

The poet Thomas Gray – the one who wrote "Elegy in a Country Churchyard" – once said,

SLIDE: "Where ignorance is bliss, 'Tis folly to be wise." Thomas Gray

But he certainly wasn't talking about saving and investing. In that realm, ignorance is not bliss. It's more like hit and miss. And sometimes there seem to be more misses than hits. What New Zealanders don't know about investing is costing them dearly.

I write two newspaper columns -- a Q&A column in the Herald and an article in the Waikato Times, Dominion Post, Christchurch Press, Otago Daily Times and other papers. And I get heaps of letters from readers.

It's great to be in touch with so many people. But I sometimes find it deeply worrying when I realise how much some correspondents don't understand.

SLIDE: 6 common misconceptions:

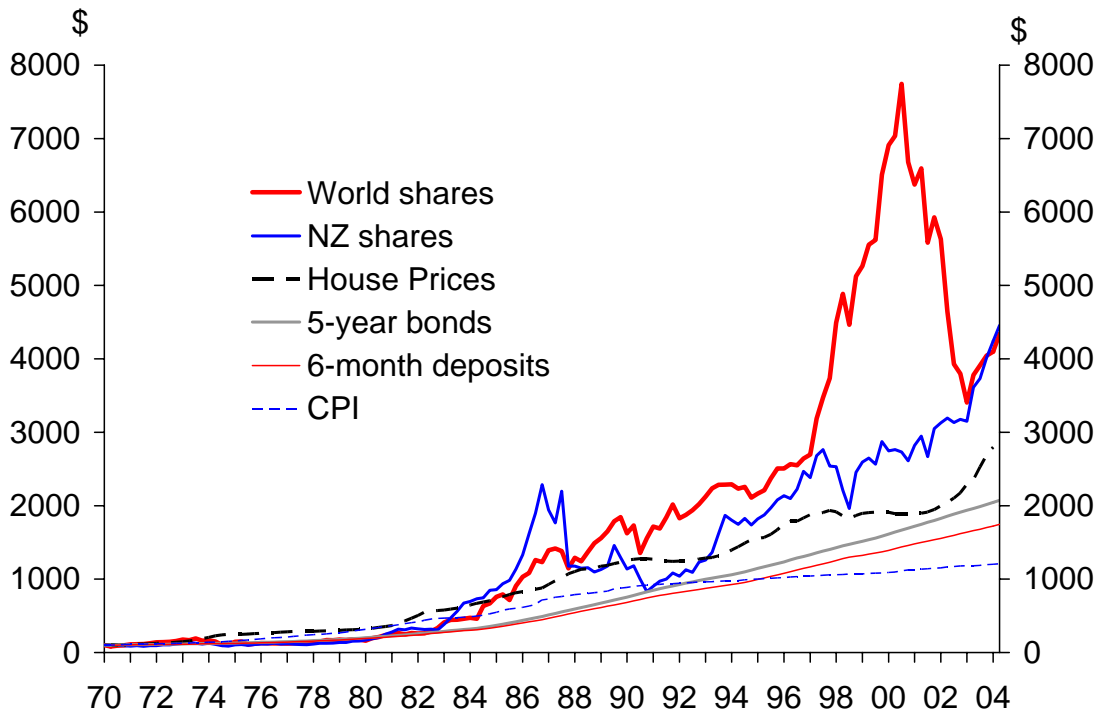
- It's best to stick with term deposits for long-term savings.
- You can't go wrong with rental property.
- Shares are too risky.
- It's easy to pick when to buy and sell shares. Just read the papers, and brokers' reports.
- If an investment has been doing well lately, get on board! If it's been diving, get out.
- If you can deduct an expense on your tax return, it costs you nothing.

Let's look at these in more depth.

SLIDE **Misconception 1:** It's best to stick with term deposits for long-term savings.

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### Accumulation of \$100 from March 1970

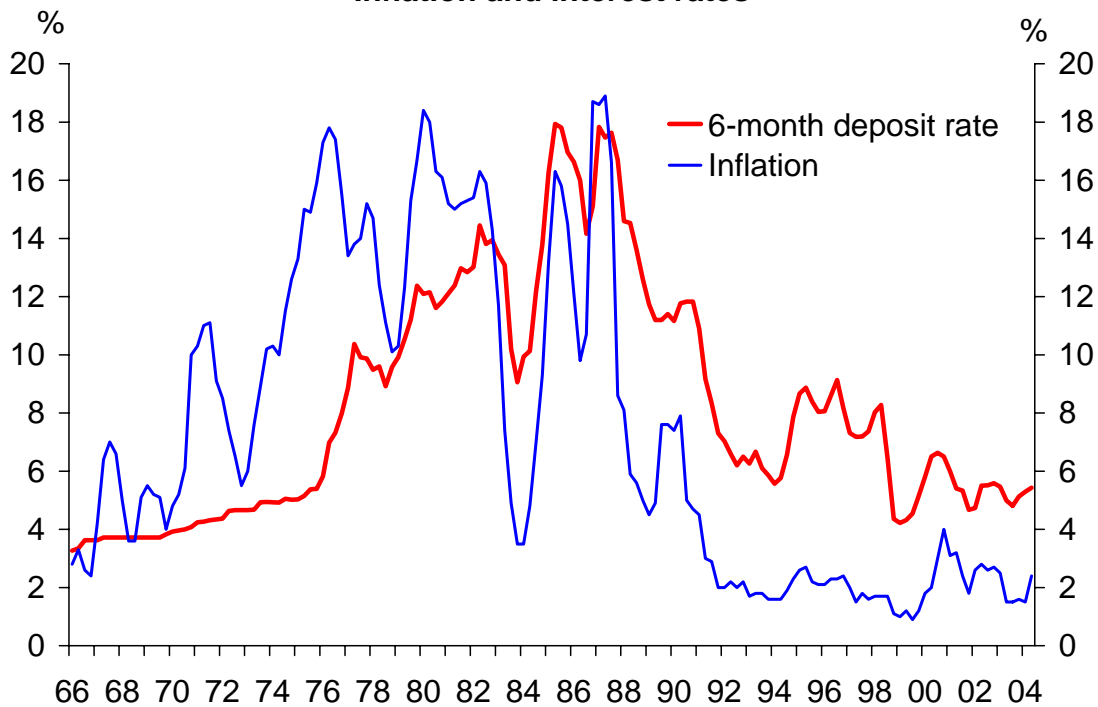


Sources: RBNZ, Statistics NZ, Quotable Value NZ, Russell Investment Group Ltd. 5-year bond and 6-month deposit rates compound quarterly.

Term deposit returns over long periods are low. Since 1970, term deposits grew more slowly than all the others, and much more slowly than NZ shares (blue) and world shares (red).

SLIDE:

## Inflation and interest rates



Sources: RBNZ, Statistics NZ. Inflation is CPI excluding interest rates over the full time period (interest rates were removed from the CPI regimen from June 1999).

In some periods, term deposit interest has been lower than inflation – when the red line is below the blue. From the late 60s all the way through to the early 80s, savers could buy less with their money when they took it out, than when they put it in, despite compounding interest.

That may not happen again, but who knows? In any case, people who save with term deposits are likely to end up with much less in retirement than those with other savings.

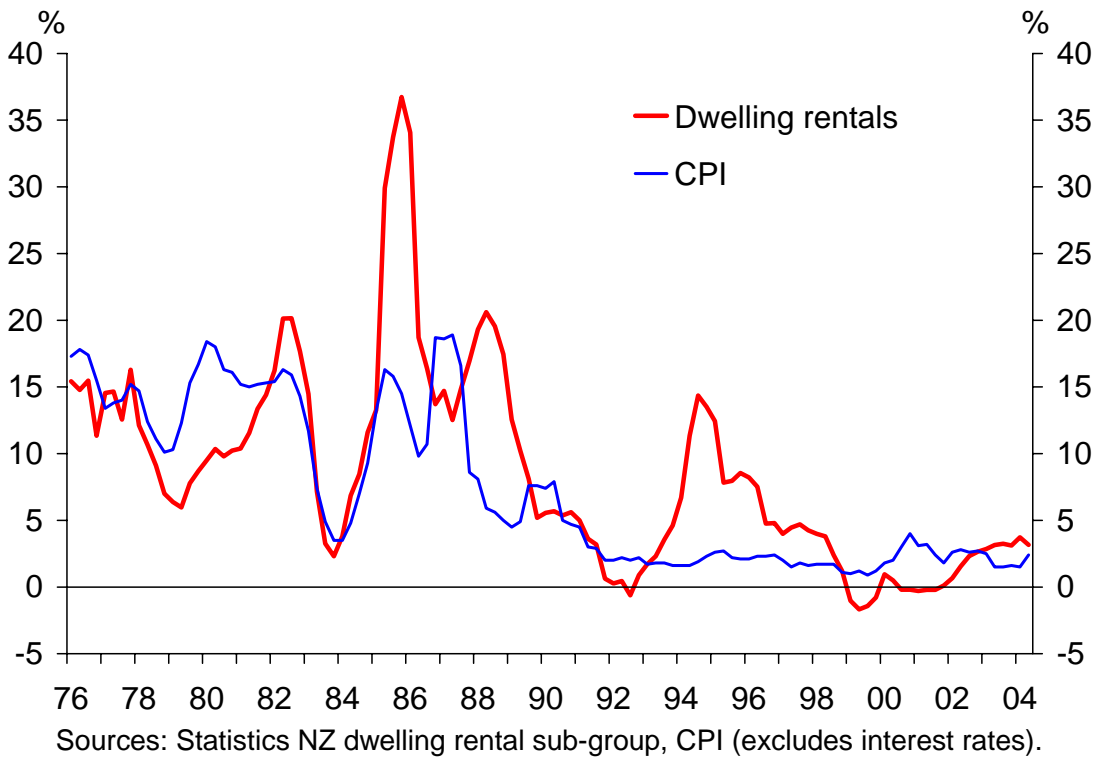
OK, some people say, let's use rental property.

SLIDE **Misconception 2:** You can't go wrong with rental property.

The fact is that rental property, especially if it's highly geared, is riskier than most people realise.

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### The ups and downs of rents

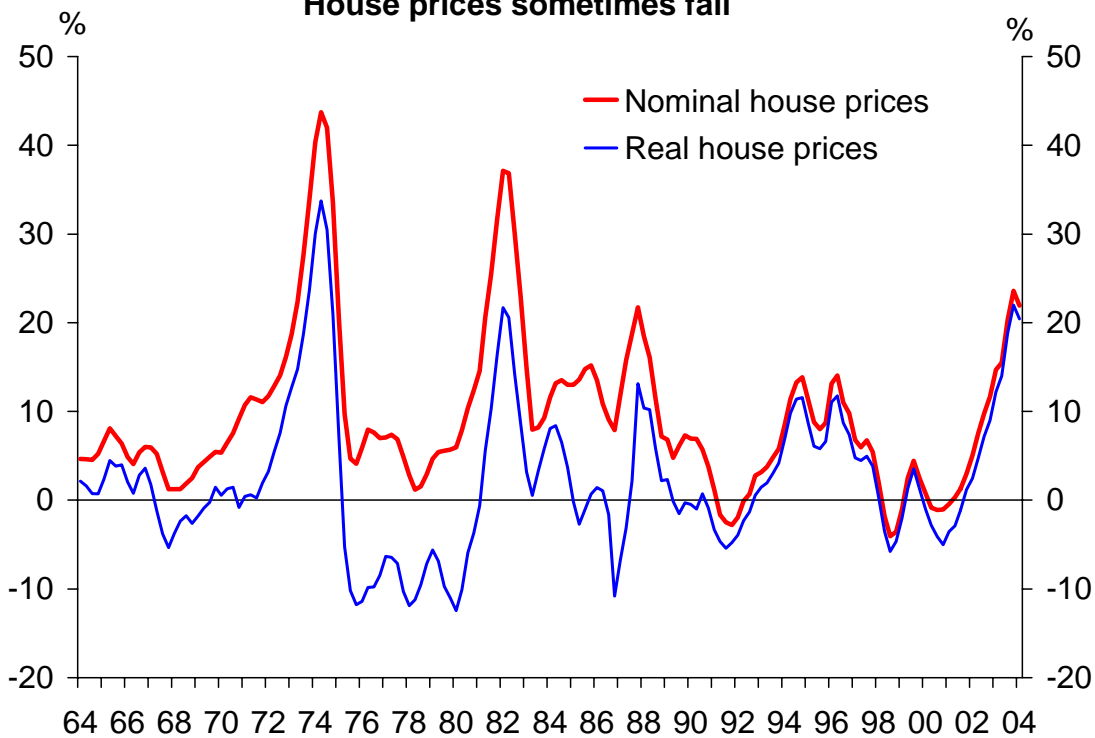


Rents don't rise nearly as fast as real estate promoters say. Quite often, they rise more slowly than inflation – whenever the red line is below the blue one. Twice recently rents have actually fallen – whenever the red line goes below zero. Now that inflation is low, that could easily happen again.

Nor can you count on house prices always rising.

SLIDE:

## House prices sometimes fall



Sources: Quotable Value NZ, Statistics NZ, RBNZ.

Real prices have fallen often – whenever the blue line is below zero. But lately, with lower inflation, nominal prices have fallen too. And they almost certainly will again at some point.

Geared property investors always say that if house prices fall, they simply won't sell. Consider this, though. If interest rates rise, OR the roof needs replacing, OR tenants wreck the place, OR the house is empty for weeks, OR the owner loses their job and they needed that income to keep the rental going – there are a scary number of possibilities – they might HAVE to sell, regardless of house prices. I've heard of more than one family that has had to sell for less than their mortgage. They ended up with no asset and still owing money to the bank.

Perhaps shares would be better? But, people say,

SLIDE **Misconception 3:** Shares are too risky.

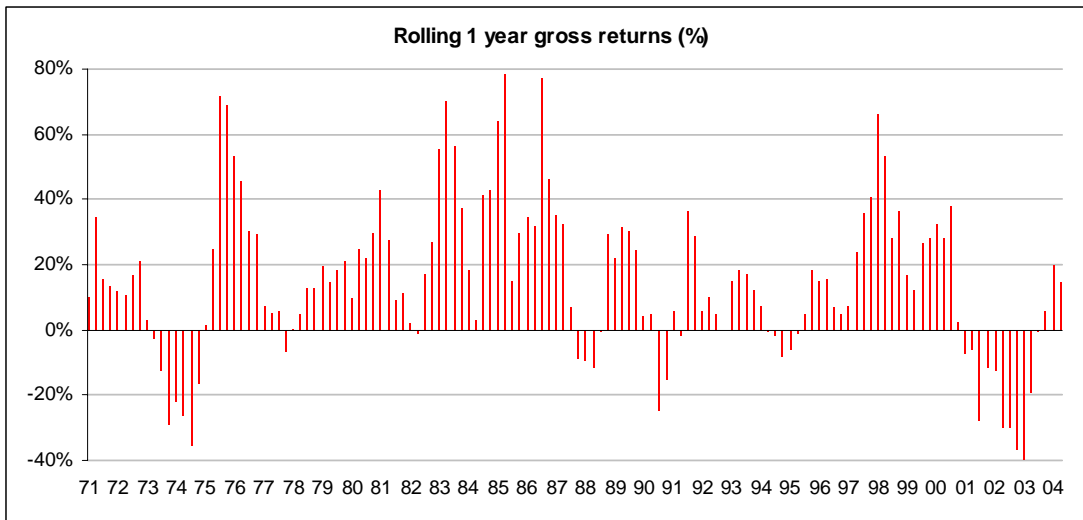
Many readers of my columns remember the 1987 crash as if it were yesterday. And nobody can guarantee that it won't happen again. But, by staying away from shares, people miss out on some of the best returns available.

They can invest safely in shares if they do two things:

Diversify widely, preferably including international as well as NZ shares

AND.... Take a long-term view.

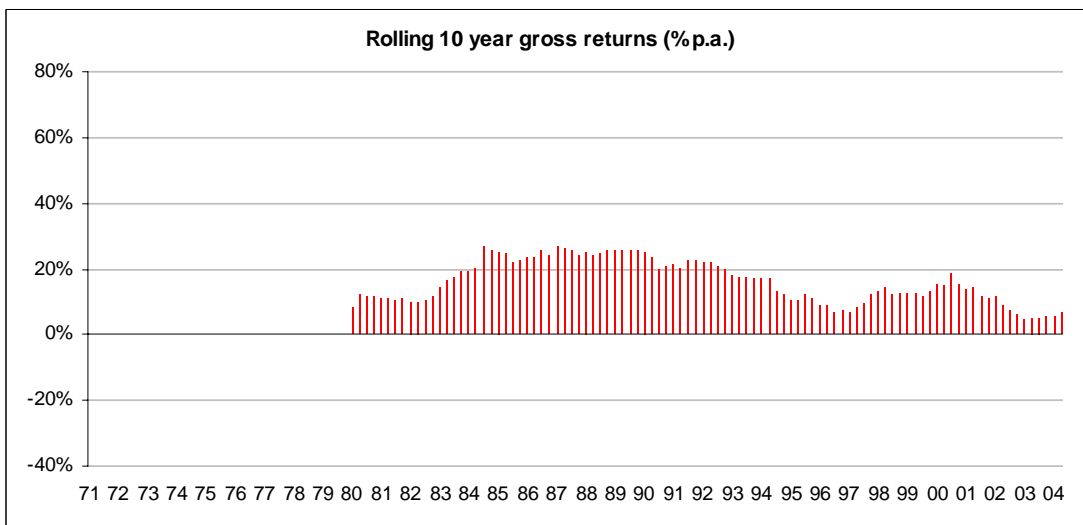
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These are annual returns on world shares since 1971. They range from almost 80% to minus 40%. No wonder investors are scared of world shares.

But, if they take a 10 year view:

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When you take a longer-term view, the 80% returns are gone, but so are the losses. If you stay in world shares for 10 years or more, you'll probably do well.

Then we have those who are OVERLY confident about shares.

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**Misconception 4:** It's easy to pick when to buy and sell shares. Just read the papers, and brokers' reports.

In fact, people often get market timing wrong.

SLIDE If you're in and out, you might miss out

Average annual returns 1992 to 2002 on the S&P500

Over 10 years, there were more than 2500 trading days.

If you were in the market all the time, your return was 10% a year.

If you missed just the 5 best days 7.5%

... the 20 best days                      3%  
 ... the 30 best days                      1%.

You could argue that, if you're in and out of the market, you would also miss some of the WORST days.

But given that, over the long term, there are more good days than bad, you're better off getting in and staying in – especially in NZ, where your gains might be taxed if you trade often.

A related problem is the tendency to chase winners. Ask people at the football or at a barbie what's the best investment, and a huge number will say whatever has been doing well in the last few months.

**SLIDE Misconception 5:** If an investment has performed well lately, get on board! If it's been diving, get out.

SLIDE: Should you go with last year's best performer?

Start with \$10,000 in 1982

Your options: Cash, NZ shares, NZ property, international shares

If each year you move the money to last year's *best* performer, today you will have \$70,000.

If you move the money to last year's *worst* performer, today you will have?

\$207,000.

I'm not suggesting people SHOULD chase the losers. Apart from the expense, tax and hassle, it's not easy, psychologically, to move money from winners to losers. Most people should establish their best long-term asset allocation and stick with it.

There's a similar situation with share funds.

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1984 – 2002

S&P500 grew 12% a year

Return for average investor in a US share fund: 2.6% a year

Research showed: People moved into funds that did well in the previous 12 – 18 months and ...

... out of funds that were often just about to perform well.

Again, the message is: select a good fund and stick with it.

**SLIDE Misconception 6:** If you can deduct an expense on your tax return, it costs you nothing.

This commonly occurs with rental property. People happily spend on rates, insurance, mortgage interest, maintenance and perhaps property management. They think that because they can deduct the items, the IRD has paid for them.

Let's look at what really happens with, for example, interest payments.

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**How much does 8% interest cost you, after you've taken the tax deduction?**

<u>Taxable income</u>	<u>Tax bracket</u>	<u>Multiply 8% interest rate by:</u>	<u>After-tax cost</u>
Less than \$38,000	21 %	0.79	6.3 %
\$38,000 - \$60,000	33 %	0.67	5.4 %
More than \$60,000	39 %	0.61	4.9 %

Even after you take your deduction, more than half the interest – or any other expense, for that matter – comes out of the investor's own pocket.

Enough misconceptions! You get the picture.

What can we do about all this misinformation?

The answer is obvious, education. And from the hundreds of letters I receive for my Herald column, I know there's a big thirst for it.

There are plenty of sources of education, such as financial institutions and advisers. The problem is that many people don't trust them. They worry – and often rightly so – that industry players are pushing their own products, or trying to generate fees for themselves.

But you people, as employers and people who run super schemes, are different. Employees and scheme members trust you much more than strangers. As long as you provide the info yourselves, or get it from an independent source, employees can rely on it.

You can do it pretty cheaply, too, for just a few dollars per employee per year. If the education helps scheme members make wiser investment decisions, those few dollars could be worth much more to them than several hundred or thousand dollars worth of employer subsidies.

They'll like you for it, too. You're giving them knowledge and power, not just for themselves, but also information they can give to family members.

From your point of view, a good education programme will help you retain members and attract new ones. A while back, Mercers did a global survey of defined contribution plans. Amongst its key findings:

SLIDE "Organizations that rate their plans as highly successful are more than twice as likely to have an educational approach to member communication that those rating them as only somewhat successful." Mercer Human Resource Consulting & Mercer Investment Consulting

If you don't want to do the educating yourself, there are options. One near and dear to me is my quarterly newsletter Holm Truths, which is written for employees, super scheme members and the like.

It offers easy-to-understand IMPARTIAL information on basic concepts – for 80c or less a copy.

Whether you do it yourself or use an outside independent source, the main point is: You are in a unique position to give your members TRUSTWORTHY information that many of them sorely need.

Their ignorance is not only costly to them, but ultimately to all of us. If New Zealanders handle their money wisely, we all benefit.

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Quote: "If you think education is expensive – try ignorance." Derek Bok, former president of Harvard University