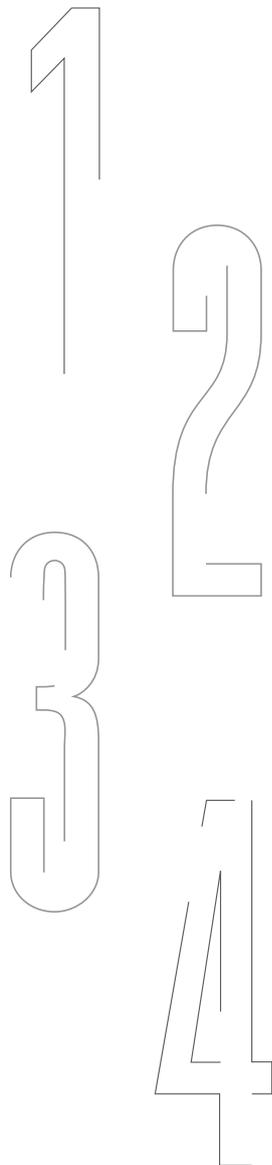


Morningstar Portfolio Construction Guide

We have created the Morningstar Guide to Portfolio Construction to help you design a portfolio to meet your objectives in life. This guide will walk through the activities required to translate your goals into the inputs needed to construct a portfolio.



Page 3 | **Define goals**

Morningstar tool: Net worth worksheet, Personal cash flow statement & Goal planning worksheet

Key concepts: Goals-based investing

Output: Present value of assets, Yearly savings capacity and Cost / time frame until key goals

Page 6 | **Calculate required rate of return**

Morningstar tool: Required rate of return calculator

Key concepts: How to interpret your required annual rate of return mean?

Output: Required rate of return to meet goals

Page 9 | **Select asset allocation target**

Morningstar tool: Morningstar Strategic Asset Allocation Model and Wealth Forecasting Engine

Key concepts: What is an asset class? What is a portfolio and why does it matter? What drives portfolio performance? Risk and return expectations of different asset classes

Output: Asset allocation target for portfolio

Page 14 | **Select investments**

Morningstar tool: Portfolio Manager / Portfolio X-ray, ETF Model Portfolios, Fund Screener, and Managed Fund and ETF research

Key concepts: What is your current asset allocation? How to select investments for your portfolio?

Output: Investments to meet your asset allocation targets



Define your goals

 By recording your dreams and goals on paper, you set in motion the process of becoming the person you most want to be. Put your future in good hands—your own.  Mark Victor Hansen

At Morningstar, we are proponents of goals-based investing. We don't feel that the old approach of using wealth maximisation at retirement as the default goal serves individuals very well. The one-size-fits-all approach doesn't take into account that each of us is unique with different goals and uses for money that occur well before retirement. At Morningstar, we are all about putting the investor first—not the investment.

There are countless ways to invest, but many investors do themselves no favours by failing to ask the most important questions first: What are my objectives? Why am I investing? Before you can research, plan, and implement an investment strategy, it's critical to understand what you plan to do first.

Most people avoid defining objectives because it involves spending time thinking about the future in very specific and concrete terms. Failing to define objectives can have several consequences. The primary investing-related consequence is not having any sense of the actual return objectives needed to meet your goals. This leads to individual investors going into two default modes—risk avoidance where too many assets are kept in “safe” assets such as cash or wealth maximisation where too much risk is taken relative to the actual investment objectives and timelines.

Putting off this exercise will not actually change your financial situation ***but ignoring issues never make them go away.*** The mechanics of what needs to be done are straightforward. Simply decide on the following:

- ▶ What are my objectives in life?
- ▶ How much will it cost to fund these objectives? (remember inflation—Morningstar estimates 2.6 per cent each year as the cost of living increases)
- ▶ When do I need the money to pay for them?
- ▶ How much have I saved already to fund these objectives?

Defining Needs & Objectives

Step 1: Determine your net worth

The first step is to take stock of your net worth by gathering up your most recent investment statements or going online to retrieve your current account balances. Note that for some accounts, such as your bank account or Super accounts featuring publicly traded securities, you'll be able to get a very current, very specific read on what those assets are worth. For other assets, such as the value of your home or investment property, you'll need to do a bit of educated guessing. However, you may want to consider excluding the value of property in this exercise. Property investing is outside of Morningstar's core competency. As a result, the models and suggestions listed in this guide are oriented towards publicly traded assets and may not be applicable to property.

In addition to your assets you will need to record any outstanding debts you have. If you are excluding your property assets from the worksheet please remember to exclude any housing-related debt as well.

Complete the *Net Worth Worksheet* to give you an idea of your assets and debt levels.

Step 2: Create a personal cash-flow statement

A personal cash-flow statement provides a point-in-time snapshot of what income comes into your household from your job and/or any other sources, as well as what you're spending and saving. Only by examining your cash flows can you determine whether your spending and savings patterns align with your long-term goals.

Complete the *Personal Cash Flow Statement* to determine how your monthly earnings and spending are tracking.

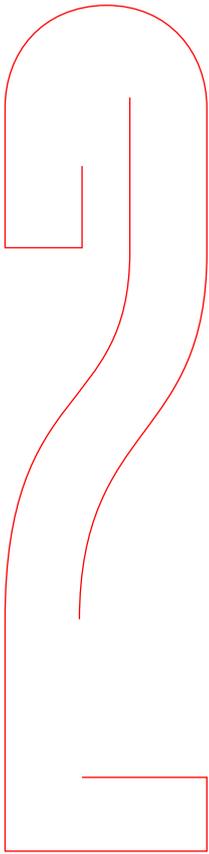
Step 3: Document your financial goals

The next step is to define and estimate the cost of each of your goals. For short- and even some intermediate-term goals, this should be straightforward. Estimating the cost of multiyear, long-term goals like retirement is trickier. The big wild card is inflation: While it's currently quite low by historical standards, it is reasonable to assume at least a 2 per cent to 3 per cent inflation rate for longer-term goals. At Morningstar we have a 2.6 per cent yearly inflation estimate.

Complete the *Goal Planning Worksheet* to give you an idea of your different goals, when you hope to achieve them and how much they are likely to cost.

Step 4: Assess where you are

If you have completed the three worksheets you have a much better view of your financial position than most Australians. The output of these three worksheets *should* give you everything that you need to assess how you are tracking against your goals, the level of investment risk that you need to take to meet your goals and any lifestyle changes you may need to make to ensure you reach your long-term goals.



Calculate required rate of return

 Hope is not a strategy.  Rudolph Giuliani

The worksheet outputs can be used to calculate the required rate of return to fund your goals. This is a variation of the time value of money formula. The time value of money formula is one of the most important concepts in investing as it answers the fundamental question—how much will an investment be worth in the future given a certain rate of return and time frame. In this case, you already know the amount of money you currently have, the amount you can save and the cost and timing of your goal. A simple re-arrangement of the formula is all that is needed to solve for the required rate of return to meet your goals.

Variable name	Description	Input source	Calculator field
Present value of assets	This is the amount you have to invest	The total net worth figure from the <i>Net Worth Worksheet</i>	Start principal
Yearly savings	This is the amount that you can save towards your goal each month. This is the difference between how much you earn in a month and what you spend	The monthly cash flow multiplied by 12 that was calculated on the <i>Personal Cash Flow Statement</i>	PMT (annuity payment)
Cost of goal	This is expected cost of the goal	This is the expected cost for each of your goals on the <i>Goal Planning Worksheet</i>	FV (Future Value)
Number of years until goal	How long until you need the money to pay for one of your goals	This is the amount of time in years until the date that you want to accomplish each of your goals on the <i>Goal Planning Worksheet</i>	N (# of periods)
Annual rate of return	This is the one variable that we have not come up with using the three goal-setting worksheets. This is also the number that links everything together and is the key to investing—what annual rate of return do you need on your investments to make sure the present value of assets that you have and your planned future monthly savings will grow to the cost of the goal in the number of years until the goal that you defined.		

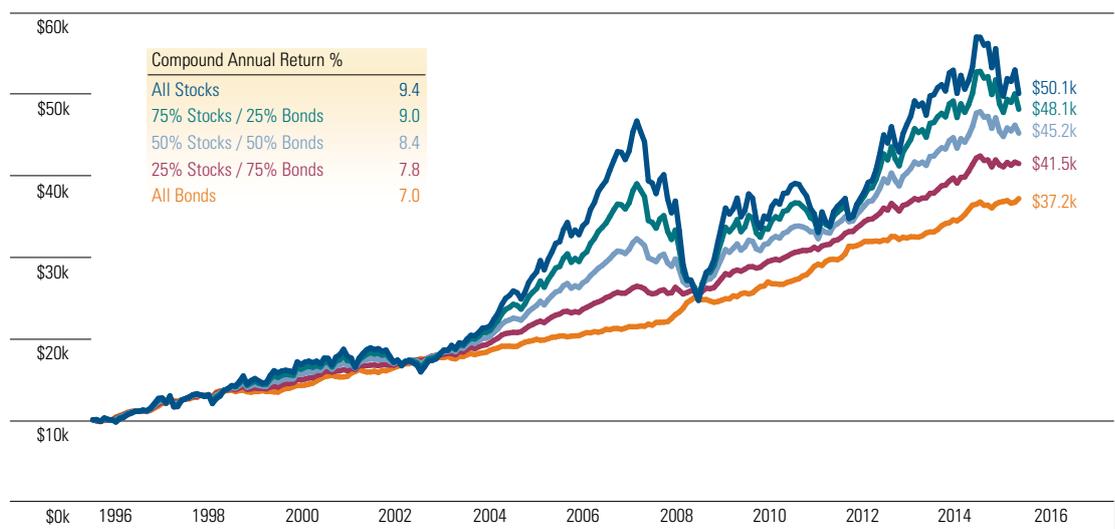
Using the [required rate of return calculator](#), you can calculate what you need to earn to meet your goals:

*The PMT (payment) indicator at the bottom of the calculator should be set to **end** of compounding period for the most conservative setting. This assumes that you are making all of your savings at the end of year rather than in equal monthly instalments. Setting it to **beginning** will assume all of the savings are made at the beginning of the year.

What does your required annual rate of return mean?

Context is critical when looking at anything that is abstract like a required annual rate of return. The first thing to do is to compare your annual rate of return to the historical average returns that have been generated from different investments. This will determine if the required level of return that you calculated is feasible.

The following chart shows some simple allocations between Australian stocks and bonds over a 20-year period (as represented by the S&P/ASX 200 index and the Bloomberg AusBond Composite 0+Y TR AUD).



Source Morningstar Direct

While past market performance may not be replicated in the future, if the return that you need to achieve your goals is dramatically higher than the all stock portfolio (9.4 per cent annually) it might be time to revisit your goals. You can either delay the timing of your goals, save more money or find cheaper goals. Go back to the *Goal Planning Worksheet* and the *Personal Cash Flow Statement* and try some different saving and goal scenarios.

If the return required to meet your goals falls somewhere under the 9.4 per cent figure you are starting out in a strong position to start looking at how to construct a portfolio.

Before we get to the process of constructing a portfolio one final note about the goals-based approach. This is a different approach to what is generally used in the financial services industry. Many financial advisors like to rely on risk tolerance questionnaires to assess an

individual's hypothetical reaction to market volatility. Asking somebody to assess their reaction to a 20 per cent reduction in their portfolio without the emotional reaction that typically occurs when an account balance continues to drop is likely to yield an answer that is next to irrelevant when the actual event happens. The real question is risk capacity—the amount of risk you should take given your available resources and the goals you want to accomplish. Rather than simply investing for its own sake, goals-based investing gives you something concrete and meaningful to strive for. It helps you connect your investments to what really matters: your family, your future experiences, and your personal needs. Concentrating on the end state and progress towards goals can help to prevent you from taking on too much risk when markets are rising (buying at the top) or too little risk when markets are falling (selling at the bottom).

Select asset allocation target

On average, 90 per cent of the variability of returns and 100 per cent of the absolute level of return is explained by asset allocation. Roger Ibbotson

What is an asset class?

An asset class is a group of securities that have common characteristics that are distinct from other asset classes. These common characteristics refer to the underlying economic drivers of cash flows as well as how the asset is expected to behave in different market environments. Asset classes are traditionally divided into 'income' or 'defensive' assets, and 'growth' assets. Generally speaking, 'growth' asset classes, such as equities, property and infrastructure, are assumed to achieve higher returns on average than defensive assets. However, growth assets tend to have wider possible variation around that average. Conversely, 'defensive' asset classes, like cash and bonds, are assumed to have lower average returns than equities, but with less variation.

What is a portfolio and why does it matter?

A portfolio is simply a range of assets that are held by an individual or organisation. These assets can be individual securities such as stocks and bonds or professionally run collective investment vehicles such as managed funds, LICs or ETFs. In addition to financial assets an investment portfolio can contain real estate investments, direct investments in businesses, direct loans or even esoteric assets such as investments in wine.

Each of these individual assets that are placed in a portfolio have their own sources of risk and drivers of returns. We can break them down into those that are directly related to the individual security and those that

are related to macro events. In the case of a single stock holding an example of the individual security level driver is a decision made by management while macro drivers would include the direction of the overall economy and decisions made by local and global political leaders.

It is this web of influences on the returns of these individual investments that will determine how your overall portfolio performs and more importantly will determine if you meet your individual financial goals for you and your family.

What drives portfolio performance?

There are two underlying drivers of how your portfolio performs. Top of mind for many individual investors is returns generated from security selection decisions. Less widely considered is the component of returns that can be attributed to asset allocation decisions. This emphasis on stock picking intuitively aligns with how many people see investing. Our minds like compelling stories—stories about companies, strategies and managers. These stories can help us tune out overwhelming details and make us more comfortable. Asset allocation decisions are never going to capture the imagination of the public. However, this foundational building block of portfolio construction is far more critical to the overall success of an investor. In the famous Brinson study first published in 1986, over 90 per cent of overall investment returns could be attributed to asset allocation decisions. While the exact proportion of returns that can be attributed to

asset allocation decisions has varied across studies, it's indisputable that it is large and too big to ignore for any investor.

A Morningstar Investor understands that successful investing is more than making one off buy and sell decisions. To help manage risk and deliver better returns, a holistic portfolio combines investments with different underlying drivers to achieve true diversification. We will take you through all the steps necessary to construct a portfolio and offer some suggested portfolios based on different return expectations and risk tolerances.

Risk and return expectations of different asset classes

When trying to accomplish a goal, an investor constructs a portfolio made up of different types of asset classes such as cash, bonds and stocks. The question at the heart of portfolio construction is the decision on what asset classes to include and how much of each to include. This process is informed by comparing the risk and return requirements to accomplish the investor's goal and the risk and return expectations of each asset class.

You have calculated the return expectations to accomplish your goals in the first part of this guide which allows us to now focus on risk. At Morningstar, we think about risk differently than most of the financial industry, who use terms such as "price volatility" and "standard deviation". These measures of risk look at how much the price of an investment will fluctuate. This works well if you are focused on the

investment but less well when you are focused on the investor and his / her goals.

Morningstar uses a simpler and more practical definition of risk. We define risk as losing money that can't be made back. For investors, that's the risk of not having enough money in time to retire or having to change your lifestyle so that your savings last throughout retirement. Take some time to think about your own view of risk and how fluctuations in your portfolio would affect your life. If you are investing for the long term and can adequately cover any short-term cash outlays with an emergency fund, then perhaps your definition of risk is the same as ours.

As an example, we can consider someone that is saving for retirement in 15 years. This individual has gone through the worksheet exercise at the beginning of this guide and has determined that they need a 3% real return (after inflation) or a 5.6% nominal return (before inflation) to meet their goal. Using this as context the individual starts thinking about how to construct their portfolio and talks to a friend at a party. The friend mentions the 3.5% nominal return term deposit she just bought at their local bank and makes the statement that she couldn't imagine investing in the stock market because it goes up and down all the time and that is too risky. The friend is looking at volatility as risky since the stock market will fluctuate. However, listening to the friend's advice will introduce a new risk—the inability to meet the goal of retirement.

Selecting a portfolio

Now that you have some background information and a clearer picture of your goals, time horizon and required return it is relatively easy to select an asset allocation target. To assist with this process, Morningstar has created five different defensive/growth asset class combinations related to five different levels of risk: Conservative, Cautious, Balanced, Growth and Aggressive.

Risk Profile	Conservative	Cautious	Balanced	Growth	Aggressive
Minimum Investment Period	2 years	3 years	5 years	7 years	9 years
Portfolio Characteristics %					
					
● Growth Assets	15	30	50	70	90
● Defensive Assets	85	70	50	30	10
Strategic Asset Allocation %					
					
● Australian Equity	5	10	17	23	30
● International Equity (50% Hedged)	7	14	24	35	45
● Property and Infrastructure	3	6	9	12	15
● Australian Fixed Interest	28	23	18	11	4
● International Fixed Interest	21	17	12	7	3
● Cash	36	30	20	12	3
Property and Infrastructure % Split					
Australian Listed Property	0	0	3	3	4
International Listed Property	3	3	3	5	6
Global Infrastructure	0	3	3	4	5
Investment Objectives					
	Conservative	Cautious	Balanced	Growth	Aggressive
	CPI + 0.5	CPI + 1.0	CPI +2.5	CPI + 3.5	CPI + 4.0

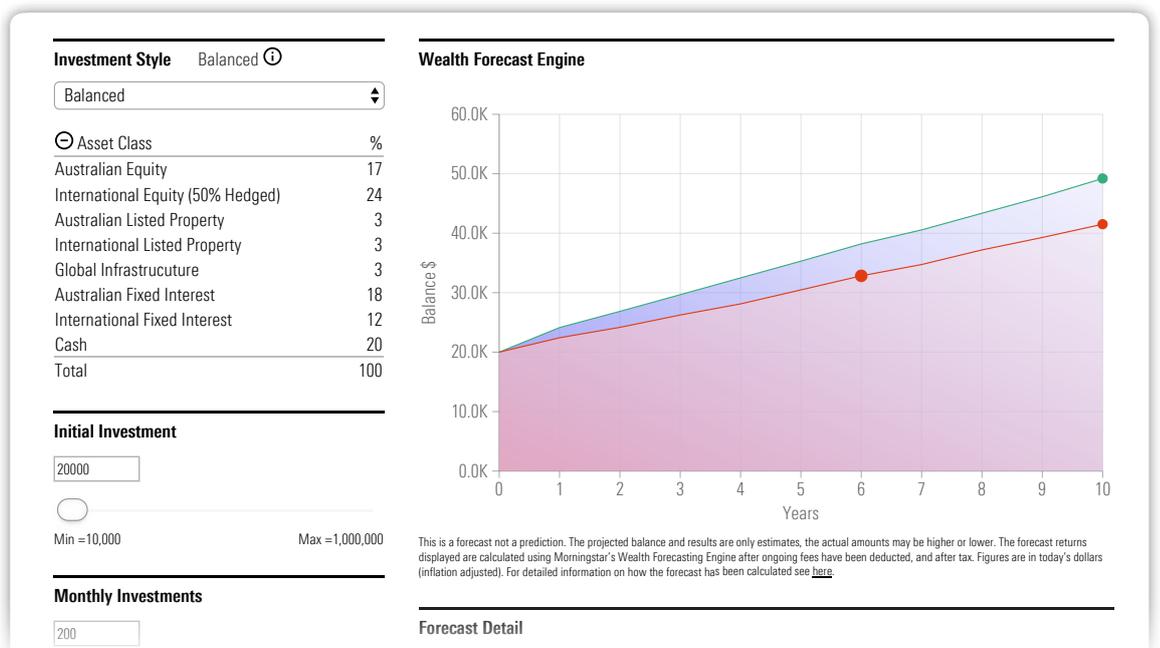
Morningstar Portfolio Construction tools

Morningstar has a number of tools that can be used to assist with portfolio construction:

Wealth Forecasting Engine

The Wealth Forecasting Engine can be utilised to explore the impact on forecasted future levels of wealth based on adjustments to time frames, levels of initial investment and the amount of monthly savings. Our engine generates at least 500 simulations of what may happen to a portfolio over a given time period. Each simulation includes up and down markets of various lengths, intensities and combinations. We then chart the middle band to give you a likely range of outcomes. The engine is designed to predict potential take home returns. That is, the value that remains after tax, inflation and estimated investment fees have been taken into account. We assume inflation will be 2.6 per cent per year and investment fees will be 1 per cent per year, which has a huge impact on any future savings. Each of the 5 portfolios that make up the Morningstar Strategic Asset Allocation Model can be selected to see the impact of different asset allocation decisions on forecasted returns.

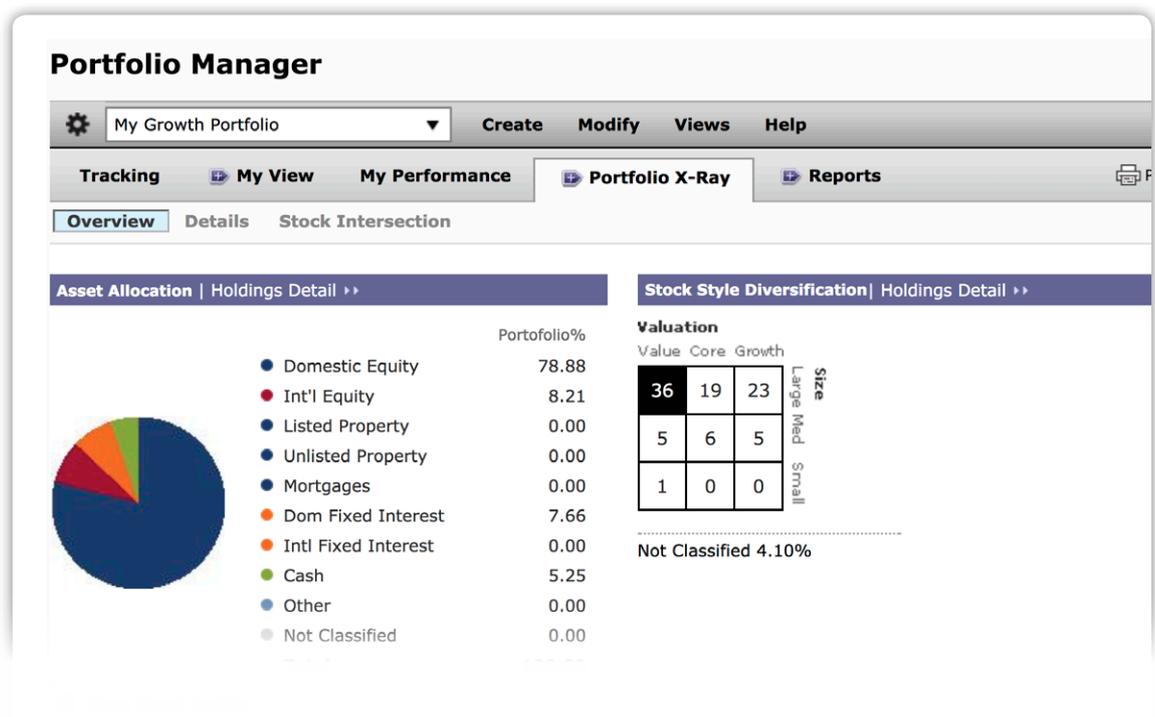
[Try it now ↗](#)



Portfolio X-Ray

Selecting an asset allocation target based on your goals is a great starting point. However, there can be large differences between your current portfolio and your asset allocation targets. A good starting point is to understand your current asset mix using the Morningstar Portfolio X-Ray tool. The Portfolio X-Ray is a module that takes Portfolio Manager holdings and provides detailed reporting on asset allocation across markets, sectors and styles.

[Try it now](#) ↗



Select Investments

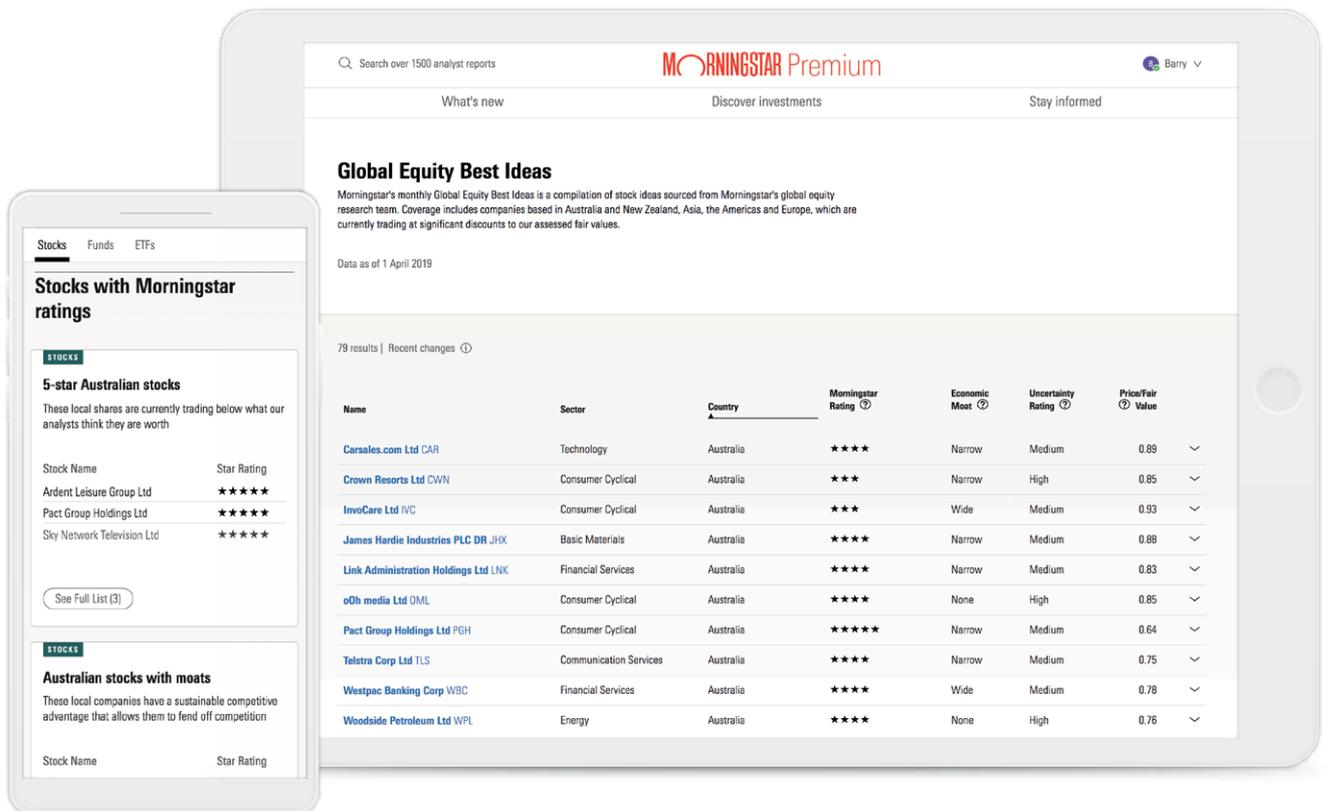
Know what you own, and know why you own it.  Peter Lynch

As stated in Part 1, asset allocation decisions can have a big impact on the overall returns generated by a portfolio. The other driver for investment returns is the performance of the actual investments that are selected for the portfolio. As a leading independent provider of investment research, Morningstar provides our readers with support in assessing new investment ideas, reviewing current portfolio holdings and / or validating third-party advice.

Discover investments

Identify the right building blocks for your portfolio. Simply apply our new location and asset class filters to 5-star stocks, moat-rated stocks, medallist-rated funds and medallist-rated ETFs.

[Try it now](#) ↗



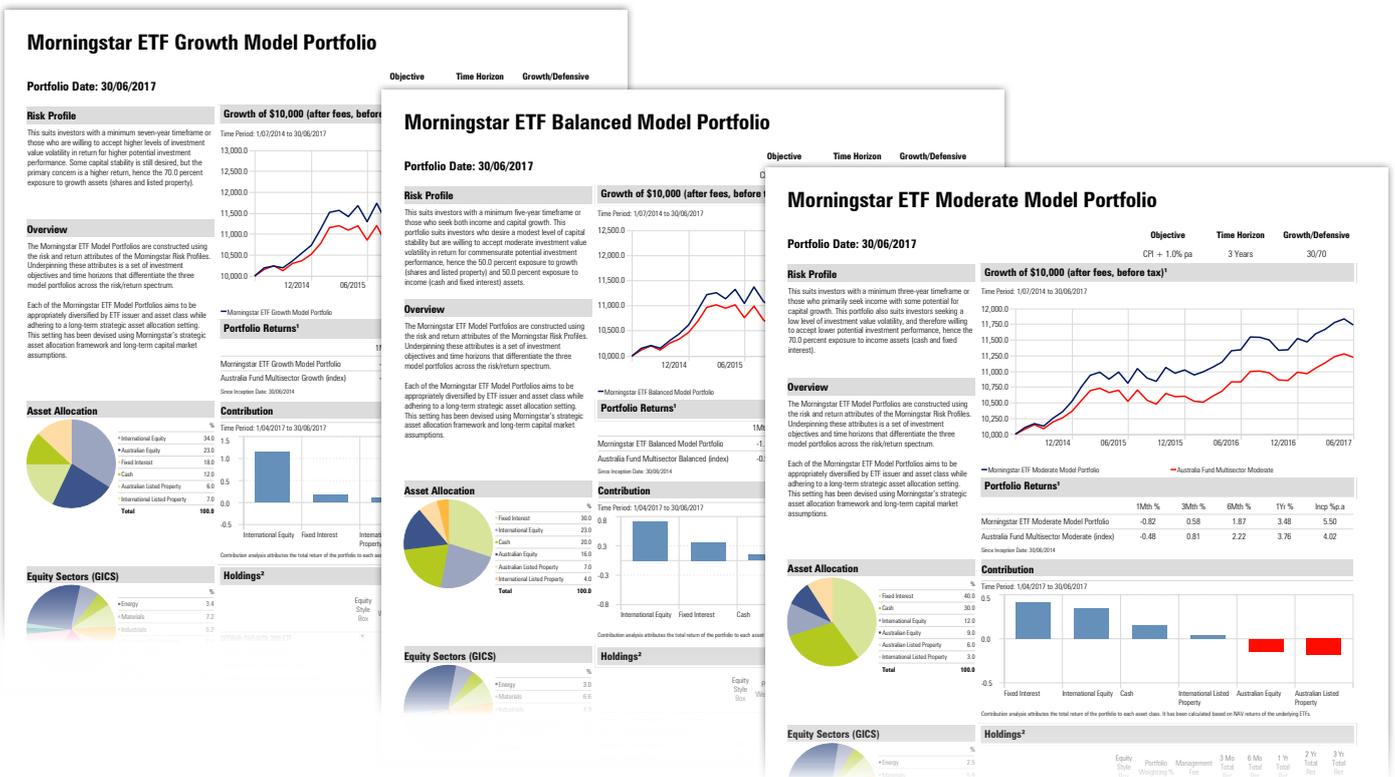
The screenshot displays the Morningstar Premium website interface. At the top, there is a search bar and navigation tabs for 'What's new', 'Discover investments', and 'Stay informed'. The main heading is 'Global Equity Best Ideas', with a sub-heading explaining that it is a compilation of stock ideas sourced from Morningstar's global equity research team. Below this, there is a table of 79 results, with the first few rows visible. The table columns include Name, Sector, Country, Morningstar Rating, Economic Moat, Uncertainty Rating, and Price/Fair Value. A mobile device overlay on the left shows a 'Stocks with Morningstar ratings' section, highlighting '5-star Australian stocks' and 'Australian stocks with moats'.

Name	Sector	Country	Morningstar Rating	Economic Moat	Uncertainty Rating	Price/Fair Value
Carsales.com Ltd CAR	Technology	Australia	★★★★	Narrow	Medium	0.89
Crown Resorts Ltd CWN	Consumer Cyclical	Australia	★★★	Narrow	High	0.85
InvoCare Ltd IVC	Consumer Cyclical	Australia	★★★	Wide	Medium	0.93
James Hardie Industries PLC DR JHX	Basic Materials	Australia	★★★★	Narrow	Medium	0.88
Link Administration Holdings Ltd LNK	Financial Services	Australia	★★★★	Narrow	Medium	0.83
oOh media Ltd OML	Consumer Cyclical	Australia	★★★★	None	High	0.85
Pact Group Holdings Ltd PGH	Consumer Cyclical	Australia	★★★★★	Narrow	Medium	0.64
Telstra Corp Ltd TLS	Communication Services	Australia	★★★★	Narrow	Medium	0.75
Westpac Banking Corp WBC	Financial Services	Australia	★★★★	Wide	Medium	0.78
Woodside Petroleum Ltd WPL	Energy	Australia	★★★★	None	High	0.76

Morningstar's ETF Model Portfolios

Morningstar's ETF Model Portfolios are a series of diversified, model portfolios that align to the five different defensive/growth asset class combinations of the Morningstar Strategic Asset Allocation Model. The ETF model portfolios use Morningstar's qualitative and quantitative ETF research to select ETFs to meet each asset class allocation.

Try it now [➔](#)



Fund screener

The Morningstar Fund Screener is a tool that can be used to find investment trusts, superannuation funds, pensions and annuities by fund manager, category, assets, minimum investment and returns criteria. The Morningstar Category feature can be used to find funds that match the asset allocation targets defined within the Morningstar Strategic Asset Allocation Model. Within each Morningstar Category the funds can be ranked by using the Morningstar Analyst Rating and the Morningstar Star Rating. Premium subscribers can also access our full analyst report, which includes our view of the role that the fund or ETF can play in a diversified portfolio as well as our assessment of the investment team, investment process and the various fees that investors are charged.

[Try it now ↗](#)

The screenshot shows the Morningstar Fund Screener interface. On the left, there are filter sections for 'Snapshot Universes' (AU Investment Trusts, AU Invest), 'Morningstar Rating', 'Analyst Rating' (with 'Bronze' selected), 'Net Assets' (Any), 'Fund Company', 'Morningstar® Category', 'Closed to new investors', and 'Closed to all investors'. The main area displays a table of funds with columns for Name, APIR, Morningstar Rating™, Analyst Rating, Morningstar® Category, and Global Category. The table shows 1-20 of 1888 results.

Name	APIR	Morningstar Rating™	Analyst Rating	Morningstar® Category	Global Category
<input type="checkbox"/> AB Managed Volatility Equities	ACM0006AU	★★★★★	Bronze	Equity Australia Large Blend	Australia Equity
<input type="checkbox"/> Aberdeen Actively Hedged Intl Equities	CRS0005AU	★★	Silver	Equity World Large Growth	Global Equity Large Cap
<input type="checkbox"/> Aberdeen Asian Opportunities	EQI0028AU	★★★	Bronze	Equity Asia Pacific w/o Japan	Asia ex-Japan Equity
<input type="checkbox"/> Aberdeen Emerging Opportunities	ETL0032AU	★★★★★	Silver	Equity Emerging Markets	Emerging Markets Equity
<input type="checkbox"/> Aberdeen Fully Hedged International Eq	CSA0135AU	★★	Silver	Equity World - Currency Hedged	Global Equity
<input type="checkbox"/> Aberdeen International Equity	EQI0015AU	★★	Silver	Equity World Large Value	Global Equity Large Cap
<input type="checkbox"/> Aberdeen Select Inv Act	CSA0114AU	★★	Silver	Equity World Large	Global Equity

Morningstar Analyst Rating and Morningstar Star Rating

The quantitative Star Rating analyses the historical performance of a fund, looking backwards. It ranks funds from one to five stars, based on past performance--both return and risk (volatility). It uses focused comparison groups to better measure fund manager skill. As always, the Morningstar Rating is intended for use as one step in the fund evaluation process. A high rating alone is not a sufficient basis for investment decisions.



The qualitative Morningstar Analyst Rating is the summary of our forward-looking view of a fund. It is the outcome of a collaborative process based on a site visit, manager questionnaire, quantitative and holdings-based analysis of the portfolio, and an assessment of key issues identified by our analysts



[Try it now ↗](#)

Goal Planning Worksheet

PREPARED FOR:

DATE: / /

You'll need:

- Net Worth Worksheet
- Cash-Flow Worksheet

GOAL: SHORT-TERM (5 years or fewer)

Goal Priority:

Goal _____

Date _____ Duration _____ Expected cost (\$)

Goal Priority:

Goal _____

Date _____ Duration _____ Expected cost (\$)

Goal Priority:

Goal _____

Date _____ Duration _____ Expected cost (\$)

Goal Priority:

Goal _____

Date _____ Duration _____ Expected cost (\$)

Goal Priority:

Goal _____

Date _____ Duration _____ Expected cost (\$)

Goal Priority:

Goal _____

Date _____ Duration _____ Expected cost (\$)

Goal Priority:

Goal _____

Date _____ Duration _____ Expected cost (\$)

Goal Priority:

Goal _____

Date _____ Duration _____ Expected cost (\$)

TOTAL: Short-Term Goals

Goal Planning Worksheet

PREPARED FOR:

DATE: / /

GOAL: INTERMEDIATE-TERM (5 to 15 years)

Goal Priority:

Goal _____

Date _____

Duration _____

Expected cost (\$) _____

Goal Priority:

Goal _____

Date _____

Duration _____

Expected cost (\$) _____

Goal Priority:

Goal _____

Date _____

Duration _____

Expected cost (\$) _____

Goal Priority:

Goal _____

Date _____

Duration _____

Expected cost (\$) _____

Goal Priority:

Goal _____

Date _____

Duration _____

Expected cost (\$) _____

Goal Priority:

Goal _____

Date _____

Duration _____

Expected cost (\$) _____

Goal Priority:

Goal _____

Date _____

Duration _____

Expected cost (\$) _____

Goal Priority:

Goal _____

Date _____

Duration _____

Expected cost (\$) _____

TOTAL: Intermediate-Term Goals

Goal Planning Worksheet

PREPARED FOR:

DATE: / /

GOAL: LONG-TERM (15 years or more)

Goal Priority:

Goal

Date

Duration

Expected cost (\$)

TOTAL: Long-Term Goals

Net Worth Worksheet

PREPARED FOR:

DATE: / /

You'll need:

- Most recent investment statements for taxable and superannuation accounts
- Most recent bank statements
- An estimate of the current market value of your home(s)
- Most recent credit card statement(s), if you have a balance on your card
- Most recent mortgage and home equity loan statements
- Most recent statements from any other debts you owe, such as HECS or auto loans

NET WORTH: ASSETS

	You	Spouse	Joint	Total
Bank accounts	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Term deposits	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Managed funds / ETFs	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Stocks	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Bonds	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Superannuation	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Primary residence	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Investment property	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Other assets (specify)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
TOTAL: Assets	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

NET WORTH: DEBT

	You	Spouse	Joint	Total
Mortgage	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Home equity loan	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Car loan	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
HECS loan	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Credit card debt	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Other debt (specify)	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
TOTAL: Debt	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

TOTAL: Assets
 - **TOTAL: Debt**
 = **TOTAL: Net Worth**

Personal Cash-Flow Statement

PREPARED FOR:

DATE: / /

You'll need:

- Most recent paycheck (If your salary is variable, use an average of your pay over the past 6-12 months)
- Statements showing income from income sources, such as pensions, Superannuation withdrawals or savings/ investment interest
- Most recent bank and investment statements
- Most recent credit card statement(s)
- Statements for other debts, such as HECS or auto loans
- Most recent bank account statements
- A record of discretionary expenditures over the past month

Income: MONTHLY AMOUNT

Salary (net: after taxes and Super)	<input type="text"/>
Spouse's salary (net: after taxes and Super)	<input type="text"/>
Pension income	<input type="text"/>
Super withdrawals	<input type="text"/>
Interest/investment income	<input type="text"/>
Other income (specify)	<input type="text"/>
Other income (specify)	<input type="text"/>
TOTAL: Monthly Income Amount	<input type="text"/>

EXPENSES: MONTHLY AMOUNT

Fixed	
Mortgage or rent	<input type="text"/>
Other real estate payments	<input type="text"/>
Auto loan	<input type="text"/>
HECS payment	<input type="text"/>
Credit card payment	<input type="text"/>
Utilities	<input type="text"/>
Tuition	<input type="text"/>
Child care	<input type="text"/>
Health insurance	<input type="text"/>
Food	<input type="text"/>
Clothing	<input type="text"/>
Other expenses (specify)	<input type="text"/>
Other expenses (specify)	<input type="text"/>
Variable (Discretionary)	
Personal care (haircuts, gym, etc.)	<input type="text"/>
Entertainment	<input type="text"/>
Supplementary Super payments	<input type="text"/>
Travel	<input type="text"/>
Other savings/investments (specify)	<input type="text"/>
TOTAL: Monthly Expenses Amount	<input type="text"/>

Income	<input type="text"/>	- Expenses	<input type="text"/>	= TOTAL: Monthly Cash Flow	<input type="text"/>
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Am I ready to invest? Your financial fitness checklist

Key points:

- ▶ Investing is easier than you think;
- ▶ But there are a few things you should get in order before diving in;
- ▶ Here's a 5-step approach to getting started.

For too many of us, investing is on the to-do list for 'sometime in the future'. I get it. It's boring. And complicated. And boring. Still, it doesn't have to be. Here's how to get started.

1. Get a clear view of your personal finances

Before investing, it's essential to have a handle on your income and expenses so you can get an overview of where your money goes. Follow these steps to create your budget, if you haven't got one already:

Track your spending

Capture your day-to-day spending habits as well as regular monthly outgoings like bills, rent or mortgage, insurance, groceries and entertainment. There are plenty of tools available to help you ([Pocketbook](#) is awesome, for example), and the longer you do so, the better your visibility will be.

Figure out your income

What do you make in a week, month, year? Find out how much you earn and, therefore, how much you can put towards achieving your financial goals. If your income fluctuates, or if you're self-employed, average out your monthly income using your most recent tax return.

Create a budget spreadsheet

It doesn't have to be fancy—just work out how much you spend and on what and remember to include an entry for money that's earmarked for savings. Some spending—like groceries or clothes shopping—might be variable, so use your previous spending as a guide.

And that's it! Having a budget doesn't mean you have to live frugally, it just means getting a clear view of where your money goes. If you want to achieve your financial goals sooner, you may have to make some adjustments, and that's where the next step comes in.

2. Follow the 50/20/30 rule

Have you heard of the 50/20/30 rule? It's super simple and super effective way to check if your budget is on track, and course-correct if needed.

Here's how it works:

Break down your income into three buckets.

- ▶ **50%** of your income goes on non-negotiable living expenses: rent or mortgage, insurance, utilities, groceries and transport
- ▶ **20%** is for achieving your financial goals, whether that's paying off debt, saving for a house or to put towards retirement.
- ▶ **30%** is for fun stuff—life would be pretty dull without going to the cinema, eating out, or holidays.

If this sounds like a lot of calculations, you can automate by setting up separate accounts and creating direct debits. That way, as soon as your pay-cheque hits, your fun money goes into a dedicated account with a specific card, and so on.

The best part of 50/20/30 rule is that it doesn't have to be rigid. If you've got \$2,000 a week in take-home pay, but your expenses come to \$750, you could divert the remaining \$250 from the 50% category into the

financial goals category to bump up your savings plan. Your ideal breakdown might then look more like 38/32/30 (it's just a lot less catchy). Likewise, you can readjust if your circumstances change.

It's also a good idea to decide ahead of time what you might do with windfalls, like a bonus at work or the cash from selling something on eBay. You might divide it along 50/20/30 lines, or you could decide in advance to put it towards securing your financial future.

3. Pay off expensive debt

Now it's time to move on to tackling expensive debt. We're not talking about your HECS/HELP debt or mortgage (provided it's in hand and you're not struggling to make repayments). The kind of debt we mean is credit card or similar debt that costs a significant amount to pay off because of high interest rates and fees.

If you've got a few of Australia's [16.7 million](#) credit cards in your wallet, you might also own a slice of the [\\$32,521,273,000](#) (and counting) in debt that, according to comparison site Finder, is currently accruing interest. Yep, it's a big problem.

Why do I have to pay off credit card debt before investing?

If, like the average Australian, you pay \$700 per year for a \$4,200 credit card debt; and earn, let's say \$500 per year in returns on a \$10,000 investment, you're actually losing money. So it pays to neutralise expensive debt first. Once you're free of this obligation, you can put your newly freed-up cash towards investments.

How do I pay off credit card debt effectively?

First, if you still regularly use your cards, stop using them for a while so that you're not still adding to the debt pile. Consider measures like reducing your credit limit in order to keep a lid on spending for the future.

Next, call your bank or lender and ask them about balance transfer, consolidation and refinancing options. You may be able to consolidate your debt with a more manageable interest rate via a bank loan, giving you some breathing space to catch up and pay

down the debt, reducing the interest as you go and paying less in fees.

However, this isn't the right solution for everyone and it will depend on your financial situation and the kind of debt you're paying off. ASIC offers an [in-depth guide](#) to deciding what's best for you, along with resources such as free financial counselling.

Put your savings towards paying off your debt. It might feel counterintuitive, but if you're only earning small amount of interest on your savings, versus a significant chunk of interest on your debt, it makes sense to pull out a chunk to get rid of your debt.

Finally, make a repayment plan that you can stick to. That way, you can get to the light at the end of that tunnel much sooner than you might otherwise, and start investing your cash instead of throwing it away on servicing debt.

4. Build your emergency fund

Depending on your investment strategy, you're likely going to lock your cash away for some time to take advantage of market growth. Ideally, you won't touch your investment until it comes time to sell your shares in order to buy a house, for example.

This means that in case of any major unforeseen circumstances—like a sudden illness, losing a job or an unexpected tax bill—you need a good savings buffer that you can fall back on. Even if you never need to put it towards an emergency, the peace of mind it offers is unbeatable. It can also take some time to release funds from an investment portfolio, so don't be tempted to invest your emergency stash.

Most personal finance experts suggest anywhere between three and six months' worth of monthly expenditure is a good range for an emergency fund, so take a look at your budget and calculate what 3–6 months in cash looks like for you.

Even starting small and putting away \$5/week will quickly start to add up until you have a healthy buffer of ready money.

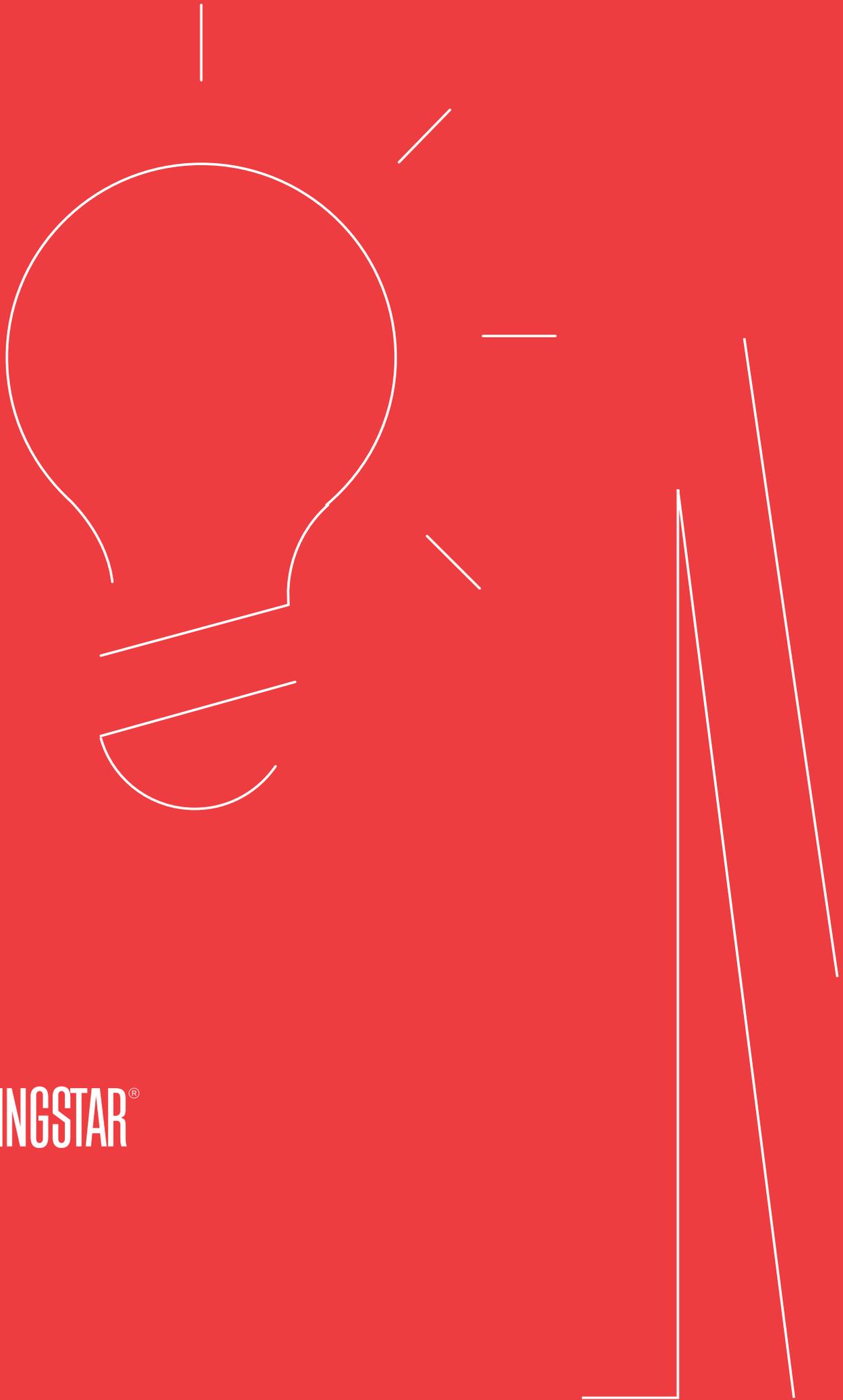
5. Start investing!

Once you have your financial house in order, you can start investing with confidence. And it's never been easier. The kind of portfolio you choose will differ depending on whether you're growing your house deposit, putting aside a lump sum or investing for retirement, so make sure you do plenty of investment research to find out what profile will suit your needs.

Making decisions about which investments to choose is incredibly daunting — not to mention time-consuming and risky. For 30+ years Morningstar has helped people, just like you, tackle investing with confidence. If you want to do it yourself we offer [research, data and tools](#) to make it as easy as possible, or if you'd prefer to pick a trusted partner we [offer ready-made investment portfolios](#).

Wrap up

It's easy to drift. Don't let 'someday' never happen. Follow our simple 5-step financial health checklist, and start making progress today. **||**



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