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THE
LAST WORD

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The 1, 2, 3 about your money

Today we will review what to do with all that money you make. In particular, how to invest it.

First, set aside emergency money. I suggest $10,000. Deposit it in a fixed deposit, although you will earn a skimpy 1 per cent per year that you'll have to forfeit in part if you must withdraw it quickly for an emergency.

Second, buy a property. It has so many advantages, your best strategy is to invest as much as possible, but that depends on how much the bank or HDB agrees to lend you. That, in turn, depends on the mortgage service ratio (MSR) and more. Don't bother trying to calculate all this yourself. Instead, simply ask the bank or HDB the maximum home loan you are allowed.

Third, make "investments in living". This includes things like a refrigerator, washing machine and – the big one – a car. Not everyone needs a car and avoid it if you can, but if you got to have it, go ahead and even buy with borrowed money if you must.

Fourth, you may be finished but ask yourself: Is my income so high, that I still have money coming in? If so, you are part of a privileged group that has to worry about investing. (Good for you!)

Fifth, where to invest? A popular choice is property, but you already did that when you purchased your home. You could add an investment property, but it's not cheap. You'll have to pay a buyer's stamp duty, the new "additional buyer's stamp duty", property taxes plus maintenance costs, and income taxes on your rental income.

Those costs make a great investment just so-so. You may be better off with safe investments like bank deposits, bonds, bond funds and a Singapore favourite, whole life and endowment insurance policies.

While risks are low risk, the returns are too. Jeremy Siegel tells why in his book: "Stocks for the Long-Run" where he shows that over any 20-year period since 1900, stocks have always out-performed bonds. (Opt out of risk and you will pay for it dearly!)

One guideline is to buy shares but hold a per cent of safe investments equal to your age. For example, a 40-year old will hold 40 per cent in fixed deposits and bonds. It's an easy rule, but check to see if you've covered your safe investments already in groups (i), (ii) and (iii). As I say, overdo it on safety and you will lose big-time on returns.

Sixth, what's left is shares. It's a good choice, since the long-run returns are high and costs to buy are low.

*Quick***Quote**

"Always go to other people's funerals or else they won't go to yours."

Yogi Berra (89),
quotable guru and baseball great

Most advice you receive, however, is the opposite. It is to pay high fees, employ professionals and jump through hoops to prove you are competent enough to invest your own money!

Seventh, KISS, which stands for "Keep it simple, stupid!" (No offence.)

It is easiest to KISS with a passively managed fund that you purchase on your own with no need for professional advice.

Is it risky? Not really. The risk is low because it is passively managed. It's called an index fund because you own all the shares in an index, like the S&P 500 in the US or The Straits Times Index here. There is no need to worry about picking stocks because everyone owns a little bit of all the shares in an index fund.

The best way to invest in index funds is probably with exchange traded funds or ETFs. They make investing cheap, since ETFs don't hire experts who try – with little success – to pick stocks that out-perform the market. ETFs are the market!

Another big plus: Most ETFs have yearly expense ratios of 0.5 per cent or less, which compares to two to three per cent for unit trusts. You need a broker to buy ETFs, and online trading is always cheapest. One-time costs are about 0.6 per cent for a "round trip", which means to buy and sell. (US and European brokerage costs are even cheaper and almost free.)

Eighth, a problem is most of the world's 1,600 ETFs are traded in US dollars, and new Singapore investing rules classify these as "specified investment products" or SIPs. SIPs are supposedly so risky, you must prove you are qualified to own them, and the standard way to do that is to take a test given by your stockbroker.

Not all investors are keen to be tested, so ETFs have yet to gain a foothold here. Another reason is advisors typically don't promote them, since ETF's can't afford to pay sales commissions from their already low fees.

One solution is to avoid the US ETFs, which you can do by trading non-SIP Singapore dollar ETFs like the SPDR STI-ETF and the NIKKO AM STI ETF. Both contain all 30 shares from The Straits Times Index, and both are approved for investing from your CPF ordinary account.

A second solution is to avoid SIP rules and trade US dollar ETFs through a US stockbroker. You can do that by opening a US dollar account with a US broker, which is easy, although some may require a US street address. You can get one with a US mailbox company that you can find with Google.

Two US discount brokers I recommend are Charles Schwab and E-Trade, with E-Trade having the fewest restrictions and lowest capital requirements.

Dr Haverkamp is an economist and adjunct faculty member at Singapore Management University. In his weekly column, he shares simple tips on how you can make money work harder for you.