GOVERNMENT BOND 2.25% MAY-28	7.6
AUSTRALIA GOVERNMENT BOND 2.5% MAY-30	7.5
AUSTRALIA GOVERNMENT BOND 2.75% NOV-29	7.5
AUSTRALIA GOVERNMENT BOND 2.75% NOV-27	7.4
AUSTRALIA GOVERNMENT BOND 2.75% NOV-28	7.1
AUSTRALIA GOVERNMENT BOND 1.5% JUN-31	5.0
NEDERLANDSE WATERSCHAPSBANK NV 3.5% JUL-27	3.2
BNG BANK NV 3.3% APR-29	2.8
EUROPEAN INVESTMENT BANK 3.3% FEB-28	2.4

* As at 22 May 2020

Download CSV

Sector Allocation

Australian Government	51.1%
Australian State Governments	23.8%
Supranational Banks	12.8%
Government Development Banks/Agencies	12.2%
Regional Authorities	0.0%

* As of 30 April 2020

Bonds

Bonds

Understanding bonds

Example: Exchange Traded Fund investing in bonds (ETF will be explored in detail later). This illustration is not a recommendation. This fund has a lot of corporate bonds.

as of 21-May-2020

Issuer	Weight (%)	Issuer	Weight (%)
JPMORGAN CHASE & CO	1.48	CITIGROUP INC	1.07
BANK OF AMERICA CORP	1.43	MORGAN STANLEY	0.93
AT&T INC	1.23	VERIZON COMMUNICATIONS INC	0.90
WELLS FARGO & COMPANY	1.18	APPLE INC	0.87
GOLDMAN SACHS GROUP INC/THE	1.13	COMCAST CORPORATION	0.78

Bonds are more complicated than term deposits because the market price (capital value) for a bond fund changes when interest rates move.

An example would be a fund with existing fixed interest rate bonds might experience a price increase in a falling interest rate environment since the returns from those bonds are now better relative to bank interest than before.

Loans

Understanding loans

The concept of a loan is relatively straight forward, but the risk/return trade off is generally not.

Example: lending the Australian Government $100m, is very different to lending a property developer $100m.

Many loans are subject to the risk of a partial or complete loss of capital. The risk depends on the security provided and the ranking of the loan relative to that security.

Many investors have lost money making risky loans in exchange for higher interest rates.

The general concept is, if something sounds too good to be true – it probably is.

If a professional lender won’t make the loan, should you?

Loans to property developers are very risky.

Shares

Understanding Shares

Also know as stocks (the US term) and equities, investors purchase an ownership interest in a thing, usually a company (although more complicated structures are invented).

There are listed and unlisted entities to invest in.

When they are listed, this means there is a market like a stock exchange that you can buy and sell the investment in – provided there is someone willing to buy! The stock exchanges have rules for those entities to comply with. If they do not comply with the rules, the stock exchange “freezes” the ability to trade in them. This is meant to improve the outcome for investors.

When shares are unlisted, this means that to sell you need to find your own buyer. It is also harder to know what the value is because there isn’t a market of other people exchanging in a transparent environment.

Shares

Direct Share Example

This is not a recommendation. An example of a company that you can buy shares in on the Australian market is ANZ Bank.

How could you go about buying shares in ANZ Bank?

Many investors now, open a bank account with a share trading platform linked, and they buy the share online. They look at the price at the time on the market, and make an offer at a price and quantity to buy. If someone likes their offer, they will transact.

Alternatively, a stockbroker will do it for you, in exchange for a fee.

Some companies make offers to the public that you can subscribe to.

Shares

Direct Share Example

People usually buy shares with two goals in mind.

Dividends – when a company declares and pays a dividend, you receive part of its profit if you are a shareholder.

Capital growth – when a company increases in value – you hope to sell the share later for a profit.

Risks: If a company fails, your investment is gone and shareholders will rank last in a distribution of what’s left.

You might not be able to sell the share for a profit. It might be a loss, for a range of reasons.

Australian Companies can pass on tax credits to investors with their dividends.

Foreign companies can attract foreign resident withholding tax (and require certain forms to be lodged to reduce those taxes).

Funds

Managed Fund / Exchange Traded Fund

To gain from diversification, many investors enter funds that hold lots of companies. It would be very expensive and there would be a mountain of paperwork for an investor to directly buy a large number of shares.

These funds will have a particular strategy, and niche.

Examples:
500 Largest Company fund
Equally weighted fund
Green energy fund
Technology fund
Country/region specific funds
Company’s that pay lots of dividend funds
Small company funds

Most investment professionals use a number of funds to achieve diversification within each category.

Managed Fund / Exchange Traded Fund

Index Funds

Index funds track a particular index and rebalance the fund to that index from time to time (could be daily, monthly, quarterly).

Example: 500 largest company index.

So if Apple was the largest company at the time and was 2% of that index, the fund would aim to hold 2% of its money in Apple shares.

Sometimes a “screen” is applied to an index as a particular strategy for a fund. For example buying the Australian ASX 200 index, but “screening out” any company that makes money from gambling, sale of weapons, etc.

The market for various funds is quite competitive, and you would struggle to buy the underlying investments yourself without a significant cost.

Shares

Domestic vs International Shares

Having lots of different shares creates diversification.

In addition to diversifying by holding multiple company’s, you can also have investments in different countries.

Example: Australia goes through a recession at a time the rest of the world is going ok. Having shares in the US as part of your portfolio might mean that you are not as badly impacted if you only had Australian shares.

When you start investing internationally, you become subject to foreign exchange rate risks. This means that movements in the foreign exchange rates change your investment returns. So the value of the company's are moving, but so is the exchange rate.

Example: Australia has a recession and the dollar drops. The value of international shares that are not hedged goes up.

Some funds offer hedging to keep returns to your local currency.

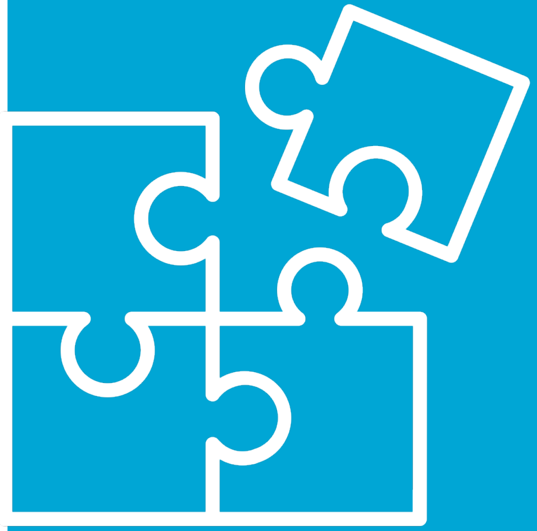
Property

Property Investment

Direct property investment is where you (or your investment vehicle) buy a property directly. It generates rent and you hope it goes up in value. The amount of debt associated with a property investment directly impacts the risk of losing your money and whether you are getting positive or negative returns. There are obviously property types ranging from residential, commercial like shopping centres, hotels and office towers and industrial properties.

Unlisted property is property available through funds but they are not listed on a stock exchange. This allows an investor to have a partial interest in a property, and to get diversification. The amount of debt held by the fund impacts your risk significantly. Valuation risk is the risk that your fund entry/exit prices are not accurate due to the valuation put on the property by the trustees.

Listed property, is property held by entities you can by and sell through a stock exchange. These can be investment funds, or they can be a business that owns a lot of real estate, or is a property investor/developer etc. The valuation for the investment comes from the market, meaning it can be more volatile.
It is considered to be more liquid because at a price, you assume you will always find a buyer (although you might not like the price).



Infastructure

Infastructure

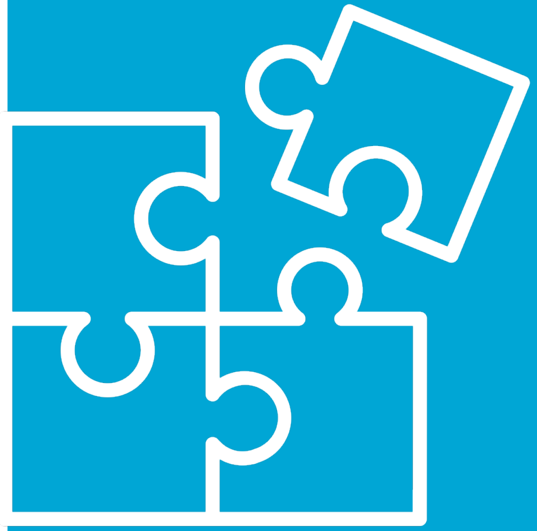
Infrastructure is a reference to a particular type of property, so not everyone thinks it’s a different category.

Examples are:
Airports
Toll roads
Electricity providers
Water Providers

Infrastructure is thought to be a more reliable income producer, and a hedge against inflation because the utility companies usually have the right to increase prices with inflation.

The COVID-19 crisis has challenged many assumptions about infrastructure.

Some argue the valuations are correlated so strongly to the share market that it shouldn’t be its own category.



Alternatives

Alternatives

Alternatives are a category for an investment that doesn’t fit elsewhere.

Examples are:

Private Equity

Venture Capital

Hedge Funds

Commodities

Financial products

Some types of Property

High risk loans

Alternatives

Excerpt from website on 23/5/2020

Example:

First State Super

Asset class	High Growth	Growth
Australian equities	26%	20%
International equities	39%	30%
Alternatives	30%	30%
Fixed income	0%	10%
Cash	5%	10%
Total	100%	100%

Property

Property investments include investments in office buildings, shopping centres and industrial estates, as well as residential property such as apartment buildings and retirement villages. Investors can access property investments either directly or indirectly by purchasing units in a property trust (unlisted or listed).

Returns from property investments reflect a combination of rental income and capital growth and are dependent on a range of economic factors, such as interest rates and employment, as well as the location and quality of properties.

Property investments are subject to a moderate to high degree of risk and are most suitable for long term investors seeking high growth over the medium to long term, who are willing to accept fluctuations in returns and the possibility of negative returns over the short term.

At First State Super we invest in a combination of unlisted and listed property assets which are traded on stock exchanges globally.

All of our pre-mixed investment options include an allocation to both Australian and global property investments, and we also offer a single asset class Property option.

Other alternatives

Real return strategies and hedge funds

Unlike traditional fund managers which are often restricted to investing in a single asset class (e.g. Australian equities), managers of real return strategies (known as 'dynamic-multi asset' managers) and hedge funds, have a wider range of allowable investments and are able to utilise a combination of equities, bonds, currencies, commodities and other liquid asset classes.

They can make investments in these asset classes via physical exposures or through the use of derivatives.

These managers aim to deliver returns above CPI or an official cash rate by dynamically moving around their exposure to the various asset classes.

SRI alternative strategies

SRI alternative strategies include both hedge funds and real return funds (described above), where the investment strategy is compliant with our guidelines for the Diversified SRI option, in addition to private market investments.

These private market investments may be in a single asset class, where the investment is expected to contribute positively to the environment or to society, while delivering an expected rate of return commensurate with the risk of the investment.

Examples include investments in renewable energy assets and private equity investments which aim to generate employment or other social benefits.

Credit income

Credit income covers a range of alternative debt investments. Like fixed income, credit income investments involve a loan to a borrower in exchange for regular interest payments, plus repayment of the principal amount at maturity. However, compared to traditional fixed income investments the loans are typically to borrowers with a lower credit rating and, as a result, command a higher rate of return to compensate the investor for the risk of default. Examples of credit investments include loans to unlisted infrastructure and real estate companies.

Our Growth, Balanced Growth and Conservative Growth pre-mixed investment options include an allocation to credit income investments.

Private Equity

Private equity offers investors an opportunity to invest in companies, both in Australia and abroad, that are not listed on a stock exchange.

Such companies can include large established companies needing investment and expertise to support future growth plans, as well as smaller, rapidly growing businesses at various stages of development.

Compared to listed equity markets, the private equity market is less efficient and less regulated, which creates opportunities for skilled managers to add value. However, private equity investments are typically illiquid, higher risk investments and so are best suited to investors with a medium to long-term investment horizon.

Except for the Diversified Socially Responsible Investment option, all of our pre-mixed investment options include an allocation to private equity investments.

Infrastructure

Infrastructure assets are the utilities and facilities that provide essential services to communities. Examples include utilities (electricity, gas, water and communications), power (including renewables), transport (airports, seaports, toll roads and rail) and social infrastructure assets (hospitals, education facilities and community infrastructure such as a convention centre). New infrastructure sub-sectors which exhibit similar features to traditional infrastructure investments, for example land title registries, have also developed over time.

Due to their scale and importance, infrastructure investments typically have high barriers to entry, but offer investors a steady income stream, potential for capital growth over the long term, and lower volatility than other growth assets such as equities. However, they are not risk-free. For example, changes to government regulation, usage volumes, and rising or falling interest rates, can all have an impact on their value.

Similar to property, investors can access infrastructure investments via direct investments in individual assets, or indirectly via unlisted or listed pooled funds. All of our pre-mixed investment options include infrastructure investments which reflect a combination of direct and indirect unlisted assets.

Strategy

Decisions:

Direct shares vs funds (managed or ETFs)

Active strategies vs passive strategies

Working with an advisor vs DIY

Investing consistently vs timing the market

Freedom Stages

1. Plan your financial freedom
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