Thomond Asset Management

Money Myths
Uncovered

BY NEAL KELLY

We don't give much credence to many of the old myths about money. We all know by now that "money doesn't grow on trees", nor does it "burn a hole in your pocket". But for all that there are many misconceptions about personal finance that could leave you out of pocket if you act on them. Most myths are harmless, but some are potentially dangerous: believe them and you could end up out of pocket. So it's time for a reality check and here is just a selection to be aware of.

Savings & Investments

I don't feel any rush to start saving.

It's never too early to get the savings habit, and the sooner you start, the longer your money has to grow. Deposit rates are historically low right now, between 2-3% being about the best you can expect from a regular savings account. You could expect a bit more on a fixed-term account.

Mind you, inflation is still negative so in truth this is a decent enough return. A deposit account is a good starting point but as your income improves and key spending dates loom in the future, you should consider starting a more growth-orientated investment, such as a stock market-linked fund or bond. Before choosing you should talk to a broker or investment adviser. Many of those planning to save say they will put money aside when they can afford it, rather than committing to a regular payment into a savings account or investment fund.

My deposit account takes the risk out of saving

If you want to live well over the long term you can't just keep your money in savings accounts - do so and it will be constantly eroded by inflation and taxes. Sure enough, it's a good idea to have such an account for rainy day spending events. But only by making your money work harder can you have a hope of securing your financial freedom. Investing through a fund invested in a spread of assets – equities, bonds, property and cash – is advised. There is some risk but without risk there's no reward!

You can't lose with Prize Bonds

Everyone loves prize bonds. Not only do you get 12 chances a year to become a millionaire, plus thousands more to win lower amounts, but unlike other forms of gambling you also get to keep your stake, which you can cash in at any time.

In practice, most people hang on to the money for fear of missing out on €1m in the next prize draw. When the money is finally withdrawn, often not until the bondholder has died, it will almost inevitably have been ravaged by inflation.

Blue chip shares are low risk

Generally big companies with history and a solid track record behind them offer investors greater security than smaller, untested ones. But there are no guarantees with equity investing. The value of blue chip shares can fall sharply – you only have to look at the Irish banks spectacular fall from grace.

Insurance

I have free travel insurance through my credit card.

The free travel cover provided on most credit cards is actually "travel accident insurance", which will usually pay out only if you suffer an accident while travelling to or from your holiday destination, in very limited circumstances. Proper travel insurance policies should cover medical expenses, repatriation costs, personal liability and cancellations. Such comprehensive cover is available free on some premium credit cards, but as they charge annual fees of up to €300, you will be paying for it one way or another.

It's a toss up whether I buy Income Protection insurance, Specified Serious Illness cover or a Payment Protection policy.

It shouldn't be. A lot of people confuse the three. There is a big difference, however. Income Protection products insure your income in the event that you are unable to continue working. Payment-protection policies are designed to cover your repayments on a loan if you suffer from an accident, illness, death or redundancy.

With most Specified Illness policies a capital sum is paid out on diagnosis of a specified medical condition or occurrence of some forms of heart attack, some forms of cancer, renal failure, major organ transplant, stroke etc. The key differences between Income Protection and Specified Illness cover are the qualifying conditions and the way in which they pay out. An Income Protection policy throws a much wider net, covering anything that can keep you of your job for three months or longer. With Specified Illness cover you are only covered for any of the illness specified on the policy. Income Protection policies pay out an ongoing taxable regular income that replaces part of your lost income if you have a long-term illness or disability and you can't work. Specified Illness cover, on the other hand, is designed to pay out a (tax-free) lump sum in the event of you suffering from a serious illness or if you have to undergo certain types of surgery.

The best insurance cover is the cheapest

Most people pick insurance policies by price alone. Only a few give the policy terms more than a cursory glance before signing up. You may believe that one policy is pretty much the same as another. Not so. They can vary quite considerably, and you normally get what you pay for. A low price can mean you have to pay a large chunk of the claim yourself, either because of a massive excess or because the maximum payout is totally inadequate for your needs. You may have to do without a courtesy car, or alternative accommodation if your home is flooded. You may end up with nothing at all because you have failed to spot the long list of unreasonable exclusions, or have missed an arbitrary deadline. The best way to choose a policy is through personal recommendation or, failing that, by consulting an independent financial adviser who knows his stuff.

I'm too young for life insurance

You may be young, but you're probably not immortal. As soon as there is someone who depends on you financially, you need life insurance. That may be a partner who you share a mortgage with, a spouse, or children – anyone who would struggle for money as a result of your death. Life assurance comes basically in two forms. The most basic form is called 'term assurance'. And then there is what is known as 'whole of life' cover, which pays out no matter when you die. Term has no investment value but simply pays out a lump sum to your dependents upon your death. The length of the term of the policy can vary but should ideally match the date at which you would expect some major debt commitment to fall due, say your mortgage. In the event of your death your next of kin would have a tidy nest egg to tide them over. This form of life assurance is the cheapest as there is no payout if you survive the term of the policy.

Pensions

I'm too young for a pension.

It's the classic response young people give. Roughly half of Ireland's workforce are in pension schemes. The others are happy to pin their faith on the State's Social Welfare pensions when it comes to retirement. People are living longer and leading more active lives in retirement. As a result it is more important than ever for them to think about where their income will come from when they stop working. The State Contributory Pension will provide a basic income at best. It is currently worth €230.30 a week, for those who qualify. But this will not go much further than meeting the cost of staple household expenses and is not going to be enough to maintain the standard of living you've been used to. For this reason, it's important for people to take control of their retirement planning, which really means making decisions now with regard to pension provision.

Banking/Mortgages

Withdrawing cash from an ATM abroad is free

Most credit and debit cards typically incur a loading fee outside this country.

Consolidating your credit cards and loans onto your mortgage saves money

It can certainly cut your monthly outgoings, and mean that you only have one creditor to deal with, rather than several smaller ones. The interest rate charged on the new combined loan may well be lower than you would have been paying on your previous debts. However, as many consolidation loans tend to be long term, you can end up paying more interest in the long run. Another problem is that the loan will be secured on your property, meaning that you now face the extra risk of losing your home if you can't keep up with repayments.

Interest-only mortgages make homes more affordable

An increasing number of homebuyers, especially first-timers, opt to pay only the interest on their mortgages and nothing off the capital. The big problem with interest-only mortgages is that they allow you to fool yourself into believing you are buying a home, when you're really only buying the difference between the purchase price and current value. Any increase will reduce the debt, but will do nothing to strengthen your position on the property ladder. But any fall in value could leave you with negative equity, leaving you with even more to repay.

About

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Warnings:

1. The income you get from an investment may go down as well as up.
2. The value of your investment may go down as well as up.
3. Benefits may be affected by changes in currency exchange rates.
4. Past performance is not a reliable guide to future performance.

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