

# Fact Sheet

## Strategy: Margin Lending

Many investors would like to increase their exposure to the share market – yet lack the funds to do so. For such investors, margin lending can be a simple and flexible ‘gearing’ option.

### What is margin lending?

Margin lending involves borrowing money to invest. The amount of money you can borrow is based on the value of your investments – in this case, the security of the loan is your investment.

Margin lending is a form of gearing that allows the investor to borrow money to invest in managed funds or shares.

### What are the benefits of margin lending?

There are many benefits to margin lending as it provides investors with the necessary funds to increase the value of their investments. For investors looking to increase their investment in shares or managed funds, margin lending can be a simple and flexible gearing option.

Of course, as with all investment issues, it is important that you seek professional financial advice about this strategy and how it applies to your personal situation.

- **Increase investment returns** – margin lending allows you to increase your investment in shares or managed funds, providing you with an increased investment base and the potential to increase your investment returns.

- **Increase investment exposure** – by increasing the amount you have to invest, you can potentially open up additional investment opportunities that may further diversify your existing portfolio.
- **Provides flexibility** – you can alter your level of gearing over time to suit your individual needs. A gearing strategy can be started with small or large amounts and can also be conducted on a regular basis, known as instalment gearing.
- **Achieve your goals** – gearing provides the opportunity to create more wealth in a faster than usual fashion by multiplying potential gains. If you have a financial goal to be achieved, gearing may form part of a suitable strategy.
- **Access tax deductions** – depending on your personal situation and the types of investments you are invested in, margin lending also has the potential to lower your tax liability and the potential to claim interest costs as a tax deduction providing you invest the borrowed funds in assets that produce an income. (Tax implications are complex and are dependent on your personal circumstances. Speak to your financial adviser about this.)

### How does it work?

#### Example 1: Personal investment with NO gearing

Personal funds	\$100,000
Borrowed funds	Nil
Invested funds	\$100,000

A 10% increase in the value of investments will provide a gain of \$10,000.

#### Example 2: Personal investment gearing

Personal funds	\$100,000
Borrowed funds	\$100,000
Invested funds	\$200,000

A 10% increase in the value of investments will provide a gain of \$20,000. This result doubles the return gained in the first example.

## Are there any risks involved?

While margin lending has the potential to accelerate your investment returns, there are also a number of risks involved. That is, by increasing your exposure to certain investments there is also the risk that these investments can decrease in value. So, while borrowing to invest can magnify investment gains, it will always magnify losses suffered if the value of your investment falls.

It is recommended that you seek professional financial advice about margin lending and the associated tax implications before making a decision.

## What if I can't pay back the loan?

Depending on the lender, there are different procedures that take place to recover the value of the loan. Lenders want to be sure that the value of an investment portfolio well and truly covers the amount borrowed to finance it. Generally, when the value of your portfolio drops too close to the value of your loan, the lender may step in and make a 'margin call'.

You would then need to cover this amount by:

- injecting more cash to lower the borrowed amount
- buying more shares to raise the value of the portfolio
- selling some of the existing portfolio to raise cash to lower the borrowed amount

This is why it is so important to maintain a cash reserve in case you ever receive a margin call from the lender.

See "Is there a way of minimising the risk?" for more information.

## Is there a way of minimising the risk?

As with all investment strategies, there are risks associated with achieving returns. However, there are some things you and your adviser should consider in order to minimise any negative implications.

**Diversify** – all investments carry some level of risk. However, you can help manage the impact of market movements on your investment by diversifying across different sectors. A diversified portfolio enhances the ability to balance exposure over various sectors.

**Staying disciplined** – it's important to remain disciplined and stay focused on your long-term financial goals. With the help of your adviser, stick to your original strategy and evaluate your portfolio regularly.

**Maintain a cash reserve** – it is a good idea to actively monitor your cash flow and ensure you do not use up all of your available funds. Try maintaining a cash reserve that can act as a buffer against a possible margin call.

**Cover your personal risk** – if something happens to you and you lose your ability to earn an income, how will you manage to service the loan? Consider ways in which you can protect yourself against a loss of future earnings with income protection, trauma insurance and life insurance.

**Seek professional advice** – all investors should seek the advice of a professional financial adviser.

## Should I consider margin lending?

Only a professional financial adviser can answer this question, as margin lending is a strategy that is not suited to all investors.

Generally, margin lending is suited to investors who:

- are looking for medium to long-term investment opportunities
- have a relatively high, secure disposable income
- are willing to take a greater risk for the chance of greater return
- have adequate cash reserves or other security to meet margin calls
- have some understanding of the stock market and its operations
- understand the financial implications of margin lending (ie potential for losses as well as gains).

Contact your financial adviser today for more information.

### ► Need more info?

If you are interested in learning more, speak with your financial adviser.