WEALTH

Simple Tips for Savvy Kiwis

Sonnie Bailey

Dedication

This book is dedicated to my wife Chrissy, and our children, Ben and Anna.

You are my true source of wealth.

Contents

Here's to your health, wealth, and happiness

This book is about wealth, defined broadly. Although it focuses on financial wealth, it's important to emphasise that real wealth isn't just financial.

There's a phrase that "your health is your wealth". People who are in good physical and mental health and have high quality relationships, for example, are genuinely wealthy, regardless of their financial status.

The connections between health and wealth don't end there. Because building wealth is a bit like staying healthy and cultivating high quality relationships. **It may be simple, but it's not always easy.**

In each case, achieving and maintaining great outcomes requires willpower, and long-term commitment.

But it's not just about willpower. There's a degree of "skillpower" involved. And sometimes, the more skillpower you have, the less willpower you need.

It's one thing to commit to being healthy. It's another to know what you should eat and how you should exercise.

The purpose of this book is to help with the skillpower. My aim is to fit a number of key tips for getting on the right financial footing into a digestible, engaging format.

My hope is that it will help with the willpower as well, and provide the motivation to put some of these steps into action.

In this book, I've split many of the key things to know about building wealth into some key lessons. I talk about:

- defining what wealth means to you and using this to guide your financial decisions;

- making wealth – saving;

- growing wealth – investing; and

- preserving wealth – including insuring the things that matter most to you and structuring your affairs appropriately.

I hope you enjoy this book. If you have any questions or feedback, feel free to email me at sonnie@fairhavenwealth.co.nz.

Why this book?

This book was prepared for the same reason I started my financial planning business, Fairhaven Wealth. I want to provide straightforward, human-friendly guidance to people who are engaged with their financial futures. I want people to have access to advice that is independent and as unconflicted and unbiased as possible.

I've worked in the financial services industry for many years. I'm a huge advocate for good quality financial advice. Most advisers I have dealt with in New Zealand and Australia care deeply about their clients and putting them in the best position possible.

However, for various reasons, many people don't receive advice. There are many reasons for this, but in large part is a result of most investment advisers charging clients as a percentage of their investment portfolio. This means that they're most interested in clients with portfolios of $200,000 or more.

I also have a healthy degree of scepticism about how some people are incentivised, whether because of conflicted remuneration, or being affiliated with financial product issuers. This creates subtle (or not-so-subtle) incentives that pit the interests of the person providing the service against the interests of their client or customer.

I believe incentives matter. As Charlie Munger, Warren Buffett's long-time business partner has said: "show me the incentives, and I'll show you the outcomes".

For example:

- Real estate agents and mortgage brokers are eager to work with people looking to buy a home or investment property. But their revenue is based on you buying a house and borrowing money. The more you spend/borrow, the better for them. The incentive is for them to focus on making the transaction happen, and not on how it fits in to your broader situation and goals.

- You can walk into a bank, and someone might speak with you. But there's a sales component to what they do. What facilities can they cross-sell to you? Can they suggest their own insurance policies, their own KiwiSaver product, or point you to their investment team who will advise on their investment products?

- Insurance advisers are happy to help, but that's because they receive a commission on the products they sell to you. They only get paid if you take out insurance, and the more you take out, the more they get paid. Financially, they're often *penalised* for telling you that you're over-insured, because it reduces their income.

- As I've mentioned, remuneration for investment advisers tends to be a percentage of the investments they are advising on. Not only does this orient their services to clients who already have money, but it can also encourage advice to be oriented towards financial assets (over which the adviser can be remunerated), rather than, say, repaying debt.

I've worked with many financial services professionals and in most cases their hearts are in the right place and they want the right things for their clients. Most advice is pretty good.

But some of it is terrible, and in my experience this is largely driven by conflicts of interest. There have been times when the advice I've seen has broken my heart.

This is where this book comes in. I want to give you independent, impartial, unconflicted, and unbiased tips for building wealth.

It is also where my business, Fairhaven Wealth, comes in. I've designed the business from the ground-up to ensure that my interests are aligned with the interests of my clients. I'm not beholden to anyone asking me to meet targets or cross-sell. My only duties are to my conscience and my clients. My success is predicated on attracting people who are attracted to my business model and personal ethos, as well as having satisfied clients who trust me and refer my business to their friends and family.

In the interest of full disclosure, there’s an ulterior motive for me making this resource freely available. It means that I attract clients who are on a similar page to me. If what I say doesn’t appeal to you, you won’t contact me. If it resonates, and you want to work together, that’s great!

Defining wealth

“Defining wealth” refers to working out what you value.

Wealth is about well-being. It’s not just about money.

I encourage people to step back and take a wider view of what it means to be wealthy. There is a financial and material aspect to this. But you can be financially rich and miserable. That’s not being “wealthy” by any definition.

I’ve had the privilege of reviewing thousands of financial advice files prepared by hundreds of financial advisers. When I used to review advice, one of the things that set the best quality advice apart from the rest was when I got a real sense of who the person receiving the advice was. What did they care about? What were their priorities in life? What did they value? How did this change over time?

One of the most important projects we have in life is deciding what we want our life to be about. This relates to defining what “wealth” means to us.

What do you want the future to hold?

Thinking about what you want and expect from the future is a good way of clarifying your values and priorities.

A good way of thinking about the future is to think in terms of futures with an “s”. Futures, plural. Because there are a lot of things outside of our control, and we can’t tell the future. But we can make best guesses.

Consider the following:

- Based on the current trajectory of your life, what does the future *probably* hold for you?

- If things work out a bit better than you expect, what might your life look like? What about if things work out a lot better?

- Are there some events (good or bad) that could happen to you or a loved one that might have a significant impact on your future?

- Can you think of any "wild card" scenarios that could happen to you? (These could be on a personal level or at the social, technological, economic, or political level.)

When you think about these scenarios, think about the commonalities. What is common about what you want? What is common about what you *don't* want? It is these commonalities, rather than the specific outcomes, that should inform your decisions.

It's valuable to have goals. But I'm not a fan of having a fixed idea of what the future holds, and sticking slavishly to it. Goals and priorities should evolve, and we should be open to opportunities even if they weren't what we expected.

There are lots of things that are outside of our control that will impact our lives. As we age and have different experiences, what we want from life changes.

What are some of your specific short- and medium-term goals?

We often have specific short- and medium-term goals. To buy a new gadget or item of clothing. To buy a new car. To go on a holiday. To pay for a wedding. To save for a house.

It's valuable to have some short- and medium-term goals. The reason for this is that it helps to clarify the financial decisions you make. If you're thinking of buying something that you don't necessarily need, you can consider it in terms of the trade-offs you need to make with respect to these other goals.

Sure, you might want that pair of shoes. But do you want it more than that trip to Noosa?

What are your retirement or financial independence goals?

Often, the goals that are hardest to work towards are the goals that are a long way in the future. Retirement is a perfect example. If you're young, it's so far away that it's an abstract idea.

The older you get, the less abstract retirement becomes.

NZ Super is generous by international standards. And for some people, this is fine – I know people for whom NZ Super is their sole source of income and they feel richer than they ever did during their working lives.

However, for most people, NZ Super won't enable you to enjoy the sort of lifestyle you really want in your retirement.

Think about this. You will only ever generate a certain amount of money in your working life. By the time you retire, you will need to have converted some of this income into assets that can generate income for you to live on. If you don't do this, your retirement will be a modest affair.

Where do you want to be at the end of your working life?

Specifically:

- When do you want to be able to retire, or be financially independent?
- What does being financially independent mean to you?
- What sort of lifestyle do you want and how much will this cost?

- Where do you want to live?
- How long do you expect to be retired for?
- What sort of capital sum will you probably need to support the lifestyle you want in your retirement?

These goals will change, and there's a lot of uncertainty here. You don't know whether you'll have any health issues or what they'll be. It's hard to predict what costs will be several decades into the future. And you don't know how long you'll live.

Having an idea that you want: say, the equivalent of a $600,000 property and investment assets (including KiwiSaver) of $500,000 by the time you reach 65, can give you some clarity and an additional benchmark for whether you're moving in the right direction.

Like all other goals, these can be subject to change. Sometimes your priorities change. Sometimes you overshoot your target and sometimes a goal becomes unrealistic. This shouldn't stop you from having goals – you just need to have an appreciation that they can, and will, change over time.

Do you and your partner define wealth in the same way?

If you're in a committed, long-term relationship, it helps to be on the same page as your partner.

Make sure you have these discussions with your partner. I can guarantee that you won't be 100% aligned. But if you have very different values and priorities, and different tolerances for dealing with debt and risk, then the sooner you address this the better.

Part of this conversation is discussing how you want to balance your financial goals against your lifestyle goals. For example, many people take time off work to raise children or pursue personal projects. Many people work part-time, or take lower-paying work that is more meaningful to them. All of these decisions are legitimate and are in line with being wealthy in the deeper sense, if they align with what both of you want out of life.

Enjoying wealth

What's the point of working hard and accumulating financial resources unless you can enjoy your wealth?

Does money buy happiness?

"I think everybody should get rich and famous and do everything they ever dreamed of, so they can see that it's not the answer." – Jim Carrey

Moving from below the poverty line to above it has a profound impact on happiness. As the financial sage Kanye West puts it, "Having money isn't everything, but not having it is".

If you're reading this book, you're probably above the poverty line. In which case you're more interested in the incremental benefits to happiness that you can achieve with greater wealth.

There is some research indicating that income has a strong correlation with happiness but flattens out once people get beyond an income of around $100,000. This is supported by the idea of the "hedonic treadmill" – people seem to return to relatively stable levels of happiness regardless of the circumstances of their lives.

This drives the popular notion that money doesn't buy happiness.

But there are some nuances to this research. It turns out that moment-to-moment happiness doesn't seem to change much as income reaches this point of diminishing returns.

But when people are asked to take stock of their lives, wealthier people tend to be more satisfied.

In other words, money doesn't necessarily improve our experience of life. But money can impact the stories we tell ourselves about our lives.

"If money doesn't make you happy then you probably aren't spending it right"

A terrific article about money and happiness is titled "If Money Doesn't Make You Happy Then You Probably Aren't Spending It Right". It was written by three renowned social psychologists – Daniel T Gilbert, Timothy D Wilson, and Elizabeth Dunn. The article was expanded into a book by Dunn and Michael Norton titled *Happy Money*.

Gilbert, Wilson, and Dunn outline several principles for getting the most happiness out of your money.

In short, they say you should:

- spend money in ways that increase your connectedness to others;

- realise that you'll adapt to purchases and experiences, good and bad, and should factor this heavily into your purchasing decisions;

- make purchasing decisions that increase anticipation; and.

- Look at how your purchasing decisions will impact how you use your time.

Specific tips include:

1. *Buy more experiences and fewer material goods*

There are a few reasons for this. We adapt to material goods more so than experiences, which often get tied up with our identity. Experiences often involve more anticipation. And experiences are often shared with people, so improve our sense of connection and relatedness to others.

2. *Use money to benefit others*

Human beings are social creatures. A lot of research indicates that social relationships are critical for happiness. Gilbert, Wilson, and Dunn state that "almost anything we do to improve our connections with others tends to improve our happiness".

3. *Buy many small pleasures rather than fewer large ones*

Hedonic adaptation is a big reason for this. If you're going to adapt to things, it's better to get lots of little hits of positivity than one big hit.

Variables that help to counteract adaptation include novelty, surprise, uncertainty, and variability.

4. *Pay now, consume later*

(Don't confuse this with "buy now, pay later"!)

Delayed gratification gives more pleasure than instant gratification. Looking forward to a purchase or event can itself provide a lot of satisfaction.

5. *Think about what you're not thinking about*

When making a major purchase, think about how it will impact how you spend your time. A large home seems great, until you realise that it demands more time in maintenance and upkeep than a more modest home. Likewise, a holiday home sounds fantastic – it represents a place to get away and spend time with friends and family. But in many ways, you'll find that you're multiplying the time you spend on maintenance and upkeep by two.

The authors recommend that you think about the effect your purchase will have on a Tuesday – ie, an ordinary day in your life. Will it really improve the quality of your life?

Would you rather *be* wealthy or *appear* wealthy?

In the late 1990s, Thomas J Stanley and William D Danko wrote a book titled *The Millionaire Next Door*.

The key point of the book is that it's one thing to have the trappings of financial wealth, and it's another thing to *be* financially wealthy.

If you see someone with an expensive car, all it tells you is that they've paid a lot of money to have that car. It doesn't tell you how much they owe on the car, or the status of their balance sheet.

It's fine to want nice things and signal characteristics such as wealth and taste to other people.

But one way of inverting this is to ask: by wanting the trappings of wealth, what am I trying to demonstrate to, and to whom? Are there other ways of signalling this message? In light of the other things in life that I value, are these expensive purchases worth the cost?

Making wealth

It’s valuable to distinguish between “making wealth” and “growing wealth”. For the purpose of this book, **growing wealth is about investing your money. Making wealth is accumulating money, so you have funds to invest.**

“Making wealth” refers to saving. And in many ways, it’s more important than investing because you have more control over this. It’s harder to control investment returns than how much you save.

Think of it this way. If you own shares in a company, the value of your shares comes down to two main factors: the market price of the shares, and the number of shares you own. You have little control over the market price. But you can control the number of shares you own.

Spend less than you earn

There are two main factors that come into play when it comes to saving. One of those is how much you spend.

From a financial independence perspective, the less you spend, the better. The less you spend, the more you can save, and the smaller the lump sum you need if you no longer want to work because your spending expectations are more modest.

When people think about saving money, it’s easy to think in terms of money spent on coffees and eating out. But far more important are what we tend to think of as “fixed costs”. Often, we make one big decision and don’t realise that we always have the option to make a different decision.

For example:

- Spending too much money on rent or buying more house than you need.

  Spending an extra $100,000 on a house might mean an extra $100 per week in interest, and an extra few years of repaying a mortgage when you could be using those years to build wealth.

- Spending too much on a car.

  You should buy the cheapest car that your ego will allow. A simple rule of thumb when it comes to cars is that if you need to borrow money to buy it, you can't afford it.

Earn more than you spend

The other factor is your earning potential. There comes a point where focusing too much on saving money is counterproductive. There are times when the focus should be on maximising your income.

Often the best investment you can make is in yourself. It can increase your lifetime earning potential.

Sometimes you need to accept that to take two steps forward you need to take one step back.

For example, taking a role that pays less but positions you well for the future can be a terrific financial decision.

Sometimes business opportunities present themselves that can substantially increase your ability to generate income, or the quality of your life more generally. That's fine – but it's important to be mindful of the potential downside, and how you will manage these risks.

Repaying debt is building wealth

Perhaps your most important financial number is your “net worth”. You calculate your net worth by subtracting your liabilities from your assets.

If you increase your assets, your net worth increases. If you decrease your liabilities, your net worth increases too.

From a net worth perspective, putting a dollar towards paying off debt is the same as putting a dollar into a savings account.

Many times, paying off debt can be the best investment available. If you earn interest or dividends, you are taxed on that income. So a 6% return will look more like 4% after factoring in tax. If you’re paying an interest rate of 5%, repaying the debt can result in a better net return.

Usually, investments involve a degree of risk. The value of your investments will go up and down over time, and the higher the potential return, the more volatility you’ll experience. When you repay debt, there are no ups and downs – you’re essentially getting a risk-free return.

Think of repaying debt as making a risk-free, untaxed return on your investment.

There are some caveats. One is that if you pay some loans off, you may incur break costs, and these should be factored into any decision to repay debt.

Some debts also aren’t worth paying off quickly. If you’re living in New Zealand, your student loan is interest free, and is also extinguished if you die. If anything, you’re incentivised *not* to pay it off early.

You won't save in a linear fashion

You may have read advice to the effect that "to retire comfortably you should save 15% of your income throughout your working life".

The sentiment is right, but the specifics are not. Maybe you should average 15%, but to say that you should do that every year of your life is absurd.

You will go through periods when you face headwinds. You need to accept this, anticipate it, and plan for it.

A good example is having children. Prior to becoming parents, you are probably DINKs – double income, no kids. It can be easy to save (and/or live a great lifestyle) when you're a DINK. During this phase you would ideally save much more than 15% of your income.

Once a baby comes along, you suddenly find that you're SIK – single income with kids. As well as having a lower combined income, kids introduce a whole new set of expenses.

You can't beat yourself up about it.

The effort you put in when you're facing headwinds often doesn't seem clear – until you've got the wind at your back. You might not necessarily see the effort pay off until your children are out of home, you've paid off your mortgage, and you can largely afford to self-insure. It's no coincidence that financial wealth is highly correlated with age!

Growing wealth

"Growing wealth" relates to investing. Once you've made some wealth, the next step is to try to grow it in a way that doesn't expose you to too much risk.

Many people think of this as the key component when it comes to being wealthy. But it's not, and in a lot of ways, it's the simplest part of the equation. For this reason, I'll keep my comments short and sweet.

There is a relationship between risk and return

There is a relationship between risk and return. The more risk you're prepared to take on, the more likely it is that you'll generate a higher return over the long-run.

However, it's important to realise that the relationship between risk and return is not black and white.

Some investments are terrible investments, however you cut it. If the maximum return you can generate is 10%, but there is a high chance that you will lose some or all of your capital, then it's not a great investment.

Cash and fixed interest investments are often thought of as being low risk investments compared to, say, property and equities. But for a young person, investing a large portion of your investable funds in cash and fixed interest can itself be risky.

This is because cash and fixed interest often return little more than the rate of inflation. This means that the value of the investment in terms of what it can buy stays static over time. Sure, you're not losing capital, but its value is being eaten away.

If you've got a time horizon of decades, then it's likely that for the privilege of holding these "safe" assets, you're going to miss out on returns that you would have generated from investing the funds elsewhere. Failing to meet your retirement objectives is itself risk.

There are many different types of investments

Different investments have different characteristics. Some of the key characteristics are:

- **Liquidity.** An asset is "liquid" if it can quickly and easily be turned into cash. All else being equal, the more liquid an investment is, the better. Cash or money in the bank is highly liquid. You can use it to buy goods and services right away, and there are limited transaction fees for doing so. Generally, publicly listed shares can take a few days to turn into cash. Property can take a long time and involves transaction fees, including agent commission and conveyancing fees. Investments in privately held companies can be very difficult to convert into cash, and there is often a lot of uncertainty about what you'll get for selling your interest.

- **Volatility.** The value of some investments, and the income they generate, can vary. Money in the bank is fairly steady: you know how much you've got, and it generates a specific rate of interest. Certainty is great, but it comes at a cost. Your rate of return is unlikely to exceed inflation by much.

  More volatile investments, on the other hand, expose you to greater potential losses as well as higher potential returns. The dividends that a given stock generates might change from year to year. The price of that stock can also change, sometimes wildly.

- **Tax.** I won't focus on this in too much detail. But I will say one thing about tax: if the primary reason for making an investment is tax, this should ring alarm bells. The most heart-breaking advice I've seen has been driven by tax considerations. Tax can be a factor, but it shouldn't be the only factor.

I will also say this: if you build financial wealth, one of your goals should be to pay a lot of tax. Paying tax means that you've generated a lot of income and wealth. A legitimate secondary goal, however, is not paying more tax than you need to.

There are also characteristics that are unique to specific investments. For example, if you're investing in a publicly listed company, it comes down to the business you're investing in and the unique challenges and opportunities in that company's business environment. If you're buying a property, there is the potential for maintenance, and risks or opportunities in relation to the rental market, or the property market in general, which can be influenced by factors outside of your control, such as interest rates and natural disasters.

Some "investments" end up not being investments at all. For example, my personal view is that contracts for difference (CFDs) and binary options aren't investments, but a form of gambling disguised as investing.

Rules for investing

Below are some major rules you should remember when investing:

- **Diversification is your friend.** If your investments are limited to one asset, then you're exposed to all of the unique risks and issues associated with that one asset. If you're invested in a number of different assets, one might perform poorly, but this will usually be counterbalanced by the other investments.

  If you're invested in different types of assets, dealing in different markets, in different parts of the world, you're reducing your risk further. Diversification is the one free lunch when it comes to investing, in the sense that you can substantially reduce your risk without substantially reducing your exposure to the upside.

- **Fees are handbrakes to building wealth.** You can't control the broader economy. No individual can. One thing that you can control, however, is fees.

  The world of finance is one area where what you pay for isn't necessarily what you get. On the contrary, it's often the case that the higher the fees, the worse the product. Beware of money vampires!

- **Beware of debt.** Borrowing to invest can magnify returns, but it also magnifies losses. It is risky. Warren Buffett puts it this way:

  "Having a large amount of leverage is like driving a car with a dagger on the steering wheel pointed at your heart. If you do that, you will be a better driver. There will be fewer accidents but when they happen, they will be fatal."

  Here is a simplified example. Imagine that you've purchased a house for $500,000, with a deposit of $100,000 and a mortgage of $400,000. If the property increases in value by $50,000, this is great. The equity in your house has risen from $100,000 to $150,000. It's a 50% return on your $100,000 investment. But if the property decreases in value by $50,000, this means your equity in the property is halved – from $100,000 to $50,000.

If you're focusing on specific investments, you're focusing on the wrong things

There have never been as many professional investment managers out there as there are today. These investment managers are smarter, more dedicated, and better resourced than ever. If you're investing in a publicly listed stock, it's likely that a well-paid professional is on the other side of the transaction. Trying to compete in this environment is like stepping onto a tennis court to play Roger Federer.

You can invest in managed funds, where investment managers pick a variety of stocks on your behalf. However, one of the ironies of having so many intelligent, well-educated, dedicated, well-informed and well-resourced investment managers in the market is that it is harder for them to actually outperform the rest of the market. It's like the All Blacks stepping onto the field against the All Blacks. This is known as the paradox of skill – the more skilful participants are, the harder it is to out-perform.

If, despite this, you want to pick individual investments, think of it as a hobby. Like some hobbies, it might end up being financially rewarding. But chances are, it'll be expensive and time-consuming.

My personal preference is to invest in low-fee, index-based managed funds. These provide you with wide diversification, low cost, and extremely high convenience. I like many of the funds issued by Simplicity, SuperLife, and several of the funds available on InvestNow. Investing in managed funds like this might seem simplistic, but in some areas in life, simplicity is a virtue. Investing is one of those areas.

Asset allocation is king

If you shouldn't be focusing on specific investments, what should you be paying the most attention to?

Asset allocation. The first, and most important, decision to make when investing in financial assets is to determine an appropriate asset allocation for you. This refers to how your funds should be invested into different classes of assets.

The first distinction is to determine what level of assets should be in “growth” assets, such as shares and property, and “defensive” assets, including cash, bonds, and term deposits.

Growth assets tend to have higher volatility. This means that the returns they generate (such as from dividends and capital gains/losses) can vary significantly from year to year. With growth assets, you have a higher likelihood of losing money in any given year.

Defensive assets, on the other hand, are much more stable in comparison. This doesn’t mean that defensive assets aren’t without risk, however. The downside with defensive assets is that the returns they generate tend to be much lower than with growth assets – especially after factoring in inflation, which eats away at the value of investments.

Over the long-run, growth assets tend to generate better returns than defensive assets. Because of this, there is a legitimate risk of being too heavily invested in defensive assets and ending up in a worse position over the long-run than you would have been by investing in growth assets.

The asset allocation that is appropriate for you will come down to a variety of factors. This includes your personal tolerance for risk (ie, your ability to sleep at night in the face of your investments going up and down in value over the short-run); your need to take on risk in order to achieve your objectives; your ability to recover from risk; and your cash flow needs over the short-, medium-, and long-term future.

If you want a detailed explanation of how someone can calculate their asset allocation, check out the following article on the NZ Wealth & Risk blog: https://wealthandrisk.nz/asset-allocation-book.

Property

Kiwis love property. Owning a home has long been a part of "the Kiwi Dream". Many people think that investing in property is a great way to invest money.

For many people, property has been a great investment. But that doesn't mean it has been for everyone.

You can still get into a great long-term financial position even if you never buy a property.

And in fact, property has some characteristics that make it riskier than many people often think.

Let's consider some of the characteristics we've discussed. Property is an illiquid asset. In other words, it takes time to sell, you don't know what you'll sell it for, and there are substantial transaction costs and inconveniences with doing so.

If you're investing in property, it's likely that a lot of your eggs are in one basket. Which is to say, you're not diversifying. You're exposed to all of the specific risks associated with that property, which aren't just limited to the property reducing in value. There are potential issues with tenants, or lack of tenants. Maintenance and upkeep can be expensive. Earthquakes and other disasters can be inconvenient or worse.

On top of that, you may also be borrowing money. Which can improve the upside but can magnify the losses.

If a financial adviser recommended an investment product with these characteristics, you'd wonder what they were thinking.

These comments may make you flinch. But consider: who has an incentive to point out the risks associated with property?

- Banks make money from lending to people to buy property. The more money they lend, the more they make. Lenders don't want property to reduce in value.

- Mortgage brokers make commission when you borrow, and the more you borrow, the more they make. The more property that trades hands, the better for them. Where is the incentive for mortgage brokers to be pessimistic when it comes to the property market?

- Real estate agents may know the market, but their incentives are the same as mortgage brokers. They make money when properties trade hands. The more the property sells for, the more they get. Real estate agents don't want the property market to slow, or for prices to fall.

- The government doesn't want property values to decrease, despite platitudes in support of housing affordability. Many voters hold most of their wealth in property, and wouldn't be happy if their wealth plummeted.

We have many well-funded industries who want to support the narrative of property being the best investment around. We hear lots of stories about people who make money from property.

But there are lots of people who don't make money from property. Where is the incentive to share their stories? People love to share their successes, but not their failures.

It's also easy to over-simplify and overstate the return you make on property. For example, I know some people who purchased their home for $25,000, and recently sold their house for $1 million. This sounds like a great return! But let's dig deeper. They owned the house for 43 years. The compounded return is only a little over 3.2% per year. Not only this, this simple calculation hasn't factored in the hundreds of thousands they've spent on maintenance and improvements over this time.

Don't get me wrong. My wife and I own a house. Property has and can be a good investment in the right circumstances. And there are certainly some influential groups (including government and banks) that want to avoid, and would try to mediate, a property free-fall.

The key point is that you can get into a great financial position without owing your home or having investment properties.

If you save enough, and invest in diversified, low cost funds that are allocated across asset classes that are appropriate for your circumstances, needs, and objectives, then you're likely to be fine.

The above comments above aren't restricted to property. The same principles apply to investing into a business or any other substantial asset meant to generate a return.

Free money

If your employer matched your savings, dollar for dollar, for up to 3% of your salary, would you consider this free money and take it?

If the government matched $1 for every $2 you saved, up to $521 matched, would you consider this free money and take it?

Broadly speaking, this is how KiwiSaver works. I don't like turning down free money. Do you?

At any given time, there can be Government initiatives that have the potential to provide you with benefits. For example, if you're looking at buying a first home at some point in the foreseeable future, it's worth looking into the KiwiSaver HomeStart grant. Keep an eye out for these sorts of schemes.

Preserving wealth

“Preserving wealth” is about ensuring you don’t lose your hard-earned wealth. It’s also about protecting your loved ones should anything happen to you.

Part of this relates to investments. Making bad investments is one of the best ways to turn a large fortune into a small fortune. Investments, and the importance of diversification in particular, are discussed in the previous chapter.

We live in an uncertain world

We live in an uncertain world. One definition of “risk” is “the effect of uncertainty on objectives”. I like this definition because it focuses on uncertainty, and specifically uncertainty as it relates to the things we care about (ie, our objectives).

As I’ve explained earlier in the book, it’s valuable to think of futures, plural. We can’t know the future because so many things in life are uncertain.

Uncertainty can work in our favour. It can help us achieve our goals faster than we expected, or catapult right past them. But it can work in the other direction, too.

From this comes an important maxim when it comes to building wealth: **to win, don’t lose.**

We need to consider the worst, and take steps to avoid these scenarios and minimise their impact should they happen.

Insurance is a tool for managing risk

In the financial services industry, the word “insurance” is often synonymous with “risk”. Many insurance advisers call themselves “risk” advisers.

I personally think this is a narrow view. Insurance is a tool for managing risks, but it's not the only tool.

Self-insurance

In some cases, the best form of insurance is self-insurance.

One of my key long-term financial goals is to be able to self-insure. I encourage young people to aspire to this goal. You don't want to be paying huge personal insurance premiums when you're sixty.

Think of Bill Gates. He doesn't need life insurance. If he dies, his family will be just fine. If you had $10 million, then you probably wouldn't need life insurance either. Your dependents will be able to live comfortably.

What about if you have $2 million or $1 million? The exact figure is different for everyone. But the question is whether, if you die, your loved ones will be provided for. If so, you probably don't need life insurance.

It's the same with other types of insurance. If you have several hundred thousand dollars available, you might not need trauma insurance. Or you might have a buffer which means you can afford to have a long waiting period before income protection insurance kicks in.

Instead of paying someone else to take risks for you, you can save your money on premiums, knowing that you are taking these risks yourself. This is self-insurance.

Insurance is best for catastrophic risks

There are different ways of managing risks. After identifying a risk, you can choose to keep it. You might choose to take steps to reduce its likelihood or mitigate its impact. You can avoid the risk. Or you can transfer the risk to someone else.

Insurance is about transferring risks to other people, and paying them to take on that risk.

Insurance works best for low probability, high impact events. Like dying unexpectedly or having a health issue that means you're unable to work and support your loved ones. These low probability, high impact events are where insurance is most valuable.

Insurance is most worthwhile for events that are unlikely but would be catastrophic for your loved ones.

This can put some kinds of insurance into perspective. For example, paying several hundred dollars for an extended warranty for a TV is a type of insurance. Sure, there's a chance that something might happen. But it's unlikely. And if it does, it might be inconvenient, but you can probably weather this risk.

Having high excesses or longer waiting periods is also worth considering. For example, you might choose to have a higher excess for your contents insurance or car insurance, because for smaller losses you'll pay the costs, and what you're looking to protect against is the scenario where your house burns down or your car is written off.

Or you might have a longer waiting period for income protection insurance, because you're confident that you could survive without an income for two or three months but what you're really concerned about is being unable to work for many years. In this case you're self-insuring for the smaller risk and insuring for the larger one.

Structuring your assets

If you're operating a business, consider operating the business as a limited liability company. If you operate a business in your own name or in partnership with another person, you can end up personally liable for the expenses of the business and even the decisions of your business partner. Make sure you get legal and accounting advice before making a decision of this nature.

There are also a lot of legitimate reasons for setting up a trust, even if you're young. Historically, some of the main reasons for establishing trusts were to minimise tax or maximise entitlements to government benefits. These reasons are less compelling than they used to be.

Common reasons for establishing trusts now are asset protection and protection from relationship property claims. Once you've put your assets into a trust, it's not technically yours. If someone sues you, trust assets are less vulnerable than assets in your own name. If you become bankrupt, those assets are more likely to be protected.

Relationship property protection is a common driver for establishing trusts. For example, my wife and I have set up a trust. One of the reasons for this is if our children ever get into relationships that don't work out, their interests in the assets we've worked to build up are more likely to be protected and won't end up with their exes.

Consider also a husband and wife who have had a long and successful relationship. They have raised well-adjusted, adult children, and accumulated significant assets. If one dies and the other remarries, those assets are less likely to end up in the hands of the new partner (and the partner's children) if they had been settled into a family trust.

Succession planning

Succession planning relates to dealing with the possibility of your untimely death or a situation where you lose capacity to make or communicate decisions.

Wills and inheritance

I subscribe to the idea that "living well is leaving well".

One of the first steps to helping your loved ones in the event of your untimely death is to have a will. This will generally make a difficult time slightly less difficult for your loved ones.

In your will, you can give specific instructions. For example, who will act as your executors, who will get your assets, and who you would like to act as guardian for your children (if you have any).

It's also worth giving some thought to the idea that people don't just receive an inheritance from you when they die.

If you have or expect to have children, for example, consider that they receive a genetic inheritance. But they also inherit a range of experiences, knowledge, beliefs, and values from you. In many ways this is more important than money, and you can share many of these types of wealth during your lifetime.

Money and love

Who you end up in a relationship with can have a profound impact on your long-term financial outcomes. If you marry someone who has significant debt, or is a spendthrift (ie, spends money in an extravagant, irresponsible way), you may find it harder to achieve your long-term retirement outcomes. I touched on this briefly when it comes to defining wealth.

It's an over-simplification, but I distinguish between "startup" relationships and "merger" relationships.

Startup relationships begin when you both have very few assets, and little human beings aren't involved. Merger marriages occur where children are involved (eg blended families) or where one partner or both partners come to the relationship with significant assets.

For merger relationships, it's important that both parties seek legal advice to ensure they are protected if things go wrong. Wills need to be updated. Trusts may need to be considered. Relationship property agreements (often known as contracting out agreements or pre-nuptial agreements) can also be very important. It's best to do this before the relationship "slips" into de facto territory. (This generally happens after living together for three years, but can happen sooner in certain circumstances, including where children are involved.)

Another thing to consider is familial love – such as when parents lend substantial amounts of money to children.

If you advance or receive a substantial amount of money to or from a loved one, seek legal advice. Getting legal advice can protect the person lending the money, the person receiving the money, and protect relationships with other loved ones.

For example, with a substantial advance there may never be an intention for the money to be repaid. But it may be best for the advance to be documented as an interest free loan that is repayable on demand.

Let's say you're in a relationship, and your parents loan money to you and your partner, and you and your partner subsequently break up. Framing the advance as a loan will give your parents the ability to demand repayment and prevent these funds from becoming divisible as relationship property.

Making it clear that an advance is a loan can also ensure that distributions made in a person's lifetime are factored into the distribution of assets on their death, avoiding ambiguity and potential fights after their death. (There is a saying that "you don't know someone until you've shared an inheritance with them.")

Taking a broader perspective

Some risks can't be insured against but are still worth managing.

It's one thing to have insurance in case you drop dead of a heart attack or you get diagnosed with cancer. But is that really the only way to manage the risk?

No. The decisions we make in our day-to-day lives impact the risks to which we're exposed.

I won't harp on about not smoking, having a diet high in whole foods and vegetables, and building activity into your life. But there's a reason that some of these factors impact the premiums you pay for certain types of insurance.

Think of it this way. There's a school of thought that says that, despite what the statistics say, heart disease and cancer aren't the leading causes of death. The leading cause of death is lifestyle choices. And with respect to these lifestyle choices, the biggest risks we take aren't swashbuckling risks – they are acts of omission: of not eating healthfully, being physically inactive, and failing to engage socially with others. There are other financial risks which aren't covered by insurance, either. For example, failing to develop marketable skills can impact you and your loved ones significantly.

For a large number of people, "retirement" is really a euphemism for being displaced from the work force.

"Career risk" is one of the biggest risks we face. Ask yourself: What are you doing to manage that risk?

Practical Tips

Keep track of your asset position

Keep track of what you own and what you owe. Record this over time and track your progress. **Focus on your net worth.**

Forecast (or: "flawcast")

Don't just think about your situation as it stands. Do your best to forecast into the future.

Many of my clients have been surprised – and pleased – to find out that they're on track towards achieving their retirement outcomes. In fact, many of my clients have realised that they can perhaps spend more, work less, or aim to retire earlier.

For other clients, this process makes them realise that they need to do more to achieve the retirement they want – or recalibrate their expectations.

When I go through this exercise with my clients I make it very clear that any long-term forecast is a "flawcast". The only guarantee I can give is that the forecast *will be wrong*. Long-term forecast will be sensitive to assumptions you make (such as investment returns, savings levels, entitlement to NZ Super, health, and longevity, to mention just a few). This doesn't invalidate the exercise but reiterates the idea that the value of a plan isn't the plan *per se* but the planning. We all need to check-in periodically and make sure we're moving in the right direction.

Automate

The more you can "set and forget", the better. As I mentioned at the start of this book, personal finance can be **simple but not easy**.

Knowledge often isn't the hard part. The hard part is often behavioural. The more you can make things simple and automatic, the better.

The best way to resist the temptation to overspend is to avoid it.

Don't fixate on investment performance

Remember that the market price of your investments represents the consensus view of many professionals, including their expectations and predictions about the future. You're not going to outsmart the collective wisdom of the market.

If you're going to make a change in your investment situation, make sure that it relates to changes in *your* circumstances, needs, and objectives, rather than external factors such as the whims of the financial markets.

If you have a sound investment strategy (for example, investing in a low-fee index-based fund or set of funds, and investing in an appropriate mix of asset classes for your risk profile), then focusing on investment performance is a red herring.

Spend your time working on factors you can control; like making sure you spend less than you earn and earn more than you spend.

Review your personal insurances regularly

Once you reach a certain point, your need for personal insurances such as life insurance, trauma/critical illness, and total and permanent disability insurance should reduce. As you build wealth and your dependents move closer to financial independence, you should be able to reduce your level of cover – and the premiums you pay. Once you have a good understanding of the risks you're managing, you should be confident reducing the level of cover as appropriate.

Live your life!

Never forget what you value, and what you want your life to be about. Don't let money rule your life any more than it needs to!

Many people take time off work to raise children or pursue projects. Many people work part-time, or take lower-paying work that is meaningful to them. Some people like nice things and are prepared to work very hard for them. Tread the path that works for you.

All decisions involve trade-offs. Make sure the trade-offs you make reflect your values and priorities and what *you* want out of life. *That* is what being wealthy is about.

The Small Print

The contents in this book are general in nature. There is no substitute for personalised professional advice.

Sonnie Bailey is an Authorised Financial Adviser (AFA). Disclosure documents for Sonnie Bailey and Fairhaven Wealth are available free and on demand. They can be found at www.fairhavenwealth.co.nz.

First Printing: 2017

Fourth edition. (First edition was titled *WEALTH: Simple Tips for Young Professionals*. Second edition improved thanks to proofing by Kirsty Peel: http://www.goodthoughts.co.nz/).

About Sonnie

Sonnie is the founder and principal of Fairhaven Wealth.

Before founding Fairhaven Wealth, Sonnie worked in the legal and financial services industries for many years.

Sonnie first became involved with financial advice as a specialist financial services lawyer. He reviewed thousands of advice files prepared by hundreds of financial advisers and provided feedback in relation to the quality and appropriateness of advice, industry best practice, risk management, and regulatory compliance. He has published work in industry publications and spoken at various financial advice conferences.

Sonnie has also worked with banks, investment management firms, insurers, and derivatives providers.

Sonnie has worked as a private client lawyer, focusing on succession, estate planning and trusts. He ran his own legal firm in Australia before relocating to New Zealand. He has also acted in independent trustee and company director positions.

He has written extensively on his blog, NZ Wealth & Risk, which can be found at www.wealthandrisk.nz.

Sonnie has published two other books: *Luck*, which is available on Amazon Kindle, and *Wealth & Risk*, which is a collection of articles from the NZ Wealth & Risk blog.

To receive updates in relation to new articles and resources on the NZ Wealth & Risk blog; new books; online courses; and special offers, sign up to the NZ Wealth & Risk mailing list by visiting www.wealthandrisk.nz, www.fairhavenwealth.co.nz, or emailing Sonnie directly at sonnie@fairhavenwealth.co.nz.