Cashflow matters
How managing your cash could change your life

Macquarie Cash Solutions

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Contents

Cashflow matters

Why manage your cash?

No matter how much money we have, or what stage of life we are at, we all have to make decisions about cash each and every day. Some of these are small, like your morning cup of coffee or buying a new shirt. Others are much bigger, like a new car or house or setting up an investment portfolio. All of these decisions, big and small, highlight the importance of managing your cashflow.

Cash is a key component of a successful investment strategy. Getting the basics right can help you reach your financial goals more quickly. Let's start by looking at what cashflow really is and why it matters.

The four components of cashflow

Income Manage all of your income, such as salary, rents and dividends	**Expenses** Pay all your living expenses, such as bills, taxes and fees
Assets Manage your savings and invest in cash-creating assets	**Liabilities** Pay your home loan, credit cards, personal loans and investment loans

Rainy day money

The Australian economy is currently in its 20th year of economic growth. Unfortunately for most of this time the household savings ratio, which is the proportion of their disposable income that Australian households save, was in a downward spiral. Between 2004 and 2005 we even hit negative savings, meaning we actually spent more than we earned. The good news is that we have started to change our ways. Our savings ratio has risen in recent years and we now save around nine per cent of our disposable income.[1]

So we are heading in the right direction. But what prompts us to save? According to a survey in June 2009[2] the main reasons are:

1. saving for a rainy day
2. holidays and travel
3. repay debts or bills
4. retirement.

So what does this tell us? While the Australian economy performed better than most of its peers during the global financial crisis, we still learnt some valuable lessons about the importance of saving for a rainy day.

Saving to repay debts or bills seems to be a high priority, however

1 Reserve Bank of Australia (RBA), *Twenty years of economic growth speech by deputy governor Ric Battelino*, 20 August 2010. Australian Bureau of Statistics, *Australian national accounts* (cat no.5206.0).

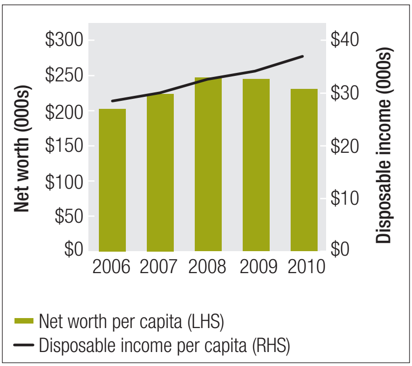
2 Melbourne Institute, *Household financial conditions index*, September 2010. The Melbourne Institute is Australia's leading and longest standing research institute in the field of economics.

only 36 per cent of us are now debt free, which is actually the lowest level since records began in 2001.[3] Australians now have one of the highest levels of debt among comparable countries, with the average level of household debt equal to 1.5 years of household income.[4]

Rising incomes, less wealth

Rising incomes don't always equate to more wealth. In Australia, our disposable income per person increased 13 per cent during the last three years. However our net worth fell by seven per cent.[5]

Making more money won't lead to greater wealth unless you are managing your cashflow so that it grows.



Source: ABS[5]

Your ideal retirement

Estimates show Australians currently approaching retirement only have $51,500 of savings to supplement their Age Pension income.[4] That may be enough to pay the bills, but it may not fund your ideal lifestyle.

Having enough money for retirement is a key savings goal for many of us. An ageing population and a shrinking workforce mean it is important to think about your financial future.

The sooner you start, the earlier you may be able to achieve your financial goals. The good news is that you generally won't spend as much when you retire. You're not travelling to work or buying work clothes. Your children, if you have them, may be all grown up. However, with extra time on your hands, it is important to have enough money to enjoy it. If you still want to go out for the occasional dinner, go to the theatre, or holiday overseas, you will need to have the money to support your ideal lifestyle.

3 Melbourne Institute, *Household saving and investment report*, June 2009.
4 NATSEM, *Income and wealth report*, April 2010.
5 Australian Bureau of Statistics, *Australian system of national accounts* (cat no.5204.0).

The road to financial independence

Building positive cashflow

Financial independence is all about cashflow. As the chart below shows, it is the point where your additional income (such as income from your investments rather than salary or wages) meets or exceeds your cost of living.

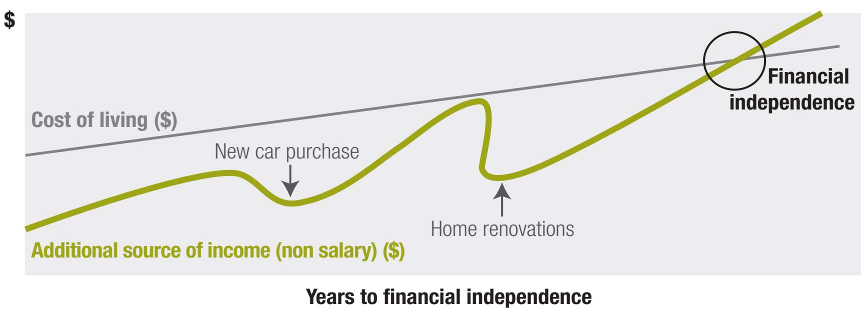
So how do you get there? To achieve genuine financial independence, and all the lifestyle benefits that go with it, you need to make sure you handle your cash so that it grows. You need to create positive cashflow by investing in cash-creating assets. That way you can create an additional source of income, over and above the income you earn by working, to help you reach financial independence sooner. As the chart shows, how you manage your cash along the way can have a big impact on when you achieve your goals.

There are a myriad of investment options available to help you build positive cashflow. Everyone's situation is different, so before making any decisions it is important to speak to your financial adviser and consider your personal goals, financial situation and needs.

Bricks and mortar

The family home is the biggest source of wealth for most Australians. Around 69 per cent of households own their home (with or without a home loan). The average value of the family home is $412,000, with an average of $142,000 still owing on the loan. In contrast, households with super funds have an average of $110,000 in super.[7]

The road to financial independence[6]



6 This chart has been created for illustrative purposes only.
7 NATSEM, *Income and wealth report*, July 2010.
8 RP Data, *An investor's guide to the nation*, October 2010.

Owning a home brings a number of benefits. After paying off your home, you can live rent-free. You can also use home equity to invest, potentially growing your wealth more than you could using just your own money. Homeowners downsizing to boost their retirement income could find their home has appreciated in value over time. Homes in Australia grew in value on average 7.3%pa for the five years to July 2010.[8]

Using the family home as a wealth creation vehicle can assist in achieving financial goals sooner. It is also beneficial that the family home is treated favourably by Australia's tax and welfare system.

Cash is king

There is currently $1.6 trillion in cash deposited in Australian banks and financial institutions, almost 1.8 times more than five years ago.[9] As investors seek more secure returns in the wake of recent market uncertainty, cash hubs and term deposits have become increasingly popular investments.

The term deposit market, in particular, has doubled during the past five years. There is now $600 billion invested in term deposits with Australian banks and financial institutions.[9] Current interest rates are quite attractive for investors, with term deposits offering a noticeable premium over the Reserve Bank's cash rate.[10]

There are a number of ways to invest in cash including cash management accounts, term deposits, and online savings accounts. These investments can help you build cashflow by earning interest on your money.

Shares and managed funds

41 per cent of Australians own shares, either directly or through managed funds.[11] You can buy or sell shares through a broker or an online trading service. Another option is to invest in a managed fund that pools your money into a fund that invests in a particular mix of assets.

[9] APRA, *Quarterly banking performance and Quarterly credit union and building society performance*, March 2010.
[10] RBA, *Retail deposit and investment rates, International official interest rates,* October 2010.
[11] Australian Securities Exchange, *2008 Australian share ownership study.*

Shares give you part ownership in companies and can help build cashflow by paying dividends (or distributions for managed funds). If the price of your shares rises, so will the value of your share portfolio, building your wealth. As the global financial crisis showed, share markets can be volatile so prices may go down – but they are generally thought to offer good returns over the long term and remain a key component of a balanced investment portfolio.

Superannuation

Australians invest 23 per cent of their wealth into Superannuation,[12] and your super can have a big impact on your cashflow. In addition to payments made by your employer, you need to decide how much you will personally contribute to your super, both now and in the future, to ensure you'll have enough money when you retire.

Some options for investing in super include retail funds, industry funds, your company's super plan or self managed super funds (SMSFs).

SMSFs, or do-it-yourself super funds, have tripled during the last six years and Australians now invest $400 billion in SMSFs.[13]

SMSF trustees are increasingly recognising the importance of cash in their fund's portfolio and cash now accounts for 28 per cent of SMSF assets.[13]

Platforms

Some investors with a financial adviser choose to bundle all of the above investments together by investing through a wrap platform, such as Macquarie Wrap. You can invest in cash hubs, term deposits, super, managed funds and even direct shares. Wraps make it easier for your adviser to manage your portfolio, provide streamlined tax reporting and you can obtain shares at wholesale prices.

Remember, it is not just about investment performance or having the right investments in your portfolio. That's because building wealth is not just about income. It is also important to have a cashflow management approach that ensures your money works harder for you.

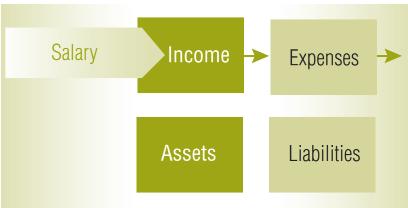
[12] Roy Morgan Research, Journal of Financial Planning, Volume 3 Issue 4, 2010.
[13] ATO *Self-managed super fund statistical report*, June 2010.

How to handle your cash

Rich or poor, young or old. It doesn't matter whether you are a sophisticated investor or starting your first job, or whether your cash comes from salary or wages, business income, share dividends, rent or even social security payments.

What does matter is how much of your cash you keep and how you handle it. While we all manage our cashflow differently, we often fall into one of three cashflow patterns.

1. Living for now



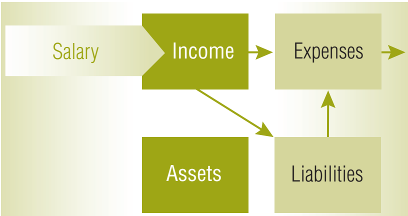
As you can see, a living for now cashflow pattern is simple. Money flows in as wages or salary and flows out to pay expenses. None of the income is saved or used to buy investment assets.

The lack of savings is an obvious problem. There is no capital being stored away for a rainy day, no wealth being accumulated and no money set aside to prepare for retirement. People caught in this cashflow pattern rarely have long-term debt, such as a home loan. This may be because they are unable to afford it or they may be considered a poor credit risk.

Surprisingly, some highly-paid individuals have a living for now cashflow pattern. They earn high incomes but spend everything they earn.

They may live an expensive lifestyle, but only if nothing goes wrong, if they keep their job and stay healthy. Unfortunately, they almost guarantee themselves no change in wealth at the end of each year and, as a result, they could face a lower standard of living in retirement.

2. Focus on looking rich



On the surface this cashflow pattern may appear far more prudent, but in reality it is just as risky. People who exhibit this cashflow pattern tend to divide their cash. They pay their expenses and buy items such as cars and high-end consumer goods.

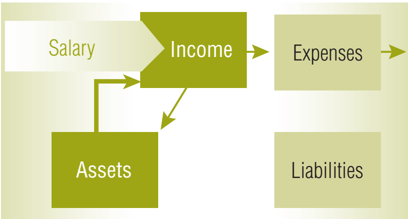
At the heart of this cashflow problem is confusion between the different types of assets. Not all assets are good for your cashflow. Some assets pay you money, others take money from you.

You may have a shiny new car, fabulous furniture and all the latest hi-tech electrical goods and gizmos.

However everything you own probably lost a high percentage of its value as soon as it left the shop and may lead to higher expenses too, such as leasing payments or running costs. These items are called depreciating assets. They cost you money, add to your expenses and their value is likely to go down over time.

While this cashflow pattern may make you look rich, you are not investing in any cash-creating assets so it can potentially set you up for a cash-poor future.

3. Positive cashflow



As you can see, the third cashflow pattern is markedly different from the other two. The key line on this chart is the flow of money from assets back into your income – that is the income generated from investments that create more cash.

By investing in assets such as term deposits, shares, investment property, or managed funds, you are creating cash. You can use this extra cash to meet expenses and, more importantly, invest in more cash-creating assets.

At this point the distinctions between the cashflow patterns become most obvious. While many people are living for now or focusing on looking rich, to achieve genuine financial success – and all the lifestyle benefits that go with it – you need to handle your cash so that it grows. You need to create positive cashflow by investing in cash-creating assets.

By doing this you can create an additional source of income over and above the income you earn. That is what wealth creation is all about.

Breaking the habit

Your cashflow plan

Let's recap. Australia has had a sustained period of economic growth, 20 years in fact, but still has one of the lowest savings rates among comparable countries. It seems Australians are not managing cashflow well.

It is time to break any bad cashflow habits. Changing ingrained money habits is particularly hard because they are rarely taught. Most of us learn them from our parents or guardians.

Psychologists tell us that one of the keys to changing an ingrained habit is to have a replacement habit waiting to take over. These five simple steps may help you change your money habits for the better.

1. Set goals

The first step to building better cashflow is to visualise where you want to be financially. The best way to do that is to write down your money goals. Your goals might include:

- saving for your dream holiday
- saving for your children's education
- creating wealth by expanding your investment portfolio
- building a larger retirement nest egg so you can retire sooner.

Make sure you don't limit your goals to what you think is achievable now. If you are really serious about changing the way you manage money, write down what athletes call stretch goals – exciting targets that will demand continuous improvements in your performance but are not impossible to achieve.

When setting your goals there are a number of factors you should consider:

- your age
- your health
- upcoming financial commitments
- short term obligations
- existing debts and assets
- likely income.

Once you have committed to a list of goals, you will have a stronger motivation to change your money habits. Make sure your goals are specific and put a timeline next to each of them so that you can monitor your progress. For example, double my investment portfolio in the next two years.

It is also important to review your goals regularly as your situation and priorities may change, for example, you may switch careers or start a family.

2. Pay yourself first

One of the most difficult (but more important) aspects of cashflow management is having the discipline to pay yourself a set amount to cover your day-to-day living expenses. By using a central cash hub you can arrange to have your living expenses and bills automatically transferred into a transactional account for you to access. Meanwhile, the remainder of your salary accumulates in the cash hub, so the money you have worked hard for starts working hard for you.

3. Think like you are a business

You don't have to run your own business to be successful, but it helps if you think like a business.

All businesses use two common measures to monitor their cashflow – an income statement and a balance sheet.

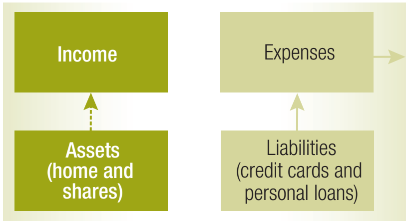
Two ways to monitor cashflow

Income statement	Income	Expenses
Balance sheet	Assets	Liabilities

The income statement measures income over expenses – it tracks what you earn against what you spend. The balance sheet compares your assets against your liabilities – what you own versus what you owe.

Businesses use these measures to help them make financial decisions – investment, borrowing, cost-cutting and expenditure. You should try to do the same. Like any business you should understand your own income statement and balance sheet and review them often to track your progress.

Cashflow patterns of assets and liabilities



The cashflow pattern shown here illustrates how the income statement and balance sheet link to cover the four key components of cashflow – income, expenses, assets and liabilities.

It reinforces yet again the importance of building assets that may help you create income, and reducing your liabilities that create expenses.

Cost to income

Your income statement will also lead you to understand another key cashflow measure – your cost-to-income ratio. In simple terms, your cost-to-income ratio is the percentage of your income (salary or wages) that is used to meet expenses (accommodation, food, entertainment, insurances etc).

Good businesses look to minimise their cost-to-income ratio. If you can calculate your own cost-to-income ratio, or the proportion of your income that goes to meeting your expenses, you will be better placed to save money, reduce debt and start to build positive cashflow.

Thinking like a business and tracking your own cashflow measures can help you to better understand your existing financial position and how you manage your money.

4. Start budgeting

The first step towards controlling your cost-to-income ratio is to have a budget or cashflow plan. Your budget should take into account your entire financial position so it is important to make a list of all of your expenses. Speak to your financial adviser or accountant for some useful tools to get you started.

5. Get advice

One of the key roles of a financial adviser is to help you practice better cashflow management.

Your financial adviser has the expertise to give you personalised advice on ways to manage your cash more effectively.

Did you know?

Research shows that people who use a financial adviser are likely to save an additional $2,457 each year compared to those who don't.[14]

[14] Investment & Financial Services Association (now called the Financial Services Council), *Value Proposition of Financial Advisory Networks*, 2009.

The debt traps

Are you spending beyond your means?

The older we get, the more complex our financial affairs can become. Unless we are very lucky we'll all have debt in one form or another throughout our lives. The secret to good cashflow is to avoid some common debt traps.

The excessive home loan

Home ownership is the great Australian dream. It feels good to take the plunge into the property market because you would like to one day have the security of owning your home outright and hope your house will increase in value.

It is unfortunate, but some home buyers get carried away with the dream and do not consider the stark reality. To buy their dream home they may borrow an amount that appears to be within their means to repay (at least on paper). In reality, they haven't planned for changing circumstances, such as rate increases or loss of income.

Buying a home or investment property commits you to making loan repayments for a long term, so it's a commitment you need to be well prepared for.

However, using your home loan effectively can assist your wealth creation goals. By making your money work harder for you, rather than the other way around, you could be paying off your home loan sooner and building an investment portfolio at the same time.

Think before you spend

There are times when you just have to have something now. You need a new car, or could really use a holiday, or the kids need new laptops for school. The only problem is you don't have money in the bank right now. Credit cards and personal loans can help you manage these cashflow dilemmas in the short term, but you may want to use them in moderation. Sometimes you genuinely do need these items now, but sometimes you may be able to wait a little longer. Think carefully before you spend and make sure you have enough money to pay back the debt.

Use credit wisely

Using credit cards can be a very convenient way to pay for everyday expenses such as groceries and bills or the occasional bargain at the summer sales. It's easy and you don't need to carry cash around or worry that you will have enough money to pay for your needs. Most credit cards come with interest free periods, so provided you pay off the full balance at the end of each month, you won't be charged with an extra amount of interest on top.

Make sure you have enough money to pay off the monthly balance. If what you are paying falls short each month, interest will start to mount up.

It is important to use your credit card wisely and be sure that you are not spending beyond your means. Here are a few tips to keep you on track:

- consolidate your debt – transfer your balance to one account
- keep track of your spending
- pay your closing balance by the due date
- set up a direct debit for easy payments
- make sure that your credit card limit is right for your financial circumstances.

Implementing your cashflow strategy

We have looked at the commitment it takes to build a positive cashflow pattern. We have discussed some of the traps to avoid and the steps to building good cash habits. Now it's time to turn your cashflow strategy into a new way of doing things.

A versatile cash hub

Consolidating your cash into one central cash hub, that receives all your income and lets you make all your payments, can help you monitor and manage your cash more efficiently.

Flexibility

To help you manage your cashflow efficiently, your cash account should be able to accept money from all sorts of sources, for example: your employer, your investments, Centrelink or tenants. It should also allow you to make all your payments for new investments, your home loan, the ATO, professional fees, and help you meet your day-to-day needs.

Visibility

Visibility is perhaps the most important part of your cashflow strategy. It is crucial that you – and your financial adviser or accountant – can see how, when and where your cash flows.

Competitive interest rates and low fees

Managing your cash shouldn't cost you money. Yet some people manage their cash from transactional bank accounts that usually pay low or no interest and may charge monthly account keeping fees or limit the number of free transactions you can make each month.

The next generation cash hub

Macquarie Cash Management Account

Macquarie have been market leaders in cash management for three decades. Our cash solutions are used by more than 400,000 investors and 10,000 financial advisers. Macquarie has built this position through exceptional service and innovative features and functionality.

Macquarie's Cash Management Account (Macquarie CMA) is the next generation cash hub. It offers an impressive range of benefits and comes with a competitive rate of interest.

Easy cashflow management

All your transactions appear on consolidated statements that provide a detailed narrative for each transaction. Accounting, tax returns and long-term record keeping are all much easier. It is also easier to calculate cashflow measures such as cost-to-income ratios and your personal income statement.

In addition to regular reporting, your Macquarie CMA gives you online flexibility and control, as well as real-time access to your account balance, transaction histories and records of interest payments. It also allows you to view any pending transactions and download statements.

Easy links

A range of online and electronic tools makes it easy to link your Macquarie CMA to all your sources of income and funds. You can have your salary, wages, investment income, share dividends and the proceeds of other investment sales immediately cleared and available in your account. You can also transfer funds from loan accounts into your Macquarie CMA when you are ready to invest them.

Using Macquarie's online services, you can direct payments to any individual or organisation that can provide you with a BSB, account number and name. You can also pay bills using BPAY® and set up regular periodic payments from your account.

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Share information and access with other professionals

One of the many advantages of having a single cash hub is the ability to share information with your financial adviser, accountant, stockbroker or other professional.

By giving your advisers access to your Macquarie CMA account information you ensure they have a complete picture of your cashflow. Online statements, transaction histories and annual tax statements make it easier and cheaper for your advisers to help you monitor your investments.

With a complete view of your cashflow, they can provide well-informed advice based on your overall financial position to support your investment decisions.

The heart of your SMSF

The Macquarie CMA gives you and your adviser, accountant, stockbroker and administrator all the tools you need to effectively manage the cashflow for your SMSF. With the Macquarie CMA at the heart of your SMSF, you can save time on administration and easily act on investment opportunities – which is why one in every four SMSFs use the Macquarie CMA.[15]

Low costs, no monthly fees[16]

The Macquarie CMA makes transacting more cost efficient with no monthly fees, helping you reduce the costs associated with running your investment portfolio.[16] Plus, you'll earn a competitive interest rate.[17]

15 Macquarie Bank Limited data, *ATO Self-managed super fund statistical report*, June 2010.

16 Fees apply for incidental services such as cheque books, bank cheques and telegraphic transfers. Please see the Product Information Statement for more information.

17 For the current rate see macquarie.com.au/personal or call 1800 806 310. The Macquarie CMA interest rate is variable and subject to change without notice.

Getting started

Useful tools

Get advice

Your financial adviser and accountant can help you structure your finances to help you manage and monitor your cashflow and integrate a cash hub into your overall investment portfolio.

Your cashflow plan

Your financial adviser or accountant can also help you with budgeting and creating a cashflow plan.

The FIDO section of the ASIC website at fido.asic.gov.au offers some useful tips on saving and budgeting and provides general information about investing.

Macquarie's cash solutions

For more information about Macquarie Cash Solutions and how you can take control and create positive cashflow talk to your financial adviser, visit macquarie.com.au/personal or call 1800 806 310.

Macquarie's home loan solutions

For information about Macquarie Bank Mortgage Solutions and how you can best structure your borrowing for your circumstances, talk to your mortgage broker or financial adviser, visit macquarie.com.au/mortgages or call 1800 007 772.

For more information speak to your adviser, broker or contact Macquarie

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