HOLM TRUTHS

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

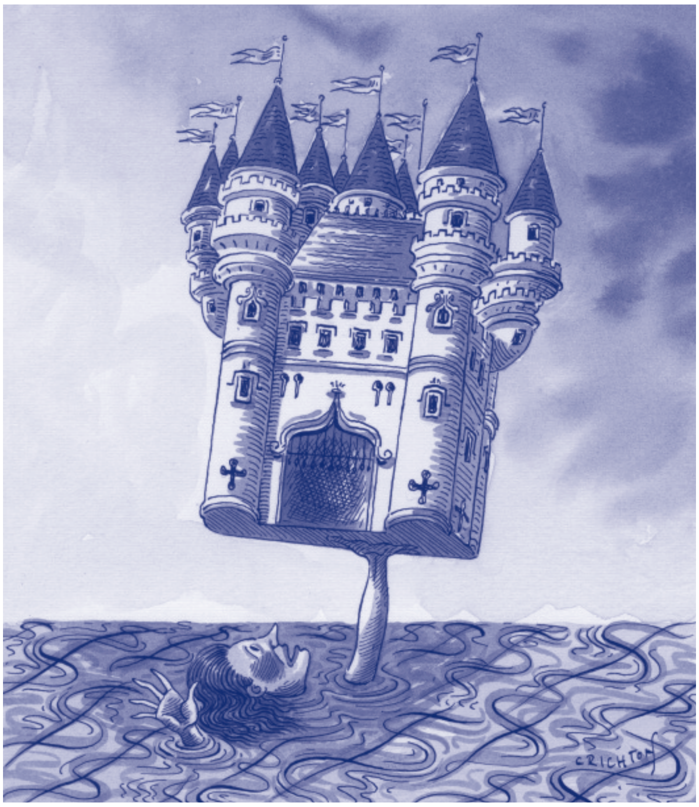
AUTUMN 2006

Stuff and happiness

A woman I know wasn't sure what to do. Should she renovate her current house, or move to a cheaper suburb and buy a house that was already up to the minute? She preferred to stay put, but would have to borrow to renovate and wasn't sure if she could afford to repay that debt.

"How about saving for a while until you can do up your house without borrowing?" I suggested.

"Oh no," she replied. "The place has to be renovated now." She ended up taking out the loan and struggling with the repayments – to say nothing of spending a considerable sum on interest.



In a recent survey by the Retirement Commission, more than a quarter of the respondents said their greatest difficulty around managing money was that they didn't have enough. But how much is enough?

Did that woman really have to have the latest in interior design? Do others have to have a plasma TV, a new car every few years, or new clothes each season? Are many New Zealanders quite simply expecting a higher standard of living than they can afford?

And – the most important question of all – do all these things really make them happier in the long term?

I'm not denying that some families find it hard to buy their children a second pair of shoes. These days in New Zealand, it's reasonable to expect kids to have alternative footwear.

Above that income level, though, there are many people who say they can't save for retirement – or can't save *much* for retirement – because they "need" to buy things they don't need.

That's their choice. But I think it's worthwhile to challenge that thinking. Those who are willing to change their ways a little may find themselves facing a much more fun-filled and comfortable retirement.

In a telling study, students at Harvard University were asked whether they would prefer:

(a) $50,000 a year while others got half that, or

(b) $100,000 a year while others got twice as much.

More than half chose (a).

"Other studies confirm that people are often more concerned about their income relative to others' than about their absolute income," said the Economist magazine. "Pleasure at your own pay rise can vanish when you learn that a colleague has been given a much bigger one."

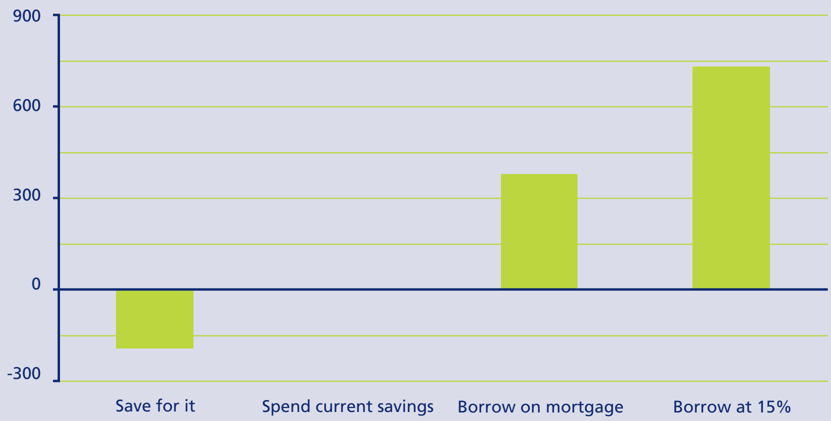
It's too easy to dismiss this tendency as a pathetic preoccupation with keeping up with the Joneses, or rather keeping ahead of them. Life is simpler if you have about as much money as the people you socialize with – whatever that level is.

(CONTINUED PAGE 2)

HE WHO HESITATES IS RICHER

Six questions to ask yourself before making a major purchase:

1. *Do I really need this?*
2. *If not, will I regard it as a worthwhile purchase in several months' time, or would it be better to save the money for a future purchase or even retirement?*
3. *Do I have the money to buy it with no borrowing?*
4. *If not, is it feasible to save until I've got the money – letting interest work for me instead of against me.*
5. *If not, how can I borrow at the lowest possible interest rate?*
6. *What will I give up in order to repay the loan as fast as possible?*



HOW MUCH OF YOUR OWN MONEY GOES INTO A $3,000 PURCHASE?

If you haven't got enough money to buy, say, a $3,000 TV out of your savings, you have several options:

• Save up for it. In our graph, we assume you save $78 a month, at 4.5% after tax, for 3 years. That would earn you about $190 in after-tax interest, and you would put in about $2,810.

• Add $3,000 to your mortgage. We assume you pay that extra amount off over 3 years, at 8%. Your extra monthly payments would be $94, and you would pay a total of $3,384 over the period.

• Take out a $3,000 personal loan at 15%. Again, we assume it is repaid in 3 years. Your monthly payments would be $104, and you would pay a total of $3,744 over the period.

With the second two options, of course, you have the pleasure of watching the TV sooner. But you pay quite a high price for that pleasure. The difference between the cheapest and dearest options is $934 – almost a third again of the $3,000!

Note that if you fund a purchase by adding to your mortgage, it's a good idea to pay off that extra money as fast as possible. If you simply pay it off along with the rest of the mortgage over many more years, you will pay much more interest on it.

***(STUFF AND HAPPINESS,** CONTINUED)*

Ask anyone who has changed countries and in the process switched to a lower standard of living. Often they will say they had just as good a time, if not better, as long as they mixed with people on similar incomes. They could all afford the same big night out.

But we can take this too far. Would your friends drop you if your coat, car or carpet weren't as flash as theirs? If so, do you want them as friends anyway?

What about your own feelings – the excitement of the first night you watch TV on your new big screen, or the first time you drive your new car with all its features? Research shows us what we already knew. We adjust quickly to such changes, and shortly afterwards we are no happier than we were before.

Let's look at what we find in a typical middle class house that we wouldn't have found a generation or so ago: a family room, more than one bathroom, a walk-in double garage, at least one computer, a fancy stereo, dishwasher, microwave, second TV set, many phones, and so on.

Despite the fact that families are smaller, homes are usually much bigger. The average 1977 house was 127 square metres, compared with 175 today, according to the Department of Statistics.

Also, we are much more likely to have more than one car per family, our bach is probably much more luxurious, and overseas travel has soared.

Admittedly, some of these items are cheaper than they were for our parents, especially after we adjust for inflation. But the price of the most expensive item of all, the home, has risen more than inflation, and so have some other items.

Are we happier with all this extra stuff? That's hard to measure, but it's certainly not clear that we are.

Before you buy another "must have" item that you don't really need – and particularly before you borrow to buy it and thus end up paying more for it – stop and think.

If you halve your spending on such items over the years, and put the saved money into retirement savings, you'll be freer with your spending at a stage in life when you'll have more time to enjoy what you buy.

What's more, your friends might appreciate your lowering the standards for them, too!

UNASSUMING BILLIONAIRES

Some of the world's richest people certainly live it up. But others live it down. Examples:

• Incredibly successful share investor Warren Buffett is the world's second richest man, according to Forbes – second only to Microsoft's Bill Gates. Buffett still lives in the house in suburban Omaha, Nebraska, that he bought in 1957.

• The founder of IKEA furniture stores, Swede Ingvar Kamprad, comes fourth on Forbes' list. He drives a 15-year-old car and flies economy class, according to The Scotsman.

• Ken Thomson, whose media conglomerate makes him easily Canada's richest man and the world's ninth richest, has been spotted in line at his local supermarket. He is said to use store coupons and buy his bread in bulk when it goes on sale.

• Li Ka-Shing, whose company recently discussed a possible joint venture with Christchurch City Council to run the port of Lyttelton, is Forbes' tenth richest man. He prefers cheap shoes and plastic watches, says the NZ Herald.

Others lower down the rich lists are similar. In their thought-provoking book "The Millionaire Next Door", Thomas Stanley and William Danko point out that many millionaires got rich by not spending much. Indeed, some of them, like Buffett, still live in "the house next door" and few people know of their wealth.

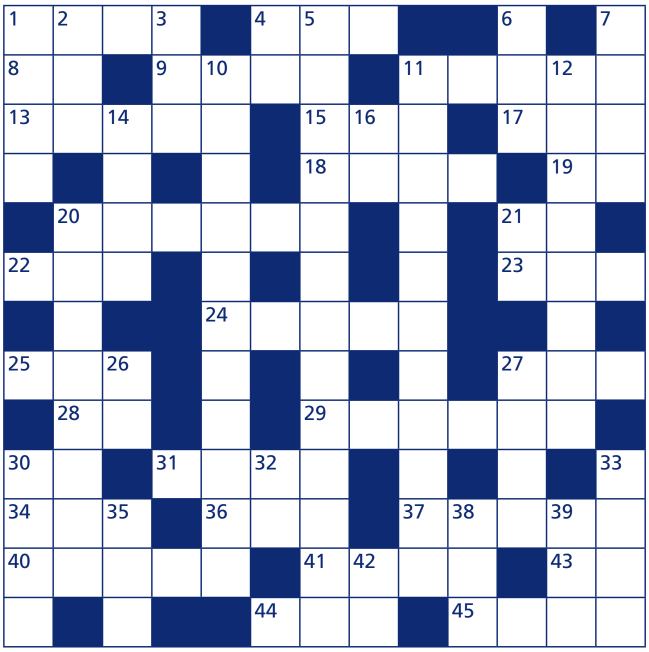
As Jonathan Clements, quoted below, puts it: "The folks with the big house, fancy cars and designer clothes are, no doubt, loaded. But they may be loaded with debt."

"The dollars you spend today are delaying your retirement."

Author and scriptwriter Jonathan Clements

HOLM TRUTHS CROSSWORD

AUTUMN 2006



Solution: Back page

ACROSS

1. Lease or hire (4)
4. Small insect (3)
8. Morning (initials) (2)
9. Summer flower (4)
11. Voter (anagram) (5)
13. Spring flower (5)
15. Sadness (3)
17. Neither/_ _ _ (3)
18. Nought (4)
19. _ _ and behold (2)
20. Earnings (6)
21. A degree (initials) (2)
22. A little more than 18 across (3)
23. And others (abbreviation) (3)
24. A fabric (5)
25. Precious stone (3)
27. Pixie (3)
28. About (2)
29. Ribbon-like food (6)
30. Myself (2)
31. Moving air (4)
34. Utilise (3)
36. Digit (3)
37. Topic or problem (5)
40. Tale (5)
41. See 20 down
43. Compass point (initials) (2)
44. Donkey (3)
45. Feeble (4)

DOWN

1. Rodents (4)
2. Like an ostrich (3)
3. Three (prefix) (3)
4. "_ _ You Like It" (2)
5. Us (3) (10)
6. Boy child (3)
7. Champion (4)
10. Chance (11)
11. Bank investment (4) (7)
12. Live a lot (anagram) 8)
14. Solo (4)
16. Offshore working holiday (initials) (2)
20. (with 41 across) Price of a loan (8) (4)
21. Exist (2)
26. Same as 30 across (2)
27. Trees (4)
30. Think (4)
32. Not yes (2)
33. Seven days (4)
35. Very long time (3)
38. Use needle and thread (3)
39. Country with biggest stock market (initials) (3)
42. Same as 4 down (2)

From the Mailbox

Dear Mary:

I am a 24-year-old who has been working for around 18 months after graduating from university.

I've managed to pay off a student loan and accumulated $10,000 in savings. I am now starting to look at investment opportunities.

I've got a real interest in property, but I am unsure about jumping into the market at the moment. Before I make any decision I am interested to see:

1. If there is going to be the slowdown in the market that has been predicted for some time.

2. The impact of many home owners coming off fixed interest rates over the next 6 months.

In the meantime I want to earn a decent return on my money. I've been looking round at other options such as term deposits and foreign exchange speculation, but I'm unsure on the best option for me.

I am interested to hear your answers to the following questions:

• Is my reluctance to get into the property market well justified?

• If you were in my shoes what would you do over the next the 12 months to help lay the foundations to become financially free at an early age?

- **House prices might fall soon, but they might keep rising slowly.**
- **In long-term investments, timing is not as important as it is over short periods.**
- **If you're in a strong position, take advantage of gearing.**
- **Foreign exchange speculation is highly risky.**

Dear Reader:

I'm afraid the answer to your first question is, "I don't know". And I would be wary of anyone who felt they could answer it.

It's impossible to accurately predict investment markets.

Everyone broadly agrees that house prices are unlikely to keep growing at the pace of recent years. But prices might do anything from falling fast to continuing to climb slowly. If they keep rising, you might be sorry you didn't buy now.

Perhaps a more important question is: How much does it matter?

If you are buying into shares, property or any other volatile investment for just a few years – a highly risky strategy – buying at a market peak can be devastating.

But if you buy for the long term, it doesn't make all that much difference. We would expect the value of your investment to rise regardless of when you started. And after many years of growth, the exact starting point is of less importance.

So *are* you buying for the long term? You will always need somewhere to live. True, you could rent for life and invest elsewhere, but as you are interested in property you probably want to own your home.

You will move house over the years. But as long as you stay in the same market, that doesn't affect our long-term perspective.

Another point: With property, you will borrow to invest – sometimes called gearing. That makes a bad investment worse and a good investment better. And as long as you are in for the long haul you can be pretty confident your investment will be good.

You are clearly in a position to

(CONTINUED PAGE 4)

HELP FROM THE GOVERNMENT

In considering his options, our young letter writer might take into account the subsidy for first home buyers in the KiwiSaver scheme, scheduled to start in April 2007.

The government will give $3,000 towards the purchase of a first home to people who have been in the scheme for three years. That will rise by $1,000 a year, to a maximum of $5,000 for those in the scheme for five years or more.

Scheme members will also be allowed to withdraw their own KiwiSaver savings to buy their first home. But they won't be able to withdraw the $1,000 initial contribution the government will make to everyone in the scheme.

Sounds pretty generous. But the big drawback is that our correspondent will have to wait several years to get the subsidy. It's probably not worth putting his plans on hold for that reason only.

Furthermore, there will be caps on household income and regional house prices. The figures haven't been announced yet, but they might make him ineligible.

(FROM THE MAILBOX, CONTINUED)

pay off a mortgage easily. So taking advantage of gearing is a good way to get yourself started on the road to financial freedom.

One good option for you, then, is to buy a house now.

What about your other options for the next year or so? The two you mention, term deposits and foreign exchange speculation, are at opposite ends of the spectrum as far as risk is concerned.

Foreign exchange movements are notoriously difficult to forecast. And speculating in forex is what is called a zero sum game. While half the speculators win, half lose. It would be quite possible to halve your savings over the next year, or even worse. I suggest you stay away.

Somewhat less risky are shares or share funds, but I don't like that idea either. As I said above, there is too big a chance you will lose money over a short period.

That leaves us with term deposits and other fixed income investments such as high-quality corporate bonds. The latter pay higher interest rates, but if you are investing for only a year or so that advantage is generally cancelled out by transaction costs.

In any case, the returns on good old term deposits are pretty high at the moment, relative to inflation. Indeed, if house prices do fall and you have parked your savings in term deposits, you will feel well pleased with yourself.

But what if house prices keep rising?

Either way – whether you buy a house now or invest in term deposits and then buy later – you may live to regret it. In neither case, though, is it a disaster.

I suggest you look around for a house, but gently.

Given that the property market is already a bit jittery, and we are heading into the slower real estate months, you are in a strong position to bargain with buyers. If you find a place that suits you, offer a low price. If the seller won't even negotiate from there, move on to another place until you get a good buy.

If that takes you a year or more, that's cool. You will be learning lots about the property market in the meantime.

P.S. Don't ignore shares or low-fee share funds once you get further down the track. It's important not to put all your long-term savings in property.

"If A equals success, then the formula is A=X+Y+Z. X is work, Y is play, Z is keep your mouth shut."

Albert Einstein

Holm Truths Crossword Solution

R	E	N	T		A	N	T			S		H
A	M		R	O	S	E		T	R	O	V	E
T	U	L	I	P		W	O	E		N	O	R
S		O		P		Z	E	R	O		L	O
	I	N	C	O	M	E		M		B	A	
O	N	E		R		A		D		E	T	C
	T			T	U	L	L	E			I	
G	E	M		U		A		P		E	L	F
	R	E		N		N	O	O	D	L	E	
M	E		W	I	N	D		S		M		W
U	S	E		T	O	E		I	S	S	U	E
S	T	O	R	Y		R	A	T	E		S	E
E		N			A	S	S		W	E	A	K

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.

Design and Production:
Scriven Art Studios Ltd., Auckland