Lurking dangers to your wealth

Money Editor ANTHONY KEANE examines 20 financial traps that can take a nasty bite out of your savings, investments or superannuation.

TRAPS are lurking everywhere in the financial world. For investors, for borrowers, and for consumers.

We asked six South Australian financial experts for their views on the biggest traps that people need to avoid. Their answers are printed below.

1. SPENDING MORE THAN YOU EARN

AMP financial planner Mark Borg says too many people fall into the credit debt trap.

"It might sound simple, but spending less than you earn is probably the number one rule," he said.

"Especially for the Generation Ys who want everything today – it's vital they do not let the lure of credit cards and the stocktake sales lead them into the debt trap."

Savings & Loans Credit Union senior manager financial planning Phil Butterfield said it was important not to let spending get out of control, and people should understand their income and spending limits and have foolproof strategies to live within them.

"For example, make sure you can always pay off your credit card within the interest-free days," he said.

2. INTEREST-FREE LOANS

Great for buying that big screen television or new fridge but potentially very dangerous for your financial health, interest-free loans should be treated with care.

Mr Borg said people should make sure they repaid the full amount within the no-interest period.

"Don't fall into the trap of paying the minimum amount on your statement – otherwise you will be hit with high interest rates at the end of the no-interest period and pay much more for the item," he said.

Finance Mutual general manager Steve Aspinall said interest-free terms usually meant the purchaser paid the full retail price for an item, without the opportunity for negotiating a discount.

3. CREDIT CARDS

Mr Aspinall said credit cards could be a useful tool for managing cash flow if repaid in full within the interest-free period, but with many people a residual debt often remained.

People who only made the minimum payment each month would see the debt and interest grow, and end up paying interest on their interest, he said.

"The original purchase cost can grow exponentially, and the longer the debt remains the worse it gets.

"If a person uses the credit card to buy groceries and fuel and doesn't pay off the balance of the card, they add greatly to their cost of living."

4. GOALS? WHAT GOALS?

Without goals or targets, people have no direction in their finances or their life.

Mr Butterfield said people needed to

Model: Ray Hirst

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67 Kensington Road, Norwood SA 5067 T 08 8130 5130 F 08 8331 9161 E admin@marinisgroup.com.au
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know what they needed before they invested.

"Work out what your financial goals are, develop effective investment strategies to meet them, and then invest," he said.

"Investing before working through your goals and strategies is a bit like buying a sports car, and then realising when you get home that there are no seats in the back for the kids."

5. LACK OF UNDERSTANDING

Going blindly into an investment can be a recipe for disaster.

Lifeplan Funds Management general manager strategy and development Matt Walsh said people should fully understand the risk of any investment before handing over the money.

"Don't be discouraged by detailed disclosure documents because they usually contain all the information you need to know," he said.

"Shorter, easy-to-read documents could be hiding a lot of traps. Don't be pressured into investing in anything that you don't fully understand."

6. GET RICH QUICK SCHEMES

Both Mr Walsh and Mr Butterfield said anything that looked too good to be true most likely was.

Mr Butterfield said when suggested returns from an investment were significantly better than you might expect, there was usually a big catch.

"In most cases, to achieve a higher return, you must take on a higher risk," he said.

7. TRYING TO TIME THE SHARE MARKET

AMP's Mr Borg said it was a mistake to count on the share market as a get rich quick investment strategy.

"Investing in any asset class is a technique to gradually build wealth," he said.

"Many investors believe they can time the market – buying in before prices rise, riding the boom and getting out before it falls.

"For most people, anticipating these market conditions can be extremely difficult and many who try actually end up worse off."

8. PANICKING WHEN MARKETS GET ROCKY

Mr Borg said a common mistake people made was jumping out of an investment in periods of low or negative return.

"As well as losing money, these investors might also miss the next price rise," he said.

"Thinking long term is the key to successful investing."

Marinis Financial Group financial strategist Theo Marinis said people should not panic when markets go down. "In fact, it is a great time to buy good assets cheaply if you can spare some extra cash," he said.

9. IGNORING SUPERANNUATION

The rules surrounding super seem to change every year, but Mr Marinis said people should not forget that super was still their friend.

"Super is just as tax friendly as it has always been. That's why the government has limited your ability to put money into it since July 1, 2007," he said.

"And if you are over 55 and still working, sprint to your financial adviser and demand they consider your eligibility to participate in the highly tax-effective transition to retirement structure. It will mean thousands of dollars to you in your retirement."

10. PAYING TOO MUCH INTO SUPER

Caps on contributions to superannuation came into force in July last year because super's tax-free status for people aged over 60 makes it an irresistible place to park retirement savings.

Exceeding these caps has nasty consequences. "If you put in too much superannuation, serious tax penalties apply," Mr Marinis said.

"For example, 46.5 per cent is charged if you exceed the $50,000 cap – or $100,000 for over 50-year-olds – on concessional contributions (where a tax deduction can be claimed), and as much as 93 per cent if you exceed these and the non-concessional contribution cap (of $150,000 a year or $450,000 in a three-year period)," he said.

11. PLAYING IT TOO SAFE

Mr Butterfield from Savings & Loans said people should not shy away from an acceptable level of variability in their investment returns.

"If you stay away from more volatile investments such as shares, you won't participate in their higher investment performance over time," he said.

"Your cash-based investment may never fall in value, but it may also never grow."

12. ALL YOUR EGGS IN ONE BASKET

A good strategy if you pick the right basket, but extremely risky for most investors.

Mr Butterfield said diversification was the key to long-term investment success.

Macquarie Private Wealth's head of strategic financial planning, Jon Wells, said investing in a single sector such as property could result in an "asset rich but cash flow-poor world".

"Many in this sector are currently suffering higher interest rate pressures on their borrowings, which is adding to their negative cash flow," he said.

"A diversified strategy that unlocks equity in such assets to invest in shares, for example, can provide a solution to the cash flow-poor investor. A more diversified approach to investing should result in long-term assets growing in tandem with the sufficient cash flows you require."

13. ONLY SEEKING TAX DEDUCTIONS

There are many types of investments that promise tax benefits, but this should not be the only reason for investing.

"Entering into investment borrowing arrangements with the sole view of chasing tax deductions can be a trap for undisciplined investors," Mr Wells said.

"It is more sensible to adopt a long-term strategy and re-invest the deductions in a conservative asset class. This dual strategy can accelerate growth potential by creating two assets that complement each other and reduce your overall portfolio risk."

14. FREE ADVICE

It can come from friends, colleagues or even taxi drivers, but almost all free advice does not take into account personal financial circumstances and goals.

Lifeplan's Mr Walsh said paying for financial advice was a good investment. "Research shows that you're more likely to get a better outcome if you receive advice that's the most appropriate for you and your objectives," he said.

Mr Marinis said people should not be scared. "You may need to shop around to find it and it might seem expensive, but good advice is the best money you can spend," he said.

"Ask the advisers 'how hard do you work for your clients?' and then ask them to demonstrate it."

15. PROCRASTINATING

Investors should not feel pressured by time, as quick decisions can lead to mistakes, but they also should not delay their investing once their plan is set.

"Once you've decided on your investment strategy, implement it," Mr Butterfield said. "Don't sit around waiting for the perfect time to enter the market – the perfect time is as soon as you're ready."

16. BORROWING TO INVEST

Using other people's money – also known as gearing – can be a powerful tool for building wealth, but people need to be careful not to over-extend their borrowings.

Many investors, including some of Australia's corporate chiefs, were stung badly this year because they had borrowed too heavily to buy shares in companies that later suffered sharp falls amid the share market downturn.

"Gearing has more risk attached to it than investing with money that has been especially put aside," AMP's Mr Borg said.

17. UNDER-INSURANCE

Mr Borg said people needed to expect, and be prepared, for the unexpected.

"Most people would prefer not to think about the disasters that could befall them," he said.

"But should the terrible or unexpected occur in a person's life, whether it's injury, illness or death, being prepared – at least for the financial impact – will make the road to recovery easier for people and their families."

18. CONSOLIDATING DEBTS

Finance Mutual's Mr Aspinall said it was common for people to try to free up extra cash by rolling all debts into their home loan, for which they paid a lower interest rate than for credit cards, store cards and personal loans.

"However, what the borrower has done is spread the cost of the purchases on the car loan and credit card over a longer time – while at a lower interest rate they will end up paying more over the term," he said.

"Loans should be structured over the term of the asset – that's why car loans are generally only for five to seven years."

Mr Borg said people should be careful with debt consolidation.

"Although it might reduce your overall monthly loan repayments, you may now be paying off depreciating assets such as cars or furniture over a 25-year period rather than over two to five years," he said.

19. LINE OF CREDIT

This is another way of buying items at the cheaper home-loan interest rates. But just like debt consolidation, if not used properly borrowers would end up paying far more for their purchases over the long term, Mr Aspinall said.

"For example, if a line of credit is used to purchase a car at say $20,000, you should make extra payments of say $350 a month so this portion of debt is repaid within five years," he said.

20. GOING WITH THE FLOW

Mr Butterfield said people should not leave their financial future to chance.

"All you need to invest is an hour or two once a year, either on your own or with a good financial adviser, getting your finances in order," he said. "That's all it will take and it will be time and/or money well spent."

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