canberra times: q&a

Q 1: Having been invested in shares for many years I am now considering moving these funds into term deposits. Is this a good idea?

Withheld, Canberra

A1: Investing in term deposits are certainly an investment option but it is important to understand the trade off and risks associated with such a decision. Consider these points:

1) The attraction of a term deposit is that it gives you a reliable return set in advance for the term of the investment.
2) While a traditional risk of a term deposit is Credit Risk, in that the institution you invest with can collapse leaving you with nothing, you are protected for the foreseeable future by the Government Bank Guarantee for investments up to $250,000.
3) The next big risk is Term Risk, where your investment is set for a given term, and should interest rates rise during that term, then you would not be able to take advantage of the increase. Obviously though you would be protected on the downside should interest rates decrease during the term.
4) Another is Liquidity Risk, where should you need access to the Term Deposit before maturity then there can be significant break costs involved in getting access to your money.
5) Then there is also Rollover Risk, whereby if you do not intervene before the end of the term then the deposit can automatically “rollover” to a new term with a lower interest rate than should you actively select a new deposit and term.
6) An alternative to Term Deposits would be to invest in say Government Backed Bonds. These would be AAA rated bonds and are generally considered “risk free” as there is very little chance of Credit Risk as the Government can always raise more taxes or even print money, to repay your Bond. As this is a lower risk investment, the interest rate offered is usually lower than Term Deposits.
7) The downside of Government Bonds is that you generally need larger funds to purchase then (say $500,000) and there is still Term Risk involved.
8) If you want access to Fixed Interest type investments without Term Risk, Liquidity Risk and Rollover Risk, then you could invest in a managed fund made up of hundreds of AAA and AA rated Government and Corporate Bonds and A1+ rated cash securities with varying terms to maturity. While this would not be covered by the Government Bank Guarantee, these high grade underlying assets still provide excellent security with broad diversification, and will often produce a higher overall return. The return however is not set it advance, rather it is determined in arrears.

The fact is that share and property investments are volatile and will move up and down in value. If you want to invest for a greater return than fixed interest and term deposit investments, then you need to take on additional investment risk and invest in shares and property. The trade off is that you need to be prepared to hold these investments for the long term, expected to be 7 years or more. If you cannot hold your investment for this timeframe, then you should not be investing in shares and property funds. Changing your investments mid strategy will lock in any losses and lose you money.

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The upside of the Global Financial Crisis is that people are now more aware of the risk of investing in growth assets. You should see a Certified Financial Planner to help you understand what your financial future looks like should you invest conservatively, compared to investing for growth. If you do not need to take on unnecessary investment risk, then this should certainly be considered.

Phil Thompson is a certified financial planner and authorized representative of Rise Financial Pty Ltd (ABN 86350987645), AFSL 311718, an Approved Financial Planning Association Professional Practice. Answers should be used as a general guide only and professional advice should be sought before making investment decisions.

Send your financial questions to phil@risefinancial.com.au

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