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MONEY WISE

1% OR UP TO 300% ANNUAL RETURN ON INVESTMENT – THE CHOICE IS YOURS!

Why would some people be happy with 1% return on their money while others will aim for 300% or more? Keeping in mind that risk increases with expected return what should we realistically be looking for?

Many would be happy with a 10% return, provided that the capital was absolutely safe and accessible at all times. Unfortunately there is no investment that can meet all three criteria. Some investments have guarantees but they are only as good as the institution or country providing them. In 2008 the Irish government issued a blanket guarantee on all bank deposits to stem the flight of money from troubled Irish banks. But it was quickly followed by a qualifying statement to the effect that the guarantee was subject to the country's ability to honour it.

If we want to 'play safe' how much should we expect?

Bank deposits are close to 'risk free' but if your money is in US Dollars, Pounds Sterling or Euro you will be lucky to earn 1% per annum in the current low interest rate environment. If you deposit funds in Rupiah you can expect a higher return, currently 5% or more, but if you are converting from a major currency you have to watch out for currency movements. As a rule of thumb you should stay with the currency in which you have commitments.

Government Bonds – your choice of return: 1.3% to 27.5%

Government bonds are among the safest of investments because governments can always print money to meet their obligations. The exception is Europe where the currency is managed by the European Central Bank. Consequently we have an absurd situation where, at the time of writing, you could invest in Euro bonds in Germany and earn only 1.3% pa or in Spain where you can earn a handsome 6.9%. If you buy the bonds from Greece you will earn a whopping 27.5%! The equivalent rate for Indonesian Rupiah bonds is currently 5.8%.

So why would anyone wish to invest in German bonds for a miserable 1.3%? The answer is investors are confident they will get their money back while there is a risk that Greece or Spain will default and their money will be lost. Investors also feel safe with US, British, Japanese and Swiss bonds, all of which are currently yielding less than 1.5% per annum for a 10 year term.

But 1.5% is less than the rate of inflation

Correct. And that means investors are actually lending their money to governments knowing they will get back less in real terms. But for many this is prudent money management. If a pension scheme for example is investing funds for thousands of employees it has to be sure it can meet its obligations to pay out pensions in full and as they are due. This is where bonds play a major role and why zero real returns are acceptable to many.

What returns are available if we accept some risk?

The sky is the limit. But let's review what realistic opportunities exist.

Corporate bonds: Companies are prepared to offer higher yields than governments in order to attract capital. Returns of 5% to 8% pa would be typical. Bond mutual funds offer easy access but keep in mind capital values can fluctuate.

Equities and commodities: Potential returns are not easy to quantify as there are many variables but over the long term an investment in a wide range of global stocks and commodities should produce returns in the region of 6% to 10% pa over time, but returns can be erratic. The past 12 years have not been good for the major markets, although very good for gold.

Real Estate: An investment in real estate should produce a return comparable to equities. But while stocks are highly liquid a real estate investment cannot be turned easily into cash and can be a serious burden should you need to sell at the wrong time. Still, a buy-to-let investment should return between 5% and 10% pa depending on location, plus hopefully, an eventual capital gain.

What investments can produce regular positive returns?

The last few years have produced sparse returns for investors. This has led many to seek investments that produce consistently positive returns. Ironically, the banking crisis of 2008 has provided opportunities for small investors to step into the role of bankers and invest in funds that lend to industries and groups. Examples are agricultural lending, mortgage lending, student accommodation and litigation funding. Current returns are in the region of 6% to 12% pa but can be higher. The biggest risk here is liquidity.

Where are the really high returns?

This would be the domain of private equity, which entails investing in projects or sometimes companies in distress, a field formerly open to only the ultra-wealthy. In successful cases returns to investors have exceeded the annual equivalent of 300%. Is there a downside? Yes, if the project is not successful you can lose all your money! Much the same risk as if you invest in your own business.

So what return should an ordinary investor be seeking?

It depends on many factors but a sensible strategy would consist of a blend of the above asset classes, excluding the last one for most.

If you can consistently achieve an annual return of between 5% and 10% above inflation you are doing well. If you are aiming for returns of 300% go ahead, but only with surplus money you are prepared to lose!

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