

# Investment Research Private Client Services



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## ***Margin Loan Rules***

***Do's and Don'ts for clients and providers***

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# Remember the good times!



- § Margin loans can amplify returns in good times
- § Dividends and earnings may offset or, indeed, cover interest costs after tax
- § There have been lots of good years (17 out of last 20 S&P/ASX200 Acc. Index)
- § “The darkest hour is just before dawn”
- § But bad years have a habit of turning up when least expected – gearing amplifies losses too
- § “Know when to hold and when to fold”

# Client Rules : The 10 Commandments



## 1. Know how margin lending works

- LVRs
- Buffers
- Volatility
- Margin calls

## 2. Understand costs

- Interest rate changes
- Capitalising interest rates

## 3. Have long-term investment horizon

- At least 5 years


## 4. Enter the market carefully

- Drip feed or dollar cost averaging

## 5. Monitor LVR

- Translate LVR into price fall needed to make a call

# Client Rules : The 10 Commandments



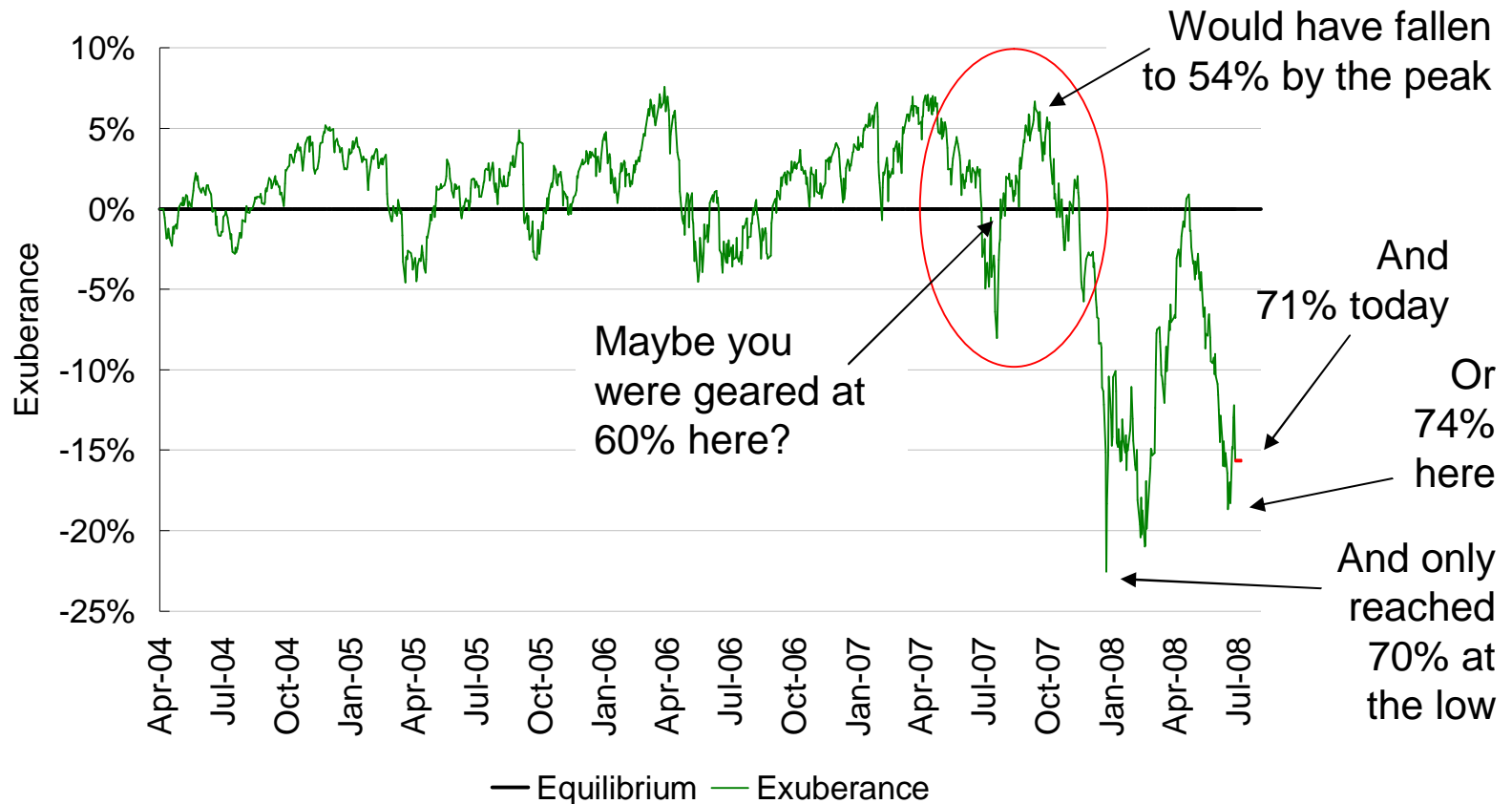
6. **Do not gear the portfolio you wouldn't!**
  - Swap gearing risk for portfolio risk
7. **Avoid single stock exposure**
  - Sufficient stocks
  - Adequate diversification
  - Adequate liquidity
8. **Have reserves at the ready**
  - Cash or redraw
  - Home equity
  - Fixed income
9. **Pre-empt margin calls**
  - Much cheaper and less fretful
10. **Have the action plan close at hand**
  - Role play worst case scenarios well before a problem
  - Are you the right person to gear

# What to look for in a margin lender



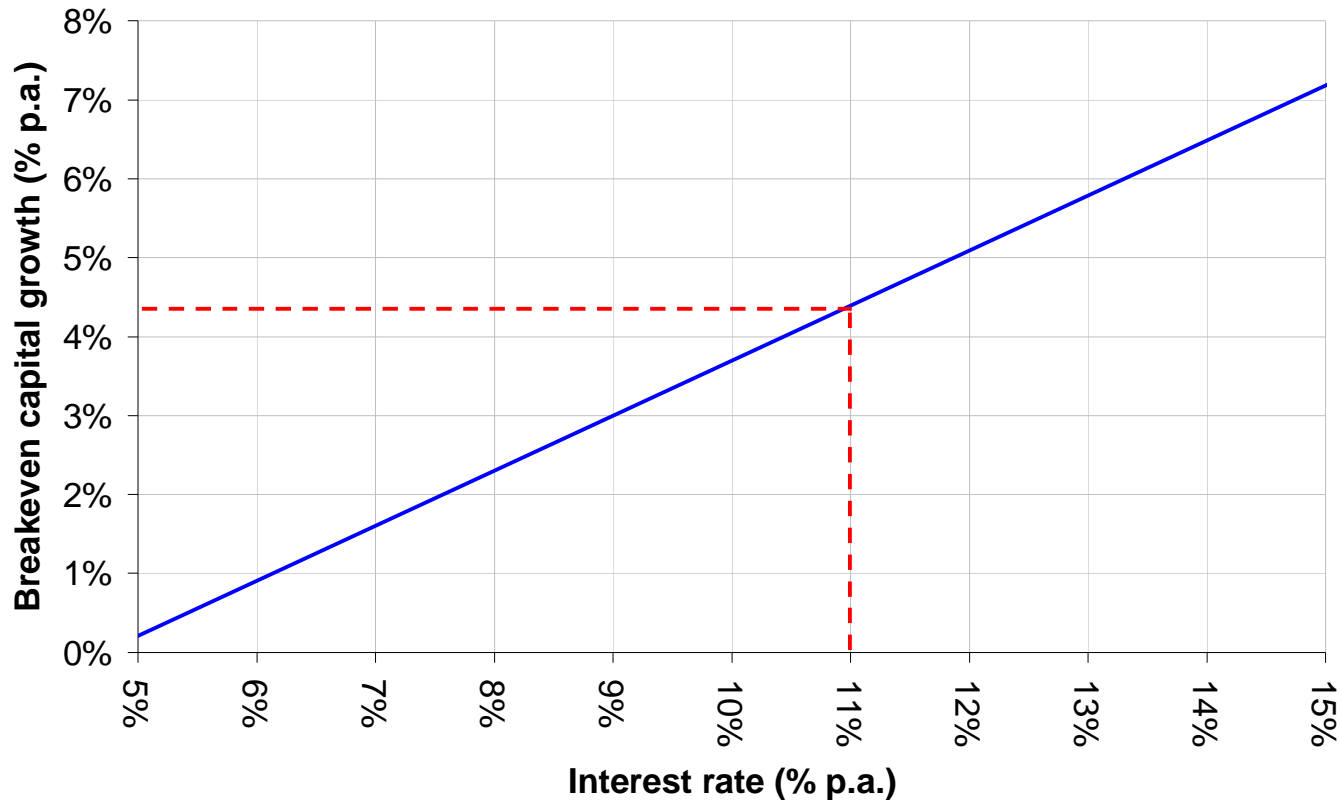
- 1. Large deposit-taking banks have strict risk & compliance procedures**
  - Appropriate LVRs and Buffers, etc
  - Daily monitoring of positions
- 2. Proactive in helping manage risk**
  - SMS on the open if in potential trouble
- 3. No stock lending!**
- 4. Capable of handling volume**
  - Everyone wants to trade at the same time
  - Will phones be answered, systems melt down
- 5. Suitability tests for clients**

# The art of exuberance



Data to 25 July 2008  
Source: Investment Research, Reuters Knowledge

# Geared vs. non-geared Capital growth required to breakeven after tax



Source: Investment Research

Assumptions: Dividend yield = 3.5%, Franking = 80%, Tax rate = 46.5% (including Medicare Levy), Company tax rate = 30%, 50% CGT discount applied after 12 months.

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