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ASK DR MONEY

Safe is risky, risky is safe

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MY friend Bernard sells life insurance. He told me he has given up trying to sell ILPs (insurance-linked products).

I asked him: 'Why, Bernard? ILPs are like unit trusts. They are a very good investment.'

'I know,' said Bernard.

'The problem is my clients tell me, 'I want to know where you and your family live. If I lose money, I will find you. You will pay me back!'

'None of my clients want to take risk. No one wants to risk losing money.'

Will you take risks?

Are you risk adverse like Bernard's clients? Or are you a gambler?

Take three easy tests to understand yourself and the stock market.

Test 1: Which do you prefer?

Choice A: \$1,000 for certain, or

Choice B: a 50 per cent chance to win \$2,000 and a 50 per cent chance to win nothing.

Answer: If you are a risk-taker, you will take the 50-50 chance and not the \$1,000 sure thing.

Basic Lesson #1: Choice B is like the stock market. Only if you are a risk-taker and chose B should you invest in the stock market.

Test 2: Which do you prefer?

Choice C: \$1,000 for certain, or

Choice D: a 50 per cent chance to win \$3,000 and a 50 per cent chance to win nothing.

Answer: Well, that's more like it! The gamble is looking better.

More people will take this risk and go for the improved payoff of \$3,000.

Advanced Lesson #2: Choice D is very much like the stock market because it rewards you for taking risk.

With Choice D, you will have occasional losses - but in the long run, the odds are in your favour.

With enough time, Choice D will always beat Choice C.

In the same way, stocks are sure to beat fixed deposits and bonds in the long run.

A word of caution: To be sure of winning, you must diversify by making many small gambles so that you don't lose everything in one huge bet.

Test 3: Which do you prefer?

Choice E: \$1,000 for certain, or

Choice F: \$3,000 for certain.

Answer: Hey, is this a trick question? Of course, everyone will take the certain \$3,000.

This leads to Very Advanced Lesson #3: Recent evidence shows the stock market is like Choice F. It offers high returns and is a sure thing!

The only requirement is that you keep your focus on the long run.

You must not panic if you lose money for one or two weeks - or even one or two years.

THE EVIDENCE

How can stocks be a sure thing if they fluctuate?

The answer is that stocks, real estate and all risky investments only fluctuate in the short run.

In the long run, they always increase in value.

That is why you can't lose if you hold on for the long run.

One more thing. You must also diversify by holding at least 15 counters.

This is easy and you can do it by owning a unit trust or an ILP.

* To prove our case, we must turn to the US. That's because there is 200 years of US stock market data but only 20 years of Singapore market data.

Evidence: Over the past 200 years, there has never been a 17-year period in which US stocks have shown a negative return.

More evidence: If you look at holding periods of 10, 20 and 30 years, stocks have out-performed bonds 80, 90 and 100 per cent of the time.

* This shows that many of us are making the wrong investment decisions by keeping our long-run investments in fixed deposits, bonds and guaranteed funds.

We think of these investments as less risky, but precisely the opposite is true.

The safest way to preserve your wealth is to buy and hold a diversified portfolio of stocks and real estate, including your home.

Our CPF accounts serve this objective very well because they require us to take a long-run perspective - at least to age 55.