COMMON FINANCIAL ADVICE

Sense or Nonsense?
This week, we explore the merits of some oft-touted financial advice  

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A lot of personal finance advice that you hear from "experts" will probably serve you well. Still, thinking the advice through would be wise; if possible, check it out to see if it applies to you. Sometimes, you can argue things differently, yet rationally.

Property is a good investment

It's not news to you that investing in property in Singapore has provided handsome returns. And you often hear predictions that property investments will continue to give "decent" returns.

Well, here's a surprise from financial planner ipac. It crunched the numbers and discovered that previous gains for private property that seemed extraordinary are actually quite down-to-earth.

The gains were just 4.1 per cent compounded annually between 1983 and 2003, based on the URA Private Property Index. A compounded gain means in the first year, the asset grew, say, 4.1 per cent. In the second year, the enlarged asset value grew at the same rate. The pattern continues in subsequent years.

If you had bought a $300,000 condominium at the start of 1983, it was worth $698,000 by the end of 2003 based on that rate of gain.

After you count mortgage interest, stamp duty and other costs, the return is significantly lower, says Ms Carly Tan, a certified financial planner at FPP Financial Advisers.

Then there is inflation, which shaves 1.4 percentage points off the 4.1 per cent return.

Inflation eats into the returns of other assets but, as the ipac study found, global shares yielded gains that pulled sharply ahead of inflation.

Global shares — as represented by the MSCI World Index — grew 10.9 per cent a year. A $300,000 investment would have snowballed into $2.634 million — yes, about eight times as much — in the same 21-year period.

Ms Tan says there is a number of global funds available in Singapore investing in the stocks that comprise the MSCI index, or using the index as a benchmark by which investors can measure the funds' performance.

Insure yourself against everything

If your family has a history of certain diseases such as heart attacks, you are well-advised to take out insurance cover against them.

If being hospitalised for a major illness will break your piggy bank, it makes sense to take out insurance.

But would you insure yourself massively if you had significant assets? What if you were as healthy as could be?

Mr Ang Hao Yao, 32, has thought through these questions, and decided to buy just one insurance policy, fending off the occasional persistent insurance agent's call.

His policy is from NTUC Income, and covers hospitalisation and some outpatient hospital treatment.

"I exercise regularly and have no health issues. But health problems are unpredictable and hospitalisation costs may rise, so I have the NTUC policy," says Mr Ang, a qualified taichi instructor.

He pays $126 a year premium.

Mr Ang, who is also an equity investor with a master's in business administration and chartered financial analyst qualifications, says: "When I die, my investment portfolio will go to my dependants. That's my insurance."

He adds: "For someone with a net worth of $2 million to $3 million, an insurance payout of $100,000 to $200,000 would not be significant to his beneficiaries."

Large insurance coverage is good to have, but it comes at a cost, he notes. "Rather than pay hefty insurance premiums, if I invest the money for an 8-10 per cent return a year, I'm sure I'll be better off in the long run."

You need at least $1 million to retire on

For many people, the $1 million that some financial planners say is necessary for retirement spending, is never going to be achievable.

What then?

The commonsensical answer from Ms Anne Tay, OCBC Bank's vice-president of wealth management, is: "At the end of day, how much you need depends on the lifestyle retirement that you would be comfortable with. You know yourself best."

What about the 70 per cent

How returns of asset classes compare

| Date | % Domestic shares | % Global shares | % Global benchmark | % Property | % CPI | % S & P Bank | % S & P 500
|------|------------------|----------------|-------------------|-----------|------|-------------|-------------
| 1983 | 25.7             | 24.2           | 7.8               | 8.5       | 1.55 | 7.5         | 10.8        |
| 1984 | 27.4             | 8.7            | 10.9              | 11.0      | 0.76 | 5.6         | 11.1        |
| 1985 | 22.5             | 17             | 23                | 9.5       | 0.76 | 6.1         | 10.2        |
| 1986 | 57.6             | 47.5           | 27.3              | 3.5       | -1.38 | 4.3         | 10.9        |
| 1987 | 42.7             | 71             | 8.7               | 14.6      | 1.52 | 3.8         | 10.7        |
| 1988 | 40.1             | 31.4           | 28.3              | 11.7      | 1.51 | 4.2         | 10.6        |
| 1989 | 31.6             | 14.8           | 2                 | 12.6      | 3.21 | 5.2         | 10.5        |
| 1990 | 19.7             | 34.8           | 3.4               | 1.3       | 3.02 | 6.5         | 10.9        |
| 1991 | 28.2             | 10.9           | 7.9               | 18.1      | 2.88 | 4.7         | 10.6        |
| 1992 | 21.1             | 3.5            | 6.9               | 16.1      | 1.79 | 2.7         | 10.4        |
| 1993 | 68.2             | 20.8           | 11.1              | 36        | 2.53 | 2.5         | 10.3        |
| 1994 | 12.2             | -4.3           | 7.3               | -4.2      | 12.9 | 3.7         | 10.7        |
| 1995 | 3.4              | 17.7           | 15.5              | 10.3      | 0.83 | 2.6         | 10.3        |
| 1996 | 3.9              | 12.7           | 2.5               | 5         | 1.96 | 2.9         | 10.1        |
| 1997 | 24.3             | 40              | 12.4              | 2.33      | 4.2  | 2.5         | 10.3        |
| 1998 | 7.6              | 22.2           | 12.9              | -3.4      | -1.49 | 4.9        | 10.4        |
| 1999 | 7.8              | 28.6           | 13.4              | 3.4       | 0.97 | 2.7         | 10.3        |
| 2000 | 22.3             | -9.3           | 5.8               | -1        | 2.1  | 2.5         | 10.3        |
| 2001 | 15.7             | -8.1           | 5.4               | -1.7      | -0.59 | 1.8        | 10.2        |
| 2002 | 17.4             | -24.4          | 12.3              | -1.8      | 0.39 | 0.9         | 10.1        |
| 2003 | 36.6             | 21              | 12.5              | -2        | 0.79 | 0.7         | 10.0        |

Annualised 21-year return: 4.5, 10.9, 9.6, 4.1, 1.4, 1.0, 0.9

1. DBS 50 Index from March 83 - January 95 & Straits Times Index from February 95 to December 01
2. MSCI World Index
3. Citigroup World Government Bond Index
4. UBS Private Property Price Index (does not include rental yields)
5. Singapore Inflation (Consumer Price Index)
6. Three-month Singapore inter-bank rates

Source: IPAC Financial Planning Singapore

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of your last drawn salary that financial planners often say you will need?

If you last earned $5,000, do you really need $3,500 a month in retirement when you don’t have expenses such as a mortgage and children’s education to worry about?

"That 70 per cent figure is recommended to maintain your current lifestyle. If you are willing to downgrade or change your lifestyle, you may not need 70 per cent," says Miss Tay.

But if you want to retire early, and want to have few or no money worries, you need to save and invest — whether it’s $500,000 or $1 million or $1.5 million.

In a Singapore Management University (SMU) survey this year, Singaporeans aged 55 were found to have on average of about $120,000 in liquid assets, inclusive of CPF cash savings.

That translates into $500 a month for the next 20 years — just enough for a simple lifestyle in retirement.

You should pay off your mortgage fast

IT’S all well and good to try to get that monkey of a mortgage off your back, but consider first if you have other debt that is being charged much higher interest rates.

A housing loan is the last loan that you should repay, says certified financial planner Dennis Ng.

The interest rate is the lowest you can get for any loan, he says. It’s around 2.5 per cent currently; on a car loan, the rate is twice as much.

"While reviewing the financial situation of clients, I’ve come across people who reduce their housing loan while buying a new car and taking up a car loan," says Mr Ng. "This does not make any financial sense at all." If you have a renovation loan, it would be something to settle early as it costs you 7 per cent in interest a year.

Credit card debt ranks up there in priority as you get charged up to 24 per cent in interest a year.

You should diversify your investments

IT’S hard to argue with this oft-quoted advice — unless you are a savvy investor.

In that case, the advice doesn’t make sense because you invest your money where you have expert knowledge.

You have the discipline to buy only when an asset is grossly undervalued.

And you don’t borrow to invest, and can wait patiently for your investments to make gains.

In short, you have the investment attributes of billionaire Warren Buffett, 75.

In his letter to shareholders this year, he revealed how concentrated the stock investments of Berkshire Hathaway, of which he is chairman and the largest shareholder, are.

Just 10 stocks made up 85 per cent of Berkshire’s total shareholdings in listed companies worth US$37.7 billion ($63.9 billion), according to the letter (which is posted at www.berkshirehathaway.com/letters/2004ltr.pdf).

Mr Buffett once said: "Wide diversification is only required when investors do not understand what they are doing."

You should start investing early

HOW very true. There’s no argument here: Start investing early, stay the course long enough, and you reap the benefits of what is widely described as the eighth wonder of the world — compounding.

Compounding, whose mechanics were explained earlier in this article, is simply an investor’s best friend.

Associate Professor Benedict Koh of SMU says there are three ways to grow wealth: Reap high yields from your assets, invest large sums of money, or invest for long periods of time.

Of the three, the last one is the most important, he says.

"If you invest in something that can grow consistently, the future value in 20, 30 years is many times the original. It’s a staggering figure because it grows exponentially."

Start with $10,000. If invested in an asset that grows at 10 per cent a year, it will reach $41,772 after 15 years.

But if invested for twice as long, namely 30 years, the sum rockets to $1,744,494 — a four-fold spike.

That’s the magic of compounding.

If you have high yields, large capital and long time periods working for you, you have Mr Buffett’s magic formula for enormous wealth.

He has a net worth of about US$40 billion, all made through investments spanning about 50 years.

Start early, and you reap another benefit: the option to pick and choose when you want to exit your investments.

 Says Prof Koh: "If you start investing at 50, you can’t exit too early or you won’t get the gains for your retirement spending. But if you start at 25, in 20 years’ time, your money would have grown a lot, allowing you to choose your time to exit.”

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