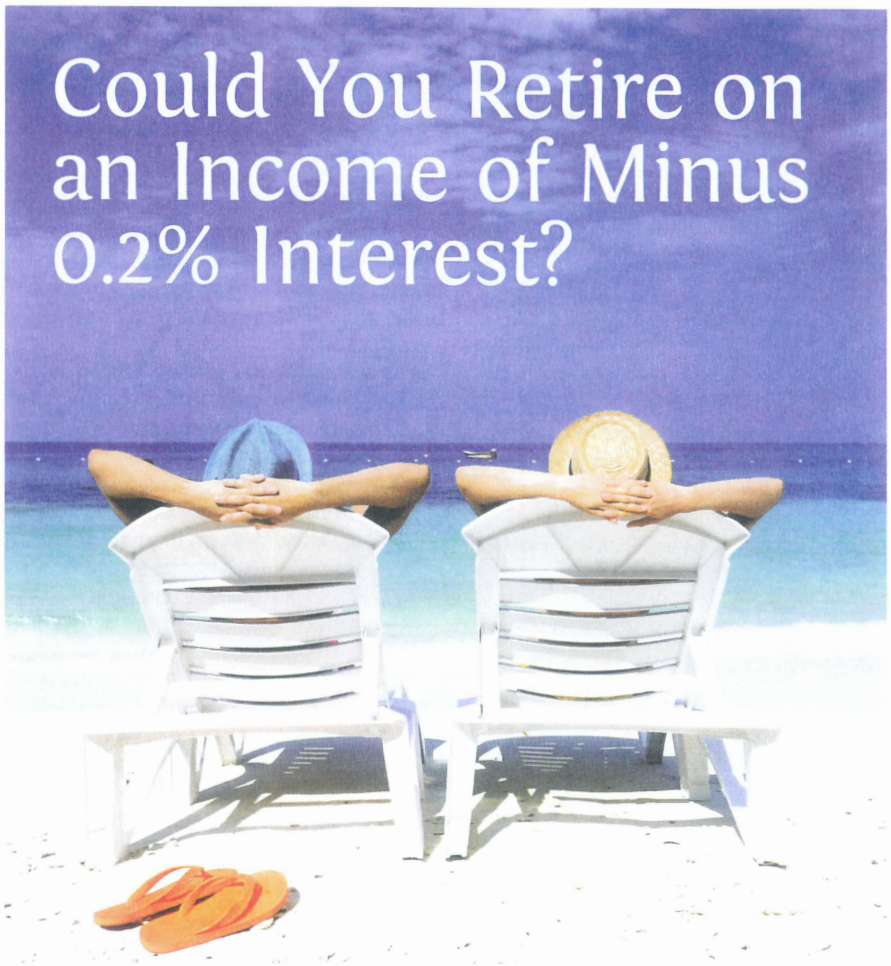
# Could You Retire on an Income of Minus 0.2% Interest?



Of course you couldn't. You would receive no income on your money and you would have to pay the bank to hold it for you. Absurd indeed, but this is the reality in Europe since the European Central Bank unexpectedly cut its benchmark lending rate to 0.05% in September, pushing deposit rates into negative territory. These rates apply only to Euro but rates in other major currencies are also close to zero.

A decade ago it was possible to get interest rates of 5% or more on deposits. Many wealthy Americans would retire to Florida and live comfortably on the interest on deposits. A million dollars in the bank for example would give them an income of $50,000 a year. Not any more. They have to look at other ways to produce an income or just draw down their savings until there is nothing left. The problem is, if they still draw down $50,000 a year their savings pot will be empty in 20 years. And that doesn't take into account inflation which eats away at the purchasing value of the drawdown. For Euro millionnaires it is now even worse. Their money will be exhausted even faster as they have to pay the bank 0.2% in negative interest every year. In the first year alone that would amount to EUR2,000.

No doubt if the depositor places a large amount with a single bank a slightly more generous rate would be offered. Here though there is a risk, albeit a small one, that the bank in question would fail, in which case only the amount guaranteed by the respective jurisdiction would be payable. And even then only if the government was solvent! In the 2008 banking crisis the Irish government was close to insolvency. Iceland had aleady collapsed, leaving depositors with huge losses. Most governments can honour their guarantees by printing more money; in Europe that is not possible as the same currency is used by all the countries in the

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Eurozone and countries such as Germany with stronger economies will not want to see their currencies devalued. To be safe therefore you would need to to place your deposit with several banks and to be ultra-safe, even in other countries.

## So where can you safely keep your money free of charge?

Under the mattress is one solution and that's not a very good one! Neither was the idea of one Japanese gentleman who was reported to have buried his cash savings in his garden. It might have worked except that he frequently dug it up to check it, no doubt drawing attention so that one day he found it had gone.

Of course, living in Indonesia you are probably thinking what's the point saving in dollars, euro or pounds when you can still get a reasonable rate of interest on Rupiah. That's fine if all your expenditures are in Rupiah although you will find inflation will eat into your capital and the interest will buy less and less if you enjoy a western lifestyle. The main risk is the reduced value of your capital relative to hard currencies after devaluations such as we saw last year.

## So where can we earn a decent rate of interest?

This is the challenge of investing and there are plenty of ways to get higher returns than in the bank – provided you are prepared to accept a higher level of risk. There is no escape from the principle that the higher the return you are seeking, the higher the risk. Let's just examine a few examples:

- **Bonds**

  These are basically simple instruments where you lend your money to a government, local authority or company in return for its guaranteed return after an agreed period and a regular 'coupon' or interest payment.

  Perhaps the best known bond of all is the US Treasury Bond, generally accepted as about the safest investment you could find since it is backed by the US government. Except that around a year ago political posturing almost led to

a default as the US had reached its approved debt limit. At the moment of writing that debt now stands, albeit for a fraction of a second, at $17,855,171,680,414 according to the website www.USDebtClock.org which you may want to check out to see how much the debt has risen since. Should you be worried? You would be if this was your credit card bill but the principles are the same. It's another good reason not to put all your faith and savings in cash and also to consider where all that debt is going to end. The clock is indeed ticking!

But, assuming US government bonds are the safest asset, how much could you expect to earn with them? Currently, if you invested $1,000,000 in a 10-year treasury bond you would receive approximately $24,000 a year or $2,000 a month. Commit to a 30-year bond and the amount rises to the princely sum of $32,000 a year. That is fixed and guaranteed for 30 years. What if you want your money back sooner? No problem, bonds are freely tradeable but the price you get may be higher or lower than the face value as it is affected by prevailing interest rates. Only on the last day can you be sure to get your exact initial investment back.

There are many other bond types available, most of them paying much more than 2.5% but the higher the return the higher the risk of default.

- **Stocks**
  If you are seeking income in retirement then there are ample 'blue chip' stocks that pay regular dividends which are generally higher than bond yields. Stocks are more volatile than bonds however and dividends are not guaranteed. Nevertheless, holding a wide range of stocks should see significant capital gain over the long term in addition to the regular dividends.

- **Alternative investments**
  Low interest rates and the erratic performance of stock markets have led many investors to seek higher returns in less conventional assets such as student accommodation, land banking, futures trading, litigation funding, private equity and a variety of hedge funds. Some have paid off well but there has also been a high casualty rate in terms of fund failures and even frauds so stepping into these areas should be limited to a relatively small part of a total portfolio. Gold pays no interest at all but can be considered a useful insurance against the falling value of paper money or political turmoil.

- **Property**
  This is an income-producing investment favoured by many. Coupled with capital appreciation, buy-to-let investments are claimed to be the best investment out of all asset classes over the past 20 years in the UK. Yields can range from 4% to 8% per annum depending on location. The cost of buying and furnishing has to be taken into account and there is no guarantee you will always find tenants although one leading management company is now offering guaranteed rentals irrespective of whether the property is occupied, such is the strength of the rental market in certain cities. The yields may not be that high but the icing on the cake with property is the capital appreciation. But keep in mind prices can also fall and you can't turn a property into cash overnight.

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## So what is the best strategy?

Firstly, unattractive as may be, it is important to have access at all times to liquid cash so a good proportion of savings should be kept safely in several banks. There are ample opportunities to obtain higher rates of return by investing in other assets but as each asset has its own set of risks the wisest approach is always to diversify. Never put all or most of your eggs in one basket.

British expatriates with private pensions in the UK can reduce future tax liablities from over 30% to as low as 2.5% per annum by transferring to an approved offshore QROPS, a window that could soon be closing. Certain trusts can also reduce Inheritance Tax liability so you can leave more of your wealth to your family.

But first you need to accumulate that wealth and it is clear from the current interest rate environment and the risks involved in seeking higher returns that we all have to save harder while we can. The ideal scenario is one where your accumulated wealth is sufficient to generate an income greater than your expenditures. That is what we might call financial independence. And it is getting harder to achieve.