



Save for set goals



While the idea of setting aside a portion of your income for a rainy day is an appealing idea in theory, in reality most people find it hard (if not downright impossible) to develop and stick with a responsible savings plan. But while it may take a good deal of commitment and sacrifice for you to reach your personal savings goals, the financial benefits that can come from a robust savings plan far outweigh the short-term cutbacks that you may have to endure. So, if you're ready to start saving money, the tips and suggestions below will help get you started on the path to financial responsibility.

Step 1 – Get a plan

DECIDE what you really want and focus on the most important goals – a car, holiday, retirement, or deposit for a home. You might want the lot, but you've got to prioritise.

Estimate how much you can save by depositing funds at regular intervals, and how long it will take to get there. Establish a budget to make this happen and stick to it. The best time to start saving is now.

Step 2 – Minimise existing debt

Make regular payments off your cards or personal loans. Minimise your costs by taking a cut lunch to work – putting \$5 aside daily can mean \$1000 extra for Christmas.

Use layby during the year to shop at sales for Christmas presents rather than having a last minute spending blow out.

Cut bank fees by reducing the number of accounts you hold. Use cash instead of credit cards if you can't pay off the monthly balance. Use a debit card if you find having a credit card increases your spending.

Step 3 – Maximise savings

Even small things like putting your change into a savings jar at the end of each day can make a difference.

Put away a small amount each payday into your bank account and set up an automatic deduction so you don't have to think about it. Add any pay rises, bonuses, special payments or that tax refund.

Think ahead – is there a Christmas Club at work? If you put away \$25 per week into such an account, it would mean \$1300 in Christmas cash.

Savings are a security buffer to cope with unexpected expenses. As they build you will be able to think beyond day-to-day expenses and pay for larger things.

Step 4 – Set up separate savings accounts

Save for longer term goals such as a car, holiday or home deposit with special purpose savings accounts which are separate from your everyday transaction account. Special purpose savings accounts offer carrot and stick incentives (eg higher interest if regular deposits are made but penalties if money is withdrawn in a particular period).

When these accounts grow to larger amounts, move into term deposits, where there is limited access – and less temptation to spend them, leaving the growing interest to compound.

Popular new online savings accounts (accessible through an ATM and piggy backing onto your transaction account) pay top interest rates and cuts bank fees, while giving instant access for an emergency. However, the instant access means they are not for the weak willed.

Step 5 – Know your finances

Savings for retirement are best made through superannuation because of the tax concessions. Make extra superannuation contributions from your pre-tax salary ('salary sacrifice'). This will increase your retirement pension – and choices.

Your money behaviour

– avoiding the traps

Managing your money behaviour, and avoiding common behavioural traps, can help you put the right foot forward when it comes to long-term success with money.

Why do mature women make better investment decisions than young men? Why does trading shares online bring worse results than the old fashioned way? Why do we all think we're better-than-average with money (and other areas of life)? And what can we do about it?

An emerging area of research called behavioural finance – which looks at the way we behave with money and investments – is shedding light on questions like these. And the results are fascinating. How we think about and manage our money has a huge impact on our lives – especially in the current environment. The good news is there are effective strategies to help us keep perspective, whatever happens in markets.

If it looks too good to be true...

One of our better human traits is that we're basically optimistic. But this also makes us vulnerable to 'too good to be true' marketing offers. As a society we spend twice as much on mass marketing than on education. So it's little wonder we're influenced so strongly by our environment and the promises of a consumer culture.

One of the only benefits of the global financial meltdown is that operators of dodgy investment schemes and 'too good to be true' offers have been put out to pasture. Sadly, there has been a human cost. Perhaps the most infamous scheme, run by Bernard

Madoff in the United States, reportedly cost investors as much as \$65 billion. For his trouble, Madoff received a 150 year jail sentence in June 2009.

Simply, 'If it looks too good to be true, then it probably is.'

The price is right

'Anchoring' is another simple way that we lose perspective. Any advertisement that follows the simple formula 'recommended retail price \$50, now \$30—save \$20,' is trying to influence our judgment by using an initial anchor price of \$50 to show what a good deal is now being offered.

The technique is also used by some real estate agents who, when observing a potential buyer's interest in a property, will casually mention that the vendor is looking for a price a good 10–20 per cent above what the vendor will probably accept.

Anchoring plays a big role in the stampede of every big market downturn. In late 2007 the Australian share market (S&P ASX 300 Price Index) peaked around 7000 points. It's now somewhere around 4300 points, depending on which day you look.

Three years ago, 6000 points seemed low. Now it seems high. Our perspective has changed. To get back to 6000 points in the next, say, five years would mean a good, healthy rate of compound growth.

The good news is there are effective strategies to help us keep perspective, whatever happens in markets.



To get ahead we need to deal with today's reality, rather than anchor on the past. Remember the only investment value that truly matters is the one you achieve when you sell. So be aware of price anchors, by all means, but don't base decisions on them.

We're overconfident (and we don't know it)

Anchoring is made worse by our habit of being over-confident in our abilities, particularly with money. So we need to know our own limitations.

learn to put your best foot forward for financial success

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Psychologists believe that overconfidence is much more common than most of us care to admit. For example, most people rate themselves as 'above average' at everyday tasks like driving a car, when this is statistically impossible. Clearly, not everyone can be better than average.

Confidence is good but within limits. Overconfidence contributes to the tendency of many investors to:

- try to do it themselves, without the right skills and experience
- make decisions too rapidly, without sufficient analysis
- fail to diversify portfolios enough, hoping that one big bet will pay off
- buy and sell investments too frequently.

This helps explain why mature women are better with money than young men: young men suffer more from over-confidence than do mature women.

One of the leaders in behavioural finance, Terrance Odean of UCLA in the US, analysed the trading activity of 10,000 accounts of stockbroking clients. He found that on average, the shares that investors bought did worse than those they sold. In other words, most investors would have been better off sticking with what they had than flipping between investments (which also racks up transactions costs). This is why, even during boom times, up to 70 per cent of market day-traders may actually be losing money.

Technologies like the internet make this worse. Not only can you think impulsively, you can now act impulsively, trading online instantly. Odean found that investors who moved to online share trading actually traded more, speculated more, and achieved lower returns than those who didn't.

So while in bad market conditions, there may be a terrible pressure to 'just do something', buying and selling investments to scratch this itch probably won't help – and may well hurt.

Golden principles

One way to combat these behavioural traits is simply to be aware of them. But unlike the exciting fly-by-night investment schemes we mentioned earlier, the main strategy to take control is seemingly 'dull'. Set your money strategy based on what the world is like today, and adjust plans as circumstances change (which they will do constantly). No financial strategy can afford to be 'set and forget'.

Successful investment approaches through history have applied four Golden Principles:

- buy good quality investments
- try not to pay too much
- diversify widely so no single investment can bring a portfolio undone – and gains can still be captured
- give it time.

A boring, conservative approach? Maybe. But one that provides a good chance of success in the long run? We think so.

The sovereign debt crisis

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Remember the carefree days of 2007, before the GFC hit? Back then, all that investors had to worry about was the risk of companies going bust. Then the GFC came along, and we learned that we had to worry about banks going bust.

Now it's countries.

The European sovereign (government) debt crisis has raised the spectre of debt default by nations, which would not only cause political problems, but plunge the global banking system back into the chaos from which it was only recently thought to have been saved.

The epicentre of the crisis is the southern European belt of nations, in particular Greece – although its fellow Euro members Italy, Spain, Ireland and Portugal also display highly parlous public balance sheets.

In early May, with Greece seemingly on the brink of insolvency and markets hammering the other perceived Euro members such as Spain and Portugal, the viability of the Euro itself was under threat. But on the weekend of Europe Day – May 9 – the European Union (EU) bit the bullet, and with the assistance of the International Monetary Fund (IMF) created a massive €750 billion (\$1.1 trillion) crisis fund, more than half of which consisted of loan guarantees.

The package helped to neutralise the markets' fear of 'contagion' spreading from Greece's diabolical state finances, but more importantly, appeared to have given the troubled southern European economies the time and breathing space to restructure their budgets and balance sheets.

In reality, the main EU economies, France and Germany, had no choice but to organise and contribute to the package, because French

and German banks are among the biggest holders of Greek bonds. It was a case of bail out their European partner nation, or bail out their own banks.

To the markets, however, this is no longer solely about Greece – but about the cracking of the edifice of the Euro. It was one thing for Greece's sovereign debt rating to be cut to non-investment-grade (or 'junk') but another for Portugal's to be cut to AA- and Spain's to AA. Spain's downgrade presages another Greece-style bailout. These far more serious downgrades call into question the financial solidarity of the Euro itself.

The rules set out for membership of the European currency have fallen short of protecting individual EU countries from other nations' debt levels. And Germany, which thought that it had locked in an assurance that any member country that got into fiscal difficulty was on its own – meaning that its taxpayers would never have to bail-out nations that did not work as hard as they did – faces the massive political pain of telling its citizens that they must work two extra years (to 60) so that the Greeks can be prevailed upon to extend their working lives by ten years to age 50.

In return, Greece had to begin the long and painful process of dismantling some of the untenable planks of its generous statist economy. A few small examples: Greek state workers receive 14 months' pay for their 12 months of work; Greece has free healthcare; free education – including tertiary. But the party is over, because tax revenue no longer pays for all of these things – although the spectacle of deadly riots on the streets of Athens in May showed that not everyone accepts this fact.

Although world markets initially welcomed the EU/IMF support package, the subsequent credit rating downgrades for Spain and Portugal put paid to any thoughts that it

had completely solved the problem. In reality, the sovereign debt crisis merely shows investors that the world still needs to 'deleverage' – to wean itself from debt.

The worry for investors is that it is not only Greece and its fellow European Union strugglers that show debt levels too high. The USA now has a budget deficit of 11 per cent** of GDP, which is not far short of Greece's, at 13 per cent.* of GDP. The UK's budget deficit this year is projected at 12 per cent* of GDP – and these are far bigger economies than Greece.

Across the developed world, there is a pressing need to bring public balance sheets back under control. The spending austerity and tax-lifting programs needed to accomplish this will bring with them high unemployment and low economic growth – to say nothing of the social costs. But these programs need to be applied.

On top of US economic growth that looks like slowing in the second half of the year, it adds up to a world not as healthy – economically or fiscally – as investors might have hoped for at this time, a year ago. This puts more pressure on China and the emerging nations to deliver what growth there is – but weak economies in the US and Europe don't help them sell exported goods there.

It is hardly surprising that after a global financial crisis the aftershock and political and fiscal pain continues to challenge the world's economies. The new normal looks more like one where it is important for investors to have more realistic return expectations and pay attention to risk within their portfolio.

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* UK and Greek figures sourced from Eurostat

** US figure sourced from the Congressional Budget Office (CBO).