



# Important investing choices

## Managing cost and contributions to achieve financial goals

The economy and investment markets can often be the central topics in conversations about financial plans, but successfully achieving our goals is not entirely dependent on these largely uncontrollable factors.

Investors can benefit from looking beyond headlines about the meteoric rise or fall of an individual stock, the newest cryptocurrency named after an internet meme, and short-term crystal ball predictions about next quarter's top performing asset class.

Looking back on the 25-year period that Vanguard has been serving Australian investors, the markets have rewarded disciplined long-term investors with strong returns. Without straying into short-term

predictions- the outlook for the next 25 years suggests that more subdued returns are likely. This underscores the importance of understanding the impact of all the choices, beyond investment selection, that form part of our financial plans.

To illustrate the impact of focusing on elements that can be controlled, modelling commissioned by Vanguard Australia illustrates how key choices focused on discipline, minimising cost and maximising contributions can empower investors to achieve their individual goals- without adopting a riskier investment strategy.

Vanguard's core purpose is to give all investors the best chance of investment success, and that goes deeper than wealth creation.



# Three individuals, at different stages of life, with different goals

Vanguard's core purpose is to give all investors the best chance of investment success, and that goes deeper than wealth creation.

Investment success is connected to our life goals – things like buying a first home, putting children through school, or ensuring a happy and healthy life after work.

While our individual financial circumstances and life goals are unique to each of us, by modelling three scenarios reflecting familiar goals for different stages of life we can illustrate the impact of some key choices.



**First home focused (18)**  
knows that while there are many more enjoyable ways to spend money after finishing school the dream of buying a house in 10 years requires good money habits starting now.



**Smart outlook (35)**  
sees their young child relishing the learning through early school years and wants to start putting money away to support an opportunity for higher education in about 15 years' time.



**Life after work (40)**  
is building a successful career and a full life, they are seeking confidence that the financial choices made today will support a rewarding life after work, looking ahead 25 years but not only considering superannuation savings.

# Control through key choices

## Disciplined asset allocation

The discipline to set and maintain an appropriate investment asset allocation is a fundamental investment principle. This involves tuning out the day-to-day market noise that can lead to impulsive and suboptimal decisions, and only reassessing investment strategies to consider long term impacts of changing market conditions.

In this modelling our individuals are invested in a broadly diversified index investment portfolio with a 70% allocation to growth assets and 30% allocation to defensive assets. This is held consistently throughout their investment time horizon, allowing the modelling to clearly show the impact of decisions beyond asset allocation.

To illustrate the experiences of these individuals the returns of this 70/30 investment portfolio were calculated retrospectively (utilising real historical market returns). As a comparison point the modelling was also run prospectively by applying long term expected investment returns of asset classes.

This showed historical returns across the past 25 years of 9.45% per annum compared with prospective returns of 6.17% per annum into the future.

The insights about the impact of investment choices are consistent with both sets of return assumptions, however the reality of muted projected returns for the future highlights the challenge investor face when making choices to meet their goals- and the temptation that exists to seek higher returns by increasing the risk in a portfolio.

## Cost

After setting an appropriate asset allocation, building an investment portfolio with low costs is another key principle of investment success. Put simply, the lower the investment costs, the greater the share of returns that stay with the investor- working towards their goals.

In the base case for this modelling each of our investors accept the industry average investment management fee of 0.85% and a buy/sell spread (a key transaction cost) of 0.2%.

Then we show the impact of a choice to minimise investment costs, represented by the average Vanguard Australia management fee of 0.29% and buy/sell spread of 0.09%.

## Contributions

In the context of working towards a long-term financial goal, increasing investment contributions will have an impact that outstrips the dollar amount added- as a result of the compounding impact it has over time.

A decision about how much to contribute is largely dependent on individual circumstances, however for the base case in this modelling we show the results of annual contribution that represents 1% of each individual's post-tax salary.

Then we show the impact of a choice to increase the annual contribution to 4% of post-tax salary.

The individuals' salaries increase by 3.2% in each consecutive year, reflecting long-run expectations for wage inflation.

The discipline to set and maintain an appropriate investment asset allocation is a fundamental investment principle.



# The impact of key choices

For each individual, a broadly diversified asset allocation (consistently represented as **70% growth** assets and **30% defensive** assets) has been set to help reach a personal goal across a defined time period. So, after the initial commitment is made what is the impact of key choices about cost and contribution?



### First home focused

This recent school leaver is 18 years old, and currently has a salary of \$35,000. In ten years they want to be closer to buying their first home and to start building a house deposit they are kicking things off with a \$500 investment.

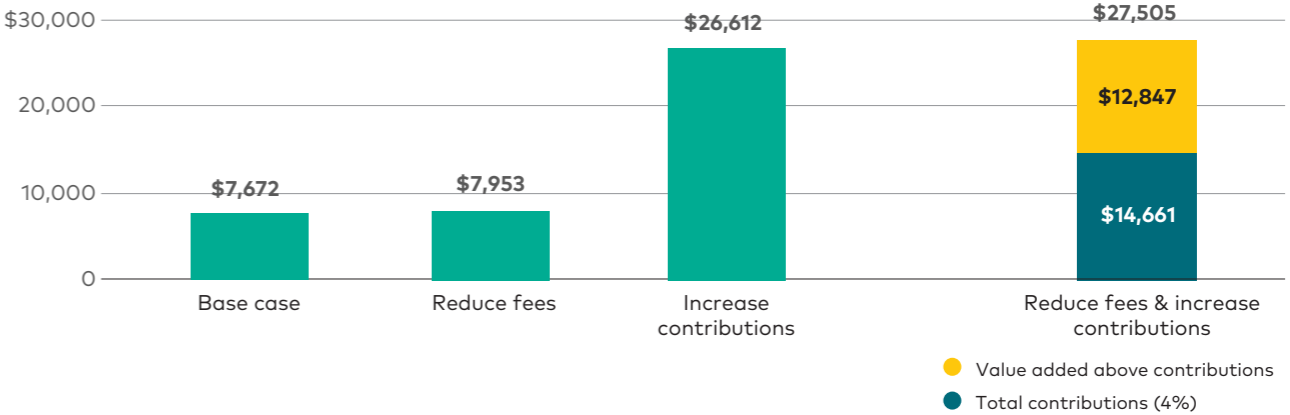


- Base case: With the industry average fee of 0.85% and contributing 1% of post-tax salary, at the end of ten years First home focused will have \$7,672 to contribute to their house deposit.
- Making the choice to reduce investment costs to 0.29%, results in a balance of \$7,953 after 10 years, representing a 3.7% increase.
- Making the choice to increase contributions to 4% of post-tax salary, sees a ten year balance of \$26,612, a 246.5% increase.

- Making the choice to both lower cost and make higher contributions, would deliver First home focused \$27,508 towards their first home purchase, a 258.5% increase on the base case.
- The total 4% contribution amount across the investment period is \$14,661, showing that an additional \$12,847 can be directly attributed to the impact investment returns compounding through the period and lower management fees. This represents 46.7% of the final value.

While housing prices in Australia continues to break records that pose challenges for first home buyers this material difference to a deposit would certainly put *First home focused* in a better position to take their first step into the property market.

First home focus  
10 years time horizon



Source: Vanguard and Deloitte, October 2021.

Smart outlook

A 35-year-old parent with a young child just starting school, thinking about the opportunities that education can provide. With a salary of \$80,000 and a starting investment of \$25,000 with a goal of supporting their child's university education in 15 years.

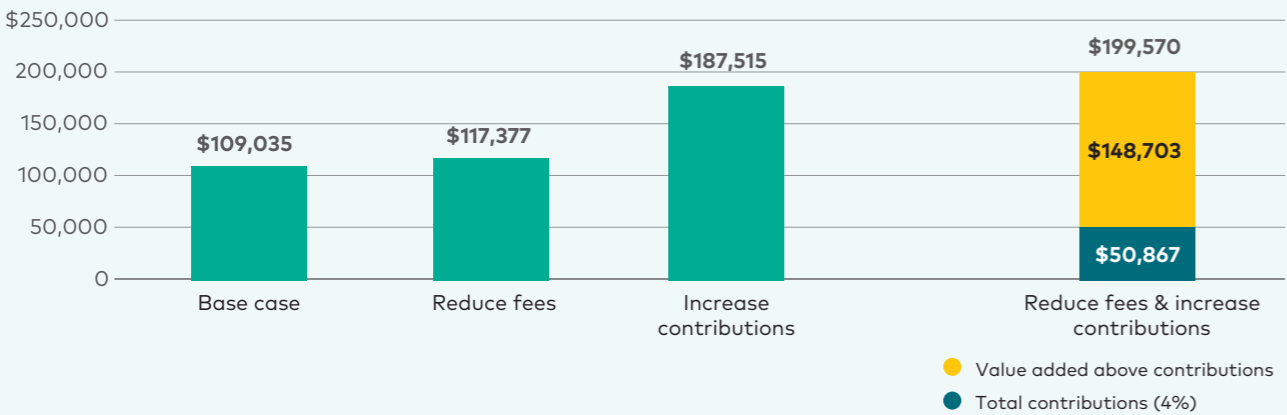


- Base case: With the industry average fee of 0.85% and contributing 1% of post-tax salary, at the end of 15 years Smart outlook will have \$109,035 to help support their child's university education.
- Making the choice to reduce investment costs to 0.29%, results in a balance of \$117,377 a 7.6% increase
- Making the choice to increase contributions to 4% of post-tax salary, sees a 15 year investment value of \$187,515 a 72% increase

- Making the choice to both lower cost and make higher contributions would see Smart outlook achieve an investment value of \$199,570 to support their child's education, an 83% increase
- The total 4% contribution amount across the investment period is \$50,867, showing that an additional \$148,703 can be directly attributed to the impact of investment returns compounding through the period and lower management fees. This represents 74.5% of the final value.

In this scenario making the choices to limit costs and increase contributions could potentially be the difference between *Smart outlook* helping their child find the best education option in their home city or being able to expand that search further afield and covering the additional expenses.

Smart outlook  
15 years time horizon



Source: Vanguard and Deloitte, October 2021.

Life after work

A 40-year-old managing their superannuation to meet their financial obligations through retirement, who is also seeking confidence about supporting a fulfilling lifestyle and greater financial flexibility as they approach retirement. Starting with an annual salary of \$90,000, an initial investment of \$50,000 has been made with a 25-year time horizon.

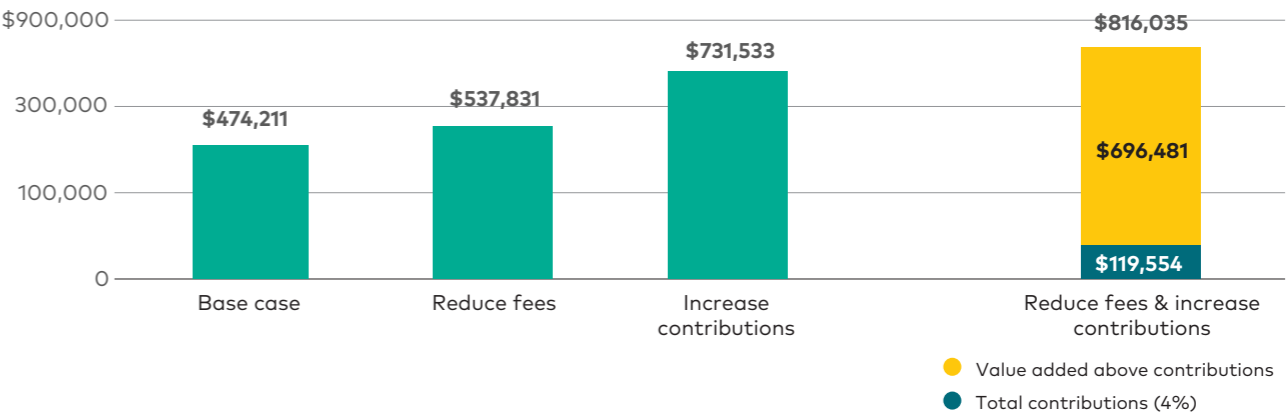


- Base case: With the industry average fee of 0.85% and contributing 1% of post-tax salary, at the end of 25 years Life after work will have \$474,211.
- Making the choice to reduce investment costs to 0.29%, results in a balance of \$537,831 a 13.4% increase.
- Making the choice to increase contributions to 4% of post-tax salary, sees a 25 year investment value of \$731,533 a 54.3% increase.

- Making the choice to both lower cost and make higher contributions would see Life after work achieve an investment value of \$816,035 to provide greater financial freedom around retirement, a 72.1% increase
- The total 4% contribution amount across the investment period is \$119,554, showing that an additional \$696,481 can be directly attributed to the impact of investment returns compounding through the period and lower management fees. This represents 85.3% of the final value.

The outcome of making these two optimal choices delivers a substantially greater degree of financial flexibility for *Life after work*, with options that might now include shortening how many years of full time work remain between them – or their partner – and retirement.

Life after work  
25 years time horizon



Source: Vanguard and Deloitte, October 2021.

# Control the things you can

Investment asset allocation is crucially important when setting a financial plan but the discipline to stick with a plan, choosing to minimise costs, and maximising contributions are elements that also play a vital role.

The impact of lower fees may be more obvious when looking at longer time periods and higher investment amounts, but the positive impact of lower fees persists in all scenarios.

Every dollar less in fees is a dollar more that remains in the investment, compounding, contributing to growth and ultimately moving people closer to their financial goals.

It is no surprise that the ability and discipline to make higher contributions has a significant positive impact, but as shown in each scenario the increase in final investment value represents far more than just the extra money contributed along the way. For our three individuals over and above the total amounts they each contributed, the lower fees and compounding investment returns through the period delivered between 45% and 85% of their final investment values.

Creating a financial plan to achieve life goals involves a number of decisions that go well beyond managing cost and contributions however, analysing these important investing choices offers a timely reminder about the powerful impact of the elements within an investors control.

## Connect with Vanguard™

[vanguard.com.au](https://vanguard.com.au)

1300 655 101



Vanguard Investments Australia Ltd (ABN 72 072 881 086 / AFS Licence 227263) is the product issuer and Operator of Vanguard Personal Investor. We have not taken your circumstances into account when preparing [the information] so it may not be applicable to your circumstances. You should consider your circumstances and our IDPS Guide, Product Disclosure Statement (PDS) or Prospectus before making any investment decision. Distributors of our products must consider our Target Market Determinations ("TMDs") which describe the investors for whom the product would likely be appropriate and consistent with their objectives, financial situation and needs. You can access our disclosure documents and TMDs at [vanguard.com.au](https://vanguard.com.au) or by calling 1300 655 101. Past performance is not an indication of future performance. This publication was prepared in good faith and we accept no liability for any errors or omissions.

© 2021 Vanguard Investments Australia. All rights reserved.  
VIAIIC\_102021