RANDS & SENSE

The Big Five of investing

Deciding where and how to invest your money can be a confusing business. There are four basic laws that will help you make the most sensible decisions. But there's a fifth law too – pay off that high-interest debt first!

Let me tell you about an investment that will give you an after-tax return of 36,5%! Does this sound too good to be true when savings accounts are currently paying between 5% and 7% interest? It's not. There are thousands of South Africans who have access to this fantastic return on investment.

If you have a personal loan and are paying the maximum permitted interest rate of 36,5%, then every rand you pay that is *more* than your minimum monthly instalment will save you 36,5% interest.

In other words, every extra rand paid off will give you a 36,5% return on your investment! Credit cards currently cost up to 26,5% in interest, so the same principle applies there.

So, if you have personal loan debt or credit card debt, your best investment is to pay off that debt first before you even think about investing elsewhere.

> "There is an old saying 'it's not timing the market that is important but time in the market!'. Trying to predict the direction of the market is difficult and even the so-called experts can get it wrong."

An example of great returns

You have a R6 000 personal loan that charges 36,5% p.a. interest over four years and you are saving R40 p.m. in a savings account that is paying you 7% p.a. Your return on your investment on your savings account at 7% is a total of R288 over the four years.

If instead of investing R40 p.m. in a savings account, you invested that R40 into your personal loan, you would SAVE yourself interest charges of R1 608! In other words, you would get a return on your investment of R1 608 instead of R288.

Another bonus of this strategy is that you will have paid the personal loan off in three years instead of four. Now, that's a great investment.

To explain how this works:

A monthly instalment of R239 will get you a personal loan of R6 000 taken over four years at 36,5% (we'll ignore monthly service fees for this example). Over the four years, this loan will cost you interest of R5 486! You can work out the interest costs quite easily as follows:

- Take your monthly payment of R239 times 48 months, which equals R11 486.
- R11 486 is therefore the total you will repay.
- You borrowed R6 000, so the interest costs are the difference between the R6 000 you borrowed and the R11 486 you repaid.
- The interest costs are therefore R5 486.

If you put R40 per month into a savings account at 7% for four years your investment will grow to R2 208 and you would have earned R288 interest.

If you increased your personal loan instalment by R40, from R239 to R279, it would take you just over 35 months to repay the loan and your total interest costs will be R3 878 instead of R5 486. Your interest saving (return on investment) is R1 608.

So, before you think about investing elsewhere, pay off your high-interest debt. When that is paid off, you can use those monthly instalments to pay yourself and start accumulating some wealth (instead of making the credit grantors wealthy!).

Once that debt is cleared, you are ready to invest. But where do you start?

Finding an adviser

The first step is to find yourself a qualified financial adviser whom you can trust. This rules out your friend's cousin's neighbour, who suggests you put all your money into this 'new internet company that will double your money in 12 months'.

Professional financial advisers have the qualification CFP (certified financial planner) and all banks will be able to put you in touch with an adviser. A good financial adviser will always conduct a proper needs analysis for you and assess your tolerance for risk.

Only by spending quality time with you, can the adviser identify the best investment strategy to suit your needs and personal risk profile.

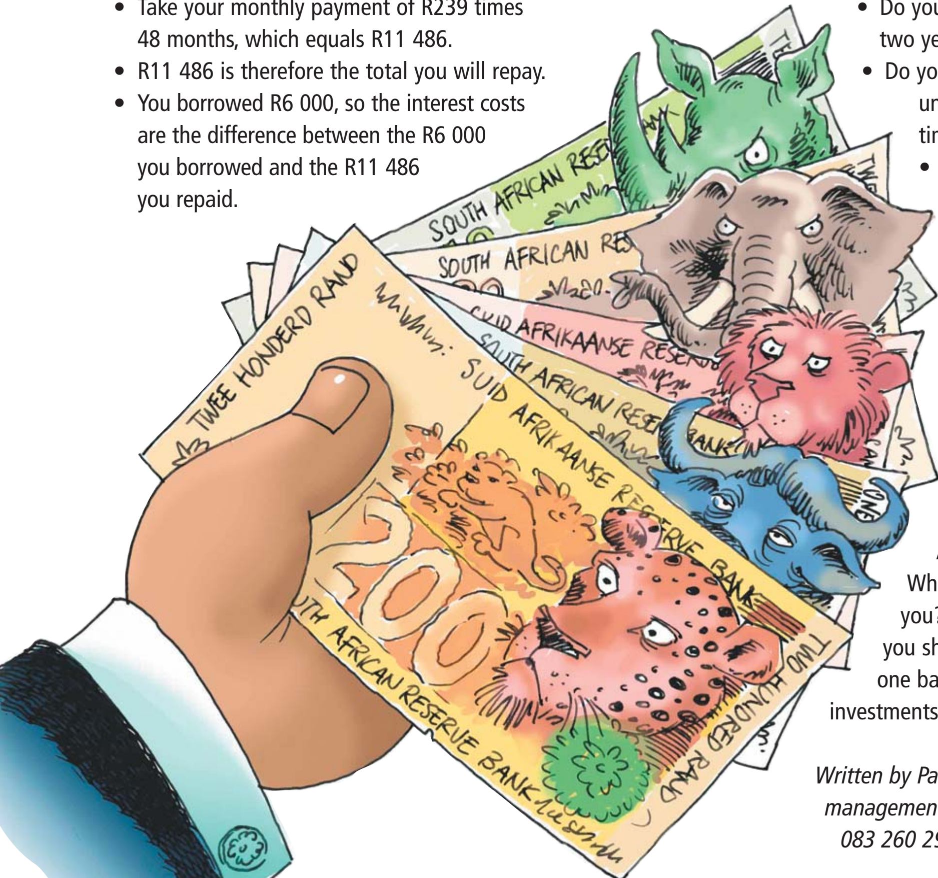
Your adviser will probably discuss with you the four rules of investing. These are:

Rule 1 of investing: Goals

Spend some time thinking about your investment goal or goals. What do you want and by when?

- Do you want to put more money away for retirement? This should be your priority investment.
- Do you want to save for a holiday in two years' time?
- Do you want to save for your child's university education in 12 years' time?
- Do you want to have money in a cash fund for emergencies?
- Do you want to save for a deposit on a house in five years' time?

Each investment goal may have a different time frame, and may need a different type of investment (see "Asset allocation" below).



Rule 2 of investing: Asset allocation

What type of investment is best for you? It is generally accepted that you should never put all your eggs in one basket and should spread your investments over different companies and sectors.

A balanced investment strategy would include cash, bonds, property and equities. The rule of thumb is that cash and bonds are short to medium-term investments and property and equities are long-term investments. All these types of assets can be bought directly, but the easiest way to diversify share investments is via collective investments (unit trusts). For more information on unit trusts, see www.asisa.co.za.

Your ideal asset allocation would suit your investment goal and your risk profile and will give you *real* returns. A *real* return is a return that is greater than inflation.

Your investment adviser will determine your needs and advise you which investment assets best suit your goals. For example, if you have a goal of saving to pay for a child's education in 12 years' time, you are saving for the long term and equities will most likely be your best investment.

Investing in a collective investment (unit trust) that has a general equity portfolio would give you this broad exposure to equities.

Rule 3 of investing: Risk tolerance

You want to be able to sleep well at night and not worry about your investments. How much risk are you willing to take?

- Will you sleep well at night if there is a risk of your investment dropping in value for a while before it increases again? Then shares (otherwise known as equities) are OK. Shares or equities will be subject to unavoidable ups and downs, but over the long term a well-balanced investment in equities will give you *real* returns.
- Do you never want to risk losing any of your original capital invested, even in the short term? If that's the case, then your best bet is money market funds, but the chances of getting *real* returns are not great.

Rule 4 of investing: Patience

Don't try to time the market. If you invest on a regular basis and stick to your investment strategy, then you will be assured of achieving your goals. For example, those investors who keep investing in equities as the market moves up or down have been rewarded for their patience over the long term.

It's better to invest on a regular basis than try to time your entry into the market in one lump sum. There is an old saying "it's not timing the market that is important, but time in the market". Trying to predict the direction of the market is difficult and even the so-called experts can get it wrong.

In summary

Get rid of your high-interest debt, make sure you are adequately invested for your retirement and then put together an investment plan using the golden rules of investing to create wealth for yourself.

All the major banks offer investment services and have educational resources available on their websites.

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