

4. KID'S EDUCATION

STORY
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Saving for your child's education is a great idea. Even if you don't currently have a plan for where they will go to high school, or if they will go to university, having some funds set aside to help with the cost of education will give you more choice when the time comes to make decisions.

If you know where you want to send your children for high school, it is useful to work out in advance what it will cost and when. If possible, it's best to start saving now to spread out the cost of their education. Hopefully, investment earnings will also help pay for some of it.

If you have two or more children going to a private high school, there may be a period when you have two or three lots of monthly fees to pay. This can be a significant burden. We recommend you plan ahead for this time by building your savings. These savings can be used to help fund some of the fees during this period. The charts (facing page) show how this can work. In this case, you keep paying \$10,400 a year (\$200 a week) towards school fees even after high school starts and you draw any additional funds you need from the savings account.

The best way to save for education expenses will depend on your current situation and your tolerance for risk. Some options are:

1. PAY EXTRA ON YOUR MORTGAGE

This is a good option for people who have low equity in their home. Getting ahead on your mortgage will save you interest and provide funds that can be redrawn. Confirm with your bank that you can redraw additional funds paid off the loan principal. Accumulating

funds in your offset account would be another way to do this, but I think it requires more self-discipline to prevent you from spending some of the money you are meant to have saved. By the end of five years you'll have paid an extra \$54,000 off your loan and saved interest of \$2618 assuming a mortgage rate of 4.5%pa.

2. HIGH-INTEREST CASH ACCOUNT

The advantages of saving into a higher-interest cash account are low risk and low fees, and the flexibility to add and withdraw funds. You can clearly see how much you've saved. The main disadvantage is that returns on cash are very low at the moment. Ideally you would establish this account in the name of the person in your family who is on the lowest tax rate to reduce the amount you pay on earnings.

3. EDUCATION BONDS

These bonds can offer tax advantages, with tax paid on earnings in the funds at 30% and the potential to receive that tax paid back at the end. My view is that these work best for families where both parents are earning at least \$87,000pa (so paying a 34.5% marginal tax rate including Medicare) and/or parents who are at least in part saving for university fees.

There are different types of education funds so you need to be clear what you are saving for when you choose one. With some funds you receive the investment earnings only if your child goes to university (otherwise they are forfeited).

With other funds you can withdraw the capital you saved to pay for high school costs but if you withdraw the investment earnings

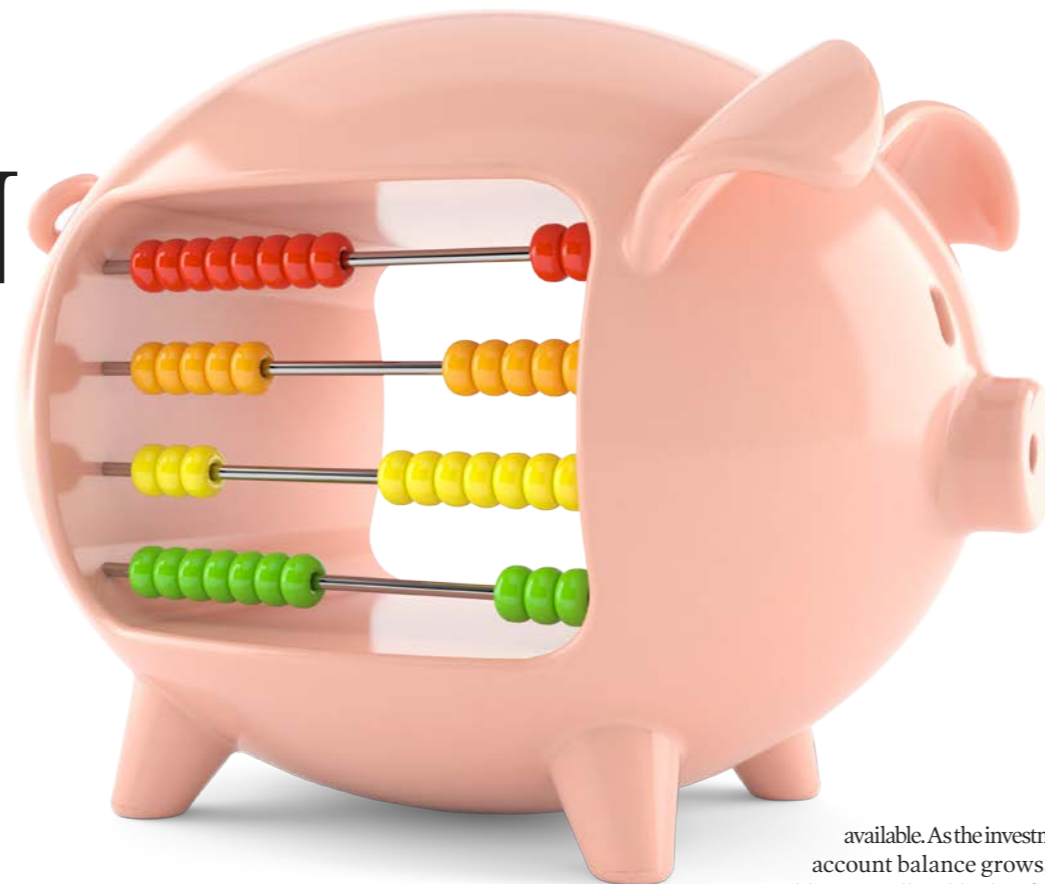
(which will be the final payment) while the student is under 18 you will lose some of the tax advantages offered by the fund.

4. INVESTING

For clients prepared to invest for the medium to long term and to accept some volatility in their balance, saving into an investment portfolio that includes shares is my preferred approach. The return you earn will naturally depend on the environment in which you invest. For a five-year to 10-year investment into 70% shares and 30% bonds, our projected return is 6%pa. That will give you a balance of \$60,000 after five years.

If you want to save with \$200pw, we would recommend the FirstChoice Wholesale Investments platform to manage this portfolio. Initially, while the balance is small, we would invest via an indexed balanced fund, such as FirstChoice Multi-Index Balanced. This has a 70% allocation to shares, so you can expect your balance to be relatively volatile and it would only suit you if you are willing to accept that it will fall periodically – 20% or more if the sharemarket collapses.

Other lower-risk investments are also



available. As the investment account balance grows, we would potentially add other funds depending on the current environment. As the time comes nearer to using the funds, we may also reduce risk in the portfolio.

To invest in a larger portfolio – for example, starting with \$50,000-\$100,000 – you could consider investing into a share trading account (if you don't mind the paperwork). In this situation, we would recommend a portfolio of exchange traded funds (ETFs), listed investment companies (LICs) and mFunds, which are managed funds that are listed on the stock exchange, so they are very similar to ETFs but offer active investment management strategies.

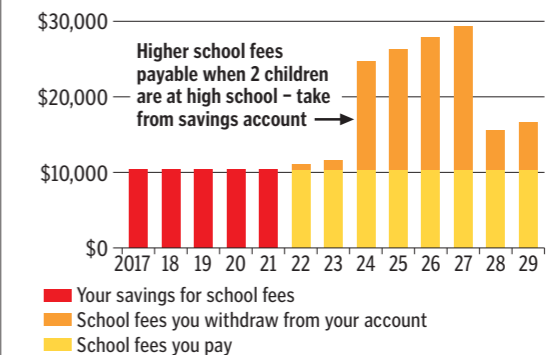
You can invest directly in individual shares but to do this well takes time and skill. Diversification across shares as well as across asset markets will help you reduce risk. Listed funds are a great way to achieve this.

MODEL PORTFOLIO

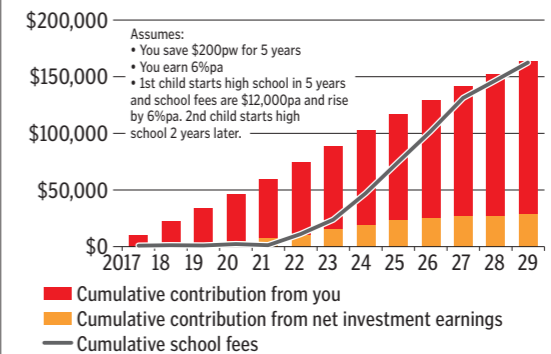
For a \$50,000-\$100,000 school fee portfolio with moderate risk, the following offers diversification, low cost, low turnover and medium- to long-term growth with some income:

- 20% Schroder Real Return CPI +5% Wholesale (mFund) – as a core, diversified active fund.
- 35% BetaShares FTSE RAFI Australia 200 ETF (ASX: QOZ) – for a low-cost, low-turnover investment in the local market.

SMOOTHING OUT YOUR FEE OUTLAY



INVESTMENT EARNINGS HELP PAY YOUR FEES



Source: Majella Wealth Advisers

- 5% Bannellong ex-20 Australian Equities (mFund) – for some exposure to potentially higher-growth smaller Australian companies.
- 5% BetaShares FTSE RAFI US 1000 ETF (QUS) – for a low-cost, low-turnover investment in US shares.
- 5% Vanguard All-World ex-US Shares Index ETF (VEU).
- 10% Platinum Capital Ltd (PMC) – for global shares with a bias to better-valued parts of the market and in particular Asia.
- 20% Kapstream Wholesale Absolute Return Income (mFund) – for a low-risk bond exposure.

As it is expensive to invest small amounts in securities purchased on the stock exchange (due to a flat minimum brokerage rate), you would also need a cash account you would save into and then you could invest once you had at least \$5000 available.

The savings strategy that will suit you best is a personal matter, so make sure you have a clear understanding of the features and risks of each strategy before deciding what is best for you.



Joanna McCreery is a certified financial planner and a director of Majella Wealth Advisers (majellawealth.com.au), a boutique financial advice firm.

REV UP RETURNS

If you are willing to take more risk and ideally plan to invest for more than five years, you could establish your portfolio with an investment loan. Ideally we'd recommend a home equity loan so that the interest rate is low and, unlike the main alternative (a margin loan), there is no need to repay your loan (make a margin call) if the sharemarket has a fall.

The advantage of using borrowings to invest is that you can potentially boost your long-term returns. The disadvantage is that your savings will fall more when the sharemarket falls. If you lose your nerve and sell your shares at the bottom of a market fall, you can potentially lose all your savings. So this approach is only for the very risk tolerant.