

Cash, bonds or shares?

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If you have “\$x” to invest, one option is to put it in the bank on deposit. This is known as a “cash” investment. Before tax, this is likely to return to somewhere between 2% p.a. to 9% a year, depending on interest rates from time-to-time. On average, over the next 20 to 30 years, the average is likely to be in the 3.5% to 4.5% a year range, before tax.

The attraction of such an investment comes from:

- the convenience of making the investment.
- the certainty of the return in the immediate future.
- the security of your capital. Unless the bank goes under, you will get your money back.
- the flexibility of the investment.
- the fact that administration fees and management fees, are not directly incurred.
- the current “low” level of inflation.
- the general comfort and perceived understanding of the investment.

In the middle of the expected range and after tax at 28%, (the maximum PIE tax rate) and after inflation of, say, 2.0%, bank deposits give an expected net real return of about 0.88% p.a. (on average).

	4.00%	<i>(gross return)</i>
tax @ 28%	-1.12%	
	2.88%	<i>(net return)</i>
inflation	-2.00%	
	0.88%	<i>(net real return)</i>

Even if inflation is higher (e.g. 2.5% p.a.), you will still normally get a positive average return after-tax and inflation. That is if you invest your money then, together with the return, it is expected to buy more goods in a year’s time than it can today.

Bank deposits are easy and can be very flexible. However, bank deposits may not be the best investment if your intended period of investment is 5 to 10 years, or if you need a higher level of income. Also, if your investment period is 5 to 10 years, there is no guarantee that inflation will stay low. With cash investments there is little margin to protect an investor against unexpected inflation, particularly where it arises from a change in government policy.

As an alternative, by leaving some of your money in cash (for a rainy day and your expenditure over the next few years), and investing the balance in, say, fixed interest or bonds, the expected return increases. Good quality - but reasonably safe - bonds are expected to return 5% p.a. to 6% p.a. over the next 20 to 30 years. Government bonds are more likely to merge 3% to 4.5%ⁱ over the next 20 to 30 years.

But while the average return is higher, to get the higher return, your money is invested for the duration of the bond. If you were to need it sooner and try to sell it before the end of

The legal stuff

This is not an investment statement for the purpose of the Securities Act 1978. An investment statement is available from SuperLife free of charge. Before making a decision to invest, you should consider whether you need to seek financial advice. If you wish to have personalised financial advice, you should talk to an appropriately experienced Authorised Financial Adviser.

the term, you may have to incur a loss. That's why some of your money should be kept in bank deposits for a rainy day and your short-term expenditure. Still, if you are investing for 5 to 10 years, bonds should be better on average but not in every year, than only money in the bank. You could also buy a bond with a higher yield, but it would not be as secure. Also, not all bonds paying 5% to 6% are secure. You still need to be careful and possibly retain some in government bonds.

Of course, if you are investing for 10 to 15 years or longer, e.g. for your retirement, you may be better off to have some of your money in shares (or property). Longer term (20 to 30 years), shares are expected to prove an "average" return of, 7% to 8% a year before tax.

The problem with shares is that while, they may return an average between 7% and 8% p.a. gross a year, they won't in every year. In some years, the return may often be as low as -20%, say or as high as +45% and occasionally or even lower and higher. If you may need your money to spend in a year's time, you would probably not want to risk getting the minus 20% return. However, if you don't need your money for at least 15 to 20 years, investing in shares should provide you with a better average return than cash or bonds, but will give you some highs and lows along the way over shorter periods.

In practice, most investors have some short-term needs, some medium term needs and some long-term needs. This is why a combination of cash, bonds and shares, often gives the best result.

Investing in bank deposits or cash is the short-term "safe" and flexible option, and for many people this is the right option. However, by accepting a little less flexibility, and being willing to invest your money for longer, (as you may get a loss if you cash them in short-term), you should be able increase your returns by investing in bonds and/or shares. The amount of money you allocate to each of cash, bonds and shares is called your "investment strategy". This is one of the most important decisions that you will make.

ⁱ Assumes BBB investment grade corporate bonds. Government stock is more likely to return to 3.0% to 4.5% p.a. on average.