

This is an original article written by Philip Loh.

Investment “alternatives” to grow wealth, or not

1. Raw land

How about buying a plot of land in Canada? The land banker promises you a return of 15% per year, ‘almost guaranteed,’ he says. ‘What can I lose from investing in land? After all, the land will always be there,’ you reason. The fact that the land might become worthless just doesn’t seem to be possible.

Personally, I have never been to Canada. Though the land banker claims that most of their clients are repeat customers, it does not rule out the possibility that this is just one big scam. Besides, I do not have the assurance that the Monetary Authority of Singapore will step in if the financial transaction goes wrong. How is it possible, you ask, since they have been paying out what they promised until now? The reason is simple. Any company is able to pay you 15% a year as long as the cash inflow is more than the outflow, as most of the matured amounts they pay you are reinvested with them. Enron and WorldCom would never have been exposed if they didn’t “run out of cash”. Any experienced auditor would tell you that it is almost impossible to detect fraud in a company if there is collusion among the employees and the top executives, unless they run out of money to pay their debtor or supplier.

A friend of mine who just sold off more than ten of his properties in Canada at a loss of \$3-4 million swore that he would not invest in Canadian properties again. How did he lose so much money? Well, when he bought his Canadian properties ten years ago, the exchange rate is about one Canadian dollar to 1.7 Singapore dollars. When he liquidated his property, he was almost on par. The Canadian property became stagnate at that time. For the 10 years, he received only marginal rental yield of 2-3% of his capital investment. Moreover, with wear and tear of his property during the 10 years, he had to settle for much lower prices compared to what he paid initially. In total, he chalked up a loss of about 30% over 10 years.

International studies have shown that property investment over the LONG run usually marginally outperform inflation. If there is any gain, it is usually due to the migration of large number of people to the region. For big cities, it is often due to the availability of vast business opportunities. As for Australia in the last 15 years, it is due to Asian migrates. The country is the number one migration choice for rich Asians due to its proximity to Asia. A flight from Hong Kong to Australia would take only about five to six hours versus a 20 hours flight to Canada. The reason for the boom in Singapore property in the 70s to 80s was strong economic growth and foreign workers and immigrants who were relocating here.

The land banker did point out that their ‘extraordinary factor’ is oil, claiming that the region which they choose to develop is rich in oil. No doubt it is true, one question remains in my mind. If the opportunity of making money is so good, why didn’t the Canadian developers take full advantage of it? Why do they have to come to Singapore to raise funds? I am sure there are enough rich Canadians to finance the development. Hence, it’s possible that the Canadians themselves are aware of the risk involved and the reality of the situation better than anyone else.

It is OK to invest in raw land as long as you are aware of the risk that you are taking, including the default risk of the company handling the transaction. More importantly, there is no investment in the world that pays 15% a year for LONG. More likely, you are buying into a bubble economy. Tokyo property prices plummeted by 60% from its peak 13 years ago. The volatility of raw land is far greater than basic property, which means the drop in price when the bubble burst could be up to 80-90% in a worst case scenario. For instance, technology funds were reaping at 18% a year for many years before the tech bubble burst in 2000 and they plunged by more than 80%. Some of you may have heard this, “The prospect for the technology sector is rosy. After all, what can you lose from investing in the ever growing technology sector,” claimed the bank investment officer five years ago.

2. ‘Principle Protected’ Funds or Structured Deposit

Banks are still pushing out Capital protected funds and Structured deposit like hot cakes. I have lost count of the number of times my clients told me that they bought some capital protected funds from a bank and the bank advisor told them that it is 100% guarantee that they would get their money back. I would like to clarify the difference between capital-protected and capital-guaranteed fund. Capital-protected funds, the ones sold nowadays, are funds whose capital is protected by the bonds they hold. It means that getting back your capital is **CONDITIONAL** upon the bond issuers redeeming their bonds at maturity. But what if the bond issuers go bust, like Enron, WorldCom or Global Crossing? Well, the fact is that you may **NOT** get your money back. Of course, the fund managers are supposed to go for bonds with good credit ratings, but Enron had one of the best credit ratings just before it announced its bankruptcy.

In a brochure of a capital protected fund issued by a bank, it screams out “Earn a reasonable return while protecting your hard-earned savings”. In the prospectus for the same fund, it is written in bold “No guarantee is given, expressed or implied, that investors will receive back any amount invested.” This simply means that investors can lose **ALL** their money in a capital protected fund and the bank is not liable. I personally believe that Singapore is the only developed country in the world that financial institutions can get away with such outright misleading representation. And the banks are expecting all the Aunties and Uncles to read between the lines and the fine print. So buyers, beware. Currently, though none of the capital protected funds had returned lesser than the minimum amount stipulated, it is simply a matter of time before it happens. Probably when it does, we will only read about it from the papers.

More recently, the banks have gone a step further by marketing principal protected structured notes. That means that instead of the capital being backed by a basket of bonds issued by different companies, they simply place all the money with **ONE** bank, maybe a “French” bank which is trying to raise about S\$10b, for some reasons not clearly stated and which no investor bothers to ask. This arrangement is particularly nerve racking because many retirees who transfer their hard earned savings into the structured notes are simply not aware of the risk they are taking. For example, in a matter of five to seven years, from 1990, many Japanese banks had gone from boom to the brink of bankruptcy. All it takes is a few major bad loans or a “rogue derivatives trader” to bring a bank down. Under such situation, the depositors of the bank would have legal preferences over the bond holders in claiming the asset of the bank. You might not hear about this issue anymore after today, but if you do, it might

just come featured with photos of hundreds of angry retirees storming the bank with their worthless scripts in their hands. A replay of the sixties you think. Maybe.

3. Foreign Currency Deposit

Banks are rolling out numerous currency products that claim to help you earn higher foreign interests. So, can you really earn higher interest? I doubt so. A well established theory in financial management states that no matter which currency you place your money, it would eventually bring you back to square one. That means whether you put your money in the form of foreign deposits such as US, Pound, Aussie or NZ, it would be the same as if you have left it in a Singapore dollar deposit, in the LONG run. How so, you ask? Well, if the banks of a particular country are offering a higher interest, it is simply because the currency traders are expecting a weaker currency for the country. Think for a moment, if the exchange rate for a particular currency is expected to be stable, the banks need not offer a high interest to attract investors to deposit their money there. The only reason that banks are offering higher interest is they need more deposits to fund their lending activities.

Usually, the depreciation of a high interest currency would eat out whatever excess interest you can earn compare to your primary currency. Many retirees would be eager to point out “my Aussie dollar fixed deposit had been paying me higher interest in the last 4 years and had appreciated against S\$ by more than 30%.” What I can say is that you are lucky. In the world of finance, sometimes you eat the bear and sometimes the bear eats you. Period.

4. Vatical Settlement contract

The term Vatical Settlements may not be familiar to the typical investor.

Simply put, Vatical Settlements are transactions whereby the beneficiary’s interest in a life insurance policy is transferred to a third-party investor. In exchange, the seller of the policy will receive a discounted cash settlement. Not only are Life Settlements an excellent opportunity for financial growth for the purchaser, they can provide the sellers with the freedom to live the remainder of their lives with more dignity and fewer monetary concerns.

Say for example a policyholder certified to have no more than three years lifespan due to a terminal illness sells his policy of sum assured \$100,000 to someone at \$60,000. If the policyholder passes away in 2 years, the buyer would receive \$100,000 which is \$40,000 more than his original investment. This works out to be more than 30% return a year. If however, due to some miracles or medical breakthrough, the policyholder survives for another 15 years, the buyer’s effective yield from his investment would drop to less than 3% a year.

There are also many ethical issues surrounding vatical settlement. So I caution all who want to invest to make sure they understand all the ethical implications fully, whether it is from the religious or moral standpoint. However, from a purely financial standpoint, the return sounds reasonable for the risk we need to take.

Options, futures and derivatives

Some advertisements claim that option trading can make money whether in a bull market or a bear market. There must be a catch right, you say. Well in fact there is. Listen carefully, they tell you that if the stock move up 10%, you make money. Even if the stock losses 10%, you also profit. However, what they did not tell you is IF the stock does not move or remain range bounded, your stock options will expire worthless and you would lose ALL your investment. Again, we believe that the so called “experts” who run seminars to impart their sure-win formula to you need never do so; because if it really worked, they would be too busy making money to run seminars. All I know for certain is that every time you open or close a derivative position, the dealer firm makes money from you. So, whether you make or lose money, the dealer gains. Sounds like a sure win formula to me.

Closely linked to futures is commodity. Most commodity traders buy or sell pieces of promissory papers that promise to deliver a certain amount of commodity at a pre-determined price. One reason to consider investment in commodities is the performance of pork bellies or coffee has very little to do with the stock markets, which means it can be a very effective hedge for your stock/bond portfolio. But investing in commodity futures contracts, while potentially quite lucrative, is a very risky investment which losses can go far beyond your original outlay. Plus, in the commodities market, individual investors find themselves up against traders who are paid to know the market inside and out. An investor in coffee futures, for example, may find himself up against someone working for Starbucks or Coffee Bean.

What is my call on all these alternative investments? Should you jump into any of them? There is indeed no simple answer. However, I believe strongly that in the long run, it is only by investing in traditional stocks and shares can you grow your money faster than inflation. Over the last 50 years, all other investments, including Money market accounts, Bonds and even Property have barely kept pace. There may be selective patches of time that some of these alternatives may top stocks and shares and it is totally up to the intelligent investors to spot them.

Before we get too carried away, take a look at the list below.

Name	Wealth (USD)	Source
Bill Gates (US)	\$40.7b	Microsoft
Warren Buffett (US)	\$30.5b	Investments
Karl & Theo Albrecht (Germany)	\$2.56b	Albertson's Inc.
Paul Allen (US)	\$20.1b	Microsoft
Prince Alwaleed bin Talal Al Saud	\$17.7b	Kingdom Holding (Saudi Arabia) Co.
Lawrence Ellison (US)	\$16.6b	Oracle
Alice Walton (US)	\$16.5b	Wal-Mart
Helen Walton (US)	\$16.5b	Wal-Mart
Jim Walton (US)	\$16.5b	Wal-Mart
John Walton (US)	\$16.5b	Wal-Mart

Listed above are the 10 richest people in the world and their net worth (as at 2003). Is their wealth created by buying raw land, options, futures or forex? Evidently, most of their wealth is vested in the stock markets. Again, it brings us back to my earlier point that the stock market is the single greatest wealth creator. And I don't expect this universal law to change very much in the next 50 years, unless the fundamental basis of how the global economy operates totally collapses. And given a choice, I would not like to bet against it!