INCOME INVESTING

Retirees are really struggling to find good, income-generating investments because interest rates are so low at the moment. This is creating an opportunity for unscrupulous product providers (also known as criminals) to offer investments with “fantastic returns at low risk”. Sadly, the people who can least afford to lose money are the ones who are most tempted by these fraudsters. If you are in a bind, you only need to look at the unit trust industry for a solution to your income problem.

CASH IS NOT KING

Falling interest rates are always welcomed by people with debt whilst those who have investment assets, especially retirees, often struggle to adapt. There are many retirees who are so afraid of losing money that they keep their investments in cash via money market accounts and fixed deposits. Unfortunately, these cash investments do not keep pace with inflation over the long term, especially when tax is deducted from the interest earned. Retirees feel this impact most acutely when interest rates drop and they start scouting for alternatives which could provide them with a better return. This is usually where their problems start because they can be lured into scams or high risk investments by unscrupulous salesmen. People in this predicament should be most cautious and sensible – offers of great returns with little or no risk should be avoided, they are usually scams.

Table: Interest and growth of unit trusts vs. inflation from 17 March 2002 to 16 March 2012

	One Year Average	Above inflation	10 Year Average	Above inflation
Money Market	5.46% p.a.	-0.65%	8.67% p.a.	2.44%
Income	6.86% p.a.	0.75%	9.25% p.a.	3.02%
Prudential Low Equity	9.86% p.a.	3.75%	10.67% p.a.	4.44%
Inflation	6.11% p.a.	n/a	6.23% p.a.	n/a
RSA Retail Bond	7.25% p.a.	1.14%	n/a	n/a

Source: Morningstar

There are a range of quality alternatives that will provide good capital growth and income without taking unnecessary risk. The table above shows the average returns of the income generating unit trusts in South Africa and their growth/interest over the last year and 10 years respectively. Money market unit trusts have underperformed inflation over the last year but they have done reasonably well over the last 10 years. However low risk, diversified unit trusts have given far better, inflation-beating returns without any unnecessary risks. To illustrate the difference in growth, if you had invested R100,000 in the average money market fund 10 years ago, you would now have R229,666 whilst you would have R275,613 in the average, low equity, unit trust. This is a difference of R45,947 which is very significant when you only invested R100,000 to start.

Low-risk, diversified unit trusts cannot invest more than 40% in shares and therefore will not experience the massive drops experienced by stock market investors. You might lose 8% in a really bad year but you should recover within 2 years. Cash investors will not have the losses but they will also not beat inflation over the long term.

If you need to keep cash because you plan to use it within the next two to three years, consider the RSA Retail Bonds. They offer the best interest rates on fixed deposits without any charges. This is in sharp contrast to some banks who charge initial fees when people place money in their money market funds. I find this practice highly unethical as the initial fees account for nearly 10% of the interest earned within the first year. It takes no real thought or advice to place money in a money market fund and therefore an upfront fee should not be charged.