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YAMAN Coach

EMPOWERING YOU

High Mileage Investing

by PFA

We are always asked the question of which investment is a good one when, in fact, all legitimate investments are good. When we say legitimate, we are excluding the scams.

Think of it as shopping for a car. Let's say that you have narrowed down your choice to two with almost identical exterior and interior features. The advantage of one model in one feature will be offset by the advantage of the other model in a different feature. It's all so confusing. But you have one more category to look at and that's the engine performance.

While both cars have the same sized engine, if efficiency is what you are after, you will go for the car that can travel the farthest distance on a liter of gas.

In the same way, investing needs to be efficient.

So let's say you are choosing between two investments. Investment A has the potential for earning 15% p.a. while investment B has the potential for 12% p.a. You are happy with earning just 12% p.a. But you cannot avoid the lure of the higher potential return. So, the correct choice will be to go for Investment A, right? Actually, not yet. You need more information.

Investment returns always have twins and they are called risk. Please note that I repeatedly used the term "potential" in presenting the returns of investments A and B. That is because there is only one investment in the world that is risk-free, and that investment cannot be found in capital markets. All other investments bear risk. But rest assured that risk is not the reward. It is there to temper your greed and help you realize what investment is truly suited for you, and not the other way around.

So, rather than asking for what investment is good, you should ask what good and investment can do for you.

Going back to our two investments, let's say investment A has a risk measure of 1.3 while investment B has 0.9. To know which investment is more efficient, you will need to compute for their risk-adjusted returns. At the risk of oversimplifying it, just divide the potential returns by their respective risk measures. Doing so will result in a risk-adjusted return of 11.5 for investment A and 13.3 for investment B.

Between the two investments, and assuming that you are happy with potentially earning at least 12% p.a., investment B would be more appropriate for you because it is the more efficient portfolio. In other words, investment B earns more return for each unit of risk that it will be leading you to take.

And since investors normally buy a number of investments and not just one, for diversification purposes, the actual risk measures to be used should be those for portfolios of securities. These measures are Jensen's alpha, Treynor ratio & Sharpe ratio.

By now you have probably lost the feeling in your legs with all of the discussion. Do not worry, the feeling will come back. And so as not to go through the same harrowing discussion when you are buying portfolios like those of pooled funds (e.g. mutual funds, unit investment trust funds, single pay variable unit-linked insurance), just ask such funds for their risk-adjusted returns (whether historical or expected). Doing so will put your options on a level playing field.

But even before looking at your investment options, make sure you know what your target return and risk appetite are. An expert and experienced financial planning coach can help you in this department.

Oh and one more thing, that one investment in the world that is risk-free can be found in Luke 6:38. Go look it up.

Visa or Mastercard?

by Coach Rose D. Gases, RFP®

Unbeknownst to many, payment cards such as VISA, Mastercard, Discover (formerly known as Diner's Club), American Express, and the like do not issue credit cards. They are known as electronic payment solutions that facilitate payment transfer from banks to merchants.

So, it is the credit card company itself, that sets the credit limits, fees, reward schemes, terms, and conditions. It is also the credit card company that lends to or advances money for you. And credit card companies expect you to pay them back in a timely way plus fees and other charges.

The electronic payments solution provider used by a credit card company will have the former's logo imprinted on the credit card.

So, which is the better card, one that uses VISA or one that uses Mastercard? For the user of the credit card, it should not matter. What matters is that the credit card holder does the following before applying for a credit card account:

Enough funds - Debt-to-equity ratio is one of the most common financial ratios used in corporate finance. It measures how much more (or less) debts are being used vs. shareholder's equity in acquiring assets for the company. The ratio can be used for household finances. And ideally, if you want no more than 50% of your assets being funded by debt, your debt-to-equity ratio should be no more than 1x. That means your debts should be at most equal to your equity in your household finances.

Interest rate – Last November 30, 2020, the BSP issued a regulation putting a cap on the annual interest rate of credit cards at 24% per annum or 2% per month. The move was to mitigate the impact of the pandemic on the borrowing public. The interest rate ceiling for installment loans was also pegged at 1% per month on an add-on rate basis (which is effectively 21.25% per annum). But while credit card companies may have similar interest rates now, the situation may change once the pandemic is over. So, make it a habit of reviewing quoted interest rates before using your card.

Fees, penalties, and other charges - Always read the fine print in the terms and conditions of credit card companies. The fine in fine print does not mean unblemished, refined, pure, free of impurities or of high quality. It simply means the terms and conditions are printed in small type. You will be surprised by the countless ways your credit card can charge you for the different types of services they offer like annual membership fee, cash advance fee, conversion fee, service fee on foreign currency, card replacement fee, late payment fee, and so on.

Reward schemes - Oh, do not fret. Credit cards also have reward schemes to mollify you for those fees they charge. You can enjoy a percentage cash rebate on your purchases with a caveat of minimum purchases. Now isn't that exciting? You can also earn points from your spending. The points you gathered can be used to redeem rewards ranging from airline tickets, electronics, accommodation among others. Some credit card companies even offer travel accident insurance coverage. But beware as such rewards will only entice you to use your card more. And when spending gets out of hand, "all hell breaks loose."

Owning a credit card is indeed convenient. By way of illustration, you will not carry with you bundles of cash to pay for the goods or services you enjoyed for your safety.

The drawback in using credit cards is that it anesthetizes your overspending. You do not feel the pain of paying. It feels like you have this unlimited source of money from that card until you hear a beep at the cashier that you have reached your credit limit.

Know by heart that the features of a credit card should only be subordinate to your current financial situation. Debt is a good leverage if used wisely. But debt can be financially and mentally draining for those who neglect to settle their debt obligations.

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Editor's Note

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Beware of Free Investment Advice

A professional investment manager is always in competition with other investors in being the first to find that "diamond in the rough" of an investment. Such an investment would typically be trading at a market price that is substantially lower than its intrinsic value. For it is when other investors finally realize the discounted price of that investment and push the price up that the professional investment manager will make his "killing."

There are many influencers on social media who provide free advice on investments. Some have evil intentions of getting others to buy into their investment idea so that what they had earlier bought would rise in value. Then such influencers exit as the price reaches their target liquidation level, leaving the others they enticed high and dry.

Still there are others who simply want to be of help to others for free. But a good adviser will always first find out what his audience needs, especially since the brain is so easily attracted to returns without considering the risks. More importantly, there will be times when investment advice will need to be modified due to the ever-changing landscape of investing. A social media influencer will not know who received and followed his advice. What if the people who heeded his earlier advice were not paying attention when he issued a follow-up advice?

Professional investment managers are silent waters, they run deep. They keep their cards close to their chest. If you want to take advantage of their expertise and experience, just buy into the funds they manage.