Start small, dream big

Can a geared share fund help you reach your goals?

The pros and cons of borrowing to invest

It's nice to dream of retiring early, owning your own home and enjoying regular overseas travel with no need to worry about bills.

But if you're like the average Australian, your ultimate financial goals can seem a long way off. It can be hard to see how to achieve big dreams, particularly if you're starting from a small base.

In some situations, using borrowed money to invest – or **leveraging** – could improve your prospects if it's done thoughtfully and conservatively.

Property leverage good, share leverage bad?

For many Australians, borrowing money to buy a residential property, generally at 10x leverage (and rates well beyond the official RBA cash rate), is seen as a conservative way to set yourself up for the long-term – particularly if the home is to live in.

There's no doubt property has produced some life-changing dollar returns. But like any other asset class, it isn't without risk.

- **Rising interest rates** could result in an immediate cashflow issue.
- A change of **employment situation** could even lead to default.
- Unexpected **health issues** present another real risk, particularly if you're underinsured or you have a low cash reserve.

So why do we tend to feel confident in gearing up to buy a property, yet hesitant to consider leverage for other types of investment?

Let's look at a geared managed fund that invests in a basket of quality Australian shares. Typically, these funds are geared at lower rates than property – perhaps around 2x leverage, rather than 10x. And the actual interest rates are often far lower than those for a property, as fund managers can often access significantly cheaper rates.

Geared share funds can also:

- remove the **risk of a margin call** so if a unit price drops, you wouldn't need to top up your loan to maintain an agreed loan to valuation (LVR) ratio
- remove the **administrative burden** of borrowing money to invest
- offer **diversity** through owning a basket of different companies in different industries
- improve **liquidity** as they can generally be sold at any time and you don't have to sell off your whole investment at once.

Now, let's consider differences in how we tend to think about property and Australian shares.

Property v shares – the tale of the tape

Investor timeframes tend to be considerably longer for property ownership. Property owners aren't concerned with daily price movements of their house, so tend to ignore **market noise**.

Share owners meanwhile are inundated by prices every second the market is open, as well as a plethora of 'expert' opinions attempting to predict what stocks will do over the shorter-term.

All this can contribute to the perception that property is less volatile than share markets. If a property's price was quoted daily, owners may be surprised by some significant price swings!

It's also worth remembering that just like stocks (and even bonds), **property markets occasionally fall significantly**. Over the past half a century or so, many markets, including Ireland, Portugal, Spain, US, UK and Japan have corrected precipitously. Japan's crash was the most severe, with Tokyo property falling by around 90% from the late eighties to the early 2000s.

Investment property owners also have to deal with **administration**, maintenance, managing tenants and other headaches. **Minimum initial investment** amounts can also make a difference to your personal situation, as a house deposit is, obviously, typically much larger.

Both asset classes can offer **tax benefits** – negative gearing for housing and franking credits for shares. In a managed fund you'll generally have less ability to manage capital gains, but this may be offset by some of the benefits mentioned above.

Thinking like a business owner

As many great investors have noted, learning to screen out market noise, and starting to think more like a business owner, is sensible. When investing in a business – whether it's starting your own website, opening a café, buying shares or even investing in a portfolio of quality businesses through a managed fund – you by definition become a business owner. So the cash profits produced by these businesses, along with their prospects for future profitability is your real priority, not a chart with a line that wiggles up and down as the price rises and falls!

This isn't to say asset price volatility doesn't matter. If you're a self-funded retiree with little or no cash, selling units at a temporarily reduced price to fund your lifestyle isn't an attractive proposition. That's why financial advisers tend to emphasise the need to maintain an adequate cash reserve.

Whether you're invested in a managed fund, direct shares or an investment property, price only matters at two moments in time – when you buy and when you sell. The return on your investment depends on these prices and the cash flows over your investment period.

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Getting a good night's sleep

Ultimately, you must be comfortable with your investment decision, and be able to sleep at night. So if the concept of gearing worries you, we wouldn't suggest going ahead, even if larger potential returns may be on offer. Everyone is different and what someone perceives as 'risk', others will perceive as opportunity.

Geared share funds may be worth considering for attaining larger financial goals, particularly if you have a long-term timeframe and can ignore the inevitable ups and downs of the share market. In fact, volatility is what allows outsized returns to materialise from shares, as it provides managers opportunities to buy when markets are offering a cheap price and sell when a high price is on offer.

Considerable caution should be used with gearing, as this style of product is not for everyone. **While leverage can significantly boost investment returns and potentially allow you to achieve your goals from a smaller capital base, it will certainly magnify volatility, as well as increase potential losses – particularly over the short-term.** But if you can ignore market movements and avoid reacting emotionally to occasional crashes (by selling at the very time you should be buying), a sensible amount of leverage could help you achieve your goals.

Want to know more?

Visit **amp.com.au/investments/specialist-funds/specialist-geared-australian-share-fund** or reach out to your portfolio specialist or BDM.

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