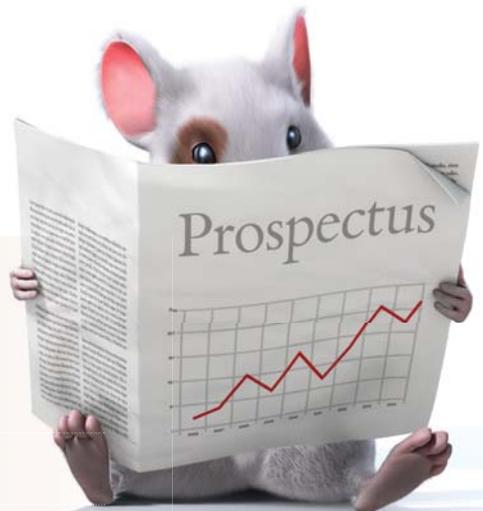


Investing

Making your money
work for you

Inside . . .

- ▨ Your investment profile
- ▨ Types of investment
- ▨ Getting the right advice
- ▨ Tips for safer investing



Your investment profile

Investing is all about making your money work for you. It may sound scary, but if you have a bank term deposit or are in KiwiSaver – you're an investor.

You become an investor when you put your money into things that can earn income or increase in value. The general aim is to earn an after-tax **return** greater than the rate of **inflation**.

Being an investor also involves a degree of risk. The higher the return, the higher the risk.

Knowing your **investment profile** will help you work out the type of investment that is right for you. There are four important issues to think about:

1. How long do you want to invest for?

If you're a short-term investor, you're better to look at a more stable investment product that offers consistent returns. If you're in it for the long term, you probably have time to go with the ups and downs of shares and property investing, say, for the promise of better returns.

In investment terms, **short term** is up to three years, **medium term** is up to 10 years and **long term** is more than 10 years (for example, an investment for retirement). It's quite common to have different investments with different durations.

What are returns?

Returns are the change in the value of your investment over time plus the value of any income received from it (e.g. dividends from shares). Returns can be positive or negative.

What is inflation?

Inflation is the rate at which the prices of goods and services increase over time. The effect of this is to reduce the buying power of your money. For example, if you put \$1,000 under your mattress today, it would only have the spending power of around \$800 in 10 years' time (at 2% inflation each year).

2. Do you need to get to your money easily?

How easily you can turn your investments into cash is called **liquidity**.

For example, a bank savings account is a high-liquidity investment because you can get to your money easily and you probably won't have to pay any penalties for taking it out. Low-liquidity investments include property (because it takes time to sell and may be expensive) and superannuation schemes (because your money may be 'locked in' until you retire).

3. Returns – do you want income or growth?

If you need an income from your investment, you're best to put your money where you can be sure of the interest it will earn, such as a bank deposit or a bond paying a fixed amount of interest for a set period. But if you want your money to grow as much as possible, you could consider more volatile investments such as shares or property, which offer higher long-term returns, but vary in value over time.

4. How much risk is OK with you?

The more **risk** you're prepared to take, the higher the returns you should get – but it also means you have a higher chance of making a loss. Getting the right balance between risk and return is one of the trickiest parts of investing.

What is risk?

Risk is the chance that an investment will not be as good as you expected or were promised. It means that you might not get some or all of your money back and you might not get any income (e.g. interest).

Risk is also about **volatility** – the possibility that your investment will go up and down. For example, if you invest for short periods of time in a volatile investment like shares there is a high risk that the investment will be in a down phase when you want to get your money out.

Try our *Risk recommender* and *Investment recommender*

sorted.orgnz

Don't believe anyone who says they can give you high returns every year without high risk.

Types of investment

Investments generally fit into four different **asset classes**: short-term deposits, bonds, property and shares.

Short-term deposits

Bank savings accounts: the returns are low compared to other investments, but these are generally secure, so your investment won't drop in value in the short term. And you can take out part or all of your money whenever you want, giving you high liquidity. Savings accounts are ideal for short-term goals, or for an emergency fund.

Bank fixed-term investments: you give the bank a lump sum for a set period (a fixed term) – usually from 30 days to 5 years. In return you get a higher interest rate than you would for a savings account. Fixed-term investments can be good for the short or medium term, depending on interest rates.

Bonds

Bonds are like an IOU issued by a government or a company.

You give them money for a certain period, and they promise to pay a certain interest rate and repay you on a certain date (called **maturity**). Bonds lock your money away for a set period of time, but many can be traded (bought and sold through a sharebroker).

Inflation and changes to interest rates can badly affect the value of bonds – if you sell a bond before maturity you may not get all your money back.

What + When = How

What you are investing for and when you are going to want your money will both determine how you will invest. For example, saving to buy a car in two years' time requires a completely different investment strategy than saving for retirement in 20 years. To save for the car you would invest in bank deposits, but to save for retirement you would be better to invest in a range of shares, property and bonds.

Finance company debentures are a kind of bond. These are not usually able to be traded. Finance companies come in many shapes and sizes, and the risk of their investments varies as well.

Property

Property is best as a long-term investment, because property markets are volatile and the costs of getting in and out are high.

Residential investment property (which you rent to tenants) – you can make money from the increase in the property's value and the rent your tenants pay, less expenses such as rates and maintenance.

Commercial property (a shop, factory, warehouse or office which you rent to a business) – most small investors in commercial property invest through a **managed fund**.

Shares

Shares are where you invest in a part of a business through the sharemarket.

You can make money from shares through capital gains (where you sell a share for more than you paid for it) and dividends (where the company makes a profit and distributes a part of the profit to the shareholders).

Shares aren't a good short-term investment because the sharemarket goes up and down. Riskier shares offer higher earnings than most investments, but they also have an equally big potential downside. If you choose them, make sure it's over as long a term as possible and be prepared to see the value go down as well as up in the short term.

The right investment mix for you depends on your risk profile and investment horizon.

For example, if you're investing for the long term, it's important to have your money in each of the four main asset classes (short-term deposits, bonds, property and shares).



Ways to invest

Direct investment

You can invest directly through a bank (short-term deposits), sharebroker (shares and bonds), real estate agent (property) or other brokers. If you invest directly in shares, bonds or property you'll need to be well informed about the sharemarket, and the business or real estate scene.

It's wisest to invest in **quality** – solid companies or properties with good cash flow that are well regarded by the market. They might be less exciting, but your money is more likely to be there when you need it.

Managed funds

In a managed fund (or unit trust) your money is pooled with that of other investors and a professional fund manager invests it in a variety of investments on your behalf.

Managed funds come in many different forms – investing in different types of assets for different objectives. Some are higher risk, some are lower risk. It's a good idea to choose the market you want to invest in first (e.g. shares or emerging markets) and then try to choose the best fund manager within that market.

Managed funds usually charge management and administration fees. These can vary a lot, so make sure you investigate all fees first.

KiwiSaver

The government's long-term savings scheme, KiwiSaver, offers benefits like employer contributions and a \$1,000 kick-start to your investment. KiwiSaver schemes are managed funds – many are **diversified funds**, which means they invest in a range of asset classes. With KiwiSaver you generally can't access your money until you reach age 65, but you may be able to use it to help you save for your first home.

See our *KiwiSaver – Is it right for you?* booklet for more information.

Workplace savings schemes

If your employer offers access to their own workplace saving scheme, check it out and compare it with other options like KiwiSaver. It may offer advantages such as a savings subsidy from your employer and lower costs (your employer may even pay these for you).

Getting the right advice

You can get investment advice from a range of providers, including financial planners, insurance companies, sharebrokers, banks and financial advisers.

You need to check the adviser is licensed to provide you with what you need.

For investments like KiwiSaver, managed funds, shares or bonds you need to talk to an **Authorised Financial Adviser (AFA)**.

Advisers who work for a company which is a **Qualifying Financial Entity (QFE)**, e.g. a bank, can also provide investment advice, but only on products provided by their QFE.

If you are looking for advice on very simple investments such as bank term deposits, you can talk to a **Registered Financial Adviser (RFA)**.

Shop around to find an adviser you feel confident about. The adviser should take time to understand your financial situation and your investment goals, and recommend investments that suit you.

How advisers get paid

Advisers often receive commissions or other incentives if you buy an investment product.

AFAs must give you a disclosure statement telling you the range of products they offer, the fees they charge and what commissions or other incentives they receive.

Your adviser should give you this statement before they offer you advice and before you pay them any money. You should not have to ask for it.

QFE advisers providing advice on investment products also have to tell you how they will be paid.

How to find out more

You can find the names of AFAs in your area on the Financial Markets Authority website at **fma.govt.nz**.

You can find out more about an **RFA** or **AFA** on the public register at **fspr.govt.nz** – including the financial services they can provide.

QFE advisers don't have to be listed individually on the register, but the company they work for must be there.

If an adviser is not on the register when they should be, then don't deal with them.

How to complain

If you can't sort out a problem directly with your financial adviser, you can complain to their dispute resolution scheme (at no cost to you).

If you feel your adviser is not behaving professionally or not putting your interests first, you can also complain directly to the Financial Markets Authority.

Tips for safer investing

▨ ...Don't put all your eggs in one basket

Aim to have a range of investments from the four different asset classes (**diversification**). This spreads your risk, as each asset class may be more profitable than the others at different times. For example, if the sharemarket is going through a bad phase, the return on bonds might well be strong.

You can also spread your risk even further by including investments from different companies, countries, industries and fund managers.

The mix that you have between asset classes is called **asset allocation**. This will determine your investment returns more than anything else. The asset allocation that you choose will depend on your own circumstances and your investment profile.

If you decide on a high-risk investment, make sure you only invest a small proportion of your total money, and make the investment for as long as possible (to give it time to recover if it takes a loss).



/// ...Do your homework

Most investments have an **investment statement** which must be given to you before you pay any money. This will tell you exactly what you're getting into and make it easy to compare one investment product with another. It's really important you read the investment statement of any product you're offered and ask your adviser if there's anything you don't understand. If in doubt, stay out!

Many investments must also have a **prospectus** which has more detailed financial and legal information. You should read, or at least ask about, the main points in the prospectus.

Finance companies and managed funds must also have a **trust deed** that sets out what the company can do with investors' money.

/// ...Check the credit rating

Credit ratings are a simple measure of risk and allow easy comparison of companies that you are looking to invest your money in. There's more information on credit ratings on the next two pages.



Credit ratings

Credit ratings are alphabetical indicators of the confidence you can have in a company's ability to pay back all the money they have promised you. They measure the risk of whether the company you invest in will fail.

The ratings are provided by independent rating agencies and are based on detailed research and analysis. The three main ratings agencies are **Standard & Poor's, Moody's** and **Fitch**.

A poor credit rating (e.g. **CC**) indicates a higher risk that you won't get your money back as promised (this is known as **default**).

But a good rating (e.g. **AA**) doesn't remove all risk – the company could still default in the future. However, you can be more confident that a company with a strong credit rating is more likely to survive than a poorly rated one.

Credit ratings will not predict default perfectly, but they are widely available, a simple measure of risk and allow easy comparison of companies that you are looking to invest your money in.

A low credit rating doesn't necessarily mean you should ignore the company – but it does signal you should invest with care and expect a high return in exchange for the risk you're taking on.

Don't confuse the letters used in credit ratings with the old school grades. While a 'B' grade may look good on a school report, a 'B' credit rating actually indicates a company with a one-in-five chance of default over five years.

All banks registered in New Zealand are required to have a rating from an approved rating agency. Credit unions, building societies and finance companies are also required to have an approved rating, although smaller deposit takers (less than \$20 million) may be exempted.



This table maps the rating scales of the three main credit rating agencies. As you can see, their scales are similar. You can also see from the table how an **AAA** rated company has a much lower risk of default (1 in 600 over 5 years) compared with a **B** rated company (1 in 5 over 5 years).

Standardised rating scale

	Strength	Standard & Poor's and Fitch scales	Moody's scale	Approx. probability of default over 5 years*
Capacity to make timely payment	Extremely strong	AAA	Aaa	1 in 600
	Very strong	AA	Aa	1 in 300
	Strong	A	A	1 in 150
	Adequate	BBB	Baa	1 in 30
Vulnerability to non-payment	Less vulnerable	BB	Ba	1 in 10
	More vulnerable	B	B	1 in 5
	Currently vulnerable	CCC	Caa	1 in 2
	Currently highly vulnerable	CC		
	Default	D	C	

* The approximate, median likelihood that an investor will not receive repayment on a five-year investment on time and in full based upon historical default rates published by each agency.

Source: Adapted from Reserve Bank of New Zealand *Bulletin*, Vol. 71, No.3, September 2008, p.57.

The information in this booklet is current as of May 2012. Laws or policies may change at any time. This booklet should not be your only source of information when you are making investment decisions. It should be treated as a guide only. You should use this booklet as a starting point and then seek professional advice.

Where to now?

- 1 Worked out your investment profile?
- 2 Understand the different types of investments?
- 3 Know how to get the right advice?

Next steps:

e.g. try the *Risk recommender* and *Investment recommender* on sorted.org.nz

Sorted booklets

Order from sorted.org.nz/ordering
or call **0800 SORT MONEY** (0800 767 866).



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This booklet was developed with the assistance of the Financial Markets Authority.



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