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PRIVATE WEALTH

# Your life. Your wealth.

The financial guide for every life stage

# Financial roadmap: Ages 25 to 55

Have you ever stopped and thought about what you would do if you had all the money you ever needed? That's financial independence.

What would you do if you were financially independent right now?

For most Australians, financial independence is just an idea; actually achieving it is a serious challenge.

While achieving financial freedom won't happen overnight (without some very lucky lotto numbers), the good news is there are some simple steps you can take to ensure you are on a clear path to achieving your financial goals and reaching financial independence – whatever that means for you.

The first step is understanding your objectives.

It's never too early or too late to start making a plan for your financial future. The right plan for you may not be right for someone else but there are some steps and tips you can follow at each life stage to help you on the path to financial independence.

We've outlined a roadmap in this book to help guide you to financial freedom:


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# 25 to 35: Laying the best foundation

In your late 20s, you've most likely finished your studies and are in the early stages of your career. This period, from 25 to 35, is a great time to do the groundwork and establish financial habits that will set you on the right path to creating financial independence in your life sooner than you may imagine. However, creating the right financial habits can be easier said than done without the right support and guidance behind you.

**Key objectives at this age might include**

- ✓ Buy a house
- ✓ Travel

**Actions and priorities**

### Budgeting

A key element to set you on the path to financial success is to understand what you're spending. Without knowing what you're spending you cannot know what you're saving.

Budgeting can be tedious and will force you to face some home truths about where your money is going but it will also give you a clear picture of your finances.

There are different budgeting strategies but our favourite is the Bucket Strategy. Based on the key objectives outlined, you create three 'buckets' for your money.

1. An expense bucket for daily spending
2. A holiday bucket for saving for your next adventure
3. A house deposit bucket

The benefit of the Bucket Strategy is it allows you to account for expenses over time so you won't need to resort to your credit card when things like your car registration come in; it's factored into your budgeting.

**Useful resource**
ASIC's MoneySmart has a great **budget planner** to help save you time and provides prompts to help you plan all your expenses.

## Pay yourself first

There is a temptation as your salary increases to spend more, rather than using it as an opportunity to increase your savings. Don't worry, we get it. We know the thrill and sense of freedom that comes with having more expendable cash and we don't want to take that away completely. The challenge is ensuring you don't simply increase your living expenses to the detriment of your savings.

A principle we love is the concept of "paying yourself first", where you put at least 10% of your income straight into savings. There's no reason you can't live off nine tenths of your salary. If you don't believe you can currently do this then perhaps it's time to review your expenses?

## Choose the investment strategy for your buckets

When you are considering how you grow your savings buckets, you will want to consider different investment strategies for each based on their specific objectives and when you may need to access these savings. These factors will influence the level of risk you should take. You always need to keep the objective in mind when investing. For example, let's look at your two savings buckets and the type of risk that is most appropriate for each:

**Travel**

Saving for a holiday is a fairly short-term investment, so you don't want to take on too much risk. You may need access to this money within 12 months and don't want to be subject to market volatility and market risk. Your safest strategy is to keep it in cash or fixed income.

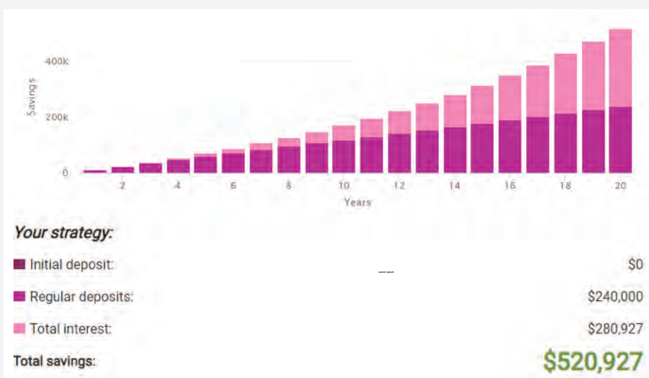
**Buy a house**

Saving for a deposit may be a much longer investment and could take five, seven, 10 years – or longer – depending on a range of factors such as your income, where you want to buy and what you can afford. You'll want a strategy that gives you access to growth investments, such as shares or different types of property, where ideally it will grow over time and you can take advantage of the power of compound interest.

**Compound interest:**
**The eighth wonder of the world**

In layman's terms, compound interest is basically interest on interest. As your investment earns interest, you continue to earn interest on the total amount of money in that investment. For example, if you are saving for your house deposit and you commit to saving $1,000 with an interest rate of 7%, in five years you will have not only saved $60,000 but you'll have earned an additional $11,593.

When you extrapolate that further, under a long term strategy over 20 years, you will have saved $240,000 with an additional $280,927 earned in interest.




Source: ASIC's MoneySmart

## Protecting your future with superannuation

If you could do something now that meant you could possibly retire earlier, or that could make the difference between you travelling around Europe or regional Victoria in your retirement, would you do it?

If you said 'Yes!' we can now tell you the answer is simple – superannuation.

Hear us out – superannuation is so important to your long-term financial independence. We get it, superannuation is complex, boring to most people, and is a pot of money that you won't be able to access for a very long time. However, choosing not to engage with your super in the early part of your career could cost you a lot of money.

There are three key things to think about when it comes to super at this age:

**1. Consolidate your super**

If you have had multiple jobs, chances are you've opened multiple super accounts. The most important thing to do at this age is to consolidate your super into one fund to avoid paying fees on multiple accounts. The government makes this extremely simple through **myGov**.

**2. Compare your fund's performance**

Most people will simply choose their employers' super fund. This might be fine but it also might not be. Make sure you compare performance to ensure you're getting the best bang for your buck. And performance isn't just the returns the fund delivered this year. You should factor in performance including fees and tax, the insurance options available and the performance timeframe.

**3. Review your investment option**

If you do not actively select an investment option within your super fund you will be automatically placed in their 'balanced' investment option by default. This means your money will be invested in a mix of assets, some deemed very safe and some deemed to have greater potential for fast growth. This option could be fine for you however it's important to remember that in your 20s and early 30s, you have a 40-year time horizon for your investment so you could potentially take on a little more risk and select an option with more growth. Although your super may seem untouchable at this stage of your life, you can take control of how it is invested and ensure that you have the right investment glide-path for every stage of your life.

**4. Additional contributions**

Contributing more to your super is a great way to improve your financial independence in retirement and can provide a substantial tax saving but in your 20s and 30s you likely won't receive much benefit for making additional contributions. For most people, we'd recommend holding off on this until closer to retirement.

## Protect your most important asset

Your current income, and your potential income over the life of your career, is by far your greatest asset, particularly at a young age. If you were to suffer a serious injury that prevented you from working you could be losing hundreds of thousands, if not millions, of dollars over your lifetime. In your 20s and 30s, income protection insurance is the most important insurance you can have so if you do fall sick or get injured you are able to continue living your life.

# 35 to 45: Reducing debt and minimising risk

By your mid-30s, you may have started a family and potentially purchased your home. With the groundwork laid, this period from 35 to 45 is the time to minimise your debts and solidify your wealth strategy to allow you make a strong push toward financial independence.

## Key objectives could include

- ✓ Pay off mortgage
- ✓ Travel

## Actions and priorities

### Repay your mortgage ASAP

You are now well into your career, you may have a partner you've combined finances with, you have a strong cash flow and budgeting strategy in place. A common question we are asked is: "Should I use any 'extra' money to repay my home loan faster or should I invest it?"

You need to keep in mind if you invest this money, it will be taxed. If you are on the top tax rate you will effectively lose half this money to tax. At a very high level, this means any investment you make would need to provide a return of almost double the interest rate on your mortgage. If your interest rate is around 5%, your investment return would need to be around 10% to justify the investment. And as interest rates rise, the return you'd need on your investment will also rise, current interest rates are at historic lows but that won't last forever!

Contributing more to paying off your home loan faster can take years off the lifetime of your loan and save thousands of dollars in interest, which will allow you to focus on asset accumulation toward the end of the loan.

### Borrow for investment

Paying off your home loan and acquiring a larger amount of equity in your home will allow you to take advantage of a 'borrow for investment' strategy where you are able to redraw on your home loan to invest in a portfolio to hopefully generate a significant rate of return.

Why is this different to investing any extra money before paying off your home loan?

When you redraw money from your home loan, the interest on the redraw component of the loan is tax deductable, meaning the required rate of return is no longer double whatever your home loan interest rate is as we mentioned earlier, it's whatever your interest rate is. So if your interest rate is 5% then that is the benchmark you need to reach, which is much more achievable. Borrowing does carry risk and you need to be aware that the market can always move against you so we highly recommend seeking professional financial advice.

This strategy brings forward your investment time horizon significantly. If you were to wait to start investing until you had fully repaid your home loan, you could miss out on 10 to 15 years of investment returns, the power of compounding interest means the magnification of those gains is substantial.

**Protect your family**

If you now have a family to care for, your obligations have increased significantly from your 20s. You are responsible for more than just yourself and if something were to happen to you that meant you couldn't earn an income, it could seriously impact your family's situation.

As your own financial situation changes, it's important for you to review exactly what insurance you have and what you're covered for. If you haven't already done so, now is the time to consider death cover, trauma cover, and total and permanent disability cover. This will ensure you and your family are protected no matter what happens to you.

This is also the time to undertake estate planning. Engage a solicitor and work with them to create a will and an enduring power of attorney arrangement so you have control over where your assets go if you were to pass away. The earlier you do it the better.


## 45 to 55: Asset accumulation

By your mid-to-late 40s you may have teenage kids nearing the end of school and you have hopefully made a significant dent in your home loan. Your cash flow will free up significantly once you've paid off the loan and school fees have finished. This is the time to analyse your funds and implement a strong asset accumulation strategy.

### Key objectives could include

✓ Prepare for comfortable retirement
✓ Establish an inheritance for your family

### Actions and priorities

**Take advantage of super**
If you've followed our advice thus far, your super should have been bubbling away nicely in the background, gradually increasing thanks to our friend, compound interest. As you near **preservation age** when you can access your super (between 55 and 65 depending on your circumstances), it becomes an increasingly valuable and tax-effective investment structure to utilise to grow your retirement nest egg.

If you already have a substantial nest egg at this stage, we are strong advocates of creating a self-managed super fund (SMSF) as it can provide more control and flexibility over your retirement savings than retail and industry funds. You will need scale to make it cost-effective due to the increased fees but it provides tremendous upside. At a minimum we recommend having at least $400,000 in your super before creating an SMSF. Key benefits of an SMSF include:

•The maximum tax you will pay on your super earnings is 15%. So if you are on the top marginal tax rate of 47% you're looking at a saving of 32% when compared to investing outside of super.
•The ability to pool your funds together with your partner and have both your nest eggs work under one investment strategy.

It's important to note that the government has restricted voluntary contribution amounts for super, currently you can only receive a tax benefit on contributions up to $25,000 per year.

# Conclusion

Achieving financial independence at any stage of life requires smart planning but it's never too early or too late to start a financial plan. Importantly, your idea of what financial independence looks like will be different from others so you need a tailored strategy to achieve your particular goals.

No matter your age, whether you're just starting out in your career or you're nearing the end of it, implementing a goals-based strategy will help you reach financial freedom.

Ultimately, it comes down to your own desire to reach your goal and depends on how willing you are to compromise and sacrifice earlier to get there sooner.

As with all financial advice, we want to emphasise that the advice contained in this eBook is general in nature and we highly recommend you speak with a professional financial planner to develop a tailored plan based on your objectives.

For more than 30 years, Hewison Private Wealth has been providing tailored, independent financial advice. We recognise the individuality of every client and provide bespoke investment advice based on their specific and unique financial needs.

**For a complimentary, obligation free call with one of our advisers, contact us.**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