

Personal Finance Strategies

By Philip Braude

Dropping Interest Rates

Last night I was a guest on the IBA English news, and was asked to comment on the effects that the recent interest rate drops will have on the man in the street. I feel that this is an important issue, and hence will address it in this article.

As has reportedly been reported in the media, the shekel interest rate has followed the dollar interest rate downwards, and is currently at a historic low level. This interest rate drop is a double edged sword – good for some, and not for others. For those who have borrowed money from banks, and are subject to fluctuating interest rates will be celebrating, as their monthly repayments have dropped. Those who have money in the bank, and are living on the interest will find that their income has dropped, and will be struggling to make ends meet.

Many savers, especially elder people, are attracted to the relative security that a fixed deposit offers. The cost for this, however is being felt now as their income is dropping. The question I have often been asked, is what alternative is there. My answer, is simple. One needs to assume a greater investment risk, but in a calculated manner. What I mean by this, is to expose oneself to a diversity of investments, giving a higher return than money in the bank, but not necessarily exposing to an overall greater risk. This is achieved, by diversifying one's investment portfolio, into different investment strategies that are uncorrelated with each other. That means that their performance is not dependant on the performance of the other. Examples of investment strategies that are different than interest deposits could include stock market investments, bond investments, property investments, hedge fund investments, investments in commodities such as energy or gold. At first glance, an investor who is not familiar with such strategies may be scared off, but it is possible to access these investments by using the skills of professionals in the specific area, and the easiest way to do this, is via the method of a mutual fund. By using mutual funds as building blocks, it is easy to build an easy to manage and well diversified investment portfolio.

An area of opportunity is that of bonds. Since bonds, which are effectively "IOU's" issued by governments or companies, carry a fixed repayment rate. As interest rates in the market drop, the value of these bonds rise. So in an environment of falling interest rates, a bond investment can be very lucrative. I would caution, however, not to only buy one bond, but a range, as there is always a risk that the bond issuer could default. In addition, one has to also be careful that when interest rates begin to rise again in the future, that the bond value will fall.

My last comment is the most important. I suggest that everyone needs to set long term goals, such as "To retire in comfort" or "To educate the children", and not focus on the short term results. Over a long term period, we are inevitably going to encounter periods of turbulence, which should not mean that the eventual goal will not be reached. By setting such goals, and sticking to the strategies, should mean that our goals are achieved.

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