

HERD INSTINCT

*Making financial decisions based on what others are doing with their money can cost you dear, says Finance Editor **Susanna Stuart***

Would you ever cheat on your taxes? Tax departments around the world wage a continual battle against tax cheats with varying degrees of success. In the 1990s the State of Minnesota tested four varying messages to find the most effective way to encourage people to pay up, on time. Different sections of the population were each shown only one campaign.

The first message was a positive reminder that taxes go toward good things like schools, hospitals, police and the fire service. Who could object to this? The second message was a 'get tough' warning about what happens to people who don't file their tax returns.

The third message took a helpful tack. If you're having trouble filling in your tax returns, don't worry – we have a helpline and a friendly service to assist you. The fourth campaign simply stated that 90% of Minnesotans had already complied with their tax obligations.

Only one of these campaigns had any significant effect. Would it surprise you to learn it was the fourth? Armed with the knowledge that basically everybody else was honest with their taxes, people responded because they didn't want to be the odd one out.

Welcome to the world of herd mentality. In financial matters one of the biggest

influences on financial behaviour is the way we perceive the rest of the herd.

If everybody we know seems to be avoiding tax, then chances are we'll put aside our own moral compass. If every dinner party conversation involves stories about how to make money in property, then the likelihood we will invest in property rises significantly.

There are many causes of our herd mentality. One is the way we're wired: In repeated experiments people make decisions that conform to what others think. Then there is the media effect: Some financial topics seem to get huge coverage and one is left asking, 'Am I too late to join the rush into gold investment?'

I often hear rumblings of the herd effect when new clients approach me for financial advice. A couple might have the strong general feeling that they need to form a family trust. Friends have talked about their trusts and the papers seem to be full of articles on the topic. KiwiSaver is another subject where herd instinct often seems to overshadow weighing the pros and cons unique to the individual.

When you are considering your own financial affairs, try to tune out what others are doing. That's their business, not yours. The herd can lead us to dangerous places. Look before you stampe. 



DON'T BE A FOLLOWER: HERD-BUSTING TECHNIQUES

- **TRUSTS** suit those who need financial protection, for example those professionals who risk getting sued. They also suit blended families and help preserve – if this is desired – your bloodline inheritances. The fact is, most households are in neither of these circumstances, and a trust may be an expensive, time-consuming option that provides little benefit.
- **KIWISAVER** Everyone loves KiwiSaver and then suddenly – as we've seen lately – the herd talks about pulling out of the scheme! The scheme hasn't changed. It suits most individuals and the \$1000 kick-start is surely worth the low price of admission. However, your money is locked in until you are 65 so if you plan to retire earlier, you can't rely on it as your only retirement fund.
- **FAD INVESTMENTS** Any investment strategy should focus not just on the risks and returns on offer, but also on your own needs. An investment might have tax implications for one person, but not another. One individual might need to focus on capital growth while another investor may need a good income stream.

HAVE YOU HEARD?

- Incredible but true, Notice Saver from Kiwibank gives you better returns than a savings account, without your funds being locked away. Just 32 days' notice to withdraw, and it paid 5% at the time of writing. Because it's PIE (portfolio investment entity) compliant, it suits investors on tax rates of 30% or 33%.
- The Government is scrapping gift duty from October 1. This will remove the need for a tax return to be filed annually by trustees for gifting programmes used to transfer assets to trusts.