$50k in five years

There are winning ways to save $50,000 for every life stage. *Money* asked five experts how to save $50,000 in five years. We gave each one a different scenario to work with: a young single in her first job, a couple of renters, a young couple with small children, a divorcee starting out again and pre-retirees counting down to retirement. This is what they came up with.

Single, first job

Erin is 24, single, and earns $55,000 in her first full-time job. She has moved into her own place and finds it hard to save anything. But she wants some financial security and money to invest. What is the best way to save $50,000 in five years?

Small amounts add up

Investing is what old people do, right? Nope, nope, nope. Look around you, it's what your most successful peers do in their 20s. Money you save sitting in a bank will not make you wealthy; it is great for short-term goals but most years it will take you backwards over time after inflation. Instead, invest and put your money to work for you.

$50,000 sounds like a lot of money, right? Rather than let it daunt you, think of it this way – $50,000 is the first step you take on the road to creating financial independence.

For a first financial goal, it's certainly not an easy one – but you know life wasn't meant to be easy. If you can follow these smart strategies to turbocharge your savings, I have no doubt that you will join the ranks of Australia's most wealthy and successful people.

That is the challenge I am setting you and here is my best advice to help you achieve financial success.

You need a cunning plan

Building a comfortable and independent lifestyle needs more than just a drive to succeed and the skill to make it happen. It takes one of two ingredients: good luck or good financial planning.

As an aside to all the financially fabulous women out there, hopefully you'll agree with me when I say a man is not a plan!

How much do you need to save?

To get to our $50,000 goal we need to devise a regular savings and investing plan. If you can save $173 each week ($750 a month or $9000 a year), in five years you can create an investment portfolio that will have achieved your $50,000 goal.

Save $173 a week

This sounds a lot but, if you can break it down to small amounts saved across your way of life, it all adds up. Reducing your takeaway coffee consumption by just one a day is a saving of $28 a week.

Takeaway lunch costs closer to $15 these days, so $75 for weekday lunches can be easily reduced by a grocery shop for some delicious and healthy lunches that take five minutes to prepare at work.

Do you pay for parking during the week? If public transport is not an option, can you park further away for free and walk the rest of the way, saving money and improving your fitness?

If eating out is your splurge, then look for BYO restaurants and set a limit for your entertainment budget each week for drinks, food and transport home.

After a night out, do you grab a taxi, use Uber or get public transport home? It doesn't seem like a lot but $30 or $40 each time adds up.

Look at your regular outgoings and make sure you actually use the service you are paying for, such as membership of a gym or wine club. Shop around for a better deal for your mobile phone, electricity, gas and health fund.

Are you being a savvy consumer? Do you look at prices when shopping or just grab what you want when you need it? Fresh fruit and vegetables in season are always cheaper than foreign imports. Convenient serve sizes save time but add a punch to the bottom line.

Maybe you can't find $173 savings in one go but, if you take a hard look at where you spend your money, you should be able to find smaller amounts that ultimately add up.

Compound your savings

The table below shows the benefits of compounding growth in your portfolio (assuming 3.5% income growth, 3.5% capital growth and a marginal tax rate of 32.5% plus the Medicare and disability levies).

How you should invest

With a sum of $50,000, direct property investing is clearly out of the question and leaving your funds in cash over the long term isn't a clever approach as inflation eats into your earnings. That leaves investing in the sharemarkets as the only real option.

A popular, proven approach to portfolio construction is "core and satellite", a powerful strategy focusing on asset allocation and blending the benefits of both active and passive investing.

The core of your portfolio comprises diversified, low-cost, passive investments such as exchange traded funds (ETFs), while the satellites comprise a fewer number of high-conviction investing ideas (such as shares or managed funds you believe will outperform the market).

What to invest in

If you're keen to take control of your own investing, you need to put aside some time to research your options. Work out how much risk you're willing to take and determine the right asset allocation for your planned portfolio (that is, the split between growth and defensive assets).

The table at right is an example of a do-it-yourself portfolio constructed with low-cost ETFs.

If you'd rather employ professionals to manage your investments, I advise a low-cost approach. By keeping your fees down, you end up with more in your pocket.

Vanguard provides a suite of low-cost options. If you have a growth focus you may want to consider its LifeStrategy Growth Fund (70% growth assets and 30% defensive assets) or its High Growth Fund (90%, 10%). Each fund costs 0.9% a year in fees and provides you with an instant, well-diversified growth portfolio. You can invest easily with a starting amount as lows as $5000 and then regularly add amounts of $1000.

Don't neglect your future

While you're successfully investing through your 20s, don't neglect your super. The $9000

continued next page

THE BENEFITS OF COMPOUNDING

	YEAR				
	2016	2017	2018	2019	2020
Opening balance	$0	$9521	$19,594	$30,250	$41,524
Annual investment	$9000	$9000	$9000	$9000	$9000
After-tax income (@3.5%pa)	$206	$425	$656	$900	$1158
Capital growth	$315	$648	$1001	$1374	$1768
Closing balance	$9521	$19,594	$30,250	$41,524	$53,451
				CGT on sale	$881
				BALANCE AFTER TAX	$52,570

ERIN'S INVESTMENTS

INVESTMENT	CODE	ALLOCATION	
High-interest account	NAp	10%	$2000
Vanguard Aust Gov Bonds	VGB	8%	$1600
iShares Aust Govt Bonds	BOND	8%	$1600
SPDR S&P/ASX 200	STW	23%	$4600
Vanguard Australian Property Securities	VAP	9%	$1800
SPDR Global Real Estate	DJRE	9%	$1800
iShares S&P 500	IVV	15%	$3000
iShares Global Healthcare	IXJ	6%	$1200
iShares Global Consumer Staples	IXI	6%	$1200
Vanguard Europe Shares	VEQ	6%	$1200
Total		100%	$20,000

starting balance in super can grow to just under $38,000 over the same five-year period if you make some smart financial decisions.

Open, read and understand your super statements. Consider additional contributions, consolidate your accounts, ensure you have the right asset allocation and investments, and keep an eye on the fees.

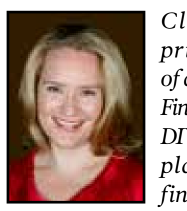
Just do it

If you dedicate time and create a sound financial plan, your finances will start to become fun and easy. The money you save and invest will help you create your dream lifestyle, free of money worries and stresses.

Get cracking, get inspired and get planning today. In the words of a well-known shoe manufacturer, just do it.

My top tips

1. The best time to start planning is today.
2. No blame, no shame – don't beat yourself up over financial mistakes.
3. Stay on top of your expenses and your credit cards.
4. However much you are saving, save more.
5. Transform yourself from a saver to an investor.



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Build a deposit with savings plan

Couple, no kids

Rose, 27, and Richard, 29, earn $113,000pa ($72,000 and $41,000 respectively). They rent and have no debts. They want to take advantage of softer property prices to buy their first home but need to boost their savings for a deposit. They are willing to cut their everyday spending to save $50,000 over five years. What is the best strategy?

Saving up enough money for a deposit on your first home can seem daunting. But if you decide that's what you want to do, you can make it easier on yourself by making a plan for how it will happen.To save $50,000 over five years, Rose and Richard need to put aside at least $833 a month. With investment earnings, they should end up with more than $50,000 if they save this monthly amount and that will retain the purchasing power of $50,000 in five years compared with now.

Make it fit within your budget

If you are a couple earning $113,000pa between you, $833 a month represents 11% of your after-tax income and leaves you with $6700pm to spend on rent and other living expenses.

If this doesn't sound like enough spending money, you should have a good look at where your money goes and work out where you can cut back. I recommend going through your bank statements and credit cards to help you work out your average monthly spending on the various categories of your budget – rent, food, clothes, entertainment, gifts and utilities. After you have done this, it is often more apparent where you can cut back.

You may also be able to set limits for discretionary expenditure – for example, no more than one takeaway meal a week or fortnight, or a monthly dollar limit on clothing. It would be worth setting an annual holiday budget too, as it's easy to spend a lot there. But remember you can average it out – if you want to have an expensive holiday one year, then make sure you keep holiday costs lower the year before.

Rental expenses are usually a big part of the budget. Look at whether you can find a less expensive option, perhaps further away from the city or a smaller place.

Set up a regular savings plan

To increase the chance you will save the required amount every month, set up an automatic debit from your bank account into a savings account.

Decide how you want to invest your savings

If you can earn a high return on your investment, you could have your $50,000 saved in a shorter time. For instance, if you can earn 8%pa, you could have $50,000 accumulated in just over four years. Alternatively, you could have $61,000 saved after five years. That's a tempting strategy.

However, with higher returns there typically comes higher risk. For instance, if you invested in a share portfolio to earn a higher return, you could be unlucky enough to have a sharemarket fall in year four when you have most of your money invested. That could potentially halve your deposit.

Consider your time frame

A five-year time frame is relatively short and for every year you are saving your time frame becomes shorter. You will no doubt have heard that you need to be a long-term investor to put your money in shares. With a time frame as short as this, you are certainly not a long-term investor. That said, this time frame does allow you to consider taking more risk than just putting your savings into a bank account or term deposit.

Consider the tax on earnings

In the table, I've assumed the funds to pay the tax on your investment earnings are paid out of those earnings. Initially you won't notice this additional tax but once you have $20,000 invested you may start to notice the additional liability. To minimise this tax liability you can:

- Invest your savings in an account in the name of the lower taxpayer.
- Invest some of your balance in Australian share funds that offer franking credits.
- Avoid high-turnover investment strategies – that is, buying and selling shares over short periods. High-turnover investment strategies can result in you paying higher capital gains taxes than necessary, reducing after-tax returns.

Investment options

- **Bank savings account or term deposits.** For risk-averse investors and for maximum certainty that you will have the $50,000 you want in five years, saving into a "high-interest" bank account is the way to go. While the best you can do on a bank account, once initial bonus rates expire, is probably about 2.5%pa, at least it is a certain positive return. Once you have accumulated sufficient funds, you can place some of your savings into a term deposit to earn a slightly higher rate.
- **Diversified share and bond investment.** With a five-year time frame, some investors may be comfortable taking on a degree of investment risk with the aim of improving the return they earn. For instance, an investment allocation that has 40% in growth assets and 60% in cash and bonds could potentially deliver a 5-6%pa return over five years with a moderate amount of volatility. Note, however, that it could also deliver a negative return if the sharemarket has a big fall during the period.

If you do put 60% of your savings in cash and bonds, it is worth thinking carefully about the investments you choose in this part of your portfolio. Government bond rates are at historic lows around the world, so investing in traditional bond funds can be expected to be much less profitable than they have been in the past. Funds that invest in floating-rate (as opposed to fixed-rate) bonds and investment-grade corporate bonds are options I would consider in the current environment.

For the 40% in growth investments, you should consider both Australian and overseas shares. There are many options available but, if you are not sure which manager to choose, you could consider a multi-manager fund. That's a fund made up of a number of different funds typically chosen by the provider for their skill and complementary investment approaches. Alternatively, there's a good range of index funds to choose from (for example, Vanguard's index funds and exchange traded funds and BlackRock's iShares ETFs). These funds simply track a particular index, such as the Australian All Ordinaries Index. They have an advantage of being low cost – but remember that if the index goes down by 10%, so will they.

On the other hand, a fund managed by a skilled manager who is carefully selecting the shares they invest in may not follow the index down and, over the long run, you may end up with a better return after fees.

I find that a diversified investment strategy is most easily accomplished using a master trust that offers a range of investment options and allows you to invest your monthly deposit straight into your chosen allocation.

Stay focused on your plan

If you are a young couple without children, this is a great time to really push yourselves to build up some savings. It's easy to get caught up in daily life and simply spend all you earn, so avoid that trap by making a plan for how you will save and stay focused on it.

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TWO WAYS TO BUILD A CACHE FOR INVESTMENT

	YEAR				
	1	2	3	4	5
Saving into a bank account or term deposits earning 2.5%pa; 32.5% marginal rate, 2% Medicare					
Opening balance	$0	$10,082	$20,329	$30,744	$41,329
Annual investment	$10,000	$10,000	$10,000	$10,000	$10,000
Income	$125	$377	$633	$894	$1158
Tax	$43	$130	$218	$308	$400
Closing balance	$10,082	$20,329	$30,744	$41,329	$52,088
Saving into diversified investment, assuming average return 3.8%pa income & 1.7% capital growth; 32.5% marginal rate, 2% Medicare					
Opening balance	$0	$10,201	$20,810	$31,846	$43,324
Annual investment	$10,000	$10,000	$10,000	$10,000	$10,000
After-tax income	$116	$351	$597	$852	$1117
Capital growth	$85	$258	$439	$626	$822
Closing balance	$10,201	$20,810	$31,846	$43,324	$55,262
				CGT on sale	$399
				Balance after tax	$54,863

Note: Any franking credits have not been included.

Couple, two kids

Emma and Ray, both 31, have two children, two months and two years old. They have a combined income of $105,000pa ($35,000 and $70,000 respectively) and a mortgage of $550,000 on their home, which is valued at $850,000. They have a $10,000 car loan but no credit card debt and Emma has a $20,000 HELP debt. Family help means they don't need to pay for childcare, and they hold $65,000 in super.

Gearing will boost returns

Having taken the step to secure their own home, Emma and Ray are now keen to start building their wealth for the future. On their current incomes, Emma and Ray have a surplus of $7500pa and they are comfortable in using all this to invest. Leveraging this surplus will be an effective strategy for Emma and Ray to adopt, so it makes sense to look for ways to enlarge what they have to work with.

The first step any household must take is to do what good governments should do: reduce unnecessary spending. But, just as in politics, you can't always please everyone, particularly two-year-olds who may have something to say when required to cut down on treats!

Find ways to save

First, there are some quick and easy wins available that don't involve taking on any risk. For example, by changing from the main supermarkets to one of their cheaper rivals or by substituting premium brands for private label items, a $13,000 grocery bill can be cut by $3250 a year, according to the latest Choice comparisons. This alone would add $16,250 to Emma and Ray's wealth over five years.

Also look at areas such as telcos, private health insurance and other insurance. By doing their homework, Emma and Ray could reduce costs further without impacting lifestyle. Even giving up the morning coffees can add $4200 to their bottom line over five years.

A secured $10,000 car loan at a rate of 8% creates a drag on cash flow. Through a sale-and-leaseback arrangement, a novated lease structure can reduce Emma's tax liability by $1300pa. This creates a $6500 tax saving over five years.

Fixing $450,000 of their home loan at 3.99% for the next three years from their current rate of 4.29% generates savings of around $4000 over three years. By leaving $100,000 of the loan variable, they have the capacity to reduce it further over the next three years without penalty if they find themselves in a position to do so. By adding an offset account against the $100,000, and using a credit card for the bulk of expenditure (one with an interest-free period, paid off in full each month), they save a further $2100 over five years.

Note that the HELP bonus ceases on December 31. By making an additional payment of $5000, a return of $250 tax free can be generated but, of course to do this they have to find $5000 extra cash.

These are just some of the many ways to save and if you're already saving in these areas you can start looking at options such as catching public transport, taking lunch to work rather than buying ($3 a day against $12, so more than $2000 a year) and, of course, not always buying the shiny new item.

With $33,050 in savings already banked, Emma and Ray need to generate an additional $17,000 over the next five years from their existing assets and surplus of $7500 a year.

Create leverage

Emma and Ray need to take on a gearing strategy as part of their regular investment of their surplus funds to turbocharge their returns. The investments should be highly liquid so they can access capital if they need it in an emergency. (This shouldn't be touched for any other purpose – an immediate wealth destroyer.) Additionally, to reduce the impact of tax, all investments should be held in Emma's name, as she has the lower marginal tax rate.

A lower-risk strategy

Emma and Ray can draw down $20,000 from the $300,000 equity they have in their home, fix the loan and (in Emma's name) invest in a diversified portfolio of exchange traded funds (ETFs). Traded on the ASX, ETFs are cost effective and allow good diversification across asset classes and also within asset classes. They are also highly liquid. A diversified portfolio can be constructed from investment in four recommended ETFs:

- iShares MSCI Australia 200 (ASX: IOZ), Australian shares, 31%.
- SPDR S&P World ex-Australia Fund (WXOZ), global shares, 35%.
- Vanguard Australian Property Securities Index (VAP), listed property, 4%.
- Vanguard Australian Fixed Interest Index (VAF), fixed income, 30%.

A portfolio with 70% growth assets (shares and property) and 30% defensive (cash and bonds) should give sufficient growth. At the same time, the defensive fixed income assets should reduce volatility. But, assuming conservative growth of 2.6%pa for this portfolio (see table), this will leave them some $7000 short.

More risk, more return

Alternatively, Emma and Ray could invest their annual surplus in two internally geared ETFs that give them exposure to the growth assets of domestic and international shares and avoid the lower returns of income assets:

- BetaShares Geared Australian Equity (GEAR), Australian shares, 50%.
- BetaShares Geared US Equity currency-hedged hedge fund (GGUS), global shares, 50%.

These ETFs have an interest rate of less than 3%. With such a low interest rate, and an estimated grossed-up (taking franking into account) dividend yield of close to 8%, the investment will be positively geared. The Australian fund invests in the S&P/ASX 200 Index, while the US fund invests in the S&P 500 Index which includes the likes of Apple, Microsoft and Johnson & Johnson. Our estimates (see table), which assume that extra borrowing is made each year, show such a strategy should more than meet the target of an extra $17,000.

However, this is a much riskier strategy, and Emma and Ray need to be aware of the potential for a bumpy ride. As with any of these strategies, the starting point needs to be a well-defined objective so that Emma and Ray take on only as much risk as necessary.

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LIFESTYLE SAVINGS

ACTION	5-YEAR BENEFIT
Grocery savings	$16,250
Coffee	$4200
Tax on car lease (excl GST savings)	$6500
Mortgage interest saving	$4000
Offset account savings	$2100
TOTAL SAVINGS	$33,050

EQUITY LOAN $20,000 IN ETF PORTFOLIO

	YEAR				
	1	2	3	4	5
Opening balance	$0	$28,460	$37,461	$47,039	$57,229
Loan	$20,000				
Own contribution	$7500	$7500	$7500	$7500	$7500
Total investment	$27,500	$35,960	$44,961	$54,539	$64,729
Return[1]	$1760	$2301	$2878	$3490	$4143
Closing balance	$28,460	$37,461	$47,039	$57,229	$68,072
Loan balance	$20,000	$20,000	$20,000	$20,000	$20,000
Interest cost (4%pa)	$800	$800	$800	$800	$800
Net return	$960	$1501	$2078	$2690	$3343
Total net return					$10,572

[1]2.6% growth, 3.8% income Note: tax has been ignored

INTERNALLY GEARED ETF PORTFOLIO

	YEAR				
	1	2	3	4	5
Opening balance	$0	$37,500	$56,438	$76,949	$99,184
Loan	$27,500	+$7500	+$7500	+$7500	+$7500
Own contribution	$7500	$7500	$7500	$7500	$7500
Total investment	$35,000	$52,500	$71,438	$91,949	$114,184
Return[1]	$3325	$4988	$6787	$8735	$10,848
Closing balance	$37,500	$56,438	$76,949	$99,184	$123,307
Loan balance	$27,500	$35,000	$42,500	$50,000	$57,500
Interest cost (3%pa)	$825	$1050	$1275	$1500	$1725
Net return	$2500	$3938	$5512	$7235	$9123
Total net return					$28,307

[1]5% growth, 4.5% income Note: tax has been ignored

After a divorce

Melissa, 52, has recently had her finances devastated by divorce and needs to rebuild them for a secure future. She has a $180,000 loan on a home worth $1.1 million and a super balance of $200,000, and earns $82,000pa plus super. Her two children, who have left school, live in the family home and still rely on her. Melissa wants to save $50,000, either to pay down her home loan or boost her super. She needs to take stock before making financial decisions.

Right balance between risk and reward

While there are many options available for Melissa to achieve an increase in her wealth of $50,000 over five years, the real challenge is saving the money. To meet this challenge Melissa either needs to spend less or earn more.

To spend less she can look forward to the exciting prospect of preparing a budget. This will help identify how money is spent now and what, if any, expenses can be trimmed. If this step results in an unpalatable outcome, then Melissa needs to move to the second option of earning more.

Maybe now is the time to consider how adult children can contribute through the payment of board. It appears to me that in recent years the concept of paying board is not as popular as it once was. This is interesting given the trend of adult children remaining in the family home for longer and hence continuing to be supported by parents.

The board payment could be linked to the earning level of the adult child, say 10-20% of their income after tax. Once your child has recovered from the shock of the concept, you should then suggest an automatic debit from their account to ensure you actually receive the money. Pleasingly this is one of the few payments that is tax free.

If unable to extract board from your children, another strategy may be to charge other people's children board by taking in foreign students. Generally under the homestay arrangement this payment is tax free unless deemed excessive.

But, besides saving the money, which option best suits Melissa – paying off the mortgage, salary sacrificing to super or negative gearing into an investment? There are risks and benefits with each of the choices. But importantly there are issues such as access to the funds if needed and Melissa's personal tolerance to risk.

Pay off the mortgage

One of the lowest-risk options is extra repayments to the home loan. This would require an additional repayment each month of $735 over the five years.

Melissa is, in effect, earning the loan interest rate (assumed to be 5%pa) after tax, which is a pretty good return compared with other low-risk options such as a term deposit at 3%pa before tax and a measly 1.8%pa after tax. A further benefit is that she retains access to the additional repayments if required, though this is also a risk as more discipline is required not to access the money.

Salary sacrifice to super

Now let's compare directing these same repayments of $735pm into super via salary sacrifice. The real power behind salary sacrificing to super is that the money is contributed before tax, with a 15% contribution tax rather than being taxed at 34.5% to 39% (including the Medicare levy) when Melissa takes it as cash. This means the payments can be made before tax, which increases the $735 to $964pm.

The table below shows the estimated value of investing in superannuation's different options in diversified portfolios after five years depending on the level of risk Melissa is prepared to take. Remember the higher the return, the higher the risk.

Even if Melissa invested in the conservative option, she would earn an additional $13,590 due to the tax saving and rate of return. This is a whopping 27% extra over repaying her mortgage.

MELISSA'S OPTIONS

STRATEGY	TOTAL SAVINGS
$735pm extra to mortgage ($180,000 @ 5%pa)	$50,000
Salary sacrifice $735pm to super (effectively $964pm) into	
Conservative investments	$63,590
Moderately conservative investments	$64,480
Balanced investments	$65,730
Moderate growth investments	$66,700
Growth investments	$68,840
Negatively gear into shares (4.3%pa growth, 2.7%pa income on 70% franked dividends	$70,000

At face value, salary sacrificing to super is the winner. However, money invested in super cannot be accessed until retirement and it is also subject to legislative risk, as can be seen from May's budget proposals.

Negative gearing

Moving up the risk scale, Melissa could try negative gearing. She has significant equity in her home to obtain an investment loan. Based on Melissa using her monthly payments of $735 from the option to repay the home loan plus the investment income, she should be able to borrow at least $200,000.

I would recommend negative gearing into shares because most investment properties require a much bigger outlay.

Based on an income of 4.3%pa and growth of 2.7%pa with 70% franking, the value of the shares in five years would be $228,500. The investment loan balance after the five years is estimated at $153,000 on the basis that the share dividends, tax refunds and Melissa's payment of $735pm all go into the investment loan.

To accurately assess the financial gain of this strategy, the amount of capital gains tax payable on sale of the shares needs to be taken into account. This is estimated to be about $5560. This results in an after-tax gain in wealth after five years of $70,000.

You would hope this strategy produced the highest gain in wealth as it is by far the most risky and probably not one recommended for a five-year time frame. The risk is high due to the increased exposure to the sharemarket coupled with the responsibility to repay the loan even if the shares do not provide the expected income and growth.

Further, negative gearing means the income from the investment is lower than the costs, such as loan interest. This loss is then claimed on your tax return as a deduction. The higher your income the higher the amount of the loss you get back from the government as a refund. This is why negative gearing is mostly suitable for high-income earners.

On assessing the three options for Melissa, I lean towards the salary sacrificing to super as, even with a conservative investment choice, the outcome is significantly better than reducing the home loan and the extra gained via negative gearing does not fully compensate for the risk.

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Plan to retire

Final push to create wealth

Fred and Jean, both 55, are in the countdown to retirement. They want to boost their savings by $50,000 in five years before they finish working. What are the strategies to get them there? Should it be invested through super or in their own names? They have a total of $350,000 in super (Fred $200,000 and Jean $150,000). Fred earns $100,000 and Jean earns $40,000.

The best thing you can do to increase your net wealth before retirement is to focus on a regular savings plan. It is the ability to save that often determines a person's level of wealth, rather than investment returns. Putting away the same amount on a regular basis will allow you to build wealth.

One of the biggest mistakes you can make in pre-retirement is to spend most of, or more than, your earnings. It's tempting to think that this is the time to enjoy yourself and do the big overseas trips; however, if you are reducing your savings, you may well leave yourself with a shortfall of wealth at retirement and be more reliant on the age pension.

Savings and spending tips

- Commit to a regular savings plan aligned with your pay cycle. It will be easier to put away smaller amounts every month or week.
- Getting into the discipline of saving can be difficult. Make it easier by automating your savings plan so that it just happens each month without your input. Setting up a salary sacrifice arrangement with your employer is a great way to do this.
- You'll be amazed how easy it can be to adjust your spending habits to a lower take-home pay. Even if you think you won't manage, try a savings plan for a few months. We naturally adjust our lifestyle to reflect the income at our disposal.
- Reinvest your earnings. This will help boost returns as income is being redeployed to add to your investment capital.
- Consider your investment time frame before choosing your strategy.

Where to invest your savings

Another mistake you can make in pre-retirement years is not having the right investment strategy. That is, you may not be taking enough risk for money that will be invested for a long time, or you could be taking too much risk for money that will be invested for only a short time.

If you have five or more years, you should consider investing in a balanced portfolio with exposure to Australian and international equities. These asset classes provide the opportunity for capital growth and higher yields but also come with more short-term volatility. An investment time frame of five years or more is long enough to ride out this short-term market volatility so that you can benefit from the potential returns.

But if you're investing for three years or less, you won't have the benefit of time to ride out that short-term volatility. In this case a more conservative portfolio, mostly in secure fixed-interest or cash-type investments, would provide stability and protection. However, you're likely to receive lower annual returns.

What to do with excess cash

In the years leading to retirement your first priority should be to ensure your mortgage is fully repaid. Until this is done your savings should be directed to additional repayments to knock over this debt as quickly as possible.

SALARY SACRIFICE

	FRED'S SUPER		JEAN'S SUPER
	NO SS	WITH SS	(NO SS)
Salary	$100,000	$100,000	$40,000
SG	$9500	$9500	$3800
Salary sacrifice	$0	$10,000	$0
Tax		$1500	
Taxable income	$100,000	$90,000	$40,000
Tax	$24,947	$21,247	$4547
Medicare	$2000	$1800	$800
After-tax income	$73,053	$66,953	$34,653
Cash flow fall		$6100	
Extra super savings		$8500	
Net tax saving		$2400	

SAVING INTO SUPER BEFORE RETIREMENT

	2016	2017	2018	2019	2020
Age	55	56	57	58	59
Opening balance	$350,000	$393,020	$439,050	$488,286	$540,938
Investment earnings after costs	$24,500	$27,511	$30,733	$34,180	$37,866
Return rate	7%	7%	7%	7%	7%
Household income (2.5%pa growth)	$140,000	$143,500	$147,088	$150,765	$154,534
Combined SG contributions	$13,300	$13,633	$13,973	$14,323	$14,681
Fred's SS contributions	$10,000	$10,000	$10,000	$10,000	$10,000
Tax inside super (10%)	-$4780	-$5114	-$5471	-$5850	-$6255
Closing balance	$393,020	$439,050	$488,286	$540,938	$597,230

Please note the above are projections only. The earnings rate each year will fluctuate in line with the investment markets and in some years will be negative.

Once the mortgage is out of the way your savings should be invested in your own name or in superannuation. Deciding which option is right for you will depend on your family income.

For couples who are both working and earning an income of more than $37,000pa, investing in super via salary sacrifice contributions could be the most tax effective way to boost your net wealth over the next five years. However, if you are a single-income couple or one partner earns less than $37,000pa it could be more tax effective to invest savings directly in the lower income-earning spouse's name.

How much to save each month

Salary sacrificed contributions can be a great way to build your super while you are still working and has tax-saving advantages when your income is more than $37,000pa.

Taking the example of Fred and Jean, starting a salary sacrifice strategy would be the best way to increase their net wealth by $50,000 over five years.

If Fred and Jean were to do nothing and continue as they have been, their combined super savings would grow from $350,000 to $546,191 in five years – assuming their super is invested in a balanced portfolio option earning an average annual return of 7% (income plus capital growth). However, if Fred begins to salary sacrifice $834pm or $10,000pa of his employment income, their combined super would grow to $597,230 in five years, adding $51,039 to their investment wealth.

Key benefits of this strategy

- Personal tax saving of about $3900pa in income tax less super tax on contributions of $1500pa, providing a total tax benefit of $12,000 over five years.
- Annual after-tax income or personal cash flow is reduced by only $508pm. So you are adding $10,000pa to super while reducing your take-home pay by only $6100pa.
- It's a great way to save as it will probably not be noticed in the family budget and is automated by your employer, so all you need to do is establish it.

The benefit of regular savings are even greater in the following five-year period. So the longer you're able to save, the more wealth you're able to build. ***M***

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