HOLM TRUTHS

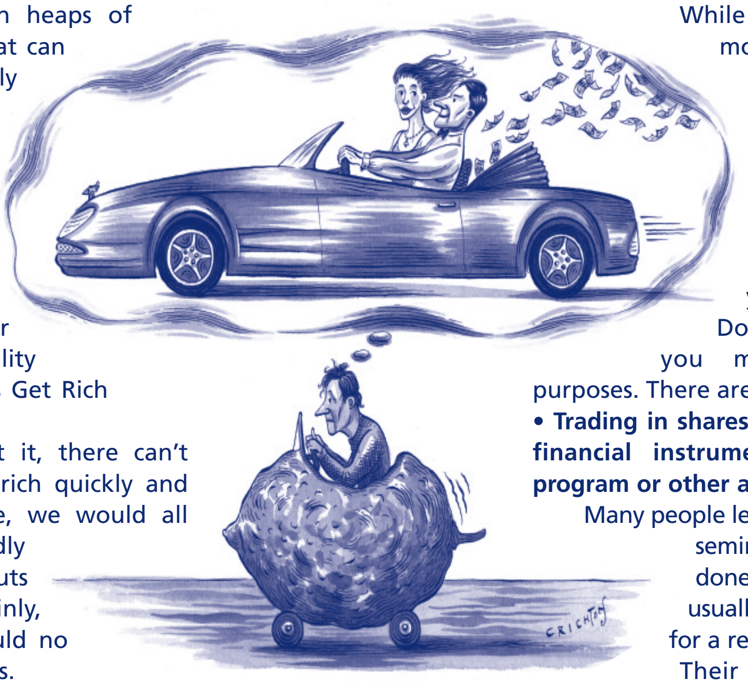
Down to earth advice for savers and investors from independent investment commentator Mary Holm

SUMMER 05-06

Can you get rich quick?

Many of us dream of overnight wealth. Even those who don't feel the need for much more money could, no doubt, find worthy causes to give the money to if it suddenly fell in their lap.

The only trouble is that most people can't get rich quickly without putting in heaps of time and/or taking risks that can also make them poor quickly – unless they inherit, are unusually lucky in a lottery or gambling, or commit a crime!



The few exceptions are people with unusual talents, perhaps in the creative arts, sports or IT, or those with a particular ability to sell something – such as Get Rich Quick books!

When you think about it, there can't be other ways of getting rich quickly and comfortably. If there were, we would all do them. That would rapidly push up the price of inputs and spread the gains thinly, to the point that they could no longer be regarded as riches.

We less talented folk, then, are left with the following options (apart from breaking the law!):

- **Investing heavily in start-ups, mining or hi-tech companies or other high-risk shares**

It's quite possible to gain hugely – or lose all your money – by investing heavily in a single high-risk company. You can, though, reduce the chances that you will come a cropper if you spread your money over several such companies.

Sure, that will also reduce the likelihood you will do enormously well. But it's a good risk/return tradeoff.

While high-risk companies are more likely than others to go belly up, many don't. They struggle along, sometimes for years, and then do well. It might be a case of getting rich slowly. So patience greatly improves your chances.

Don't, however, use money you might need for other purposes. There are absolutely no guarantees.

- **Trading in shares, options, futures or other financial instruments, using a computer program or other analysis**

Many people learn about these methods at seminars. And some claim to have done well with them – although usually they have been trading for a relatively short period.

Their early success, which is probably simply luck, prompts them to invest more. Often they end up with substantial losses.

Others are less successful from the start, but the seminar promoters claim that is because they haven't followed the system closely enough. They press on, more diligently, and might do well for a while. But only for a while.

Many claims are made for trading financial instruments. I've yet to be convinced that any of them work – especially after you allow for the high costs of frequent trading and possible tax on capital gains, to say nothing of the costs of the training, computer programs and so on.

Ask yourself: If somebody does find a way to make money by analysing markets, why would they share their

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LOTTERIES, HORSES & CASINOS

The quickest and easiest way to get rich is to win at gambling.

Remember, though, that the people who run these activities need to cover their costs and make a profit before they pay out prizes.

That means the average gambler will, over time, put in more money than he or she wins.

Unless you are unusually lucky, or perhaps in some cases have more knowledge than most people, gambling won't make you rich.

Still, you may be willing to lose more than you gain in exchange for the entertainment.

(CAN YOU GET RICH QUICK?, CONTINUED)

secret with strangers? Why not just stay home and get rich themselves?

• Starting a new business with the aim of making lots of money fast

To do this you need to spot a gap in the market for a product, service, or better way of doing things – and fill it in a profitable way.

You need to be confident that enough people will want what you offer – or you should at least have sound plans to convince them of that!

You will probably also need: lots of time and energy; a good business strategy; a competitive advantage so that others can't just copy you; and start-up capital or at least enough savings to keep you alive while you work on the business.

It's possible to get rich quickly with a business, but nobody claims it's easy.

• Making highly geared investments, using a mortgage or other loan, with the aim of short-term gain

You get the market return not just on your deposit but also on the borrowed money, which might be many times your deposit.

For example: You put in $10,000 and borrow $90,000. The return is 8% a year, so the $100,000 grows to $108,000.

The $10,000 you have put in has grown to $18,000 – by an impressive 80% – in one year.

But – you have to pay interest.

The key to getting rich with borrowed money is to make a much higher return – including both ongoing income and capital gain – than the interest you pay.

Such high returns generally come only on investments whose value fluctuates, such as property and shares.

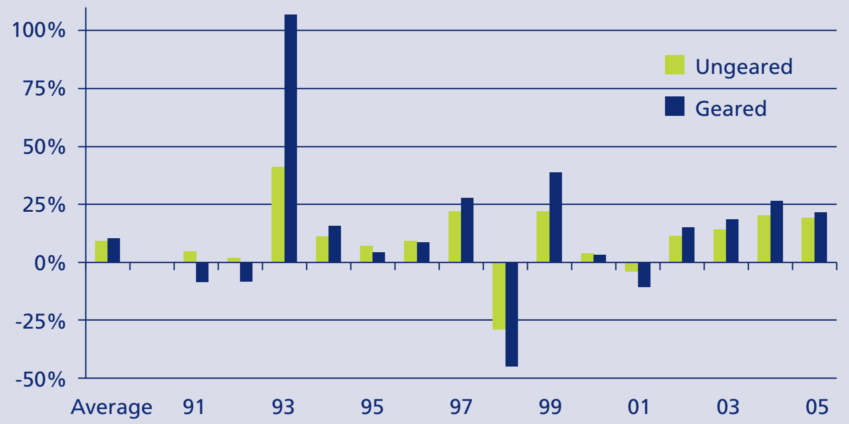
It's very important, then, to be sure you won't be forced to sell at a time when the market happens to be down.

Consider possible cash flow problems: a decline in dividends or rent; loss of income from other sources; or the unexpected need to spend more on your investment, such as for property maintenance.

If you would have to sell your geared investment in those circumstances, you are taking high risk.

It's possible, too, that the value of your investment will fall permanently below your original price – especially with shares. Spreading your money across many shares greatly reduces this risk.

GET RICH BY GEARING?



The graph shows the annual after-tax return on a diversified investment in NZ shares for which you have borrowed $3 for every $1 of your own money, versus an ungeared investment. We assume you borrow by adding to your mortgage, so the interest rate is the floating mortgage rate. All net dividends are reinvested.

Generally, a geared investment is more volatile. If you're lucky enough to gear your investment in the right period, you can make more money. For example, if you invested $100,000 – made up of $75,000 borrowed and $25,000 of savings – in September 2001, you would have almost $65,000 four years later, after you had paid back the loan. That's growth on your $25,000 of almost 27% a year. But if you had simply invested the $25,000, it would have grown to about $45,000, growth of 16% a year.

However, there are also periods when:

• The share market falls and geared investments fall further, eg 1998 and 2001.

• The share market rises, but the return is not as high as the mortgage interest rate, so the ungeared investment does better, eg 1995.

• The share market rises a bit, but the mortgage rate is so much higher that the ungeared investment gains but the geared investment loses, eg 1991.

Over the whole period, September 1990 to September 2005, a geared $100,000 investment ($75,000 borrowed and $25,000 of savings) would have grown to almost $106,000 after you've paid back the loan – growth of 10.1% a year. An ungeared $25,000 investment would have grown to $92,000, growth of 9.1% a year.

Given that over the long haul we expect share returns to be higher than mortgage interest rates, geared share investments will usually outperform ungeared investments over long periods. But by no means always! And don't forget to take into account fees and risks.

Still, even after diversification, you need to face the fact that returns are unforeseeable on both property and shares. And if you have to sell your investment asset at a loss, you can end up still owing money to the lender.

People who have used their home as security for a loan have sometimes been forced to sell it.

Even when things aren't that bad, you might still pay more in interest than you gain from gearing, leaving you worse off than if you had simply invested your own capital.

Conclusion

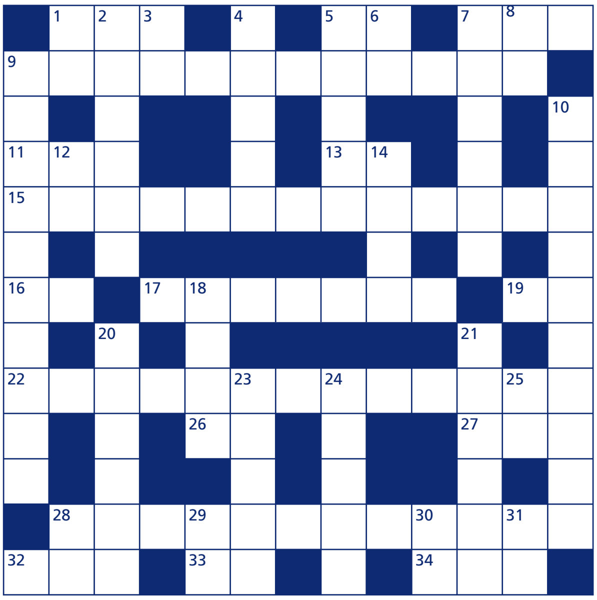
All Get Rich Quick ideas involve risk, sometimes lots of risk. That's not bad in and of itself. But it could leave you broke.

Most also require lots of time and effort – which means foregoing other income you could have made using that time and effort.

It's a good idea to work through a worst case scenario and know you could cope with it.

If you have what it takes, I wish you that other key ingredient: good luck!

"Here is exactly how to get rich quick. Count your blessings. What? You have no blessings? Oops! Think again! Everyone can find some blessings if they but look more closely." Rev Lucinda Schersing



Solution: Back page

HOLM TRUTHS CROSSWORD SUMMER 2005-06

ACROSS

1. Crazy (3)
5. Compass point (initials) (2)
7. Cry (3)
9. Suddenly become wealthy (3,4,5)
11. Women's undergarment (3)
13. _ _ I were you (2)
15. Housing (13)
16. 0.62 of a mile (abbrev.) (2)
17. I nag Reg (anagram) (7)
19. Hello! (2)
22. Disagreeable (13)
26. Drivers' organisation (initials) (2)
27. Bolted (3)
28. The cost of a loan (8,4)
32. NZ sales tax (initials) (3)
33. Belonging to me (2)
34. Fuss (3)

DOWN

1. I (2)
2. Assault (6)
3. Medical practitioner (abbrev.) (2)
4. Get lost! (5)
5. Sea creature (5)
6. France, Germany, Italy etc (initials) (2)
7. Beautiful (of a landscape) (6)
8. All right (2)
9. Opposite to 9 across (2,8)
10. Fenced icon (anagram) (10)
12. A Christian church (initials) (2)
14. Light brown (4)
18. Girl's name (4)
20. Way of pronouncing (6)
21. Overseas (6)
23. Sprite (5)
24. To cook in an oven (5)
25. Big US city (initials) (2)
28. Exists (2)
29. Printer's measure (2)
30. Egyptian sun god (2)
31. Opposite to "from" (2)

From the Mailbox

You can overdo caution.

Spend principal as well as interest in retirement.

A simple calculation shows how much to spend.

Dear Mary:

I am 82 and my wife is 78. We have a mortgage-free home and no other debt.

Our day-to-day living expenses are covered by NZ Super and a small company pension. In addition, we have term investments of $900,000. Most of that is in several banks, but $80,000 is in a finance company.

We make a point of spending all our interest on travel, helping relatives and generally living a pleasant life. We never touch the capital, i.e. our investments pay quarterly spending money. Unfortunately, we have a continuing lack of financial confidence.

Are we spending too much, or maybe too little? We have no children.

I realise it all depends on the rate of inflationary effect on the capital, how long we both live, how long we have to spend in a nursing home, gardening help, housekeeping help etc etc.

All jolly good questions, and I can hear you crumpling this letter up and thinking, "How the hell can I be expected to answer such ridiculous imponderables?

But wait, Mary – how the hell can an old guy like me set about it if you find it unanswerable?

Somehow such financial problems just have to be solved by everybody in the fullness of time. Your comments really would be appreciated.

Dear Reader:

Caution is good, but it can be overdone. Just as some overly cautious younger people put all their retirement savings in bank term deposits, so some overly cautious retired people spend too little. And you are amongst them.

Presumably you have worked hard to build up your considerable nest egg. Now is the time to enjoy the fruits of your labour.

The big worry, of course, is that if you spend your capital, you might outlive your money.

In your case, that's not too serious, as you have not only NZ Super but your company pension to fall back on. Still, it would be comforting to know your savings will last the distance.

I assume that the sale of your home, after you both die, will take care of any legacies you plan to leave.

You haven't got children, but even people with offspring sometimes decide that their home is enough of a legacy for their family.

So let's spend your $900,000!

Given that you've got plenty to come and go on, I suggest you set aside a generous amount, $50,000, for emergencies. That leaves us with $850,000 to play with.

How long will you live?

An internet calculator tells us that the average man of 82 will live seven more years (rounded up), and the average woman of 78 will live eleven more years.

But that's not really good enough. Half of us live longer than average. So let's look at the ages beyond which only 25% of people live. For you it's 91; for your wife it's 92.

For the moment, then, we'll assume that you've got another 9 years and your wife another 14 years of life.

A simple way to work out how much of your savings you can spend each year is to divide the $850,000 by 14 years, which comes to about $60,700 year.

What about the interest you earn on your unspent balance? We're assuming, very conservatively, that the after-tax interest will be about the same as inflation. That means that you can increase the $60,700 by the inflation rate each year.

Take that money firstly from your after-tax interest and then from term deposit principal. You might set up your deposits so they mature at

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HELP ON THE INTERNET

You can get more detail on how much money you can afford to spend in retirement by using the "Managing your nest egg" calculator on the Retirement Commission's website, www.sorted.org.nz

It calculates your life expectancy, and tells you how much you can spend if you want to use interest, dividends, rent and other income only; use up your savings in equal amounts each year; use up your savings but spend 5% less each year, and so on.

Couples can also allow for a decrease in spending after the first person dies.

(FROM THE MAILBOX, CONTINUED)

regular intervals to make this simpler.

These numbers might disappoint you. You're probably receiving somewhere around $60,000 a year, before tax, on interest alone these days.

But the tax makes quite a difference. So does the fact that, under our proposed plan, your spending can increase by inflation.

Still, given that after-tax deposit interest is a fair way above inflation these days – and given that you are likely to want to spend less in future years – it wouldn't be foolish to err on the generous side now and spend, say, $65,000 or $70,000 a year for a few years.

And you could quite justifiably blow $100,000 on a world trip or two in the next little while.

Keep an eye on how you are doing by making the same calculation as above every year or so. If your health stays good, you might want to push your life expectancy up by a year every few years.

Potential worries:

• Gardening and housekeeping help
When you can no longer do these tasks yourself, you are likely to be spending less on travel, entertainment and so on. Your $60,000-odd should cover that comfortably.

• Nursing home expenses
Care in a high-quality home typically costs around $40,000 a year for one. If you are both in a home, you could cover the extra costs by selling your home. If all else fails, the government will pay for you.

• Living to an unusually old age
One way to deal with this is to plan to leave a certain amount to charity. Subtract that from the $850,000 before making your calculations. Then, if you run out of spending money at 90, 95 or 100, you can become the charity! Or you can make use of the equity in your home. Possibilities include: a home equity release scheme; moving to a cheaper home; subdividing; taking in a boarder; or converting part of your home to a flat.

• Finance company failure
You have $80,000 invested in a finance company. Even if it's a lower risk company, there is still some chance it will fail.

Note, too, that the amount is relatively small. Assuming the company doesn't fail, the extra return won't make much difference to you anyway.

Given your strong position financially, I suggest that when that investment matures you transfer the money to a bank. You don't need the worry.

Someone of your age with more financial knowledge might invest partly in high quality corporate bonds, which tend to have higher returns than term deposits. Again, though, you don't need to, so why bother.

"Prudence keeps life safe, but does not often make it happy." Samuel Johnson

Holm Truths Crossword Solution

	M	A	D		S		S	E		S	O	B
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	I	N	T	E	R	E	S	T	R	A	T	E
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You're welcome to send questions to From the Mailbox. Email them to maryh@pl.net, or mail them to P.O. Box 8520, Symonds Street, Auckland. Please include your phone number. Unfortunately, Mary can't answer all questions in Holm Truths, and cannot correspond directly with readers.

WRITER AND PUBLISHER

Award-winning journalist Mary Holm writes the *Money* column for the NZ Herald and *The Investor* column in the Waikato Times, Dominion Post, Christchurch Press and other major newspapers. She runs seminars, and is the author of *Investing Made Simple* (Penguin, $27.95, at good bookstores) and *Snakes & Ladders – A guide to risk for savers and investors* and *The REAL Story – Saving and investing now that inflation is under control* (both published by the Reserve Bank. They can be downloaded from www.rbnz.govt.nz. Click on publications.). Mary holds a BA in economic history, MA in journalism and MBA in finance.

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