The Australian Finance Podcast Episode Transcript

Episode: Q&A: Margin loans, using DRPs and is broker data good?
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Speakers: Kate Campbell & Owen Rask
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Please read this prior to using this transcript:

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Episode transcript:

Owen:
Hey there. Here's a quick note. This podcast contains general financial advice only. That means it's not specific to you, your needs, goals or objectives. So don't act on the information until you've spoken with your financial advisor. You'll find our full disclosure, disclaimer, and link to our financial services guide in the show notes. Welcome to this episode of the Australian Finance Podcast. Kate, it's always a pleasure to be with you.

Kate:
Wonderful to be back on and recording in-person.

Owen:
What a positive start to this episode, I might add. We came out of the blocks very positive, lots of energy.

Kate:
I've only had one coffee, but I'm feeling it.

Owen:

Yeah, you're feeling it. It's good. It's because it's a Q&A episode. This is where we take your questions, we try and answer them, and we have a bit of fun doing so. So if you ever want to ask a question, Kate, where can people find us?

Kate:
I'd love you to send your questions to our podcast inbox. Podcasct. Podcast, I can't even speak this morning @rask, R-A-S-K.com.au. We can't answer everyone's emails, but I do look at them all and our team does, so we'll pick the best ones and the most interesting ones and the ones we haven't covered before and pop them in the Q&A, or turn them into a future episode.

Owen:
Yeah. That's it. We'd love to hear from you. Honestly, even if you don't have a question, you just want to send us some feedback or whatever, we'd love to hear from you. The other way you can get in touch and you can actually get help quicker is by going to the Rask Australia Facebook group, there's a link in the show notes. And what you can do there is you can hear from others in the community who have similar questions and are on a similar journey. It's actually a really positive community. There's no, "Hey, what do you think of this stock?" It's all like, "Hey, I'm going through this."

Kate:
You go to Twitter for that always.

Owen:
Follow us on Twitter for that maybe. But for Facebook, it's a great resource for asking questions and getting some feedback. We're going to answer some questions, we're going to talk about margins loans, we're going to talk about brokerage, analyst reports, and all different types of stuff in this episode. But it's always important to remember that anything that we answer in this episode is limited to general financial information only. We do not take into account your personal needs, goals or objectives. So that means it's not personal advice and it's not specific to you. If you want that advice, please seek the counsel of a financial professional, AKA a financial advisor.

Owen:
Kate, we've got some great questions.

Kate:
Yes.

Owen:

Are you going to put on an accent for these questions?

Kate:
I think I would butcher it completely. I've never been an accent person. But apparently, I put on a different voice for the podcast according to my entire family who laugh at me every time they hear the podcast.

Owen:
That's it, you are a different person on the podcast.

Kate:
Yeah. I don't know.

Owen:
Maybe you are. Maybe you transform when you come into studio.

Kate:
They also think I have a different phone call voice.

Owen:
You have what?

Kate:
When I have phone calls, my family think I speak very differently.

Owen:
What do they say? Do they say you speak very-

Kate:
Apparently, I speak more deeply, which reminded me of Elizabeth Theranos, the scandal, Elizabeth Holmes who put on a deeper voice.

Owen:
Yeah, right. What did she do? Can you just fill me? Because this is from the Bad Blood book, that's a book about an entrepreneur that took people for a ride.

Kate:
Well, the whole thing's going through the courts in the US at the moment, so there's some great podcasts to have a look at. John Carrerou is doing one of the podcasts. She was supposed to be this wonderful entrepreneur who raised, I think it was billions to

have this device that would test for hundreds of things you can test in blood tests. And the device really barely even test for one thing. They kept this up going for a long time, everyone got taken along for the ride, and it seemed really too good to be true. Unfortunately, it was. It would be fantastic technology. But it's a fascinating story of the Silicon Valley hype and just if you one smart person on board, you keep attracting the other smart people and they all follow like sheep almost.

Owen:
So she basically convinced people of this thing, and then she silenced people. That's the belief, that they silence people within the organisation from speaking up. And then they got really big investors on board or well-known investors like billionaires and whatever. And then because they were on board, everyone else jumped on and then this whole thing built up until eventually it just shattered.

Kate:
Yeah. Even the smartest people in the world fall for these frauds and deceptions and get really excited with these kind of companies. So it's always a learning lesson. I'd really encourage listening to some of the podcasts on it.

Owen:
Yeah, or even the book, Bad Blood.

Kate:
Yes, that is also a wonderful book.

Owen:
It's a great book.

Kate:
I've just been fascinated by the whole thing. If you like True Crime podcast, you might like listening to this case as well.

Owen:
It's blends finance and true crime. Okay. We've got a question here, it's a beast. And it's the first question that we're going to tackle today because it's going to take up a bit of the episode, and it's a question that could have its own episode, but we're going to bring this in. So just to confirm what the next questions are, just in case this isn't really your jam and you're thinking, "Do I still listen?" We've got some questions on, about buying ETFs in Australia versus overseas, and we've got another question about DRPs, and a

question about using broker data. The first question, however, is the big one, which is from Bryce, from Port Hedland, which is in WA, if I'm not mistaken.

Kate:
So hi to Bryce and all your friends, if you're listening.

Owen:
Bryce, good day, mate. And thanks for sharing the podcast around with your friends in Port Hedland. He writes in. Did you want to read out his question?

Kate:
Yes. Heads up, this is about margin loans. "Long-time listener, first time commenting," says Bryce. "With interest rates so low, are more people taking out margin loans and how do they work? I use self-wealth to invest and I'm no doomsday prepper, but I'm considering a hyperinflation hedge via a margin loan."

Owen:
Whoa.

Kate:
Yeah. "I know you guys don't offer financial advice, but you both put an unbiased lens on things like this for the layperson. Great work and keep those episodes pumping." Which we're trying to do.

Owen:
Yeah, we're trying to do, so thanks, Bryce.

Kate:
But I thought it was a good question because it got me thinking more about margin loans. It's not something I'd considered for myself. I have been aware, I have dealt with clients that have had them in previous roles, but I thought it was a good opportunity to dive in deeper to talk about this topic with our listeners and maybe talk about some of the pros and cons. Because some people in the financial space swear by margin loans, absolutely love them, promote them. We don't really about them, we don't talk about most forms of debt that much.

Owen:
Yeah, it's true. We don't actually, and there's a few good reasons for that. One of them would be, if we say something mildly positive about something that is potentially very risky, and someone takes that out of context, it can be pretty damaging for that person.

Not that we avoid it, we just don't necessarily advocate for these types of things that often.

Kate:
Yeah. And we believe in making mistakes and making small mistakes, but something like a margin loan, as we'll explore, can amplify your mistakes if you are not too sure what you're doing or you haven't worked it all out. So that is probably one of the reasons we haven't talked about it too much, but we will get that. But I thought maybe if we wanted to just start on hyperinflation, because that word was chucked in there.

Owen:
Okay, here we go. Bryce just inserted hyperinflation in there somewhere.

Kate:
I was listening to a fund manager's talk yesterday, and they kept using the word disinflation. This is a little bit different. So I don't know if you wanted to quickly explain hyperinflation and maybe use an example.

Owen:
Oh, you want me to use an example and it's going to involve some maths?

Kate:
Yes.

Owen:
Okay. Basically, I guess the thing is that hyperinflation is this idea that the price of goods and services goes up quickly, far quicker than any of us would like. And you might be thinking, "Ah, yeah, what's a bit of inflation if this goes up by X% per year." Well, typically, hyperinflationary environments result in wars. So it's not normally a good time for people because you end up with people that are in poverty, you end up with super high interest rates, and you end up with government policy that puts people out of jobs and so on and so forth. Now, that's the doomsday side of things. So I brought that in Bryce myself.

Owen:
The reality is, hyperinflation is basically just the cost of things going up rapidly. And it goes up so quick that you can't really control it. So the government in Australia and the government, the RBA, which is the reserve bank and in the US, it would be The Fed, in England, it would be the Bank of England, and so on and so forth. What they do is they set interest rates to control inflation, and they want inflation to be around two to 3% per

year. That's the price of a cup of coffee going up very modestly every year. And that basically helps stimulate the economy. If prices are slightly going up, it creates incentives and allows for wage increases and all that sort of stuff.

Owen:
Unfortunately, what can happen in an environment where people have lots of money is inflation can start to creep in and it gets higher and higher and higher. And if that happens at the same time as we have supply shortages, which for those of you in the construction sector that are listening to this, you would know this, for those of you that have been trying to buy furniture online-

Kate:
Oh, the insane increase in the price of timber.

Owen:
Yep, timber, steel, all that stuff, the raw inputs, everything like that is going up because of supply constraints. And so what is happening is the price of those are going up. So if you have some timber, you are going to get more money for it because people want it even more than ever. And so what we have is rapid growth in prices. This has many different impacts, but if we can spare you the details. Basically, what happens is the price of a cup of coffee, we're going to use this as an example. If we go down to Vacation, which is one of the really popular cafes here in Victoria, Axil's another good one, and so is Lune is croissants, just to get that out there.

Owen:
If we've got hyperinflation, which might be 50% per month, basically, what happens, our $5 cup of coffee goes to $7.50, then it goes to $11 the next month, and then it goes up to $16 a month after. And all of a sudden, four months down the track, your coffee is no longer $5, it's $16. And your wages, chances are, haven't gone up that quick. So, you're not paying for that cup of coffee.

Kate:
And you have a lot less purchasing power.

Owen:
That's it. And then the cafe owner doesn't get sales, and then they lose a job, unemployment rises, and that's where you see the spiral takeover.

Kate:

And you have to spend that money as quickly as possible because the next day it's going to be even more expensive to buy goods. So you have absolutely no incentive to keep any of the money in the bank, you want to buy the goods as soon as possible.

Owen:
So what can actually happen is your currency can actually be less valuable. In some countries where you see this, what happens is, people end up buying things rather than having money. So they might buy cars and they just put cars in their yard because the cars hold more value, and if something terrible happens in that country, at least they could sell the car overseas where they can get an actual currency. So we've seen hyperinflation in Germany before the World War II, we saw it in Argentina, which eventually then tried to peg its currency to the US dollar and that failed. And it was really bad for their country.

Owen:
They're still dealing with it today, even decades later. Basically, it's kind of like a dystopian view of the world, but the reality is, it don't happen that often. And what you hear in the news about this type of stuff happening is extremely rare.

Kate:
And the government desperately would not want this to happen.

Owen:
No government anywhere in the world and no central bank anywhere in the world wants this to happen. We saw it in Zimbabwe actually. And today in Zimbabwe, for the one US dollar, you might get a wheelbarrow full of currency. I

Kate:
I think there was some quite popular imagery from that time, and people having to wheelbarrow just to buy... a wheelbarrow of money just to buy a bottle of milk.

Owen:
Yeah. So you basically pay for things based on the weight of the paper rather than the actual paper itself. Anyway, so that's hyperinflation, so people get really concerned about this. I've spoken to professional investors that get concerned about this. Personally, I'm not as concerned about this. People think that the price of timber going up and all these different types of things is really important, and it is, but we tend to see this coming out of crisis. We tend to see supply constraints. And so I would say, first of all, that personally, I'm not preparing for hyperinflation, so that's good news.

Owen:
Second of all, if you were preparing for hyperinflation, a margin loan is probably... That's like stacking risk on top of risk, in my opinion.

Kate:
If you really want to prepare for hyperinflation, you need the bunker, you need the baked beans, you need everything like that.

Owen:
You need maybe to spread your money out overseas, I don't know. But the reality is here that hyperinflation, it could happen, I would just say it's extremely low probability. It could happen, but it's extremely low probability. And if over the last say 100 years to 150 years, that's where I get my base rate, and not many countries have experienced hyperinflation that have been managed well. So Kate, now that we've had a primer on hyperinflation, which is quite a while, now, what is a margin loan?

Kate:
Listeners are very familiar with the idea that when we buy a per property, we don't have $500,000 to just go and buy that apartment in Melbourne that's got Cladding or something like that. So we have to borrow, often 80%, maybe more, if we pay LMI or we have one of the various government incentives. We might buy a $500,000 apartment, but we only have to come up with $100,000 ourselves and we borrow 80% of the money. So that's a familiar concept, but what banks, because they create various products, you can also get, what's called a margin loan where you can borrow to invest in shares, ETFs, managed funds, various products that the bank, and then are some other providers that aren't banks that do margin loans in Australia. So it's worth having a look at that.

Kate:
But you can actually borrow money, which is secured against the shares, ETFs you buy. And often, you might be able to borrow up to 75 or 80%. Maybe you want to have a $100,000 share portfolio, you've got $25,000, and then you borrow $75,000 as part of this margin loan, and you can invest it in any ETFs and shares, managed funds that the bank or the provider has on their books.

Owen:
Yeah. So let's just take stock here. If you've been around investing and you've seen the advertising enough, you've probably seen things called CFDs, that's contract for difference. That's not a margin loan, although it uses margin. So this is where the lingo gets a bit confusing. CFDs have leverage inbuilt in them. A margin loan is different

because a margin loan is actually a loan secured against an investment in shares. So you might say to CommSec or whichever big broker you use, or the bank, "I want to buy blue chip shares and I've got 20,000, can you give me the other 80,000 to get to 100?"

Owen:
It's actually a pretty common thing. It's actually a pretty common thing that people would do this. It was very, very common before the GFC when debt was super cheap and people could basically get cheap, cheap cash or debt, put it into their brokerage account, and buy shares. Now, there are many, many risks associated with this. I think the first few things that we need to talk about are, how do they work? And Kate, if you can give us the simple definition of an LVR, which is something that people will come across, and an approved securities list.

Kate:
Yeah. So the approved securities list, if you just Google approved securities list and maybe CommSec, which is one of the big providers of margin loans in Australia, it's really the list of all the shares and ETFs, managed funds that the lender is willing... So you might find this really speculative mining company that has a $10 million market cap, and the bank might say, "Hey, I'm not letting you invest using this margin loan in this company," but something big like A200 or BHP, they might be completely fine with. But the thing is, each security, each share or ETF, the bank will run their own risk assessment and they'll let you invest in different ratios.

Kate:
I had an example, this is from CBA's approved securities list when I was having a look yesterday on the 22nd of November. So A200 had a portfolio LVR of 80%. So if you had $20, you could use $80 of your margin loan to invest in that company, and you would cough up the other $20. Whereas something like A2 Milk had a portfolio LVR, which I can read CommSec's definition in second, but of 40%. So you might want to buy $100 of A2-

Owen:
Milk shares?

Kate:
Oh, I was talking about after pay, I'm mixing up the codes. I don't know what A2 Milk's is. But anyway, if you wanted to buy $100 of after pay shares, you'd put forward $60 and they would provide you with $40. So there's different limits for different companies. And so CommSec definition of portfolio LVR was if you're in a diversified portfolio with five or more securities.

Owen:
Okay. So I've just looked at the CommSec's accepted shares list. A2 Milk has a portfolio LVR of 55%. And as you said, after pay, APT, it's a ticket code, is 40%. So that gives you an indication of how risky those two things are. So we had A200 at 80%, which is that diversified ETF. They're saying, "You can have up to an 80% loan on this." And that's a reflection of that being less risky. But they're saying, "We would only give you 40% if you bought after-pay shares, and that's a reflection of that being more risky." The way they calculate these things is probably a bit of science and a bit of art in there.

Owen:
But I would say the basic premise is that you can expect after-pay shares to bounce up and down all around all the time. Whereas say with A200, it's a bit more stable, even though it does bounce up and down. So maybe I can just throw it to you then to give us an example.

Kate:
Yeah. I guess I was using an example of you with $100,000 because most of them have a minimum of 10 or $20,000 you have to get in the loan, so they won't do it. They're not going to just do it for $500 because there's a bit of paperwork and things like that. It's also worth noting that the margin loans will often have a buffer of around 5% because it's really common for the share price to move 5% in a day. And so you don't want to have a margin call where the lender's going to ask you top up cash or reduce some of your positions. So this will give you some, having that 5% buffer. I guess I put an example together of you wanting to buy $100,000 in Rask shares. So we're pretending they're listed here-

Owen:
We're pretending that Rask is on the stock market.

Kate:
... they're on the bank's approved securities list. So at a 75% LVR, you are going to put forward 25,000 and the bank's going to lend you, if you're approved $75,000. So you're going to have an LVR of 75%. Yep, makes sense. So you are going to contribute the remaining using your cash. Then, if the market falls by 10%, now, this $100,000 in Rask shares is only worth $90,000. You still got to have to pay that bank the $75,000. The drop comes out of your investments.

Owen:

So if I'm investing using a margin loan, my money is the first money to go. It's like if we had a house and the house value fell, the bank gets its money before I get my money.

Kate:
They don't take the fall in the share price, they don't take on that loss, so you have to deal with that. If your portfolio, so you've bought $100,000 of Rask shares, $75,000 was funded by Bank of Kate. There we go.

Owen:
Bank of Kate, Kate's giving me a loan. I like this.

Kate:
Bank of Kate's giving you $75,000.

Owen:
Yes, please.

Kate:
Then now, your shares have fallen. Rask shares have fallen by 10%. So the whole portfolio is only worth $90,000. So this would drive up your loan to value ratio, which was 75% before, to 83% because it's $75,000, which is the amount you loaned, divided by the total portfolio value currently, which is $90,000. And so, suddenly, because your LVR is 83% and if we've got that 5% buffer in, that would only take us from 75 to 80%, you've suddenly above your limits. So the Bank of Kate is going to call you up and say, "Hey, Owen, you've got top up your loan with some cash to bring your loan value ratio back down to 75%."

Owen:
Okay. So this is the margin call? This is when they say they call you and they say, "Hey, you need to put cash in or we're going to sell some of these shares"?

Kate:
Yeah, or you might have to sell some yourself. Otherwise, if you don't take action within 24 hours, however long I decide to give you, it'll be in the fine print, we'll just sell the whole portfolio from underneath you and take the money.

Owen:
Yep. So they're always in control.

Kate:

Yeah. And if it's fall significantly and the total amount available is less than the amount we let you, you're going to owe us some money.

Owen:
Yeah. So this is just like, if you can't pay the loan on your mortgage, the bank will sell the house for you or on your behalf.

Kate:
Yeah. But at least with that, it doesn't happen that quickly. There's quite a few processes and there's hardship things. I had a friend who was investing throughout '08, '09 during the market crash, but he was on an overseas holiday and he wasn't contactable. Suddenly, the market crashed, he had no idea, he was in the middle of nowhere, and the bank couldn't contact him, and they just sold his whole portfolio out from underneath him. So that is one risk, quite prominent risk that you have to be able to manage this.

Owen:
Wow. Okay. Interesting. So we've got hyperinflation, which is a big one, and then we've got margin loans, which is like a loan on your house except the bank can pull it out from underneath you.

Kate:
Yeah. Then you can also reduce your LVR, so you could borrow less from the bank to begin with, which gives you a lot more wiggle room before there's a margin call. So you could say, "I want to buy $100,000 of Rask shares, but I'm only going to borrow $50,000 from the Bank of Kate and I'm going to cough up 50,000 myself." Then your loan to value ratio would only be 50%. So Rask shares would have to fall so much more before the bank gives you a call.

Owen:
Right. Okay. So most people would want to do the maximum LVR because then they get the maximum amount of buying power, but that's the maximum amount of risk for a margin call.

Kate:
So different lenders will have different maximums. A bank might only approve you for 70% of the loan value, they might choose, "Oh, we're only going to lend you up to a 50% LVR. We're going to give you up to $30,000 or something like that," depending on how they feel about you as a borrower.

Owen:

Yeah. Let's talk about the pros and cons. And maybe I'll start with one. We've got Monique here in the studio with us. Hey, Monique. We're talking about how we could use an example. Basically, anytime you use debt in investing or to do anything, it's like you're plugging your guitar into the amp. If you're a terrible guitarist, no one wants to hear it, but you've plugged it into the amp, it's going to be loud, things are going to go wrong.

Kate:
Sounds even worse.

Owen:
Sounds even worse. But if you're a good guitarist, plug it into the amp, and it's going to sound great and everyone can enjoy it. This is like investing, except the thing is, no one's really that good at investing all the time that they can use this much debt, at least in my opinion. And so there are a few people that should use margin loans, that's my short answer to it. I don't use one and I don't think I ever will, and I'll explain why in just a minute, because I think there's better ways to do it. There's a famous in investor out of the US called Tom Gayner who works for Markel Corp, it's an insurance company. It's like a mini Berkshire Hathaway.

Owen:
And he basically says that he avoids companies with debt because it's like playing poker and then someone can take the cards out of your hands at any time. And that's basically it. You're playing poker where someone can take the cards away from you. And typically, they take the cards away from you at the best time to invest.

Kate:
And the worst time to sell.

Owen:
And the worst time to sell. In investing, the probably the number one rule is never be a forced seller, never be someone that's forced to sell an investment, because if you are a good investor, you don't want to put yourself in that situation. And we saw this during COVID when even companies that use debt, they were way down by this anchor of paying interest at the same time as companies without debt, were able to invest more money. So you do not want to be in that situation. That's just my overall opinion.

Owen:

But Kate, what are some of the pros, if we're trying to be balanced as Bryce said we do, try and take an objective lens to these things. If we're trying to be balanced, what are some of the reasons why people would consider a margin loan?

Kate:
The first thing, which I think it's not as relevant now that ETFs are available, but diversification, when you could only buy individual shares. If you only had 20,000 to invest, maybe you could buy a handful of different shares, but if you wanted to diversify your portfolio even more and buy 20 different shares, maybe you don't have enough capital to do that. So by having a margin loan, you've got more funds to play with and invest. The second one is leverage. If you know what you're doing, amplifying your gains and you do need to take into account the fees.

Kate:
We haven't even mentioned fees, but the bank doesn't do this for free. The bank is taking on risk and it generally costs more than a loan for a house, the interest you're going to pay per year.

Owen:
It's riskier for them to lend it to you.

Kate:
Yeah. Access to that larger pool of funds, it doesn't need to be secured against a property, so sometimes when you have loans, they'll secure it against-

Owen:
They'll say, "We'll only give you a loan, but if something goes wrong, we get your house."

Kate:
Yeah. So you don't have to do that, but they are secured against equity and the bank or the lender does have a lot more control to sell it underneath you. So you do lose a bit of control. It can be a good tool, and I know there are people that do promote it on their podcast, but in a bull market, when things are going well, margin loans can make things go even better, but the tables can turn quite quickly.

Kate:
And another thing is that interest charged on a margin loans, generally tax deductible, and I've linked to the ATO resource on that, so you can learn more about that.

Owen:
Yeah. So we had Chris Bates on the podcast as the mortgage broker and he basically said that he would never buy shares with cash, he would always use debt. And the reason why he said that is because if you can use debt to invest in shares, you can claim the interest. It's like negative gearing.

Kate:
It'd be interesting, I think, because often people that are more experienced, property investors and are used to that debt and leverage cycle that maybe a margin loan is a bit more comfortable, but for me who's never bought a property, who's not really used to debt taking on more debt to buy shares, that concept's a bit weird to me.

Owen:
Yeah. I'll tell you why I wouldn't use a margin loan just a sec, but I'll just go through some of the cons that we've got on the list here, the additional risk that you would take by using leverage, so just as you said, it magnifies the gains, it can magnify the losses. The lender can change the rules, lowering the maximum LVR, removing securities. So if you bought after pay today and they say tomorrow, "No, that's no longer allowed." The interest rates on these things can go up and down, typically up when you don't want it to, and margin calls and market declines.

Owen:
I think this is the key question is, when the price of your investment falls because investments do fall, they inevitably do, do you have enough money to keep the position active or will you be that forced seller?

Kate:
And if you take the maximum LVR available, whether that's 75% or 80%, if the market falls by 30%, you could be in for quite a significant market margin call in a market crash. And so you would have to come up with a lot of money, which you might not actually have sitting around, and you don't want to be just rating your emergency fund.

Owen:
That's it. So those are some of the cons. Now, if I could be so simple as to suggest that if people are actively considering doing this, first of all, get advice. But second of all, if you have a home, I think the better way to do it is to use a line of credit against your house because you get lower interest costs. So if you have equity in your home, you have to a certain percentage of equity in your home, you may be able to use a percentage of that money to then go and invest in ETFs and buy shares and that sort of stuff.

Owen:
And what you can do is you can claim the interest because it's an investment, typically, I believe, I could be wrong. We should refer to the ATO page on that again, just to be sure, but I'm pretty sure you can at least offset a portion of it. The other thing to keep in mind is that there is no margin call because your property is security. So you can use that instead as a backstop for the bank. So if your shares drop, the bank only sees the loan against the property, they don't necessarily see the loan against the shares, but still, all the same rules apply. You don't want to just go out and buy crazy companies that just going to fall and put you under a lot of stress. But that is probably how I'd do it. And we covered this with Chris Bates and the podcast not too long ago.

Kate:
And I think investing is already risky, investing in individual shares and small companies is even riskier, why add an extra layer of risk and uncertainty and admin to that whole thing? And I think I just wanted to mention the interest cost because that is an important part of the equation, but I'm just looking CommSec website now, November 21, the variable rate is 5.5% per annum paid monthly in arrears. There is that tax deductible component, but you do have to do quite well in your investments to make that worth it beyond the typical returns you'd be getting already.

Owen:
Well, the thing is, if it's say 6%, you've got to make 6% excluding tax, let's say tax rates 30%, you might have to make 4%. And so it's always very alluring because it's always just within grasp, but you're, "Oh yeah, I could make 4%. Yeah, I could make 5%." And so I remember quite a few years ago, this could be back maybe five to 10 years ago, this investor that I didn't really know, but he was a really good investor, he said, "You could almost just go and take out a home loan and buy Tesla shares because the dividend's 8%."

Owen:
And he's like, "You could get the franking credits, which would make it like 12%, and then you could claim the interest on your loan, which will be like even less like 3%." So he is like, "As long as Tesla pays the dividend, you're making money." And I thought about that and I was like, "Yeah. That makes a lot of sense." But Tesla then eventually cut its dividend and all those types of things happened. So it's just important to be prudent with these things. And there are other ways to do it, I would say, CFDs are a really quick way to blow up your money. They even say that on the advertisements that most people lose money.

Kate:
Yeah. In the fine print.

Owen:
It has to be on the ad. And it says like, "70% of people lose money," or whatever it is, we don't know the exact number, but it's crazy. Margin loans can work for prudent people, I don't advocate for them. Maybe some people do, that's fine. I would be more inclined to use a stable asset to lend against rather than a liquid asset like this that has margin calls. That's just my two cents on the topic. It's a great question, and it's basically an episode in itself, but we've got a couple more questions here that we want to get to, Kate. Let's try and do a bit more rapid fire with these ones. Maybe you put this one to me and I'll ask you on the next one.

Kate:
Okay. This was Ross Fire email, essentially asking, with the S&P 500 or any shares or ETFs, sometimes you can buy them on the Australian Stock Exchange or the US Stock Exchange like on the NASDAQ or the NYSE. So in particular for the S&P 500, we can buy ETFs that do that in Australia, and we can buy them in the US. Is there any advantage to buying them in the US over buying them on the Australian Stock Exchange?

Owen:
That's a good question by Ross, because this is getting brought up more and more with organisations like stake and SelfWealth, making it easier to invest.

Kate:
And some thematic ETFs as well. Have much longer track records, are much bigger in the US. And ETF provider in Australia might be doing a very similar product, but is there an advantage to investing in the US one?

Owen:
There's not really. And in fact, I would say, if you just took exactly the same ETF with exactly the same fees, I'd say you buy the Australian one every day of the week, because if you invest in the US, you have to fill out W-8BEN form, which is the tax form. You also expose yourself to certain taxes like estate taxes. Not that you're going to die anytime soon, hopefully, but if you did what would happen to your money? There are also withholding treaties, and that's what the W-8BEN form is for between American and Australian, makes your tax return more complicated, generally speaking.

Owen:

Sure, if you have stake or self-welfare, whoever that makes the interface really easy, sounds good, but is it really... And then you've also got to deal with, which you've brought up, which is the currency. Do you want to be exposed to currency? Is it hedged? Is it not hedged? And the final thing is in Australia, you got CHESS, you've got the security of share registries that you know, I would honestly just go with an Australian one. There's so many in Australia, you don't need to buy US-listed ETF right now. That could change, if there's certain products like crypto, ETFs have been around for a long time, not in the states, but overseas, maybe people want those in the past.

Kate:
And there are some particular thematic ETFs that you can't find on the Australian market. I was looking at one the other day, which is a millennial consumer goods ETF, which was quite large in the US, and investing in particular trends of people that fell into that millennial aid category. And so there's a lot of interesting ETFs that can look quite attractive and shiny listed over there that aren't here. But I think if it's something as simple as the S&P 500, like the top 500 US companies, I would probably just stick with Australia, investing at various Australian Stock Exchange, because it's just a bit simpler, and it's simpler at the end of the day, simpler with tax, simpler with administration.

Owen:
Yeah, for sure. Cool. That's a great question from Ross. Thanks for that, mate. We've got another listener starting with, ah, Renee. Renee writes via email says, is it worth having a DRP? And this is the comment. I think the question is here, as I have mentioned before, Barefoot Investor was what got us into improving our personal finances and investing. So when I started buying some share/ETFs, I followed Barefoot's advice and elected to do the dividend reinvestment plan or DSP where it is available. But now I'm learning a bit more.

Owen:
I'm wondering if I should be thinking about this share price when I do this. Our portfolio is still in the beginning stages, so if there is a share price in the hundreds, it's going to take some time, years for the dividend reinvestment plan to build up to the full amount of a share and be reinvested. I'm thinking it would be better just to be paid the dividend and add it to my investing bank account to then be used when I make a regular monthly investment. I would love to hear your thoughts on this. Basically what Renee is asking is, I've elected to take my dividends instead of in cash to be reinvested, but I don't get enough of a dividend to get one new share. So what can I do?

Kate:

I think this is quite topical because some of the ETFs and especially the popular ones, I think A200 is nearly $200 or?

Owen:
Yeah. Right.

Kate:
So it doesn't really matter with ETFs what the price is apart from when it comes to dividend reinvestment plans, because if say your ETF was around $100 unit price, it was paying 5% in dividends this year, so you're going to receive around $5, to reinvest that it's going to take a long time before you get a whole individual, another $100 unit. And so what they do is they hold the residual amount until it accumulates enough to buy you another unit and reinvest that. So for someone with a smaller portfolio with something that doesn't pay very high dividends, it could take many, many years before you get issued another unit or share in that particular product.

Kate:
So in terms of that, I think sometimes it can actually be more worthwhile to get it paid out in cash because you don't have these residual amounts sitting around doing nothing, but it could be many, many years before you get actually that additional unit.

Owen:
You may as well take it.

Kate:
So you may as well do something. And sometimes when you sell, when you haven't actually had a full dividend or unit reinvested because you didn't have enough, it gets donated to charity or the money just gets lost. So you don't always get that money back. So I think sometimes with smaller amounts, it is easier, especially with those larger unit priced ETFs.

Owen:
For sure. So I guess the end of the day here, Renee, it's going to take you many, many years to get another unit, you may as well just take the money and go and invest it. Purely from a compounding perspective, you can go and do something with it, whatever you want to do. There are benefits to some of them, we've talked in the past about how some listed investment companies have particular tax benefits to being DRP, but for the most part... and they're not even called DRPs, DSSPs, aren't they?

Kate:

Mm-hmm (affirmative).

Owen:
So in that case, you might want to consider the tax benefits, but honestly for small amounts of money, you could probably just take it and reinvest it.

Kate:
Yeah. I think the bigger risk is that the money just gets lost in the system if you don't have that $5, $10 paid out into your cash account. So you can do what you want with that. You can build it up into your next $1,000 parcel that you invest in another ETF or share. And I think it's just really worth considering whether it's worth it, whether it's worth the administration of having to keep that rolling over.

Owen:
Cool. Kate, maybe I'll let you ask this last question. It's from Renee by email as well.

Kate:
Wonderful, Renee, who was one of our listener stories earlier this year. The other question was about broker data, and in particular, Renee uses SelfWealth and really loves the experience investing with them. And they've got some really handy tools such as stock reports, forecast, and recommendations. She knows that we always say to do your own research, but was wondering if we would consider this data that the broker's providing as a credible information source?

Owen:
Yeah, sure. Great question, Renee. Just so people are aware, I do have a live session with SelfWealth, so I go live on their platform and I teach people to invest basically and help people invest. The thing is there are many great tools inside SelfWealth, as there are many platforms. The thing to keep in mind is that a lot of the information that you have in many brokerage accounts, this is not specific to SelfWealth, you probably don't need every day. I personally, I don't use data that much, I tend to go to the primary source.

Owen:
So what by that is, if I want to learn about, say investing in Afterpay, I want to know about what the company does, I want to know who the management team is, I would go to the annual report for Afterpay, or the website for Afterpay. I might look at share prices, and I'll use the brokerage account to get annual reports. That's where I'll get the annual reports from, but I don't necessarily then go into the data section and use all that. Now, SelfWealth I know from experience users Refinitiv, which is a pretty reliable source of

data, but there are some brokerage counts that use different sources of data, which is pretty poor quality, like you first in this... you go in and there'd just be things missing.

Kate:
Yeah. And sometimes it can be a month delayed or a day delayed. So you really have to be careful and checking, when was the data sourced? Where's the source? Like Morningstar sometimes provides some of the data, which is reasonably good, but sometimes they're just scraping articles from the web in. So they're not always from great sources. And I guess thinking if it's free, is it actually good quality? Is it written by someone who knows something or is it written by a robot?

Owen:
That's it. And sometimes what happens is... Just to clear up something, sometimes when people read broker reports, what they mean is they think of SelfWealth, they think of Stake, they think of CommSec, but those brokers aren't the brokers that we're talking about when we say broker reports. Broker reports are actually written by analysts. And those analysts work for brokers like Morgans, Bell Potter.

Kate:
Goldman Sachs.

Owen:
Goldman Sachs, UBS, the big, big brokers. And the reason why we say maybe don't trust them and it's not because their analysts aren't great, it's because they often have a conflict. And so if you go into a brokerage account, you might see Goldman Sachs recommendation. I know CommSec does this, for example, there's Goldman Sachs, there's Morningstar. And then you'll go into another platform and it'll have different analysts research.

Owen:
It's not necessary the platform itself that's saying, "Oh, look at this company." It's the analysts and the companies, they work for that, and what goes into those research reports that may not necessarily always, always be the best use of your time spent researching. And what I mean by that is some of those brokers and analysts that write those reports work for a company that is incentivized to get you to buy the shares.

Kate:
Yeah. Or they might be helping that company do a capital raising or a share purchase plan, all sorts of things.

Owen:
And that's happened recently. We've had one company that we follow at Rask. There was a big buzz about it on HotCopper and all these online forums where everyone's like, "Oh, did you see these analyst report that's come out, has come out?" Well, it turns out that that company behind that analyst was actually paid 4% of all of the shares in the IPO plus $40,000. And then when they pump the share price up, then they got the money to do the capital raising, so they get paid to do the capital raising for that company. So any of the research in between the beginning and the end is basically, you have to seriously question whether that was genuine or not.

Kate:
And it can take a bit more research to actually find if this particular company's recommend has a brokerage report coming through on CommSec saying, buy up to $6 for a stock, what the actual trail is and what the links are. Sometimes they're not related, they might just try to be encouraging trading or CommSec might be playing for the data, other times there are certain incentives, which most of them are actually allowed to do things like this.

Owen:
So just in summary here, Renee, what I would say just for some clarity here, if you're investing for a very long period of time, and when I say very long, I mean like three, five or 10 years, it is far better to have an understanding of what the business does than it is to know what someone else thinks of it or what the latest profit ratio is. This is coming from an analyst, I'm telling you this, it's far better to know what the company does, believe in that company story for the long term, trust the management.

Owen:
And so all of that stuff you can get from the annual reports, from reading about the company, watching interviews, listening to podcasts with them. And sure, the analyst reports help and the data help, but it shouldn't be the primary source. I think most investors, and this is what we see, it's like investing becomes more of an art form the longer you've done it. In the beginning, you search for answers with like price earnings ratio below 10 equals buy, or dividend yield is good, therefore buy. We search for these answers.

Kate:
We like creating rules.

Owen:

Yeah. And that's just because we systematise it because it's the easiest way for us to get over this steep learning curve in investing. But over time, you begin to realise the art form of investing, and the art form is that you focus on the companies and the people, which you can't quantify in a spreadsheet, but you know that it's positive. And so Renee, I know you've been investing for a while now because we've spoken to you on the podcast, so we know who you are. And we know that you're at this stage now where you're starting to ask these questions where you want to learn about companies and you want to know what works and what doesn't.

Owen:
I would just say, take your time to read the chairman's letter. That's always in the beginning, or chairperson's letters, it's at the beginning of the annual report, and then read the managing director's letter and what they have to say, and use those tools in addition to anything that you see in your brokerage account.

Kate:
Yeah. And I think there's always something to be said with everything when it comes to investing, going to the primary source, because data gets distorted on the way.

Owen:
None of our analyst's team are allowed to use the data source from data providers.

Kate:
Yeah. And sometimes things are out of date, sometimes things are wrong, but I wouldn't say like someone like SelfWealth or CommSec would be putting any intentionally wrong data, but sometimes things can get broken on the way.

Owen:
Oh, yeah, they can, for sure.

Kate:
There's data coming out on like thousands of different shares, so it's not all ways 100% accurate. And sometimes it takes a long time to update. So often with a newly listed company on CommSec, it can take quite a while for all of the data to flow through. And it can all look quite empty for a while and the share price can look skewed up if it's not filtering through. So I think good starting point, but definitely go to primary sources and do your own research.

Owen:

Yep, for sure. So just to recap this episode, Bryce asked us, he's from Port Hedland, by the way, great part of the world. He asked us about margin loans. Kate, we talked about hyperinflation, you talked about margin loans, how LVS work. We talked about the pros and cons, being that there are some pros and there are some cons. I maybe referenced that I'd probably use a line of credit before I use that because it's like pulling the cards away from a poker player. Ross asked about buying the S&P 500 ETF on the ASX or US market. It's probably easier in Australia.

Owen:
Renee said, "Is it worth using a DRP if you only get a smaller amount of money?" Maybe you could take the money and reinvest it your own way. And finally, we talked about broker data and is that data and the broker reports and analyst price targets worthwhile or should you do your own research? We think do your own research, as well as using that if that's what you want to do. One final thing with the broker reports, I use them to read the business section, so what the analysts have found out about the business, not their valuation section. So I think if you break that up, you'll do a better job of it. Kate, that's a wonderful Q&A episode. We spoke about a lot.

Kate:
Jam pack is the final one for the year. So I just wanted to remind people that if you do you have topic suggestions for the podcast for 2022, send them through to podcast@rask, R-A-S-K.com.au, or post them in our Facebook community. We'll have all the links in the show notes so you can get involved and keep the conversation going over the summer.

Owen:
Yes. Kate and I, I should say, do a big planning day for AFP. We've got one coming up. And that's basically where we sit down. This year we did shares month, or was that last year, I get so confusing?

Kate:
It was this year.

Owen:
It was this year. Wow. Where we do share-

Kate:
We've had a few requests to do that shares month series again, including that 10K portfolio, which was quite popular.

Owen:
It was super popular, obviously that was popular.

Kate:
Many secrets were released.

Owen:
Yeah. So if you have any suggestions for us to do, themed months, one thing we want to do next year is get on the road too, so keep an eye out for that, send it into us, say good day. Cool. Kate as always, thanks for joining me.

Kate:
Thanks for listening everyone.

Kate:
Thanks for tuning in to this episode of the Australian Finance Podcast, where our mission is to improve the financial futures of all Australians. If you'd like to learn more, create a free account at rask.com.au/account, to download free episode workbooks, bonus resources and take our amazing free personal finance courses.

Owen:
You can also join our online community by following the link in the description. If you enjoyed the show, what we'd love is for you to leave us snappy review on iTunes, and you can follow us on Twitter and Instagram @raskaustralia. Kate and I are also on both of those channels. Finally, if you have any feedback, suggestions for episodes or guests to come on the show, or you just have a question for us, shoot us an email at podcast@rask.com.au.