MONEY

RIGHT PLACE, WHITE TIME
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Saving is child's play at their first communion

The rite of passage is the perfect time in which to open a bank account for your child and teach them how to look after the pennies, writes *Eithne Dunne*

ALAMY

On their communion, a child may receive several hundred euros in cash from friends and relatives so it can be a financial eye-opener

If you have a child set to make their first holy communion this year and you haven't got around to disavowing them of the notion that the trees are laden down with crisp fivers and tenners, you might want to do so soon.

The average first communion candidate here receives €570 in cash from relatives and friends on their "big day", according to a survey by Ulster Bank. So, even if they've never had more than a few pennies to rub together up to now, they will soon be feeling pretty flush and could use some guidance on money and saving.

Frank Conway, founder of MoneyWhizz, which runs financial literacy programmes for schoolchildren, says that while children as young as three have some understanding of the role of money, most don't begin to develop real financial awareness until about the age of seven. This, he says, is a good time to start educating your child about financial matters. For many parents, the opening of a bank or credit union account is a symbolic first step.

Kevin Johnson, chief executive of the Credit Union Development Association, says first communion time is often when parents (and sometimes grandparents) bring a child in to open their first savings account. "Parents and children alike often enjoy the process of taking these first steps," he says. "And regularly visiting a branch with a child so they can lodge their savings, no matter how small, can prove a beneficial routine."

Johnson says that getting children into the habit of saving means that by the time they are young adults, they are well accustomed to it.

Piggy bank or bank account?
According to Bob Quinn, principal at The Money Advisers, a simple piggy bank can be the most effective way to start teaching young children about saving.

"It can work particularly well if there are two or three kids in the house as then it can be turned into a game; for example, who has collected more €2 coins?" he says. "Children are visual creatures and need to be motivated. With a piggy bank they get the tactile element of picking it up to see how heavy it is."

Conway also believes that the piggy bank is a great place to start. Better still, he says, give your children several money boxes or piggy banks each, so they can save up separately for a few different things. This allows them to set clear goals for themselves. To help motivate them further, you can introduce rewards.

"For example, you could give them a top-up if they reach a certain amount of money, or even offer to add €1 for every €4 they save," he says.

Conway says opening a bank account for your child should not replace the piggy bank but it can work well in tandem with it. The point is to teach your child the money in the piggy bank is for short-term goals, while the money in the bank is for the longer term.

Having a bank account can also appeal to younger kids by giving them a sense of responsibility and ownership. "Getting a statement in the post – with their name and balance on it – is a real novelty for kids," says Conway.

> **Regularly visiting a branch with a child so they can lodge their savings — no matter how small — can prove a beneficial routine**

The other great advantage to a bank account is that it takes the money out of immediate temptation. For slightly older children, says Conway, opening a bank account allows you to teach them not just about saving, but about how banking works and even a bit about the principle of taxation. "With kids aged 7-12, you can start teaching them about taxation – the fact that although their money will earn some interest in an account, they will also have to pay Dirt. We teach them that tax is a form of sharing."

When it comes to how much autonomy to give a child over their savings, Quinn says they should be allowed to spend them as they see fit – but that the parents' role is to help them understand what level of enjoyment they will get from whatever they want to buy.

"If they want to spend €500 on something that will be thrown to the side in three weeks, you have to try to get them to understand that, and guide them as to the level of enjoyment they'll get from it relative to the cost."

Children's savings accounts
All the main banks offer savings accounts aimed at children. These do not come with transaction fees but, as with any deposit account, interest earned is liable for Dirt. In most cases, the advertised interest rate only applies up to a fairly modest balance, after which it drops to near-zero. The EBS Children's Savings account for children aged up to 11 comes with an AER of 1.75% on the first €5,000 (0.01% after that). It also, however, comes with a bonus payment of €20 after the first six months (subject to Dirt and terms/conditions). Bank of Ireland has a Young Savers account for children aged up to 12, with AER of 2.5% on the first €5,000. Note that if you exceed the €5,000 amount, even temporarily, your interest rate will drop to 0.25%.

AIB has a Junior Saver account for kids aged 7 to 11. They get interest of 2% on the first €1,000, and 0.01% on anything over that. PTSB's Safari Saver account for children aged up to 12 pays 0.25% on the first €20,000; exceed this and you'll earn just 0.05% on the entire amount. Ulster Bank's urFirst account for children aged up to 11 comes with an AER of 0.95%. Gimmicks across the board range from free backpacks to free money boxes.

Credit unions also cater for young savers, and there's the option of savings stamps from An Post. These are €1 each; note you can't cash them in but they can be lodged to a new or existing account.

With a bank account, make sure your child doesn't have unrealistic hopes about how much their cash will earn. Even if a child were to open one of the above accounts and put their first communion spoils – say, €500 – in, leaving them untouched for a year, once Dirt is deducted they'll have earned €18.11 from EBS (assuming they qualify for the bonus payment); €7.27 from Bank of Ireland; €6.30 from AIB; €2.99 from Ulster Bank; or 79c from PTSB.

Larger amounts
If your aim is simply to encourage your child to save, or to teach them about how banking works, there's no need to concern yourself with rates. But don't make the mistake of using one of these accounts as a repository for heftier financial gifts from, say, grandparents, as your child will see little or no return.

Quinn says some grandparents with significant cash reserves are using the annual small gifts tax exemption to the max by giving €6,000 per year (€3,000 from Granny and €3,000 from Grandad) to a grandchild. He says it's worth making sure this kind of money is not going into a standard-issue savings account.

"Say you have a four-year-old and their grandparent wants to put money somewhere for them using the small gifts exemption. In this situation you are looking at perhaps a 15-year investment, so my advice is to put it into something linked to equities where you can possibly make a return over the long term."

And for parents who would prefer to issue more rigid guidelines on spending/saving among their kids, well-known US financial adviser Suze Orman has some specific advice. Her suggestion is that, should your child get cash from a generous relative, you let them spend 50% of it – no judgment – get them to save 40%, and let them choose a charity to which to donate the remaining 10%.

MARKET MOVER
COLM O'BRIEN

Colm O'Brien is head of index funds for Europe, the Middle East and Africa at Legal & General Investment Management (LGIM). LGIM is responsible for managing more than €1.1 trillion, including over €380bn in index funds. It offers a range of index funds to Irish investors, including the L&G World Equity Index, L&G Europe Ex UK Equity Index, L&G Emerging Markets Equity Index and Euro Treasury Bond Index. Available through Aviva Life products, the funds are open to those with a minimum lump sum of €10,000 or a regular monthly sum of €100.

Fund philosophy
Index funds differ from actively managed funds in that they aim to replicate — rather than outperform — a market index. However, the term "passive", which is often used to describe these types of funds, is misleading, according to O'Brien.

"In reality, there's a lot of work to do in order to deliver market returns," he says. "Indices have to be rebalanced on a regular basis to reflect changes in the markets; for example, where new companies are added to or removed from an index. The indices themselves do not account for the transaction and management costs associated with running the fund, which can eat into investors' returns. So in order to accurately replicate an index, we already have a number of hurdles to overcome on behalf of our clients."

O'Brien says he and his team also work to bring about change in the investee companies, either through direct engagement or by collaborating with regulators about issues their clients care about.

Performance
The L&G World Equity Index Fund has returned 22.61% since its launch in March 2017, 0.24% above the MSCI World Index. Since launching in February 2017, the L&G Emerging Markets Equity Index Fund has returned 27.61%, 0.04% ahead of its benchmark. LGIM launched the L&G Europe Ex UK Index Equity Fund in September 2016; since then the fund has returned 17.24%, 0.14% ahead of benchmark. The more defensive L&G Euro Treasury Bond Index Fund has returned 1.05% with its benchmark index return of 0.90% since its launch in December 2016.

Buying and selling
According to O'Brien, *pictured*, LGIM has developed a philosophy for managing index funds called "pragmatic replication". The primary aim is to tightly track the performance of a given index, but in an intelligent way.

"Our index fund managers are given a bit of flexibility," he says. "They can move away from the index very slightly — a fraction of 1% at most — for a small period if there is a way of delivering a better outcome for investors." The top three holdings in the L&G World Equity Index at present are Apple, Microsoft and Amazon; for the L&G Europe Ex UK Equity Index the top three are Nestlé, Novartis and Roche Holding.

Outlook
O'Brien says there has been a shift towards index funds for some years now, with many investors seeing the benefits of this type of fund.

"Significantly lower fees provide a good way of reducing overall portfolio costs and, by tracking an index, these funds will deliver a return consistent with the underlying market over the long term."

Gary Connolly

Buffett does not hedge his bets — and neither should you

Warren Buffett's annual letter to shareholders is one of the most widely read dispatches in the business world. Buffett's insights, expressed with his trademark clarity and humour, are a bounty for the amateur investor. This year did not disappoint.

December 2017 marked the end of a 10-year bet Buffett waged with a hedge fund firm, Protégé Partners. And the bet was this: each gets to choose an investment for a 10-year period and the best performer commits to pay the other $500,000 (€405,000) — so a pot of $1m to be donated to a charity of the winner's choice.

Buffett's pick was a low-cost investment in an unmanaged S&P 500 index fund. Protégé Partners picked five "fund-of-funds". Those fund-of-funds in turn owned interests in more than 200 hedge funds.

Let's cast our minds back to December 2007. The housing crisis in America had already started and the early signs of stress in the banking sector had begun to appear. The run on Northern Rock in the UK was the previous September. At the time of the bet, it looked like an active approach was the right call. A static bet on the US stock market that had been on a tear since October 2002 looked almost naive.

The managers of the five fund-of-funds possessed a further advantage: they could – and did – rearrange their portfolios of hedge funds during the 10 years, adding better funds while exiting those hedge funds it deemed unworthy. So how did it pan out? The hedge funds got off to a good start, each beating Buffett's index fund in 2008. Then, as Buffett says, "the roof fell in". In every one of the nine years that followed, the fund-of-funds as a whole trailed the index fund. Result: Buffett 125%; Protégé 36%.

I'm not naive enough to think that one bet for a single 10-year period allows you to draw much by way of conclusion, but Buffett has been highlighting the following lessons for more than half a century now.

Lesson No 1: A low-cost, low-turnover approach won out. Despite great resources and even greater incentives to perform, the actively managed approach came up well short. An investor would have needed a fair dose of fortitude to withstand the early losses, but it is ever thus with stock markets.

Originally, Protégé and Buffett each funded their portion of the ultimate $1m prize by buying zero-coupon US Treasuries at an equivalent yield of 4.56% — so in effect they only had to part with $318,250, knowing that after 10 years this would compound up to $500,000.

By November 2012, the bonds they bought had increased significantly in price and the yield (which moves inversely to the price) had declined to less than 1%. The cash return from dividends on the S&P 500 at the same time was 2.5% annually, about triple the yield on their bonds and with a long history of growing from year to year.

Protégé and Buffett agreed to sell the bonds in 2012 and use the proceeds to buy 11,200 Berkshire "B" shares. The result: more than $2.2m was donated to charity rather than the $1m they had originally pledged.

This is lesson No 2. Buffett has long been disparaging about the academic view of risk, which equates it to volatility or the dispersion of returns. In Buffett's view investing is an activity in which consumption today is foregone in an attempt to allow greater consumption at a later date. "Risk" is the possibility that you fail to meet this objective.

We tend to think about money in nominal terms – euros and cents in our bank account. In no long-term sense is this money. In the long run, the only rational definition of money is buying power. If my living costs double and my capital and interest thereon remain the same, I have lost half my money. If money is buying power, risk then becomes that which threatens it while safety is that which preserves or enhances it.

Buffett's switch in 2012 from bonds to equities would be categorised by an academic as having increased his risk; outside of the walls of academia, this makes little sense.

The final lesson is the advantage conferred to those that eschew activity with their investments. Buffett made one decision in the 10 years. The 200-plus hedge-fund managers that were involved almost certainly made thousands of "buy" and "sell" decisions. I'm not drawing a line of causation from a do-nothing approach to easy riches, but there is an undeniable correlation.

I long ago realised I'm no Warren Buffett. But you don't have to be a genius to see the profit in applying the simple lessons from his bet.

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