



Paul Clitheroe's

TOP
TEN

steps to
financial security



My real-life money experience has taught me that there are ten commonsense steps that will really work when it comes to your life and your money.

TOP TEN TIPS

my ten steps to financial security

1. have a plan
2. budget and take control of your money
3. save little, save often
4. avoid punting and silly risks
5. don't plan to save cash
6. plan to own your home debt-free
7. super is good – invest in it!
8. minimise tax
9. protect your assets
10. take advice if you need it

STEP ONE

have a plan

Having a plan certainly sounds sensible; it gives us a sense of direction and provides a path to follow.

Fine, but what should your plan look like, and how do you arrive at one? This is where individual personality comes into it.

Some people have a very clear idea of where they want to be and how to get there, many others don't. But everyone has at least some goals, objectives or expectations, dependent to a large extent on their stage in life.

So, as the first step in formulating your plan, think about these objectives, and then write them down. You should end up with something like this.

for a young person

- ~ I want to complete my education by doing a three-year apprenticeship/degree. During this time I am prepared to earn little money as I am investing in my skills to allow me to earn a better income later. Completing my apprenticeship/tertiary studies is my main objective.
- ~ During these three years I will live at home, and intend to save \$50 a week in order to travel to Europe



at the end of my apprenticeship. However, I will reassess my plan at that time as I may use the money to buy a car instead, or continue to save to build up a deposit on a home.

- ~ My employer's contributions to super will form a base for my future.

Now while this may seem pretty vague, remember that youth always requires flexibility. It isn't really possible to have a plan at age 18 or 20 that says by my sixties I will:

- ~ have been happily married for 40 years
- ~ have three children and six grandchildren
- ~ own my home
- ~ have an investment property
- ~ be retired.

Life isn't that certain. But as you get older your life becomes more settled and your plans firm up.

for a married couple with young children

- ~ We will continue additional mortgage repayments to pay off the family home in nine years.
- ~ At that stage, we will buy an investment property, start an investment plan or top up super.



- ~ We will have sufficient insurance if one of us is injured, gets sick or dies.
- ~ We will educate our children as well as we are able.
- ~ We will continue to monitor our employers' super and to top this up if our budget allows us to do so. Our target is a 12% contribution each.
- ~ We plan to be financially independent by the age of 60 or younger.

for a retired couple

- ~ We wish to leave at least the value of our family home to our children. We have a will lodged with our solicitor.
- ~ We have \$350,000 investment money. We plan to use it to give us \$30,000 pa in income after tax. If doing this reduces the capital that is left to our children, then that is acceptable.
- ~ We will apply for any pension benefits available to us.
- ~ Our investment plan will be one of putting security first. We will avoid high-return/high-risk investments.
- ~ We wish to stay in our home as long as possible. If, for health reasons, we cannot stay at home we will consider living in an environment where help is available.



Setting objectives is central to a plan. After all, there's not much point in having a plan if you have nothing to aim for!



Once you have set your objectives you have a good reason to draw up a plan – and a reason to stick to it. I'm sure a young apprentice will be much better able to stick to the plan to save \$50 a week by thinking about the end objective – the trip, car or home. Trying to save \$50 a week for no particular reason does not work for long in my experience.

Now you can start to build your plan – which is how you achieve your objectives. You can get very sophisticated with your planning but, in my experience, commonsense plans work best. Certainly a financial adviser can help you (but you will still need to be able to tell the adviser what your objectives are). The next page outlines an example of a simple plan.

- ~ people tend to spend 110% of what they earn
- ~ you can't save cash
- ~ being the richest person in the graveyard isn't very clever
- ~ people don't plan to fail, they fail to plan



turning objectives into a plan

I want to save \$50 a week.

Do a budget. Have \$50 taken from your pay and transferred to a separate, online saver account without ATM card access.

I want to pay off my mortgage in nine years.

Use a mortgage calculator (MoneySmart has a good one) to work out how much your repayments need to be. Will your budget allow for this? Arrange to have your repayments increased.

I want a comfortable life in my retirement.

Use your budget to plan how much you need to spend each year. Write down your assets, and what income your assets can generate and for how long. Can you get a pension? What level of risk are you comfortable with? You may find a financial adviser can help you here.

what your plan should contain

1. your objectives

Be as specific as you can.

Set short-term (this year), medium-term (1 to 5 years) and long-term (5 years plus) objectives.

2. your budget

This is a 'must do' – the vast majority of us won't win Lotto or inherit \$1 million. You will only achieve most of your objectives by spending less than you earn.

3. your current financial position

Here you should list all your assets and your liabilities, this will tell you what you are worth today.

4. protection

Would your loved ones be ok if you weren't able to take care of them financially – review your insurances.

Make sure you have a current Will that reflects your wishes.

By working through these four items you have taken the first key step to controlling your money.

You understand where you are now. Your objectives tell you where you want to be. Your plan should take you from where you are today, to where you want to be.

You will only achieve your objectives by spending less than you earn.



STEP TWO

budget and take control of your money

Now, it drives me absolutely nuts when I think that if you are on the average full-time adult income of just over \$68,000 pa, in your working life you will earn around \$2 million in today's dollars. If inflation averages 4% this becomes more than \$5.5 million. But how much are you likely to save? If you are like most people, not much, unless you do something about it!

I know life is expensive. And I reckon that you think if you earned an extra few thousand dollars, you'd be okay. But you know what? You probably wouldn't.

Let me explain. I have clients who earn as little as \$20,000 and as much as several million a year. Guess what? They all have a problem saving money.

'That's ridiculous,' I hear you saying. How could anyone earn so much money and not have some left over? Well, life is like that – our expectations and our expenditures grow in line with what we earn. We rapidly learn to spend the extra we make.



Believe me, we tend to spend all we earn – and to justify it. But take note that many of us are living well beyond the basics (food, shelter, clothes) and are spending money on things we want (a selection of clothes, cars, holidays, movies, eating out) rather than on what we need.



It's not what you earn that matters – it's how much you spend.

I have financially comfortable clients who have never earned above the basic wage. I also have clients who are nearly broke who earned 20 times the basic wage. What is the single difference? It's simple: my comfortably-off clients consistently spent less than they earned and they saved the rest. They paid off their home, didn't build up credit-card debt, and paid cash for cars, holidays and household goods.



KEY THOUGHT

Make a commitment to the concept ‘if you can’t afford it, you can’t afford it’.

I want you to take control of your money because life will be a lot happier if you do. But I don’t want you to think you can’t afford to have fun along the way. That’s silly. I want you to draw up a budget that includes fun things in it. I want your budget to allow you to enjoy your money, yet still enable you to save.

And saving is critical, because if you can save on a regular basis you will become financially comfortable. If you can’t, you won’t.

Look, I realise budgeting for regular saving is pretty boring, but it’s ‘getting rich slowly’ and it’s the only way I know how to guarantee that you will actually get there.

STEP THREE

save little, save often

I am told on a regular basis ‘the stuff you talk about makes sense, but it’s all too hard’. But what many people don’t realise is that you don’t need to save a fortune every week.

If you save \$1 a day during your working life, how much will you have at age 65? Well, if you can average 10% on your savings (which is quite possible if these savings are put, for



example, into shares), \$1 a day saved from age 18 to age 65 should be worth around \$400,000.

~ \$2 dollars a day is \$800,000.

~ \$5 a day is \$2 million.



No miracles, no magic or silly numbers – just a sensible savings strategy and compound interest.

Hang on though – you (like me!) may not be 18. So how does it work for us? Well, when you're older, hopefully you can save more than \$1 a day. Let's say you save \$5 a day. In 25 years time, it should be worth over \$200,000 \$10 a day should be worth over \$400,000. Even with only five years to save, \$10 a day should be worth around \$250,000.

STEP FOUR

avoid punting and silly risks

If there is one thing experience has shown me, it's that risk equals return. Now, low-cost punts like Lotto, a lottery ticket, or a bet on the Melbourne Cup don't worry me at all. These are small things and can be good fun. I lose my money cheerfully, because we don't have a statement in our plan that says 'we plan to become comfortable by winning Lotto'. Incidentally, do you know what your chances are of winning Lotto? Well, it's around seven million to one, so I wouldn't count on it!

Humans seem to instinctively want to find an easy way to make money and one that involves little work, like the 'get rich quick' schemes you often see advertised in the papers. The ads use the words 'easy', 'simple', 'no capital required', 'high returns', and 'get rich'. Clearly, the operators of these schemes understand human psychology.

Think about it though. They want you to pay them to access their 'get rich quick' plan. If it works so well, why don't they take their own advice to get rich themselves? It's painfully obvious isn't it? The schemes don't work.

That was certainly the case with the schemes run by notorious property spruiker Henry Kaye from the late 1990s. Preying on our desire for instant wealth, Kaye - through his deceptively named outfit, 'National Investment Institute', promised to teach ordinary Australians how to become overnight property millionaires without the need for either upfront cash or debt.

Kaye used an ongoing program of free investment talks as a launchpad to flog grossly overpriced 'investment' seminars, which in some cases cost many thousands of dollars to attend. The courts later declared it would be virtually impossible for ordinary investors to become millionaires using information Kaye provided, though not before plenty of people put themselves deep in hock to hear what Kaye had to say.



But that's not the end of it. To supplement his substantial seminar income, Kaye went one step further and began flogging over-priced properties to his followers. These 'investments', as you may have guessed, did little to enhance the wealth of his followers, but everything to line the pockets of Kaye and his cronies.



The whole sorry story came to an end in 2003 when Kaye's spruiking empire was shut down amid court action from both the Australian Investments and Securities Commission (ASIC) and the Australian Consumer and Competition Commission (ACCC). While plenty of people got a very raw deal from Kaye, the whole scenario should send a warning to all Australians about unqualified investment gurus claiming to know the way to overnight riches. A quick check with ASIC would have confirmed that Kaye had neither credentials nor a licence to give financial advice, nor were his seminars approved by ASIC, contrary to what was stated in his advertising material.

Whether it's Henry Kaye or some other would-be investment guru, when it comes to get-rich-quick schemes it is the promoter, not the consumer, who stands to make a bundle. What's more, I'll bet you these spruikers use your money to do what you should be doing, namely, paying off a mortgage, buying good shares or investing in decent property.

Another thing to be wary of are higher promoted investment returns than you would normally expect to get. As an example, in 1990, an investment fund called Estate Mortgage ran a series of television and print ads claiming very high returns and also high security. In fact, one of the claims they made was that they were better than a bank or a building society.

Simple research would have shown you that their returns were up to 5% higher than equivalent investments. This is because they were lending money on high-risk projects. After all, if they were paying investors 17% (given their annual fee was around 2%), then they must have been lending money out at 19%.

At the time you could have borrowed from a bank at 15%, which makes you wonder what sort of people would borrow from Estate Mortgage, at 4% higher? As was soon discovered when Estate Mortgage collapsed in 1991, people prepared to pay 19% were those the banks wouldn't touch – and with good reason, as it turned out. They were high-risk borrowers, many involved in property development, whose high failure rate during the major residential property market shakeout of the early 90s ultimately brought Estate Mortgage down. The result was that hundreds of thousands of investors in Estate Mortgage lost part of, or in some cases, all of their life savings.

The message here is simple. If something offers a higher return it will have a higher risk. Don't get me wrong, though, I'm not against risk. If you take no risk you must expect a low return. Just don't let anyone fool you into thinking you can get a high return with low risk.

Investors should manage risk, not avoid it. Shares make a terrific long-term investment, although they are riskier than cash. Over 10 years, they typically earn you around 5% pa more on your investment than leaving it in a bank. With cash in a bank, however, your chances of losing money in any one year are effectively zero, while with shares you have around a one-in-four chance of losing money in any one year.



**KEY
THOUGHT**

- ~ risk equals return
- ~ if it looks too good to be true, it is
- ~ don't plan to be financially comfortable by punting

**STEP
FIVE**

don't plan to save cash

So, if you don't save cash what are you meant to save – cowrie shells? Not really – unless you live in a tribal community that uses shells as money.

Look at your budget for the past year. It may show that you should have saved say, \$2,500 – but where is the money? It's most unlikely to be in your pocket or your savings account because, in my experience, Australians can't save cash.



If you did plan to save around \$2,500 a year, you would have to put away either \$48 a week, \$96 a fortnight or \$208 a month

– and the most appropriate time to make that regular saving is when you get your regular pay packet. Furthermore, to make sure that the money you intend to save actually gets saved - rather than going into your pocket as cash and getting spent - it's best to have your paymaster automatically direct your specified amount straight into a savings vehicle.

What's more, money directed straight out of your regular income into savings, rather than receiving it as cash, is a relatively painless way to build up a nest egg – and it's quite likely you won't even notice its absence.

Consider directing these regular savings into something worthwhile like an online account, your mortgage or your super. And if you do this, and stick with it, you will get rich – not quickly, but slowly.

Have your savings automatically 'locked' away before you spend them. Set up auto direct debits.



STEP SIX

plan to own your home debt-free

Now, you don't need any convincing here do you? This is conventional wisdom. Yes, I know renting can be shown to be more cost-effective than home ownership in the short term – but in the long term, home ownership comes out in front.

I also know negative gearing can be a very tax-effective way of buying a property in which you might one day live but, as a general rule, owning your own home and eliminating the debt against it as quickly as possible is a key wealth-creation strategy.

First and foremost, plan to own your home, debt-free.

STEP SEVEN

super is good - invest in it!

It may take some work on my part to win you over to the line that super is good. You no doubt see it as confusing, ever-changing, overly complex, too restrictive, and loaded with fees. And, yes, you'd be right.

But the Government is on the right track with a compulsory super system. Australians are not good voluntary savers which is why many people own nothing at retirement except perhaps their home. And the only reason they own that is because the bank would have taken it away if they had not kept up their repayments.

I believe compulsory and voluntary super is good for us, as it has so many elements that fit with my ten steps to financial security. It is regular saving; it's tax efficient (really, it is!); it's generally invested in good quality long-term assets (shares, property and fixed interest); and the fact that (like your house) you really can't get your hands on the cash is also a huge plus. As a part of your long-term plan, super makes sense.

STEP EIGHT

minimise tax



I am always amused when people complain about paying too much tax. It seems to me that people who pay a lot of tax earn a lot of money. Investors who pay a lot of tax have a lot of investment income.

An easy way to pay less tax is to earn less money. But who wants to do that? In one way, it rather pleases me when my tax bill goes up each year – it means I'm doing better.

Despite this somewhat arcane way of thinking, clearly you should still plan to legally minimise your tax. In other words, I want you to legally avoid tax, but not illegally evade tax.

The key point is that, while you should always try to minimise tax, you should never let tax minimisation strategies drive your investment decisions. For instance, if it is appropriate for you to borrow money for a good investment, go ahead and do it. And if this investment gives you tax advantages along the way, fine, treat that as a bonus, not as the main attraction. If you find yourself or an adviser saying, 'let's negatively gear (borrow money) for an investment to reduce tax', stop. Take a deep breath and think hard.

Don't let me give you the impression that borrowing money to invest is not legitimate; it is. But if the investment is not

fundamentally sound you will lose money you do not own, outweighing any tax benefits you could ever hope to receive.



**KEY
THOUGHT**

Focus on investment returns rather than on tax benefits. Tax should not drive your decisions.

**STEP
NINE**

protect your assets

Now, I'm sure you already understand that you need to insure your home, contents, car and other valuables. This type of insurance is relatively cheap and a 'must have'. However, while the need to have insurance may seem obvious, plenty of Australians either do not insure their assets, or are underinsured.



The other asset you need to protect is you. What happens if you get sick, have an accident or, at the extreme end of it all, die? I am a very firm believer in buying as little insurance as you need but, at certain stages of your life, you really need quite a lot.

**STEP
TEN**

take advice if you need it

You'll have to forgive my bias when I talk about the advantages of having a good adviser. I know there are plenty of shonks out

there who want to separate you from your money, but there are also a growing number of excellent advisers who are not simply trying to flog you product for commission.

But let me say here that you can plan to build and protect your wealth by yourself and you don't need to be Einstein to do it either. Simply following my ten steps will give you most of what you need to know – it's just that most of us find it more efficient to do what we do best and to consult others for assistance when we need it.

Even if you do choose to see an adviser you should still work through these ten steps. The best way to use an adviser is not to be totally dependent on their skills but to develop a relationship where you both have an understanding of your plan. Then the adviser can be of great assistance in selecting and monitoring your investments, tax and insurance.



It's your money. Ultimately you are responsible.

Let me add one final point. It concerns me that a few people I know have reached their financial goals but have developed such squirrel - like habits that they hate spending money on anything. Remember, I believe the value of money is to give you options – you must plan to have fun along the way.

I would also hope that one day when you do stop work, you will recognise that part of your hard work was to give you freedom later in life. Unless you have accumulated millions you will then start to eat into your capital. But that's okay – that's what it's for!



It's quite amazing how a little commonsense and planning combine to make you rich – slowly!



So, there you have my ten steps. It's not hard to sit down and use these steps to build your own plan. And, I hope you can see how important it is to have one, no matter how basic.

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If you need help formulating your plan, an ipac adviser can help. Call **1800 626 881** or visit **www.ipac.com.au** to make an appointment.

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