

7. Invest your Savings

You should invest your savings for the long term and aim to achieve a yield that is 2% per annum higher than inflation. If inflation is expected to be 2%, you should aim to achieve a net yield of at least 4% per annum.

To achieve this yield, you have to take risk by investing in asset classes, such as equities, that have produced a higher rate of return in past years. You can manage your risk through diversification. You should also look for investments that have low charges, so that most of the yield goes to you.

Tips for investment

- a) Invest in a large, professionally managed fund as it offers diversification. You will not be badly affected if some investments go bad, as the impact is small and is compensated by other good investments.
- b) Choose a low cost fund, where the fund manager takes only a small fee. If you choose an indexed fund, you enjoy diversification and pay a fee of only 0.3% per annum.
- c) Invest for the long term, i.e. 10 years or longer. The fund will do badly in some year but will do well in other year. Over the long term, you can get an average rate of return.
- d) Invest 80% of your savings in a fund that is largely or fully in equity, as equity gives a higher return over the long term. You have already reduced your risk through diversification and averaging out the good and bad years.
- e) You can keep 20% of your savings in a money market fund or in short term assets. The return may be lower, but you can withdraw the savings at any time to meet emergency needs, without having to pay a penalty or suffer a capital loss.
- f) Avoid trading in the market. There is a high transaction cost involved in buying and selling your investments. Most investors are not able to read the market well to achieve a trading gain that can offset the cost. Their financial adviser is also unable to read the market well, in most cases.

Reduce the cost of investment

You have to reduce the cost of investment. The cost comes from the following:

- Transaction cost payable on the purchase and sale of your investment
- Annual management fee payable for managing your investments

You should avoid transaction cost of more than 2% and the annual management fee to less than 1%.

Transaction cost

The following table shows how much you have to pay in transaction fee for an investment:

Amount invested	1%	2%	3%	4%	5%
\$10,000	\$100	\$200	\$300	\$400	\$500
\$20,000	\$200	\$400	\$600	\$800	\$1,000
\$30,000	\$300	\$600	\$900	\$1,200	\$1,500
\$40,000	\$400	\$800	\$1,200	\$1,600	\$2,000
\$50,000	\$500	\$1,000	\$1,500	\$2,000	\$2,500

If you invest \$50,000 at a upfront charge of 5%, the amount taken away from you is \$2,500.

Annual cost – lump sum investment

The following table shows the amount of an investment of \$50,000 at various yields:

Amount invested	Years	4.0%	3.0%	2.0%	1.0%
\$50,000	5	\$60,833	\$57,964	\$55,204	\$52,551
\$50,000	10	\$74,012	\$67,196	\$60,950	\$55,231
\$50,000	15	\$90,047	\$77,898	\$67,293	\$58,048
\$50,000	20	\$109,556	\$90,306	\$74,297	\$61,010
\$50,000	25	\$133,292	\$104,689	\$82,030	\$64,122
\$50,000	30	\$162,170	\$121,363	\$90,568	\$67,392

If you invest \$50,000 over 25 years and earned a net yield of 4%, you will get \$133,292. If the fund manager takes away 2% and gives you a net yield of 2%, you will get \$82,030 (representing a reduction of 38%)

Annual cost – regular investment

The following table shows the amount of an annual investment of \$5,000 at various yields:

Amount invested	Year	4.0%	3.0%	2.0%	1.0%
\$5,000	5	\$28,165	\$27,342	\$26,541	\$25,760
\$5,000	10	\$62,432	\$59,039	\$55,844	\$52,834
\$5,000	15	\$104,123	\$95,784	\$88,196	\$81,289
\$5,000	20	\$154,846	\$138,382	\$123,917	\$111,196
\$5,000	25	\$216,559	\$187,765	\$163,355	\$142,628
\$5,000	30	\$291,642	\$245,013	\$206,897	\$175,664

If you invest \$5,000 annually over 25 years and earned a net yield of 4%, you will get \$216,559. If the fund manager takes away 2% and gives you a net yield of 2%, you will get \$163,355 (representing a reduction of 25%).

Avoid Structured Products

You should avoid structured investment products, such as capital guaranteed products, capital protected products, credit linked notes, equity linked notes, dual currency investments, life insurance saving policies and land banking products.

Most of these products are designed by the financial institution and have high charges that are taken from your savings to pay the expenses of creating, marketing and administering the product and the profit margin. After deducting these expenses and charges, the investor gets a poor return on these investments.

It is all right to buy a structured or life insurance product if the upfront expenses are low, say less than 2% of the invested sum and the product is easy to understand and designed to give good value to the consumer (and not to make excessive profit for the issuer). Most products in the market do not fit into this category.

Return on asset classes

The following table shows the historical average return for various periods up to end of 2006. These are annualized returns, inclusive of reinvestment of dividend, converted into Singapore dollars.

Computed up to end 2006				
Asset Class	5 year	10 year	15 year	20 years
Spore equity	17.8%	8.0%	9.3%	9.2%
Global equity	6.5%	9.1%	8.7%	7.7%
Global bond	3.9%	4.5%	5.3%	5.5%

The return earned on Singapore equity over the past 20 years has been slightly higher than global equity, which earned more than global bonds.

Equity earned about 2% to 3% more than bonds and about 3% to 4% higher than the inflation rate.

Low Interest Environment

This is my personal estimate of the future yield based on a low interest rate environment. It will differ from the estimate of another person.

Asset class	Average	Volatility
Equity fund	5% to 8%	High
Property fund	3% to 6%	Medium
Bond fund	2% to 5%	Low-medium
Fixed deposit	1% to 3%	Low

If inflation picks up significantly, the average return should increase correspondingly.

Although the volatility is high for equity and property funds, it can be reduced by investing for the long term (i.e. 10 years or longer). This will average out the return over good and bad years and produce a more stable average yield.

Investing your CPF savings

Your savings in the CPF earn an interest rate of 2.5% in the ordinary account and 4% in a few other accounts. You are allowed to use your savings in the ordinary account to invest in an approved property or approved investments.

The interest rate paid on these savings is pegged to market rates and is subject to a minimum level.

As the interest rate on the ordinary account is rather low, it is appropriate for the CPF member to use the maximum amount of the savings to pay for a property, and reduce the interest charges on the mortgage loan for the property. If there is excess savings in the ordinary account, the CPF member can invest the savings in approved investments to get a higher yield.

You can use the same approach on investing your CPF savings and your personal savings – invest for the long term to get a yield of 2% higher than inflation.

Many insurance agents will approach you to offer investment products that give a projected yield that is higher than 2.5%. You should also be aware that the projected yield is not guaranteed – you may get an actual yield that is lower.

You should also study the embedded charges that come with these products and make sure that they do not take away more than 1% from the actual yield.

You must also consider the penalty that is imposed on early termination of the investment.

Supplementary Retirement Scheme

You can invest part of your personal savings in the Supplementary Retirement Scheme (or SRS).

You are allowed to deduct your voluntary contribution under SRS from your taxable income, giving you an immediate tax saving.

The accumulated savings in the SRS can be withdrawn in instalments after age 62 over a period of 10 years. 50% of the amount withdrawn is subject to tax.

You can benefit from the tax treatment under SRS in the following situation:

- Your tax rate after age 62 is lower than the tax rate at the time of contribution (likely to be true)
- The accumulated saving is less than 2 times of the actual savings (likely to be true for investments of less than 15 years)

The amount that can be allowed is rather small, for people who are already contributing to the CPF. The current cap is less than \$12,000. A larger contribution is allowed for foreigners working in Singapore who do not contribute to CPF.

The following table shows the tax savings under different situations, assuming that the contribution in SRS earned an average yield of 4% per annum.

Tax rate	Years	SRS saving	Tax saved	Taxable benefit	Tax rate	Tax payable	Net saving
5%	5	\$10,000	\$500	\$6,083	5%	\$304	\$196
5%	10	\$10,000	\$500	\$7,401	5%	\$370	\$130
5%	15	\$10,000	\$500	\$9,005	5%	\$450	\$50
5%	20	\$10,000	\$500	\$10,956	5%	\$548	(\$48)
10%	5	\$10,000	\$1,000	\$6,083	5%	\$304	\$696
10%	10	\$10,000	\$1,000	\$7,401	5%	\$370	\$630
10%	15	\$10,000	\$1,000	\$9,005	5%	\$450	\$550
10%	20	\$10,000	\$1,000	\$10,956	5%	\$548	\$452
15%	5	\$10,000	\$1,500	\$6,083	5%	\$304	\$1,196
15%	10	\$10,000	\$1,500	\$7,401	5%	\$370	\$1,130
15%	15	\$10,000	\$1,500	\$9,005	5%	\$450	\$1,050
15%	20	\$10,000	\$1,500	\$10,956	5%	\$548	\$952
20%	5	\$10,000	\$2,000	\$6,083	5%	\$304	\$1,696
20%	10	\$10,000	\$2,000	\$7,401	5%	\$370	\$1,630
20%	15	\$10,000	\$2,000	\$9,005	5%	\$450	\$1,550
20%	20	\$10,000	\$2,000	\$10,956	5%	\$548	\$1,452

The largest benefit accrues for investment of shorter duration (i.e. less than 15 years) and for a large difference in the tax rate before and after retirement.

End of chapter