SUPERLIFE
powered by SMARTSHARES

Level 15, 45 Queen Street, Auckland Central 1010

PO Box 105262, Auckland City 1143

Money Month Tips

August 2024

Author: Cameron Watson,
Head of Investor Education at Smartshares

What's your personal top tip for someone just starting their financial journey?

My top tip is to do three things: start early, invest regularly into a balanced portfolio and invest for the long term so compounding can work its magic.

Markets can be volatile, they move up and down. Investing a lump sum means you invest at a point in time, exposing you to what is called 'market-timing risk' – the risk that the market falls not long after you invest. People who invest in regular instalments over time can actually benefit from market volatility. If the market falls, they may be able to invest at lower prices, thus reducing their average purchase price. Investing regularly on autopilot is a great way to build up savings without having to lift a finger, and it also removes the emotion from your investment decisions – which is usually a good thing.

The benefit of starting early is that you will be investing for a longer time, and time is the fuel for arguably the most powerful force in investing, compounding.

Compounding is the process of earning returns on returns. If you invest $1,000 and earn a return of 5% your portfolio will grow by $50 and the value of your investment at the end of the year will be $1,050. Over the second year, if your portfolio again gains 5% your return will be $52.50. The return is higher by $2.50 because you earn the return not only on your original $1,000 but also on the $50 you earned last year (5% on $50 is $2.50). The power of compounding becomes more obvious over the long term. After 10 years the original investment would be worth $1,629, after 20 years $2,653.

Regular savers can benefit from compounding. Someone who can save $200 a month ($2,400 a year) for 30 years will invest $72,000 and, using an illustrative annual return of 5% (after tax and fees), their end value would be $163,075. This means over half (56%) of their end value would have come from compounded returns.

It was with good reason that Albert Einstein once called compounding "the eighth wonder of the world".

SUPERLIFE
powered by SMARTSHARES

Level 15, 45 Queen Street, Auckland Central 1010

PO Box 105262, Auckland City 1143

Calculations use the Superlife savings calculator. Please note, the 5% return is used here for illustrative purposes only. It is not an indicator of future returns.

What's surprised you the most about your own financial journey?

I am always surprised by how many surprises markets spring on us as investors. Whether it is a sea change in the fortunes for our local market or overseas markets, a sharp increase (or fall) in interest rates or a new emerging technology that sets markets alight, there is always something unexpected happening. It has highlighted to me the importance of having a diversified portfolio both within, and across, different asset classes and markets.

When it comes to money, what keeps you up at night?

Hopefully, your investments shouldn't keep you up at night. There is a golden rule of investing called "the sleep test" which says your portfolio should have a mix of low and higher risk assets which aligns with your tolerance for risk. While it has a feel-good factor – who needs extra stress in their lives – there is also a serious angle to this maxim.

Having a balanced mix of assets means people are more likely to be able to ride out declines in markets and not sell out after markets have fallen. This locks-in their loss and can mean they miss the inevitable rebound in markets. As well, having some of the portfolio invested in growth assets, like shares, helps mitigate our concerns that our savings will not grow adequately over the long term.

Inflation is a key risk we should all be aware of. I call it "the invisible risk" as it eats away at the purchasing power of our savings, often without us noticing. According to the Reserve Bank's inflation calculator, over the 24 years since the start of this century (from December 1999 to June 2024), the compound average annual rate of inflation has been 2.6%. This has reduced the buying power of $1.00 by 46% to just 54 cents over this period. In other words, goods and services that cost $1.00 in December 1999 now cost $1.86.

Growth assets, like shares and property, are regarded as providing the best protection against inflation over the long term.

Past performance is not a reliable guide to future performance. The calculations and returns used in this article are illustrative and intended as a guide only, and are not an indicator of future returns. The value of investments can go down as well as up and investors may not get back the full amount invested nor any particular rate of return referred to in this article. Returns are not guaranteed. This information is intended to provide a general guide and is based upon, and derived from sources Smartshares Limited considers reliable. Neither Smartshares Limited nor NZX Limited, or their respective directors and employees accept any liability for any errors, omissions, negligent misstatements, or for the results of any actions taken, or not taken in reliance on this information. This information is not a substitute for professional advice. In preparing this information Smartshares Limited did not take into account the investment objectives, financial situation or particular needs of any particular person.

Accordingly, before making any investment decision, Smartshares Limited recommends professional assistance from a licensed Financial Advice Provider is sought.