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Why to avoid the latest 'hot' investment product

A recent survey has just shown that term deposits are the most popular asset class among New Zealander investors right now. The survey finding won't come as a surprise to most of us in the financial planning industry. Fixed rate products have always held a powerful attraction for Kiwi investors, and in times of strife finding a very safe harbour for one's money seems the right and proper thing to do.

New Zealander investors are by no means alone in this. Australians too, are saving more than ever before, and in fact are among the greatest savers on the planet right now, out-stripping the Chinese in their bid to keep household spending to a minimum and stash away their hard-earned dollars for a rainy day. In other developed countries, the same dynamic applies – with the wounds of the GFC still healing, it will be a while before many ordinary investors feel bold enough to venture beyond the safety of cash or bonds.

Responding to this understandable investor sentiment, the financial services industry is only too happy to oblige by offering products to meet demand. You only need a pulse to be aware of the great variety of fixed rate products to choose from at the moment.

Unfortunately, many investors seeking a safe harbour in such products are doing no such thing. To begin with, some of the products themselves are far from low risk. The apparent security of receiving a 'fixed' annual return is actually meaningless if the underlying investments, which must yield investor returns, are high risk to the extent that there is a very real chance of losing some or all of your principle. What's the point of earning 8% a year if you end up losing 30% of your capital?

While most bank term deposits don't fall into this category, bonds offered by companies, even very well known ones, need to be carefully scrutinised. As a rule of thumb, the higher the rate offered, the higher the implicit risk. Which is why that high yielding bond which seems like such a great investment in difficult times, may turn out to be anything but.

Even those investors who prudently confine themselves to Government or bank issued bonds, without the benefit of an overall financial plan, are putting themselves at risk. In subscribing to what I call 'broker mentality' – i.e. buying whatever is today's 'hot product' – investors may be denying themselves the possibility of long term wealth creation.

When times are booming, the hot products are managed funds, index-linked portfolios and equity products of all descriptions. Shares are sizzling – time to buy! What happens when the bubble bursts? Suddenly 'prudence' is the flavour of the month. Which is when bonds, fixed rate products and term deposits become the asset class of choice.

Paradoxically, it is exactly when markets are ramping up to ever new heights that investors would do well to ensure they have some fixed rate products in their portfolio to protect them from precipitous falls like we saw between 2007 and 2009. And those investors who include some exposure to shares in the darkest days benefit far more from market upswings than those who jump on the trend when it has already run some way.

The message here is – investors need a plan. A strategy. Buying what's hot because that's what is being promoted by all and sundry is understandable – but flawed. Long term investors have properly informed plans which include allocations to shares, fixed rate products, property and perhaps other asset classes. These plans are worked out according to investors' circumstances and goals – not according to what's hot and what's not.

My appeal to investors interested in long term creation is simply this: before making any major investment decision, consult a professional planner. Investing in what's being promoted right now may be the right thing – but it could just as easily be the wrong thing to do too. Only an investment plan, designed specifically for you, provides the best possible chance of creating long term wealth.

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