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GETTING YOUR FEET WET IN INVESTING

With interest rates at historical lows, it's time to put your money to work. In the first of *Lifestyle*'s money pages, **Mavis Teo** advises the virgin investor to start small and stay disciplined.

THE AVERAGE DEPOSIT rate in local banks is around 0.25%. Inflation rate (2012) was at 4.9 per cent and expected to rise further this year. It no longer makes sense to keep your money in savings deposits. The average national wage increase is only about 2.1per cent. Therefore, your money is losing value day by day, and your plans for a cozy retirement is becoming more of a distant dream.

The world of investing can be a mind-blogging quagmire for the uninitiated. The best way is to start with baby steps.

Risk Versus Return

There is always a trade-off between risk and return. The higher the return, the more risky the investment will be, and vice versa.

Mr Ang Ser-Keng, senior lecturer of finance at Lee Kong Chian School of Business, Singapore Management University, laughs at the idea of risk-free investments. "Even sovereign bonds have been known to default, though the likelihood is very low. If someone tells you an investment product will yield a guaranteed return of 4% in the current market, you should be very careful."

"I find that people who are new to investing, tend to take too much risk; an inordinate amount of risk to the money they put in. They tend to punt," says Mr Ang. One example he gives is buying stock. With only $1000, it is difficult to buy a significant amount of a blue-chip stock, so these investors tend to buy penny stocks which yield them a larger lot with the same amount of money. However, penny stocks tend not to pay dividends and trade with much higher volatility and risk. The value of your stock could swing widely in a day. Blue chips are a much safer bet, and most pay dividends. For example, Singtel pays a dividend of about 6 per cent, which is already higher than banks' deposit rates, plus Singtel is a stable company to boot.

Setting Aside Money You Can Lose

Instead of going into investing with a big bang, start small and conservative. If you don't think you will lose sleep over $1000, then start with this amount. You can start to build up your investment fund with gains from this money. This $1000 should also not be money you need soon.

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Before you set up an investment fund, you should set aside an emergency fund. There should be enough money in this fund that will see you through six months of zero income, for example, if you suddenly find yourself out of a job. Make a list of your monthly expenses – including mortgage or rental, transport, food, income tax payments, utilities, household expenses and other things you can't do without, and multiply that by six.

Dollar-cost Averaging

A common complain among individuals who fear the financial market but don't mind having more money is that they don't have the time, energy or know-how about when to enter and exit the market.

According to Mr Ang, understanding the concept of dollar-cost averaging takes the hard work out of investing. It is a technique of setting aside a fixed amount of money to purchase the product at fixed intervals, through ups and downs in the market. Mr Ang says, "Dollar-cost averaging can work through compounding." Compounding in investing is the process of earning interest on top of interest already earned. This means your interest earnings are reinvested, snowballing with the later earnings. Historical facts have shown that the market has a tendency to grow over time. So investing early and staying invested in a systematic manner usually generates good returns. A longer time horizon also pays you better. A good example: a 12-month deposit will give you a higher interest rate than a 3-month deposit.

Products You Can Start With

You don't need to start with an investment portfolio of bonds, stocks and commodities if you are just starting to invest. "That would be like learning to run before learning to walk," says Mr Ang. "You can worry about asset diversification later when you have grown your funds to a sufficient amount to consider other products."

Mr Ang feels that ETFs (exchange-traded funds) are a good entry point for the virgin investor. ETFs are basically funds which track the performance of a stock index. This means that the newbie investor is able to "own" a basket of quality stocks, without having to come up with the cash outlay for individual stocks. Units trusts, or funds managed by banks, come with associated costs such as sales or retail charges and realisation fees when you unwind your holdings, whether or not you make money.

ETFs, on the other hand, come with much lower costs. They have become very popular with investors who don't want to spend too much time monitoring their investments. ETFs are open-ended funds that can be bought and sold on a stock exchange, during trading hours on most trading platforms, like stocks. ETFs tracking The Straits Times Index, for example, tracks the entire index, using only just a single security. This allows investors diversification without the time and costs of picking a basket of stocks. The dividends of an ETF are reinvested immediately. You can start investing in ETFs with just a few hundred dollars.

There are quite a few ETFs issued locally by various platforms. For example, there is the MSCI Singapore Index Fund issued by iShares. A prudent investor should also do his or her homework by finding out more about the company behind the ETF, and other information like costs, liquidity and transaction volumes.

Trade With Your Head

Mr Ang feels that it is very important to have discipline in investing. To be disciplined means to set limits for cutting loss, like exiting the market, and cashing out if you are happy with the earnings. "If the market does rise further after you have cashed out, don't waste time and energy agonising with this wisdom of hindsight. There's a possibility you could be losing money instead if the market had gone the other way."