YOUNG AND LOOKING TO INVEST?

CAPE TOWN: Over the last few weeks I have received numerous emails from people asking me to write articles about how younger people should be investing. This article is my first response and provides some general guidelines for your investment decisions. You are welcome to keep sending your questions and I will try to answer as many of them as possible – thanks for all your mails so far!

EXERPTS FROM TWO OF THE EMAILS I HAVE RECEIVED

"Hi Warren, I am a regular reader of your column on moneyweb and enjoy the articles and advice given. As you mostly deal with clients that have large amounts to invest and not in direct need of the money I would appreciate it if you can write a piece targeted at a younger generation." Dawie

"Morning Warren, I was wondering if you could look at something like: "Young people 25+ and smart investing if being handed a substantial inheritance". Most young people don't know enough or have enough life experience to know good or bad advice when they hear it. Impartial opinions also count as most advisors have their own subjective ideas about investments. Also including simple stuff like: Buy or bond a house? / Buy or finance a car? (with the inheritance which is become up front capital)" Tarryn

I have shortened these emails and cannot answer them in detail but I hope the investment principles below will suffice.

DEBT

If there is only one lesson to learn from this article, it is this: debt KILLS people...literally. It is a major cause of suicide, divorce and unhappiness in relationships. Whilst debt can be a valuable financial tool, I think it should only be offered to people in very rare circumstances. When you are young, you should try at all costs, to avoid debt, especially short term debt as described below. I know it is hard not to buy clothes, TV's and furniture when you are starting out but debt is not the way to buy these items. Rather save for a few months and buy one big item per month.

TYPES OF DEBT

Short term debt:	Credit card, store card, personal loans, Hire Purchase agreements. This can only be described as bad debt and should be avoided – always.
Medium term debt:	Vehicles financed over 54/60 months. You can use debt to buy a car BUT be careful, too many people spend too much on cars. You should not spend more than 20% of your salary repaying car debt. Don't forget maintenance costs and insurance – these are part of your vehicle costs.
Long term debt:	Home loans: This can be good debt but try to make sure your debt repayments are small enough that you can pay all the running expenses of the property and still save money.

As you can see from the information above, there are times that you should use debt BUT you need to be careful and treat it as a necessary evil rather a way to live a better lifestyle. If you cannot afford to buy nice things without debt then you cannot afford them. Those who live without debt early in their careers are always in a better financial position than their contemporaries who live with debt.

SHARES

All young people should be investing in shares. They are the best investments for long term capital growth. There are many ways of buying shares e.g. directly via a stockbroker, through Exchange Traded Funds (ETF's), through unit trusts or other investment products. My preferred route for young people who want to save on a monthly basis is via ETF's. Try not to plan to use your share investments for short term goals like holidays or car purchases. If you are disciplined, you could start investing in shares at age 25 and be in a position to retire at 40 or 45! I am not saying that investing/saving is easy but it is simple. You need to spend less that you earn, every month and save the balance. I like ETF's because they give you a broad exposure to the stock market (if you choose the SWIX or Top 40 ETF's) and they are really cost effective. A good source of ETF information is www.etfsa.co.za

PROPERTY

This is the most difficult investment for me to discuss. Long term returns on residential property have actually been very poor despite what your parents and grandparents say. Over time, residential property tracks the inflation rate of the country. Like any investment, there are periods when the market does well but time is a great leveller of performance. The reason your older family members think property is such a great investment is because it is probably the only forced saving they have made and they have benefitted from the power of compound growth. Had they invested in shares with the same discipline over the same amount of time, they would be far wealthier than they are now. There are property investments that I like, these are listed property companies and they have been great investments since they started in 1983. The only problem with listed property is the income from these investments is taxable so they are more suited to older people.

Many people will argue that your home is a source of security which is partly true however, you cannot earn income from your home and it only costs you money. I view a home as a lifestyle asset and not an investment. If you have enough capital then it is a good idea to have a home but if you don't have enough capital then you should rent. The rent you pay is bound to be much less than your bond repayment, maintenance and rates. However, if you are not disciplined with money then a home loan is a good way to force you to save. As most people are very undisciplined with their money – a home becomes a good last resort but it is still not a great investment – shares are much better.

There are many people who have made fortunes with property investments but they have been more like businesspeople who have used property as their business. This is similar to the way people have used the IT or medical industries to make their fortunes. I always hear from fans of buy-to-let properties because they say you can borrow money to buy a residential property and then rent it out. This means you can potentially create wealth using the bank's money. In principle, it is a great idea but it requires a large amount of work and expertise to do this successfully over time. You have massive risks if tenants don't pay and then don't move out. In addition, you have high transaction and maintenance costs. That means buy-to-let is more like a business venture than a passive investment. If you are not willing to get involved with non-paying tenants or you have a full time job and enjoy your leisure time then buy-to-let is not for you.

HOW MUCH IN SHARES AND PROPERTY

A good general rule of thumb is to take your age (e.g. 25) and subtract it from 100 to work out how much of your money should be in shares. If you are 25 then you should have 75% of all your money in shares. Naturally every person's situation is different but this is a nice guideline. The balance of your money will need to be in listed property and cash. As this is a general rule, you need to realise

that your specific financial position will dictate whether this is the correct route. If you require income from your investments then you may need more money in listed property and cash to smooth the effects of stock market volatility. Every person needs a cash safety net as protection in the event of emergencies or unexpected expenses e.g. an expensive car service or insurance claim. I suggest you keep three months of expenses in an emergency account. This can be kept in a money market account or 30 day notice account with a bank. If you have a home loan then you can keep it there provided you can access the money at short notice.