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THE LAST WORD

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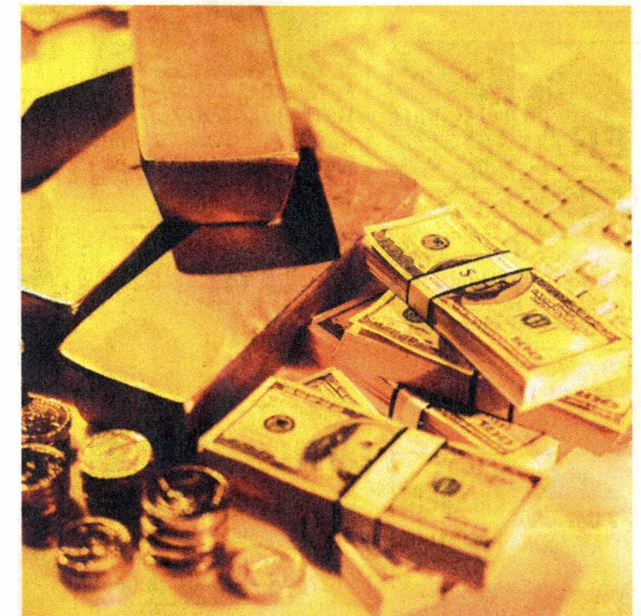
How to get rich



I thought you might want to know how to get rich. So here's my advice: First, save a little money. Next, invest it to make a high return.

That's easy. Of course, getting high returns could be difficult and not without risk. But risks make the returns uncertain. Is there a way around that – to get low risks and high returns?

Surprisingly, yes. Step one is to diversify your portfolio. It is easy enough if you buy a unit trust or get a bargain and buy an exchange-traded fund (ETF). Both types of funds give an investor hundreds of shares with a single purchase.

The other way is to DIY (do it yourself) by buying 15 or more counters, which is all you need to get 90 per cent of the benefits of diversification. The advantage of buying stocks is there are no annual expenses like you have with unit trusts and ETFs.

Step two is to buy and hold. Keep your investments through thick and thin and you will earn the stock market's long-run returns, which are about 12 per cent in Singapore and 10 per cent in the United States.

Do both of these and you will lower the variance of your portfolio without the need for low-risk and low-return bonds. Big institutions, like pension funds and insurance companies, use this strategy to earn higher returns.

Market timing

How about market timing, which is selecting a good time to buy (when the market is low) and a good time to sell (when it is high)? Don't get those backwards!

Of course, this beats buy and hold if you time the market's highs and lows correctly, but can you? Can anyone? Many so-called experts claim this ability and most currently recommend that you sell. Take Dr. John Hussman, who writes a widely-followed newsletter and, like others, he finds the stock market to be over-valued based on price-earnings ratios which are at historic highs.

Each expert has his or her preferred valuation indicator. Investing legend Warren Buffet likes "total market capitalisation to gross domestic product (GDP)" which tells the size of the US stock market (measured by price times the number of shares) compared to the GDP. Mr. Buffet says anything over 100 per cent shows it's time to sell and the ratio is now at 115.

*Quick***Quote**

> **"You should buy a stock whenever the chart looks like a squirrel sitting on a clown's shoulder."**
>
> Technical stock analyst, "Pointy-Haired boss" in the cartoon comic strip "Dilbert"

The one problem with the experts' advice is their sell signals have been in place for years and the stock market keeps marching higher. How can the experts be so wrong, even with the data solidly in their favour?

The answer, I think, lies with one statistic that contradicts the sell signals. It is interest rates, which are at all-time lows and have even gone negative in a dozen countries. Two with the lowest rates are Denmark and Switzerland, where interest is minus 0.75 per cent and minus 0.60 per cent. As I will show, this explains why today's high stock prices are not too high.

The anti-matter of finance

Why are people so frightened of negative interest? Mostly because it is counter-intuitive. It's the anti-matter of finance, and no one has much experience working with it. Does it mean banks will pay us to borrow money? The answer is yes. Does it also mean depositors must pay banks to keep their money with them? Again, yes.

One small qualification about the banks paying us to borrow: It applies to institutions like mutual funds, hedge funds and pension funds. It is difficult for individuals to get negative interest rate deals since most personal loans are riskier and charge higher interest.

Today's super-low and negative interest rates mean the only place to earn a reasonable return is in risky assets like stocks and property. So, people buy them because there is nowhere else to go, and this has driven stock prices to all-time highs. It is happening to property too but more slowly, although some markets are red-hot now like New York, San Francisco, Miami and London.

What about the future? If interest rates rise, will people switch out of stocks and property, and into bonds and fixed deposits? Maybe. But keep in mind that experts have been predicting higher interest rates for the past three years and we still haven't seen them. Will we now?

It is possible. On the one hand, the US economy seems to be recovering, which is sure to push rates higher. Also, the mad rush to devalue currencies makes imports more expensive, which adds to inflation and pushes interest rates higher.

On the other hand, Europe has committed to quantitative easing for at least the next 18 months, which will require massive bond purchases that will push interest rates lower. Low oil prices are also holding down inflation and interest rates.

What to do? My advice is to invest in assets like stocks and property. They are still the only game in town that earns a reasonable return. And in the long-run stocks have out-performed bonds in every 30-year holding period in history, according to research by Professor Jeremy Siegel at the University of Pennsylvania.

An adjunct professor at SMU, Dr Haverkamp contributes this column weekly to help our readers understand money matters better.

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