Reserve Bank of New Zealand
Te Pūtea Matua

Upside, downside

A guide to risk for savers and investors

Section 3

Looking ahead as you invest

Putting short-term money in volatile investments

If you're investing money for just a short period, it's risky to put it in investments with fluctuating values, such as shares or property. There's too big a chance that you will lose money, or at least not do well.

Over longer periods, though, you'll go through some good times as well as some bad times, and – as long as your investments are diversified - chances are high that you will do well.

How long is long-term? Some experts say five or seven years, many say 10 years or even more.

In a single year, you have about a one in three chance that an investment in shares will lose value. Over three years, it's about one in five, but over 10 years, it's about one in 48.

Your definition of long term will depend on your risk tolerance and your circumstances.

In some situations, such as saving for an overseas trip you want to take in the future, you might be willing to risk putting some of your money in shares or a share fund. After all, if you're unlucky, you can always make a cheaper trip. But if you need a certain amount to fund your education or your child's education, you might take less risk.

Certainly, if it's money you plan to spend in just one or two years, you're well advised to keep it in bank term deposits.

KiwiSaver

For most people, KiwiSaver is a long-term investment. In many cases, you don't expect to spend the money for decades.

However, if you are within, say, 10 years of withdrawing money, either to buy a first home or to spend in retirement, it's a good idea to move money from higher-risk funds into lower-risk funds.

Some providers offer KiwiSaver funds in which the risk is adjusted for your age. Your money is automatically invested in higher-risk funds when you are young, and the risk is gradually reduced as you approach retirement. This can work well, but avoid such a fund if you plan to withdraw money to buy a first home, as you will be put into too-risky investments.

Older people should keep in mind that they may not spend their KiwiSaver money soon after they reach New Zealand Superannuation age. They may fund their early retirement with other savings and use KiwiSaver money in their 80s or 90s. In that case, they are likely to receive higher returns, and get better protection from inflation, if they leave the money in higher-risk funds until they are within about 10 years of spending it.

Buying investments that are hard – or expensive – to get out of

When you tie up money for a period, you think you won't need to draw on it before that period expires. But it's surprising how often things change, and you suddenly need the money.

Obviously, one way to avoid having to sell an investment early is to maintain an emergency fund in a bank account. But you can overdo this, as the emergency money is likely to earn a lower return than in alternative investments.

Before committing to an investment for a particular period, it's wise to understand what would happen if you need to get out early.

Fixed interest

Issuers of some fixed interest investments, such as bank term deposits, charge a penalty if you want to get your money before maturity.

However, with bonds listed on the New Zealand Exchange, you can sell before the term ends if you want your money out early. Usually, though, you'll find that you get either more or less than you put in.

If it's less, that may be because the company's credit rating has fallen. On the other hand, the company may be in fine shape, but market interest rates have risen since you bought the bond.

Let's look at an example. You bought a $5,000 five-year bond with a 6 percent coupon rate. That means you get 6 percent interest a year, and $5,000 back at the end. But since you bought the bond, interest rates have risen, and other companies with similar risk profiles are now issuing bonds at 8 percent.

If you decide to sell your bond before maturity, nobody will want to buy it for $5000 when, for the same money, they could get an 8 percent bond. They will buy yours only if they get it more cheaply, perhaps for $4,500.

You always have the option, though, of holding the bond until maturity, when you should get the full amount back.

Note, too, that the reverse can also happen. If market interest rates fall since you bought your bond, everyone will be keen to buy it. In our example, you might get $5,500 for your bond.

Property

Direct investments in property are illiquid, meaning they are not easy to sell. Sometimes, you're lucky and can find a buyer quickly, at a good price. But don't count on it.

Property prices go through cycles. In between the booms come periods of slow sales. If you have to sell at such a time, you may be forced to lower your price to well below what you had hoped for – and even then it may take months to sell.

Some indirect property investments can also be much less liquid than the promoters claim. Firms that run property syndicates or similar, which usually own one or several commercial buildings, often say they will help you to find a buyer if you need to get your money back before maturity. Investors often find, though, that there are no buyers on the horizon, or that buyers offer them much less than they originally put into the investment.

You can reduce such problems by investing in property portfolios that are listed on the stock exchange.

Shares and share funds

Most shares are listed on a stock exchange, so can be traded fairly easily – although some smaller shares are traded quite infrequently. Some share funds, called exchange traded funds or ETFs, are also listed, and even the unlisted ones are usually fairly easy to get out of.

Unlisted shares, perhaps in a family company, are usually much less liquid.

KiwiSaver

In most cases, KiwiSaver money is tied up until you withdraw it to buy a first home or to spend in retirement. For a first home withdrawal, you can take out all the money in your account except $1,000. You may also be eligible for a First Home Grant of up to $5,000, or $10,000 for a couple – or double those amounts if you buy a newly built home. You have to contribute regularly to KiwiSaver for three years and earn less than a maximum income. There are also house price caps. See www.kaingaora.govt.nz.

In retirement, you can take out some or all of your KiwiSaver money whenever you want to, or leave it there until you die.

In some other circumstances, you may be able to withdraw some or all of your KiwiSaver savings. These include: significant financial hardship, serious illness, and leaving New Zealand permanently. Also, people who have owned a home before but don't currently own one, and who are in a similar financial situation to a first home buyer, can withdraw some of their money to buy a home.

When you die, your KiwiSaver money goes to your estate and the money is available to your heirs. They don't have to wait until you would have reached New Zealand Superannuation age.

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