MARGIN LENDING BACK IN THE PICTURE

Margin lending levels may never revert to the pre-GFC highs, but investors are slowly and carefully re-thinking the strategy for their portfolio, **Jassmyn Goh** writes.

MARGIN LENDING HAS been largely out of favour since the global financial crisis (GFC), and the debacle at Storm Financial.

However, it looks like margin lending is on the rise again with investors cautiously dipping their toes back in the waters.

Fiducian financial planner, Michael Dale, attributed the dramatic margin lending plunge during the GFC to the media, which he said sensationalised the events.

"It's not really a complex strategy to understand," he said.

"It's just I think greed gets in the way and when the markets are particularly soaring people just don't think about what could happen and they don't have their contingency plan.

"It's always doom and gloom, it's blood on the street but the opportunity arrives when those things happen and can only be taken advantage of if people are already planning for it by having enough cash."

According to the Reserve Bank of Australia (RBA), total outstanding margin debt stood at $11.68 billion as at March 2015, compared to its peak of $41.6 billion in December 2007.

It has taken six years for margin lending to hop on the road to recovery.

While the number of investors using margin loans is not even close to its peak of 248,000 investors in 2007, there are currently 72,000 users, according to Investment Trends, head of research, Recep Peker.

"For many many years the margin lending market had been shrinking but what's really interesting is that now there's a bit of growth in dollar terms," Peker said.

"Although there are fewer investors using margin loans, the margin loan dollars are actually growing and what you'll find is that the average loan size per investor is growing."

PLANNERS ON THE PERIPHERY

Peker said there is great opportunity now for financial planners, as research found 103,000 people were interested in either taking their first margin loan ever, or had used it before and would like to take loans again.

"With the end financial year drawing closer, it's common that we always see an influx of new margin lending customers before the tax year ends as people pre-pay the loan, miss the financial year, and get the tax offset."

- Andy Rogers

But tighter regulations around margin lending have meant planners were avoiding writing more loans due to increased paperwork and compliance burdens.

"Financial planners are saying 'if it was easier I'd actually write more margin loans'," Peker said.

Peker noted that investors were increasingly turning to brokers instead of financial planners when looking to use a margin loan but did not know the reason.

"If you ask a broker whose idea it was to set up their most recent margin loan, 59 per cent of them will say it was their clients', but with financial planners it's a quarter of their clients'," he said.

"This shows that the broker channel is more directed."

He said from September 2013 to 2014 the direct channel for margin loans increased quite rapidly by $726 million, to $5.1 billion.

Market research firm, CMC Markets, found in their August 2014 Margin Lending Investors Report that investors leaned towards margin loans due to lower interest rates, and because they recognised it was a way of increasing diversification in a portfolio.

CMC head of stockbroking, Andy Rogers, said while the overall number of clients using margin lending dipped, overall loan balances remained unchanged because the core clients who wanted to use it remained with the product throughout the post-GFC period.

"But the people that dropped off maybe were using it because it was fashionable. Definitely now we're seeing an influx… it's definitely become more in vogue," Rogers said.

Margin lending firm, Leveraged, found investors were gearing due to record low interest rates, and to meet their financial goals such as a comfortable retirement, buying property, and saving for their children's education.

Leveraged head of direct, Darryl Drown, said low interest rates had lured investors back to margin loans, and the industry had stabilised.

"So they're saying we can get a high yielding portfolio, a diversified portfolio and this is the time to be back in the stock market. And so we're seeing margin leading coming back into vogue," Drown, said.

Peker agreed, saying almost 40 per cent of planners wanted to use margin loans because they wanted to take advantage of the low interest rates, with only five per cent wanting to decrease their use due to administration burden.

However, he said only 42 per cent of planners provided margin lending advice, compared with 75 per cent in 2007.

MAKING USE OF THE PERKS

As investors risked outliving retirement savings, and with changes expected in superannuation, Drown said Leveraged was seeing investors looking outside superannuation for longevity investments.

With younger investors finding it harder to buy property due expensive real estate and stringent home loan requirements, they were

starting to use margin lending as a way of securing a loan for the deposit.

However, Investment Trends found the average current margin lending investor was 48 years old, with an average outstanding margin debt of $250,000, equivalent to 28 per cent of their total investment portfolio.

Rogers recommended moderate gearing to shelter investors.

"A little bit of gearing can help you along the way and you can obviously survive the ups and downs because you're not that highly geared because it's your call to take the 50 per cent or whatever the loan-to-value ratio is on the stock," he said.

Rogers noted that investors were also taking advantage of the tax benefits associated with taking out a margin loan towards the end of the financial year.

"They can look at the tax advantage and especially with the end financial year drawing closer, it's common that we always see an influx of new margin lending customers before the tax year ends as people pre-pay the loan, miss the financial year, and get the tax offset," he said

However, Dale warned that the tax benefit should not be the reason that drives investors towards the strategy.

"If you are borrowing you can always pay the interest in advance because you're borrowing money for an asset which is tax deductible. But the tax advantage or benefit is just part of it. It would never come into the discussion of 'this is why you're doing it'," he said.

SCHOOLING CLIENTS

Although Peker said financial planners found their clients now had a better understanding of the strategy, CMC Markets, Leveraged, and Fiducian were offering a range of educational resources on gearing strategies such as seminars, webinars, and written guides to assist investors in understanding the benefits and managing the risks of using margin lending to help achieve their financial goals.

"It's really about education and when you sit down and go through a long-term investment strategy to achieve something it becomes much more clear the reasons why someone would do that because it's not suitable for everyone," Dale said.

Leveraged and CMC Markets also teamed up to launch their integrated platform in an effort to close the gap between the lender and the broker.

ON THE UPSIDE...

Margin lending took a beating after the GFC and the Storm Financial debacle, but there does seem to be a flicker of light.

Thanks to record low interest rates, borrowing never looked this attractive to investors, who were looking to diversify their portfolio to meet their wealth creation goals.

While Dale said margin lending would always be around, the future of the strategy was changing already.

Leveraged and CMC Markets' platform uses real time technology and risk management tools to meet clients' needs.

However, Dale warned that investors need to look at margin loans as a long-term strategy of at least 10 years to get the most out of the strategy.

"The key words are monitoring, monitoring, and monitoring; it needs to be done regularly and the clients need to be fully aware and reinforced all the time of what the consequences are of not being aware of what can happen," he said.

"But we're just human beings, we have emotions and that's the problem." MM