Wealthy and wise

There are three roads to amassing riches… Finance Editor Susanna Stuart helps you to pick the right one for you

AT LEAST HALF OF my clients are at the stage of their lives where they're conserving their wealth. Many had humble beginnings and started with very little. So how did they amass their assets? In New Zealand a string of finance and property companies have collapsed, causing many people to wonder what the best path to wealth creation ought to be. Essentially you have a choice of three avenues; the one you take depends on your personality, your risk tolerance and your available resources.

Build your own business This takes vision, stamina and the preparedness to risk everything to succeed. Not everyone has these traits. Most people I know who have retired from their own business say having a clear market for their product or service was key. Most say an element of luck was also behind their success. Still, we all have luck – good and bad – and these business owners not only had the skill to spot the lucky break, but the perseverance to do something with the opportunities. Most drew only modest-to-good salaries out of their businesses, and focused rather on building the value of the company – selling it for a good sum after years of hard work. One variation of this story is when business owners sell off shares in their venture, while retaining a minority shareholding to effectively get a lump sum as well as a future income stream. Either way, those who've succeeded have built their business with the express aim of one day selling this asset.

Buy tangible assets There is a fundamental sense of security in owning bricks and mortar assets – in the form of rental property. The income stream also makes up-front borrowing feasible so you face less absolute risk than a business owner. There are some risks, including market cycles when annual returns fall significantly or – as we see this year – when changes to the tax regime also cloud the picture. This avenue requires less sacrifice than owning a business. Even so, it's best suited to those who are committed to managing properties themselves and enjoy being a landlord, with the people skills (and business focus) to handle sometimes difficult situations. Investing in non-rental tangible assets such as art and collectibles requires a high level of knowledge and expertise. These assets don't offer an income stream so they offer investors no financial reward other than potential capital gains.

Invest in financial assets Not everyone is a risk taker or entrepreneur or has the time, patience, inclination or skills to build a business. Neither does every business start-up succeed. So the third option is the road most travelled by wealth builders: Investing in financial assets managed by others. The most popular way to do this is buying shares via the stock exchange or through managed funds (super funds, unit trusts, KiwiSaver). The latter require almost no hands-on management, nor do they call for a lump sum up front. They offer investors the ability to save regularly so they are excellent for people saving for retirement.

Compared to these managed funds, direct ownership of shares adds an element of hands-on fun to the process, but you need to keep a constant eye on your portfolio (see Guide to Buying Shares, opposite). While you can make short-term gains, share investing requires a long-term horizon to ride out the market ups and downs, but you can expect to be rewarded with greater returns. To increase the certainty of returns, investors can include fixed-interest bonds in the mix and this is strongly recommended for those needing cashflow.

All three avenues require something from you – whether it's determination, tolerance of risk, expertise or a steady dedication to keep investing.

EIGHT TIPS FOR BUILDING YOUR WEALTH

- Be clear about your objectives; set target dates for action.
- Choose an avenue that suits your lifestyle and tolerance of risk. Look at the risks as well as the returns.
- Seek advice. When buying or setting up a business a good accountant and solicitor will play crucial roles. A good broker or financial adviser can advise on appropriate financial assets.
- Buy assets when they are cheap.
- Consider liquidity. Will you need access to cash? Cashflow is important.
- Borrowing to invest can increase your return – but it can also magnify the risk.
- Measure whether your wealth building strategy is on track.
- Be patient. Building your wealth is a lifetime activity.

Potted guide to buying shares

What are shares? If you want a stake in businesses run by other people, you can buy shares in publicly listed companies. These companies are listed on the stock exchange and information about them is publicly available. To buy and sell shares on the stock exchange, you'll need a sharebroker.

Two types of income Shareholders have little say in the day-to-day running of the business, but when the company makes a profit it may pay it out as a dividend to investors, possibly providing you witha steady income stream. You might also get the benefit of capital gain if the company grows in value and its price goes up. Of course the value of a company can also go down – especially if it makes losses or lacklustre profits year after year. When you buy shares you need to consider whether you wish to focus on earning an income stream, or on making capital gains – or both. Your strategy ought to reflect your needs.

But wait – there's risk Share ownership does have its risks. Unlike bank deposits, where the interest rates are steady, there's no set rate for company dividends. The capital gain is not certain either. If and when companies go broke, you stand to lose money. The performance of companies depends not only on the way they're run, but on the ups and downs of their markets or the wider economy. To reduce risk, you can hold a range (a portfolio) of shares. The key to making money is to ensure the price you pay for the shares is warranted, and to invest in companies that are in robust industries that make money.

Another way to reduce risk For the average investor the most efficient way to invest in companies is via a managed fund. This is a pooled fund which brings together investors' monies to buy shares. In New Zealand you can access these through Portfolio Investment Entities (PIEs) or through a KiwiSaver scheme with shares. With a pooled fund you're relying on the fund manager to choose stocks wisely. Some PIEs invest in just New Zealand shares; others focus on overseas shares. The latter gives you access to a more diverse range of companies. However, if your focus is on income rather than capital gain, you should include Australian and New Zealand shares; these pay relatively high dividends compared to global companies. Some pooled funds offer a regular savings facility which allows you to add periodic amounts to the sum you already have invested.

Get advice Investment in shares, or even in managed funds, requires knowledge and expertise. Not only do the fortunes of companies, and of managed funds, change over time but so do your needs. A sharebroker will generally be skilled in advising which shares make attractive investments, but you may need to consult a trusted financial adviser to get a portfolio that is tailored to your needs, your risk tolerance, your life stage and your tax status. N

For more information on investing go to www.nzx.com and www.sorted.org.nz.

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