Investing Myth #2 – The "Safe Investment"

Last week I talked about how sensible investing in shares isn't gambling. This week I'm going to tackle a myth that is "the other side of the coin" – that there are absolutely safe investments. Lets examine why this is not the case:

Bank deposits - One only has to think back to 2008 when some of the largest banks in the world needed rescuing by the taxpayer. Although depositors originally had the safety of the Government Guarantee Scheme, after the SCF bailout in 2011 the RBNZ introduced the Open Bank Resolution (OBR). Little known to most Kiwis, in the case of a bank failure the OBR allows the Reserve Bank to take some of your savings to keep the banks afloat.

As alarming as it is, the risk of this happening is low and there is actually a greater risk to your bank deposits – inflation. Similar to if a fuel company was to in someway water down the petrol over time so you didn't notice it, central bank "money printing" causes inflation which decreases the value of money. It's often considered as a tax on savers and if you aren't making high enough returns to beat inflation then you have negative real returns.

In recent years many investors have turned to gold, which is generally considered inflation proof and safe from government meddling. While true that gold can be a good hedge against inflation what people forget is that owning gold comes at a cost – there is an opportunity cost as it doesn't pay you any interest or dividend and a storage cost unless you consider burying it. In times of low inflation like now gold is essentially making negative returns.

In New Zealand there is a persistent myth that property and land prices only go up however you only have to look at other countries which have had property crashes of over 30%: USA, Spain, Ireland and Japan to name a few. Because most property investment is carried out using leverage (i.e. a mortgage), adverse price and interest rate movements can have magnified negative effects on investors.

So if none of the above investments in their own right can be considered completely safe how can you protect your wealth? Diversification has been coined "the only free lunch in investing" and is by far the best way to protect your wealth. By investing between and within each of the asset classes above, as well as shares and bonds, you can still have exposure to potential outperformance in each investment but also lessen greatly the risks associated with individual investments, markets and governments.

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